LLOYD'S

MARKET BULLETIN

REF: Y4574

Title	South African Binder Agreements: New Regulations Published
Purpose	To inform the Lloyd's Market of changes to regulations relating to the conclusion of binder agreements in South Africa
Type	Event
From	Cameron Murray, Senior Manager, International Regulatory Affairs General Counsel Division
Date	21 March 2012
Deadline	31 December 2012
Related links	Official Government Notice – Amendment of Regulations made under the Short Term Insurance Act 1998

This bulletin is addressed to all Lloyd's market participants involved in binding authority business in South Africa. It provides a brief summary of new South African Binder Regulations ('the regulations') which came into force on 1 January 2012. The regulations do not apply to reinsurance business, only direct insurance business.

1. Background

The South African Financial Services Board (FSB) has revised Part 6 of the Regulations under the Short-term Insurance Act 1998 (the Act) relating to binder agreements (the Binder Regulations). All binder agreements concluded with a South African intermediary after 1 January 2012 must comply with these new Binder Regulations and all binder agreements concluded on or before that date must be aligned within one year.

The broad principles underlying the regulations are (1) accountability of the insurer - the insurer is responsible for complying with the Act and regulations and rules made under it irrespective of the fact that the insurer outsources some of its functions to a third party; (2) responsible outsourcing - where an insurer outsources "binder functions" (see description below) to a third party, the insurer must ensure that the contractual arrangements, and the oversight and management of the contractual arrangements, facilitate the insurer's compliance with the Act and the fair treatment of policyholders; (3) policyholder protection; and (4) managing potential conflicts of interests.

2. Binder holders

The Regulations specify who an insurer may enter into a binding authority agreement with (a "binder holder"). Binder holders (i.e. Lloyd's coverholders and service companies) will be either an "underwriting manager" or a "non-mandated intermediary".

2.1 Underwriting manager

An "underwriting manager" is a person who acts as an agent of an insurer and performs one or more of the *binder functions* referred to in section 48A of the Act (see Section 3 below).

As in the past, an underwriting manager is not permitted to deal directly with the public in marketing, soliciting or selling policies. It may only derive business from an intermediary that sells policies direct to the public which is not an associate of that underwriting manager. An underwriting manager may, however, perform other intermediary services, such as premium collection, policy servicing and the receipt and/or processing of claims.

An underwriting manager may not delegate, assign or sub-contract any binder functions.

In addition to performing binder functions and intermediary services (other than marketing, soliciting or selling policies directly to the public), an underwriting manager may perform "outsource services" for an insurer. Examples of "outsource services" include running of IT systems, preparation of insurance surveys, disposal of salvage and provision of other services that are not incidental, but in addition, to intermediary services or binder functions. If the underwriting manager undertakes intermediary or outsource services for an insurer, those services may be outsourced to a third party on behalf of the insurer, provided the insurer agrees, or on its own behalf.

An underwriting manager may act on behalf of more than one insurer in respect of the same class of business if all of the relevant insurers agree to this in writing. In the regulations 'insurer' means a short-term insurer or Lloyd's as a single entity.

An underwriting manager can also perform services in relation to reinsurance policies. Binder activities do not include any activities relating to reinsurance and therefore the restrictions applicable to binder functions do not apply to reinsurance business underwritten on an insurer's behalf by an underwriting manager.

2.2 Non-mandated intermediary

A "non-mandated intermediary" is an intermediary who is not an underwriting manager (or a "mandated intermediary", i.e. a person who acts only for the policyholder) but a person who may act on behalf of a policyholder and an insurer.

A non-mandated intermediary can undertake intermediary services for its policyholder client and for an insurer. It can also perform binder functions on behalf of the insurer where so appointed by that insurer under a binding authority. However, it is not permitted to delegate such binder functions.

A non-mandated intermediary can also provide “outsource services” for the insurer.

3. Binder functions

Binder functions consist of:

- entering into, varying or renewing short-term policies on behalf of an insurer;
- determining the wording of a policy
- determining premiums under a policy
- determining the value of policy benefits under a policy
- settling claims under a policy (as distinguished from the intermediary service of processing claims)

Binder functions do not include activities in relation to reinsurance policies.

A binder holder may not delegate, assign or subcontract any of the binder functions performed by it. This does not however prohibit a binder holder from outsourcing certain functions that do not fall within the definition of binder functions, such as the collection of, or accounting, for premiums and receiving, submitting or processing claims (an administrative service).

4. Binder agreements

Binder agreements must be in writing and are only permitted to cover binder functions. If the underwriting manager or non-mandated intermediary is to undertake non-binder activities as well, these must be covered by a separate agreement.

The Act and regulations specify what must be included in the binder agreement. This includes, among other things, information and requirements in respect of management, reporting, competence, systems, service levels, governance and dispute resolution processes.

A binder agreement may only be cancelled on 90 days’ notice. This applies in all circumstances, including non-renewal and lapsed, but the insurer may prevent the binder holder from performing certain or all binder functions during the termination period. If during the 90 day period the binder holder is unable to perform the binder functions, the insurer can step in and take over those functions or appoint someone else to carry them out.

The insurer must inform the Registrar of the date on which the binder agreement will terminate at least 60 days before the termination of the agreement. With this notification the insurer must provide the reasons for termination, how the policies and policyholders will be dealt with in future and how the legislative requirements for termination will be complied with. It is Lloyd’s intention that this notification to the Registrar will be handled centrally through Lloyd’s South Africa.

The binder agreement granted to a non-mandated intermediary must limit the discretion of the binder holder regarding:

- the maximum value of policy benefits that may be determined under the policy;
- the maximum value of each claim that may be settled by the binder holder under the policies to which the binder agreement relates;
- the risk factors that must be considered by the binder holder when entering into, renewing or varying a policy or determining the value of policy benefits; and
- other parameters in accordance within which the binder holder may carry out binder functions under the binder agreement.

A binder holder, whether an underwriting manager or a non-mandated intermediary, must give the insurer full details, including contact details of the insured and risks underwritten on the insurer's behalf. The binder holder must update this information in the records of the insurer at intervals of not more than 60 days. The binder agreement must specify how long these intervals will be.

All binder agreements entered into since 1 January 2012 must comply with the Act and regulations. The Act specifies about 20 requirements and there are another 36 or so under the regulations.

Parties to binder arrangements entered into prior to 1 January 2012 have until 31 December 2012 to ensure that their arrangements are aligned, and fully compliant, with the regulations. Please note that any binding authority entered into prior to 1 January 2012 that includes intermediary and/or outsource services in addition to binder functions will have to be replaced by separate new agreements which comply with the Act and regulations by 31 December 2012.

5. Remuneration

5.1 Binder functions

Binder holder fees must be reasonably commensurate with the actual costs of the binder holder associated with rendering the binder services together with an allowance for a reasonable rate of return.

All premium and claims costs must be determined by the insurer and no amounts may be added to the premium or deducted from claims in order to remunerate any intermediary.

5.2 Intermediary services

Intermediary services are remunerated by way of regulated commission (12.5% of gross written premium for motor and 20% for other classes).

The fee payable by an insurer to a non-mandated intermediary that is a binder holder must be disclosed to a policyholder.

5.3 Outsource services

Outsourcing fees must be reasonable and commensurate with the cost of the actual process, service or activity outsourced.

5.4 Profit share

Only an underwriting manager is entitled to a profit share from the profits derived from the policies for which binder functions are performed by the underwriting manager.

The regulations prohibit a non-mandated intermediary that is a binder holder from (directly or indirectly) receiving or being offered any share in the profits of an insurer in respect of the binder functions it performs under the binder agreement with that insurer or in respect of the type or kind of policies referred to in the binder agreement.

5.5 Broker fees and premium financing arrangements

There is nothing to prevent an underwriting manager from collecting the policy fee/commission charged by the broker to its client. However, an underwriting manager may not invoice the policyholder for the broker fee/commission. This is a matter between the broker and its client and should be invoiced separately or stated separately (and not as part of the premium) on the schedule page of the policy.

The regulations do not apply to premium financing arrangements and, as such, these arrangements are not classed as binder functions, intermediary services or outsource services. An underwriting manager may enter into any reasonable commercial arrangement with the policyholder in relation to premium financing transactions.

6. Associates

An underwriting manager is not permitted to conduct business with a non-mandated intermediary that is an associate of that underwriting manager (e.g. a member of the same group of companies or persons in accordance with whose direction or instructions the board of directors is accustomed to act) unless it is granted an exemption by the Registrar.

7. Conclusion

The regulations contain detailed new requirements in respect of binding authority business. Any binding authority entered into since 1 January 2012 must comply with the regulations while parties to binder arrangements entered into prior to that date have until 31 December 2012 to ensure that their arrangements are aligned, and fully compliant, with the regulations.

Underwriters will be issued with revised and compliant model wordings to be used in South African binding authorities in due course. It is advised that any binding authority agreements which are to renew before this information is received are extended for a brief period to

ensure that they do not breach the terms of the regulations upon renewal. An extension of a contract according to its terms for a maximum period of six months does not constitute the conclusion of a new contract. Under these conditions a new binder agreement would not be necessary until 31 December 2012.

Any binder agreements which have renewed or incepted since 1 January 2012, and which have not been made compliant with the regulations, will need to be endorsed with the new model wordings when they are available and made compliant with the regulation as soon as possible.

This bulletin provides a brief summary only of the regulations. Anyone affected should read the Act and regulations in conjunction with the Policyholder Protection Rules issued by the FSB and take legal advice where necessary to ensure compliance with Act and the regulations.

Next Steps

- Lloyd's will amend and issue a revised version of the South African Binding Authority Endorsement LSW1598A for endorsement onto all current Binding Authority Agreements, whether they incepted before or after 1 January 2012.
- Lloyd's will issue further standard documents to be used by the Market when complying with the regulations.

For further information please contact:

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