LLOYD'S

MARKET BULLETIN

REF: Y4716

Title	Approval of Binding Authority Agreements by Lloyd's South Africa
Purpose	In order to comply with strict South African regulatory requirements relating to binder agreements, Lloyd's South Africa must now give prior approval to all binders concluded with South African coverholders and service companies.
Type	Event
From	Cameron Murray, Senior Manager, International Regulatory Affairs General Counsel Division +44 (0)20 7327 6677 & LITA@lloyds.com
Date	22 August 2013
Deadline	1 October 2013
Related links	Y4397, Y4574, Y4599,

Issue

Lloyd's has determined that strict South African regulatory requirements governing the manner in which binding authority agreements are concluded with South African intermediaries present a severe regulatory non-compliance risk. As a result, all binding authorities concluded with South African intermediaries must now be approved by Lloyd's South African office (Lloyd's South Africa).

Background

On 23 December 2011 the South African Financial Services Board (FSB) issued the revised Part 6 of the Regulations under the Short-term Insurance Act 1998 (the Act) relating to binder agreements. All binder agreements concluded with a South African intermediary after 1 January 2012 must comply with the regulations and all binder agreements concluded on or before that date must have been aligned within a year.

The FSB has since been attempting to provide clarity to the insurance industry on certain aspects of the regulations and Lloyd's has engaged with the FSB extensively through this process. The FSB has recently issued its interpretation in Information Letter 3-2013 and Lloyd's is now able to implement procedures to manage non-compliance risk. Further guidance is available from Crystal, Market Bulletins Y4574 & Y4599 and a guidance note available on Crystal or in Appendix I.

Approval of Binders

From 1 October 2013 all binder agreements concluded with a South African coverholder or service company must, prior to inception, be checked for compliance with the regulations and approved by Lloyd's South Africa.

This does not apply to binders which only permit the writing of reinsurance business.

In the first instance this process will apply to all new coverholder and Service Company binders incepting on or after 1 October 2013 and all renewals taking place on or after 1 October 2013.

For all successive renewals subsequent to this first check a binding authority which has already been approved by Lloyd's South Africa will not have to go through the approval process if the Lloyd's broker or managing agent advises Lloyd's South Africa of any changes to the binding authority, identifying those changes where applicable.

If the changes are suitable, Lloyd's South Africa will then provide a letter confirming the continued acceptance of the contract for attachment to the renewal documents.

Lloyd's underwriters should ensure that, where a binder agreement is arranged through a broker, they have had sight of the approval letter from Lloyd's confirming that the agreement is in order.

To ensure that this approval requirement is met Lloyd's have instructed Xchanging that no South African binding authority for business incepting or renewing on or after 1 October 2013 should be processed without checking for sight of Lloyd's South Africa's letter of approval. The letter of approval should be submitted to Xchanging alongside the agreement.

Binding authority agreements are to be submitted to Lloyd's via email to both Carla Vieira, General Manager of Lloyd's South Africa (Pty) Ltd, and Amit Khilosia, Senior Manager, Africa. Lloyd's will review the binding authority documentation and provide approval or comments, including advice on any further steps that must be taken before approval, within 10 working days. The review process can be expedited by the early submission of full details and complete documentation.

For new coverholders or service companies this requirement is in addition to the usual approval procedure by Lloyd's Delegated Authorities Department.

Additionally, since 2010, Financial Services Board Directive 151.A.i(ST) has placed an ongoing requirement for Managing Agents to notify Lloyd's South Africa of the termination of binding authorities at least 65 days prior to the expiry date. This notification is to be carried out in a standard form and forwarded to Lloyd's South Africa (at the contact details above) for onward transmission to the FSB. Further details and the standard notice are available in Y4397.

Further Information

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APPENDIX I - SOUTH AFRICA BINDER AGREEMENTS GUIDANCE

1. PURPOSE

The aim of this document is to provide guidance to all persons in the Lloyd's market concluding or involved in the conclusion of binder agreements in South Africa.

This paper should be used as a practical guide to S 48A and Part 6 of the Regulations of the Short-term Insurance Act 1998 (the 'Binder Regulations'). It should be read with the Act and Regulations themselves and with guidance and wordings released by Lloyd's already; namely, Market Bulletins Y4574 & Y4599 and the South African Binding Authority Endorsement wording.

2. WHO NEEDS A BINDER?

2.1 'Binder Functions'

Under S48A of the Short Term Insurance Act 1998 (STIA) all entities performing 'binder activities' require, in writing, a binding authority. Binder activities include:

- i. entering into, varying or renewing an insurance policy without the insurer becoming aware of the act until after the act has been performed;
- ii. determining the wording of a policy;
- iii. determining the premiums under a policy;
- iv. determining the value of policy benefits under a policy; and,
- v. settling claims under a short-term policy without the insurer becoming aware of the act until after the act has been performed.

The authority granted to a coverholder to perform the above functions is expected to vary.

Other functions commonly performed by intermediaries on behalf of insurers are divided into two further categories: intermediary services[1] and outsource services.[2]

The FSB considers certain functions to be incidental to the activity of being a coverholder. These 'incidental' functions are deemed inseparable from the core binder functions.

A coverholder may outsource the incidental activities to a third party, whilst an insurer may outsource the incidental functions where there is no binder and none of the core activities above are being performed by the binder holder. This is because 'outsource' and 'binder' activities are remunerated differently.

[1] 'Intermediary services' are defined in the STIA 1998 as: i) selling policies (performing any act the result of which is that another person will enter into, vary or renew a short-term policy), ii) ongoing policy services (maintaining, servicing or otherwise dealing with policies), iii) collecting or accounting for premiums, or iv) receiving, submitting or processing claims.

[2] 'Outsource services' are defined in FSB Directive 159.A.i. as functions in addition to binder activities and intermediary services, but which are often outsourced to third parties by insurers. Examples of these include running call centres, running IT systems, insurance surveys or salvage.

A non-exhaustive list of incidental activities is available from Table A, attached to this document. The FSB has stated that it will interpret which other activities, not listed below, may also qualify on a case by case basis.

2.2 'Binder Holders'

All persons performing the above binder activities and in possession of a valid binding authority agreement will be classified as 'binder holders' by the Regulations. This will include all types of Lloyd's coverholder or Service Company.

Intermediaries are sub-categorised into three groups under the Regulations: 'mandated intermediary', 'non-mandated intermediary' and 'underwriting manager'.

The binder regulations do not apply to reinsurance business. A binder agreement with a coverholder solely engaged in reinsurance does not need to follow the regulations.

3. HOW DO I CLASSIFY COVERHOLDERS?

3.1 Mandated Intermediaries

A mandated intermediary may not enter into a binder agreement. Such persons act only for the policyholder and are defined as being in possession of a full 'mandate' from same. A mandated intermediary is distinguished by the fact that they can bind policyholders without referring back, e.g. they can move a book of business without prior policyholder consent.

3.2 Non-Mandated Intermediaries (NMI)

An NMI acts for both the insurer and the policyholder. NMIs do not possess a mandate to perform any act on behalf of a policyholder (including terminating a policy) without their prior approval. An NMI may enter into a binder agreement and also may perform intermediary services for both the insurer and client and, additionally, outsource services for the insurer.

3.3 Underwriting Manager (UM)

A UM is different from an NMI in that it acts solely for the insurer. As such, on behalf of the insurer, it may perform binder activities, intermediary services and outsource services.

A UM may not sell or enter into policies dealing direct with the public and may only enter into, vary or renew policies for business with an intermediary.

UMs may not act for more than one insurer for the same class of policies without the permission of all the other insurers with whom the UM has a binder in that class of policies. Please note that Lloyd's underwriters collectively are to be considered as a single insurer.

4. HOW MAY COVERHOLDERS BE REMUNERATED?

The various activities usually performed by intermediaries on behalf of insurers must be remunerated separately under the Regulations. Also, no intermediary may receive a fee from policyholders for any service performed for which the intermediary has already received any form of consideration from an insurer.

4.1 Intermediary Services Commission

Intermediary services performed may only be remunerated by way of regulated commission.

Irrespective of how many South African intermediaries render services in relation to a policy, the total commission payable must not exceed 12.5% of the gross premium for a motor policy or 20% for any other short term policy.

4.2 Binder Activities Fee

Binder activities may only be remunerated by way of a fee save in the case of an underwriting manager who can earn a profit share (see 4.4). The fee paid to the coverholder by the insurer must be ‘reasonably commensurate’ with the costs of rendering those services and may allow for a ‘reasonable rate of return’ for the coverholder. This should be based on costs to the coverholder and not the insurer and may be expressed as fixed Rand amount or a percentage of gross premiums.

A clarification of ‘reasonable rate of return’ for a coverholder and ‘reasonably commensurate’ with the cost of providing the service is yet to be issued by the FSB, though the regulator has indicated that there will be more flexibility applied to UMs than NMIs.

Please note that a coverholder or service company may **not** receive an extra or separate fee for ‘incidental binder activities’ performed, i.e. as an intermediary or outsource fee. These must be bundled into the main binder fee which should then reflect the cost of performing all core and incidental binder activities. These activities are listed in Table A below.

4.3 Outsource Services Fee

Outsource services may be remunerated by a separate fee which is reasonable and commensurate with the cost of the process, service or activity outsourced. Where a coverholder performs ‘incidental’ binder activities these may not be remunerated by way of an outsource fee over and above the standard binder fee. The same applies if the coverholder outsources any binder functions, i.e. no extra or separate outsourcing fee may be recovered from the insurer if the binder holder is already being remunerated for those incidental functions, the third party must be remunerated by the coverholder from the original binder fee.

4.4 Profit Share

An UM, and not an NMI, may receive profit share from profits made, in relation to the policies referred to in the binder agreement.

However, no amounts may be added to premiums or deducted from claims to remunerate any intermediary. For example, this will prevent underwriting managers from charging a debit order fee in addition to premiums.

4.5 How Should Coverholder Remuneration be Expressed?

Remuneration provided to a coverholder by an underwriter should be based on the FSB’s standard ‘activity-based format’. This should be expressed as far as possible in the manner set out in Table B below or Annexure B to FSB Information Letter 3/2013. This format will be used for reporting to the FSB so they can monitor fees being paid by insurers.

Remuneration should be expressed in a fixed Rand amount or as a percentage of gross premium income. As in 4.2 above, it should be ‘reasonably commensurate’.

5. WHAT MUST THE TERMS OF A BINDER PROVIDE FOR?

Many of the mandatory provisions listed below will already be present or catered for partially in Lloyd’s model binding authorities and the South African Binding Authority Endorsement. However, a completed binding authority agreement should, with the schedule and endorsements, be checked against the requirements below to ensure compliance with the Act and Regulations.

Aside from the definitions of intermediary activities, controls on who may enter into a Binder Agreement and the provisions governing remuneration, the main requirements relating to mandatory inclusions in a binder can be found in Section 48A of the STIA and Regulation 6.3 of the Regulations.

Please note that a binder agreement may only relate to arrangements or relationships between a coverholder and the insurer in respect of ‘binder functions’ as well as incidental or ancillary functions. Other services provided by the coverholder to or on behalf of the insurer must be dealt with in terms of an intermediary or outsource agreement. Binder and intermediary activities (other than functions which are incidental to operating a binding authority) must be separated from any existing agreement.

- First, a binder must explicitly state whether a coverholder is an NMI or UM.

5.1 Coverholder Authorities – A binder must explicitly state:

- The binder functions which are to be performed by the coverholder and what kinds of policies may be entered into.
- **Wordings** - Whether a coverholder has authority to determine wordings and, if so, to what extent. An underwriter may grant a coverholder varying degrees of discretion with regards to this function. The activities contained in Table A outline the factors to be taken into account here.
- **Premium** - Whether a coverholder has authority to determine premium and, if so, what the gross premium will be or at the very least what the basis for the calculation thereof will be. The scope of the coverholders’ mandate must be set out in the agreement and an underwriter may grant a coverholder varying degrees of discretion. Accordingly, the description of the function in the agreement will vary if the coverholder has discretion to apply an underwriting methodology or if the premium is pre-defined. Certain elements may be determined by the coverholder or the coverholder may determine the basis for the calculation fully, but this must be detailed. A binder agreement concluded with an NMI must limit the discretion of the coverholder to apply a separate pricing methodology to individual policies. UMs may be granted full discretion with respect to a pricing methodology. Attention should be paid to this point when drafting binder agreements with NMIs which handle complex or individual risks. Details in the agreement should generally relate to the design of the methodology to be used in the pricing of policies, rather than determining specific premiums for individual policies that the binder holder enters into, varies or renews. A description of the activities considered as part of this binder function is contained in column 2 of Table A.

- **Benefits** - Whether a coverholder has authority to determine maximum policy benefits, including deductibles. If so, given that an underwriter may grant a coverholder varying degrees of discretion, the slip should state the extent of the coverholder's discretion in respect of this function. An NMI should have limited discretion to determine benefits.
- **Claims** - The extent to which the coverholder has authority to handle and settle claims and the circumstances under which they are to exercise this authority. Only UMs and not NMIs may refuse to renew a policy, reject or refuse to pay a claim or part of a claim, terminate, repudiate or deny the insurers liability or declare a policy void without first referring to the underwriter.

5.2 Remuneration – A binder must set out:

- The full basis of remuneration, by way of a binder fee as outlined in 4.2 above, for binder activities. The binder must specify the Rand value of the remuneration payable to the binder holder in respect of each policy or, if the Rand value is not fixed or is not determinable on entering into the agreement, the basis for the calculation of the fee.
- Remuneration paid to the binder holder should be described in the binding authority as per Table B below. Remuneration will have to be reported by Lloyd's to the FSB in the format in Table B on a regular basis.

5.3 Disclosure Obligations – A binder must oblige a coverholder to:

- Disclose to policyholders that the policy is with "*certain underwriters at Lloyd's"* via a binding authority with the intermediary in question.
- If the coverholder is an NMI, disclose to policyholders the coverholder's remuneration payable or basis for remuneration payable to it by the insurer.
- Include the name of all insurers, i.e. *"certain underwriters at Lloyd's"* in all advertisements etc.
- Keep proper books and accounts and to permit a Lloyd's underwriter full and unfettered access to its books and accounts relating to the policyholders of said Lloyd's underwriter. A coverholder must be obliged to make available, upon request, the details of all policyholders to an insurer or Lloyd's underwriter. This provision effectively transfers ownership of data. The agreement must also specify that the Registrar of Insurance may have access to the coverholder's business information at any time.

5.4 Reporting and Settlement Obligations – A binder must oblige a coverholder to:

- Report, provide bordereaux and settle all premiums to an underwriter no later than 15 days after the end of each month. Please note that payment to the Lloyd's broker by the coverholder is deemed to be payment to the Lloyd's underwriter.
- Update policyholder and policy information in the records of the insurer. This information must enable the insurer to identify and contact policyholders and assess its liability under the policies. These records must be submitted at least every 60 days.
- Submit to periodic performance and compliance reviews. The frequency of these reviews must be specified alongside the manner in which they will be carried out.

5.5 Restrictions – A binder must prohibit:

- The sub-delegation of binder activities (in the strict sense, not ancillary services) by the coverholder to any party. For further information of outsourcing please refer to section 2 above.
- A coverholder which is an NMI from performing certain function which are permitted of an UM. Please see section 5.7 below for further details.

5.6 Termination Period – A binder must provide for:

- A termination period of <u>not less than 90 days.</u> This is completely irrespective of the circumstances under which a binder is to be terminated, including lapsing or non-renewal. During this period the coverholder is obliged to transfer all records relating to policies written under the binder agreement to the insurer, including names and identity numbers of all policyholders. However, during the termination period an underwriter may prohibit a coverholder from writing business and *"take reasonable measures to limit any risks it may be exposed to"*; this is designed to address termination arising from or a serious failure, misconduct or criminality on the part of the coverholder.
- Underwriters are obliged by the Regulations to notify the Registrar of the termination of any binder at least 60 days before the end of the termination period mentioned above. Any intention to terminate a binder should be notified to Lloyd's South Africa so that Lloyd's may aid underwriters in handling this notification. This updates the current procedure set out by FSB Directive 151.A.i and Market Bulletin Y4397.

5.7 Non-Mandated Intermediaries – A binder with an NMI must:

- Limit the discretion of the NMI to determine the maximum value of policy benefits or the maximum value of any claim payment under the binder.
- Deny the NMI authority to refuse a policy renewal, reject any part of a claim, deny an insurer's liability or declare a policy void.
- Define the risk factors that are to be considered by the coverholder when entering into, varying or renewing a policy or determining the value of policy benefits.
- Deny the NMI the authority to refuse to renew a policy, to reject or refuse to pay a claim or part of a claim, to terminate, repudiate or deny the insurers liability for policy benefits or to declare a policy void.

6. WHO MAY A COVERHOLDER DEAL WITH?

Intermediaries who are associates of one another, generally, may not deal with each other. NMIs may not deal with any associated mandated intermediaries and an UM may not deal with either a mandated intermediary or an NMI that is an associate of it.

Legal entities should be considered associates if they are subsidiaries or a holding company in the same group, a member of a close corporation or have the same board of directors or the board of the one company controls the board of the other.

If two companies have the same shareholder(s) but are not in the same group of companies and one company does not control the other, i.e. they have separate boards of directors exercising separate control, they are not associates.

7. BINDING AUTHORITY WORDINGS

It is a mandatory requirement to attach the standard South African Binding Authority Endorsement to all binding authority agreement wordings.

A large number of the requirements relating to the information to be specified in a binding authority are included in the South African Binding Authority Endorsement and it should be read by all practitioners carefully prior to attachment to a binding authority wording.

However, it has been impossible to cater for every requirement above as many provisions will vary depending on the specific arrangement. As such, all stakeholders should take extra care to ensure that no provisions of their standard agreements or the schedule deviate from the terms of the Act, Regulations, Endorsement or this document. For example, quarterly reporting of bordereaux and settlement of accounts is not permitted under the regulations and must be done monthly.

Further Information

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TABLE A

ACTIVITIES FALLING UNDER THE VARIOUS BINDER FUNCTIONS		
BINDER FUNCTION	**ACTIVITIES**	**INCIDENTAL ACTIVITIES**
a) Entering into, varying or renewing an insurance policy	• Conclude a new contract • Conclude a renewal contract • Vary a policy through an endorsement • Vary insurer liabilities under a group policy • (UMs only) Cancel, void or refuse to renew a policy	• Issuing policy wordings • Maintaining accounts, books and records • Reconciling monthly premiums received • Maintaining a policy management system • Keeping policyholder records • Updating underwriters' data • Upkeep of risk management system to support administration of: policies, BCP, software etc. • Advertising and marketing
b) Determine the wording of a short-term policy	Determine the wording or amendments to the wording of a policy either subject to limits prescribed by the insurer with respect to the risks that may be identified and/or benefits provided and/or other factors, or with full discretion	• Enuring legal requirements are met • Ensuring alignment with any limitations prescribed • Facilitating training programmes in relation to policy wordings
c) Determine premiums under a short-term policy	Determine the premiums under a policy, wither using the underwriting criteria and rating methodology determined by the insurer, or with discretion with respect to the client segmentation and actuarial pricing	• Consideration of financial soundness of business and policies, as well as fair treatment of customers, in setting pricing • Ensuring alignment with underwriting limitations prescribed • Policy screening • Sign-off and record keeping of underwriting exceptions • Performing ITC scoring of new business • Performing client life time value scoring of existing business • Developing remedial measures for unprofitable business • Managing unprofitable clients
d) Determine the value of policy benefits under a short-term policy	Determine the value of benefits under a policy either using the underwriting criteria and benefit	• Consideration of financial soundness of business and policies, as well as fair

	limits determined by the insurer or with discretion with respect to the client segmentation and actuarial pricing	treatment of customers, in setting pricing • Ensuring alignment with underwriting limitations prescribed • Policy screening • Sign-off and record keeping of underwriting exceptions • Performing ITC scoring of new business • Performing client life time value scoring of existing business • Developing remedial measures for unprofitable business • Managing unprofitable clients
e) Settle claims under a short-term policy	• Determine and accept liability • (UMs only) Reject claims • (UMs only) Repudiate liability under a policy	• Receive and categorise claims • Appoint and payment of loss adjuster and investigators • Assess merits/determine liability of insurer and quantum of claims • Attend to all administration regarding settlement of claims • Consideration of contributory negligence in third party claims and third party recoveries • Payment of settled claims (not including actual transfer of funds by a bank) • Facilitate ex gratia payments • Revise claims estimates • Manage motor and non-motor salvage • Manage third party recoveries and claims • Recovery of any paid amounts for insurer • Maintain a claims register & record keeping • Submission of claims bordereaux • Manage claims float • Authorising repairs or replacements • Accounting for excesses and deductibles • Management of data and ratios • Maintaining controls/governance over claims handling

TABLE B

ACTIVITIES FALLING UNDER THE VARIOUS BINDER FUNCTIONS	FEE		PROFIT SHARE (UMS ONLY)	
	Personal	Commercial	Personal	Commercial
a) Enter into, vary or renew an insurance policy				
• Conclude a new contract or a renewal contract or vary a policy through an endorsement • Vary insurer liabilities under a group policy • (UMs only) Cancel, void or refuse to renew a policy	(Please tick below)			
b) Determine the wording of a short-term policy				
• Determine the wording or material amendments to the wording of a policy, subject to limits prescribed by the insurer with respect to the risk that may be indemnified and/or benefits provided and/or other factors; or • Determine the wording or amendments to the wording of a policy with full discretion	(Please tick below)			
c) Determine premiums under a short-term policy				
• Determine the premiums under a policy using the underwriting criteria and rating methodology determined by the insurer; or • Determine the premiums under a policy with full discretion with respect to the client segmentation and actuarial pricing	(Please tick below)			
d) Determine the value of policy benefits under a short-term policy				
• Determine the value of benefits under a policy using the underwriting criteria and benefit limits determined by the insurer; or • Determine the value of benefits under a policy with full discretion with respect to the client segmentation and actuarial pricing	(Please tick below)			
e) Settle claims under a short-term policy				
• Determine and accept liability for claims: Please list all incidental activities performed in relation to the settlement of claims binder function: • (UMs Only) Reject claims or repudiate liability under a policy	(Please tick below)			