



SOUTH AFRICA

FINANCIAL SECTOR ASSESSMENT PROGRAM

March 2015

DETAILED ASSESSMENT OF OBSERVANCE ON THE INSURANCE CORE PRINCIPLES

This Detailed Assessment of Observance on the Insurance Core Principles on South Africa was prepared by a staff team of the International Monetary Fund. It is based on the information available at the time it was completed in February 2015.

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INSURANCE CORE PRINCIPLES DETAILED ASSESSMENT OF OBSERVANCE

Prepared By
**Monetary and Capital
Markets Department**

This Detailed Assessment Report was prepared in the context of an IMF Financial Sector Assessment Program (FSAP) mission in South Africa during May 2014, led by Cheng Hoon Lim, IMF and overseen by the Monetary and Capital Markets Department, IMF. Further information on the FSAP program can be found at <http://www.imf.org/external/np/fsap/fssa.aspx>

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Glossary

| | |
|--------|---|
| AML | Anti-Money Laundering |
| ALM | Asset-liability management |
| APN | Advisory Practice Note |
| ART | Alternative risk-transfers |
| ASB | Accounting Standards Board |
| ASSA | Actuarial Society of South Africa |
| BSD | Bank Supervision Department |
| CA | Companies Act |
| CAR | Capital Adequacy Requirements |
| CDD | Customer due diligence |
| CEO | Chief Executive Officer |
| CFO | Chief Financial Officer |
| CFR | Council of Financial Regulators |
| CFT | Combating the Financing of Terrorism |
| CIS | Collective Investment Schemes |
| CMS | Council for Medical Schemes |
| CoB | Conduct of business |
| DEO | Deputy Executive Officer |
| DTI | Department of Trade and Industry |
| EO | Executive Officer |
| ERM | Enterprise risk management |
| FATF | Financial Action Task Force |
| FAIS | Financial Advisory and Intermediary Services Act |
| FIC | Financial Intelligence Centre |
| FICA | Financial Intelligence Centre Act |
| FIC | Financial Intelligence Centre |
| FIPFA | Financial Institutions (Protection of Funds) Act (FIPFA), |
| FIU | Financial Intelligence Unit |
| FSAP | Financial Sector Assessment Program |
| FSB-SA | Financial Services Board |
| FSBA | Financial Services Board Act |
| FSLGAA | Financial Services Laws General Amendment Act |
| FSOC | Financial Stability Oversight Committee |
| FSPs | Financial services providers |
| IAIS | International Association of Insurance Supervisors |
| IBNR | Incurred but not reported |

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| | |
|----------------------|--|
| ICPs | Insurance Core Principles |
| IFIA | Inspection of Financial Institutions Act |
| IFRS | International Financial Reporting Standards |
| ILAB | Insurance Laws Amendment Bill tabled in Parliament on 21 June 2013 and withdrawn in April 2014 |
| IRBA | Independent Regulatory Board for Auditors |
| JSE | Johannesburg Stock Exchange Ltd |
| GRAP | Generally recognized accounting practice |
| King III | King Report on Governance for South Africa, 2009 |
| MCR | Minimum Capital Requirements |
| MLTFC Regulations | Money Laundering and Terrorist Financing Control Regulations |
| MoF | Minister of Finance |
| MoU | Memorandum of understanding |
| LTIA | Long-term Insurance Act 52 of 1998 |
| NCR | National Credit Regulator |
| NT | National Treasury |
| OCAR | Ordinary Capital Adequacy Requirement |
| OCR | Outstanding claims reserve |
| ORSA | Own Risk and Solvency Assessment |
| PAIA | Promotion of Access to Information Act |
| PEPs | Politically exposed persons |
| PPFM | Principles and Practices of Financial Management |
| RiBS | Risk based Supervision for intermediaries |
| SA | South Africa |
| SAM | Solvency Assessment and Management |
| SAP | Standard of Actuarial Practice |
| SARB | South African Reserve Bank |
| SCR | Solvency capital requirement |
| STIA | Short-term Insurance Act 53 of 1998 |
| TCAR | Termination Capital Adequacy Requirement |
| TCF | Treating Customers Fairly |
| UPP | Unearned premium provision |
| URP | Unexpired risk provision |
| WEF | World Economic Forum |
| VaR | Value at Risk |

EXECUTIVE SUMMARY

The insurance sector is an important pillar of the financial system in South Africa. In 2013, assets held by insurers accounted for nearly 23 percent of financial sector assets in South Africa. As at end-2013, there were 78 long-term insurers, 87 short-term insurers, 6 reinsurers and 11 captive insurers (excluding cell captive insurers). The long-term insurance sector is highly concentrated with the top five conglomerates dominating the market with over 73 percent of total industry assets in 2013 while the short-term insurance industry is less concentrated. The insurance sector is adequately served by a wide range of intermediaries, with approximately 10,992 financial services providers (FSPs) as at March 31, 2014.

Insurance regulatory and supervisory regime in South Africa is in transition. Currently, the Financial Services Board (FSB-SA) regulates the non-banking financial services industry, including the insurance sector, in South Africa. With the goal of achieving a safer financial sector to serve South Africa better, the Government has proposed major changes in the financial sector. The four policy objectives are: financial stability, consumer protection and market conduct, financial inclusion and combating financial crime. Market realities in the insurance sector pose significant regulatory challenges, which are well recognized by the authorities. These considerations include the dominance of financial conglomerates, high market concentration, demands of an economically diverse consumer base, high unemployment and slow growth in recent years.

As part of the regulatory reforms, a Twin Peaks supervisory structure will be adopted, with functional separation of prudential and market conduct mandates. The prudential supervisor will be part of the South African Reserve Bank, which will serve as the micro-prudential and macro-prudential supervisor. The FSB-SA will be transformed to a dedicated market conduct supervisor. The Government, through the Minister of Finance, will be responsible for the policy framework for the financial sector.

The authorities have been proactive in updating and/or formalizing the regulatory regime to better reflect current international best practices, which are well progressed. The key regulatory initiatives include the implementation of a formal group supervision framework, a risk-based Solvency Assessment and Management regime (SAM) and Treating Customers Fairly (TCF) approach to conduct of business supervision. The FSB-SA will have formal legal authority to supervise insurance groups including direct powers over a group holding company. SAM will be supported by explicit regulatory requirements on corporate governance and risk management frameworks. The TCF approach seeks to ensure that fair treatment of customers is embedded within the culture of regulated entities, using a combination of principles and rules to deliver fair outcomes for consumers. The proposed enhancements to the regulatory framework to entrench the above in legislation would significantly improve observance with the Insurance Core Principles. While this assessment does not reflect these on-going regulatory initiatives, the key proposals of the reforms are summarized by way of additional comments in this report.

The proposed regulatory enhancements will bring the regulatory regime in line with the international standards promulgated by the IAIS. Nonetheless, there is scope for fine-tuning in the following areas:

- a) A proportionate licensing and supervisory approach for friendly societies and clearer boundaries between medical schemes and insurance products;
- b) Priority of ranking for policyholders in the event of winding-up;
- c) Enhance the proposed group supervision framework by establishing explicit requirements on intra-group transactions and risk exposures e.g., intra-group reinsurance;
- d) Provide explicit conduct of business requirements on product development and provide the supervisor with the authority to require notification of certain types of new insurance products and prohibit certain products that do not meet prescribed standards;
- e) Public disclosure requirements for all insurers and clear legal authority to supervise compliance;
- f) Address the remaining legal deficiencies in the AML-CFT regime;
- g) Appropriate indicators for assessing systemic risk of insurers and reinsurers; and
- h) A crisis management and resolution framework to deal with cross-border crisis effectively.

The FSB-SA has introduced a risk-based supervision framework, which has been evolving to improve supervisory intensity and effectiveness. In this regard, there is scope for more intensive on-site visits with a baseline supervision cycle that are proportionate to the risk profiles of insurers and reinsurers. This would also include a systematic approach to evaluating the nature of supervision of reinsurers and other counterparties used by insurers. Group supervision should cover all insurance groups with holistic off-site monitoring of intra-group transactions and aggregate group exposures, including joint on-site visits of financial conglomerates. It is important that conduct of business risks be addressed in the Risk Assessment Document. To improve supervisory effectiveness, the FSB-SA is advised to strategize an appropriate risk-based supervisory cycle to cover the large number of FSPs. It is also advisable for the FSB-SA to adopt a more structured macro-prudential surveillance framework that also considers cross-sectoral inter-linkages and system-wide market conduct issues.

Pending the implementation of the Twin Peaks, the FSB-SA could be further strengthened in a number of areas by: a) formalizing the objectives for insurance supervision and the legal authority for group-wide supervision in the legislation; b) strengthening operational independence to minimize undue political or industry interference; and c) reviewing the adequacy of supervisory resources and augment skill sets in light of current and impending regulatory initiatives. It is important that the FSB-SA continues its positive engagement with domestic and international counterparts to ensure effective supervisory cooperation.

Going forward, the implementation of the enhanced regulatory regime as well as more effective and holistic supervision under the Twin Peaks hinges on the adequacy and quality of supervisory resources of the FSB-SA.

ASSESSMENT OF INSURANCE CORE PRINCIPLES

A. Introduction and Scope

1. This assessment provides an update on the regulatory and supervisory developments in the insurance sector of South Africa since 2010. The assessment was conducted by Mala Nag (IMF Expert) and Su Hoong Chang (external expert engaged by the IMF) from May 6 to May 23, 2014. In 2010, a formal assessment was conducted on South Africa's observance with the Insurance Core Principles (ICPs) issued by the International Association of Insurance Supervisors (IAIS) in 2003. The status of implementation of the recommendations arising from the 2010 ICP assessment is summarized in the Appendix.

2. The current assessment is benchmarked against the ICPs issued by the IAIS in October 2011, as revised in October 2013. The assessment is undertaken as part of the Financial Sector Assessment Program (FSAP) by the IMF. The ICPs apply to all insurers, whether private or government-controlled. Specific principles apply to the supervision of intermediaries. The institutional arrangements for financial sector regulation and supervision are outlined in Section C.

B. Information and Methodology Used for Assessment

3. The level of observance for each ICP reflects the assessments of its standards. Each ICP is rated in terms of the level of observance as follows:

- a) **Observed:** where all the standards are observed except for those that are considered not applicable. For a standard to be considered observed, the supervisor must have the legal authority to perform its tasks and exercises this authority to a satisfactory level.
- b) **Largely observed:** where only minor shortcomings exist, which do not raise any concerns about the authorities' ability to achieve full observance.
- c) **Partly observed:** where, despite progress, the shortcomings are sufficient to raise doubts about the authorities' ability to achieve observance.
- d) **Not observed:** where no substantive progress toward observance has been achieved.

4. The assessment is based solely on the laws, regulations and other supervisory requirements and practices that are in place at the time of the assessment in May 2014. While this assessment does not reflect on-going regulatory initiatives, the key proposals of these initiatives are summarized by way of additional comments in this report. The authorities have provided a full and well-written self-assessment, supported by anonymized examples of actual supervisory practices and assessments, which enhanced the robustness of the assessment. Technical discussions with and briefings by officials from FSB-SA also enriched this report; as did discussions with industry participants.

5. The assessors are grateful to the authorities for the full cooperation and thoughtful logistical arrangements, particularly the helpful co-ordination of various meetings with industry

participants. The assessors also benefitted from the valuable inputs and insightful views from meetings with insurers as well as industry and professional organizations.

C. Overview—Institutional and Macroprudential Setting

Institutional Framework and Arrangements

6. The responsibility for regulating/supervising the financial services industry in South Africa is divided in a number of agencies. The South African financial services regulators operate under an explicit delegation of powers in the relevant financial sector legislation passed by Parliament. The Financial Services Board (FSB-SA) regulates the non-banking financial services industry, including the insurance sector, in South Africa. The Bank Supervision Department (BSD) of the South African Reserve Bank (SARB) is the prudential supervisor for banks while the National Credit Regulator (NCR) a statutory body established under the National Credit Act (accountable to the Department of Trade and Industry (DTI)) regulates the market conduct of consumer credit activities of all credit providers. The Financial Intelligence Centre (FIC), statutory body established under the Financial Intelligence Centre Act (accountable to the Minister of Finance), is responsible for anti-money laundering (AML) and combating the financing of terrorism (CFT) regulation, in coordination with the relevant supervisory agency responsible for supervising financial institutions. Lead responsibility for setting financial regulatory policy lies with the National Treasury (NT).

7. At the time of assessment, the Financial Services Board (FSB-SA) regulates the non-banking financial services industry, including the insurance sector, in South Africa. FSB-SA is a statutory body established under the Financial Services Board Act (FSBA). The supervisory mandate of the FSB-SA covers insurers, financial services providers (intermediaries), retirement funds, friendly societies, collective investment schemes, and financial markets. The regulatory and supervisory functions, including those under the Long-term Insurance Act (LTIA) and the Short-term Insurance Act (STIA), are entrusted to the executive officer within the FSB-SA. The FSB-SA also supervises banks' advice and intermediary services. Medical schemes, which are closer to social security funds and generally do not involve underwriting of individual risks, are regulated by the Council for Medical Schemes (CMS) (accountable to the Minister of Health). The FSB-SA is subject to the general authority of the Minister of Finance, who appoints its board members and selects the senior officers, after consultation with the Board of FSB-SA.

8. In July 2011, the Cabinet adopted a package of regulatory reforms for the financial sector outlined in the policy document, *A safer financial sector to serve South Africa better*. The reforms address four policy objectives: financial stability, consumer protection and market conduct, expanding access through financial inclusion and combating financial crime. The key proposals include:

- a) Shifting to a Twin Peaks supervisory structure by separating prudential and market conduct supervision. The prudential supervisor will be a statutory body under the SARB, which will serve as the micro-prudential and macro-prudential supervisor. FSB-SA will be transformed

- to a dedicated market conduct supervisor. The Government, through the Minister of Finance, will remain responsible for the policy framework for the financial sector;
- b) Strengthening the operational independence, integrity and accountability of all regulators;
 - c) Expanding the regulatory system to include macro-prudential supervision, and establish an inter-agency Financial Stability Oversight Committee (FSOC). The FSOC will also have a central role in crisis management and resolution;
 - d) Strengthening market conduct supervision and the ombudsman system, and expanding the scope of the FSB-SA to cover market conduct in retail banking, taking account of the work of the NCR;¹
 - e) Clarifying roles and responsibilities of all relevant regulators. Current legislation does not spell out who is responsible for policy, legislation, regulation and supervision, and is often not consistent across different pieces of legislation governing the different financial regulators;
 - f) Increasing the scope of regulation e.g., private pools of capital, credit ratings agencies etc.;
 - g) No exemption for public entities and funds operating in the financial system from general legislation and regulatory standards applicable to the private sector institutions and funds. Any exemptions given should be transparent, and subject to review on a regular basis;
 - h) Improving enforcement capacity of financial regulators and removing legislative barriers to cooperation and sharing amongst regulators without compromising the principle of confidentiality for tax affairs or market sensitive information; and
 - i) Rationalizing advisory and technical committees and enhancing consultation processes with the industry and key stakeholders.

9. Public consultation on implementing the Twin Peaks, conducted in February 2013, set out more detailed proposals. Entities subject to both prudential and market conduct oversight— notably insurers, banks, certain financial conglomerates and financial market infrastructures—will be regulated by both the SARB and the FSB-SA. The SARB, as the systemic regulator, will supervise systemic risks arising from key financial markets infrastructure such as the payment, clearing and settlement systems. Both supervisors are jointly responsible for licensing securities exchanges with the FSB-SA as the lead supervisor. Clearing house licenses and rules will, where practical, be joint responsibility. Both supervisors are required to consult each other on relevant matters, as mandated in the legislation. SARB will supervise AML-CFT compliance of institutions under its authority while the FSB-SA will supervise those not under the SARB's purview. The transition will be implemented in two phases. Supporting legislation will be developed in the first phase (2013/14)² while the second

¹ Consultations within government are necessary to assess the impact of having two separate regulators covering different aspects of market conduct in the retail banking sector (transactional banking in the FSB-SA and credit extension in the NCR), and how best to coordinate their work.

² In December 2013, the NT invited comments on the Financial Sector Regulation Bill 2013 that establishes the new prudential and market conduct authorities.

phase will focus on the broader harmonization process of regulatory and supervisory systems over the next several years.

10. Coordination and information sharing amongst all financial regulators will be enhanced through the FSOC³ and the Council of Financial Regulators (CFR).⁴ An interim FSOC has been established although it has no tools available and lacks legislative backing. The final FSOC is expected to have clear mandate, powers and accountability arrangements. The CFR will provide interagency coordination between regulators on issues of legislation, enforcement and market conduct. The CFR will be supported by technical committees comprising officials from the regulatory agencies, NT and other key stakeholders.

11. Since the previous ICP assessment in 2010, the FSB-SA has continued to work on three major regulatory initiatives with respect to the insurance sector. An Insurance Laws Amendment Bill (ILAB)⁵ was tabled on June 21, 2013, which introduced interim measures relating to the governance, risk management and internal controls of all insurers, as well as insurance group supervision. Due to other legislative priorities, the ILAB was withdrawn in April 2014 and the provisions contained in the ILAB will be given effect through a Board Notice and other means. At the time of assessment, the status of these initiatives are summarized below:

- a) **Solvency Assessment and Management regime (SAM)** shares the broad features of the European Union's Solvency II regime, adapted for local market circumstances. It is a risk-based solvency regime that applies to all insurers (including government owned insurers) except for micro-insurance business, which will be subject to a simplified regime. Requirements on corporate governance and risk management frameworks, which support the progressive implementation of SAM (interim measures), will be address through a Board Notice to be published by November 2014 for implementation by January 1, 2015. SAM is expected to be fully implemented in January 2016;
- b) **Treating Customers Fairly (TCF) approach to conduct of business supervision**—The TCF approach seeks to ensure that fair treatment of customers is embedded within the culture of regulated entities. It will use a combination of market conduct principles and explicit rules to drive the delivery of clear and measurable fairness outcomes; and
- c) **Insurance group supervision framework** – A formal framework for insurance group supervision will be introduced which will, *inter alia*, gives the FSB-SA direct powers over a

³ The FSOC will comprise the SARB, FSB-SA and the NT (as observer) and chaired by the SARB Governor.

⁴ The CFR will comprise the heads of key financial regulators such as the BSD, the FSB-SA and NCR; agencies such as South African Revenue Service and the FIC; relevant standard-setters such as the Independent Regulatory Board for Auditors (IRBA) and the Accounting Standards Board; and nonfinancial regulators such as the Competition Commission and officials from the Department of Trade and Industry.

⁵ The necessary legislation to give effect to SAM was to be enacted and implemented in two phases. Phase 1 was going to consist of the ILAB. This is now being replaced with subordinate legislation in the form of a Board Notice to be issued pursuant to the enactment of the FSLGAA that authorizes the FSB-SA to prescribe a governance and risk management framework for insurers. Phase 2 will be the Insurance Bill, which is currently being drafted and it is targeted for implementation from 1 January 2016 and will repeal the existing insurance legislation.

group holding company. Certain regulatory provisions currently applicable to solo undertakings will apply with the necessary changes to a controlling (holding) company of an insurance group and to the insurance group. The framework will be provided in the next version of the draft Financial Sector Regulation Bill, expected to be published for comment in mid-2014 and with effect from January 1, 2015.

Market Structure and Industry Performance

Industry Structure and Recent Trends

12. The insurance sector is an important pillar of the financial system in South Africa. The risks undertaken by the sector are predominantly domestic with the exception of a handful of insurers that have international operations through branches and/or subsidiaries overseas. In 2013, assets held by insurers accounted for nearly 23 percent of financial sector assets in South Africa. The insurance sector is divided between long-term (life) insurance and short-term (non-life) insurance. Long-term insurance assets were equivalent to 64 percent of GDP, while short-term insurance assets contributed to 3.4 percent of the GDP at the end of 2013. Life insurance penetration – premiums in relation to GDP—is 21.6 percent, one of the highest in the world. The significant scale of long-term insurers is due to their large share of the retirement savings market in the country. Approximately 50 percent of long-term insurers’ balance sheets are composed of retirement savings reflecting the tax-advantages for insurance policies, including various forms of annuity products and private pension fund plans.

Table 1. Insurance Market—Licensed Insurers

| Insurers | 2009 | 2010 | 2011 | 2012 | 2013 |
|------------------------|------|------|------|------|------|
| Life (long-term) | 80 | 80 | 80 | 79 | 78 |
| Non-life (general) | 91 | 89 | 86 | 89 | 87 |
| Composite ¹ | 4 | 4 | 4 | 4 | 4 |
| Reinsurance | 7 | 7 | 7 | 7 | 6 |
| Captive ² | 11 | 11 | 11 | 11 | 11 |
| Total | 193 | 191 | 188 | 190 | 186 |

Source: FSB-SA.

1/ In South Africa, only reinsurers are allowed to underwrite both life and non-life insurance within the same composite entity.

2/ An insurer that insures risks within the group and only a small part (if any) of its portfolio covers risk from unrelated parties.

13. Total number of licensed insurers declined marginally from 2009 (Table 1). The decline was partially due to consolidation in the marketplace and orderly exits including a few failures. In the past 5 years, three small insurers failed and were placed under curatorship, business rescue or liquidation. In two cases, no policyholder was adversely impacted and the claims were settled by the curators but policyholders of the third insurer suffered estimated losses (in the form of claims not paid) in the range of R20 million. The non-life sector experienced relatively more consolidation as smaller players merged or exited the market.

14. Considerable inter-linkages within the financial system exist as a result of the main activities of insurance groups (Table 2). There are a few large conglomerate groups where domestic banks indirectly own two of the larger long-term and three short-term insurers. While the

non-financial sector entities, including manufacturing and industrial entities, indirectly own many insurance entities, a number of insurance groups are dominated by securities firms mostly offering unit-linked and other retirement investment products, often targeted at high net worth clients. The public sector, through statutory entities, controls one long-term insurer and a few short-term insurers. Beyond inter-connectedness, the conglomerate groups have engineered products that allow them to offer end to end financial solutions to their customers. The move to a Twin Peaks supervisory structure is intended to enhance supervision at the conglomerate level and improve conduct of business (CoB) supervision.

Table 2. Main Activities of Insurance Groups

| | |
|------------|-----------|
| Insurance | 21 |
| Banking | 5 |
| Securities | 8 |
| Retail | 7 |
| Other | 1 |
| | 42 |

Source: FSB-SA.

15. The long-term insurance sector is highly concentrated with the top five conglomerates dominating the market with over 73 percent of total life insurance assets in 2013. Although there are 78 long-term insurers operating in South Africa, the top 10 insurers capture 88 percent of the market. Old Mutual Life Assurance Company (South Africa) Limited is the largest insurer capturing over 22 percent of market share. With the benefits of economies of scale and pricing powers, these groups enjoy competitive advantages against their smaller domestic peers.

16. The short-term insurance sector is less concentrated, with top five insurers producing 44 percent of the total non-life premiums in 2013. The industry is served by 87 insurers comprising of mostly domestic insurers, some local subsidiaries of the large global groups (particularly in the reinsurance sector) as well as a few small mutual/co-operative organizations. Gross written premiums increased by 9.6 percent in 2012 with similar increase in the previous year. The growth was mainly attributable to increase in consumer credit insurance, infrastructure development projects, re-pricing of risks in personal lines (due to increase in overall motor repair costs and weaker Rand) and commercial insurance sector.

17. The insurance sector is adequately served by a wide range of intermediaries. As at March 31, 2014, there were approximately 10,992 licensed FSPs, down from 12,051 in 2011. This is due to tighter fit and proper and educational requirements to improve policyholder protection and conduct of business. For both long-term and short-term insurers, brokers are the dominant distribution channel; however, in-house agents are popular for individual life insurance sales. With the presence of banking conglomerates, the bancassurance model is also a significant distribution channel in the urban centers. Banks that offer bancassurance must be registered as FSPs, with bank staff acting their representatives. Despite the FAIS regulatory environment which has raised some of the standards of professionalism in the intermediary sector, the potential for mis-selling and poor outcomes for policyholders persists. The TCF and the Retail Distribution Review (RDR) initiatives

currently underway are expected to bring benefits to policyholders and the financial services industry.

18. The high lapse⁶ ratio, calculated as a percentage of new policies issued over the period, have hovered around 50 percent in South Africa. This is partly due to the large number of policies in the lower income segment (funeral and assistance policies) where consumers feel pressures of slow economic growth and high unemployment. Within cell captive insurers, a number of lapses occurred among consumer credit insurance policies due to a trend for consumers to consolidate unsecured loans in response to affordability challenges, with a corresponding lapsing of credit life policies and consolidating accounts into one policy. Lapses have also been seen when large individual group schemes, including bancassurance business, were moved to different insurers due to commission structure or new business incentives. In addition, the introduction of new generation products has led some policyholders (on advice of their intermediaries) lapsing existing policies in order to replace them with new generation products. This has contributed to the increase in lapses for typical insurers.

Assets and liabilities

19. The asset mix of the long-term insurance industry has changed, with higher exposures to equities and collective investment schemes (CIS), making market risk the most important challenge in the sector (Table 3). Total assets increased 13.2 percent in 2012 and this growth was attributable to demand in the credit life policies, increased business from retirement funds and expansion in unit-linked business over the years. Consequently, the biggest exposure on the asset side relates to equities and CIS which together constituted 65 percent of the total assets as at end-2013, an increase from 49 percent in 2011. With respect to the unit-linked business, policyholders assume the market risks of the underlying investment portfolios.

20. The investment profile of short-term insurers is relatively conservative, with approximately 38 percent weighted in cash and deposits and South African government securities. However, significant usage of reinsurance exposes the sector to potential credit risk arising from default of reinsurers. A number of insurers also make use of underwriting managers/brokers where premiums are collected on behalf of the insurer. Exposure to default by an underwriting manager/broker also constitutes credit risk for short-term insurers. However, this is mitigated since intermediaries are required by law to provide security in the form of a guarantee before an intermediary can collect premiums on behalf of an insurer and be registered as a financial services provider under the FAIS. It was also noted that 38 percent of the total assets of short-term insurers were deposited or invested in banks including the Big-4 banks in South Africa.

⁶ A policy is said to “lapse” when the premiums are not paid within the required period of grace and the policy has no cash value; or the debt against the policy exceeds the cash value of the policy.

Table 3. Composition of Assets—Long-term (Life)

| (in Rand million) | 2011 | % | 2013 | % |
|------------------------------|------------------|-------------|------------------|-------------|
| Assets | | | | |
| Cash and Deposits | 143,269 | 11 | 125,846 | 8 |
| Government & semi-government | 147,131 | 11 | 111,038 | 7 |
| Equities and CIS | 623,864 | 49 | 1,071,350 | 65 |
| Debentures and loan stock | 112,544 | 9 | 187,716 | 11 |
| Immovable properties | 58,822 | 5 | 48,702 | 3 |
| Fixed Assets | 135,247 | 11 | 2,348 | |
| Debtors | 64,879 | 5 | 99,031 | 6 |
| Other Assets | | | 2,243 | |
| Total | 1,285,756 | 100% | 1,648,274 | 100% |

Source: FSB-SA.

21. Asset transfers between parent and insurance subsidiaries are permitted for capital management purposes. This includes capital injections and dividends payments. The FSB-SA reviews related party transactions under the current risk-based supervisory framework; however, there is scope for further controls when a formal group-wide supervision framework is introduced.

22. On the liabilities side, long-term insurers have been increasing their technical provisions that are reflective of growth in premiums and the growth in asset backing unit linked policies. (Table 4). The level of technical provision tracks the trend in premium level, with higher growth recorded in unit linked policy sales where the policyholder retains the investment risks. In 2012, investment business with guarantees constituted approximately R45 billion or 3 percent of total policyholder liabilities. Some but not all of the with-profit portfolios, which comprised 14 percent of total liabilities, also have elements of guarantees attached. Some legacy policies offer a minimum rate of return, typically in the 3 percent to 5 percent range, with the guarantee only applied to that portion of the premium that is invested. Currently some products are sold with a guarantee of around 7 percent, and the guarantees are typically fully matched. Insurers also offer policies that will reset the capital guarantee every five years for as long as the original capital remains invested.

23. For the short-term insurance sector, technical provisions have been increasing since 2011 to accommodate for the interim measures implemented pending the introduction of SAM (Table 4). For statutory accounting, short-term technical provisions are not discounted.

Table 4. Trend in Technical Provisions—Long-term

| (In Rand millions) | 2009 | 2010 | 2011 | 2012 |
|---------------------------------------|------------------|------------------|------------------|------------------|
| Technical provisions | 1,211,104 | 1,350,640 | 1,454,806 | 1,650,788 |
| <i>of which:</i> | | | | |
| Participating (with profits) policies | 338,075 | 357,460 | 256,517 | 275,198 |
| Non-participating policies | 357,978 | 388,266 | 519,309 | 582,525 |
| Unit-linked policies | 515,051 | 604,914 | 678,981 | 793,065 |
| Gross premiums | 310,560 | 289,032 | 316,273 | 361,124 |

| Trend in Technical Provisions—Short-term | | | | |
|---|--------|--------|--------|--------|
| Technical provisions | 27,619 | 26,317 | 47,688 | 59,547 |
| Gross premiums | 7,352 | 6,730 | 7,049 | 7,495 |

Source: FSB-SA.

Operating Performance

24. The solvency position for long-term insurers has been relatively stable while the ratios for short-term insurers have decreased since 2011 under the enhanced capital requirements (Table 5). This is because prior to 2011, the minimum and prescribed capital requirements were largely based on Solvency 1 calculations that were less risk-sensitive.

Table 5. Solvency: Assets Available Over Required*(End-period)*

| | 2011 | 2012 | 2013 |
|---|-------|-------|-------|
| Solvency: Assets capital over: Ratios (in percent) | | | |
| <u>Life</u> | | | |
| Available capital resources over Minimum Capital Requirement | 19.53 | 18.49 | 15.85 |
| Available capital resources over Prescribed Capital Requirement | 3.44 | 3.56 | 3.62 |
| <u>Short-term</u> | | | |
| Available capital resources over Minimum Capital Requirement | 68.68 | 12.89 | 4.80 |
| Available capital resources over Prescribed Capital Requirement | 3.83 | 2.39 | 1.99 |

Source: FSB-SA.

25. Although the regulatory solvency ratios remain adequate for long-term insurers, market risk pressures have increased (Table 6). The FSB-SA has been conducting stress tests and further tests are planned under the SAM framework. Currently, the five large conglomerate life insurers have an average of 3.4 times the free assets to capital adequacy requirement. Going forward, the coverage ratios will be lower under the SAM framework as the calculations will increase the denominator with more focus on the capital available.

Table 6. Free Assets to Capital Adequacy Requirement

| Number of Life insurers* | 2012 | 2013 |
|---------------------------------|-------------|-------------|
| Covered 0–1 times | 0 | 0 |
| Covered 1–2 times | 28 | 20 |
| Covered 2–5 times | 31 | 34 |
| Covered 5–10 times | 16 | 10 |
| Covered 10+ times | 2 | 5 |
| Median | 2.6 | 2.8 |

*Excluding information on reinsurers, run-off companies under curatorship or liquidation.
Source: FSB-SA.

26. For short-term insurers, the underwriting profits have stabilized but susceptible to weather related claims and a depreciating exchange rate (Table 7). In 2013, motor and property insurance combined made up 86.7 percent of the total gross premium income for this sector. It was noted that management and commission expenses have been coming down marginally and the loss ratios have generally stabilized around 58 percent in the recent years.

Table 7. Performance Indicators for Short-term Insurers

| | 2012 | 2013 |
|---|-------------|-------------|
| Net premiums increase (year over year % change) | 4 | 7 |
| Claims or Loss ratio | 58 | 58 |
| Combined ratio | 89 | 89 |
| Management Expenses | 23 | 23 |
| Commission | 8 | 8 |
| Underwriting profit (loss) | 11 | 11 |
| Investment Income ratio | 16 | 17 |
| Surplus asset ratio | 55 | 55 |
| Capital Adequacy Ratio (median) | 1.6 | 1.9 |

Source: FSB-SA and SARB.

Key risks and vulnerabilities

27. Although South Africa fared relatively well through the global financial crisis, its economy continues to face macroeconomic and structural challenges. Slow growth in recent years and prolonged labor unrest has exacerbated high unemployment, inequality and other vulnerabilities. South African financial markets face a transition to a tighter external environment as US monetary policy begins its gradual process of normalization. The transition to higher interest rates is likely to be accompanied by higher volatility and lower capital inflows amid slowing domestic growth in South Africa.

28. Long-term insurers are particularly exposed to market risk in the current economic environment. Market risks include steep drop in equity markets, significant adverse developments in the level of volatility of interest rates across the term structure, significant adverse currency

movements, and significant drops in price levels of property investments. In a recent stress test, conducted by FSB-SA, considering market risk in isolation of other risks, only two small insurers demonstrated an inability to remain solvent under this combined scenario.

29. Beyond market risk, the second biggest driver of long-term underwriting risk is lapse and surrender risk, particularly in the retirement fund space. It was observed that as unemployment increased, many insurance policies lapsed as policyholders cashed in their savings or invested in other regulated entities, e.g., CIS. The FSB-SA has stepped up its efforts to educate consumers and also improve market conduct practices with greater intermediary oversight and impending RDR review. Other underwriting risks including mortality and morbidity catastrophes are particularly from pandemic or unexpected worsening in HIV/AIDS mortality. The long-term retirement savings market also exposes the insurers to longevity risk on annuities business.

30. Short-term insurers have to confront difficult market conditions and difficult underwriting exposures. Insurers are exposed to premium pricing and reserving risk, severe catastrophe risks, both natural and man-made, and counterparty default risks. The FSB-SA's combined stress test scenario revealed that a few insurers might be under solvency strains although this is still being investigated.

31. Due to the dominance and interconnectedness of the major financial conglomerates in the South African market, one of the biggest risks to the stability of the insurance sector is a default by one of the major banks. In addition to cross-ownership and equity investments, long-term insurers are a major source of funding for banks. For instance, insurers, pension funds and unit trusts hold substantial amounts of assets in bank deposits, which expose them to counterparty risks and banks to liquidity risks. A bank failure could pose significant credit risk to an affiliated insurer or other non-bank entity, while there could be contagion risk to banks if insurers make large deposit withdrawals due to financial strains. Shocks in one sector, can be transmitted through the financial system, potentially becoming systemic. It was also noted that insurers see diversified cash management as a challenge against a backdrop of concentrated banking system, particularly for short-term insurers given their significant share of deposits and money market funds in the banking system.

D. Preconditions for Effective Insurance Supervision

Sound and sustainable macroeconomic and financial sector policies

32. Sound economic, fiscal and financial sector policies over the past 20 years had insulated South Africa's economy from the worst of the global shocks in 2008–09. The flexible inflation-targeting framework provided an anchor for monetary policy during times of excessive volatility while a flexible exchange rate lessened the impact of disruptive capital flows. South Africa's fiscal position enabled the authorities to respond appropriately to a substantial fall in domestic tax revenue and the need for increased spending to deal with the crisis. The authorities had also been proactive in dealing with rapid credit expansion by banks through raising capital adequacy requirements and setting conservative leverage ratios. In addition, the National Credit Act helped to

protect households and consumers from reckless lending practices. South Africa is a signatory to the Southern African Development Community memorandum of understanding on macro-economic convergence, which sets a benchmark of government debt to GDP at 60 percent.⁷ However, fiscal imbalances remain moderate and growth is steady, yet still below potential. National Government has laid the basis for a new, more inclusive growth path, guided by the National Development Plan.

33. Financial inclusion is one of the policy priorities of South Africa. The government played a key role in facilitating the adoption of the Financial Sector Charter in 2004 to promote financial inclusion. The Charter commits major financial institutions to work more closely with government, labor and the wider community to transform the financial sector to better serve the poor and vulnerable. In 2010, 37 percent of 33 million South African adults did not have a bank account and only 40 percent had a formal long-term insurance product.⁸ The initiatives undertaken to improve access to financial services include promoting entry into the banking sector, creating an enabling framework for co-operative banks, facilitating the entry of smaller dedicated banks, improving the governance arrangements of Postbank, and introducing deposit insurance for co-operative banks and improving access to housing and small business finance. The authorities are working on regulatory reforms to implement a micro-insurance policy framework.

A well-developed Public Infrastructure

34. South Africa is ranked 53rd in global competitiveness by the World Economic Forum (WEF) in 2013-14,⁹ out of 148 countries. The positive factors cited by the WEF included the quality of its institutions, intellectual property protection, property rights, and in the efficiency of the legal framework in challenging and settling disputes. The high accountability of its private institutions further supports the institutional framework. South Africa also does reasonably well in business sophistication and innovation. The top three problematic factors indicated by the Forum were: inadequately educated workforce, restrictive labor regulations and inefficient government bureaucracy. In particular, it is plagued by high unemployment rate of over 20 percent, with the rate of youth unemployment estimated at close to 50 percent.

35. The judicial authority in South Africa is vested in the courts, which are independent and subject only to the Constitution and the law. The Constitution provides for the following courts: Constitutional Court; Supreme Court of Appeal; high courts;¹⁰ magistrates' courts and any other court established under an Act of Parliament. The law of contract, applicable to insurance

⁷ The SARB noted a consistent increase in the total loan debt of the South African national government mainly as a result of countercyclical fiscal policy responses during the global financial crisis. South Africa's debt to GDP ratio was estimated by the IMF at 42.3 percent in 2012, which is expected to remain stable in the foreseeable future (Source: Financial Stability Review September 2013, SARB).

⁸ Source: NT paper on "A Safer Financial Sector to Serve South Africa Better," February 2011.

⁹ Source: The Global Competitiveness Report 2013–2014.

¹⁰ Including any High Court of Appeal that may be established by an Act of Parliament to hear appeals from high courts.

policies, is a common-law system based on Roman-Dutch law.

36. The WEF ranked South Africa number one on its strength of auditing and accounting standards, for three consecutive years. The Accounting Standards Board (ASB) is responsible for setting standards of generally recognized accounting practice (GRAP). All public and constitutional entities were using GRAP since 2009 while trading entities started from 2013. The ASB has adopted International Financial Reporting Standards (IFRS) for the private sector, including insurers. South Africa adopted international auditing standards in 2005 and the independence of auditors are mandated under the Companies Act. Auditors who are in public practice are regulated by the Independent Regulatory Board for Auditors (IRBA), who registers auditors and is responsible for developing and maintaining auditing and ethical standards. Qualified accountants entering other disciplines are subject to the jurisdiction of the South African Institute of Chartered Accountants (SAICA), which has about 28,000 members. Auditors are required to report irregularities during audits to IRBA, which will be referred to the relevant authority, including the South African Revenue Service; the Johannesburg Stock Exchange (JSE); and the SA Police Service. They also have whistle blowing obligations to the FSB-SA, with legal immunity. IRBA monitors registered member's compliance with standards.¹¹

37. The Actuarial Society of South Africa (ASSA) issues technical guidance and sets professional conduct standards for actuaries, including continuous professional development. ASSA is not a statutory body and is not subject to statutory oversight. Nonetheless, it has recently established an Actuarial Governance Board to strengthen its self-regulatory functions, including oversight of the ASSA's disciplinary procedures. Insurers must appoint statutory actuaries who are required to give an opinion to the FSB-SA on the valuation of assets, liabilities and capital requirements.

38. A wide range of economic, financial and social statistics is readily available to insurance businesses and the FSB-SA. The statistics are available from the SARB, the government statistical service, Statistics South Africa (mortality statistics for the general population), and ASSA (assured lives mortality tables). The SARB reports on summary insurance sector developments, including financial strength indicators, in its half-yearly Financial Stability Report.

Effective Market Discipline in Financial Markets

39. General corporate governance requirements set out in the Companies Act is supplemented by the King Report on Governance for South Africa 2009 (King III) that took effect on March 1, 2010. King III provides a list of best practice corporate governance principles including a

¹¹ 12 inspectors monitored about 4 500 auditors daily, in 3-6 year cycles, depending on the risk level of the clients. Non-compliant auditors are subject to an investigations process and if found guilty, may be liable for sanctions ranging from a fine to being struck from the register.

principle on integrated reporting and disclosure. Insurers must be public companies incorporated under the Companies Act and are expected to observe King III on an “apply-or-explain” basis.¹²

Mechanisms for Consumer Protection

40. The respective South African insurance industry associations have established ombudsman schemes to deal with complaints that are contractual in nature. The Financial Services Ombud Schemes Act regulates voluntary ombudsman schemes and establishes a statutory ombudsman to address complaints in respect of which the voluntary ombuds offices, the Pension Funds Adjudicator or the FAIS Ombuds do not have jurisdiction. The current ombudsman system is under review.¹³ There is no policyholder protection scheme/fund to protect policyholders against the insolvency of insurers. During 2013, the FSB-SA sought inputs from industry associations on the establishment of a Policyholder Protection Scheme and this matter will be taken forward by a joint NT/SARB/FSB Resolution Policy Working group.

Efficient Financial Markets

41. As a major international financial sector, financial markets in South Africa are generally functioning well although exchange controls continue to apply. South Africa’s financial market development was ranked 3rd place by the WEF. The JSE was established in 1887 and has since evolved to a modern securities exchange providing fully electronic trading, clearing and settlement in equities, financial and agricultural derivatives and other associated instruments. There were 397 companies listed on the JSE in 2013, and the turnover of shares for 2012/13 was R 3,529.5 billion with an average number of trades per day of 120, 172. Liquidity (equity turnover as a percentage of market capitalization) amounted to 43.5 percent in 2012/13. Market capitalization of all securities listed on the JSE amounted to R 8,644.5 billion (approximately US\$930 billion) as at March 31, 2013. This ranks the JSE as the 19th largest stock exchange in the world in terms of market capitalization. Institutional investors (including long-term insurers) are eligible for foreign portfolio investment allowance¹⁴ under the Exchange Control Regulations. They must submit a quarterly report to the SARB providing information on the allocation of assets and proposed portfolio adjustments to bring foreign asset levels back in line (if applicable). Insurers have provided feedback that the exchange controls did not have material impact on their investment operations.

¹² This approach is favored over the “comply or explain” approach as the latter could denote “a mindless response to the King Code and its recommendations whereas the “apply or explain” regime shows an appreciation for the fact that it is often not a case of whether to comply or not, but rather to consider how the principles and recommendations can be applied.”

¹³ A comprehensive review was commissioned by National Treasury and the FSB-SA in 2011. The review will also address the future role of the Financial Services Ombudsman Scheme Council, presently fulfilling a coordinating role for all ombudsman schemes.

¹⁴ It is the amount institutional investors are allowed to invest offshore, which is up to 25 percent of the underwritten policy business of long term insurers and 35 percent of the investment linked business of long term insurers.

42. The limited liquidity in longer term debt instruments poses challenges for insurers' asset liability management. This was an issue noted in the 2008 FSAP Update, which partly reflects the low level of outstanding government debt. South African investors have access to assets issued and traded abroad, subject to exchange control. There is an emerging interests amongst some insurers in long-term investments in infrastructure or sustainable/renewable energy projects.

E. Recommendations and Authorities' Response

Table 8. Summary of Compliance with the ICPs

| Insurance Core Principle | Level | Overall Comments |
|---|--------------|---|
| 1 - Objectives, Powers and Responsibilities of the Supervisor | LO | <p>The FSB-SA is the primary authority responsible for insurance supervision and its powers are clearly defined in legislation. Although the objectives of insurance supervision are not explicitly stated in the legislation, the Mission and Vision statement of the FSB-SA gives effect to the objectives of insurance supervision. Currently, the FSB-SA supervises insurance groups through moral suasion or an informal framework based on its general powers to require information.</p> <p>The authorities have made good progress in identifying the changes required to align insurance supervision with international standards.</p> <p>The Financial Sector Regulation Bill and the Insurance Bill are expected to provide for the objective of supervision i.e., the maintenance of a fair, safe and stable insurance market for the benefit and protection of policyholders.</p> |
| 2 - Supervisor | PO | <p>The existing governance structure of the FSB-SA and its Board are adequately defined including internal governance procedures and internal audit arrangements. There is effective communication and prompt escalation of significant issues to appropriate levels within the FSB-SA. Some members continue to hold active managerial or board membership in the FSB-SA regulated entities. As some Board members are related to regulated entities, they may not be fully independent from commercial interests.</p> <p>The FSB-SA consults widely when introducing regulatory reforms. Recent legislative amendments have removed the requirement that certain supervisory powers be subject to the approval of the Minister of Finance, reducing the risk of political interference. The FSB-SA has added significant resources to its Insurance Division over the last four years; however, it was noted that additional skilled staff complement will be needed to effectively implement the regulatory reform agenda and supervise complex conglomerates.</p> |
| 3 - Information Exchange and Confidentiality | O | <p>The FSB-SA is empowered to coordinate, collaborate and share information exchange information with other domestic and foreign</p> |

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| Requirements | | regulators and does so in practice, with appropriate regard to the need to safeguard confidential information. Written agreement or strict reciprocity is not required for information exchange. The FSBA was amended recently to further facilitate information exchange and strengthen confidentiality requirements. |
| 4 - Licensing | LO | The licensing framework and supervisory guidance for license applications are clear and transparent. Various mechanisms including the Licensing Committee and rights of appeal against a decision of the FSB-SA help ensure that the licensing framework is consistently applied. Although current legislation does not specifically include licensing requirements relating to governance, risk management and group structure, its Risk-Based Supervisory Framework practices informs the licensing decision. |
| 5 - Suitability of Persons | O | The scope of suitability requirements apply to board of directors, senior management and significant owners. However, Key Persons in Control Functions are not covered due to the absence of requirements to establish such functions. (ICP 8) This regulatory gap will be addressed in the upcoming proposed Board Notice. The FSB-SA is able to compensate for some of the gaps, especially in respect of Key Persons in Control Functions, by means of its Risk-Based Supervisory Framework practices which include review of control functions. |
| 6 - Changes in Control and Portfolio Transfers | LO | <p>The Insurance Acts set clear ownership and control thresholds above which approval is required. Although current control thresholds are relatively higher than international best practices, proposed amendments and changes in control definitions are well progressed.</p> <p>The FSB-SA has the authority to approve or deny proposals to acquire or increase controlling interests in an insurance company. These are assessed, based on the same criteria as those for a new license application, and approved only when not prejudicial to policyholder interests. These powers and processes have recently been strengthened through a legislative amendment that requires insurers to notify the FSB-SA when they become aware of proposed changes in control. While insurers are not explicitly required to notify the FSB-SA in the case of a significant decrease in the ownership, below the pre-determined control levels, such cases are usually identified through FSB-SA's risk-based supervisory process.</p> <p>The FSB-SA also has the necessary powers to approve portfolio transfers that take into consideration policyholder interests.</p> |
| 7 - Corporate Governance | PO | There are no explicit corporate governance requirements in the Insurance Acts or regulations. The FSB-SA relies on the registration requirements for insurers as the high-level legal basis to supervise insurers' governance practices. The FSB-SA does not have a formal role in checking insurers' observance with the King III best practice principles on a "apply or explain" basis. The FSB-SA reviews insurers' corporate governance through qualitative questionnaires and |

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|---|----|---|
| | | <p>discussions during on-site visits.</p> <p>In recognition of the need to strengthen the regulatory regime, the FSB-SA is in the process of issuing a Board Notice to establish explicit governance requirements for insurers. The proposed Board Notice will also clarify the FSB-SA's supervisory powers to supervise insurers' corporate governance. The group supervision framework that will be provided for in the next version of the draft Financial Sector Regulation Bill¹⁵ will provide for the governance requirements for solo insurers to apply to controlling companies of an insurance group that provides a governance framework or performs a control function for an insurer. A comprehensive corporate governance framework at the group level is expected to be implemented in January 2016.</p> |
| 8 - Risk Management and Internal Controls | PO | <p>The Insurance Acts or supervisory guidelines do not at present specifically require insurers to establish, and operate within, effective systems of risk management and internal controls. While the regulatory requirements relating to the role of statutory actuaries and outsourcing are comprehensive, there are no explicit requirements on insurers to establish risk management, compliance and internal audit functions. King III partly addresses the role for internal audit on an apply-or-explain basis. The FSB-SA reviews insurers' risk management and internal controls as part of its risk-based supervision. The proposed Board Notice will establish comprehensive provisions relating to risk management and internal controls.</p> |
| 9 - Supervisory Review and Reporting | LO | <p>The FSB-SA uses a risk-based supervisory approach to evaluate the risk profile of regulated insurers. It takes into account the institution's financial condition, the future strategy, suitability of governance, management processes, compliance with legislation and other supervisory directives. The risk-based approach helps the FSB-SA to prioritize supervisory focus and to allocate supervisory resources. The FSB-SA has adequate documentation and follow-up processes in place for off-site monitoring and on-site visits and refines the risk-based supervisory process continuously.</p> <p>While the FSB-SA collects adequate information for regulated insurers on a solo basis, only a few large insurance groups are subject to group-related information requirements. Due to significant interconnectedness with other financial sectors, the FSB-SA recognizes the need for more standardized reporting of intra-group transactions and aggregate risk exposures. More systematic review of quantitative and qualitative information and joint inspections should be extended to all insurance groups.</p> |

¹⁵ Expected to be published for comment in mid-2014, with effect from January 1, 2015.

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| | | Given the absence of group market conduct requirements, supervision in this area is currently not addressed in the risk-based supervision framework for insurance groups; however, there is adequate supervision of market conduct requirements for solo insurers. The FSB-SA has, in the past, adopted a more reactive market conduct supervision approach. Since lapse rates, surrenders and churning issues have been challenging from a prudential and market conduct perspective, the planned introduction of a dedicated quarterly CoB return, for supervisory monitoring and enforcement actions, is a positive step. |
| 10 - Preventive and Corrective Measures | O | <p>The FSB-SA is empowered to take action against a person who conducts insurance business without the necessary authorization. The Insurance Acts and the Financial Institutions (Protection of Funds) Act also provide a sufficiently wide range of remedies to address non-compliance with the Acts by insurers. Preventative and corrective actions are regularly taken and implementation of measures is closely monitored.</p> <p>The FSB-SA Risk-Based Supervisory Framework supports early intervention and its approach to progressive escalation of actions or remedial measures at various stages depending on the severity of the situation. Once issues are identified, the FSB-SA has adequate powers to initiate timely and proportionate preventive and corrective measures.</p> |
| 11 - Enforcement | O | The FSB-SA has sufficiently wide range of enforcement powers, which have been frequently applied in practice. The Enforcement Committee (EC) within the FSB-SA adjudicates on all alleged contraventions and is empowered to impose unlimited penalties, compensation orders and cost orders. The criteria that guide sanctions are clear, objective and publicly disclosed. A dedicated Insurance Enforcement Department supports appropriate, consistent and legally sound enforcement of sanctions. In practice, the FSB-SA has taken enforcement actions against several insurers, including the 3 insurers that failed. |
| 12 - Winding-up and Exit from the Market | PO | <p>The Insurance Acts provide for clear triggers for the FSB-SA to take action in case of an insurer becomes financially unsound. The winding-up regime has been tested with the failure of three insurers in the past five years. However, policyholders do not currently have priority of claims over unsecured creditors in the event of the winding-up of an insurer.</p> <p>The FSB-SA is participating in a Resolution Policy Working Group (supported by the World Bank) consisting of the NT, the SARB and the FSB-SA. The Working Group is considering improvement to the prevailing legislative frameworks for the resolution of financial institutions, including the establishment of a policyholder protection scheme.</p> |
| 13 - Reinsurance and Other | LO | The FSB-SA reviews the proposed reinsurance arrangements of an applicant as part of the licensing process. Insurers may only obtain |

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| Forms of Risk Transfer | | relief in respect of “approved reinsurance policy” when calculating their technical provision. However, other on-going regulatory requirements on insurers’ reinsurance operations, including intra-group reinsurance transactions, have not been established. There is also no regulatory policy on the treatment and accounting for ART. The FSB-SA requires insurers to submit information on their reinsurance program, including ART used and statements on overall reinsurance strategy. In addition, short-term insurers must conduct stress tests that incorporate specific scenarios of default by the largest reinsurer. The FSB-SA review insurers’ reinsurance arrangements as part of its off-site analysis and verifies the reinsurance program during on-site visit. However, it does not specifically assess cedants’ liquidity management with respect to reinsurance. |
| 14 - Valuation | LO | The valuation regime is intended to be prudently realistic and is based on financial reporting standards, subject to prudential filters for assets and prudent valuation methodologies for certain types of assets and technical provisions prescribed by the FSB-SA. Long-term insurers must observe the SAPs issued by the ASSA in the estimation of technical provisions. The methodologies for estimating technical provisions of long-term insurers take into account the relevant underlying risks. They must use best-estimate assumptions, take into account policyholders’ reasonable expectations and maintain explicit compulsory and discretionary margins. For short-term insurers, there is no requirement to have an explicit margin over current estimate but an implicit margin is incorporated via the use of prudent factors and the policy of no discounting. |
| 15 - Investment | LO | The FSB-SA has established requirements on the investment activities of insurers including eligible assets; diversification requirements; non-admitted assets for solvency purposes; prohibition against encumbrances of assets; use of nominees as well as investments in derivatives. The proposed Board Notice will enhance the regime by establishing explicit requirements on insurers to have an explicit investment policy and explicit asset-liability management policy. |
| 16 - Enterprise Risk Management for Solvency Purposes | PO | Pending the implementation of SAM, the Insurance Acts and supervisory guidance do not address regulatory requirement relating to ERM and ORSA. In the interim, the FSB-SA has introduced semi-annual economic stress tests for the six largest long-term and short-term insurers, and annual economic and insurance stress test for all insurers. The FSB-SA reviews insurers’ ERM framework and is closely monitoring insurers’ progress in terms of ORSA. The Pillar II Readiness exercise in 2012 revealed that while insurers have made progress on ERM issues, almost 85 percent of the insurers were either weak or needed improvement with respect to ORSA preparations. A follow-up Pillar II readiness review is underway. |
| 17 - Capital Adequacy | LO | The current solvency regime is transparent and the requirements |

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| | | <p>are more risk-based for long-term insurers compared to short-term insurers. In practice, the CAR has proven to be largely sufficient in preventing insurer failures or losses to policyholders, largely because of the prudence built into the calculation of technical provisions. While the insurance laws only provide a single point of supervisory intervention, continuous monitoring by the FSB-SA allows early identification of potential breaches of CAR which facilitates timely intervention. As insurers move closer to the minimum CAR, supervisory action and intervention will be triggered and intensified if necessary.</p> |
| 18 - Intermediaries | O | <p>All entities (including insurers and banks) providing insurance intermediation services and/or advice must be authorised as FSPs. The FSB-SA has detailed requirements for licensing FSPs, who are subject to risk-based ongoing supervision. Adequate requirements are in place for FSPs to ensure that they conduct business in a professional and transparent manner. Disclosure requirements are adequate and sufficient safeguards are in place to protect client funds. The FSB-SA has also taken actions against unlicensed individuals and entities.</p> <p>While the FSB-SA's regulatory environment has generally raised the professional standards of conduct of FSPs, the potential for mis-selling and poor outcomes for policyholders seems to persist. The TCF initiative currently underway is expected to bring benefits to consumers and the financial services industry as a whole. The FSB-SA has begun embedding TCF into its regulatory and supervisory framework, which includes explicit minimum governance requirements. There is scope to improve the governance requirements and to supervise the implementation in a more robust manner.</p> <p>The cross-sector Retail Distribution Review is expected to focus on the broad review of distribution practices and the regulatory framework governing FSPs. This review is expected to go beyond disclosure of information on remuneration and propose structural interventions to reduce potential conflicts of interest.</p> |
| 19 - Conduct of Business | LO | <p>The FSB-SA has most of the necessary requirements for the conduct of business of insurance to see that customers are treated fairly throughout the product cycle. There are processes in place to review that customers are treated fairly, both before a contract is entered into and through to the point at which all obligations under a contract have been satisfied. The authorities are addressing the current regulatory gaps by engaging with the market conduct participants to improve conduct of business practices. The implementation of the TCF initiative is currently underway and the outcomes are reported in the FSB-SA annual report.</p> <p>The authorities have embarked on the Retail Distribution Review aimed at strengthening the CoB regime to address structural issues</p> |

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| | | <p>e.g., in the areas of commission and conflict of interest. In addition, the FSB-SA has drafted a Conduct of Business Return, which will require insurers to regularly report key indicators of TCF outcomes (including statistics on lapses and surrenders, claims ratios, complaints, etc.). Furthermore, the proposed Board Notice to enhance governance requirements for insurers will improve management of risks relating to unfair policyholder treatment.</p> <p>The shortcomings include a lack of requirements for insurers and FSPs to establish and implement policies and procedures on the fair treatment of customers and improve legislation to take into account the interests of different types of customers when developing and marketing insurance products. Authorities are also working on enhancing management of conflict of interests, claims and ombudsman services and on protection of private information on customers.</p> |
| 20 - Public Disclosure | PO | <p>The Insurance Acts do not have explicit public disclosure requirements, although the adoption of IFRS partly addresses the standards under this ICP. Unless an insurer is listed, there is no obligation to make the financial statements available to persons other than persons that have a beneficial interest in the insurer. The FSB-SA does not monitor the disclosures made by insurers to market participants. Under the SAM framework, public disclosure requirements will be established as part of Pillar III requirements.</p> |
| 21 - Countering Fraud in Insurance | PO | <p>The FSB-SA has minimal direct legislative powers in respect of insurance fraud. Nonetheless, fraud in general constitutes a criminal offence under the common law and the Criminal Law imposes sanction against fraud. Although not specifically required in legislation, the FSB-SA expects insurers to implement effective risk prevention procedures and controls, which implicitly covers insurance fraud risks. FSPs are required to address risks (including fraud risks) that result in financial loss to clients and others. The FSB-SA checks whether insurers and FSPs have implemented fraud prevention measures although there has not been a thorough examination in this area.</p> |
| 22 - Anti-Money Laundering and Combating the Financing of Terrorism | PO | <p>The legislative framework of the AML-CFT regime comprises the FICA, the MLTFC Regulations and Exemptions in Terms of the FICA. The AML-CFT regime covers long-term insurers and FSPs. The FIC has issued directives and Guidance Notes relating to the AML-CFT obligations of accountable institutions. However, some parts of the guidelines issued by the FIC are not legally enforceable due to the current legal gaps in the AML-CFT regime.</p> <p>The FSB-SA is a designated AML-CFT competent authority and is empowered to conduct AML-CFT on-site inspections and impose administrative sanctions. Assessing the compliance by long-term insurers and FSPs with their AML-CFT obligations is embedded in the FSB-SA's risk-based supervisory approach. The FSB-SA has sufficient resources to carry out its AML/CFT mandate. Insurers and</p> |

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| | | FSPs submit suspicious transactions reports to the FIC directly. The FSB-SA is authorized to cooperate and exchange information with relevant authorities (ICP 3) and has a MoU with the FIC. However, disclosure of information to a foreign FIU may only be provided pursuant to a written agreement and subject to reciprocity. |
| 23 - Group-wide Supervision | PO | <p>The FSB has been developing its approach to group supervision in the past few years. Currently, there are no explicit regulatory powers to conduct group-wide supervision. In practice, group-wide supervision is informal and relies, in respect to information gathering on groups and follow-up action, on FSB-SA's general authority and standing rather than on specific legislative provisions. Despite the informality, the FSB-SA has been able to cooperate and coordinate conglomerate supervision with the SARB on systemic issues on a regular basis.</p> <p>To date, the FSB-SA has focussed on a few large conglomerates and its supervision relies mainly on some financial indicators. The FSB-SA is developing standardized regulatory reporting to assess the broader group risks and risk mitigants, corporate governance, reporting arrangements and market conduct issues.</p> |
| 24 - Macroprudential Surveillance and Insurance Supervision | LO | The FSB-SA uses information from its supervisory analysis and external sources to identify/assess the extent to which macro-economic vulnerabilities and financial market risks (both local and international) impinge on the financial condition of insurers and the stability of the insurance sector as a whole. While there is no formal process to assess the potential systemic importance of insurers, the FSB-SA supervises the major and potentially systemic insurance groups more closely. Under the proposed Twin Peak supervisory structure, the SARB will serve as the macro-prudential supervisor. |
| 25 - Supervisory Cooperation and Coordination | O | Despite the lack of a formal framework, the FSB-SA is able to coordinate and cooperate with other relevant supervisors on insurance groups in practice through its general standing and the willing participation of the insurance groups concerned. The FSB-SA has hosted one supervisory college as the group-wide supervisor and plans to host supervisory colleges for four other insurance groups for which it is the <i>de-facto</i> group-wide supervisor. It has signed coordination agreements as an involved supervisor in several colleges. Legislative provisions are pending to enhance the framework for cooperation and coordination in group-wide supervision. |
| 26 - Cross-border Cooperation and Coordination on Crisis Management | LO | The FSB-SA has demonstrated its ability and willingness to support and participate in resolving crisis situations. However pre-crisis preparation, coordination and cooperation should be enhanced. While the current legislative framework does not hinder cooperation and coordination in a crisis, the gaps noted should be addressed to facilitate more effective cross-border crisis management. In this regard, the proposed Board Notice on risk management frameworks and the proposed crisis management and resolution framework are positive initiatives. |

Table 9. Summary of Observance Level

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| Observed (O) | 6 |
| Largely observed (LO) | 11 |
| Partly observed (PO) | 9 |
| Not observed (NO) | - |
| Total | 26 |

Table 10. Recommendations to Improve Observance of the ICPs

| Insurance Core Principle | Recommendations |
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| 1 - Objectives, Powers and Responsibilities of the Supervisor | The authorities are encouraged to expedite the finalization of the proposed Financial Sector Regulation Bill and the Insurance Bill that establish the objectives of insurance supervision and confer legal authority on the FSB-SA to conduct group supervision. |
| 2 - Supervisor | The authorities are advised to: <ul style="list-style-type: none"> a) revise criteria for appointment of Board members to ensure there is no undue political or industry interference; b) expedite the legislative amendments to have explicit legal provisions regarding the appointment and dismissal of the head of the supervisor and members of its governing body; c) review the adequacy of supervisory resources and augment skill sets in light of current and impending regulatory initiatives and increased need for supervisory cooperation domestically and internationally; d) consider exempting the supervisors from the government's austerity measures and administrative guidance to strengthen their effectiveness and financial autonomy, particularly as the supervisors are not funded from the fiscus; and e) consider how best to enhance the effectiveness of the internal audit functions within the supervisors, such as the need for enhanced regulatory and supervisory experience in reviewing the integrity of supervisory process. |
| 4 - Licensing | The authorities are recommended to: <ul style="list-style-type: none"> a) expedite legislative amendments to formalize the licensing requirements relating to governance, risk management and group structure; b) review current exemptions for friendly societies and adopt proportionate approach for these entities; and formulate clearer boundaries between medical schemes and insurance products that should be supervised under the Insurance Acts. |
| 5 - Suitability of Persons | The authorities are advised to: <ul style="list-style-type: none"> a) expedite the proposed Board Notice to ensure that appropriate governance and ongoing suitability requirements, including for Key |

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| | <p>Persons in Control Functions, are present in both at the solo and the insurance group holding company level;</p> <p>b) consider encouraging Board Members, Senior Management, and Key Persons in Control Functions to have an annual self-assessment to discuss and confirm ongoing suitability requirements and to identify where the Board may have skills gap, on a collective and on an individual basis, to ensure continued education or additional measures can be taken on a timely basis.</p> |
| 6 - Changes in Control and Portfolio Transfers | <p>The authorities are recommended to:</p> <p>a) introduce a definition of "significant" owner based on control and percentage; and</p> <p>b) expedite legislative amendments to authorize the FSB-SA to approve any significant increase above the predetermined control levels and to approve any significant decreases as well.</p> |
| 7 - Corporate Governance | <p>The implementation of the proposed Board Notice, the Financial Sector Regulation Bill and the Insurance Bill will address the current regulatory gaps. The FSB-SA is advised to plan for adequate supervisory resources to implement the enhanced corporate governance framework effectively.</p> |
| 8 - Risk Management and Internal Controls | <p>The implementation of the proposed Board Notice will address the current regulatory gaps on risk management and internal controls. It is advisable that the FSB-SA provides guidance to short-term insurers on monitoring potential ML/TF risks, which will contribute the authorities' review of the ML/TF risk profile of the short-term insurance industry (ICP 22).</p> |
| 9 - Supervisory Review and Reporting | <p>The effectiveness of on-going supervision could be strengthened by:</p> <p>a) Ensuring that three year supervisory cycle is completed for all insurers and reinsurers and more intensive on-site visits, especially for the more complex insurers;</p> <p>b) Formulating appropriate group supervision plan that would cover all insurance groups in a risk-based proportionate manner, including joint on-site visits of financial conglomerates;</p> <p>c) Increasing off-site monitoring of intra-group transactions and aggregate group exposures and limits and establishing procedures for insurer/groups to report group related risks and risk direction for off-site monitoring;</p> <p>d) Instituting procedures to capture CoB risks in the current RAD such that both prudential and CoB supervision form part of the risk assessment;</p> <p>e) Strategizing an appropriate risk-based supervisory cycle for CoB on-site visits to cover the large number of licensed FSPs, facilitated by the proposed CoB return; and</p> <p>f) Ensuring adequate skilled supervisory resources are in place to achieve appropriate coverage and supervisory intensity.</p> |
| 12 - Winding-up and Exit from the Market | <p>It is recommended that the authorities expedite the changes to the legislative framework such that high legal priority is given to the protection of the rights and entitlements of policyholders.</p> |
| 13 - Reinsurance and Other Forms of Risk Transfer | <p>The implementation of the proposed Board Notice will address most of the current regulatory gaps on reinsurance. In addition, the FSB-SA is</p> |

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| | <p>advised to:</p> <ol style="list-style-type: none"> a) adopt a systematic approach to evaluating the nature of supervision of reinsurers and other counterparties used by insurers; b) formulate clear policy position on the treatment and accounting for ART; c) establish explicit requirements on reinsurance with related companies, including – <ul style="list-style-type: none"> • management of liquidity, concentration, and contagion risk as well as potential conflicts of interests; • assessing the acceptability of reinsurance with related companies based on both qualitative (e.g., purpose) and quantitative criteria. |
| 14 - Valuation | The valuation regime under the SAM Framework will be based on economic valuation, with explicit margins over current estimate for technical provision. |
| 15 - Investment | The proposed Board Notice provisions governing insurers' investment activities and asset-liability management will address most of the current regulatory gaps. The authorities are advised to formulate appropriate investments requirements at the insurance group level. |
| 16 - Enterprise Risk Management for Solvency Purposes | The proposed Board Notice covering risk management and the implementation of the SAM Framework will significantly enhance the regulatory regime for ERM. |
| 17 - Capital Adequacy | The impending implementation of the SAM Framework and the Insurance Bill, including financial soundness requirements for insurance groups, will bring the solvency regime in line with ICP 17. |
| 18 - Intermediaries | <p>The authorities are advised to maintain the positive momentum in embedding the TCF in all regulatory and supervisory practices with respect to FSPs and expediting the Retail Distribution Review. In addition, the authorities are encouraged to:</p> <ol style="list-style-type: none"> a) Actively monitor persistence rates of intermediaries; b) Ensure governance requirements for intermediaries are effectively embedded and enforced to better protect policyholders; c) Consider ways to simplify the FSP structure to have greater focus on supervising insurance intermediaries to improve policyholder protection; d) Consider establishing cyber-surveillance to enhance the detection and the prevention of illegal sale of insurance products via internet, social networking services, and mobile telephony; and e) Ensure adequate resources for more robust implementation of recent legislative amendments and effective supervision of intermediaries. |
| 19 - Conduct of Business | <p>The authorities are advised to expedite the current CoB initiatives which will address the following gaps:</p> <ol style="list-style-type: none"> a) explicitly require insurers to take into account the interests of different types of customers when developing and marketing insurance products; b) provide explicit conduct of business requirements on insurance |

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| | <p>product development and provide the supervisor with the authority to require notification of certain types of new insurance products and prohibit certain products that do not meet prescribed standards;</p> <p>c) have appropriate governance framework on strengthening conflict of interest; and</p> <p>d) review the adequacy of supervisory resources of FSB-SA to effectively implement the TCF regime, more proactive CoB supervisory approach and fine tuning the regulatory policies in light of actual supervisory experience.</p> |
| 20 - Public Disclosure | It is recommended that authorities establish explicit public disclosure requirements in line with ICP 20 that are applicable to all insurers and provide clear legal authority to the FSB-SA to supervise compliance with the requirements. |
| 21 - Countering Fraud in Insurance | The Board Notice proposed by the FSB-SA will require insurers to establish an explicit insurance fraud risk management policy, including prompt reporting to the relevant authorities, in line with ICP 21. |
| 22 - Anti-Money Laundering and Combating the Financing of Terrorism | <p>The proposed Board Notice will enhance measures that insurers must take in respect of managing risks associated with ML-FT. In addition, the authorities are advised to:</p> <p>a) Expedite the passage of the amendments to the main AML-CFT legislation to address the remaining technical deficiencies in the AML-CFT regime;</p> <p>b) Consider how best to improve supervisory coordination and engagement of the industry to facilitate effective compliance by insurers and FSPs with their AML-CFT obligations; and</p> <p>c) Periodically assess the potential ML-FT risk in the short-term insurance industry to take account of evolving ML-FT typologies and consider whether to apply the FATF standards to short-term insurance.</p> |
| 23 - Group-wide Supervision | <p>It is recommended that authorities establish clear and consistent regulatory regime for group-wide supervision to provide:</p> <p>a) explicit powers for the FSB-SA to:</p> <ul style="list-style-type: none"> • enforce group-wide supervision requirements (including reporting requirements) for unregulated companies, including holding companies; • refuse or revoke authorization where a firm's ownership links may prevent effective group supervision; • approve intra-group transactions and cross-shareholdings to prevent concentration risk, risk of contagion, and double gearing of capital; <p>b) regulatory reporting at both solo and consolidated levels for all insurance groups;</p> <p>c) a more formal risk assessment program for heads of group; and</p> <p>d) group-wide market conduct requirements.</p> <p>It is important for the authorities to ensure effective implementation of the group supervision framework supported by adequate supervisory resources with appropriate skills. In addition, cross-sectoral coordination</p> |

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| | mechanisms could be enhanced and formalised, particularly with respect to groups majority-owned by securities entities. |
| 24 - Macroprudential Surveillance and Insurance Supervision | The authorities are advised to formulate macro-prudential surveillance framework appropriate to the nature, scale and complexity of the insurance sector under the Twin Peaks supervisory structure. The considerations include: <ul style="list-style-type: none"> a) Developing more robust indicators for assessing systemic risk of insurers and reinsurers; b) Taking account of cross-sectoral linkages e.g., cross-shareholdings across the sectors, <i>bancassurance</i>, linked policies; and c) Inclusion of risks arising from system-wide market conduct issues, including reputational risks. |
| 26 - Cross-border Cooperation and Coordination on Crisis Management | It is important that the FSB-SA continues to engage the relevant supervisory colleges on the preparations and common tools for managing a cross-border crisis and identifying (and resolving, as far as practicable) barriers to efficient and internationally coordinated resolutions. The work of the Resolution Policy Working Group would inform the formulation of a crisis management and resolution framework that will deal with cross-border crisis effectively. The framework should explicitly address: plans and tools for dealing with insurers in crisis as well as requirements for insurers to provide information in a timely fashion and to maintain contingency plans and procedures which should be tested and reviewed regularly. |

Authorities' responses to the assessment

43. The FSB-SA would like to thank the Assessors for the report on the detailed assessment of the IAIS Insurance Core Principles. We believe the report is comprehensive and displays a good understanding of the FSB-SA regulatory and supervisory frameworks (both existing and planned). The assessment was extremely useful exercise in terms of providing an independent and objective benchmarking of the standards of insurance regulation and supervision in South Africa against international standards.

44. The report accurately reflects the various ways in which the FSB-SA is already well-advanced in addressing some of the identified gaps in our regulatory framework and supervisory practices. The assessment was a useful tool in the refinement of the regulatory and supervisory framework enhancements currently underway.

DETAILED ASSESSMENT

Table 11. Detailed Assessment of Observance of the ICPs

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| ICP 1 | <p>Objectives, Powers and Responsibilities of the Supervisor</p> <p>The authority (or authorities) responsible for insurance supervision and the objectives of insurance supervision are clearly defined.</p> |
| Description | <p>Regulatory Structure</p> <p>South Africa's institutional arrangements for financial regulation and supervision involve multiple government authorities, advisory and oversight committees and self-regulatory organisations. Lead responsibility for setting financial regulatory policy objectives lies with the Minister of Finance (MoF) through the NT, which steers legislation through the Parliament.</p> <p>In its articulation of policy reform objectives for the financial services sector, the NT has indicated that its policy agenda rests on five pillars - financial stability, consumer protection, better access to financial services, improved regulatory coordination, and comprehensiveness (meaning that all businesses in the financial sector should be on the regulatory radar). These objectives are mutually reinforcing.</p> <p>At the time of this assessment, the authorities responsible for insurance supervision and insurance related financial sector matters included:</p> <ul style="list-style-type: none"> - <i>The FSB-SA</i> is the primary authority responsible for the prudential and market conduct regulation and supervision of insurers. It also regulates other non-bank financial institutions as well as securities markets activities; - <i>SARB</i> is the prudential regulator and supervisor of banks; - <i>NCR</i> under the DTI regulates the market conduct aspect of granting of consumer credit by all credit providers. Since credit and credit life insurance business forms an important part of the consumer credit, close cooperation is required in this sector; - <i>CMS</i> which reports to the Department of Health and regulates medical insurances schemes; and - <i>FIC</i> is a separate unit under the MoF responsible for administering the broader AML-CFT regime. The unit works in coordination with the relevant supervisory agencies, including the FSB-SA, responsible for supervising the institutions. <p>The LTIA and the STIA, collectively referred to as "the Insurance Acts or Acts," are the primary legislation that define the FSB-SA's authority for insurance supervision. The supervision and enforcement of the Insurance Acts are entrusted to the FSB-SA. Responsibilities of the FSB-SA are centralized under the Financial Services Board Act (FSBA) in the executive officer of the FSB-SA (<i>LTIA s2; STIA s2 and FSBA s3</i>).</p> <p>Objectives of Insurance Supervision</p> <p>The objectives of insurance supervision, although not directly provided for in the primary legislation, are elaborated in the Mission and Vision statement of the FSB-SA:</p> <ul style="list-style-type: none"> • The FSB-SA Vision is to have a sound and trusted financial services and investment |

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| | <p>environment in South Africa.</p> <ul style="list-style-type: none"> • The FSB-SA Mission is to regulate and supervise financial institutions and markets to protect consumers of financial services. <p>In practice, the Vision and Mission is given effect through oversight of prudential supervision, market conduct supervision and monitoring of financial stability (through stress testing). A strategic plan giving effect to the Mission and Vision is also in place. The Mission and Vision statements and the strategic plan are regularly updated. The strategic plan is approved by the FSB-SA's Board, and by the Minister of Finance and tabled in Parliament (i.e., the document is in the public domain).</p> <p>Legal Powers of the FSB-SA</p> <p>The Insurance Acts provide for enforceable subordinate legislation to be issued. The MoF issues regulations and the FSB-SA issues Board Notices, Directives,¹⁶ Rules, information letters and supervisory guidelines. Except for information letters and supervisory guidelines, all are legally binding and enforceable in the court of law. Non-compliance is addressed through a number of preventive and corrective measures (see ICP 10 and ICP 11) and referrals to the Enforcement Committee¹⁷ (EC) of the FSB-SA or referrals to the national prosecuting authorities. In 2013, the EC enforced penalties ranging from R50,000 to R2 million for various offences. The issuance of Directives is also used to compel compliance.</p> <p>The Insurance Acts are supplemented by the following:</p> <ul style="list-style-type: none"> • Inspection of Financial Institutions Act No. 80 of 1998 (IFIA); • Financial Institutions (Protection of Funds) Act No. 28 of 2001 (FIPFA); and • The Financial Intelligence Centre Act (FICA). <p>The IFIA authorises the FSB-SA to appoint inspectors to undertake inspections of regulated and unregulated persons. The FIPFA affords the FSB-SA the power to summon insurers and other persons to appear before it, place an institution under curatorship (with the consent of the insurer), apply to Court for an injunction or request the Court to place an insurer under curatorship, statutory management or business rescue or in liquidation. The Insurance Acts, the IFIA and the FIPFA, empower the FSB-SA to act swiftly and decisively to achieve the objectives of insurance supervision for the protection of policyholders. Critical supervisory measures to protect policyholders' interests are not allowed to be suspended pending appeal from insurers.</p> <p>Conduct of Business and Policyholder Protection</p> <p>Intermediaries and financial advisors (collectively known as FSPs must be registered to provide insurance intermediary and financial advisory services. The primary legislation for CoB in respect of intermediaries and advice is the Financial Advisory and Intermediary Services Act (FAIS Act). The Insurance Acts are the primary legislation for CoB in respect of other aspects of insurance business (through the policyholder protection rules).</p> |
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¹⁶ Directives were introduced in 2008 and are not required to be published in the Government Gazette.

¹⁷ The Enforcement Committee is currently made up of 20 members appointed by the Board of the FSB-SA.

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| | <p>In practice, the FSB-SA work together with various regulators and supervisors to promote and ensure adequate oversight of prudential and market conduct supervisory measures. Although there is scope to improve the legislative powers, these are being advanced through the Twin Peak legislative reform agenda and the TCF initiative.</p> <p>Group supervision</p> <p>Currently, group-wide supervision of insurers is undertaken on an informal basis on the general authority and standing of the FSB-SA rather than specific legislative provisions. The FSB-SA is able to request information relating to insurance groups through insurers under the authority afforded to the FSB-SA in the Insurance Acts. In addition, the FSBA allows the FSB-SA is to coordinate, collaborate and share such information with other regulators ((<i>LTIA s4; STIA s4; FBSA s22</i>)).</p> <p>Microinsurance</p> <p>NT has prioritised access to financial services as an important objective in the financial sector's reform agenda. In response to the need for enhancing financial inclusion while ensuring adequate consumer protection, the South African government has taken a policy position to regulate and license the microinsurance¹⁸ industry. Following the release of the micro-insurance policy document in July 2011, the NT and the FSB-SA have established a steering committee and various working groups to oversee the drafting of a dedicated microinsurance regulatory framework.</p> <p>Corrective Legislative Actions</p> <p>The FSB-SA regularly initiates legislation, including corrections in legislation. This was illustrated by the recently enacted Financial Services Laws General Amendment Act (FSLGAA), effective from February 28, 2014, that aligned the Insurance Acts to the Companies Act, closed regulatory gaps identified in the Insurance Acts, provided for enhanced supervisory powers and clarified the status of financial services legislation vis-à-vis general legislation to the extent that such legislation may impact on the stability of the financial services sector and impede effective supervision. These amendments were proposed by the FSB-SA and supported by the national government.</p> <p>The FSB-SA also frequently reviews the legislation applicable to market intermediaries to ensure effectiveness and relevance of existing legislation and that all risks posed to investors are adequately addressed. This was also illustrated by the latest amendments to the FAIS Act through the recently enacted FSLGAA where much of the fit and proper requirements for the intermediaries were expanded.</p> <p>Ongoing Regulatory Initiatives</p> <p>An Insurance Laws Amendment Bill (ILAB) was tabled in Parliament on June 21, 2013. The</p> |
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¹⁸ Microinsurance refers to insurance that is accessed by the low-income population (also known as the mass market), provided by a variety of different providers and managed in accordance with generally accepted insurance practice. It forms part of the broader insurance market, distinguished by its particular focus on the low-income market, which translates into distinct means of product design and distribution.

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| | <p>ILAB proposed amendments to the Insurance Acts to explicitly stated the objective of the Insurance Act to promote of the maintenance of a fair, safe and stable long-term insurance market for the benefit and protection of policyholders. Given that the ILAB was withdrawn, the authorities would address this under the Financial Sector Regulation Bill and the Insurance Bill.</p> <p>The insurance group supervisory powers of the FSB-SA will be announced later in 2014 as part of the second draft of the Financial Sector Regulation Bill. Specifically, the FSB-SA will have direct powers over the group holding company. The Bill will provide for the governance requirements for solo insurers to apply to holding companies of an insurance group. Those provisions relate to the notification of the appointment, resignation or termination of appointments of directors and managing executives, removal of appointees that are not fit and proper, changes in capital structures, and changes in shareholding, financial soundness, judicial management and liquidation. It is envisaged that the effective date of these and other critical amendments will be in place by next year.</p> |
| Assessment | Largely Observed |
| Comments | <p>The FSB-SA is the primary authority responsible for insurance supervision and its powers are clearly defined in the legislation. Although the objectives of insurance supervision are not explicitly stated in the legislation, the Mission and Vision statement of the FSB-SA gives effect to the objectives of insurance supervision. Currently, the FSB-SA supervises insurance groups through moral suasion and an informal framework based on its general powers to require information.</p> <p>The authorities have made good progress in identifying the changes required to align insurance supervision with international standards. The Financial Sector Regulation Bill and the Insurance Bill are expected to provide for the objective of supervision i.e., the maintenance of a fair, safe and stable insurance market for the benefit and protection of policyholders.</p> <p>The authorities are encouraged to expedite the finalization of the legislative amendments that establish the objectives of insurance supervision and the legislative changes that confer legal authority on the FSB-SA to conduct group supervision.</p> |
| ICP 2 | <p>Supervisor</p> <p>The supervisor, in the exercise of its functions and powers:</p> <ul style="list-style-type: none"> • is operationally independent, accountable and transparent; • protects confidential information; • has appropriate legal protection; • has adequate resources; and • meets high professional standards. |
| Description | <p>Governance, accountability and independence</p> <p>The governance structure of the FSB-SA is clearly defined in the FSBA. The FSB-SA is subject to the general authority of the Minister of Finance who appoints the members of the FSB-SA Board and its Executive Committee consisting of the Executive Officer (EO),</p> |

five Deputy Executive Officers (DEOs) and a Chief Actuary.

The FSB-SA Board consists of eleven directors with relevant industry or academic backgrounds. However, it was noted that some members continue to hold active managerial or board membership in FSB-SA regulated entities. As some Board members are related to regulated entities, they may not be fully independent from commercial interests. The Board remains primarily responsible for the governance oversight of the FSB-SA while the NT is responsible for financial sector policy, which informs the FSB-SA's strategic direction and policy, operational performance, financial matters, risk management and compliance. The Board is expected to exercise leadership, integrity and judgment in directing the FSB-SA in a manner based on accountability and responsibility. The Board has appointed various Board Committees, including an Audit and Risk Committee. As such, the Board is the focal point of the corporate governance system within the FSB-SA (*Board Charter s3*).

The mandate, role and responsibilities of the Board are stipulated in the Board Charter. Authority for the day-to-day management of the FSB-SA has been delegated to the senior management team. In general, the Board is not expected to participate in the day-to-day regulatory and supervisory activities of the FSB-SA. There is adequate delineation of functions between the EO and the Board.

The FSB-SA exercises authority and performs functions assigned in terms of the Insurance Acts and other supporting Acts. The Board supervises the overall performance of the FSB-SA's functions and generally does not interfere or assert its authority on the senior management team of the FSB-SA. The FSB-SA informed that there were no executive overrides from the Board or the Minister.

The FSBA further regulates the relationship between the Board, the executive and the Minister in respect of delegations, reporting and removals from office, and internal governance arrangements. The FSBA allows for the delegation of powers to appropriate persons. In this regard, a system of delegation is in place that maximizes administrative and operational efficiency and provides adequate checks and balances.

The FSB-SA, as a public entity, is subject to the Public Finance Management Act (PFMA). This Act requires various internal governance arrangements to be in place, including the establishment of an internal audit function, which is currently outsourced. The internal audit report for 2013 did not reveal any significant issues, although it would be preferable for the internal audit to have the necessary supervisory or regulatory expertise for effective audits. The FSB-SA is also subject to the Public Audit Act which regulates the external auditing of its financial statements.

The FSBA defines the relationship between the FSB-SA and the executive in respect of the FSB-SA's mandate; the PFMA defines the relationship between the FSB-SA and the executive and the legislature in respect of broader governance and accountability issues; and the Constitution of the Republic of South Africa, 1996 defines the relationship between the FSB-SA, the executive, the legislature and the judiciary. The separation of powers doctrine is firmly entrenched in the Constitution and protected by the Constitutional Court.

As part of the government's accountability framework, the FSB-SA submits an annual report, including audited financial statements, to the Minister of Finance and to the Parliament. The FSB-SA is required to report on its strategic objectives and outcomes, key performance measures and indicators for assessing its performance in delivering the desired outcomes and objectives and the actual performance against the strategic objectives and outcomes. The annual report is also published and available to the public.

Further, the Insurance Acts require the FSB-SA to annually submit, to the Minister of Finance, a report on the activities under the Acts during each year. The Minister must table the report in Parliament. This report contains aggregate information about the financial situation of the insurance sector, observations on major developments in the sector and an update on regulatory developments.

All decisions of the FSB-SA are subject to the Promotion of Administrative Justice Act which enforces consultation, transparency and equal treatment. In addition, the FSB-SA has put in place various processes and procedures to ensure consistent and expedient supervisory actions. Mechanisms for the effective communication and prompt escalation of significant issues to appropriate levels within the supervisor include review panels for both quarterly and annual statutory returns, as well as review panels to agree on regulatory actions resulting from concerns identified on on-site visits. More urgent concerns or contraventions are immediately escalated to the DEO. The relatively flat structure of the FSB-SA ensures that matters can be expeditiously escalated. The DEO has delegated authority to make decisions where action must be taken immediately in case of an emergency (e.g., prudential solvency matter or fraud), such decisions are shared with the EO. For prudential supervisory matters, the Risk-Based Supervisory Framework is also used for escalation of decisions that are required to be taken promptly.

Appointment and Dismissal Procedures

Currently, the FSBA does not include explicit procedures for the appointment and dismissal of the EO or the members of the FSB-SA Board or place an obligation on the Minister to publicly disclose the reasons for dismissal.

Since the decision to dismiss a member of the FSB-SA Board constitutes an administrative decision, a person so dismissed has the protection afforded under the Promotion of Administrative Justice Act, meaning that the member may insist on reasons for the decision and may take the decision on review. Further, as the EO (and other members of the Executive of the FSB-SA) are staff members of the FSB-SA, the Labour Relations Act applies. This Act affords specific protection and remedies to staff and Board against arbitrary decisions.

The Insurance Acts clearly specify the circumstances which the Minister exercises authority as opposed to the FSB-SA. Except for the function to advise the Minister on matters concerning financial institutions and financial services in general, the FSB-SA is not obliged to consult or secure the approval of the Minister in the exercise of its regulatory and supervisory powers. The Insurance Acts were specifically amended since the last FSAP, through the FSLGAA, to remove the requirement that the FSB-SA must

seek the approval of the Minister prior to prohibiting an insurer from entering into new business i.e., placing the insurer in run-off or in liquidation (*FSBA s3; LTIA s12 & s42; STIA s12 & s41*)).

Funding and supervisory resources

The FSB-SA prepares its strategic plan and budget, and allocates its resources in accordance with its mandate, objectives and perceived risks. The strategic plan and budget of the FSB-SA are approved by the Board of the FSB-SA and the Minister of Finance and tabled in Parliament in terms of the PFMA. The FSB-SA is responsible and accountable to the Minister of Finance and Parliament for the implementation of its strategic plan and budget. Once the annual budget has been approved, the EO of the FSB-SA may authorize a higher overall level of expenditure, if this appears necessary to respond to emerging risks and achieve supervisory objectives. The FSB-SA has a system of financial delegation that allows for various levels in the FSB-SA's staff structures to approve out of budget expenditure up to a specified level.

The FSB-SA does not receive any funding from government. It is funded through levies imposed on financial institutions and fees charged for services rendered. Although the industry is consulted on the levies imposed, the decision as to the quantum of the levies is at the sole discretion of the Board. Any levy imposed under the Act is tax deductible and is a debt due to the FSB-SA and may be recovered by way of judicial process in a competent court (*FSBA s15A*).

Currently, approximately 26 percent of the overall FSB-SA budget is allocated to supervision of insurers. Approximately 33 percent of the overall budget is allocated to the regulation and supervision of FSPs. Only when the amount exceeds the specified level, the approval of the Board is required. In practice, however, the budget has never been exceeded in the last four years.

Transparency and Consistency of Requirements

Regulatory requirements, set out in the legislation and subordinated legislation including Board Notices and Rules, are published in the Government Gazette. In addition, regulatory interpretations and guidance, as well as supervisory requirements, are set out in directives, guidance notes, information letters, reporting templates and forms. These are utilised to enhance implementation of the legislation and subordinate legislation and provide guidance to the insurance industry in a manner that facilitates the achievement of the stated insurance supervision objectives. The regulatory and supervisory requirements are developed in consultation with the insurance industry to help ensure that they are appropriate to the objectives they are intended to meet and take into account the proportionality principle.

Further, the FSB-SA has adopted a Risk-Based Supervision (RBS) framework for supervising insurers (ICP 9). This framework has been communicated to the industry and the industry is regularly updated with developments on this methodology. The RBS framework includes mechanisms to ensure that the supervisory procedures are applied consistently through panel reviews.

All legislation, subordinated legislation, directives, guidance notes, information letters,

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| <p>service level agreements and administrative forms are published on the FSB-SA website.</p> <p>Review and Consultation</p> <p>Regulatory requirements and supervisory procedures are reviewed regularly. This was illustrated by the amendments to the Insurance Acts through the recently enacted FSLGAA and the Discussion Paper on the review of third-party cell captive insurance and similar arrangements published in June 2013.</p> <p>All legislation is subject to prior public consultation in accordance with the requirements of the South African Constitution. All other regulatory requirements and supervisory procedures are subject to prior consultation with the industry in accordance with the well-established practices of the FSB-SA. A comment-and-response document is usually published together with the final requirements or procedures.</p> <p>Appeals against Supervisory Decisions</p> <p>A person who feels aggrieved by a decision of the FSB-SA may appeal against that decision to the Appeal Board established under the FSBA. An appeal lodged does not suspend any decision of the FSB-SA pending the outcome of an appeal, unless the chairperson or a deputy chairperson of the Appeal Board,¹⁹ on application by a party, directs otherwise. The FSB-SA has the opportunity to oppose such an application (<i>FSBA s26, 26A and 26B</i>).</p> <p>A person who feels aggrieved by a decision of the Appeal Board may take that decision on judicial review to the Courts, in accordance with the Promotion of Administrative Justice Act. The FSB-SA informed that, to date, this has never impeded timely decisions to protect policyholders.</p> <p>Confidentiality of Information</p> <p>No information obtained in the performance of any power or function under the FSBA, the Insurance Acts or the FICA is allowed to be utilised or disclosed by: members (former members) of the Board or Board Committees; members or former member of the Appeal Board or the Enforcement Committee; or employees/contractors of the FSB-SA. Information may only be disclosed to another regulatory authority subject to appropriate confidentiality safeguards (refer to ICP 3). Breaches of confidentiality provision is liable to a fine not exceeding R1 million or to imprisonment not exceeding five years or to both. No such fines have been needed in the last five years (<i>FSBA s22; s27</i>).</p> <p>The disclosure of information is also regulated under the Promotion of Access to Information Act and will be further regulated under the Protection of Personal Information Act that was enacted in 2013. The latter Act aligns the South African legislative environment with international standards and provides for the criminalisation of information sharing in contravention of the Act. The Act has not yet commenced. In addition, the Act provides for a transitional period of one year. The FSB-SA is in the</p> |
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¹⁹ Appeal Board is made up of 12 members, including 5 attorneys, 2 advocates and 4 members that are active in the accounting field. The chair of the Appeal Board is a retired judge.

process of developing processes and procedures to ensure compliance with the Act.

Code of Conduct and Conflict of Interest

The members of the Board, all staff of the FSB-SA are subject to a code of conduct included in the FSB-SA's Employees' Human Resources Policies and Procedures that requires them to, at all times, observe the highest professional standards and appropriate standards of confidentiality. The code of conduct also requires staff to avoid conflict of interests and prohibits certain activities or relationships that may give rise to a conflict of interests. To date, the FSB-SA had one non-compliance case with the code of conduct that led to a disciplinary action. This code of conduct is part of the conditions of employment for all staff and is enforced through appropriate disciplinary actions in accordance with prevailing labour laws. Periodic measures are in place to review any conflicts of interest (*FSBA s19*).

Legal Protection

The FSB-SA staff (including its Board members, executive, staff, contractors, and consultants) are indemnified from liability of loss sustained as a result of any bona fide exercise of his or her duty under the Acts administered by the FSB-SA (*FSBA s23*).

Resources

The FSB-SA is generally able to attract and retain skilled staff, hire outside experts as necessary, provide training, and rely upon an adequate supervisory infrastructure and tools. Salaries of FSB-SA staff are annually benchmarked to market rates so as to ensure skilled personnel can be attracted and retained. Authorities should also consider exempting the supervisors from the government's austerity measures and administrative guidance to strengthen their effectiveness and financial autonomy particularly as the supervisors are not funded from the fiscus.

The FSB-SA's Insurance Division takes responsibility for the administration of the Insurance Acts. At the end of March 2014, total number of staff included one DEO, management team of 7 heads of departments, 59 staff members and 10 administrative staff. The Insurance Division is further supported by the Actuarial Insurance Team which consists of three qualified actuaries and 10 actuarial students. The current budget for 2014-2015 (and the budget of the preceding two years) provides for further strengthening of the FSB-SA's staff to enhance the FSB-SA's ability to effectively perform its functions.

All staff employed by the FSB-SA are required to have specific minimum qualifications. Except for administrative positions, all staff are required to have applicable university degrees. In the case of more senior positions, relevant experience is a prerequisite for a person to be appointed. Appropriate and on-going training is provided to staff in accordance with an annual training plan. To demonstrate its commitment to professional development and training, the FSB-SA allocates about 1.5 percent of its human resources budget towards training. The FSB-SA is also able to avail training from experienced foreign regulatory authorities and international organizations frequently as evidenced from the 2013 Annual Report.

Although insurance related resources have almost doubled in the last five years, there is

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| | <p>scope to further increase the supervisory resources and skill set to accommodate new initiatives underway including, SAM requirements, increased corporate governance oversight and insurance group supervision. The TCF framework initiative will also require increased skills in relation to market conduct oversight.</p> <p>Outsourcing of Supervisory Functions</p> <p>In order to perform its functions, the FSB-SA is allowed to enter into an agreement with any person for any specific services. The Insurance Acts further provide for specific instances where the FSB-SA may make use of other professional persons to assist the FSB-SA in performing functions under these Acts. To date, such outsourced functions have included inspections and review of data processing systems. Where functions are outsourced, appropriate contractual arrangements are entered into to ensure clearly defined roles and responsibilities and appropriate oversight exists. The standard contract of the FSB-SA includes specific provisions relating to maintenance of confidentiality of information. (FSBA s12)</p> <p>Ongoing Regulatory Initiatives</p> <p>The Financial Sector Regulation Bill places explicit requirements on the Minister regarding the appointment and dismissal of the head of the supervisor and members of its governing body. The Bill is expected to improve on the governance and accountability framework to ensure the regulators have the necessary operational independence.</p> |
| Assessment | Partly Observed |
| Comments | <p>The existing governance structure of the FSB-SA and its Board are adequately defined including internal governance procedures and internal audit arrangements. There is effective communication and prompt escalation of significant issues to appropriate levels within the FSB-SA. Some members continue to hold active managerial or board membership in other FSB-SA regulated entities. As some Board members are related to regulated entities, they may not be fully independent from commercial interests.</p> <p>The FSB-SA consults widely when introducing regulatory reforms. Recent legislative amendments have removed the requirement that certain supervisory powers be subject to the approval of the Minister of Finance. The FSB-SA has added significant resources to its Insurance Division over the last four years; however, it was noted that additional skilled staff complement will be needed to effectively implement the regulatory reform agenda and supervise complex conglomerates.</p> <p>The authorities are advised to:</p> <ol style="list-style-type: none"> a) revise criteria for appointment of Board members to ensure there is no undue political or industry interference; b) expedite the legislative amendments to have explicit legal provisions regarding the appointment and dismissal of the head of the supervisor and members of its governing body; c) review the adequacy of supervisory resources and augment skill sets in light of current and impending regulatory initiatives and increased need for supervisory cooperation domestically and internationally; d) consider exempting the supervisors from the government's austerity measures and |

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| | <p>administrative guidance to strengthen their effectiveness and financial autonomy particularly as the supervisors are not funded from the fiscus; and</p> <p>e) consider how best to enhance the effectiveness of the internal audit functions within the supervisors, such as the need for regulatory and supervisory experience in reviewing the integrity of supervisory process.</p> |
| ICP 3 | <p>Information Exchange and Confidentiality Requirements</p> <p>The supervisor exchanges information with other relevant supervisors and authorities subject to confidentiality, purpose and use requirements.</p> |
| Description | <p>Legal authority</p> <p>The FSB-SA is empowered to direct an insurer to furnish, within a specified period, specified information or documents. In this regard, the FSB-SA is able to request information relating to an insurance group, including non-regulated entities within the group, indirectly through an insurer (<i>LTIA s4; STIA s4</i>).</p> <p>The FSB-SA is empowered to cooperate and share information with local and foreign supervisors. Recent amendments through the FSLGAA, which became effective on February 28, 2013, further strengthened information exchange and confidentiality requirements under the FSBA.</p> <p>Notwithstanding the obligation to observe official secrecy, the FSB-SA may disclose information:²⁰</p> <ol style="list-style-type: none"> In the course of performing functions under the FSBA or the FICA; For the purposes of legal and other proceedings; When required by a court; If the EO²¹ or DEO opines that the disclosure is appropriate: i) for the purposes of warning, informing or alerting the public of breaches or risks; ii) in the public interest; iii) to a regulatory authority for supervisory purposes, ensuring the stability of the financial system and coordinating the supervision of financial institutions; iv) in accordance with a cooperation agreement; v) to deter, prevent, detect, report and remedy fraud or other financial crimes; or for the AML-CFT purposes. <p>Subject to the safeguards under the FSBA, the existence of a MoU is not a pre-requisite for information exchange (<i>FSBA s22 (1); s22(2)</i>).</p> <p>To facilitate supervisory coordination and cooperation, the EO or a DEO is authorized to:</p> <ol style="list-style-type: none"> liaise with any regulator on matters of common interest; participate in the proceedings of any regulator; advise or receive advice from any regulator; prior to taking any material regulatory action against a financial institution, inform a |

²⁰ Information does not include aggregate statistical data; information and analysis about the financial condition or business conduct practices of a financial services sector or a part thereof.

²¹ The EO of the FSB-SA is the Registrar of Pension Funds, Registrar of Friendly Societies, Registrar of Long-Term Insurance, Registrar of Short-Term Insurance, Registrar of Securities Services, Registrar of Collective Investment Schemes and the Registrar of Financial Services Providers.

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| | <p>relevant regulator of the pending action, or where this is not possible, inform the relevant regulator as soon as possible after taking the action; and</p> <p>e) negotiate and enter into cooperation agreements or memoranda of understanding (MoU) with other regulators, including a provision that the EO, DEO or the other regulator: be informed of adverse assessments of qualitative aspects of the operations of a financial institution; or may provide information regarding significant problems within a financial institution (<i>FSBA s22 (3)</i>)</p> <p>Information may only be disclosed if, prior to providing information, it is established that the requesting authority has appropriate safeguards in place to protect the confidentiality of information. The FSB-SA may only request information for performing the powers and functions under the FSBA and FICA. Any information requested from or provided by another authority:</p> <p>a) must only be used for the purpose for which it was requested;</p> <p>b) must not be made available to third parties without the consent of the authority that provided the information; and</p> <p>c) if lawfully compelled to disclose the information, the FSB shall inform that authority of the event and the circumstances; and where possible, use all reasonable means to oppose the disclosure of or protect the information. (<i>FSBA s22 (4)</i>)</p> <p>Supervisory practices</p> <p>The FSB-SA has concluded 78 MoUs and 3 Multilateral MoUs with local and international regulatory authorities. On January 10, 2013, the FSB-SA submitted its application to become a signatory to the IAIS Multilateral MoU on Cooperation and Information Exchange, which was pending finalization at the time of assessment.</p> <p>The MoU executed with the SARB provides for the arrangements for mutual assistance and information exchange as well as coordinate the supervision of financial conglomerates (see ICP 25). The FSB-SA has been able to obtain information on non-regulated entities indirectly through the insurer entity within the group, which was shared with the SARB for the purpose of supervisory risk assessment.</p> <p>The FSB-SA also participates in supervisory colleges both domestically and internationally and has signed confidentiality agreements regarding information obtained at international supervisory colleges (ICP 25). The FSB-SA recently informed all SADC regulators of criminal charges brought against former directors of an insurer.</p> <p>The FSB-SA assesses each request for information from another supervisor on a case by case basis, including against the safeguards set out in the FSBA. Strict reciprocity in terms of the level, format and detailed characteristics of information exchanged is not required. The FSB-SA has not refused any request for information on this basis.</p> <p>Only the EO or a DEO may disclose information to another regulatory authority. If a request for information is received that requires the consent of another authority, the</p> |
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| | <p>request is escalated to the FSB-SA, who will request the consent. To date, the FSB-SA has not been compelled by law to disclose information.²²</p> <p>The FSB-SA endeavours to respond in a timely and comprehensive manner when exchanging relevant information and in responding to requests from supervisors seeking information. A register is maintained in respect of information requests and all requests are channelled through a specific department within the Insurance division and the International and Local Affairs Unit of the FSB-SA. The FSB-SA is in the process of developing processes and procedures to ensure that the recent amendments through the FSLGAA are implemented appropriately.</p> |
| Assessment | Observed |
| Comments | The FSB-SA is empowered to coordinate, collaborate and share information exchange information with other domestic and foreign regulators and does so in practice, with appropriate regard to the need to safeguard confidential information. Written agreement or strict reciprocity is not required for information exchange. The FSBA was amended recently to further facilitate information exchange and strengthen confidentiality requirements. |
| ICP 4 | <p>Licensing</p> <p>A legal entity which intends to engage in insurance activities must be licensed before it can operate within a jurisdiction. The requirements and procedures for licensing must be clear, objective and public, and be consistently applied.</p> |
| Description | <p>Regulatory authority</p> <p>The requirements for licensing or registration are set out in: LTIA and STIA; Guidelines for Registration as a long-term or short-term insurer of the LTIA or STIA; and Information Letter 6 of 2012 relating to service level commitments</p> <p>In South Africa, no person is allowed to conduct insurance business unless the person is registered under the respective insurance legislation. Life or long-term²³ and non-life or short-term²⁴ insurance business is subject to strict licensing requirements (referred to as 'registration' under the insurance legislation) (<i>LTIA s7(1); STIA s7(1)</i>).</p> <p>Non-compliance with the insurance legislation constitutes a criminal offence and is subject to various regulatory actions. There are specific exclusions for certain entities from the requirement to register under the insurance legislation.</p> |

²² The FSB-SA has in the past secured the consent of a regulatory authority to include information received from that authority in an application to Court – however, not in respect of an insurance matter.

²³ Under the LTIA, long-term policy means an assistance policy, a disability policy, fund policy, health policy, life policy or sinking fund policy, or a contract comprising a combination of any of those policies; and includes a contract whereby any such contract is varied.

²⁴ Under the STIA, a short-term policy means an engineering policy, guarantee policy, liability policy, miscellaneous policy, motor policy, accident and health policy, property policy or transportation policy or a contract comprising a combination of any of those policies; and includes a contract whereby any such contract is renewed or varied.

Exclusions under the Insurance Acts

The insurance legislation excludes certain entities from the requirement to register. These entities are regulated under separate distinct legislation:

- Pension Fund;
- Friendly societies if the policy benefits do not exceed R7,500 per member or the prescribed maximum amount. Although most friendly societies are small in terms of number of members and total assets, a few friendly societies have a large presence with over R150 million in total assets. Registration and supervisory oversight of friendly societies are less stringent;
- A Fund established under the Labour Relations Act;
- Medical schemes regulated by the Council for Medical Schemes (CMA). Although the schemes share insurance characteristics, these schemes are closer to social security funds and do not underwrite individual risks;
- Agricultural co-operatives conducting incidental insurance business subject to certain conditions;
- The unemployment insurance fund under the Unemployment Insurance Act; or
- The Land and Agricultural Bank of South Africa.

Registration Requirements

The Insurance Acts requires that a registration may not be granted if:

- the applicant does not have the financial resources (minimum R10 million in fully paid up capital), organization or management that is necessary and adequate for the carrying on of the business concerned;
- fit and proper criteria are not met;
- it is contrary to the interests of policyholders;
- the applicant is not, or will not be, able to comply with the Act; or
- the registration is contrary to the public interest.

Guidelines for Registration as a long-term or short-term insurer and an application form for registration as an insurer have been published on the FSB-SA's website.

The application process requires an applicant to submit a 5 year business plan that projects the minimum capital required to support future operations beyond the minimum requirement. The matters that must be addressed in the business plan include:

- the applicant's risk management systems including reinsurance arrangements, internal control systems, information technology systems, policies and procedures to be adequate for the nature and scale of the business;
- system of governance;
- the business lines and risk profile, and details of projected setting-up costs, capital requirements, projected development of business, solvency margins and reinsurance arrangements;
- information regarding primary insurance and inward reinsurance;
- information on the products to be offered by the insurer;
- information on contracts with affiliates and outsourcing arrangements;
- information on the applicant's reporting arrangements, both internally to its own management and externally to the supervisory authority.

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| | <p>Currently, the Insurance Acts do not prescribe specific suitability or fit and proper requirements for significant owners, nor specific governance framework requirements. The FSB-SA explained that, in practice, these requirements form part of the considerations that inform a licensing decision through the legal provision that:</p> <ul style="list-style-type: none"> • the direct or indirect control of the applicant must not be contrary to the interests of policyholders or the public interest; • the applicant must have the organisation or management that is necessary and adequate for the carrying on of the business concerned, combined with the matters that must be addressed in the business plan regarding the system of governance (<i>LTIA s9; STIA s9</i>). <p>Forms of Establishment</p> <p>An application is not granted unless the applicant is a public company registered²⁵ under the Companies Act and has the carrying on of insurance business as its main object. An insurer could also be incorporated as a mutual insurer without share capital.</p> <p>The Insurance Acts do not make provision for foreign insurers to access the domestic market on a branch basis or on a cross-border service basis only. A foreign insurance subsidiary is subject to the same requirements as an insurer that is domestically owned. The FSB-SA liaises with the home regulatory authority if a foreign entity wishes to establish a subsidiary in South Africa and requests information on the good standing of that entity in the foreign jurisdiction (<i>FSBA s22</i>).</p> <p>Only reinsurers are allowed to operate as composites in South Africa. Under the Insurance Acts, a direct insurer cannot undertake long-term and short-term insurance business under the same registration.</p> <p>Review of Group Structure</p> <p>Where the applicant is part of a group, the Insurance Acts and relevant supervisory forms do not currently require the applicant to submit its full group reporting structure. However, in practice, the FSB-SA uses the authority to direct an insurer to furnish specified information or documents required to assess whether the group structure may hinder effective supervision. The information requested includes all of the material entities within the group (including both insurers and other entities, including non-regulated ones) (<i>s4 of the Insurance Acts</i>).</p> <p>Timeliness of Review</p> <p>Information Letter 6 of 2012 relating to service level commitments sets out the timelines within which the FSB-SA assesses an application for registration as an insurer. The current timeline is 180 calendar days. The FSB-SA is of the view that a maximum six month timeframe for making a decision and informing the applicants of the decision is reasonable given the objectives of insurance regulation and the potential negative</p> |
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²⁵ Application to be a public company is reviewed by the Commissioner of the Companies and Intellectual Property Commission who approves the registration.

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| | <p>impact that a poorly-considered decision may have on the broader insurance market.</p> <p>If an incomplete application is received, an applicant is afforded an opportunity to supplement its application. In these instances the service level commitment is normally suspended until the required information is received. In practice, the actual time taken to assess applications, make a decision and inform applicants is usually far shorter than 180 days, once all information is provided. Statistics on the average time taken to process applications were seen to be less than 30 days (<i>Info Letter p3.3 -3.5</i>).</p> <p>Prior to refusing an application for registration, the FSB-SA affords the applicant an opportunity to provide additional information to improve the application. Where an application has been refused, the FSB-SA provides the rationale behind the decisions for refusal in accordance with the Promotion of Administrative Justice Act (<i>PAJA s4</i>).</p> <p>Refusal of Registration and Additional Requirements</p> <p>An application for registration is refused if the applicant does not meet the registration requirements. In practice, it was noted that only a couple of applications for registration were declined as most applications were voluntarily withdrawn.</p> <p>If the application warrants, the FSB-SA imposes additional conditions or limitations on insurers pre or post registration including:</p> <ul style="list-style-type: none"> ▪ authorizing the insurer to enter into only certain policies determined by the FSB-SA; ▪ authorizing the insurer to enter into certain policies determined by the FSB-SA subject to particular terms or conditions determined by the FSB-SA; ▪ limiting the policy benefits under certain policies as determined by the FSB-SA; ▪ limiting the premiums that the insurer may receive, during a period determined by the FSB-SA, in respect of all or certain policies; ▪ requiring the insurer to enter into reinsurance policies as determined by the FSB-SA; ▪ requiring that the provisions of the memorandum and articles of association; ▪ conditions reasonably necessary to ensure that the insurance business concerned is carried on soundly in compliance with the Acts; and ▪ different conditions may be determined in respect of different insurers. <p>Consistency of Application Review</p> <p>The FSB-SA has established a Licensing Committee²⁶ under the FSBA. This committee advises the FSB-SA on the merits of each application for registration. It is not compulsory for the FSB-SA to act on the recommendation made by the Committee. The main reason for appointing the Licensing Committee is to ensure impartiality and objectivity of assessing the strength of an application. The FSB-SA should consider augmenting registration summary documentation to match the supervisory Risk Assessment Document with risk analysis and conduct of business reviews to increase consistency of</p> |
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²⁶ The Licensing Committee is a seven persons committee appointed by the Board of the FSB-SA to advise the FSB-SA on the desirability to register a specific applicant, amongst others, as an insurer. Members of this Committee are all non-FSB-SA staff. Members are appointed on merit, based on their knowledge and experience obtained in the financial industry and members act in their personal capacity.

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| | <p>application reviews.</p> <p>Scope of Registration</p> <p>A registration certificate issued by the FSB-SA clearly identifies if that insurer or reinsurer is registered for long-term or short-term insurance business and the classes of insurance business that may be underwritten. Classes constitute the different types of insurance policies identified in the Insurance Acts. All registered insurers are on the website and also publicly available as part of the Annual Reports of the FSB-SAs. The FSB-SA issues a certificate of registration authorising the person to carry on the insurance business and specifying the conditions based on which the registration was granted (<i>LTIA s9; STIA s9</i>).</p> <p>Ongoing Regulatory Initiatives:</p> <p>The proposed Board Notice and further legislative initiatives will entrench current practice in legislation including providing for: the FSB-SA to prescribe specific fit and proper requirements; specific governance framework requirements, for both solo insurers and insurance groups; and requirement that the group structure of an insurance group may not hamper effective supervision.</p> <p>In July 2011 the Minister of Finance, through the NT, published a policy document titled: “The South African Microinsurance Regulatory Framework”. The policy document sets out the policy framework for financial inclusion, in particular the twin policy concerns of promoting better access to formal insurance products while ensuring that consumer protection is strengthened, which intends to achieve the following objectives:</p> <ul style="list-style-type: none"> ▪ Extending access to a variety of good-value formal insurance products appropriate to the needs of the low-income households; ▪ Enabling current informal insurers to provide formal insurance, in the process establishing new, well-capitalized insurers and promoting small business development; ▪ Lowering the barriers to entry to encourage broader participation in the market and promote competition among providers; ▪ Ensuring protection of consumers of microinsurance; and ▪ Facilitating effective supervision and enforcement. <p>The drafting of regulatory and legislative reforms to give effect to the microinsurance framework is in progress.</p> |
| Assessment | Largely Observed |
| Comments | <p>The licensing framework and supervisory guidance for license applications are clear and transparent. Various mechanisms including the Licensing Committee and rights of appeal against a decision of the FSB-SA help ensure that the licensing framework is consistently applied. Although current legislation does not specifically include licensing requirements relating to governance, risk management and group structure, the same risk-based assessment informs the licensing decision.</p> <p>The authorities are recommended to:</p> <ol style="list-style-type: none"> a) expedite the proposed Board Notice to formalize the licensing requirements relating to governance, risk management and group structure; |

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| | <p>b) review current exemptions for friendly societies and adopt proportionate approach for these entities; and</p> <p>c) formulate clearer boundaries between medical schemes and insurance products that should be supervised under the Insurance Acts.</p> |
| ICP 5 | <p>Suitability of Persons</p> <p>The supervisor requires Board Members, Senior Management, Key Persons in Control Functions²⁷ and Significant Owners of an insurer to be and remain suitable to fulfil their respective roles.</p> |
| Description | <p>Regulatory Authority</p> <p>High level fit and proper requirements are set out in the: LTIA; STIA; Guidelines for Registration as a long-term or short-term insurer of the LTIA or STIA; and Risk-Based Supervisory Framework for Insurers</p> <p>Currently, the Insurance Acts require directors, managing executives (defined as the chief executive officer (CEO) and manager who reports directly to that CEO), public officers, auditors, statutory actuaries and significant shareholders to meet suitability requirements. The FSB-SA has specific forms for fit and proper assessments:</p> <ul style="list-style-type: none"> ▪ the application form for registration as an insurer (<i>LTIA s9; STIA s9</i>); ▪ the notification form for the appointment or termination of a director, managing executive or public officer that requires information relating to criminal, financial and supervisory indicators (<i>LTIA s18; STIA s18</i>); ▪ the application form for the appointment of an auditor or actuary that requires information relating to criminal, financial and supervisory indicators (<i>LTIA s19, s19A, s20; STIA s19, s19A, s20</i>); and ▪ the application form for a change in shareholding that requires information relating to financial soundness and integrity. The integrity requirements include that direct or indirect control of the applicant must not be contrary to the interests of policyholders and that the registration must not be contrary to the public interest including the prospective shareholder must be fit and proper (<i>LTIA s9; STIA s9</i>). <p>In respect of vetting the suitability requirements of directors, managing executives and public officers, the FSB-SA uses the services of an outsourced contracted verification agent which verifies credit standing, criminal records and qualifications. In respect of auditors and actuaries, the FSB-SA relies on the suitability assessments undertaken by the IRBA and the ASSA, respectively.</p> <p>Ongoing Suitability</p> <p>The Insurance Acts, respectively, require the appointment of an auditor or statutory actuary to be approved by the FSB-SA (<i>LTIA s19, s19A, s20; STIA s19, s19A, s20</i>).</p> <p>For significant owners/shareholders, the approval of the FSB-SA is required for any</p> |

²⁷ Control functions include risk management, compliance, actuarial and internal audit functions.

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| <p>person who, directly or indirectly, acquires or holds shares in an insurer or related party of that insurer. Approval is not granted if it is considered to be contrary to the public interest or policyholders' interests (<i>LTIA s25, 26; STIA s25, s26</i>).</p> <p>The legislation also requires the FSB-SA to be notified, within 30 days, of any termination or resignation of any director or managing together with the reasons for such terminations (<i>LTIA s18; STIA s18</i>).</p> <p>The FSB-SA is empowered to disqualify or remove persons found not suitable to hold the relevant positions. Legislation allows the an insurer to terminate the appointment of a director, managing executive, public officer, auditor or statutory actuary of an insurer, if the person is not fit and proper to hold the office (<i>LTIA s21; s22; STIA s21, s22</i>).</p> <p>If a significant owner is prejudicial or harmful to the insurer, legislation empowers the FSB-SA to apply to the Court for an order compelling such shareholder to:</p> <ul style="list-style-type: none"> • reduce the shareholding within a period determined by the Court, that shareholding to a shareholding with a total nominal value not exceeding 25 per cent of the total nominal value of all the issued shares of the insurer; and • limiting, with immediate effect, the voting rights that may be exercised by such shareholder by virtue of his, her or its shareholding to 25 per cent of the voting rights attached to all the issued shares of the insurer (<i>LTIA s25-27; STIA s25-27</i>). <p>The recently enacted FSLGAA amended the Insurance Acts by authorising the FSB-SA to prohibit an insurer from carrying on business if in the opinion of the FSB-SA the insurer is not managed or owned by persons who are fit and proper (<i>LTIA s12; STIA s12</i>).</p> <p>If a foreign entity wishes to establish a subsidiary in South Africa, the FSB-SA liaises with the home regulatory authority and requests information on the good standing of that entity. The FSB-SA also liaises with other relevant authorities both inside and outside South Africa with respect to the suitability of Board Members and Senior Management (<i>FSBA s22</i>).</p> <p>Supervisory Practice</p> <p>The financial soundness and integrity of governance structure and significant owners are assessed initially during licensing, through the ongoing risk-based supervisory exercise, and when there are changes in significant ownership or control (ICP4; ICP6). The FSB-SA's supervisory framework incorporates assessment of governance and financial strength of ownership. This is applicable to the supervisory oversight of insurance subsidiaries and branches operating outside South Africa. In the last three years, the FSB-SA has removed board members and issued court orders for shareholders particularly in relation to the three failed institutions.</p> <p>During the assessment of this ICP, the assessors reviewed various reports to assess the FSB-SA's ongoing review of governance requirements.</p> <p>Ongoing Regulatory Initiatives:</p> <p>Although the Insurance Acts do not currently place an obligation on insurers to notify</p> |
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| | <p>the FSB-SA of any material changes to the fit and properness of directors, managing executives, public officers, auditors, statutory actuaries and significant shareholders, the Insurance Bill will impose this obligation.</p> <p>The ILAB and Insurance Bill were expected to enhance the requirements relating to the suitability of persons in May 2014. As the ILAB is withdrawn, the governance requirements for insurers (including internal control functions) will be enhanced through the proposed Board Notice.</p> <p>Pending the Board Notice, the notification form for the appointment or termination of a director, managing executive or public officer requires all insurers to make a declaration that they will notify the FSB-SA of any material changes affecting the completeness or accuracy of the answers provided in the notification form.</p> |
| Assessment | Observed |
| Comments | <p>The scope of suitability requirements apply to board of directors, senior management and significant owners. However, Key Persons in Control Functions are not covered due to the absence of requirements to establish such functions. (ICP 8) This regulatory gap will be addressed in the upcoming proposed Board Notice. The FSB-SA is able to compensate for some of the gaps, especially in the Key Persons in Control Functions, by means of its Risk-Based Supervisory Framework practices which includes review of control functions.</p> <p>The authorities are advised to:</p> <ol style="list-style-type: none"> a) expedite the proposed regulatory initiatives to ensure that appropriate governance and ongoing suitability requirements, including for Key Persons in Control Functions, are present in both at the solo and the insurance group holding company level; b) consider encouraging Board Members, Senior Management, and Key Persons in Control Functions to have an annual self-assessment to discuss and confirm ongoing suitability requirements and to identify where the Board may have skills gap, on a collective and on an individual basis, to ensure continued education or additional measures can be taken on a timely basis. |
| ICP 6 | <p>Changes in Control and Portfolio Transfers</p> <p>Supervisory approval is required for proposals to acquire significant ownership or an interest in an insurer that results in that person (legal or natural), directly or indirectly, alone or with an associate, exercising control over the insurer. The same applies to portfolio transfers or mergers of insurers.</p> |
| Description | <p>Legislative Authority</p> <p>The requirements for changes in control and portfolio transfers are set out in the LTIA, STIA, CA, Application forms for the acquisition of shares, Application forms and Guidelines for transfers; Guidelines for Registration as a long-term or short-term insurer in terms of section 9(1) of the LTIA or STIA; and Information Letter 6 of 2012 relating to service level commitments</p> |

Changes in control

The FSB-SA has general powers and processes to ensure that changes of control are assessed and approved only when not prejudicial to policyholder interests. These powers and processes have recently been strengthened through a legislative amendment that requires insurers to notify the FSB-SA when they become aware of proposed changes in control.

Definition of Control

Definition of control in the Insurance Acts was recently amended by the FSLGAA. A person is deemed to exercise control over an insurer if that person, alone or with related parties:

- holds shares in the insurer of which:
 - the total nominal value represents 25 percent or more of the nominal value of all the issued shares;
 - the total number of shares represents 25 percent or more of all the shares in a specific class of shares issued by that insurer;
- is directly or indirectly able to exercise or control the exercise of more than 15 per cent of the voting rights associated with securities of that company; or
- has the right to appoint or control the appointment of directors who control more than 15 per cent of the votes at a meeting of the Board (*LTIA s26, STIA s25*).

Notification of Changes in Control

Prior to recent revisions, approval of significant increase above the predetermined control levels was not automatically required. This meant that a person could increase the shareholding from 25 percent to over 51 percent without additional notification to the FSB-SA. The FSB-SA had resolved this issue by additional conditions attached to its approvals requiring controllers to seek further approvals if they propose to acquire 50 percent or more of the shareholding (*LTIA s26, STIA s25*).

Subsequent to the FSLGAA, an insurer is now required to inform the FSB-SA if a person, directly or indirectly, acquires shares or any other financial interest in excess of stated percentages or exercises control (*LTIA s 26(2A); STIA s25(2A)*).

All insurers are also required to provide information on significant shareholders in the annual statutory returns, including any changes in the upstream organization structure. The FSB-SA is also improving its procedures to have a systematic supervisory procedure for ensuring up to date organization structure and identification of beneficial owners. Qualitative annual returns are also verified to assess notification requirements and supervisory review procedures.

The Insurance Acts do not, at present, require notification from insurers in the case of a significant decrease below the predetermined control levels. The Insurance Bill will require the approval of the FSB-SA for disposing of, directly or indirectly, a beneficial interest in an insurer or a related party of that insurer in a manner that will result in that person no longer being a significant owner of that insurer.

The FSB-SA should also consider requiring the board of an insurer and management to

discuss and confirm if the organization structure is manageable and if any proposed changes to the structure of the group increases the risk profile of the group.

Review of Change in Ownership Application

The application form for a change in shareholding requires information relating to financial soundness and integrity similar to that required in the application form for registration of an insurer. Similar to an application for a new registration, an application for the acquisition of a controlling share in an insurer is referred to the Licensing Committee as described under ICP 4 for Licensing.

Foreign Ownership

The legislative powers apply irrespective of where the intermediate or ultimate beneficial owner of an insurer is located. The FSB-SA has the power to require information on the ultimate intended beneficial owner. The FSB-SA liaises with the home regulatory authority and requests information on the good standing of that entity in the foreign jurisdiction (*LTIA s4, s26; STIA s4, s25; FSBA s22*).

Demutualization and Conversion of Companies

The legislation requires the FSB-SA's prior approval of any transaction or agreement to convert a mutual insurer (an insurer without share capital) to a public company having a share capital (*LTIA s37(1); STIA s36(1)*).

The FSB-SA recently reviewed a demutualization application of an insurer and took various steps to satisfy itself with the new governing organizational document of the company and its continued financial soundness, including actuarial review, before giving approval.

Portfolio Transfer

The legislation empowers the FSB-SA to approve any insurance transaction which constitutes an agreement by which all or any part of the insurer's business is transferred to another person. Such transactions include any arrangement whereby the liability of an insurer towards policyholders is to be substituted for a liability of another insurer, which are deemed as a scheme for the transfer of the insurance business concerned. The FSB-SA requires affected policyholders to be made aware of the nature of such substitution (*LTIA s37; STIA s36*).

The FSB-SA normally appoints an actuary for long-term insurers, at the cost of the parties to the transaction, to review such applications and report on the assessment of the transaction. Any policyholder, shareholder or creditor of the insurer concerned is allowed to file affidavits and other documents relating to the transfer and be heard by the FSB-SA in connection with any objections to the transaction. The FSB-SA maintains an objection register with relevant details of how each affidavit was handled. The approval of the FSB-SA is not granted if the transaction is inconsistent with the Acts or contrary to the interests of the policyholders concerned.

If an insurer is able to receive signed consent agreements from each policyholder for the transfer of their policies to another insurer, the insurers concerned are not required to

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| | <p>seek approval for such a transfer arrangement.</p> <p>Supervisory Practice</p> <p>In practice, the management of the insurers concerned normally meet with the FSB-SA to discuss the pertinent aspects of the proposed transaction and to share the rationale and objectives and next steps in the supervisory process. Continued policyholder protection is a key consideration.</p> <p>In the last three years, the FSB-SA approved 22 portfolio transfers. No applications were declined. The majority of these transfers were due to consolidation within domestic insurance groups. For all significant portfolio transfers involving long-term insurers, an independent actuarial report was reviewed before granting approval. This was to ensure that the policyholders continue to be as well protected under the new insurer.</p> <p>Ongoing Regulatory Initiatives</p> <p>The Insurance Bill will reduce the percentage referred to in control definitions to 15 percent. Consideration is being given to reduce this percentage further to 10 per cent under the Insurance Acts. The legislative changes will also introduce a definition of significant owner based on control and percentage. The Insurance Bill will also require the approval of the FSB-SA for disposing of, directly or indirectly, a beneficial interest in an insurer or a related party of that insurer in a manner that will result in that person no longer being a significant owner of that insurer.</p> |
| Assessment | Largely Observed |
| Comments | <p>The Insurance Acts set clear ownership and control thresholds above which approval is required. Although current control thresholds are relatively higher than international best practices, proposed amendments and changes in control definitions are well progressed.</p> <p>The FSB-SA has the authority to approve or deny proposals to acquire or increase controlling interests in an insurance company. These are assessed, based on the same criteria as those for a new license application, and approved only when not prejudicial to policyholder interests. These powers and processes have recently been strengthened through a legislative amendment that requires insurers to notify the FSB-SA when they become aware of proposed changes in control. While insurers are not explicitly required to notify the FSB-SA in the case of a significant decrease in the ownership, below the pre-determined control levels, such cases are usually identified through FSB-SA's risk based supervisory process.</p> <p>The FSB-SA also has the necessary powers to approve portfolio transfers that take into consideration policyholder interests.</p> <p>Authorities are recommended to:</p> <ol style="list-style-type: none"> a) introduce a definition of "significant" owner based on control and percentage; and b) expedite legislative amendments to authorize the FSB-SA to approve any significant increase above the predetermined control levels and to approve any significant |

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| | decreases as well. |
| ICP 7 | <p>Corporate Governance</p> <p>The supervisor requires insurers to establish and implement a corporate governance framework which provides for sound and prudent management and oversight of the insurer's business and adequately recognizes and protects the interests of policyholders.</p> |
| Description | <p>Legal and Regulatory Framework</p> <p>At the time of assessment, the Insurance Acts or supervisory guidelines do not explicitly require the board of an insurer to set and oversee the implementation of a governance framework. However, the registration requirements under the Insurance Acts is interpreted as requiring an insurer to maintain an effective governance framework:</p> <ul style="list-style-type: none"> a) An application for registration may not be granted if the applicant does not have the organisation or management that is necessary and adequate for the carrying on of the business concerned (<i>LTIA s9; STIA s9</i>); and b) An insurer may be prohibited from undertaking new business if it is unable to satisfy the registration requirements (<i>LTIA s12; STIA s12</i>). <p>The above forms the legal basis for the FSB-SA's supervision of insurers' governance practices.</p> <p>The CA contains basic provision on corporate governance, specifically regarding the composition of the board, audit committee and social and ethics committee. In addition, the CA requires a board member to: act in good faith, honestly and reasonably; exercise due care and diligence; act in the best interests of the insurer; and not to use his/her position to gain undue personal advantage or cause detriment to a company (<i>CA s76</i>).</p> <p>Insurers must establish an audit committee comprising at least three members of whom at least two shall be independent non-executive directors. The functions of the audit committee include: a) assisting the board in evaluating the adequacy and efficiency of internal control systems, accounting practices, information systems, auditing processes and actuarial valuation processes (only applicable for long-term insurers) ; b) facilitating and promoting communication and liaison between the board and the managing executive, auditor and internal audit staff; c) recommending measures to enhance the credibility and objectivity of financial statements and reports; and d) advising on a matter referred by the board (<i>LTIA s23; STIA s22</i>).</p> <p>The King Report on Governance for South Africa 2009 (King III), which took effect on March 1, 2010, sets out best practice corporate governance principles. King III applies to all entities, irrespective of corporate form, on an "apply or explain" basis.²⁸ Listed insurers have to comply with the listing requirements of the JSE, which comprise a mix of mandatory and voluntary (apply or explain) principles.</p> |

²⁸ This approach is favored over the "comply or explain" approach as the latter could denote "a mindless response to the King Code and its recommendations whereas the "apply or explain" regime shows an appreciation for the fact that it is often not a case of whether to comply or not, but rather to consider how the principles and recommendations can be applied."

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| | <p>King III sets out the role and functions of a board, including the duties of the board and individual directors to act in the best interest of a company (not just shareholders) and oversight of risk governance. The relevant King III Principles include the expectation on the board to:</p> <ul style="list-style-type: none"> a) Determine risk tolerance and risk appetite and ensure effective and ongoing risk assessments as well continual risk monitoring by management (<i>Principle 4</i>); b) Appoint the chief executive officer and establish a framework for the delegation of authority. The chief executive officer should not also fulfill the role of chairman of the board (<i>Principles 2.16 & 2.17</i>); a) Comprise a balance of power, with a majority of non-executive directors and the majority of non-executive directors should be independent. (<i>Principles 2.18</i>); b) Establish risk, nomination and remuneration committees; and adopt remuneration policies aligned with the strategy of the company and linked to individual performance (<i>Principles 2.23.6 & 2.25.1</i>); and c) Establish an effective and independent audit committee (<i>Principles 3.1. 3.4 3.7 & 9.1</i>). <p>Supervisory practice</p> <p>The FSB-SA does not have a formal role in checking the quality of the insurers' explanations for departures from the King III principles. Insurers are required to provide qualitative information on their governance and risk managements as part of the annual statutory returns, based on a check-list of questions including risk governance. The FSB-SA would review the composition and quality of insurers' board as part of its off-site monitoring. The FSB-SA supervisors discuss insurers' corporate governance policies and practices during on-site visits.</p> <p>To pave the way for implementing the SAM framework, a Pillar II Readiness survey was conducted in 2012. The first phase of the exercise involved the completion of a questionnaire on a self-evaluation basis, which was followed up through interviews with selected insurers. About 60 percent of the respondents indicated that the chairpersons of their boards are not independent²⁹ and less than half of the respondents had reviewed the performance of their boards. Approximately 45 percent rated their board functions as weak, particularly in the areas of IT governance/charter and fit and proper policy.</p> <p>Notably, two out of three insurer failures in the last five years were attributable to inadequate corporate governance, which were exacerbated by the main shareholder in both the insurers also being the chief executive officers.</p> <p>On-going regulatory initiatives</p> <p>The FSB-SA was in the process of issue a Board Notice to establish explicit corporate governance requirements. Consultation on the proposed Board notice will be conducted in June 2014, with the final Board Notice expected to be issued in November 2014. The key corporate governance requirements to be introduced include:</p> |
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²⁹ A board member who sits on multiple boards within an insurance group does not meet the independence criteria.

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| | <p>a) A board to determine and oversee the implementation of the insurer's business objectives and strategies for achieving those objectives, consistent with the long-term interests and viability of the insurer and the legitimate interests of its stakeholders and policyholders;</p> <p>b) Clear definition of the roles and responsibilities allocated to the board, Senior Management and heads of Key Control Functions to promote an appropriate separation of oversight function from management responsibilities;</p> <p>c) An overall adequate spread and level of knowledge, skills and expertise at Board level and the Chairperson must be an independent director;</p> <p>d) Governance, powers and resources of the board;</p> <p>e) Directors to act in the best interests of an insurer and policyholders and exercise independent judgment and objectivity in decision making;</p> <p>f) A board's oversight of the design and implementation of sound risk management and internal control systems and functions;</p> <p>g) An explicit remuneration policy covering at least the directors, senior management, heads of control functions and major risk-taking staff;</p> <p>h) Reliable and transparent financial reporting for public and supervisory purposes;</p> <p>i) Appropriate, timely and effective communications with the FSB-SA and relevant stakeholders on insurers' governance; and</p> <p>j) Appropriate policies and procedures for a board to oversee management.</p> <p>The relevant corporate governance provisions at the legal entity level, with the necessary changes, will be applied to a controlling company if that controlling company provides a governance framework or a part thereof or performs a control function for or on behalf of an insurer that is part of that insurance group through the Financial Sector Regulation Bill. A full-fledged corporate governance framework at the group level will be introduced under the Insurance Bill, expected to be implemented in January 2016.</p> <p>The FSB-SA will be explicitly empowered to: review an insurer's governance framework; require board or Senior Management to demonstrate that governance framework requirements are being complied with; and direct the insurer, its board or Senior Management to strengthen its governance framework.</p> |
| Assessment | Partly Observed |
| Comments | <p>There are no explicit corporate governance requirements in the Insurance Acts or regulations. The FSB-SA relies on the registration requirements for insurers as the high-level legal basis to supervise insurers' governance practices. The FSB-SA does not have a formal role in checking insurers' observance with the King III best practice principles on a "apply or explain" basis. The FSB-SA reviews insurers' corporate governance through qualitative questionnaires and discussions during on-site visits.</p> <p>In recognition of the need to strengthen the regulatory regime, the FSB-SA is in the process of issuing a Board Notice to establish explicit governance requirements for insurers. The proposed Board Notice will also clarify the FSB-SA's supervisory powers to supervise insurers' corporate governance. The group supervision framework that will be provided for in the next version of the draft Financial Sector Regulation Bill will provide for the governance requirements for solo insurers to apply to controlling companies of an insurance group that provides a governance framework or performs a control</p> |

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| | <p>function for an insurer. A comprehensive corporate governance framework at the group level is expected to be implemented in January 2016.</p> <p>The implementation of the proposed Board Notice, the Financial Sector Regulation Bill and the Insurance Bill will address the current regulatory gaps. The FSB-SA is advised to plan for adequate supervisory resources to implement the enhanced corporate governance framework effectively.</p> |
| ICP 8 | <p>Risk Management and Internal Controls</p> <p>The supervisor requires an insurer to have, as part of its overall corporate governance framework, effective systems of risk management and internal controls, including effective functions for risk management, compliance, actuarial matters, and internal audit.</p> |
| Description | <p>Current regulatory Regime</p> <p>At the time of assessment, there were no explicit requirements for insurers to establish, and operate within, effective systems of risk management and internal controls. As in the case of current corporate governance regime (ICP7), the FSB-SA supervises insurers' risk management by relying on the registration requirements under the Insurance Acts.</p> <p>King III sets out the best practices for risk management which, <i>inter alia</i>, expects the board of directors to:</p> <ul style="list-style-type: none"> ▪ be responsible for the governance of risk; ▪ determine the levels of risk tolerance; ▪ be assisted by the risk committee or audit committee; ▪ delegate to management the responsibility to design, implement and monitor the risk management plan; ▪ ensure that risk assessments and risk monitoring are performed on a continual basis; ▪ ensure that frameworks and methodologies are implemented to increase the probability of anticipating unpredictable risks; ▪ receive assurance regarding the effectiveness of the risk management process; and ▪ ensure complete, timely, relevant, accurate and accessible risk disclosure to stakeholders. (<i>Principle 4</i>) <p>Control Functions</p> <p>The appointment of a statutory actuary is subject to the approval of the FSB-SA, who is also empowered to require an insurer to remove a statutory actuary on fit and proper grounds. To qualify as a statutory actuary, a person must be a permanent resident in South Africa, a Fellow of the Actuarial Society of South Africa and has appropriate practical actuarial experience relating to insurance business (<i>LTIA s20; STIA, s19</i>).</p> <p>A statutory actuary must: a) submit a statement to the FSB-SA on the reasons for the</p> |

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| <p>termination of his/her appointment; and b) report concerns on the financial soundness or contravention of statutory duties to the board.³⁰ If the matter is not rectified satisfactorily within 30 days, the statutory actuary must inform the FSB-SA without delay. The statutory actuary has legal protection for furnishing the report or information in good faith. A long-term insurer shall not introduce a policy or award bonus or policy benefits unless the statutory actuary is satisfied with actuarial soundness. While the statutory actuary serves an important role, this is not equivalent to a full-fledged actuarial function, particularly for a large insurer (<i>LTIA s20, s46; STIA, s19A</i>).</p> <p>A statutory actuary shall: a) have the right of access at all times to the accounting records and other books and documents of an insurer and be entitled to require from the directors or officers the information and explanations necessary for the carrying out of his or her duties; and b) be entitled to attend and speak at a general meeting or the board of directors meeting of the insurer (<i>LTIA s20(8); STIA s19A</i>).</p> <p>There is no explicit regulatory requirement for insurers to have effective control functions with the necessary authority, independence, and resources. In particular, the Insurance Acts are silent on insurers having to establish risk management, compliance and internal audit functions.</p> <p>King III partly addresses the role of internal audit, on an apply-or-explain basis:</p> <ol style="list-style-type: none"> a) The board should ensure that there is an effective risk based internal audit; b) Internal audit should follow a risk based approach to its plan; c) Internal audit should provide a written assessment of the effectiveness of internal controls and risk management; d) The audit committee should be responsible for overseeing internal audit; and e) Internal audit should be strategically positioned to achieve its objectives (<i>Principle 7</i>). <p>Insurers are required to appoint a public officer that is responsible for ensuring that the insurer complies with the Insurance Acts. However, this is not equivalent to an effective compliance function capable of assisting the insurer to meet its legal and regulatory obligations and promote and sustain a corporate culture of compliance and integrity, especially for large insurers with more complex operations (<i>LTIA s16; STIA s16</i>).</p> <p>Outsourcing</p> <p>Given the dominance of investment-linked policies, risks arising from outsourced operations such as unit pricing and fund administration is particularly important for long-term insurers. Some short-term insurers outsource certain aspects of their operations via binder arrangements.</p> <p>The FSB-SA has issued a directive on outsourcing by insurers that sets out the principles and key requirements for outsourcing, including requirements on:</p> <ul style="list-style-type: none"> • an outsourcing policy covering, <i>inter alia</i>, limits on the types and overall level of |
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³⁰ Such a report must also be submitted to the FSB-SA if the insurer's ability to comply with financial soundness requirements is materially prejudiced or where immediate remedial action must be taken.

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| | <p>outsourced functions or activities and the extent to which activities can be outsourced to the same person;</p> <ul style="list-style-type: none"> • internal review and approvals; • written contracts and the requirements for such contracts; • on-going management and regular review; • notification of the outsourcing of control, management or material functions and any material developments such as pending termination, material non-performance, etc. (<i>Directive 159.A.i</i>). <p>In addition, regulations on binder functions (i.e., entering into, varying or renewing policies, determine the wording of policies, determining premiums or policy benefits and settling claims) have been issued. The binder regulations regulate: to whom binder functions may be outsourced; matters that must be addressed in agreements; remuneration payable; and reporting.</p> <p>Supervisory practice</p> <p>The FSB-SA reviews insurers' risk management and internal controls as part of its risk-based supervision. It would analyse insurers' statutory returns and qualitative check-list and may issue a query letter to an insurer for clarification, explanation or action on any potential deficiencies in risk management and internal controls. The FSB-SA has an established Actuarial Team that assists in assessing the work of the statutory actuary.</p> <p>The FSB-SA's on-site visits focus on various risk areas of insurers and their ability to implement and maintain appropriate risk management. Reports from the internal audit function are called for as part of the preparation for on-site visits. After the on-site visit, a management letter is issued communicating the FSB-SA's findings and required preventative or corrective action, if any, by reference to best practice.</p> <p>The Pillar II Readiness survey conducted in 2012 revealed different states of maturity of risk management across the industry. Many insurers are in the process of acquiring and developing resources and systems to relate their risk management practices to their underlying business models. On the other hand, only 23 percent of the respondents indicated that their internal controls needed improvement. While a majority of the respondents have established risk management and compliance functions, the establishment of internal audit and a separate actuarial function recorded a lower level of implementation. Notably, almost 90 percent of respondents outsourced some of their control functions.</p> <p>On-going regulatory initiatives</p> <p>The FSB-SA proposes to introduce explicit risk management requirements, via a Board Notice, on an insurer to:</p> <ol style="list-style-type: none"> a) establish and maintain effective risk management and internal controls systems. The risk management system must be reviewed regularly by the insurer's internal audit function or an objective external reviewer; b) develop and regularly review written risk management policies that include a definition and categorisation of the material risks and risk limits for each type of risk. The risk management policies must incorporate explicit policies for: asset-liability |
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| | <p>management; investment; reinsurance and other forms of risk transfers; remuneration; underwriting risk; and insurance fraud risk management. For a long-term insurer, an explicit AML-CFT policy must also be in place;</p> <p>c) establish and maintain the following control functions: risk management; compliance; actuarial control; and internal audit functions. There are provisions relating to the authority and responsibilities of each control function as well as the appointments, performance assessment, remuneration, disciplining and dismissal of the head of each control function; and</p> <p>d) Provisions on outsourcing by insurers, which will replace the Directive 159.A.i.</p> <p>The FSB-SA intends to issue supervisory guidance on good and bad governance, risk management and internal control practices.</p> |
| Assessment | Partly Observed |
| Comments | <p>The Insurance Acts or supervisory guidelines do not at present specifically require insurers to establish, and operate within, effective systems of risk management and internal controls. While the regulatory requirements relating to the role of statutory actuaries and outsourcing are comprehensive, there are no explicit requirements on insurers to establish risk management, compliance and internal audit functions. King III partly addresses the role for internal audit on an apply-or-explain basis. The FSB-SA reviews insurers' risk management and internal controls as part of its risk-based supervision. The proposed Board Notice will establish comprehensive provisions relating to risk management and internal controls.</p> <p>The implementation of the proposed Board Notice will address the current regulatory gaps on risk management and internal controls. It is advisable that the FSB-SA provides guidance to short-term insurers on monitoring potential ML/TF risks, which will contribute the authorities' review of the ML/TF risk profile of the short-term insurance industry (ICP 22).</p> |
| ICP 9 | <p>Supervisory Review and Reporting</p> <p>The supervisor takes a risk-based approach to supervision that uses both off-site monitoring and on-site inspections to examine the business of each insurer, evaluate its condition, risk profile and conduct, the quality and effectiveness of its corporate governance and its compliance with relevant legislation and supervisory requirements. The supervisor obtains the necessary information to conduct effective supervision of insurers and evaluate the insurance market.</p> |
| Description | <p>Regulatory Authority</p> <p>The Insurance Acts empower the FSB-SA to conduct prudential and certain CoB supervision through various regulatory reporting, information requirements, off-site monitoring, on-site visits and ad hoc inquiries.</p> <p>The relevant legislative requirements for supervisory review and reporting are set out in LTIA, STIA, FAIS Act, CA, FIPFA, IFIA and the Prudential Risk-based Supervisory Framework for Insurers (PRSFI).</p> |

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| | <p>Supervisory Approach</p> <p>The FSB-SA uses the PRSFI to evaluate the risk profile of insurers, taking into account their financial condition, future strategy, governance, management processes and compliance with the legislation and other supervisory directives. The risk-based approach helps the FSB-SA to prioritize supervisory focus and to allocate supervisory resources. The PRSFI was revised in 2012 to incorporate international developments.</p> <p>The PRSFI facilitates timely supervisory intervention to increase the likelihood that corrective measures will be effective in maintaining the safety and stability of the insurers. Under the PRSFI methodology, supervisors are required to:</p> <ol style="list-style-type: none"> a) Understand an insurer's environment, industry and business profile to ascertain its <i>Significant Activities</i> and the materiality/importance of each activity. This covers the business focus, group structure, risk profile and internal control environment. Both qualitative and quantitative factors are used to assess the materiality/importance of an activity; b) Assess the level of risk inherent in these activities and the quality of risk management to determine the <i>Net Risk</i> and the <i>Direction of Risk</i> for each activity. The quality of risk management considers both the operational management and the independent oversight functions;³¹ c) Determine an insurer's <i>Overall Net Risk</i> rating, i.e., the weighted aggregation of Significant Activities, taking into account the importance of each activity; and d) Decide on the <i>Composite Risk Rating (CRR)</i>, which is the overall assessment of a FRI's safety and soundness, combining the Overall Net Risk with explicit consideration of the adequacy of earnings, liquidity and capital. <p>The methodology also requires an assessment of the overall effectiveness (based on characteristics and performance indicators) of an insurer's oversight functions, at each activity and at the insurance entity level.</p> <p>Regulatory reporting</p> <p>The FSB-SA receives regular reporting that is subject to sufficient review and analysis processes. All insurers are required to submit prescribed annual audited statutory returns and unaudited quarterly returns to the FSB-SA. In addition to the statutory returns, insurers submit copies of their published financial statements. The prescribed returns are submitted on a solo basis. Consolidated group reporting is required from the five largest insurance groups. The annual returns are required to be submitted within four months after the insurer's year-end. The quarterly returns are required to be submitted within one month after the insurer's quarter-end (<i>LTIA s36; STIA s35</i>).</p> <p>The CA requires all public companies (which most insurers are) to comply with IFRS. These standards are set by the APB. Auditor's statement, including an audit opinion, forms part of the annual regulatory filings and submitted within six months from the insurer's year-end. The appointed auditors and statutory actuaries are required to report to the insurer and to the FSB-SA any irregularities and non-compliance of legislation that</p> |
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³¹ The FSB-SA has identified the Oversight Functions to include: board of directors, senior management, internal audit, risk management, actuarial, compliance, and financial analysis.

they identify in the course and scope of the work they were required to do. The supervisory process places heavy reliance on work done by the auditors and statutory actuaries, although there is good interaction with the auditors and actuaries.

The annual audited statutory returns for insurers include quantitative and certain qualitative reporting requirements with respect to off-balance sheet exposures and qualitative reporting requirements on corporate governance matters. Related party transactions are included in the statutory returns; however, there is currently no approval process in place for significant related-party transactions. Specific reporting requirements for cell captive insurers have been included in the statutory returns.

Insurers are required to notify the FSB-SA in respect of every director or managing executive appointment, resignations or terminations within 30 days. All appointments of an auditor or statutory actuary are required to be approved by the FSB-SA (*LTIA s18, s19, s19A, s20; STIA s18, s19, s19A, s20*).

Outsourcing arrangements by insurers to a third party (or within the same insurance group) also requires notification to the FSB-SA. Review of significant outsourcing arrangements are included in on-site visits (*Directive 159.A.i*).

Insurers that fail to maintain a financially sound condition are required to notify the FSB-SA, without delay, and furnish the reasons accordingly. Board documents for the larger insurers are reviewed during on-site visits. Business plan projections currently do not form part of the current risk analysis; however one-year projections are reported as part of the annual statutory return (*LTIA s29; STIA s28*).

A record of all queries received on the completion of the statutory returns are maintained and considered on the review of the returns to facilitate correct and comprehensive reporting. Where an insurer is rated as high-risk, it is generally required to submit prescribed monthly returns with the information and in the format prescribed by the FSB-SA.

If a return is incorrect or incomplete, the FSB-SA has the power to direct an insurer to submit a corrected return within a specified period. If the FSB-SA requires further investigation, the FSB-SA has the power to direct the insurer to provide additional information or require additional reports to be compiled by a person nominated by the FSB-SA at the cost of the insurer.

The FSB-SA also has the authority to direct an insurer to furnish, within a specified period, any ad hoc or specified information or documents required for supervisory purposes. This section has frequently been used to seek further information and details including information on upstream holding companies (*s4 of the Insurance Acts*).

Off-site monitoring and review

The FSB-SA has a unified team for supervisory review that are involved in both off-site monitoring and on-site visits. Dedicated supervisory teams for each portfolio of insurers support the review process. Statutory returns and other information are analysed in a

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| | <p>timely manner and with the support of the Actuarial Team and other risk experts within the Insurance Division.</p> <p>The analyses of the annual returns are informed by the Risk Assessment Document (RAD). The RAD provides high level executive summary of an insurer and/or sub-group, analysis of the operating environment, strategic plan, inherent risks and risk mitigants in place. The Assessors reviewed a sample of RADs with its composite risk rating and overall net risk was documented in sufficient detail for a high-level report.</p> <p>In addition, standard inherent insurance risks have been developed by the Actuarial Department. Actuarial Guidance Notes assist with the valuation of liabilities, technical reserves and capital. The RADs are also supported by more detailed Section Notes for each significant activity and risk. These reviews provide the analyst with a good basis to request additional information on the future direction of the insurer. Additional information is often requested and in some cases the findings have prompted on-site visits. The on-site visits also inform the risk ratings and assessments of insurers.</p> <p>On a quarterly basis, the FSB-SA's industry analysts present commentary and write-up to supervisory staff on the industry trend and the issues identified in the Financial Stability Review Report produced by the SARB. This is also used to assist with the macro-prudential review and analysis.</p> <p>The annual statutory returns include a statement requesting the budgeted or forecasted business per lines of business, expected claims, risks, and the other matters. Although currently, no variance analysis is done, the information is scanned for risk direction of the insurer. The bi-annual stress and scenario test returns of the major, significant, insurers are also analysed.</p> <p>Other sources of information, including information received from SARB supervisors, rating agency reports and media reports, also inform the risk rating of an insurer or prompts supervisory actions. In practice, such actions have prompted request for information, engagement with the management of the insurer or an on-site visit.</p> <p>The Assessors noted that the FSB-SA had adequate documentation and follow-up processes in place for off-site monitoring on prudential matters.</p> <p>On-site Visits and Inspections</p> <p>The FSB-SA has strengthened its approach to on-site supervision, including the introduction of PRSFI and added additional supervisory resources. It is authorized to conduct on-site visits and initiate an inspection under the IFIA if the FSB-SA suspects any material non-compliance with legislative requirements that needs to be investigated. The legislative powers are broad and authorize on-site visits and inspections of any function or an outsourced activity. (<i>Insurance Acts s4</i>) (<i>FIPFA ch1</i>)</p> <p>A workflow process has been put in place to ensure that a structured approach is followed in the conducting of on-site visits. A supervisory plan is drawn-up on an annual basis at the beginning of each financial year. In preparation for an on-site visit a letter is</p> |
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sent to the insurer informing them of the intention to conduct an on-site visit, the scope of the visit and a request for information in preparation of the on-site visit. Prior to an on-site visit, a draft RAD is prepared, and the persons (such as chairpersons of board committees, senior management, internal audit function, statutory actuary) with whom the on-site visit team would like to meet are identified and this is communicated to the insurer.

Once statutory returns and other information requested have been reviewed, a query letter is issued to the insurer for any clarification, explanation or action by the insurer as identified. An insurer must respond to the letter within a specified period and the response is assessed to determine if regulatory action must be taken.

The FSB-SA conducted 80 (market conduct and prudential) on-site visits in the 2013/14 financial year which revealed weaknesses in the following areas: poor governance systems, particularly amongst small insurers; poor oversight over outsourcing arrangements; undue reliance on individuals (key-person risk); and IT system challenges.

The FSB-SA also conducted post-registration or licensing on-site visits and no major concerns were identified. For the first time in 2012, the FSB-SA also conducted two prudential group holding company on-site visits. These on-site visits assisted the development of a risk-based on-site program for insurance groups.

After conducting an on-site visit, a report and the findings are presented to an internal peer review panel to ensure quality and consistency of supervisory assessment and decisions. After which, a management letter is issued to the insurer communicating the findings and outlining the required preventative or corrective action plans. The insurer is required to respond within a specified period and the response is assessed to determine if further regulatory action must be taken. The insurer's willingness and promptness in taking preventative or corrective actions are considered in the assessment of an insurer and factored into the on-going supervision of that insurer.

CoB Supervision

CoB off-site monitoring and on-site visits for insurers and FSPs are based on a similar risk-based supervision framework tailored for CoB supervisory reviews. Off-site monitoring of mandatory compliance reports and audit reports form an essential part of the supervisory process. On the insurance side, 33 CoB on-site visits were conducted in the 2013/14 financial year highlighting similar areas of concern that had been identified during the prudential on-site visits, as well as challenges experienced by insurers with regard to compliance with Binder Regulations. There were also instances of non-compliance with the STIA, LTIA, and FAIS Act e.g., false advertising, naming contraventions and inadequate disclosures. There were also joint prudential and CoB on-site visits.

Supervisory Resources

The size of the Insurance Division has increased in recent years to enhance the frequency and intensity of on-site supervision and to build a team of technical experts to provide support to front-line supervisors. The Insurance Division has adequate resources available to deliver its supervisory plan at the time of assessment. However, the

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| | <p>Assessors noted that to conduct full on-site inspections on the large insurers and on the conglomerate insurance groups, more resources will be needed. This is particularly important in an environment where inter-connectedness in financial conglomerates has been highlighted as one of the main risk drivers.</p> <p>Supervisory plan³²</p> <p>The FSB-SA Insurance Division develops an annual on-site plan, focused on higher-risk insurers and insurance groups. As part of the overall plan and the risk-based prudential supervisory approach which promotes early identification and on-going management of systemic and organisational risks, the FSB-SA focuses its supervisory attention on insurers based on the risk profile of the relevant insurer. This approach has been communicated to the industry and the industry is regularly updated with developments.</p> <p>The supervisory cycle requires all insurers to be included in the supervisory plan whereby each insurer and reinsurer is expected to have at least one on-site visit every three years. Responsibility for coordinating the various steps of the supervisory cycle for an insurer is assigned to designated staff within the FSB-SA referred to as a Relationship Manager (RM). Each registered insurer is allocated to a supervisory team within the insurance divisions. The Assessors found instances where on-sites were not completed according to the supervisory cycle.</p> <p>The FSB-SA adopts different supervisory stance that reflects individual insurers' overall risk rating:</p> <ul style="list-style-type: none"> ▪ Low to moderate risk rating: supervisory activities include assessing the financial condition and operating performance, reviewing statutory returns, meetings with the insurer; regular risk-based supervisory reviews; on-site visits, follow up on any corrective measures. ▪ Moderate to above average composite risk rating (early warning): supervisory activities include issuing a management letter to the insurer on required rectification measures; meetings to discuss remedial actions; escalating reporting requirements as necessary; conducting enhanced supervisory reviews; requiring an increase in capital; and imposing conditions. ▪ Above average to high composite risk rating (Risk to financial viability or solvency): enhanced monitoring and supervisory reviews; requiring a business plan which incorporates appropriate remedial measures; enlarging the scope of external audit or a special audit; adopting alternative valuation methods for assets or liabilities; and requiring a special actuarial review. ▪ High composite risk rating (Future financial viability in serious doubt): engaging external specialists to address specific concerns; and impose/vary registration conditions. ▪ High composite risk rating with an increasing trend (Non-viability/solvency imminent): prohibiting new business; curatorship or applying for liquidation. |
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³² A Supervisory Plan is a tool for supervisors to determine the frequency, scope and depth of supervisory review.

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| | <p>Insurance Groups</p> <p>Currently, there are no legislative requirements relating to information to be submitted by insurance groups. The FSB-SA's approach is relatively informal and relies on the general authority and standing of the regulator rather than specific provisions. To date, for the five largest insurance groups are requested to submit quarterly unaudited returns on a group-wide basis. Smaller insurance groups, that have supervisory concerns, are also requested to submit an unaudited return on a group-wide basis, which is also analyzed and followed up on.</p> <p>With respect to insurance groups, an information request was issued in 2012 requesting the insurance groups to provide the FSB-SA with the material functions outsourced within the group and to third parties outside the group; the structure of the insurance group; and a risk indication identifying the top four risk areas of the various material entities within the group.</p> <p>Joint on-site visits between the different divisions of the FSB-SA and the FIC in respect of dual-regulated insurers also take place. With respect of groups that have banks and insurance subsidiaries, the SARB and FSB-SA have conducted joint on-site visits with appropriate risk assessment recorded in the RAD.</p> <p>Ongoing Regulatory Initiatives</p> <p>The FSB-SA intends to introduce a dedicated quarterly CoB return in late 2014. The proposed return will enable the FSB-SA to carry out enhanced detailed offsite analysis of the insurer's conduct of business and customer treatment practices.</p> <p>Annual and quarterly reporting by insurance groups as described in the ILAB, will be subject of further consultation in the second phase of the draft Financial Sector Regulation Bill.</p> |
| Assessment | Largely Observed |
| Comments | <p>The FSB-SA uses a risk-based supervisory approach to evaluate the risk profile of the regulated insurers. It takes into account the institution's financial condition, the future strategy, suitability of governance, management processes, compliance with legislation and other supervisory directives. The risk-based approach helps the FSB-SA to prioritize supervisory focus and to allocate supervisory resources. The FSB-SA has adequate documentation and follow-up processes in place for off-site monitoring and on-site visits and refines the risk-based supervisory process continuously.</p> <p>While the FSB-SA collects adequate information for the regulated insurers on a solo basis, only a few large insurance groups are subject to group-related information requirements. Due to significant interconnectedness with other financial sectors, the FSB-SA recognizes the need for more standardized reporting of intra-group transactions and aggregate exposures. More systematic review of quantitative and qualitative information and joint inspections should be extended to all insurance groups.</p> <p>Given the absence of group market conduct requirements, supervision in this area is currently not addressed in the risk-based supervision framework for insurance groups.</p> |

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| | <p>However, there is adequate supervision of market conduct requirements for solo insurers. The FSB-SA has, in the past, adopted a more reactive market conduct supervision approach. Since lapse rates, surrenders and churning issues have been challenging from a prudential and market conduct perspective, the planned introduction of a dedicated quarterly CoB return, for supervisory monitoring and enforcement actions, is a positive step.</p> <p>The effectiveness of on-going supervision could be strengthened by:</p> <ol style="list-style-type: none"> Ensuring that three year supervisory cycle is completed for all insurers and reinsurers and more intensive on-site visits, especially for the more complex insurers; Formulating appropriate group supervision plan that would cover all insurance groups in a risk-based proportionate manner, including joint on-site visits of financial conglomerates; Increasing off-site monitoring of intra-group transactions and aggregate group exposures and limits and establishing procedures for insurer/groups to report group related risks and risk direction for off-site monitoring; Instituting procedures to capture CoB risks in the current RAD such that both prudential and CoB supervision form part of the risk assessment; Strategizing an appropriate risk-based supervisory cycle for CoB on-site visits to cover the large number of licensed FSPs, facilitated by the proposed CoB return; Ensuring adequate skilled supervisory resources are in place to achieve appropriate coverage and supervisory intensity. |
| ICP 10 | <p>Preventive and Corrective Measures</p> <p>The supervisor takes preventive and corrective measures that are timely, suitable and necessary to achieve the objectives of insurance supervision.</p> |
| Description | <p>The FSB-SA has appropriate tools and mechanisms for identifying prudential and CoB issues at insurers and for responding in a proportionate manner with escalating severity.</p> <p>Operating without License</p> <p>In South Africa, legislation prohibits a person from carrying on insurance business unless that person is registered or authorised to carry on the kind of insurance business concerned and carries on that business in accordance with the legislation (<i>LTIA s7(1), STIA s7(1)</i>).</p> <p>The Insurance Acts and the FIPFA authorise the FSB-SA to take a number of regulatory actions against persons that conduct unregistered insurance business. If the FSB-SA suspects that an entity is conducting business in South Africa without authorization, it investigates the matter and communicates directly with the entity. If the response is unsatisfactory, the FSB-SA can take various actions:</p> <ol style="list-style-type: none"> issue a directive to cease unregistered insurance business (<i>LTIA s4; STIA s4</i>); bring criminal charges (<i>LTIA s66; STIA s64</i>); take action under the FIPFA: <ul style="list-style-type: none"> • referral to the Enforcement Committee for the imposition of a penalty; • enter into an enforceable undertaking with that person to cease the unregistered business; |

- apply to Court to: compel cessation of contravention; prevent the concealment, removal, dissipation or destruction of assets or evidence; and seize and remove assets pending the exercising of legal remedies available to the FSB-SA.

In practice, the FSB-SA has in a number of instances used the above powers. Most of the matters were detected through consumer complaints and/or other insurers highlighting discrepancies. The FSB-SA uses public warning notices on its website and press releases to advise the public of individuals or entities that conduct insurance activities without the requisite license.

Power to take Corrective and Preventive Measures

The Insurance Acts and the FIPFA provide the FSB-SA with a wide range of prevention and correction measures:

- a) Ad hoc on-site-visit or intensifying off-site monitoring through monthly reporting and information requests (see ICP 9.1);
- b) Directive to an insurer to undertake or desist from undertaking certain actions or not operating under sound business requirements (*s4 of the Insurance Acts*);
- c) Varying the conditions of registration of an insurer (*s11 of the Insurance Acts*);
- d) Prohibiting non-insurance business (*LTIA s15; STIA s15*); and
- e) Requiring the insurer to terminate the appointment of a director, managing executive, public officer, auditor or statutory actuary on fit and proper grounds (*LTIA s22; STIA s21*).

Preventive and corrective actions also apply to ownership of an insurer. If a particular shareholding or a shareholder will be prejudicial to the insurer, the FSB-SA may apply to the Court for an order:

- compelling such shareholder to reduce that shareholding; and
- limiting the voting rights that may be exercised (*s26 of LTIA; s25 of STIA*).

The FSB-SA has specific powers when an insurer is failing to maintain a financially sound position. It can direct the insurer to furnish specified information relating to the nature and causes of the failure and its proposals to ensure compliance and may authorize the insurer to adopt an appropriate course of action. In addition, the FSB-SA may, after further consultation with the auditor and the statutory actuary, authorize modification of that course of action. In the past, such modifications have included transfer some or all assets or liabilities, including insurance liabilities, customer property, data and systems, and the financial institution's ownership in shares or to increase capital levels (*s35 of LTIA; s34 of STIA*).

Progressive Escalation

The FSB-SA issues Information Letters and general Directives to insurers on the interpretation and application of the Insurance Acts where trends that may lead to non-compliance have been identified. The guide to intervention in the PRSFI includes a supervisory regime that supports progressive escalation in remedial measures that can be taken when issues arise in insurers. As risks increase, the supervisory intensity increases and preventive and corrective actions are required to be taken. The PRSFI supports early intervention and taking progressive escalation of actions or remedial

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| | <p>measures at various stages depending on the severity of the situation.</p> <p>The decision-making structures of the FSB-SA are a relatively flat allowing for actions to be taken immediately in emergency situations. Adequate support functions are in place to assist in the execution and implementation of decisions. Most often, minor preventative or corrective actions are achieved through communication with the insurer, given the generally good standing and relationship with the industry.</p> <p>Engagement always takes place with Chairperson of the Board or the Chief Executive of the insurer where the FSB-SA requires preventative and corrective measures to be taken. Management letters from the FSB-SA to insurers regarding preventative and corrective measures are required to be shared with the entire Board as well as the external auditors of the insurer. Appropriate follow-up on corrective action plans are in place together with increased frequency of reporting measures.</p> <p>Ongoing Regulatory Initiatives</p> <p>The regulatory initiatives will further extend the circumstances under which the FSB-SA may require plans to achieve compliance specifically in respect of financial soundness requirements. It will also allow certain preventative and corrective measures to be applied directly to insurance groups.</p> |
| Assessment | Observed |
| Comments | <p>The FSB-SA is empowered to take action against a person who conducts insurance business without the necessary registrations. The Insurance Acts and the FIPFA also provide a sufficiently wide range of remedies to address non-compliance with the Acts by insurers. Preventative and corrective actions are regularly taken and implementation of measures is closely monitored.</p> <p>The FSB-SA Supervisory Framework supports early intervention and its approach to taking progressive escalation of actions or remedial measures at various stages depending on the severity of the situation. Once issues are identified, the FSB-SA has adequate powers to initiate timely and proportionate preventive and corrective measures.</p> |
| ICP 11 | <p>Enforcement</p> <p>The supervisor enforces corrective action and, where needed, imposes sanctions based on clear and objective criteria that are publicly disclosed.</p> |
| Description | <p>Legal authority</p> <p>The FSB-SA has stipulated effective enforcement as an important factor in its strategic plan. In this regard, the FSB-SA has an extensive range of enforcement powers:</p> <ol style="list-style-type: none"> Issue of formal directives to ensure compliance or prevent a contravention of the Insurance Acts. Failure to comply with a directive constitutes a criminal offence (<i>LTIA s4; STIA s4</i>); Limiting or prohibiting all or part of the insurance business if an insurer fails to operate in an appropriate manner including provision of misleading information (<i>s12 of the Insurance Acts</i>); |

- c) Entering into an enforceable undertaking with the insurer (FIPFA);
- d) Requiring termination of key persons on fit and proper grounds, for example withholding material information or providing false information to the FSB-SA (*LTIA s22; STIA s21*);
- e) Applying to the Court for an order compelling reduction of shareholding and limiting voting rights, or forcing a change of ownership if a particular shareholder will be prejudicial to the insurer (*LTIA s26; STIA s25*); and
- f) Conservatorship, curatorship and taking control of insurer (*Part VI of the Insurance Acts*).

Fines and penalties

The FSB-SA, under the FIPFA, may refer cases to the Enforcement Committee (EC). The EC, appointed by the Board of the FSB-SA,³³ is an administrative body established within the FSB-SA to adjudicate on all alleged contraventions of legislation administered by the FSB-SA. The EC may impose penalties, compensation orders and cost orders. Such orders are enforceable as if it was a judgment of the High Court of South Africa.

There is no prescribed maximum amount for sanction, which is at the discretion of the EC. The FIPFA provides guidance in respect of the factors the EC will take into account when determining an appropriate sanction. All sanctions imposed by the EC are publicly disclosed by law. The EC can also order an insurer to pay a financial penalty to the FSB-SA or any person who suffered loss or damage, as a result of the contravention (*FIPFA s6D(3)*).

The Insurance Acts authorizes the FSB-SA to impose a penalty of R5 000 for every day a return, information or document as provided for in the Insurance Acts are late. In practice, the FSB-SA regularly imposes penalties for the late submission of information (*LTIA s68; STIA s66*).

Corrective and enforcement actions can be taken concurrently and are not necessarily interdependent. The process of imposing sanctions can therefore function independently from taking preventive and corrective measures and *vice versa*. In practice, the FSB-SA has in a number of instances taken concurrent actions; i.e., referred a matter to the EC for a financial penalty and required the implementation of corrective actions.

Supervisory Practices

The FSB-SA regularly engages with the relevant insurers to assess if necessary actions and measures are implemented. Follow-up on-site visits are scheduled where the FSB-SA has had to take enforcements matters, depending on the seriousness of the non-compliance.

The FSB-SA has referred matters to the EC and maintains a register of penalties and EC

³³ The EC consists of independent members who are appointed for their knowledge and experience (with reference to the different industries). In addition, the chairperson and deputy chairpersons must either be advocates or attorneys with more than 10 years' experience, or judges.

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| | <p>decisions. It has also applied to Court to place an insurer in curatorship. These applications were granted by the Courts with wide ranging powers for the curator (as requested by the FSB-SA).</p> <p>A dedicated Insurance Enforcement Department provides legal support, including advice and recommendations on regulatory actions and enforcement matters. It also assists in facilitating quicker and more appropriate, consistent and legally sound enforcement of sanctions.</p> <p>The Enforcement Unit of the FSB-SA enforces sanctions imposed by the EC. The National Prosecuting Authority and the South African Police Service enforce criminal sanctions imposed. All other sanctions are enforced by the Insurance Enforcement Department in collaboration with the Legal department of the FSB-SA.</p> |
| Assessment | Observed |
| Comments | The FSB-SA has sufficiently wide range of enforcement powers, which have been frequently applied in practice. The EC within the FSB-SA adjudicates on all alleged contraventions and is empowered to impose unlimited penalties, compensation orders and cost orders. The criteria that guide sanctions are clear, objective and publicly disclosed. A dedicated Insurance Enforcement Department supports appropriate, consistent and legally sound enforcement of sanctions. In practice, the FSB-SA has taken enforcement actions against several insurers, including the 3 insurers that failed. |
| ICP 12 | <p>Winding-up and Exit from the Market</p> <p>The legislation defines a range of options for the exit of insurance legal entities from the market. It defines insolvency and establishes the criteria and procedure for dealing with the insolvency of insurance legal entities. In the event of winding-up proceedings of insurance legal entities, the legal framework gives priority to the protection of policyholders and aims at minimizing disruption to provision of benefits to policyholders.</p> |
| Description | <p>Winding up and Exit of an Insurer</p> <p>The legislation currently grants powers to the FSB-SA to cancel the registration of an insurer where:</p> <ul style="list-style-type: none"> • an insurer is unable to commence the carrying on of business within a reasonable period after its registration; • an insurer ceases to write policies to an extent which no longer justifies its continued registration; • all of the insurance business of an insurer has been discontinued (<i>LTIA s13; STIA s13</i>). <p>The Insurance Acts provide for the winding-up of an insurer by Court order. The provisions of the CA and the Insolvency Act apply in respect of winding-up processes and procedures. The latter Act specifies when winding-up may take place (including the actions that are regarded as an “act of insolvency”) (<i>LTIA s42, s13; STIA s41, s13</i>).</p> <p>The Insurance Acts provide that:</p> <ul style="list-style-type: none"> ▪ an “act of insolvency” also relates to the inability of an insurer to maintain a financially sound position; and |

- in addition to any question whether it is just and equitable that an insurer should be wound up, it must be considered whether it is in the interests of the policyholders of that insurer that the insurer should be wound-up.

The Insurance Acts authorises the FSB-SA to apply for the winding-up of an insurer. Any application by a person, other than the FSB-SA, for winding-up may not be heard unless all relevant documents were also served on the FSB-SA. The FSB-SA may, if satisfied that the application is contrary to the interests of the policyholders of the insurer concerned, join the application as a party and file affidavits and other documents in opposition to the application.

In practice, the FSB-SA has supported an application for the winding-up of an insurer by a third party as it was in the interest of the policyholders of the insurer to do so. A number of insurers have exited the market subsequent to an amalgamation or transfer of business.

Entitlement of Policyholders

Policyholders do not currently have priority ranking in the event of the winding-up of an insurer. This means that policyholders rank *pari passu* with unsecured creditors. The FSB-SA has been engaging the Department of Justice and Constitutional Development on the insolvency law reform process that has been ongoing for a number of years. The FSB-SA has also appealed to the Department of Justice and Constitutional Development for ranking policyholders ahead of unsecured creditors in its deliberations.

The lack of priority ranking for policyholders is further complicated by the presence of third party cell captives and similar arrangements in South Africa. In its Discussion Paper on cell captives, the FSB-SA noted that "...cell captive arrangements are governed by contractual arrangements.....there is no legal ring-fencing of funds in the case of liquidation, as the current insurance legislative framework regards all the assets and liabilities of third party cells as part of the assets and liabilities of the insurer."

Ongoing Regulatory Initiatives:

The FSB-SA has been engaging with the Department of Justice on the insolvency law reform process that has been ongoing for a number of years.

The FSB-SA is also participating in a Resolution Policy Working Group (supported by the World Bank) consisting of the NT, the SARB and the FSB-SA. The Working Group is considering improvement to the prevailing legislative frameworks for the resolution of financial institutions, including the establishment of a policyholder protection scheme.

With respect to the policyholder protection scheme, the FSB-SA sent a letter to industry representative bodies, namely the Association for Savings & Investment SA, South African Insurance Association, Financial Intermediaries Association of Southern Africa, and the South African Underwriting Managers Association in July 2013, to solicit contributions on the benefits, risks and features that should inform the establishment of a policyholder protection scheme in South Africa. This process is also being taken forward by the joint NT/SARB/FSB-SA Resolution Policy Working Group for further

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| | considerations. |
| Assessment | Partly Observed |
| Comments | <p>The Insurance Acts provide for clear triggers for the FSB-SA to take action in case of an insurer becomes financially unsound. The winding-up regime has been tested with the failure of three insurers in the past five years. However, policyholders do not currently have priority of claims over unsecured creditors in the event of the winding-up of an insurer.</p> <p>The FSB-SA is participating in a Resolution Policy Working Group (supported by the World Bank) consisting of the NT, the SARB and the FSB-SA. The Working Group is considering improvement to the prevailing legislative frameworks for the resolution of financial institutions, including the establishment of a policyholder protection scheme.</p> <p>It is recommended that the authorities expedite the changes to the legislative framework such that high legal priority is given to the protection of the rights and entitlements of policyholders.</p> |
| ICP 13 | <p>Reinsurance and Other Forms of Risk Transfer</p> <p>The supervisor sets standards for the use of reinsurance and other forms of risk transfer, ensuring that insurers adequately control and transparently report their risk transfer programmes. The supervisor takes into account the nature of reinsurance business when supervising reinsurers based in its jurisdiction.</p> |
| Description | <p>Legal framework</p> <p>An applicant for registration under the Insurance Acts is required to provide reinsurance projections and the assumptions and strategy supporting these projections, including a letter of reinsurance support. Detailed information on the reinsurance program must also be submitted as part of the business plan projections (<i>LTIA s9; STIA, s9</i>).</p> <p>Registered insurers (include reinsurers throughout this ICP) must submit the prescribed information on their reinsurance arrangements as part of their audited annual statutory returns. The information to be furnished include: reinsurance premiums, reinsurance recoveries, extent of catastrophe cover, statements on overall reinsurance strategy and the use of “financial relief arrangements” (such as finite reinsurance).</p> <p>Currently, the supervision of reinsurance focuses on the concept of “approved reinsurance policy”. Insurers may obtain relief for reinsurance ceded when calculating their technical provision only if the reinsurance ceded falls within the definition of “approved reinsurance.” Approval for long-term foreign reinsurance must be granted by the FSB-SA for each contract, usually subject to security or collateral to be held with the local insurer covering the technical provisions. Short-term foreign reinsurance is automatically approved if the foreign reinsurer provides adequate security/collateral i.e., in money, irrevocable guarantee or a letter of credit in prescribed format (<i>LTIA, Schedule 3; STIA s1</i>).</p> <p>The regulatory regime does not have explicit requirements for an insurer to:</p> |

- a) have explicit reinsurance and risk transfer strategies as part of their wider underwriting and risk and capital management strategies;
- b) maintain systems and procedures for ensuring that reinsurance strategies are implemented, including controls over risk transfer transactions; and
- c) promptly document the principal terms and conditions and finalise the formal reinsurance contract in a timely fashion.

In the absence of a group-supervision framework, there are no explicit regulatory requirements with respect to intra-group reinsurance transactions.

Supervisory practices

The FSB-SA would review insurers' reinsurance arrangements based on information submitted in their audited annual statutory returns. Individual reinsurance arrangements are not checked as part of its off-site monitoring, unless there is a particular concern. During on-site visits, the FSB-SA reviews insurers' reinsurance program through system walk-throughs and discussions held with the Senior Management, the Board or Board-subcommittee responsible for the oversight of the insurer's reinsurance strategy and program.

Since 2010, insurers must conduct annual stress tests that incorporate the specific scenario of 100 percent default by the largest reinsurer and a 100 percent default by the largest reinsurer on maximum event retention with respect to catastrophic event. This facilitates understanding of the economic impact of reinsurance arrangements. The FSB-SA uses the information to conduct peer comparisons and benchmarking.

The FSB-SA analyses the insurers' liquidity position on a quarterly and annual basis as part of the assets diversification (collateral) requirements. However, it does not specifically assess whether cedants control their liquidity position to take account of the structure of risk transfer contracts and likely payment patterns arising from reinsurance.

Notwithstanding that there is no explicit regulatory policy on the use of financial reinsurance, insurers are required to submit information on alternative risk transfers (ART) in their annual statutory returns. The FSB-SA noted that ART mechanisms are commonly used in cell captive arrangements³⁴ as "contingency insurance policies," typically policies that provide for profit sharing. ART solutions in the form of financial reinsurance arrangements are not that common in South Africa; however it is used quite often by smaller life insurers that are experiencing growth strain. While there is no explicit policy on accounting treatment of such ART arrangements, the FSB-SA monitors these arrangements closely.

On-going regulatory initiatives

The FSB-SA will issue a Board Notice which will specifically require an insurer to have an explicit reinsurance and other forms of risk transfer policy that:

- a) outlines appropriate strategies and procedures for the selection of suitable

³⁴ This is a form of self-insurance by entities or corporates that have mature risk management practices.

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| | <p>reinsurance programs and other risk transfer techniques;</p> <p>b) ensures transparent reinsurance arrangements and associated risks that allows understanding of the economic impact; and</p> <p>c) provides for processes and procedures for ensuring that reinsurance strategies are implemented and complied with, and appropriate systems and controls over its risk transfer transactions.</p> <p>In 2012 the FSB-SA commissioned a reinsurance review project to assist in the development of a revised regulatory framework for reinsurance business in South Africa. The project report informs a policy paper, planned for release in mid-2014, on whether to allow reinsurance to be conducted on a branch basis in South Africa.</p> |
| Assessment | Largely observed |
| Comments | <p>The FSB-SA reviews the proposed reinsurance arrangements of an applicant as part of the licensing process. Insurers may only obtain relief in respect of “approved reinsurance policy” when calculating their technical provision. However, other on-going regulatory requirements on insurers’ reinsurance operations, including intra-group reinsurance transactions, have not been established. There is also no regulatory policy on the treatment and accounting for ART. The FSB-SA requires insurers to submit information on their reinsurance program, including ART used and statements on overall reinsurance strategy. In addition, short-term insurers must conduct stress tests that incorporate specific scenarios of default by the largest reinsurer. The FSB-SA review insurers’ reinsurance arrangements as part of its off-site analysis and verifies the reinsurance program during on-site visit. However, it does not specifically assess cedants’ liquidity management with respect to reinsurance.</p> <p>The implementation of the proposed Board Notice will address most of the current regulatory gaps on reinsurance. In addition, the FSB-SA is advised to:</p> <p>d) adopt a systematic approach to evaluating the nature of supervision of reinsurers and other counterparties used by insurers;</p> <p>e) formulate clear policy position on the treatment and accounting for ART;</p> <p>f) establish explicit requirements on reinsurance with related companies, including –</p> <ul style="list-style-type: none"> • management of liquidity, concentration, and contagion risk as well as potential conflicts of interests; • assessing the acceptability of reinsurance with related companies based on both qualitative (e.g., purpose) and quantitative criteria. |
| ICP 14 | <p>Valuation</p> <p>The supervisor establishes requirements for the valuation of assets and liabilities for solvency purposes.</p> |
| Description | <p>Current valuation Regime</p> <p>The valuation regime is based on financial reporting standards, subject to prudential filters for assets and prudent valuation methodologies for certain types of assets and technical provisions prescribed by the FSB-SA. For long-term insurers, ASSA’s actuarial standard also address the valuation, recognition, de-recognition and measurement of assets and liabilities (<i>Board Notice 14 of 2010; Board Notice 169 of 2011; SAP 104</i>).</p> |

If the calculation of an asset, liability or capital adequacy does not reflect a reasonable value, the FSB-SA may appoint another person to place a reasonable value or direct an insurer to calculate the value in a manner which the FSB-SA determines (*LTIA s31(3), schedule 3; STIA s30(3)*).

Assets

Assets are stated at fair value (economic valuation) except where otherwise directed by the FSB-SA. The Insurance Acts provide a list of eligible assets and non-admitted assets (e.g., premiums outstanding beyond 60 days, goodwill, prepaid expenses and negative liability under long-term policies). The FSB also prescribed certain valuation methods to be applied for investments in group undertakings (*LTIA Schedules 1 & 3; STIA, Schedules 1 & 2 & s31(1); Board Notice 169 of 2011 p3.1; Board Notice 14 of 2010, p7*).

Only assets actually held by and registered in the name of an insurer or an approved nominee may be taken into account. An asset is deemed not to be held by an insurer if it has been encumbered. Insurers shall not encumber its assets without the approval of the FSB-SA (*LTIA s32(c), s34 & Schedule 3; STIA, s31(c) & s33*).

Liabilities

The *technical provisions* of both long-term and short-term insurers for statutory purposes are net of approved reinsurance. However, the financial reporting standard separates the gross technical provisions and reinsurance assets. Where a reinsurer is in default or known to be at serious risk of default, the ASSA expects actuaries to report such reinsurances explicitly rather than as a component of the net technical provisions. The *other liabilities* of an insurer (excluding technical provisions) shall be determined in accordance with financial reporting standards applicable to widely-held companies (*LTIA Schedule 3; STIA Schedule 2; APN 401 p3.11.7*).

An insurer's own credit standing is not taken into account when calculating the value of technical provisions and other liabilities.

Technical provisions of Short-term insurers

Technical provisions shall include: outstanding claims reserve (OCR); incurred but not reported (IBNR) reserve; unearned premium provision (UPP); and unexpired risk provision (URP). There are prescribed methodology for calculating UPP, OCR and IBNR. IBNR is calculated based on specified development factors for each class of business, with no allowance for diversification. The factors are higher for long-tail or more volatile classes of business and effectively assumes full development over six years. The computation of URP is to be determined in consultation with the auditor and statutory actuary (where one is appointed) (*STIA s32 & Schedule 2; Board Notice 169 of 2011*).

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| | <p>The ASSA has issued an Advisory Practice Note (APN)³⁵ on the calculation of technical provisions and the considerations for using an alternative method instead of the method prescribed by the FSB-SA where the FSB-SA approved the use of an alternative method. An actuary should normally conduct sensitivity analyses of key assumptions to understand the uncertainty surrounding the central estimates proposed. As the current regulations do not specify an approach or requirements for margins, an actuary may recommend a margin to be added to the central estimate, by choosing an appropriate level of sufficiency. The ASSA left the choice of approaches and methodologies to setting margins to actuaries, guided by the purpose of the exercise. (APN 401)</p> <p>Technical provisions are not calculated based on discounted values of future cash flows.³⁶ The calculations are formula driven based on varying risk factors by class of business. In some cases where insurers have applied to use a different basis to calculate technical provisions, the time value of money was allowed for. No specific criteria for the determination of appropriate rates are established by the FSB-SA and the appropriate discount rate is considered on a case by case basis (<i>Board Notice 169 of 2011; APN 401</i>).</p> <p>There is no explicit split between current estimate and margins over the current estimate. Rather, the margins are implicitly included in the standard factors used for valuing IBNR reserves. Insurers generally use a level of conservatism (not explicitly stated) when valuing OCR and where applicable, the URP. The UPP is based on office premium (net of reinsurance) and not on the risk premium and therefore has a built-in or implicit margin. However, as the valuation of liabilities is retrospective for short-term insurers, there is a risk that it may not reflect the inherent uncertainty of all future cash-flows over the full time horizon (e.g., it may not reflect the uncertainty of latent claims).</p> <p>Technical provisions of long-term insurers</p> <p>The FSB-SA has issued supervisory guidance for calculating technical provision. This is supplemented by the Standard of Actuarial Practice (SAP)³⁷ 104 issued by the ASSA. Technical provision are calculated using a discounted cash flow basis that must take into account future premiums and assumptions regarding future investment returns, bonus declarations, expenses, mortality experience, morbidity experience, lapses, surrenders and other relevant factors. The assumptions must: be best-estimate assumptions; take into account the reasonable expectations of policyholders; and be modified by compulsory margins and discretionary margins. The current discount rate is based on the</p> |
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³⁵ APNs provide advice to ASSA members to guide them in their relevant area of practice. Failure to comply with an APN will not in itself constitute grounds for complaint under the disciplinary procedures. It is recommended that any departure from an APN be disclosed.

³⁶ The ASSA advised that "discounting should be applied if it will make a material impact to the central estimate result. As a general guideline, when the discounted mean term of liabilities is expected to exceed four years, then estimates should be discounted." When discounting is applied, results should be disclosed both before and after discounting.

³⁷ SAPs are standards that all ASSA members must adhere to. A material breach of the SAP will in itself be ground for a complaint under the disciplinary procedures and will amount to strong prima facie evidence of unprofessional conduct.

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| | <p>investment return earned on the assets backing the liabilities. (<i>Board Notice 14 of 2010</i>)</p> <p>The compulsory margins are calculated based on various factors (ranging from 7.5 percent to 25 percent) applied to best-estimate assumptions: mortality, morbidity, medical, lapses, terminations, surrenders, expenses, expense inflation, and charge against investment returns. The intention is to introduce a degree of prudence to allow for possible adverse deviations in experience during the expected future lifetime of the business. The compulsory margins must be added throughout the lifetime of policies except for regular renewable policies (e.g., group policies that are re-priced annually).</p> <p>Discretionary margins may be included where the Statutory Actuary believes that: a) the compulsory margins are insufficient for prudent reserving; or b) a discretionary margin should be used to defer the release of profits consistent with policy design or company practice. For participating policies, where a policy of smoothing bonuses has been followed, the liabilities should be increased by any positive bonus stabilization reserve that exists.³⁸ In practice, most insurers maintain discretionary margins.</p> <p>Technical provisions are not calculated on an economic basis because the discount rate is not necessarily a market consistent discount rate. Linked products have implicit margins as not all the future cash flows are valued (e.g., taking the current value of units, i.e., asset shares as the liability).</p> <p>Long-term insurers must allow for future bonuses (on discretionary participation contracts) and dynamic policyholder behavior if it is expected to cause a strain (if it creates a profit it is not allowed). The ASSA recommends the use of market-consistent stochastic models to quantify reserves required to finance possible shortfalls in respect of embedded investment derivatives (<i>LTIA Schedule 3; APN110</i>).</p> <p>The reasonable expectations of policyholders will depend on the types of policy, the practice of the insurer, the manner in which benefits are presented to policyholders and the expectations created by marketing materials. In this regard, the FSB-SA has issued a Directive on Governance of Discretionary Participating Business that establish requirements for insurers to:</p> <ol style="list-style-type: none"> a) Define the Principles and Practices of Financial Management (PPFM) for discretionary participation products; b) Publish the PPFM and disclose the parameters for exercising discretion, which should include: the methodology to calculate emerging of surplus, and this is allocated between policyholders and shareholders; the approach adopted for smoothing the amounts payable under discretionary policies; managing conflict of interest between policyholders and shareholders as well as between different generation of policyholders; |
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³⁸ If the smoothing process has resulted in a negative bonus stabilization reserve because of a downward fluctuation in the market value of backing assets, it is acceptable to reduce the liabilities to reflect the amount that can reasonably be expected to be recovered through under-distribution of bonuses during the ensuing three years, provided that the Statutory Actuary is satisfied that if market values of assets do not recover, future bonuses will be reduced to the extent necessary.

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| | <p>c) Governance arrangements to ensure that decisions are in accordance with the PPFM and monitor any changes to the PPFM. The preference is to establish Discretionary participation Committee of the Board; and</p> <p>d) Annual confirmation of compliance to the PPFM in the statutory returns (<i>Directive 147.A.1</i>).</p> <p>In addition, the ASSA expects the Statutory Actuary to consider what policyholders' expectations have been created and whether an insurer has taken clear action to change any previously held expectations to determine which expectations need to be taken into account in the valuation. Some of the specific ways in which expectations are frequently created: a) where there is a history of maintaining bonus rates or strong smoothing of bonus rates over a sustained period; and/or b) the illustration of future values assuming the maintenance of bonus rates creates an expectation that those rates will be maintained (<i>SAP 104 p3.5</i>).</p> <p>Supervisory practice</p> <p>The FSB-SA has the authority and actuarial expertise to assess the adequacy of technical provisions maintained by insurers. It has allowed the use of alternative methods by the statutory actuaries if it is satisfied that the methods proposed reflect the risks of the policy portfolios and for a limited period, subject to further supervisory review.</p> <p>SAM Framework</p> <p>The economic balance sheet approach adopted under the SAM Framework integrates the interdependencies between all assets and liabilities, calculated at market consistent values.</p> <p>For assets, economic valuation is achieved by using market observable values. Where market observable values are not available, the insurer can use either a mark to market or mark to model approach.</p> <p>Insurance liabilities are valued by taking the probability weighted present value of future cash flows, with an explicit risk margin to allow for the cost of capital associated with the uncertainty of the future cash flows. The FSB-SA plans to use the government bond rates as the default option for discounting but may allow the use of swap rates for certain components of liabilities in line with the investment policy. The valuation of embedded options and guarantees under long-term policies will be explicitly provided. For other liabilities, a market value is obtained through market observable data, failing which the valuation will use a mark to model or mark to market approach. An insurer's own credit standing will not be taken into account when calculating technical provisions and other liabilities.</p> |
| Assessment | Largely Observed |
| Comments | <p>The valuation regime is intended to be prudently realistic and is based on financial reporting standards, subject to prudential filters for assets and prudent valuation methodologies for certain types of assets and technical provisions prescribed by the FSB-SA. Long-term insurers must observe the SAPs issued by the ASSA in the estimation of technical provisions. The methodologies for estimating technical provisions of long-</p> |

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| | <p>term insurers take into account the relevant underlying risks. They must use best-estimate assumptions, take into account policyholders' reasonable expectations and maintain explicit compulsory and discretionary margins. For short-term insurers, there is no requirement to have an explicit margin over current estimate but an implicit margin is incorporated via the use of prudent factors and the policy of no discounting.</p> <p>The valuation regime under the SAM Framework will be based on economic valuation, with explicit margins over current estimate for technical provision.</p> |
| ICP 15 | <p>Investment</p> <p>The supervisor establishes requirements for solvency purposes on the investment activities of insurers in order to address the risks faced by insurers.</p> |
| Description | <p>General Legal requirements</p> <p>Insurers must hold assets in South Africa³⁹ that are not less than the aggregate value of its liabilities which are to be met in South Africa and capital adequacy requirement in respect of those liabilities. The assets deemed to be held in South Africa are prescribed (<i>LTIA s32(1)(a), Schedule 1; STIA s29(2), Schedule 1</i>).</p> <p>The Insurance Acts requires diversification of assets and specify non-admitted assets for solvency purposes. Long term insurers must hold eligible assets covering their liabilities under non-linked policies. The Short-Term Insurance Regulations and the Long-term Insurance Regulations prescribe the limitation on assets including the applicable concentration limits for each category of assets. Investments requirements apply at the insurance entity level (<i>LTIA s31(1), Schedules 3; STIA, s30(1), Schedule 2</i>).</p> <p>Insurers shall not invest in derivatives except for: a) derivatives acquired out of surplus assets; b) reducing investment risk; c) efficient portfolio management or d) assets designated for linked policies. A short-term insurer is also required to have the asset at the settlement date of the derivative instrument which matches the obligations under that instrument and from which it can discharge those obligations (<i>LTIA s34(2); STIA s33(2)</i>).</p> <p>Insurers shall not, without the approval of the FSB-SA: a) encumber its assets; b) allow its assets to be held by another person on its behalf; c) directly or indirectly borrow any asset; d) give security in relation to obligations between other persons, unless registered to write guarantee policy; e) include in its assets, shares directly or indirectly held in its holding company⁴⁰ (<i>LTIA s34; STIA, s33</i>).</p> <p>Standing approvals were granted to insurers to use the services of nominees (both local</p> |

³⁹ A claim qualifies as an asset in South Africa only if it is enforceable in accordance with the law of South Africa Republic and is realizable in South Africa.

⁴⁰ However, an insurer could, in a policyholder fund, hold shares in its holding company as the shares were deemed to be held by the insurer as a trustee. The FSB-SA imposes a limit of 10 percent in aggregate of the holding in policyholders fund, shareholders fund and by all the subsidiaries of the holding company (*LTIA, s32(2) and Directive 141.A.1 (LT) – Investment in shares of the insurer's holding company*).

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| | <p>and foreign), subject to meeting the minimum conditions prescribed by the FSB-SA. Nominee companies are approved by the FSB-SA⁴¹ and a register of all approved nominee companies, specifying the categories of approval, is published on the FSB-SA website (<i>Directive 126 Ai</i>).</p> <p>Currently, insurers are allowed to use nominees of related entities and no additional measures are required to safeguard assets attributable to policyholders. Under the Financial Institutions (Protection of Funds) Act (FIPFA), nominees must be controlled by regulated financial institutions. This matter will be considered by the Nominee Steering Committee and if necessary, appropriate requirements may be issued in 2014 (<i>FIPFA, s2</i>).</p> <p>The statutory actuary of the long-term insurer shall be satisfied that the kinds and spread of its assets is proper and suitable having regard to the nature of its various liabilities and maturity profile, including asset-liability matching requirements prescribed by the FSB-SA. There is no such asset-liability management requirement for short-term insurers (<i>LTIA s31(2)</i>).</p> <p>There are no investment requirements at the insurance group level e.g., appropriate policy and restrictions on intra-group investment transactions; fungibility of investments within an insurance group or centralized function.</p> <p>On-going regulatory initiatives</p> <p>The FSB-SA proposes to issue a Board Notice to establish regulatory requirements on:</p> <ol style="list-style-type: none"> a) An explicit investment policy that: provides for the investment of assets in accordance with the Insurance Acts; specifies the nature, role and extent of its investment activities and how it complies with regulatory investment requirements; and b) An explicit asset-liability management policy that clearly specifies the nature, role and extent of the insurer's asset liability management activities and their relationship with product development, pricing functions and investment management. <p>The Insurance Bill will be based on the prudent person investment principle. In particular, the draft legislation requires insurers to invest:</p> <ol style="list-style-type: none"> a) only in assets and instruments whose risks the insurer can properly identify, measure, monitor, manage, control and report, and appropriately take into account in the assessment of its overall solvency needs taking into account its specific risk profile, approved risk tolerance limits and business strategy; b) assets held to cover the technical provisions in a manner appropriate to the nature and duration of its insurance liabilities; and in the best interest of all policyholders and beneficiaries taking into account any disclosed policy objective. In addition, in the case of a conflict of interest, the insurer must ensure that the investment is made in the best interest of policyholders and beneficiaries; and c) assets in a manner that reasonably ensures the security, quality, liquidity and profitability of its whole portfolio of assets and the availability of assets. |
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⁴¹ According to the "Requirements Imposed by the Financial Services Board (FSB) for Nominee Companies to Operate in South Africa" as published in the Government Gazette of 27 May 2007.

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| Assessment | Largely Observed |
| Comments | <p>The FSB-SA has established requirements on the investment activities of insurers including eligible assets; diversification requirements; non-admitted assets for solvency purposes; prohibition against encumbrances of assets; use of nominees as well as investments in derivatives. The proposed Board Notice will enhance the regime by establishing explicit requirements on insurers to have an explicit investment policy and explicit asset-liability management policy.</p> <p>The implementation of the proposed Board Notice provision governing insurers' investment activities and asset-liability management will address most of the current regulatory gaps. The authorities are advised to formulate appropriate investments requirements at the insurance group level.</p> |
| ICP 16 | <p>Enterprise Risk Management for Solvency Purposes</p> <p>The supervisor establishes enterprise risk management requirements for solvency purposes that require insurers to address all relevant and material risks.</p> |
| Description | <p>The Insurance Acts or supervisory guidelines do not at present specifically require insurers to establish an enterprise risk management (ERM) framework or to perform own risk and solvency assessment (ORSA). There are no explicit requirements for an insurer to establish and/or maintain:</p> <ol style="list-style-type: none"> Accurate documentation of risk measurements; A risk management policy which describes the relationship between the insurer's tolerance limits, regulatory capital requirements, economic capital and the processes and methods for monitoring risk; An explicit asset-liability management (ALM) policy. Nonetheless, for long-term insurers, the statutory actuary must be satisfied that the assets are proper and suitable to the nature and term of its liabilities; An explicit investment policy; Explicit policies in relation to underwriting risk; and A risk tolerance statement and embed its defined risk tolerance limits in its day-to-day operations. <p>Supervisory practice</p> <p>The FSB-SA expects the larger insurers to implement effective ERM, which is reviewed as part of its risk-based supervisory approach. The 2012 Pillar II Readiness survey revealed that many insurers have not formally articulated their risk appetite. While some insurers have established risk limits, most are somewhat rudimentary and require formalization.</p> <p>Many insurers have already adopted some of the ORSA principles in anticipation of the implementation of the SAM Framework, with a few already producing ORSA reports. The 2012 Pillar II Readiness exercise revealed that:</p> <ol style="list-style-type: none"> almost 85 percent of insurers rated themselves as either weak or needing improvement, with respect to ORSA preparations. more than 90 percent of insurers have documented their risk management strategy; more than 90 percent of long-term insurers have a formal ALM policy; almost 90 percent of insurers have a formal investment policy; |

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| | <p>e) almost 72 percent of insurers have a formal policy on underwriting; and f) more than 80 percent of insurers have their risk management system fully or partly independently reviewed by internal audit team or an objective third party.</p> <p>The FSB-SA was conducting a further assessment of the progress made by insurers in terms of their ORSA.</p> <p>The FSB-SA has introduced semi-annual economic stress tests for the six largest long-term and short-term insurers, and annual economic and insurance stress test for all insurers. The stress test is based on a market risk combined scenario of a steep drop in equity markets, significant adverse developments in the level of volatility of interest rates across the term structure, significant adverse currency movements, and significant drops in price levels of property investments. Furthermore, worsening due to counterparty risk of market instruments is also included, as is concentration risk. As such, the combined market risk profile represents a significant deterioration in the overall economy. These stress tests indicated that “insurers continue to reflect resilience to adverse economic stresses and scenarios.”</p> <p>SAM Framework</p> <p>Insurers are required to conduct ORSA at least annually. When there is any material change in the risk profile of the business, a self-assessment of their risks and the level of solvency needed to cushion those risks should also be performed.</p> <p>Under the SAM regime, the current stress tests will no longer be required, since the standard capital formula under SAM provides a comprehensive stress test, covering both individual risks as well as an implied combined scenario.</p> <p>Going forward, the ORSA will require insurers to conduct a number of stress tests, including reverse stress tests. These will provide valuable insights into concentrations and stability risks. In addition, it is proposed that a supervisory committee be established under the new Twin Peaks regime to periodically review industry-level statistics and consider if any specific macro-prudential stress tests may be required. These will be conducted as-and-when deemed necessary, and will consider the emerging risk universe as potential stressors.</p> |
| Assessment | Partly Observed |
| Comments | <p>Pending the implementation of SAM, the Insurance Acts and supervisory guidance do not address regulatory requirement relating to ERM and ORSA. In the interim, the FSB-SA has introduced semi-annual economic stress tests for the six largest long-term and short-term insurers, and annual economic and insurance stress test for all insurers. The FSB-SA reviews insurers’ ERM framework and is closely monitoring insurers’ progress in terms of ORSA. The Pillar II Readiness exercise in 2012 revealed that while insurers have made progress on ERM issues, almost 85 percent of the insurers were either weak or needed improvement with respect to ORSA preparations. A follow-up Pillar II Readiness review is underway.</p> <p>The proposed Board Notice covering risk management and the implementation of the SAM Framework will significantly enhance the regulatory regime for ERM.</p> |

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| <p>ICP 17</p> | <p>Capital Adequacy The supervisor establishes capital adequacy requirements for solvency purposes so that insurers can absorb significant unforeseen losses and to provide for degrees of supervisory intervention.</p> |
| <p>Description</p> | <p>Capital Adequacy Requirements (CAR) An insurer shall at, all times, maintain its business in a financially sound condition. In particular, the aggregate value of an insurer's assets must not be less than the aggregate value of its liabilities and CAR, calculated in accordance with prescribed valuation rules (ICP 14) (<i>LTIA s30, s31, Schedule 3; STIA s28, s29, s30, Schedule 2</i>).</p> <p>The current solvency regime is not based on a total balance sheet approach. Nonetheless, a clear distinction is drawn between assets backing liabilities, assets backing CAR and the remainder of assets (i.e., free assets⁴²). Assets backing policyholder liabilities drive capital requirements for market and credit risk. For long-term insurers, a market risk adjustment is made to reflect the market risk inherent in the assets backing CAR. The risks inherent in the free assets are not accounted for in calculating CAR.</p> <p>The regulatory capital requirements are prescribed in a transparent manner, in consultation with the insurance industry and the ASSA and the bases on which they are determined are clear.</p> <p>Long-term insurers The CAR is determined by the statutory actuary as the <i>highest</i> of:</p> <ol style="list-style-type: none"> a) a termination CAR which is an amount that will ensure that the liability under each policy is not less than the amount that will become available to policyholders on surrender or lapse, making due allowance for reasonable expectations of the policyholder; b) an ordinary CAR which is the amount determined in accordance with ASSA guidelines, which is calibrated at a 95 percent of sufficiency over the lifetime of the policy; c) The minimum CAR, which is the <i>higher</i> of: R10 million; operating expenses multiplied by 13 and divided by 52; or 0.03 percent of gross contingent liabilities under unmaturing policies. <p>Credit for management actions under a) and b) may only be recognized where the board of director has approved the relevant management action and the statutory actuary is satisfied that such action will be taken (<i>LTIA Schedule 3; Board Notice 14 of 2010</i>).</p> <p>Under the ASSA methodology:</p> <ul style="list-style-type: none"> • CAR is the <i>higher</i> of: Termination Capital Adequacy Requirement (TCAR) and Ordinary Capital Adequacy Requirement (OCAR). • TCAR is the sum of Lapse CAR and Surrender CAR. The Lapse CAR equals the amount required to ensure that no policy has a negative liability while the Surrender CAR equals the amount required to ensure that no policy's liability is less than its |

⁴² Defined as those assets in excess of the total of the liabilities and the CAR.

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| | <p>current surrender value. In effect, the TCAR ensures that a long-term insurer is in a position to survive a very selective “run-on-the-bank” scenario.</p> <ul style="list-style-type: none"> • The OCAR is computed based on factors that establish capital needs for each major risk category. The factors covers the following risks: lapse; surrender; mortality, morbidity and medical fluctuations; annuitant mortality fluctuation; mortality, morbidity and medical assumptions; expense fluctuation; investment; credit; and operational and other risks. The results are summed with an adjustment to recognize independencies and diversification. Initially, an Intermediate OCAR will be calculated, which will then be grossed up⁴³ to reflect the effect of the assumed fall in fair value of the assets backing the OCAR and the credit risk of those assets, to get the OCAR (SAP 104). <p>The current regime addresses risks in:</p> <ol style="list-style-type: none"> a) Technical provisions through the prescribed and discretionary margins required in addition to the best estimates. However, this allowance for risk is not explicitly linked to the sources of risk, apart from that there is risk arising in using incorrect assumptions; b) CAR - allows for risk by requiring the calculation of risk charges for the following risks: lapse, surrender, mortality, morbidity, medical, expense, longevity, investment, credit and operational. Insurers may allow for further risk capital if they believe that there are risks not covered by this list. The risk charges are aggregated by assuming that the various risks are independent, except for operational risk. <p>Short-term insurers</p> <p>The CAR is the <i>highest</i> of:</p> <ol style="list-style-type: none"> a) the minimum CAR, which is the <i>higher</i> of: R10 million; or operating expenses multiplied by 13 and divided by 52 or 15 percent of net premium income; or b) the solvency CAR - the sum of Basic Solvency CAR and Operational Risk Capital. <p>The Basic Solvency CAR takes into account material risk categories, which include insurance (by class of business), market (by category of assets) and credit (depending on recognised credit ratings) risks. Operational Risk Capital is the <i>lower</i> of 30 percent of Basic Solvency CAR or 3 percent of earned premiums/technical provisions (as defined) (Board Notice 169 of 2011).</p> <p>There is no overall target criteria specified for the CAR. Nonetheless, the FSB-SA considers that the various factors used for each risk in the calculation of the capital charges are based on a target criterion of 99 percent sufficiency level over a one year horizon.</p> <p>Own funds</p> <p>There is currently no tiered approach in classifying own funds, which basically requires tier 1 capital. Insurers can make <i>ad hoc</i> applications to issue hybrid capital instruments.</p> |
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⁴³ The grossing up factor will be based on the assumed change in asset values contained in the resilience scenario envisaged in the Investment CAR and the losses arising from credit risk as envisaged in the Credit Risk CAR and will depend on the assets assumed to be backing the CAR.

In that case, a tiered approach will be used in assessing the application based on the criteria of permanency, availability, subordination and mandatory servicing requirement.

Solvency Intervention Ladder

If an insurer gives notice to the FSB-SA or if the FSB-SA is satisfied that an insurer is breaching or is likely to breach MCR, the FSB-SA may, direct that insurer to furnish: a) specified information relating to the nature and causes of the failure; and b) its proposals as to the course of action to ensure compliance. There is no other intervention point (*LTIA s35; STIA s34*).

Currently there is no explicit power for the FSB-SA to increase/vary the CAR. However, this objective may be achieved by directing an insurer to place a proper value on an asset/liability/capital requirement (ICP 14) or by imposing licensing conditions. Insurers may apply for a reduced minimum CAR, if the nature, scale and complexity of their business justify same. This is only expected to be required in limited circumstances, mainly for run-off cases.

Group Solvency Requirements

In the absence of a legal framework for group-wide supervision, there is no formal solvency requirement at the group level. The FSB-SA currently requests insurance groups that are of potential systemic importance to submit quarterly unaudited returns on a group-wide basis. The group capital assessment is based on the aggregation and deduction technique, i.e., the group capital requirement is calculated as the sum of the CAR for the solo entities, adjusted for any intra group transactions (loans and guarantees but not reinsurance). This approach does not allow for diversification between solo entities.

Internal models

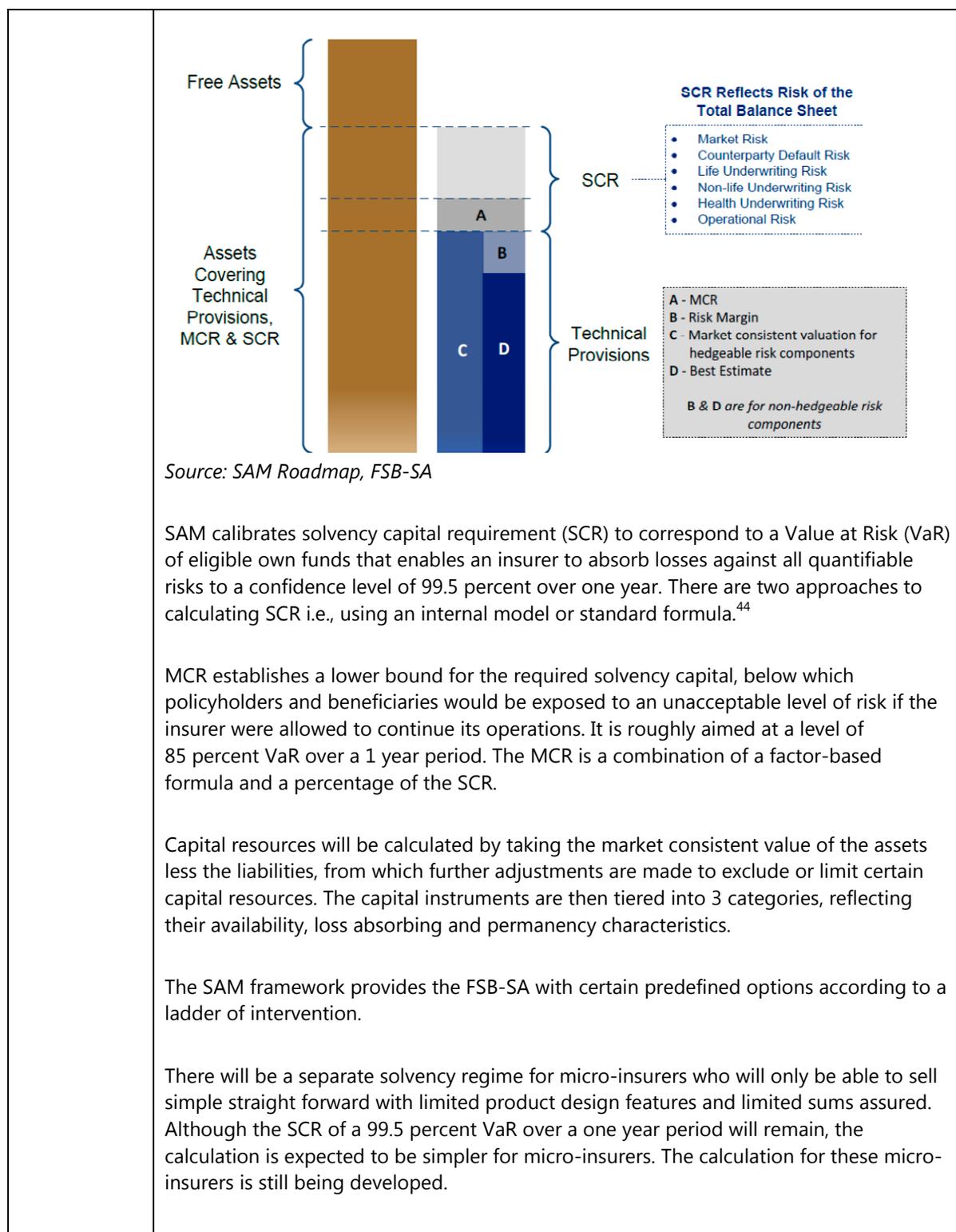
Internal models are provided for subject to the approval of the FSB-SA. In practice, the FSB-SA has not prescribed requirements that would allow an insurer to apply for approval to use an internal model under the current Insurance Acts and has not allowed the use of internal models.

Supervisory practices

While there is currently only one intervention level, in practice the FSB-SA has a range of activities and responsibilities, depending on the risk rating of an insurer (ICP 9). The FSB-SA assesses the regulatory capital requirements of insurers continuously as part of its risk-based supervision. As insurers move closer to the minimum CAR, supervisory action and intervention will be intensified ranging from monthly reporting to placing insurers under curatorship (ICPs 10 and 11).

On-going regulatory initiatives and SAM Framework

SAM, based on Solvency II with adaptations for local circumstance, will apply to insurers and insurance groups. It is a risk-based solvency framework, based on a total balance sheet approach. Insurers' solvency balance sheet under SAM is depicted as follows:



⁴⁴ "To accord with the principle of proportionality, simplifications to the standard formula may be developed, allowing smaller insurers to use proxy calculations for parts of the standard formula."

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| | <p>Financial soundness requirements for insurance groups will be introduced in the draft Financial Sector Regulation Bill. The deduction and aggregation method will be used for calculating the group SCR. However, there will be no group MCR in Phase 1. Final measures for insurance group supervision will be introduced in Phase 2 through the Insurance Bill, including financial soundness requirements with the following additions:</p> <ul style="list-style-type: none"> ▪ A group MCR will be introduced based on the sum of the MCRs of the solo entities; and ▪ An option for groups to apply the accounting consolidation methodology to the South African insurance related entities, subject to approval from the FSB-SA. <p>The group SCR will include a capital charge for non-financial entities.</p> <p>The Insurance Bill will require that an internal model must be approved for the purposes of calculating the SCR and the FSB-SA has published guidance on the Internal Model Approval Process. In preparation for the implementation of the Insurance Bill, the FSB-SA has commenced with an internal model pre-application process.</p> |
| Assessment | Largely Observed |
| Comments | <p>The current solvency regime is transparent and the requirements are more risk-based for long-term insurers compared to short-term insurers. In practice, the CAR has proven to be largely sufficient in preventing insurer failures or losses to policyholders, largely because of the prudence built into the calculation of technical provisions. While the insurance laws only provide a single point of supervisory intervention, continuous monitoring by the FSB-SA allows early identification of potential breaches of CAR which facilitates timely intervention. As insurers move closer to the minimum CAR, supervisory action and intervention will be triggered and intensified if necessary.</p> <p>The impending implementation of the SAM Framework and the Insurance Bill, including financial soundness requirements for insurance groups, will bring the solvency regime in line with ICP 17.</p> |
| ICP 18 | <p>Intermediaries</p> <p>The supervisor sets and enforces requirements for the conduct of insurance intermediaries, to ensure that they conduct business in a professional and transparent manner.</p> |
| Description | <p>Regulatory Authority</p> <p>The Financial Advisory and Intermediary Services Act, 2002 (FAIS Act) regulates the rendering of financial services in respect of financial products (including insurance products) by Financial Service Providers (FSPs). Financial service is defined as the furnishing of advice and/or the rendering of intermediary services. The relevant requirements and supervision of FSPs are set out in the following: FAIS Act; General Code of Conduct for Authorised FSPs and Representatives (General Code); Codes of conduct for Administrative and Discretionary FSPs; LTIA and Regulations under LTIA; STIA and Regulations under STIA; FIPFA and IFI Act.</p> <p>The FAIS Act also applies to persons who are domiciled outside of South Africa but who are rendering financial services in South Africa in respect of a financial product. In</p> |

addition, the Financial Advisory Services Regulations prohibit a person, whether within or outside South Africa, to canvass for, market or advertise any business related to the rendering of financial services by any person who is not an authorized FSP or representative of such FSP (*FAIS Reg s3(a)*).

Licensing of FSPs

The FAIS Act requires that all persons who render financial services must either be an authorized (licensed) FSP or appointed as a representative of an authorized FSP. This means that insurers, banks or securities firms are also required to be authorized as FSPs if they provide advice (either directly or through their insurance agents) or render intermediary services through direct channels. FSPs are classified into various categories, with insurance-related FSPs falling under mainly Categories I and IV (*FAIS s7*).

Individuals acting as representatives of FSPs are not directly licensed by the FSB-SA but must comply with FSP requirements. There are currently 124,776 representatives on record in South Africa. If an FSP acts through individual representatives, it must ensure that the representatives are fit and proper and continue to meet FSP requirements. FSPs also must take responsibility for the actions of their representatives. The FSB-SA is notified of all representative appointments and keeps a central register (available to the public) of such appointments. It is also notified of any terminations of representatives. The FSB-SA has taken actions directly to bar individuals who are judged not to be fit and proper (*FAIS s13 and s14A*).

The FSP licensing application process sets out the submission of specified forms and requirements including, general business information; directors, officers and substantial shareholders (over 25 percent); representatives; the compliance officer; the firm's operational ability; financial soundness; and its external auditor. In practice, all applicants are expected to provide a copy of their business plan, policies, procedures and systems to comply with the FICA and other applicable legislation; as well as internal controls structure, and procedures. Applicants that apply for licensing in multiple categories are required to meet higher requirements. The FSB-SA of FSPs also has the authority to request additional information from an applicant deemed important (*Board Notice 60*).

The FSPs (and their key individuals and representatives) must comply with prescribed fit and proper standards that include honesty and integrity, competency, financial soundness and operational ability. Depending on the products, different competency requirements that include experience, qualifications, regulatory examinations and continuous professional development requirements apply. In addition, FSPs must comply with requirements that include the fair treatment of clients, disclosures (in respect of products, product providers, remuneration, status, and relationships), conflict of interest requirements, financial needs analysis, and complaints management (*General Code s2; FAIS s8*).

The FSB-SA grants a licence only if all licensing requirements are met. The licence is granted for a specific category and is restricted to specific products. Prior to final approval, the Licensing Committee of the FSB reviews the application to ensure that fair and consistent standards are met. As per FAIS records, it takes approximately 8 weeks to review and approve or deny an application. The FSB-SA, at any time, may impose

conditions and restrictions on the licence of a FSP.

Exemptions from certain conditions for registration are allowed under the FAIS Act. Such exemptions have been granted to facilitate greater access to financial services and products by the low-income sector (i.e., microinsurance) such as funeral insurance policies.

As at March 31, 2014, there were approximately 10,992 licensed FSPs, down from 12,051 in 2011. The FAIS has indicated that the drop is due to tighter licensing, fit and proper requirements, and educational requirements instituted to improve policyholder protection and conduct of business in South Africa. For the long-term insurers, the sales force for individual life policies is mainly insurer's in-house agents (53 percent) and for group life policies is mainly brokers (51 percent). For short-term insurers, the broker channel dominates the personal lines, corporate and commercial insurance distribution network.

On-going regulatory requirements

The FSB-SA has an extensive set of requirements for FSPs to ensure that they conduct business in a professional and transparent manner. The PPR issued under the Insurance Acts require insurers to deal with FSPs that are licensed under the FAIS Act (*FAIS s7(3); LTIA s62; STIA s55*).

Minimum capital requirements are set for FSPs to address operational and credit risk. These initial capital requirements are required to be maintained at all times by FSPs (*Board Notice 106 of 2008 Part IX; FAIS s8*).

The requirements are consistently applied per licence category. All intermediaries within the same category are required to meet the same criteria and requirements. Where the risk associated with the licence category is higher, the requirements that apply to intermediaries of the specific licence category are also higher, see example below:

| FIT AND PROPER CRITERIA | CATEGORY I | CATEGORY II & IIA |
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| Entry level requirement | Grade 12 or an equivalent NQF level 4 qualification. | A recognised degree or an equivalent. |
| Experience | Experience requirements range from 6 months to 2 years depending on the product that the provider is responsible for. More complex financial products require more experience. | Experience requirements range from 1 to 3 years depending on the product that the provider is responsible for. More complex financial products require more experience. |
| Qualification | A recognised qualification appropriate to the financial product for which services are rendered. | Already met the qualification requirement at entry level. |

FSPs are also required to ensure that any of their representatives who no longer comply with the requirements of the Act or Code or has failed to comply with any provision of the Act in a material manner, is prohibited by that FSP from rendering any new financial service.

Regulatory returns

FSPs are required to submit documents including compliance reports, financial statements and audit reports, to the FSB-SA of FSPs. FSPs are also required to notify the FSB-SA of FSPs of any changes in key individuals and representatives. (*FAIS Act s17-19*)

FSPs (other than FSPs who are sole proprietors with no representatives) must appoint a Compliance Officer (CO) to oversee its compliance function and to monitor compliance with the FAIS Act and other relevant regulatory requirements. The CO must submit compliance reports to the FSB-SA. The frequency of the submission of compliance reports depends on the licence category. The higher the risk of a FSP, the more frequently compliance reports must be submitted. The form and content of the compliance reports are determined by the FSB-SA and is published on the FSB's website. The CO must also comply with fit and proper requirements and other criteria determined by the FSB-SA and must be approved by the FSB-SA to act as a compliance officer.

FSPs must inform the FSB-SA, within 15 days, of any change in respect of the information provided in the application for a licence. This information forms part of the off-site supervision of an FSP.

The auditor and CO of a FSP must inform the FSB-SA of any irregularity or suspected irregularity in the conduct or the affairs of a FSP which they became aware. Failure to do so constitutes a criminal offence. An auditor shall also report on whether an FSP who receive or hold client funds has proper segregation of client funds.

Corporate Governance

The CA is the primary law that sets out director's duties and King III applies to all entities regardless of corporate form on an 'apply or explain' basis. While there is no explicit reference to "corporate governance" in the FAIS Act, the FSB-SA considers that corporate governance requirements are implicit in the different Codes of Conduct that require FSPs to demonstrate adherence to basic corporate governance principles. The assessment of corporate governance is embedded in the risk-based supervision approach for FSPs (see supervisory practices below).

Disclosure and Conflict of Interest

With respect to the terms and conditions of business between an FSP and the customer, the FSP is required to provide the client with certain information within 30 days, including:

- General information on the FSP's business;
- Legal and contractual status of the FSP and the client's responsibility, if any;
- Contact details of the relevant compliance department or the representative;
- Financial services which the FSP is authorised to provide and any restrictions

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| <p>applicable;</p> <ul style="list-style-type: none"> • Guarantees or professional indemnity or fidelity insurance cover, if any; • FSP's relationship with the insurer. <p>FSPs are required to adopt maintain and implement a conflict of interest management policy that must be published in appropriate media to ensure that it is easily accessible. FSPs are required to avoid conflicts of interest and where avoidance is not possible must mitigate any conflict of interest with disclosure of the following:</p> <ul style="list-style-type: none"> • the measures taken to avoid or mitigate the conflict; • any material ownership interest or financial interest that the provider or representative may be or become eligible for; • the nature of any relationship or arrangement with a third party that gives rise to a conflict of interest; and • inform a client of the conflict of interest management policy and how it may be accessed (<i>General Code s3</i>). <p>FSP must disclose in specific monetary terms all charges, fees, remuneration or monetary obligations payable to the product supplier. If the amount is not reasonably pre-determinable, its basis of calculation must be adequately described. They must also disclose:</p> <ul style="list-style-type: none"> • the monetary obligations assumed by the client, the consequences of non-compliance and any anticipated or contractual increases; • any incentive, remuneration, consideration, commission, fee or brokerages payable to the provider as well as the identity of the product supplier. <p>An FSP must furnish a written statement on existing policies, at least annually, showing:</p> <ul style="list-style-type: none"> • any ongoing monetary obligations of the client; • the main benefits provided; • for products with an investment component, the value of the investment and the amount of such value which is accessible to the client; and • any ongoing incentives, consideration, commission, fee or brokerage payable to the provider (<i>General Code s7(4)</i>). <p>The General Code of Conduct prohibits an FSP to offer or receive any financial interest (including remuneration) other than those listed. Aspects of improper incentives and remuneration through outsourcing by insurers are also addressed. (<i>General Code s3A; Directive 159.A.i; Regulations on binder functions</i>).</p> <p>The General Code sets out rules covering representations made to a client by a FSP. It mandates the provision of clear information to clients concerning product suppliers or insurers, and any conflict of interest of the FSP with the insurer. The Code requires the FSP to supply the client with detailed, specified information concerning the contracts entered into with insurers and requires the FSP to conduct a needs analysis and ensure that any advice provided is appropriate to the needs and risk profile of the client. Similar provisions apply to insurers offering advice under the Policyholder Protection Rules (<i>PPR</i>).</p> <p>Commissions paid by insurers to the FSPs are subject to caps, for both long-term and</p> |
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short-term insurance products. On investment products, only 50 percent of the total commission may be paid upfront—a recent provision aimed at reducing early termination charges and the incentives on intermediaries to switch clients from one product to another that had previously been a feature of the market (*LTIA Regulations Part 3A*).

In practice, disclosure and conflict of interest are routinely monitored through the CO and audit reports and from any complaints received. The FSB has been developing its processes, systems in this regard as well.

The legislation provides for the suspension, withdrawal of an authorisation, withdrawal of the approval of a key individual or debarment of any person on a number of grounds including the non-compliance with any provision of the FAIS Act (*FAIS s9, s14, s14A*).

Client Monies

FSPs are also required to hold professional indemnity insurance (minimum R1 million) and, where they hold client funds, to hold such funds separately in a ring-fenced account. However, FSPs that collect short-term insurance policies are not subject to this last requirement as they are required to hold security in respect of these premiums (*STIA s45*).

The Insurance Acts provide that for the purposes of the validity of a policy the payment of a premium under the policy, to a person on behalf of the insurer shall be deemed to be payment to the insurer under that policy (*LTIA s47; STIA s54*).

The FAIS Act requires that client monies be kept separately, that a separate report signed by the auditor be submitted annually to the FSB-SA of FSPs to demonstrate compliance. In particular, a separate bank account, designated for client funds must be maintained and all funds held on behalf of clients must be deposited within one business day of receipt. (*FAIS s19(3); General Code s10*).

Supervisory Practices

The FSB-SA uses the Risk Based Supervision (RiBS) framework to facilitate the early identification of supervisory concerns and on-going assessment based on the risk profile of FSPs. The RiBS also sets out the basis for sharing of information and co-operation between departments where different licences are issued to a single financial institution or group of financial institutions.

Under the RiBS framework, an initial rating is allocated to an FSP once the license is approved. Ratings vary by factors such as nature of intermediary service provided (discretionary services are viewed as higher risk), products offered, number of representatives, and assets under management. This initial rating is updated as and when an onsite visit is conducted. The information received via complaints, profile changes, audit reports, financial statements and compliance reports have an effect on a FSP's risk-rating. All FSPs are assigned to a risk category: small, small-medium impact, medium impact, medium-high impact and high impact. The intensity of supervision differs for the different impact categories.

Compliance with the FAIS Act and governance practices are assessed using off-site monitoring, supplemented with on-site visits. Where supervisory concerns are detected during the review of statutory returns, the FSB-SA interacts with the FSP to mitigate any risk to consumers and to implement corrective measures or where necessary to take regulatory or enforcement action. Most concerns that have arisen have been resolved in a timely manner.

The on-site visits can either be scheduled or unscheduled in response to information, complaints or allegations which come to the attention of the FSB-SA. Routine on-site visits are also conducted on FSPs to supplement the analysis of statutory reports and to enable the FSB to obtain information and detect problems that cannot be obtained or detected through off-site monitoring. An inspection is conducted if the FSB-SA of FSPs suspects that there has been material non-compliance with legislative requirements that needs to be investigated. The Financial Institutions (Protection of Funds) Act and the IFIA also authorize on-site visits and inspections in respect of persons to whom a FSP has outsourced any function or activity.

In 2013, there were 10 CoB on-site visits that revealed concerns in respect of assistance business group policies. Non-compliance identified were addressed with the relevant insurers and corrective actions were taken. In addition, 10 other on-site visits found challenges experienced by insurers in aligning binder agreements with binder Regulations and related remuneration matters. The FSB-SA conducted 412 on-site visits on FSPs rendering financial services in respect of insurance products and conducted 35 on-site visits on insurers to determine their compliance with the FAIS Act.

The FSB-SA of FSPs has taken regulatory several actions against FSPs where necessary. The list of suspensions and withdrawals of FSPs and the list of Enforcement Committee decisions is published on the website of the FSB-SA.

Ongoing Regulatory Initiatives

The FSB-SA is implementing an approach to CoB regulation and supervision informed by the concept of "Treating Customers Fairly" (TCF). The TCF approach seeks to ensure that fair treatment of customers is embedded within the culture of regulated entities. It will use a combination of market conduct principles and explicit rules to drive the delivery of clear and measurable fairness outcomes, such that customers are confident that they are dealing with firms where the fair treatment of customers is central to the firm culture. The FSB-SA has already begun embedding TCF into its regulatory and supervisory framework, with work underway to further entrench these principles in legislation. This will include explicit minimum governance requirements.

The FSB-SA has embarked on a cross-sector Retail Distribution Review ("RDR") that focuses on a broad review of distribution practices and the regulatory framework governing them, in the retail financial services sector as a whole. The RDR is expected to go beyond disclosure of information on remuneration and propose structural interventions to reduce potential conflicts of interest. The RDR will also inform the enhanced future market conduct regulatory framework of the FSB-SA in the Twin Peaks regulatory framework. A discussion paper in this regard will be published in June 2014.

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| Assessment | Observed |
| Comments | <p>All entities providing insurance intermediation services and/or advice must be authorized as FSPs. The authorization requirement also applies to insurer and banks in their role as distributors of product or providers of advice through their agents. The FSB-SA has detailed requirements for licensing FSPs, who are subject to risk-based ongoing supervision. Adequate requirements are in place for FSPs to ensure that they conduct business in a professional and transparent manner. Disclosure requirements are adequate and sufficient safeguards are in place to protect client funds. The FSB-SA has also taken actions against unlicensed individuals and entities.</p> <p>While the FSB-SA's regulatory environment has generally raised the professional standards of conduct of FSPs, the potential for mis-selling and poor outcomes for policyholders seems to persist. The TCF initiative currently underway is expected to bring benefits to consumers and the financial services industry as a whole. The FSB-SA has begun embedding TCF into its regulatory and supervisory framework, which includes explicit minimum governance requirements. There is scope to improve the governance requirements and to supervise the implementation in a more robust manner.</p> <p>The cross-sector Retail Distribution Review is expected to focus on the broad review of distribution practices and the regulatory framework governing FSPs. This review is expected to go beyond disclosure of information on remuneration and propose structural interventions to reduce potential conflicts of interest.</p> <p>The authorities are advised to maintain the positive momentum in embedding the TCF in all regulatory and supervisory practices with respect to FSPs and expediting the Retail Distribution Review. In addition, the authorities are encouraged to:</p> <ol style="list-style-type: none"> Actively monitor persistence rates of intermediaries; Ensure governance requirements for intermediaries are effectively embedded and enforced to better protect policyholders; Consider ways to simplify the FSP structure to have greater focus on supervising insurance intermediaries to improve policyholder protection; Consider establishing cyber-surveillance to enhance the detection and the prevention of illegal sale of insurance products via internet, social networking services, and mobile telephony; and Ensure adequate resources for more robust implementation of recent legislative amendments and effective supervision of intermediaries. |
| ICP 19 | <p>Conduct of Business</p> <p>The supervisor sets requirements for the conduct of the business of insurance to ensure customers are treated fairly, both before a contract is entered into and through to the point at which all obligations under a contract have been satisfied.</p> |
| Description | <p>Regulatory Authority</p> <p>The FSB-SA has set various CoB requirements to ensure customers are treated fairly throughout the product life-cycle. The COB regulatory framework is established under the following legislation:</p> <ul style="list-style-type: none"> The LTIA and STIA regulate the conduct of insurers in their capacity as insurance |

product providers, as well as aspects of the contractual and remuneration arrangements between insurers and insurance intermediaries;

- The FAIS Act regulates insurers in their capacity as distributors of insurance. More particularly, financial advice and intermediary services provided by insurers and FSPs. Insurance intermediaries (whether they are agents of an insurer or brokers) are also subject to CoB requirements.

These requirements will be further enhanced through the full implementation of the TCF initiative, including reforms to the market conduct regulatory framework.

Dealing with Customers and Establishing Fair Treatment of Customers

The Insurance Acts and the Policyholder Protection Rules (PPR) issued under these Acts currently provide general requirements for insurers to act with due skill, care and diligence when dealing with potential customers and policyholders. These stem from various requirements placed on insurers, including requirements relating to advertising, inducements, policy documentation, and cancellation of policies, claims handling, and outsourcing matters. (*LTIA s62, STIA s55*)

The General Code issued pursuant to the FAIS Act explicitly requires FSPs to render financial services honestly, fairly, with due skill, care and diligence, and in the interests of clients and the integrity of the financial services industry. (*General Code s2*)

The TCF framework is specifically formulated to have policies and procedures on the fair treatment of customers. The FSB-SA regularly engages with the insurers and the FSPs in respect of the quality of their interaction with potential policyholders and policyholders. A substantial number of existing regulatory requirements already allow the FSB-SA to apply the principles of TCF within the existing regulatory framework. The FSB-SA has also begun embedding TCF into subordinate regulations within the existing regulatory framework. In most cases, a material failure to deliver fair outcomes will already be actionable under existing regulation. Despite the fact that the TCF approach has not yet been fully entrenched in the legislative frameworks, the FSB-SA has begun embedding TCF into its supervisory framework. Where a particular unfair outcome cannot be framed as a breach of existing regulation, the FSB-SA engages with insurers and FSPs to encourage fair treatment of customers on a moral suasion basis.

During on-site visits and when specific concerns are being investigated, insurers' and FSPs' progress in embedding TCF and the extent to which they are able to provide evidence of TCF delivery are assessed. In addition, the FSB-SA has already begun using the TCF outcomes as indicators in assessing adherence to the PPR's or General Code.

Interests of Different Types of Customers

Recent amendments to the LTIA and STIA, through the FSLGAA, give the FSB-SA the power to issue rules and various policyholder protection standards. These rule-making powers enable the FSB-SA to make rules regarding particular product features for particular types of customers. For example, such rule-making powers is being utilized to prescribe specific norms and standards for micro-insurance products aimed at low-income policyholders.

Review of the internal product approval governance processes, including how these

processes identify the appropriate target market for products and how they take policyholder interests into account, is one of the focus areas for on-site visits. The TCF self-assessment tool and other communications also set out regulatory expectations in this regard.

Going forward, the FSB-SA will strengthen governance requirements for insurers under the SAM framework, including governance requirements in relation to product approval processes. The FSB-SA's statutory quarterly Conduct of Business Returns also has been drafted to capture a range of quantitative and qualitative CoB indicators. This will enable the FSB-SA to assess emerging CoB risks posed by different types of products in relation to different types of customer groups and their interests.

Promotion of Products

The Insurance Acts prohibits advertisement, brochure or similar communication that is misleading or contrary to the public interest. This includes any incorrect statement of fact or any policy documents that does not prominently include the name of the insurer underwriting the policy (*LTIA s4(3); STIA s4(3)*).

In addition, the General Code deals with advertising and marketing and specifically provides that an advertisement by any FSP must not contain any statement, promise or forecast which is fraudulent, untrue or misleading (*Code s14*).

In practice, the FSB-SA has taken action against a number of insurers in respect of misleading advertising and marketing. This includes requiring insurers to change the content of television, on-line and print advertising material. In order to improve implementation, the FSB-SA is in the process of issuing an Information Letter on advertisements, brochures or similar communications to provide further guidance to the industry. Consultation on the draft Information Letter has taken place and the Information Letter is expected to be issued shortly.

Information Requirements at Point of Sale

The General Code contains requirements with regard to the timing, delivery, and content of information provided to customers at point of sale. It also requires that appropriate advice is given before concluding a sale and that appropriate records are kept. The Code imposes a general obligation to ensure that any information must be provided timely so as to afford the client sufficient time to make an informed decision about the proposed transaction (*General Code s3-7; s8-9*).

The PPR's impose specific disclosure obligations on direct marketer insurers to disclose a number of specific, prescribed particulars to policyholders at the earliest reasonable opportunity but prior to the conclusion of a relevant insurance transaction, provided that oral disclosures must be confirmed in writing within 30 days.

Long-term insurers must provide policyholders with a policy information summary that sets out material representations made to the insurer, the premiums payable and the policy benefits. This summary must be provided as soon as possible, but not later than 60 days after a policy is concluded or varied. The PPR provide for 30 day "cooling off"

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| <p>period within which a policyholder may cancel an insurance transaction (<i>LTIA s48</i>).</p> <p>Review of disclosure practices, advice process and the related controls are reviewed during on-site visits of insurers and FSPs. They must also furnish compliance reports under the FAIS Act on compliance with various aspects of the prescribed advice process. For example, in investigating an FSP's conduct, the FSB-SA considers the lapse and replacement ratio⁴⁵ of the insurance products sold by the FSP or where the FSP had advised a client to purchase such products. The FSB-SA has taken regulatory action (withdrawals of licenses/enforcement penalties) against FSPs and representatives for non-compliance with the requirement to provide suitable advice. In this regard, the FSB-SA was also advised to consider persistence rates of FSPs to gauge the rationale behind the conduct of business and take appropriate actions.</p> <p>The FSB-SA, as part of the TCF implementation and the current RDR, is reviewing the responsibility of the insurer (in its capacity as product provider) for the quality of the advice provided by agents or brokers. The FSB-SA is also developing prescribed, standardized templates for "Key Information Documents" (KIDs) which all retail product suppliers, including insurers, will be required to produce, maintain and provide to potential customers prior to point of sale.</p> <p>Conflict of interest</p> <p>The provision of advice by an FSP and the management of conflicts of interest in relation to that advice, is regulated by the FAIS Act. The PPR also require direct marketers to disclose to the policyholder the existence of any circumstance which gives rise to an actual or potential conflict of interest in relation to direct marketing, and take all reasonable steps to ensure fair treatment of the policyholder.</p> <p>The General Code contains both principles-based requirements regarding the avoidance, management and mitigation of conflicts, as well as rules-based requirements in relation to maintaining a conflict of interest management policy; conflict related disclosure obligations; and prohibitions on specific types of conflicted remuneration and business models. The Code also applies to bancassurance models.</p> <p>In practice, adherence to the General Code obligations in relation to conflicts of interest is monitored through on-site visits and specific questions in the FAIS off-site compliance monitoring reports.</p> <p>The current RDR is expected to minimize the inherent conflicts of interest in the current commission-based remuneration model for insurance intermediation. Pending full implementation of the Review findings, the FSB-SA has introduced interim measures to address specific conflicted remuneration models. Information letters in this regard have been issued in relation to certain distribution models where broker support functions are remunerated in a way that could lead to advice bias, as well as in relation to the intended</p> |
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⁴⁵ The lapse and replacement ratios are indicative of whether the advice provided by the FSP was suitable and/or whether the FSP had acted in the best interest of the client.

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| <p>prohibition of certain fees currently paid by insurers over and above commissions.</p> <p>Service of policy</p> <p>The PPRs require that information on contractual changes and salient features are disclosed at inception, during the life-time of the policy and at exit. Contractual changes that trigger specific disclosure obligations include policy loans, cessions, claims, assistance group scheme transfers, and unilateral termination of general insurance policies.</p> <p>The General Code requires ongoing disclosures on a regular basis (at least annually) by means of a written summary, including</p> <ul style="list-style-type: none"> • the main benefits provided by the products, • where any product was marketed or positioned as an investment or as having an investment component, the value of the investment and the amount of such value which is accessible to the client; and • any ongoing incentives, consideration, commission, fee or brokerage payable to the intermediary in respect of such products (<i>General Code; s7(4)</i>). <p>The General Code also provides that where any material or significant changes affecting a client occur, or otherwise where necessary in relation to the advice or service concerned, a disclosure of the changes must be made without delay. In addition, the Code provides that service must be rendered in accordance with the contractual relationship and reasonable requests of the client, which must be executed as soon as reasonable possible and with due regard to the interests of the client.</p> <p>In practice, compliance with PPR and FAIS disclosure obligations are monitored on an ongoing basis through on-site visits and through the off-site FAIS compliance reports.</p> <p>Claims handling and Complaints Management</p> <p>The PPRs places specific requirements on insurers in respect of claims handling. These include specific timelines for various elements of the claims process, including the handling of any claims related disputes (<i>LTIA Rule 16; STIA Rule 7.4</i>).</p> <p>The insurance Binder Regulations also set specific requirements where claims handling are outsourced to a binder holder (third party with authority to make decisions binding on the insurer). The Outsourcing Directive's requirements would apply to other service providers to whom aspects of claims assessment or settlement are outsourced.</p> <p>The PPR's require all insurers, including direct marketers, to provide policyholders within a reasonable time after contract commencement of details of any available internal complaint resolution systems and procedures. It also requires insurers to provide details of the manner in which complaints must be lodged and the particulars of the Short-term Insurance Ombudsman and Long-term Insurance Ombudsman (<i>Rule 16 for Long-term insurers; and Rule 7.4 for Short-term insurers</i>).</p> <p>The General Code contains comprehensive requirements relating to handling complaints in a timely and fair manner. A FSP must maintain an internal complaint resolution system</p> |
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and procedures based on the following:

- Maintenance of a comprehensive complaints policy outlining the provider's commitment to, and system and procedures for, internal resolution of complaints;
- Transparency and visibility: ensuring that clients have full knowledge of the procedures for resolution of their complaints;
- Accessibility of facilities: ensuring the existence of easy access to such procedures at any office or branch of the provider open to clients, or through ancillary postal, fax, telephone or electronic helpdesk support; and
- Fairness: ensuring that a resolution of a complaint can during and by means of the resolution process be effected which is fair to both clients and the provider and its staff (*Code paras. 16-18*).

An FSP is further required to handle complaints from clients in a timely and fair manner and to take steps to investigate and respond promptly to such complaints. It must further where a complaint is not resolved to the client's satisfaction, advise the client of any further steps which may be available to the client in terms of the Act or any other law.

The voluntary Insurance Ombudsman schemes essentially deal with customer complaints against product suppliers (insurers) who are voluntary members. The voluntary Ombudsman have no jurisdiction over brokers. Most of the insurers offering insurance policies are members of the voluntary ombud schemes who publish individual insurer complaints data. The publication is done to promote transparency and to encourage the insurers to benchmark their standards of complaints handling with other insurers.

The FAIS Ombud was introduced in 2004 to adjudicate on complaints against FSPs (including advice and intermediary services by both insurers' agents and brokers). The FAIS Ombud, in its capacity as the statutory ombud, can also deal with complaints against financial institutions that do not fall within the jurisdiction of any other ombud scheme or where there is uncertainty over jurisdiction. If a product supplier withdrew from the voluntary scheme they would automatically be caught in the statutory net. All brokers fall under the statutory jurisdiction of the FAIS Ombud.

Despite the revisions to the ombud system, it was observed that the fragmented nature of the system (combination of statutory and voluntary schemes) poses some confusion for policyholders and also risks and inconsistencies in the approach. As part of the TCF implementation, complaints management requirements are in the process of being strengthened and more detailed complaints reporting requirements are also being introduced.

The existing statutory returns require reporting of some claims data. In practice, the FSB-SA reviews claims handling process, including information regarding claims rejections and disputes, during on-site visits. The FSB-SA is currently in the process of conducting a thematic review – comprising both on-site visits and off-site questionnaires—of insurers' complaints/claims management processes and practices. Complaints data and qualitative inputs from the various Ombud schemes are also reviewed to identify trends in relation to volumes and types of complaints, including in relation to claims disputes.

The proposed quarterly Conduct of Business return will require detailed statistics on claims, including claims ratios, claims rejections, and claims processing in relation to different types of products, customers and distribution models. As part of the TCF implementation, complaints management requirements are being strengthened and more detailed complaints reporting requirements are also being introduced. Initial consultation on these requirements has already taken place.

Privacy Protection

The General Code prohibits FSPs from disclosing any confidential information acquired or obtained in respect of a client unless written consent of the client has been obtained beforehand or disclosure of the information is required in the public interest or under any law (*Code s3(3)*).

The disclosure of information is also regulated under the recently enacted Protection of Personal Information Act. This Act brings South Africa in line with international data protection laws and at the same time protects personal information collected and processed by public and private organisations. However, this Act is in waiting commencement and all FSPs (including insurers) are taking preparatory measures to implement the Act.

Supervisory Disclosure supporting TCF

The FSB-SA frequently issues media releases to warn the public against, amongst others, unregistered operators or entities that are contravening legislation. It has established a dedicated Consumer Education Department that has various initiatives in place to educate consumers, including on insurance related matters.

Ongoing Regulatory Initiatives:

The FSB-SA is implementing an approach to market conduct regulation and supervision informed by the TCF concept. The TCF approach seeks to ensure that fair treatment of customers is embedded within the culture of regulated entities. It will use a combination of market conduct principles and explicit rules to drive the delivery of clear and measurable fairness outcomes, such that customers are confident that they are dealing with firms where the fair treatment of customers is central to the firm culture. Work underway to further entrench these principles in legislation. The TCF approach requires the following outcomes:

1. Customers can be confident they are dealing with firms where TCF is central to the corporate culture.
2. Products and services marketed and sold in the retail market must be designed to meet the needs of identified customer groups and targeted accordingly.
3. Customers must be given clear information and be kept appropriately informed before, during and after the time of contracting.
4. Where customers receive advice, this must be suitable and must take account of their circumstances.
5. Products perform as firms have led customers to expect, and service is of an acceptable standard and as they have been led to expect.
6. Customers do not face unreasonable barriers imposed by firms to change product, switch providers, submit a claim or make a complaint.

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| | <p><i>Market Conduct under Twin Peaks</i></p> <p>New supervisory tools are expected to enhance conduct of business in South Africa. Tools include “mystery shopper” techniques, sourcing information from third parties such as intermediaries, suppliers, media, ombud schemes and consumer bodies, consumer and industry surveys. These will be supported by enhanced reporting requirements from regulated institutions.</p> |
| Assessment | Largely Observed |
| Comments | <p>The FSB-SA has most of the necessary requirements for the conduct of business of insurance to see that customers are treated fairly throughout the product cycle. There are processes in place to review that customers are treated fairly, both before a contract is entered into and through to the point at which all obligations under a contract have been satisfied. The authorities are addressing the current regulatory gaps by engaging with market participants to improve conduct of business practices. The implementation of the TCF initiative is currently underway and implementation progress is reported in the FSB-SA annual report.</p> <p>The authorities have embarked on the RDR aimed at strengthening the CoB regime to address structural issues e.g., in the areas of commission and conflict of interest. In addition, the FSB-SA has drafted a Conduct of Business Return, which will require insurers to regularly report key indicators of TCF outcomes (including statistics on lapses and surrenders, claims ratios, complaints, etc.). Furthermore, the proposed Board Notice to enhance governance requirements for insurers will improve management of risks relating to unfair policyholder treatment.</p> <p>The shortcomings include a lack of requirements for insurers and FSPs to establish and implement policies and procedures on the fair treatment of customers and improve legislation to take into account the interests of different types of customers when developing and marketing insurance products. Authorities are also working on enhancing management of conflict of interests, claims and ombudsman services and on protection of private information on customers.</p> <p>The authorities are advised to expedite the current CoB initiatives which will address the following gaps:</p> <ol style="list-style-type: none"> a) explicitly require insurers to take into account the interests of different types of customers when developing and marketing insurance products; b) provide explicit conduct of business requirements on insurance product development and provide the supervisor with the authority to require notification of certain types of new insurance products and prohibit certain products that do not meet prescribed standards; c) have appropriate governance framework on strengthening conflict of interest; and d) review the adequacy of supervisory resources of FSB-SA to effectively implement the TCF regime, more proactive CoB supervisory approach and fine tuning the regulatory policies in light of actual supervisory experience. |

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| ICP 20 | <p>Public Disclosure</p> <p>The supervisor requires insurers to disclose relevant, comprehensive and adequate information on a timely basis in order to give policyholders and market participants a clear view of their business activities, performance and financial position. This is expected to enhance market discipline and understanding of the risks to which an insurer is exposed and the manner in which those risks are managed.</p> |
| Description | <p>The Insurance Acts do not have specific public disclosure requirements. However, the CA requires all public companies to comply with IFRS, which partly addresses the disclosure standards under this ICP. Only one mutual insurer is not a public company.</p> <p>The Insurance Acts require insurers that are not public companies to submit audited financial statements prepared in accordance with the CA to the FSB-SA. While disclosure by the supervisor is not considered public disclosure by insurers, annual statutory returns of insurers (excluding commercially sensitive information) may be made available to the public by the FSB-SA, on request. These include high level information on governance (such as directors, senior management and members of the audit committee), assets, technical provision and other liabilities and the solvency ratio which reflects the capital required. However, the methods and assumptions used in preparing information are not made available to the public. The FSB-SA's annual reports provide aggregate industry information. This is published and is available to the broader public.</p> <p>Insurers that are listed on the JSE disclose more information in accordance with the JSE Listings Requirements. Listed insurers report public information on the external environment in which an insurer/insurance group operates as well as the objectives and strategies of the insurer/insurance group.</p> <p>Ongoing Regulatory Initiatives</p> <p>Under the SAM framework, public disclosure requirements will be established as part of Pillar III requirements. The Insurance Bill is expected to introduce public reporting requirements and further enhance statutory reporting obligations.</p> |
| Assessment | Partly Observed |
| Comments | <p>The Insurance Acts do not have explicit public disclosure requirements, although the adoption of IFRS partly addresses the standards under this ICP. Unless an insurer is listed, there is no obligation to make the financial statements available to persons other than persons that have a beneficial interest in the insurer. The FSB-SA does not monitor the disclosures made by insurers to market participants. Under the SAM framework, public disclosure requirements will be established as part of Pillar III requirements.</p> <p>It is recommended that authorities establish explicit public disclosure requirements in line with ICP 20 that are applicable to all insurers and provide clear legal authority to the FSB-SA to supervise compliance with the requirements.</p> |
| ICP 21 | <p>Countering Fraud in Insurance</p> <p>The supervisor requires that insurers and intermediaries take effective measures to deter, prevent, detect, report and remedy fraud in insurance.</p> |

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| Description | <p>Legal Framework</p> <p>The Insurance Acts do not expressly address insurance fraud. However, fraud in general constitutes a criminal offence under the common law and is prosecuted as such. The Criminal Law Amendment Act imposes minimum sentences⁴⁶ for the offences of fraud, forgery and uttering a forged document where the amounts involved exceed R500 000. Prejudicing an investigation into any criminal offence is also an offence.</p> <p>At the time of assessment, the FSB-SA did not have explicit legislative powers to require insurers and FSPs to take effective measures to address potential fraud risks. Nonetheless, the General Code requires FSPs to have and effectively employ resources, procedures and appropriate technological systems that can reasonably be expected to eliminate the risk that clients, product suppliers etc, will suffer financial loss (and the FSB-SA considers that this implicitly includes losses arising from fraud). The FSB-SA requires insurers to allocate appropriate resources and implement effective risk prevention procedures and controls to safeguard their financial soundness and considers this to implicitly include anti-fraud measures.</p> <p>Industry Collaboration</p> <p>Insurers in South Africa have a keen interest to prevent and mitigate potential losses arising from insurance frauds. Some insurers engage the services of external investigators, particularly to identify/ascertain inflated or fraudulent claims. In addition, the South African Insurance Crime Bureau has been established by the insurance industry to provide a database of insurance fraud, and to promote the exchange of information and training to combat insurance fraud.</p> <p>Supervisory practices</p> <p>The FSB-SA does not have legislative authority to make and enforce specific rules or regulations relating to insurance fraud. However, it refers any fraud (not only insurance related fraud) to the appropriate enforcement authorities.</p> <p>The EO or the DEO of the FSB-SA may disclose information, if in their opinion, disclosure is appropriate for purposes of: warning the public against conducting business with a financial institution or other person conducting activities in contravention of legislation; alerting the public to activities carried out by financial institutions which constitute a potential risk to consumers; and developing and implementing policies and activities to deter, prevent, detect, report and remedy fraud or other criminal activity in relation to financial services. (<i>FSBA s22</i>)</p> <p>The FSB-SA has a good understanding of the common types of insurance fraud in South Africa e.g., fraudulent claims from cash-back hospitalization or assistance/funeral policies, and unauthorised intermediary services. Through its risk-based supervisory approach, the FSB-SA discusses fraud prevention measures with insurers and FSPs. However, there have not been any thorough assessments of the adequacy of their</p> |
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⁴⁶ In the case of a first offender, the punishment is 15 years or more. In the case of a second offender, the sentence is 20 years or more and in the case of any subsequent offender, the sentence is 25 years or more.

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| | <p>systems and controls used to manage insurance fraud risks.</p> <p>On-going regulatory initiatives</p> <p>The FSB-SA proposed to issue a Board Notice requiring an insurer to implement risk management policies that must incorporate an explicit insurance fraud risk management policy, which:</p> <ol style="list-style-type: none"> outlines appropriate strategies, procedures and controls to deter, prevent, detect, report and remedy insurance fraud; effectively manage fraud risk; and provides for the prompt reporting of insurance fraud to the relevant authorities. |
| Assessment | Partly Observed |
| Comments | <p>The FSB-SA has minimal direct legislative powers in respect of insurance fraud. Nonetheless, fraud in general constitutes a criminal offence under the common law and the Criminal Law imposes sanction against fraud. Although not specifically required in legislation, the FSB-SA expects insurers to implement effective risk prevention procedures and controls, which implicitly covers insurance fraud risks. FSPs are required to address risks (including fraud risks) that result in financial loss to clients and others. The FSB-SA checks whether insurers and FSPs have implemented fraud prevention measures although there has not been a thorough examination in this area.</p> <p>The Board Notice proposed by the FSB-SA will require insurers to establish an explicit insurance fraud risk management policy including prompt reporting to the relevant authorities, in line with ICP 21.</p> |
| ICP 22 | <p>Anti-Money Laundering and Combating the Financing of Terrorism</p> <p>The supervisor requires insurers and intermediaries to take effective measures to combat money laundering and the financing of terrorism. In addition, and the supervisor takes effective measures to combat money laundering financing of terrorism.</p> |
| Description | <p>The last assessment on South Africa's AML-CFT, conducted in 2008,⁴⁷ noted that it has a relatively strong legal framework although the effectiveness of the implementation could not be established. The assessment also found a large number of serious technical shortcomings with respect to preventive measures across the range of financial institutions. Since the evaluation, South Africa took some steps to address the deficiencies identified, including by amending the Financial Intelligence Centre Act (FICA) to strengthen FSB's supervisory powers with respect to AML/CFT and improve the sanction regime for non-compliance with AML-CFT requirements and strengthening of fit-and-proper requirements for financial service providers (FSP) and insurance providers. At the time of assessment, draft amendments to the FICA, which are expected to close most of the legal gaps with respect to AML/CFT preventive measures and supervision of the financial sector and to introduce a risk-based approach (RBA) to these aspects, were undergoing public consultation.</p> |

⁴⁷ The assessment was conducted jointly by the FATF and the Eastern and Southern Africa Anti-Money Laundering Group against the 2003 AML-CFT standard.

Legal and Institutional framework

The legislative framework of the AML-CFT regime comprises the FICA, the Money Laundering and Terrorist Financing Control Regulations (MLTFC Regulations) and Exemptions in Terms of the Financial Intelligence Centre Act. Financial institutions covered by the FICA (accountable institutions) included long-term insurers and FSPs (except short-term insurance intermediary services). Short term insurers are not accountable institutions (*FICA Schedule 1 and Schedule 2*).

The National Treasury coordinates AML/CFT efforts at the national level with substantive support from the FIC. The FIC is a statutory body established under the FICA (accountable to the Minister of Finance) acting as the financial intelligence unit (FIU) of South Africa. It is a member of the Egmont Group of Financial Intelligence Units. A Counter-Money Laundering Advisory Council was established in 2001 under the FICA to advise the Minister on AML-CFT policies and best practices and the exercise by the Minister of the powers entrusted under the FICA. The Council has been inactive and is likely to be abolished under the pending legislation. The South African Police Service is the main agency that is responsible for investigating money laundering and terrorist financing and referring cases to the National Prosecution Authority for prosecution.

The FSB-SA is one of the designated supervisory authorities under the FICA, responsible for ensuring compliance with FICA by accountable institutions under its purview. It is empowered to appoint an inspector to conduct inspections (on-site visit for FSB) on AML-CFT matters. However, an inspection that is not a routine inspection can only be conducted after consultation with the FIC (*FICA s45, s45B(6)(b), s26(2)*).

FICA sets high-level legal obligations on accountable institutions to:

- a) Identify clients before establishing a business relationship or concluding a single transaction (*FICA s21*);
- b) Keep records on business relationship and transactions for at least 5 years after termination of business relationship or conclusion of transactions (*FICA s22, s23*);
- c) Have free and easy access to the records kept by third parties (*FICA s24*);
- (b) Report cash transactions or electronic transfers of money above the prescribed amount (*FICA s28, s31*);
- (c) File suspicious transaction reports (*FICA s29*);
- (d) Formulate and implement internal rules to comply with FICA (*FICA s42*); and
- (e) Provide training and appoint a compliance officer (*FICA s43*).

The FICA, the Insurance Acts and the FAIS Act authorise the FSB-SA to issue directives to long-term insurers and FSPs in consultation with the FIC. The FIC is authorised under the FICA to issue general directives and guidelines to long-term insurers on the application of the FICA. To date, only the FIC has issued directives and guidelines that apply to all accountable institutions. The FIC has issued two directives on registration matters relating to accountable institutions. The authorities explained that Guidance Notes issued by FIC are legally enforceable with reference to the specific provision in the FICA e.g., cash threshold reporting. However, certain sections of the other guidelines are not legally enforceable (e.g., due diligence requirements on politically exposed persons) because the legal provisions are still pending. The FSB-SA has not established

supervisory guidance on AML/CFT requirements applicable to insurers and insurance intermediaries.

Coordination, cooperation and exchange of information

The FSB-SA's legal powers to share information with local and foreign authorities are outlined in ICP 3. In addition, the FICA allows the FIC to obtain information from the FSB-SA to identify proceeds of unlawful activities and to achieve its objectives. FIC and FSB-SA are also expected to co-ordinate their approach to exercising their powers and performing their functions under the FICA (*FICA s36, s45(1D)*).

The FSB-SA has entered into a MoU with the FIC. The MoU formalises the manner in which the FSB-SA and the FIC will coordinate and exchange information. Furthermore, the FSB-SA and other domestic regulators attend quarterly FIC Enforcement Forum for the purpose of exchanging information.

Information obtained under the FICA, other than information obtained during supervision or inspection, may be disclosed only to authorities (including supervisory authorities) specified. Disclosure to another FIU may only be provided pursuant to a written agreement and subject to reciprocity. No person may disclose confidential information obtained from the FIC except: a) within the scope of that person's powers and duties; b) for carrying out the provisions of the FICA; c) with the permission of the FIC; for the purpose of legal proceedings, or d) by an order of court (*FICA, s40 and s41*).

Supervisory practices

South Africa has not completed a national assessment of ML/FT risks. Nonetheless, the FSB-SA has a good understanding of the ML-FT risks in the insurance sector. The resources and expertise of the Insurance Compliance Department in respect of AML-CFT supervision have been enhanced. Staff of the FSB-SA attends FATF meetings to learn about AML-CFT typologies in the insurance and intermediary sectors to update their understanding of ML-FT risks.

The FSB-SA requires insurers and FSPs, as part of their annual statutory returns and compliance reports, to submit information on AML-CFT matters such as the number of suspicious transactions reports that were submitted to the FIC directly. Assessing the compliance by long-term insurers and intermediaries with their AML-CFT obligations is embedded in the FSB-SA's risk-based supervisory approach.

The Insurance Division conducted 12 AML-CFT on site visits on insurers in 2012/13 and no systemic ML-FT risk was identified and no regulatory action was taken against insurers. During 2012/13, the FAIS Supervision Department performed 399 AML/CFT on-site visits, of which 95 reports have been followed up to remedy minor findings identified, and one report was referred to the Enforcement Unit of the FSB-ASA for further investigation. During the on-site visits, supervisors ascertain that: insurers/FSPs have a nominated officer to take responsibility for compliance; employees have been provided with appropriate training; the necessary AML/CFT policies and procedures are in place; a proportionate risk-based approach had been adopted to combat and prevent money laundering risk; and that they exercise their obligations to submit suspicious transactions to the FIC appropriately (*FICA s45A, s45B*).

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| | <p>The FSB-SA reviews the effectiveness of its own measures annually during strategic business planning sessions. Its written reports to FIC on any action taken against regulated entities are used as inputs in its annual review of implementation of the FICA. The FIC may share suspicious transactions reports with the FSB-SA selectively for follow-up although no such reports were forwarded to the FSB-SA in 2012/13.</p> <p>On-going regulatory initiatives</p> <p>The FSB-SA will issue a Board Notice requiring long-term insurers to develop and implement an explicit AML-CFT policy that: outlines appropriate strategies, procedures and controls to deter, prevent, detect, report and remedy ML and FT; provides for the prompt reporting of AML-CFT matters to relevant regulatory authorities; and provides for the matters as may be prescribed.</p> |
| Assessment | Partly Observed |
| Comments | <p>The legislative framework of the AML-CFT regime comprises the FICA, the MLTFC Regulations and Exemptions in Terms of the FICA. The AML-CFT regime covers long-term insurers and FSPs. The FIC has issued directives and Guidance Notes relating to the AML-CFT obligations of accountable institutions. However, some parts of the guidelines issued by the FIC are not legally enforceable due to the current legal gaps in the AML-CFT regime.</p> <p>The FSB-SA is a designated AML-CFT competent authority and is empowered to conduct AML-CFT on-site inspections and impose administrative sanctions. Assessing the compliance by long-term insurers and FSPs with their AML-CFT obligations is embedded in the FSB-SA's risk-based supervisory approach. The FSB-SA has sufficient resources to carry out its AML/CFT mandate. Insurers and FSPs submit suspicious transactions reports to the FIC directly. The FSB-SA is authorized to cooperate and exchange information with relevant authorities (ICP 3) and has a MoU with the FIC. However, disclosure of information to a foreign FIU may only be provided pursuant to a written agreement and subject to reciprocity.</p> <p>The proposed Board Notice will enhance measures that insurers must take in respect of managing risks associated with ML-FT. In addition, the authorities are advised to:</p> <ol style="list-style-type: none"> a) Expedite the passage of the amendments to the main AML-CFT legislation to address the remaining technical deficiencies in the AML-CFT regime; b) Consider how best to improve supervisory coordination and engagement of the industry to facilitate effective compliance by insurers and FSPs with their AML-CFT obligations; and c) Periodically assess the potential ML-FT risk in the short-term insurance industry to take account of evolving ML-FT typologies and consider whether to apply the FATF standards to short-term insurance. |
| ICP 23 | <p>Group-wide Supervision</p> <p>The supervisor supervises insurers on a legal entity and group-wide basis.</p> |

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| Description | <p>Background</p> <p>The FSB-SA has been developing its approach to group supervision in the past few years. In its original policy document published in 2011, <i>A safer financial sector to serve South Africa better</i>, the government acknowledged that the financial sector is globally integrated but regulated nationally and launched a formal review of South Africa's financial regulatory system.</p> <p>As envisaged under the Twin Peak supervisory structure, coordinated conglomerate supervision is pivotal to a twin peaks regulatory framework, especially where financial group includes banking, securities and insurance businesses. Such supervision is being developed as part of a financial stability focus and is expected to be coordinated with the market conduct regulator to address market conduct risks in conglomerates.</p> <p>The FSB-SA acknowledges that due to the dominance and interconnectedness of the major financial conglomerates in the South African market, one of the biggest risks to the stability of the insurance sector is a failure of one of the major banks in the banking sector.</p> <p>Legislative Authority</p> <p>As at the time of assessment, the FSB-SA had no direct powers in the Insurance Acts in relation to group-wide supervision. Despite the lack of legislation, the FSB-SA has conducted limited scope group-wide supervision through its current informal approach and the willing participation of the insurance groups. Until the legislation is in place, the FSB-SA continues to request information relating to insurance groups indirectly through insurers under the authority afforded to the FSB-SA in the Insurance Acts (<i>Insurance Act s4</i>).</p> <p>Scope of the group subject to group-wide supervision</p> <p>Despite the informality, the FSB-SA cooperates and coordinates group supervision with the SARB frequently. The FSB-SA and the BSD determine which groups constitute a financial conglomerate. The SARB will serve as the group-wide supervisor in cases where a bank is the controlling company. The FSB-SA serves as the leading group-wide supervisor where the head of the group is not a bank controlling company.</p> <p>Definition of insurance group</p> <p>The informal definition that is applied to determine an insurance group is as follows:</p> <p style="padding-left: 40px;">"A group is considered to be an insurance group for the purpose of group-wide supervision if there are two or more entities of which at least one is an insurer and one has significant influence on the insurer. The significance of influence is determined based on criteria such as participation, influence and/or other contractual obligations, interconnectedness, risk exposure, risk concentration, risk transfer and/or intra-group transactions. The scope of the group is limited to those entities falling under the holding company that is the ultimate holding company in South Africa."</p> <p>The IFRS principles on consolidated accounts are used to determine the scope and inclusion of entities within the definition of an insurance group, which essentially</p> |
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| | <p>includes subsidiaries and associates. The assessment of significant influence is required to be consistent with the consolidated accounts. The FSB-SA considers significant influence as evidenced by: representation on the Board of directors; participation in the policy-making process; material transactions between entities; interchange of managerial personnel; management on a unified basis; and potential voting rights.</p> <p>In deciding which entities⁴⁸ are relevant, consideration is given to:</p> <ul style="list-style-type: none"> ▪ non-operating holding company (including intermediate holding companies) incorporated in South Africa; ▪ insurers (including subsidiary insurers); ▪ other regulated entities, such as banks and/or securities companies; ▪ non-regulated entities (including parent companies, their subsidiary companies and companies substantially controlled or managed by entities within the group); and ▪ Special purpose entities. <p>Group-wide supervision</p> <p>To date, the FSB-SA's approach is relatively informal and relies, in respect to certain quantitative information gathering on groups and follow-up action, on the general authority and standing of the regulator rather than specific legislative provisions. Group reporting standards are relatively undeveloped. The scope of group supervision extends to the insurance group holding company level within South Africa only and includes financial conglomerates (i.e., where the group includes one or more insurance companies and another financial institution).</p> <p>The FSB-SA currently requests the larger insurance groups and conglomerates to submit quarterly unaudited returns on a group-wide basis. The FSB-SA also performs an annual solvency calculation on a group-wide basis for these insurance groups (ICP 17).</p> <p>The FSB-SA has over the past two years applied its risk-based supervisory approach to insurance groups but on a limited basis. Although the information on inter-connectedness and cross-shareholdings is received and analysed to assess group exposure, to date, only a few large insurance groups have undergone an on-site risk assessment.</p> <p>The FSB-SA has also attended various external supervisory colleges in the UK with the Prudential Regulatory Authority and in Switzerland with FINMA to discuss the foreign insurance or conglomerate groups operating abroad. The FSB-SA is coordinating the Sub-Sahara Regional Supervisory Group for the African insurance groups. The FSB-SA together with SARB formed quarterly cross-sector supervisory colleges in order to discuss the major domestic banking and insurance groups.</p> |
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⁴⁸ Insurers, other regulated entities, non-regulated entities and special purpose entities include both South African entities and entities outside South Africa, which fall under the NOHC incorporated in South Africa.

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| | <p>Group-wide market conduct</p> <p>The required legislative framework is not yet in place. However, the FSB-SA is able to request information relating to group market conduct issues indirectly through insurers under the authority afforded to the FSB-SA in the Insurance Acts (the Acts s4).</p> <p>Ongoing Regulatory Initiatives</p> <p>The proposed Board Notice and the Twin Peaks Bill will introduce insurance group supervision. The Board Notice proposal includes a clear definition of an insurance group and the approach to calculating the financial condition of the group. As the proposed statutory provisions will be incorporated into the current insurance legislation, the same remedial action that can be taken against a solo entity will also apply to an insurance group. The FSB-SA will act as insurance group supervisor for the entirety of groups domiciled in South Africa, except for those groups where the SARB is the group supervisor i.e., where the head of the group is a bank controlling company.</p> |
| Assessment | Partly Observed |
| Comments | <p>The FSB has been developing its approach to group supervision in the past few years. Currently, there are no explicit powers to conduct group-wide supervision. In practice, group-wide supervision is informal and relies, in respect to information gathering on groups and follow-up action, on the FSB-SA's general authority and standing rather than on specific legislative provisions. Despite the informality, the FSB-SA has been able to cooperate and coordinate conglomerate supervision with the SARB on systemic issues on a regular basis.</p> <p>To date, the FSB-SA has focussed on a few large conglomerates and its supervision relies mainly on some financial indicators. The FSB-SA is developing standardized regulatory reporting to assess the broader group risks and risk mitigants, corporate governance, reporting arrangements and market conduct issues.</p> <p>It is recommended that authorities establish clear and consistent regulatory regime for group-wide supervision to provide:</p> <ol style="list-style-type: none"> a) explicit powers for the FSB-SA to: <ul style="list-style-type: none"> • enforce group-wide supervision requirements (including reporting requirements) for unregulated companies, including holding companies; • refuse or revoke authorization where a firm's ownership links may prevent effective group supervision; • approve intra-group transactions and cross-shareholdings to prevent concentration risk, risk of contagion, and double gearing of capital; b) regulatory reporting at both solo and consolidated levels for all insurance groups; c) a more formal risk assessment program for heads of group; and d) group-wide market conduct requirements. <p>It is important for the authorities to ensure effective implementation of the group supervision framework supported by adequate supervisory resources with appropriate skills. In addition, cross-sectoral coordination mechanisms could be enhanced and formalised, particularly with respect to groups dominated by securities entities.</p> |

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| ICP 24 | <p>Macroprudential Surveillance and Insurance Supervision</p> <p>The supervisor identifies, monitors and analyses market and financial developments and other environmental factors that may impact insurers and insurance markets and uses this information in the supervision of individual insurers. Such tasks should, where appropriate, utilize information from, and insights gained by, other national authorities.</p> |
| Description | <p>The FSB-SA uses various sources of information to identify, monitor and analyze market and financial developments and other environmental factors that may impact insurers and insurance markets:</p> <ul style="list-style-type: none"> a) Supervisory information and unaudited quarterly statutory returns. The information is used as inputs for the quarterly reports on the long-term and short-term insurance markets. This analysis assists in determining any evolving risks and trends in the insurance sector; b) Quarterly unaudited returns from insurance groups that are considered to be of systemic importance, on a group-wide basis. These returns are analyzed to a limited extent in terms of the macroprudential impact; c) SARB quarterly Financial Stability Review reports highlight local and international economic indicators and developments, main financial indicators for financial institutions and the major risks and to the South African financial system. On a quarterly basis, a presentation and write-up is provided to supervisory staff on the industry results and issues identified in the reports, which informs the risk ratings and assessments of insurers; and d) Other sources of information such as rating agency reports, media releases etc. <p>Based on the information available, an industry analyst in the FSB-SA would prepare/update sections notes on the operating environment of the insurance industry, which are inputs for the FSB-SA's risk-based assessment of insurers. The section notes cover global economic environment, key economic indicators in South Africa, the operating environment and outlook for the insurance industry. The analysts also present their key observations to the insurance supervisors on a quarterly basis.</p> <p>In the analysis of an insurer's annual or quarterly return, comparisons are made to that insurer's peer group as well as the market as a whole. The annual reports of the FSB-SA provide insurer-specific and aggregate information about the financial situation of the insurance sector and observations on major developments in the sector.</p> <p>The above macro-analysis informs the FSB-SA's assessment of the extent to which macro-economic vulnerabilities and financial market risks (both local and international) impinge on the financial condition of insurers and the stability of the insurance sector as a whole. In this regard, the FSB-SA considers the impact of risks to global financial stability on the South African insurance market. For example, in response to the European sovereign debt crisis, the FSB-SA and the SARB issued a joint information request to the major groups in the insurance and banking industry on information on their exposures to various EU states. Following the financial crisis in 2008/2009, the FSB-SA introduced stress testing requirements for the insurance industry (ICP 16).</p> <p>At the time of assessment, there is no formal process to assess the potential systemic importance of insurers, including policies they underwrite and instruments they issue in traditional and non-traditional lines of business. Nonetheless, the FSB-SA has established</p> |

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| | <p>a dedicated Insurance Group Supervisory Department in 2011. The focus of this Department is to undertake more intensive and intrusive supervision of the major and potentially systemic insurance groups. The FSB-SA recognised that the South Africa insurance market is very concentrated and most of the large insurers/insurance groups have significant interconnectedness in the financial system. Under the risk-based supervisory approach, the FSB-SA would form good understanding of the business models and significant activities as well as the related risks of these insurers/ insurance groups, which are reflected in the risk assessment document.</p> <p>On-going regulatory initiatives</p> <p>The Financial Sector Regulation Bill will establish the Twin Peaks supervisory architecture and the SARB will serve as the macro prudential regulator through a financial stability oversight committee.</p> |
| Assessment | Largely Observed |
| Comments | <p>The FSB-SA uses information from its supervisory analysis and external sources to identify/assess the extent to which macro-economic vulnerabilities and financial market risks (both local and international) impinge on the financial condition of insurers and the stability of the insurance sector as a whole. While there is no formal process to assess the potential systemic importance of insurers, the FSB-SA supervises the major and potentially systemic insurance groups more closely. Under the proposed Twin Peak supervisory structure, the SARB will serve as the macro-prudential supervisor.</p> <p>The authorities are advised to formulate macro-prudential surveillance framework appropriate to the nature, scale and complexity of the insurance sector under the Twin Peaks supervisory structure. The considerations include:</p> <ul style="list-style-type: none"> d) Developing more robust indicators for assessing systemic risk of insurers and reinsurers; e) Taking account of cross-sectoral linkages e.g., cross-shareholdings across the sectors, <i>bancassurance</i>, linked policies; and f) Inclusion of risks arising from system-wide market conduct issues, including reputational risks. |
| ICP 25 | <p>Supervisory Cooperation and Coordination</p> <p>The supervisor cooperates and coordinates with other relevant supervisors and authorities subject to confidentiality requirements.</p> |
| Description | <p>Legal authority</p> <p>The FSB-SA's powers to exchange information and cooperate with domestic and foreign regulatory authorities are outlined in ICP 3. Supervisory cooperation and coordination in respect of insurance groups relies on the general authority and standing of the FSB-SA, in the absence of a formal legal framework. The FSB-SA has been able to obtain information from insurance groups (including non-regulated entities) indirectly via the regulated entities.</p> <p>The FSB-SA is empowered to enter into MoUs to:</p> <ul style="list-style-type: none"> a) co-ordinate and harmonize the reporting and other obligations of financial institutions; |

- b) provide mechanisms for the exchange of information including adverse assessments in a financial institution or significant problems within a financial institution;
- c) provide procedures for the coordination of supervisory activities to facilitate the monitoring of financial institutions on an on-going basis including on-site visits or inspections;
- d) assist any regulatory authority in regulating and enforcing any laws that are similar to Financial Services Board legislation (*FSBA s22(3)*).

Domestic coordination and cooperation

A working bilateral framework between the FSB-SA and the SARB is in place. The working framework is governed by a bilateral MoU to initiate dialogue on issues relating to the major financial services groups as well as joint enforcement matters and systemic issues. The FSB-SA and the SARB determine which groups constitute a financial conglomerate and agree on the lead supervisor. A recent example on supervisory coordination was the joint on-site reviews of selected insurance groups' activities related to unsecured lending.

Since 2010, the FSB-SA and BSD established frequent supervisory meetings for the five largest banking and insurance groups. A more formalized supervisory coordination arrangement is adopted for supervisory cooperation and information exchange in respect of group structures, group solvency assessments, intra-group transactions, risk concentration and governance.

The cooperation of the SARB and the FSB-SA with the NCR has not changed fundamentally since the previous FSAP in 2010, except for specific projects to address issues of mutual concern. The authorities plan to formalize the coordination relationship with the NCR by including the NCR in the current bilateral MoU.

Regional and international Cooperation

The FSB-SA participates in several supervisory colleges as an involved supervisor. It has signed coordination agreements with respect to these colleges that address information flows between involved supervisors, communication with the head of the group, convening periodic meetings of involved supervisors and comprehensive assessment of the group.

The FSB-SA hosted the first supervisory college with the SARB and other regional supervisors for one major insurance group in 2013.⁴⁹ Agreement was reached on the FSB-SA assuming the role of the group-wide supervisor. The FSB-SA presented on the working of a supervisory college and the roles and responsibilities of the group-wide supervisor and other involved supervisors. The attendees were requested to sign a confidential and non-disclosure agreement but not a formal coordination agreement. The senior management of the group also presented on the group strategy, financial results and business model. Involved supervisors shared with the college members on

⁴⁹ The decision to have a supervisory college in respect of this group was informed by the extent of the group's international activities, its systemic importance for South Africa and the African region, and the group's strategy to further expand into Africa.

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| | <p>the group's operations in their jurisdictions. The FSB-SA's assessment of the group takes into account the assessment made by the involved supervisors, as far as relevant.</p> <p>The FSB-SA plans to host regional supervisory colleges for other insurance groups for which it is the <i>de facto</i> group-wide supervisor, covering at least four groups with systemic implications. Notably, these groups are not only systemic in the South African market but also systemic in most of the other emerging markets in the Sub-Saharan African region. At these colleges the agreement of the involved supervisors will be obtained for the FSB-SA to act as the group-wide supervisor. The FSB-SA is in the process of formulating the key functions of these colleges. Coordination agreements will also be entered into with the involved supervisors.</p> <p>On-going regulatory initiatives</p> <p>Enhancement of supervisory coordination and cooperation is one of the key objectives of the regulatory reforms for the financial sector outlined in the policy document, <i>A safer financial sector to serve South Africa better</i>.⁵⁰ The bilateral MoU between FSB-SA and SARB also needs to be updated to reflect the division of responsibilities under the Twin Peaks structure as well as to provide for explicit mechanisms for resolving differences in opinion. An informal Council of Financial Regulators was established as a mechanism for enhancing cooperation and information sharing although it has not been meeting actively.</p> <p>In addition, the authorities proposes to establish an explicit legal framework for supervisory cooperation and coordination in respect of insurance groups.⁵¹</p> <ul style="list-style-type: none"> • The FSB-SA must, together with the involved regulatory authorities determine or agree on: the need for a group-wide supervisor; which authority is the group-wide supervisor; the roles and responsibilities of the group-wide supervisor and the other involved supervisors; • Participation in formal or informal structures for cooperation and coordination (such as supervisory colleges); • Entering into cooperation agreements, including the procedures for: the exchange of information on an ongoing basis and in emergency situations; communications with the holding company of an insurance group; convening regular meetings; and conducting comprehensive assessments of the insurance group. <p>Under the proposed framework, the FSB-SA as the group supervisor is required to:</p> <ul style="list-style-type: none"> • initiate suitable coordination arrangements which are proportionate to the nature, scale and complexity of the risks inherent in the insurance group and establish the key functions of these coordination arrangements; |
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⁵⁰ Principle 7 states: "The legislative framework should allow for a lead regulator for every financial institution that is regulated by a multiple set of financial regulators. All regulators involved must strive to coordinate their supervisory activities. Financial institutions are generally regulated or supervised by more than one regulator, often falling under different Ministries. Regulators should be obliged to coordinate their activities, formalized through legislation or MoU. The lead regulator must ensure that effective consultation takes place between regulators, and should not inadvertently undermine other regulators."

⁵¹ Expected to be introduced via the draft Financial Sector Regulation Bill.

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| | <ul style="list-style-type: none"> • act as the key coordinator, convener and chairperson of meetings and supervisory colleges; take the lead in carrying out insurance group supervision; • take into account assessments by relevant regulatory authorities in respect of any person that is part of an insurance group; • coordinate crisis management preparations; and • proactively share information on insurance groups. |
| Assessment | Observed |
| Comments | Despite the lack of a formal framework, the FSB-SA is able to coordinate and cooperate with other relevant supervisors on insurance groups in practice through its general standing and the willing participation of the insurance groups concerned. The FSB-SA has hosted one supervisory college as the group-wide supervisor and plans to host supervisory colleges for four other insurance groups for which it is the <i>de-facto</i> group-wide supervisor. It has signed coordination agreements as an involved supervisor in several colleges. Legislative provisions are pending to enhance the framework for cooperation and coordination in group-wide supervision. |
| ICP 26 | <p>Cross-border Cooperation and Coordination on Crisis Management</p> <p>The supervisor cooperates and coordinates with other relevant supervisors and authorities such that a cross-border crisis involving a specific insurer can be managed effectively.</p> |
| Description | <p>While the FSB-SA has not formally developed plans and tools for dealing with insurers in crisis, it has demonstrated that it is willing and able to share information in a way that does not compromise the prospects of a successful resolution, subject to confidentiality safeguards. This was evident in a recent case where a crisis evolved from the head of the group due to solvency and liquidity challenges and its South African operations was significant to the group. The FSB-SA worked closely with the home supervisor in the development of a plan to assist this insurance group to reorganise its capital resources.</p> <p>There has been no crisis situation in any insurance group for which the FSB-SA is the group-wide supervisor or where a coordinated supervisory solution was not possible. While there have been no instances where the FSB-SA needed to inform the group-wide supervisor of an evolving crisis, the FSB-SA is committed to working with other supervisors in this regard.</p> <p>Official meetings and interactions with other relevant supervisors relating to specific cross-border insurers during <i>non-crisis periods</i> are typically conducted at supervisory colleges. The FSB-SA has not coordinated crisis management preparations formally with other supervisors. At the supervisory college hosted by the FSB-SA, while the potential impediments to a coordinated solution were not specifically addressed, exchange control regulations and investment requirements together with localisation of reinsurance arrangements have been identified as potential impediments. In colleges where the FSB-SA is an involved supervisor, limited focus has been given to the inter-linkages between the insurer and the financial system or the potential impediments to coordinated solution.</p> <p>The current legislative framework does not have explicitly requirements on insurers to be</p> |

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| | <p>capable of providing information required, in a timely fashion, to manage a financial crisis. Nonetheless, the FSB-SA has required insurers to furnish additional information in response to emerging market developments to monitor the potential impact on insurers and the insurance industry. For example, during the European sovereign debt crisis, the FSB-SA and the BSD issued a joint information request to the major financial groups on their exposures to various EU countries, to be submitted quarterly. Following the financial crisis in 2008/2009, the FSB-SA asked the major insurers to perform a stress test to identify any potential risks and requirements were developed following this exercise. Going forward, it is helpful to establish clear policy on the information requirement and key contact points during a crisis, particularly in a group context, so that the timeliness of information will not be affected in an emergency.</p> <p>There are also no explicit requirements on insurers to maintain contingency plans and procedures for use in a going-and-gone-concern situation. Despite the lack of legislative authority, some insurers have been asked to draw up a contingency plan particularly where there is a high level of interconnectedness of the insurance operations within an insurance group.</p> <p>On-going Regulatory initiatives</p> <p>The Financial Sector Regulation Bill proposes to establish a crisis management and resolution framework. A resolution framework provides authorities with the appropriate tools and powers to limit contagion, thereby reducing both the private and public costs associated with a financial crisis. The Bill provides for resolution powers and identifies the SARB as the resolution authority for systemic institutions in South Africa. However, where taxpayers' money is at risk, the Bill provides for crisis management decisions to be taken by the Minister of Finance.</p> <p>The proposed Board Notice on risk management framework will require insurers to include, at least, processes for ensuring adequate contingency planning, business continuity and crisis management.</p> |
| Assessment | Largely Observed |
| Comments | <p>The FSB-SA has demonstrated its ability and willingness to support and participate in resolving crisis situations. However pre-crisis preparation, coordination and cooperation should be enhanced. While the current legislative framework does not hinder cooperation and coordination in a crisis, the gaps noted should be addressed to facilitate more effective cross-border crisis management. In this regard, the proposed Board Notice on risk management frameworks and the proposed crisis management and resolution framework are positive initiatives.</p> <p>It is important that the FSB-SA continues to engage the relevant supervisory colleges on the preparations and common tools for managing a cross-border crisis and identifying (and resolving, as far as practicable) barriers to efficient and internationally coordinated resolutions. The work of the Resolution Policy Working Group would inform the formulation of a crisis management and resolution framework that will deal with cross-border crisis effectively. The framework should explicitly address: plans and tools for dealing with insurers in crisis as well as requirements for insurers to provide information in a timely fashion and to maintain contingency plans and procedures which should be tested and reviewed regularly.</p> |

Appendix I. Status of Implementation of 2010 FSAP Recommendations⁵²

| ICP | Recommendation | Status |
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| 2 | The FSB Act or the legislation on insurance regulation should be amended to set out objectives of regulation in line with the Insurance Core Principles. | An Insurance Laws Amendment Bill ("ILAB") was tabled in Parliament on June 21, 2013. The ILAB proposes amendments to the Long-term Insurance Act No. 52 of 1998 and the Short-term Insurance Act No. 53 of 1998 ("Insurance Acts") to explicitly state the object of the Insurance Act as the promotion of "the maintenance of a fair, safe and stable long-term insurance market for the benefit and protection of policyholders." Due to other legislative priorities, the ILAB was withdrawn in April 2014 and the provisions contained in the ILAB will be given effect through a Board Notice and other means. The Financial Sector Regulation Bill and the Insurance Bill will provide for the objective of supervision. |
| 3 | <p>Strengthening of the framework is recommended:</p> <ul style="list-style-type: none"> i) to enable the FSB-SA to set all major requirements on insurers via board notices without reference to government; ii) to set out causes for which board and executive members may be removed from office and to require publication of the reasons in each case; and iii) to remove provisions in the insurance legislation for the FSB-SA's exercise of certain powers to be subject to Minister of Finance approval. <p><i>In addition, it is recommended that the staff code of conduct is expanded to require employees to notify their manager when they are negotiating employment with a regulated entity.</i></p> | <ul style="list-style-type: none"> i) The recently enacted Financial Services Laws General Amendment Act No. 45 of 2013 (enacted on January 16, 2014, effective from February 28, 2014) amended the Insurance Acts to allow the Registrar to make Policyholder Protection Rules without reference to the Minister of Finance. However, the Minister may under sections 72 and 70 of the Insurance Acts, respectively, make regulations in respect of certain matters. <p>Under the Financial Sector Regulation Bill (that will give effect to the "Twin Peaks" regulatory architecture) the powers of the regulator will also be enhanced. The Bill, however, could be further clarified to ensure that there is no overlap between the regulator and NT in respect of imposing detailed requirements on insurers and other financial institutions. It has been proposed by the FSB-SA that requirements, in the form of Rules, may be prescribed by the FSB-SA to give effect to provisions in legislation.</p> ii) The Financial Services Board Act No. 97 of 1990 does not include explicit procedures for the appointment and dismissal of the Executive Officer or the members of the FSB-SA Board or place an obligation on the Minister to publicly disclose the reasons for dismissal. However, as the decision to dismiss a member of the FSB-SA Board constitutes an administrative decision, a person so dismissed has the protection afforded under the |

⁵² Italicized recommendations were not listed in the table of recommendations but included the detailed assessment under the respective ICPs.

| ICP | Recommendation | Status |
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| | | <p>Promotion of Administrative Justice Act; i.e., the member may insist on reasons for the decision and may take the decision on review. Further, as the Executive Officer (and other members of the Executive of the FSB-SA) is a staff member of the FSB-SA, the Labour Relations Act No. 66 of 1995 applies. The latter Act affords specific protection and remedies to staff against arbitrary decisions.</p> <p>The Financial Sector Regulation Bill places explicit requirements on the Minister regarding the appointment and dismissal of the head of the supervisor and members of its governing body (the Executive Committee). See section 4 of the Bill.</p> <p>iii) The recently enacted Financial Services Laws General Amendment Act amended the Insurance Acts to remove the requirement that the Registrar must seek the approval of the Minister prior to prohibiting an insurer from entering into new business (i.e., placing the insurer in run-off) or applying to Court for the winding-up of an insurer. The FSB-SA's exercises of certain powers are no longer subject to Minister of Finance approval.</p> <p>The FSB-SA's Employees' Human Resources Policies and Procedures promulgated in terms of section 19 of the Financial Services Board Act does not require employees to notify their manager when they are negotiating employment with a regulated entity.</p> |
| 6 | <p>It is recommended:</p> <p>i) that license requirements in the legislation are extended to refer also to the need for adequate governance, internal controls and risk management;</p> <p>ii) that legislation is amended to bring larger friendly societies within the scope of the insurance legislation; and</p> <p>iii) that the introduction of a micro-insurance regime is expedited in order to help bring basic protections to all buyers of insurance.</p> | <p>i) While the Insurance Acts do not currently prescribe specific governance framework requirements, in practice these requirements form part of the considerations that inform a licensing decision through the application of the requirement in section 9 of the Insurance Acts that the applicant must have the organisation or management that is necessary and adequate for the carrying on of the business concerned, combined with the matters that must be addressed in the business plan regarding the system of governance (which requirements provide the Registrar with the means to require an applicant to have a sound governance framework).</p> <p>Following on the enactment of the Financial Services Laws General Amendment Act No. 45 of 2013 that authorizes the Registrar to prescribe a governance and risk management framework for insurers, a Board Notice will be issued in 2014 that provides for specific governance framework (including risk management and internal controls) requirements, for solo insurers. Once enacted these requirements will form a formal, legislated</p> |

| ICP | Recommendation | Status |
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| | | <p>part of licensing considerations.</p> <p>ii) Larger friendly societies will be brought within the scope of the insurance legislation through the legislation that will entrench microinsurance in the legislation as discussed below.</p> <p>iii) In July 2011 the Minister of Finance, through the National Treasury published a policy document titled: "The South African Microinsurance Regulatory Framework". The policy document sets out the policy framework for financial inclusion, in particular the twin policy concerns of promoting better access to formal insurance products while ensuring that consumer protection is strengthened, which intends to achieve the following objectives:</p> <ul style="list-style-type: none"> ▪ Extending access to a variety of good-value formal insurance products appropriate to the needs of the low-income households; ▪ Enabling current informal insurers to provide formal insurance, in the process establishing new, well-capitalised insurers and promoting small business development; ▪ Lowering the barriers to entry to encourage broader participation in the market and promote competition among providers; ▪ Ensuring protection of consumers of microinsurance; and ▪ Facilitating effective supervision and enforcement. <p>The drafting of regulatory and legislative reforms to give effect to the microinsurance framework is in progress.</p> |
| 7 | <p><i>It should consider making formal requirements in relation to statutory actuaries holding other positions in the insurance company.</i></p> <p><i>It may also be preferable for the FSB-SA to be able to take action directly itself against shareholder controllers rather than having to apply to a court.</i></p> <p><i>It is recommended that FSB-SA develop and publish guidance on what criteria it uses to determine fitness and propriety of directors and managers.</i></p> | <p>Statutory actuary</p> <p>Directive 53.A.i (LT) provides that the statutory actuary of a long-term insurer may not simultaneously be the managing director or chairperson of the board of directors, but may be a director of the insurer. At present there are no formal requirements in relation to statutory actuaries holding other positions in short-term insurers. However, sections 22 and 21 of the Insurance Acts, respectively, authorise the Registrar to require an insurer to terminate the appointment of a director, managing executive, public officer, auditor or statutory actuary of that insurer, if the person or firm concerned is not fit and proper to hold the office concerned.</p> <p>The application form for approval of the appointment of a statutory actuary contains a request for information from the statutory actuary on potential conflict of interest that he/she</p> |

| ICP | Recommendation | Status |
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| | | <p>may have relating to the insurer he/she is proposing to act for. The information provided is considered in our decision to approve an appointment or not.</p> <p>The Board Notice referred to under ICP 6 will specifically provide that an insurer must establish and maintain an actuarial function, and that this function may be performed by the statutory actuary. Requirements for control functions, including requirements relating to the reporting structures, independence, resources, expertise, responsibilities and functions of a control function will also be prescribed.</p> <p>Shareholder controllers</p> <p>At present the Registrar must apply to Court to have the shareholding of a significant owner reduced.</p> <p>The Insurance Bill will empower the Registrar, to amongst others, -</p> <ul style="list-style-type: none"> ▪ direct a significant owner to reduce, within a specified period, the proportion of the voting rights or beneficial interest held by that person in the insurer, directly or indirectly, alone or with a related party, to a specified percentage; ▪ direct a significant owner to dispose of, within a specified period, the full beneficial interest held by that person in the insurer, directly or indirectly, alone or with a related party; ▪ limit, with immediate effect, the voting rights that may be exercised by a significant owner by virtue of the proportion of the voting rights or the capital held. <p>Fit and proper requirements</p> <p>The Financial Services Laws General Amendment Act introduced a definition of “fit and proper requirements” into the Insurance Acts. The Insurance Acts therefore define “fit and proper requirements” as including such qualities of competence, integrity and financial standing as may be prescribed by the Registrar by notice in the Gazette. These requirements have not been prescribed yet, but will be prescribed in the near future (the amendment only became effective on February 28, 2014).</p> <p>Pending these requirements being prescribed the information required in the following forms determined by the Registrar and made available on the website of the FSB-SA inform the fit and proper assessments:</p> <ul style="list-style-type: none"> ▪ the application form for registration as an insurer (section 9 of the Insurance Acts); |

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| | | <ul style="list-style-type: none"> ▪ the notification form for the appointment or termination of a director, managing executive or public officer that requires information relating to criminal, financial and supervisory indicators (section 18 of the Insurance Acts); ▪ the application form for the appointment of an auditor or statutory actuary that requires information relating to criminal, financial and supervisory indicators (sections 19, 19A and 20 of the Insurance Acts, respectively); ▪ the application form for a change in shareholding that requires information relating to financial soundness and integrity. The integrity requirements are based on section 9 of the Insurance Acts that requires that the direct or indirect control of the applicant must not be contrary to the interests of policyholders and that the registration must not be contrary to the public interest (which requirements, in combination, are interpreted by the Registrar to mean that the prospective shareholder must be fit and proper – as can be demonstrated by various examples of how this interpretation has been applied). |
| 8 | <p>It is recommended that revisions be made to the legislation to complete the framework of powers—in particular:</p> <ul style="list-style-type: none"> i) to place a requirement on insurance companies themselves to notify the FSB-SA when they become aware of proposed changes of control; and ii) to establish predetermined control levels in law at which further approval of controllers is always required. | <ul style="list-style-type: none"> i) Sections 26(2A) and 25(2A), respectively, of the Insurance Acts (as amended by the Financial Services Laws General Amendment Act) require an insurer to inform the Registrar if a person, directly or indirectly, acquires shares or any other financial interest as referred to in sections 26 and 25 of the Insurance Acts. ii) Sections 26 and 25 of the Insurance Acts, respectively, provide that the Registrar may grant an application subject to the aggregate nominal value or number of a specific class of the shares owned by the person concerned and his, her or its related parties not exceeding such percentage as may be determined by the Registrar without further approval in terms of these sections. Approval of significant increase above the predetermined control levels is therefore not automatically required, but only where the initial approval made the approval subject to this condition. This condition cannot at present be imposed in respect of an approval granted for a person to control an insurer. The Insurance Bill will address this anomaly. |
| 10 | <p>FSB-SA should add to existing requirements in relation to internal controls with new requirements, in particular on the role of internal audit and controls over outsourcing. While there are already plans for work in this area as part</p> | <p>Control functions & internal audit</p> <p>The Insurance Acts or supervisory guidelines do not at present specifically require insurers to have effective control functions with the necessary authority, independence, and resources. However, sections 9 and 12 of the Insurance Acts, in combination, essentially require an insurer to maintain an</p> |

| ICP | Recommendation | Status |
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| | <p>of the SAM project, the FSB-SA could consider some acceleration of this work.</p> | <p>effective governance framework. The FSB-SA utilises section 9 read with section 12 of the Insurance Acts as the basis for requiring the Boards of insurers to address gaps in their governance frameworks – including requiring them to establish or enhance control functions, and address their authority, independence, and resources, based on the nature, scale and complexity of the risks in the insurer’s business.</p> <p>The effectiveness of insurers’ internal audit function is regularly assessed using off-site monitoring, supplemented with on-site visits, even where there are no supervisory concerns. The on-site visits are structured, risk-based on-site visits that focus on various risk areas at insurers and their management’s ability to implement and maintain appropriate risk management. Reports from the internal audit function are called for as part of the preparation for on-site visits. Where there are supervisory concerns, the Registrar advises insurers accordingly. Most concerns that have arisen have been resolved in a timely manner.</p> <p>The Board Notice referred to under ICP 6 will specifically provide that an insurer must establish and maintain the following control functions:</p> <ul style="list-style-type: none"> ▪ a risk management function; ▪ a compliance function; ▪ an actuarial control function; and ▪ an internal audit function. <p>The Board Notice will also specify how each control function must be structured, that the authority and responsibilities of each control function must be determined and documented and that the control functions must be regularly reviewed by the insurer’s internal audit function or an objective external reviewer (the internal audit function must be regularly reviewed by an objective external reviewer). Requirements for any control function, including, requirements relating to the reporting structures, independence, resources, expertise, responsibilities and functions will also be prescribed.</p> <p>Outsourcing</p> <p>The Registrar has issued a directive under sections 4(4) read with sections 9(3) and 12(1) of the Insurance Acts on the outsourcing by insurers of any aspect of their insurance business to a third party (or within the same insurance group) – Directive 159.A.i (LT & ST).</p> <p>The directive –</p> <ul style="list-style-type: none"> • sets out the principles with which any outsourcing must comply; |

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| | | <ul style="list-style-type: none"> • sets out the key requirements for outsourcing, such as – <ul style="list-style-type: none"> - requiring an outsourcing policy and the requirements for that policy (such as setting limits on the types and overall level of outsourced functions or activities at the insurer and the extent to which activities can be outsourced to the same person); - requiring internal review and approvals; - requiring written contracts and the requirements for those contracts; - requiring on-going management and regular review; - notification to the Registrar of the outsourcing of control, management or material functions and any material developments (such as pending termination, material non-performance and the like) with respect to the outsourcing of a control, management or material function. <p>Regulations on binder functions (i.e., entering into, varying or renewing policies, determine the wording of policies, determining premiums under policies, determining the value of policy benefits under policies and settling claims under policies) have been issued under the Insurance Laws. The binder regulations regulate –</p> <ul style="list-style-type: none"> • to whom binder functions may be outsourced; • matters that must be addressed in agreements; • remuneration payable; and • reporting. |
| 11 | <p><i>It is nonetheless recommended that FSB-SA considers how to complement its existing work with a broader analysis of wider information (including market indicators and information on relevant foreign market developments) and with more frequent exercises to assess the impact of actual or possible market wide events (such as a flu pandemic, major emergency etc.) This will require the recruitment of more specialist expertise in risk and risk management.</i></p> <p><i>As in all countries, there is a need to develop a macroprudential surveillance, which should include issues related to the close links between banks and insurers in South Africa such as the potential for increased regulatory arbitrage between the</i></p> | <p>In the analysis of an insurer’s annual or quarterly return, comparisons are made to that insurer’s peer group as well as the market as a whole. In the analysis of an insurer, not only is the statutory submission used as an input but various other sources of information such as rating agency reports, media releases, the Financial Stability Review Report of the Financial Stability Unit of the SARB and the like. All insurers are subject to stress tests as part of the prescribed annual statutory returns. The major insurance groups in the South African market are requested to submit stress testing results in respect of market risk on a bi-annual basis. All insurers must submit stress testing results on both the market and the insurance risks on an annual basis. Market risk is also assessed as part of the risk assessment done on all insurers. Where market risk is rated as high, the insurer is engaged with as part of on-going supervision. The results of these stress tests, amongst others, inform the risk rating of each</p> |

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| | <p><i>two regulatory regimes.</i></p> <p><i>Annual aggregate data could be made available more quickly than at present and without charge.</i></p> | <p>insurer in accordance with the FSB-SA's risk-based supervisory approach. Various risk experts have been added to the FSB-SA Insurance Division (in the SAM Unit) to provide technical support to front-line supervisors.</p> <p>The Registrar prepares and publishes an analysis of the aggregated unaudited quarterly statutory returns by type and the market as a whole. This analysis assists in determining any evolving risks and trends within the industry.</p> <p>On a quarterly basis the Financial Stability Unit of the SARB also produces a Financial Stability Review Report. This report highlights local and international economic indicators, main financial indicators for banking and non-banking financial institutions and also identifies the major risks to the South African financial system.</p> <p>On a quarterly basis a presentation and write up is provided to supervisory staff on the industry results and the issues identified in the Financial Stability Review Report. This informs the risk ratings and assessments of insurers.</p> <p>The FSB-SA also considers the impact of risks to global financial stability on the South African insurance market. By way of an example, in respect of the European foreign debt crisis a joint information request by the FSB-SA and the BSD was issued to the major groups in the insurance and banking industry. This request was in respect of information on the legal entities' exposures to various EU countries.</p> <p>The FSB-SA cooperates and coordinates group supervision with the Bank Supervision Department of the SARB ("BSD"). For insurance groups / financial conglomerates, a differentiation is made between systemically important and non-systemically important groups. For systemically important groups, a more formalised arrangement is followed between the FSB-SA and the BSD by way of general information requests, supervisory cooperation and information exchange in respect of group structures, group solvency assessments, intra-group transactions, risk concentration and governance. For other groups, in particular the banking/insurance groups, bi-annual discussions between the FSB-SA and SARB are held at which these groups are discussed.</p> <p>The annual report of the FSB-SA prepared in accordance with the Public Finance Management Act that, amongst others, provide aggregate industry information annually is published and is available to the broader public. The annual reports of the Registrar prepared in accordance with the Insurance Acts reflect insurer specific and aggregate information about the financial situation of the insurance sector, and observations</p> |

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| | | <p>on major developments in the sector. The timeframes for publishing these reports have been reduced and these reports are available to the public at no cost. Specifically, annual aggregate information on the industry is now made available on the FSB-SA website ahead of the publication of the full reports.</p> |
| 15 | <p>It is recommended that</p> <ul style="list-style-type: none"> i) the FSB-SA be given powers to bar individuals from acting in responsible capacities in the future; and ii) that its powers to impose penalties on directors, managers and employees are extended. | <p>Sections 22 and 21 of the Insurance Acts, respectively, authorise the Registrar to require an insurer to terminate the appointment of a director, managing executive, public officer, auditor or statutory actuary of that insurer, if the person or firm concerned is not fit and proper to hold the office concerned.</p> <p>A record is kept of supervisory concerns and/or contraventions relating to individuals, which is checked prior to approving appointments to responsible capacities.</p> <p>The Insurance Acts do not generally allow for directors, managers and employees of insurers to be held accountable for contraventions by the insurer. They are however accountable where a specific requirement is imposed on them.</p> |
| 16 | <p>The FSB-SA should seek reforms to provide that in the event of winding-up, there is preference for insurance policyholders; or should seek provisions for an insurance scheme that would pay out in case of policyholder loss on an insurance company insolvency.</p> | <p>Policyholders do not currently have the status of preferred creditors in the event of the winding-up of an insurer.</p> <p>The FSB-SA has been engaging with the Department of Justice and Constitutional Development on the insolvency law reform process that has been ongoing for a number of years. The FSB-SA is motivating for a creditor preference for policyholders ranking below secured creditors (as defined in the existing Insolvency Act).</p> <p>The FSB-SA is also participating in a Resolution Policy Working Group (supported by the World Bank) consisting of the National Treasury, the SARB and the FSB-SA. The Working Group is considering enhancements to the prevailing legislative frameworks for the resolution of financial institutions, including the establishment of a policyholder protection scheme.</p> |
| 17 | <p>It is recommended that:</p> <ul style="list-style-type: none"> i) FSB-SA be given additional powers to enforce requirements for unregulated companies, including holding companies; ii) FSB-SA should extend the reporting it requires of the largest insurance groups to all groups and should ensure | <ul style="list-style-type: none"> i) An insurance group supervisory framework will be introduced with the next version of the draft Financial Sector Regulation Bill, expected to be published for comment mid-2014 and with effect from January 1, 2015. <p>Group-wide supervision is currently done on an informal basis and relies, in respect to information gathering on groups and follow-up action, on the general authority and standing of the regulator rather than specific</p> |

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| | <p>that companies undertaking investment business are included in the scope of consolidated supervision; and</p> <p>iii) the FSB-SA could also further develop its approach to lead regulation of conglomerates in cooperation with the SARB.</p> | <p>legislative provisions.</p> <p>ii) The FSB-SA is able to request information relating to insurance groups indirectly through insurers under the authority afforded to the FSB-SA in the Insurance Acts (see section 4 of the Acts, respectively). However, as stated above, the FSB-SA's current approach is relatively informal and relies, in respect to information gathering on groups and follow-up action, on the general authority and standing of the regulator rather than specific legislative provisions.</p> <p>Despite this, the Registrar currently requests insurance groups which are of potential systemic importance to submit quarterly unaudited returns on a group-wide basis. In addition, the Registrar has requested a number of non-systemically important groups to submit unaudited group returns where there was a concern regarding the solvency or the liquidity position of the group. Standardised returns for insurance group reporting are still being developed and finalised.</p> <p>The scope of group supervision extends to the ultimate insurance group holding company level within South Africa. Accordingly, the scope of group-wide supervision includes insurance groups that are financial conglomerates.</p> <p>The FSB-SA has over the past two years applied its risk-based supervisory approach to insurance groups, but to date only a few insurance groups have undergone a full on-site risk assessment.</p> <p>iii) The FSB-SA cooperates and coordinates group supervision with the BSD. For insurance groups / financial conglomerates, a differentiation is made between systemically important and non-systemically important groups. For systemically important groups, a more formalised arrangement is followed between the FSB-SA and the BSD by way of general information requests, supervisory cooperation and information exchange in respect of group structures, group solvency assessments, intra-group transactions, risk concentration and governance. For other groups, in particular the banking/insurance groups, bi-annual discussions between the FSB-SA and SARB are held at which these groups are discussed.</p> <p>The FSB-SA also participates in international supervisory colleges where the FSB-SA is an involved supervisor for the global group.</p> |

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| | | <p>The FSB-SA hosted its first international supervisory college in 2013 (for the Old Mutual Emerging Markets group) where it invited all the involved insurance supervisors of the group and where the FSB-SA is the group-wide supervisor.</p> |
| 18 | <p>It is recommended that the FSB-SA commits to providing more feedback and guidance to companies on its observations and experience of good and bad risk management practices.</p> | <p>Once statutory returns and other information required or requested have been analysed, a query letter is issued to an insurer if any clarification, explanation or action by the insurer was identified. After conducting an on-site visit, a management letter is issued to the insurer communicating the FSB-SA's findings and required preventative or corrective action, if any, by reference to best practice.</p> <p>Under the Insurance Bill, it is intended that the FSB-SA will issue "Level 3" guidance on good and bad governance, risk management and internal control practices.</p> |
| 19 | <p>FSB-SA should develop fuller requirements on the use of derivatives, drawing on their experience from supervision of good and bad practice. It could consider including derivatives management issues in its thematic supervisory work program.</p> | <p>Investment in derivative instruments is only allowed for efficient portfolio management or for the purpose of reducing investment risk. See section 34(2) and 33(2) of the Insurance Acts, respectively. In the case of a short-term insurer, it is also required that the insurer will have the asset at the settlement date of the derivative instrument which matches the obligations under that instrument and from which it can discharge those obligations.</p> <p>The annual statutory returns have been amended to include more relevant information on derivative transactions.</p> <p>Furthermore the Actuarial Society of South Africa Professional Guidance Note number 110 (SAP110) recommends a suitable methodology to be used by statutory actuaries in reserving for embedded investment derivatives. The guidance note recommends the minimum steps that should be taken by the actuary when setting up a reserve. It recommends the use of market-consistent stochastic models to quantify reserves required to finance possible shortfalls in respect of embedded investment derivatives.</p> <p>The Insurance Bill will require that –</p> <ul style="list-style-type: none"> ▪ that investment in derivative instruments is acceptable if the instruments contribute to a reduction of risks or facilitate efficient portfolio management. ▪ that assets must be properly diversified in a manner that avoids excessive reliance on any particular asset, issuer or group, or geographical area and excessive accumulation of risk in the portfolio as a whole; and investments in assets issued by the same issuer, or by issuers belonging to the same group, may not expose the insurer to |

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| | | <p>excessive risk concentration.</p> <ul style="list-style-type: none"> ▪ insurers to limit investment any assets which are not admitted to trading on a regulated financial market to prudent levels. |
| 21 | <p>It is recommended that:</p> <ul style="list-style-type: none"> i) the FSB-SA develop requirements on risk management and controls in relation to investment assets, drawing on their experience from supervision of good and bad practice; and ii) they address the lack of requirements in relation to safekeeping of assets. | <p>i) The Board Notice referred to under ICP 6 will enhance the existing requirements by requiring insurers to have an explicit investment policy that provides for the investment of all the insurer's assets in accordance with the Insurance Acts, specifies the nature, role and extent of the insurer's investment activities and how the insurer complies with the value of and limitations on assets requirements as may be prescribed, establishes explicit risk management procedures with regard to more complex and less transparent classes of asset and investment in markets or instruments that are subject to less governance or regulation and addresses and includes the matters as may be prescribed.</p> <p>The Insurance Bill will require that the valuation of assets and other liabilities is based on an economic valuation of the whole balance sheet. The final legislation will also require that assets and other liabilities must be valued at fair value and according to IFRS (and according to adjustments to IFRS as appropriate) to the extent that the valuation reflects an economic valuation.</p> <p>The Insurance Bill will be based on the prudent person investment principle. In particular, the draft legislation requires an insurer, in respect of its whole portfolio of assets, to invest only in assets and instruments whose risks the insurer can properly identify, measure, monitor, manage, control and report, and appropriately take into account in the assessment of its overall solvency needs taking into account its specific risk profile, approved risk tolerance limits and business strategy.</p> <p>The Insurance Bill will require –</p> <ul style="list-style-type: none"> ▪ insurers to invest assets held to cover the technical provisions in a manner appropriate to the nature and duration of its insurance liabilities; and in the best interest of all policyholders and beneficiaries taking into account any disclosed policy objective. In addition, in the case of a conflict of interest, the insurer must ensure that the investment is made in the best interest of policyholders and beneficiaries. ▪ insurers to invest all assets, specifically those assets covering the minimum capital requirement and the solvency capital requirement, in a manner that |

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| | | <p>reasonably ensures the security, quality, liquidity and profitability of its whole portfolio of assets and the availability of assets.</p> <ul style="list-style-type: none"> ▪ that assets must be properly diversified in a manner that avoids excessive reliance on any particular asset, issuer or group, or geographical area and excessive accumulation of risk in the portfolio as a whole; and investments in assets issued by the same issuer, or by issuers belonging to the same group, may not expose the insurer to excessive risk concentration. <p>ii) In terms of section 34(1)(b) of the Insurance Acts, respectively, an insurer shall not allow its assets to be held by another person on its behalf without the approval of the Registrar, given generally or in a particular case, and subject to such conditions as the Registrar may determine. Standing approvals in terms of the above sections of the Acts were granted to insurers to use the services of nominees subject thereto that the minimum conditions, as set out in Directive 126.A.i , for both South African and Foreign Nominee Companies are at all times adhered to.</p> <p>Nominee companies are approved according to the <i>Requirements Imposed by the Financial Services Board (FSB) for Nominee Companies to Operate In South Africa</i> ("Requirements document") as published in Board Notice 63 of 2007 in the Government Gazette of May 27, 2007. According to this Requirements document a register of all approved nominee companies, specifying the categories of approval, will be maintained by the FSB-SA and published on the FSB-SA website.</p> <p>All requirement of the Insurance Acts relating to the financial condition of the insurer (therefore also the requirements with regard to the use of nominees) apply extraterritorially (and to the off-shore business of a locally registered insurer) irrespective thereof that that business is deemed to be insurance business under the Act or not.</p> <p>In this regard also note that the Registrar issued Directive 159 Ai on Outsourcing on April 12, 2012. This Directive sets out the general and overarching requirements that an insurer must comply with when outsourcing any aspect of its insurance business. This means that it applies in addition to the existing regulatory framework. An insurer must therefore, in addition to the Outsourcing Directive, comply with the specific regulatory requirements set out in the regulatory framework, such as the requirements relating to nominee business, under the</p> |

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| | | Insurance Acts. |
| 26 | <p>It is recommended that the FSB-SA review the full range of disclosures that would be useful to stakeholders, drawing on IAIS work, and then consider to what extent these are met by existing requirements on public companies and where there are gaps in available information.</p> <p>The FSB-SA should consider whether they can make the non-confidential parts of returns more readily available for all companies.</p> | <p>The Registrar, under sections 36 and 35 of the Insurance Acts, respectively, requires insurers to submit prescribed annual audited statutory returns and unaudited quarterly returns to the Registrar. The annual audited statutory returns require quantitative and qualitative information. The annual statutory returns of insurers (excluding commercially sensitive information) are available to the public on request. These include high level information on governance (such as directors, senior management and members of the audit committee), assets, technical provision and other liabilities and the solvency ratio which reflects the capital required. However, the methods and assumptions used in preparing information are not available to the public.</p> <p>The annual report of the FSB-SA prepared in accordance with the Public Finance Management Act provides aggregate industry information. This is published and is available to the broader public.</p> <p>The annual reports of the Registrar prepared in accordance with the Insurance Acts reflect insurer specific and aggregate information about the financial situation of individual insurer's and the insurance sector, and observations on major developments in the sector. This includes a number of key financial indicators for each insurer, although published with a time lag.</p> <p>A number of audit firms also regularly publish an analysis of the financial results of South Africa's major insurers. See the websites of PwC and KPMG in this regard.</p> <p>The Insurance Bill will introduce public reporting requirements and further enhance statutory reporting obligations. The Insurance Bill will require an insurer to annually publicly disclose the prescribed quantitative and qualitative information on its profile, governance and controls, financial position, technical performance and the risks to which it is subject, in the form and manner as may be prescribed. The Registrar in prescribing the information, form and manner must take into account the need to ensure that the information is -</p> <ul style="list-style-type: none"> ▪ accessible to market participants; ▪ timely, comprehensive and meaningful; ▪ reliable as a basis upon which to make decisions; ▪ comparable between different insurers operating in the same market; and ▪ consistent over time so as to enable relevant trends to be discerned. |

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| 27 | <p>It is recommended that the adequacy of FSB-SA's powers to make and enforce fraud requirements under the insurance legislation is reviewed and that requirements are introduced for insurance companies.</p> | <p>The Insurance Acts do not expressly address insurance fraud. Although the Registrar does not have the express legislative authority to make and enforce specific rules or regulations relating to insurance fraud, it refers any fraud (not only insurance related fraud) to the appropriate enforcement authorities and is authorised under section 22 of the Financial Services Board Act to share any information relating to such fraud with other domestic or international regulatory authorities.</p> <p>Although not specifically required in legislation, the Registrar requires insurers to allocate appropriate resources and implement effective risk prevention procedures and controls to safeguard their financial soundness.</p> <p>The Registrar and the Registrar of FSPs through their risk-based supervisory approached monitor if fraud prevention measures are in place.</p> <p>The South African Insurance Crime Bureau ("SAICB") has been established by the South African insurance industry to provide a database of insurance fraud, and to promote the exchange of information and training to combat insurance fraud.</p> <p>The Board Notice referred to under ICP 6 will require an insurer to develop and regularly review adequate written risk management policies that include a definition and categorisation of the material risks to which the insurer is exposed, taking into account the nature, scope, and time horizon of the insurance business and the levels of acceptable risk limits for each type of risk. The risk management policies must incorporate an explicit insurance fraud risk management policy, which policy –</p> <ul style="list-style-type: none"> ▪ outlines appropriate strategies, procedures and controls to deter, prevent, detect, report and remedy insurance fraud; ▪ effectively manage fraud risk and possible risks to its financial soundness or continuity caused by fraud; ▪ provides for the prompt reporting of insurance fraud to relevant regulatory authorities; and ▪ provides for the matters as may be prescribed. |
| 28 | <p><i>It is recommended that FSB consider:</i></p> <p><i>i) the recruitment of some specialist expertise in this area—recognizing that much of the work of raising standards through supervision should fall to the</i></p> | <p>i) The resources and expertise of the Insurance Compliance Department in respect of AML/CFT supervision have been enhanced.</p> <p>ii) Compliance with the FICA by long-term insurers and FSPs is embedded in the risk-based supervisory approaches</p> |

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| | <p><i>insurance supervisory agency; and</i></p> <p><i>ii) that AML/CFT issues, particularly insurance companies' high level approach to and resourcing of compliance be addressed as part of regular onsite work on individual companies as well as through thematic visits.</i></p> | <p>adopted by the FSB-SA. Insurers' and FSPs' compliance with the FICA are regularly assessed using off-site monitoring, supplemented with on-site visits, even where there are no supervisory concerns. The on-site visits are structured, risk-based on-site visits that focus on various risk areas at insurers and FSPs, and their management's ability to implement and maintain appropriate risk management, including ML/FT risks. Where there are supervisory concerns, the Registrar advises insurers accordingly. Most concerns that have arisen have been resolved in a timely manner.</p> <p>The FSB-SA and the Financial Intelligence Centre ("FIC") regularly share information on ML/FT risks faced by long-term insurers. The FSB-SA also attends FATF meetings to learn about ML/FT typologies in the insurance and intermediary sectors to enhance the understanding of ML/FT risks to which insurers and intermediaries may potentially be exposed.</p> |