South African Reserve Bank
Prudential Authority

FSCA
Financial Sector Conduct Authority

Insurance Act 18 of 2017

Joint Communication 1 of 2020

COVID-19: Regulatory response

Objective of this Joint Communication

This Joint Communication (Communication) sets out the responses by the Prudential Authority and the Financial Sector Conduct Authority (jointly referred to as the Authorities) to the COVID-19 pandemic as well as the observed and predicted impacts it has, or is likely to have, on the South African economy and specifically the South African insurance industry.

The Authorities recognise that the COVID-19 pandemic has, and will have, an impact on insurers' financial soundness. The Authorities nevertheless expect that insurers will continue to operate in a prudent and socially responsible manner. To this end, this Communication outlines some of the regulatory and supervisory actions that the Authorities are implementing to alleviate the stress caused by COVID-19 on insurers.

The Authorities will continue to engage with the insurance industry and all other relevant stakeholders during this time, and may issue further communication or implement any additional actions as and when necessary as further analysis on the impact of COVID-19 is conducted, especially in relation to the impact on the financial soundness of South African insurers.

1. Purpose

This Communication sets out the Authorities' current position concerning the COVID-19 pandemic and its impact on the economy and, more specifically, on the South African insurance industry, i.e. the insurers, policyholders and other stakeholders.

The Communication does not have the force of law and is only intended to signal an indication of the Authorities' regulatory and supervisory responses to the COVID-19 pandemic in respect of those matters that are an immediate priority to alleviate the stress experienced by the insurance industry.

Insurers are urged to continue to act in good faith towards their policyholders and the citizens of South Africa, and to make prudent decisions in the spirit of solidarity. The potential assistance discussed in this Communication should not be seen as a relaxation of the Authorities' regulatory or supervisory actions, or as an opportunity for insurers to unduly benefit from any potential regulatory or supervisory actions by the Authorities.

2. Prudential and market conduct matters

The Authorities have identified certain immediate priorities that warrant further consideration by insurers, while acting in a responsible manner towards their shareholders, other stakeholders and, most importantly, their policyholders. The Authorities undertake the actions set out in this section in an effort to assist insurers.

2.1 Retention of the Solvency Capital Requirement

The Solvency Capital Requirement (SCR) is, by design, a risk-based and risk-sensitive framework that provides information that is important to both the insurer and the Prudential Authority, as this information relates to the insurer's financial soundness as well as the risks it is more exposed and more sensitive to. The SCR can also be viewed as a buffer designed to absorb losses from severe stress events, such as the COVID-19 pandemic that has severely impacted the investment market and is also expected to put a strain on underwriting activities, although arguably not to the severity envisaged in the SCR calibration.

The Prudential Authority is cognisant that insurers may experience lower SCR ratios during this crisis as a result of the broader COVID-19 impact and second-order effects.

The Prudential Authority accepts that, while adjustments to the parameters prescribed in the Financial Soundness Standards (FS Standards) are possible, such adjustments would most certainly have unintended consequences and adverse knock-on effects, including a reduction in the value of the SCR regime and a limitation of the supervisory powers of the Prudential Authority. In light of such unintended consequences and adverse knock-on effects, the Prudential Authority is of the view that the SCR, as set out in the FS Standards, should be retained. The SCR provides information that allows for effective supervision without which the insurer, the Prudential Authority and other stakeholders, including investors and policyholders, could not make informed decisions.

The Prudential Authority will be applying judgement in determining supervisory intervention triggers for each insurer when considering the impact of COVID-19 on its SCR ratio, effectively permitting lower SCR ratios temporarily. The appropriate supervisory intervention trigger will be determined within the context of the Prudential Authority's statutory mandate to promote and enhance the safety and soundness of insurers, and to support insurers through the stress experienced as a result of COVID-19. To this end, such supervisory intervention triggers and the tolerance of lower SCR ratios shall apply only in cases as a result of COVID-19.

The Prudential Authority will permit insurers that are experiencing conditions of financial unsoundness, that is, SCR ratios below 100% due only to the impact of COVID-19, to continue operations without exercising regulatory action. This will allow insurers that are experiencing financial distress as a result of COVID-19 to continue operating under these circumstances and to progressively recover to healthy SCR ratios (i.e. SCR rations greater than 100%). Please be advised that where SCR ratios drop below 100%, the Prudential Authority will intensify supervisory activities in line with its prudential mandate, taking into account the temporary supervisory intervention triggers.

Minimum Capital Requirement (MCR) ratios below 100% will not be tolerated and will be met with stringent supervisory intervention by the Prudential Authority. In this regard, insurers' attention is drawn to the provisions of section 39(3) of the Insurance Act 18 of 2017 (Insurance Act).

2.2 Reporting requirements

Regulatory reporting

The Authorities are aware of the significant challenges facing the financial services industry given the impact of the COVID-19 pandemic, coupled with the current strain on the economy. The Authorities acknowledge the difficult operating environment that can no longer be regarded as business-as-usual and therefore direct insurers to take note of the following recently published communiqués by the Authorities:

- Prudential Authority: *Impact of Covid-19 on PA reporting timelines.pdf*
- Financial Sector Conduct Authority: *FSCA Communication 9 of 2020.pdf*

Insurers are furthermore advised to proactively engage with the Authorities, through their normal supervisory interaction channels, if challenges are experienced in complying with any of the aforementioned requirements, including any reporting obligations. Such challenges will be assessed on a case-by-case basis with due consideration of legislative and supervisory requirements as well as the operational challenges faced by institutions to achieve timeous compliance with prudential requirements, including regulatory reporting requirements.

Own Risk and Solvency Assessments

The COVID-19 pandemic is a stress event that is unlikely to have featured in the Own Risk And Solvency Assessments (ORSAs) of many insurers, and the Prudential Authority expects that COVID-19 will have an impact on the ORSA processes of all insurers. To this end, the Prudential Authority acknowledges that some insurers' next ORSA submission might differ in certain aspects. Insurers' ORSA policies should set parameters for their out-of-cycle ORSA triggers and the consequences of when such triggers are activated. The Prudential Authority reminds insurers to review their ORSA policies and out-of-cycle ORSA triggers and, if relevant, to submit these out-of-cycle ORSA reports to the Prudential Authority at their earliest convenience.

2.3 Dividends and bonuses to staff

The scale of insurance claims as a result of COVID-19 is still unclear, although severe potential impacts have already been identified. The Prudential Authority expects that insurers will experience an increase in claims across different lines of business, including but not limited to business interruption, consumer credit, credit life, life risk and funeral policies.

The Prudential Authority urges insurers to apply prudence and take all necessary steps to maintain financial soundness throughout this period. The Prudential Authority therefore expects that insurers will consider whether it is necessary to temporarily suspend all discretionary dividend distributions, including share buybacks and cash bonus payments to senior management.

The Prudential Authority further expects insurers to take appropriate action in respect of any distributions on dividends that may have already been declared by the insurer and in respect of the accrual, vesting and payment of variable remuneration, in a manner that is aligned to the remuneration policy of the insurer and in accordance with the relevant legal requirements, as applicable.

The Prudential Authority will continually review this guidance in light of new information on the duration and extent of the COVID-19 stress event. In exercising prudence, insurers should ensure that their assessment of their overall solvency needs are forward-looking, taking due account of the current level of uncertainty on the depth, magnitude and duration of the impacts of COVID-19 on the economy and the uncertainty on insurers' solvency positions.

Insurers are also reminded of the legislative requirements relevant to the payment of dividends as set out in section 39(1)(b) of the Insurance Act.

2.4 Outstanding premiums

For purposes of this paragraph, the following terms are described:

Premium relief – means a temporary release from the obligation to pay the premium payable under a policy in whole or in part, either by:

a. allowing the non-payment of premium for a limited amount of time;
b. allowing for an extended period of grace for the payment of premium; or
c. a reduction in the amount of premium payable for a limited amount of time without reducing or limiting any policy benefits under the policy.

Outstanding premiums – means premiums that are due and not paid in whole or in part, and are not included in the best estimate liability, but rather added to the balance sheet as premium debtors.

The Authorities call on insurers to consider how they can provide premium relief or other mechanisms, which could go a long way to assist their policyholders in the spirit of solidarity, while still maintaining sound risk management and governance practices.

There is recognition by the Authorities that such potential premium relief concessions would place strain on an insurer's cash flows, revenues and balance sheet. In particular, for outstanding premiums, an insurer would raise on its balance sheet a premium debtor, which may be quite burdensome during this stress event.

If insurers make such concessions that would increase the outstanding premiums, the Prudential Authority will, through its supervisory engagements with the relevant insurer, put in place the necessary arrangements for such outstanding premiums caused by the COVID-19 pandemic to not be included in the default risk SCR calculation, where such outstanding premiums would have attracted capital requirements in the ordinary course. The Prudential Authority is of the opinion that where outstanding premiums could be offset against future claims, that those outstanding premiums should not attract capital requirements.

Monies due from an intermediary that had already received the premiums from policyholders would not be considered for any relief.

The Financial Sector Conduct Authority published two exemption notices, which will bring some relief in the form of:

a. An exemption for certain long-term insurers from regulations 3.5, 3.17 and 4.2(1) of the Regulations under the Long-term Insurance Act 52 of 1998:

   i. deferral of commission clawbacks by insurers in an attempt to support broker sustainability; and
   ii. accessibility for investors to their investments (for those investors taking up the premium holiday and then paying back the premiums, where a likelihood exists for them to breach the 20% rule and extend the restriction period).

b. An exemption of certain short-term insurers and independent intermediaries from regulation 5.2 of the Regulations under the Short-term Insurance Act 53 of 1998. This exemption is also granted in an attempt to support broker sustainability; the insurer can still pay commission and the broker can accept the commission on those policies where the policyholders have opted for a premium relief and the premium has not been received by the insurer.

The Authorities have noted that some insurers and underwriting managers are using premium relief to induce customers to cancel their policies and move their business. This is regarded as an undesirable practice and the Financial Sector Conduct Authority wishes to reiterate its position that it will not hesitate to proceed with regulatory action against insurers or underwriting managers employing this practice.

2.5 Foreign exchange limits

The Financial Surveillance Department of the South African Reserve Bank (FinSurv) will grant over-exposed institutional investors, including linked and non-linked insurance companies, a dispensation where they will not be required to realign their foreign asset holdings to be in line with the respective foreign portfolio investment limits, for a specific period and subject to certain conditions. Further communication will be issued by FinSurv in this regard.

2.6 Insurers' actions

Insurers that are experiencing solvency problems are encouraged to engage with the Prudential Authority through their normal supervisory channels. Insurers are further advised not to take any drastic actions, including selling investments under these circumstances or implementing management actions, such as the removal of non-vested bonuses, without prior engagement with the Authorities.

It is important that even during this difficult period, insurers should continue to ensure that their disclosures to policyholders are clear and in plain language, as required by the Policyholder Protection Rules. Insurers should endeavour to have information readily accessible on their websites and leverage other communication channels as relevant to the target markets. Policyholders should be advised of the contact details for guidance on COVID-19 policy options, if there are such options.

Requests for further information about the Communication may be submitted via email to Makgompi.Raphasha@fsca.co.za **and** Jooste.Steynberg@resbank.co.za.

PRUDENTIAL AUTHORITY **FINANCIAL SECTOR CONDUCT AUTHORITY**

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