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Third-party cell captives as an enabler for transformation in the insurance sector

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GUARDRISK
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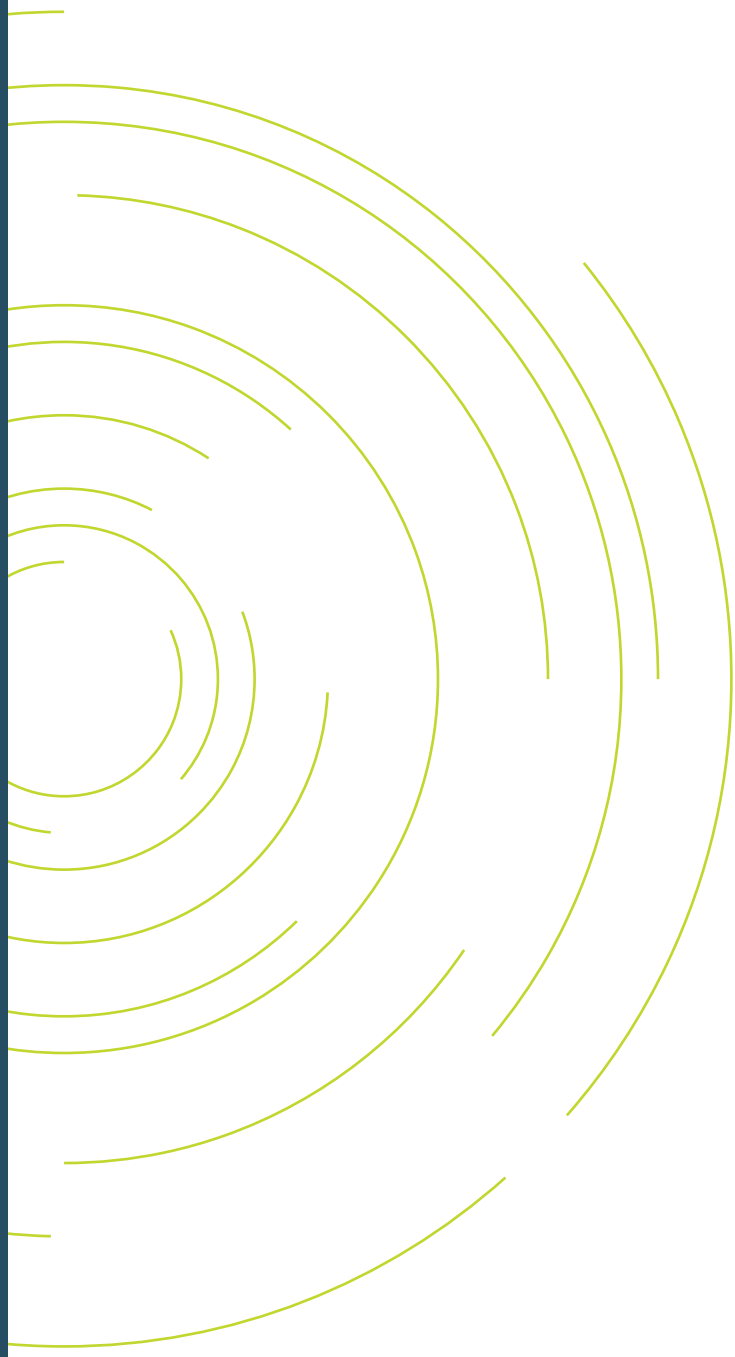

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ASISA	Association of Savings and Investments South Africa
B-BBEE	Broad-Based Black Economic Empowerment
COI	Conflict of interest
FSB	Financial Services Board (up to 31 March 2018)
FSC	Financial Sector Charter or Financial Sector Code
FSCA	Financial Services Conduct Authority (from 1 April 2018)
INSETA	Insurance Sector Education and Training Authority (INSETA)
IT	Information technology
LTIA	Long-term Insurance Act, 52 of 1998
MCR	Minimum capital requirement
NMI	Non-mandated intermediary
PA	Prudential Authority (from 1 April 2018)
PPR	Policyholder Protection Rules
SAIA	South African Insurance Association
SCOF	Parliamentary Standing Committee on Finance
STIA	Short-term Insurance Act, 53 of 1998
TCF	Treating Customers Fairly
TPA	Third-party administrator
UM	Underwriting manager

Foreword

Cenfri is an independent, non-profit think tank. We are driven by a vision of a world where all people live their financial lives optimally to enhance welfare and grow the economy. Our core focus is on generating insights that inform policymakers, market players and donors seeking to unlock development outcomes in the financial sector.

In line with our vision, we have a long-standing engagement in microinsurance in South Africa, dating back to the development of the microinsurance regulatory proposals in 2008. Over the years, we closely tracked developments on the market and regulatory fronts to ask: *How can insurance serve more South Africans, better*?

In the 2008 Microinsurance Discussion Paper, the regulators noted that a dedicated microinsurance licence will not be the only option for extending the reach of the insurance market. One of the alternatives identified was the cell captive mechanism, as it may encourage new entrants into the insurance space without being subject to the full compliance burden of an insurer. In 2009, under the FinMark Trust insurance portfolio, we commissioned a study to review the cell captive mechanism and its potential to support the development of the microinsurance market in South Africa. It is one of the few publicly available documents describing the cell captive landscape in South Africa.

During the conversations around the parliamentary hearings on financial sector transformation in 2017, the developmental potential of the cell captive arrangement once again came to the fore, but this time with a much broader focus. *Can cell captives be part of the solution to achieve a more transformed insurance market? If so, what needs to happen to enable that role*?

To pursue these research questions, Guardrisk (as the cell captive market leader) decided to fund this study on behalf of the industry. The aim is not to provide a one-sided industry perspective. Rather, this report seeks to highlight the potential of this market for transformation and to identify industry, as well as regulatory imperatives, to unlock such potential, as basis for ongoing dialogue between policymakers, regulators and market players.

To ensure that the report provides an accurate and independent perspective on the market, the research question, approach and outcomes were discussed with regulators and policy-makers at the inception of the study and the authorities were given an opportunity to review the draft report before finalisation. We also consulted industry associations and a range of market and regulatory stakeholders during the research process and debated and discussed the draft findings in public stakeholder workshops in Johannesburg and Cape Town.

We are grateful to all the stakeholders who were willing to dedicate the time to share their views and experiences with us. We trust that this document will prove informative and will stimulate debate on this important matter. Any errors or omissions are our own.

Doubell Chamberlain

Managing Director: The Centre for Financial Regulation & Inclusion

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Executive summary

South Africa has a strong insurance sector that serves a broad customer base and plays an important role in the economy. However, to fulfil its full developmental role, it is imperative that the pace of transformation in the insurance sector – as in the financial sector and economy more broadly – be accelerated. This imperative was clear from the parliamentary hearings on transformation in the financial sector in 2017. It has now been entrenched in regulation through the Insurance Act of 2017, and it forms the backdrop to the build-up to the Financial Sector Summit of 2018.

But what is meaningful transformation and what structures can be leveraged to promote it? This study looks specifically at the potential of the cell captive vehicle as an enabler for transformation.

The cell captive is a uniquely South African construct that emerged in the early 1990s as a way for entrepreneurs or organisations with an insurance business concept to participate in the insurance market without obtaining an insurance licence of their own.

Under a cell captive arrangement, a cell captive account is created on the books of a licensed cell captive insurer (the promoter) and a cell owner buys a special class of shares in the cell captive insurer to capitalise that cell. By virtue of such ownership and subject to the conditions agreed in the shareholder participation agreement, the cell owner can draw dividends on the proceeds of the cell, obtain underwriting from the cell captive insurer and benefit from a number of other services provided by the promoter. The cell owner can also act as binder holder to the cell captive insurer. While first-party cells essentially self-insure, third-party cells sell insurance to external businesses or individuals and are the focus of this study.

The current cell captive landscape comprises more than a dozen cell captive insurers that, together, have a cell base of well over 300, of which around 70% are third-party cells. Of these, about two-thirds are short-term cells.

The cell captive structure holds a number of benefits from the cell owner's perspective. It is an entry route into the insurance market that provides for direct control of the business and participation in the economic benefits of insurance, at lower cost and with fewer compliance hurdles than a full insurance licence. The cell owner also has the autonomy to tailor the product offering to their vision and/or customer needs (as opposed to a pure distribution relationship), as well as the ability to innovate in a nimble structure that sits outside of the corporate culture and legacy systems of "traditional" corporate insurers.

However, the cell captive structure also holds potential risks, not least the risk of conflicts of interest arising from complex ownership, service provider and intermediary relationships. These risks gave rise to a regulatory review culminating in a discussion paper, released in 2013, proposing several regulatory reforms. With the introduction of the Insurance Act on 1 July 2018 and the market conduct reforms of the past several years, a number of these proposals have already been implemented. A Joint Communication published by the Prudential Authority and Financial Services Conduct Authority when the Insurance Act came into effect suggests a path forward for the rest, but a few aspects remain unresolved pending the publication of draft Conduct Standards.

Against this backdrop, this study asks two main questions:

- *Can the cell captive vehicle be a true enabler for transformation?*
- *Are there any remaining regulatory uncertainties or proposed positions that impact the potential economic and transformation value of cells being fully accessed and further developed?*

Based on desktop research, in-depth regulatory review and consultations with more than 30 market and regulatory stakeholders, the study finds that cell structures do indeed allow for a greater diversity of players to participate in the market and share in the economic benefits of insurance. The analysis indicates that a number of cells already fulfil a transformation role in one of, or a combination of, the following three pillars:

- **Ownership, management and control.** The analysis shows that the cell captive structure is suitable for and used by (black) entrepreneurs or businesses wishing to enter the insurance market. It allows for direct ownership and control over insurance business by a broader range of players than conventional licence holders. In some instances, cell ownership has also facilitated graduation to a full insurance licence.
- **Capacity and skills development.** The cell captive structure allows the insurer to provide the cell with establishment support, ongoing capacity-building support and mentorship. It therefore fulfils an "incubation" role for new players in the insurance market: either for capacity-building to the point of becoming a cell or in building capacity of cells as part of the graduation path to fully fledged insurer status.
- **Access.** Although the cell structure is not the only avenue for enhancing inclusion, a number of cell arrangements have an explicit financial inclusion focus.

Despite the role already played across these pillars, the high level of business acumen and capacity required to establish a cell means that cell ownership is not an instant solution for increasing the number of small black businesses in the insurance market. The cell structure is a complement, rather than a substitute, to corporate insurer ownership transformation. Moreover, many cells are not yet transformed and there is currently no concerted effort by industry to deliberately use the cell captive structure as a transformation vehicle.

What can be done to ensure that the full transformation potential of the cell captive market be unlocked?

The build-up to the Financial Sector Summit provides a good opportunity for the potentially transformative role of cell captives to be institutionalised into industry-wide transformation commitments. This can be done by making the potential transformation role of cell captives explicit, by exploring appropriate financing structures for new black-owned cells and by committing to capacity-building plans to identify and incubate promising black businesses into the cell captive space, as well as in becoming insurance licence holders, where appropriate. Making these commitments explicit means that focus and support can be dedicated to unlocking the full potential of cell captives for transformation.

For this potential to be realised, it is also essential that regulatory certainty be created on the few regulatory proposals that are still to be implemented. The main issue revolves around the question of "Who may be a cell owner?". This links to the definition of what an affinity scheme is in the insurance space and the question of whether any conflicts of interest arise when a cell arrangement that does not have an affinity relationship with its customers sells insurance. The analysis suggests that the comprehensive market conduct regulatory reforms that have been implemented since 2013 sufficiently mitigate potential conflicts of interest to warrant a general broadening of the categories of entities eligible for cell ownership.

Moreover, where insurance is distributed through an affinity, the protection of the market conduct framework should mean that the product offering does not need to be limited to those products related to the underlying business of the affinity. To ensure regulatory certainty, it would be important to extend this position to the whole market, not just through case-by-case discretion applied through the licensing and approval process.

In short, facilitating the development and transformation of the insurance market through the cell captive vehicle requires an industry commitment to deliberately leverage the cell captive structure for transformation to go hand in hand with a regulatory framework that ensures investment and innovation in the market.

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1 Introduction

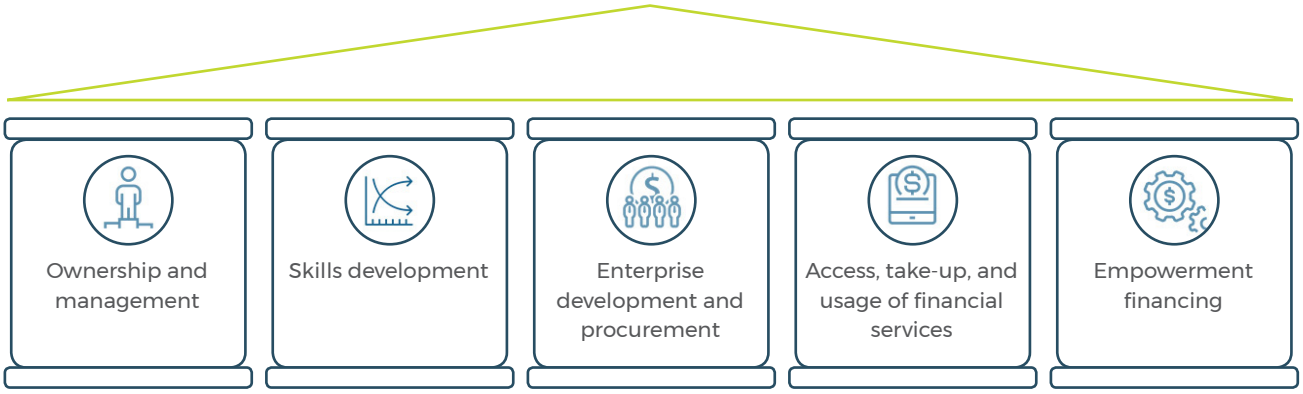
Insurance fulfils an important role in economic growth and development. Empirical evidence confirms that insurance plays a critical role in supporting and sustaining inclusive growth (USAID, 2006; literature review in Lester, 2014; Webb, 2012) and South Africa is no exception. The South African insurance sector is among the most well developed in the world and plays a strong role in the economy via both its risk transfer and capital intermediation functions. Thanks to the strong funeral insurance culture, insurance also plays an important role in the financial lives of many low-income South Africans. However, unlocking the true potential of the insurance sector to serve South Africa requires a step up in transformation.

The transformation imperative. The origins for this study lie in the parliamentary hearings on transformation in the financial sector of 2017[1] and the question that arose in that light on what more can be done to transform the financial sector, including the insurance industry. A transformed financial sector is better positioned to support poverty alleviation and address income inequality, which is critical for economic and political stability. In contrast, an untransformed sector that benefits relatively few South Africans would limit the economy from reaching its full potential of funding infrastructure and long-term capital projects that promote a healthy competitive environment, inclusive growth, and the creation of jobs (SCOF, 2017)[2].

This study asks: *What is the role of cell captives as part of the bigger imperative to transform the insurance sector?*

Intricately linked to inclusion, business development and market conduct imperatives. Transformation is defined across six pillars:

Figure 1. Transformation pillars



Source: National Treasury (2017[3])

1 Joint Standing Committee on Finance (SCOF) and Portfolio Committee on Trade and Industry (PCTI) parliamentary hearings on transformation in the financial sector held on 14 March, 22 March and 3 May 2017.
2 SCOF and the Portfolio Committee on Trade and Industry 1st Report on the Transformation of the Financial Sector (SCOF & PCOTI, 2017)
3 National Treasury submission to SCOF and Portfolio Committee on Trade and Industry (Momoniat, Havemann & Masoga, 2017).

A holistic view of transformation across the pillars asks: **who is involved** in the value chain (diversity, empowerment of black-owned and managed players), **how do they operate** and serve customers (market conduct), and **to benefit whom** (financial inclusion; market conduct outcomes; welfare impact).

More than a decade of voluntary commitments. The Financial Sector Code aims to address black economic empowerment, promote economic integration and improve access to financial services[4]. It is the culmination of more than a decade[5] of voluntary commitments negotiated between industry, labour and government: from the Financial Sector Summit of 2002, to the first tri-partite Financial Sector Charter agreement in 2004, to the eventual gazetting of the FSC as a B-BBEE Code in November 2012[6], to the latest code amendments gazetted in 2017[7].

Towards a new compact. In the second half of 2018, NEDLAC is scheduled to host a new Financial Sector Summit. The second summit will, among others, engage stakeholders on the progress in implementing the original agreements, the competitive environment relating to ownership and licensing of financial services, and the process towards new targets[8]. This stems from a recognition and a sense of urgency – as was apparent from the 2017 parliamentary hearings – that more needs to be done to accelerate the pace of transformation.

Ownership, management control and access as main insurance priorities. In the insurance industry, specifically, all stakeholders agree that, although there is progress, accelerated change is required. This is clear from the progress that the industry reports against their financial sector charter targets, where green arrows indicate below-target achievement and blue arrows denote on- or above-target achievements:

Figure 2. FSC achievements in the insurance industry relative to targets[9]

	Life offices	Short-term insurers
Black ownership	↑	↓
Management control	↓	↓
Access to financial services	↓	↓
Skills development	↑	↑
Procurement	↑	↑

Source: ASISA (2017), SAIA (2017).

4 See: Financial Sector Code (2017).
5 In August 2002, the National Economic Development and Labour Council (NEDLAC) hosted the first Financial Sector Summit. The Summit provided NEDLAC partners from government, business, labour and community constituencies with the opportunity to make representations and negotiate agreements on transforming the financial sector. In 2004, the Financial Sector Charter (FSC) Council was established and the Financial Sector Charter came into effect, with its original targets and FSC codes. In 2007, the Department of Trade and Industry (DTI) promulgated Generic Codes of Good Practice on Broad-based Black Economic empowerment (B-BBEE Codes), which essentially rendered the FSC redundant. Since 2007, negotiations were underway to re-align the FSC and the B-BBEE Codes. In November 2012, the FSC was agreed and gazetted.
6 B-BBEE Act No. 53 of 2003, S9 (1) d)
7 See: Financial Sector Code (2017).
8 See: Nedlac (2018).
9 Also see Appendix A for more details on achievement of targets.

The challenges are particularly notable at the ownership, senior/middle management and financial inclusion levels. Where financial inclusion is concerned, for example, results from the FinScope consumer survey shows that a marked divide remains between uptake of insurance among white and black population groups.

Insurance Act ups the ante. The Insurance Act, 18 of 2017 ("the Insurance Act"), which became effective on 1 July 2018, places emphasis on the developmental, financial inclusion, and broad-based transformation objectives governing the insurance industry. The Act explicitly defines "transformation of the sector" with reference to the Financial Sector Code and the Broad-Based Black Economic Empowerment Act. Notably, industry commitments towards transformation will now be considered in licensing decisions and the Prudential Authority is mandated to have regard to transformation considerations when developing and implementing Prudential Standards.

Role for third-party cell captives as part of the bigger picture. As government, labour, community and industry start to reconsider their joint transformation compact in the build-up to the new Financial Sector Summit, it is an opportune time to think out of the box in terms of the solution. Cell captive structures are a potential entry route into the insurance market at lower cost and compliance hurdles than a full insurance licence. What benefits does the cell captive structure hold for transformation and what are the issues that need to be addressed to ensure that these benefits materialise?[10]

Methodology. This document draws primarily on insights gained from more than 30 consultations with cell captive insurers, regulators, policymakers, cell owners, financiers and reinsurers[11]. The interview insights have been amplified by desktop research and a review of current and proposed regulation. The draft analysis and conclusions were presented and tested at two stakeholder workshops (one in Johannesburg, one in Cape Town). The analysis in this document reflects inputs and comments received at these workshops.

Structure. The rest of this paper outlines the cell captive landscape, its benefits and challenges, to conclude on the role of cell captives in transformation:

- Sections 22 and 3 provide an overview of the cell captive structure: what a cell captive is and how it operates, how cell captives are regulated, what different types there are and the landscape of cell captive insurers and cells in South Africa.
- Section 4 outlines the benefits of the cell captive structure, as well as the risks and issues posed by the structure.
- This leads to a discussion, in Section 5, on the current and potential role of cell captives in transformation.
- Section 6 concludes on the market and regulatory imperatives for unlocking this potential.

The main text is amplified by a number of appendices that outline regulatory details and case studies on cell captive arrangements.

10 It is important to note that these questions play out alongside and not as a substitute to the imperative and strategies for transformation of the industry more broadly.

11 See Appendix J for a meeting list.

2 The cell captive structure

A contractual arrangement based on equity participation. The cell captive structure is unique to the South African insurance industry[12]. The Insurance Act defines a cell structure, applicable to both first-party and third-party cell structures, as follows:

"cell structure" means an arrangement under which a person (cell owner) –

a) holds an equity participation in a specific class or type of shares of an insurer, which equity participation is administered and accounted for separately from other classes or types of shares

b) is entitled to share in the profits and liable for a share of the losses as a result of the equity participation referred to in paragraph (a), linked to profits or losses generated by the insurance business referred to in paragraph (c)

c) places or insures insurance business with the insurer referred to in paragraph (a), which business is contractually ring-fenced from the other insurance business of that insurer for as long as the insurer is not in winding up"

The cell structure is established by means of a contractual arrangement and the assets of each cell structure are contractually ringfenced. Thus, the cell structure is not a recognised legal persona, but is nevertheless regarded as legally robust[13].

First-party versus third-party cell structures. There are two types of cell structures. A *first-party cell structure* is used where a cell owner wishes to insure its own operational risks.[13]. In this instance, the cell owner is the policyholder and beneficiary under the insurance policy issued by the cell captive insurer. Claims under the policy are limited to funds available in the cell structure. Under a *third-party cell structure*, policies are issued to third parties, i.e. members of the public. Claims made under the policies are not limited to funds available in the cell structure and the cell captive insurer is liable for those claims where funds under the cell structure are insufficient.

12 Similar structures in the United Kingdom and other domiciles around the world are created by statute through a Protected Cell Company (PCC) arrangement. PCCs can be found in Guernsey, the Cayman Islands, the Irish Republic, Bermuda and numerous states of the USA. In these jurisdictions, a PCC is a legal entity (i.e. has legal persona) that operates with two distinct groups: a single core company and an unlimited number of cells. A board of directors is responsible for the management of the PCC, including all the cells. Although each cell is independent of each other, (i.e. the assets of each cell is statutorily segregated) and of the core, the entire unit is a single legal entity. Other similar structures are incorporated cell companies (ICC) and series limited liability companies (series LLC). These latter two structures were created to further enhance the segregation and security of the internal cells. Each of the individual cells comprise of a separate legal entity within a large conglomerate. See Simpson & Rennick (2017) for more details. See Joint Communication 2 of 2018 paragraph 5 for the regulator's rationale why PCC legislation is not being considered for South Africa.

13 Apart from the situation where the cell captive insurer is in a winding-up state, the assets and liabilities in respect of each cell structure are separately ringfenced and no cross-subsidisation between cells is allowed. The robustness of cells structures is further enhanced through the recent introduction of prescribed solvency requirements under the new Prudential Standards for ringfenced funds. One cell captive insurer interviewed confirmed that monthly solvency calculations are performed on all cell structures and solvency levels are carefully monitored. The Prudential Authority will also be publishing a Prudential Standard prescribing terms to be included in shareholder agreements to further enhance the robustness of these agreements.

This study is limited to third-party cell structures as it is the type of cell structure which has the largest potential to play a transformative role in the South African insurance sector. It is also the area where the Financial Services Board (now restructured into the Prudential Authority and the Financial Services Conduct Authority[14]) raised several concerns as published in its paper Review of third-party cell captive insurance and similar arrangements – Discussion paper; dated 11 June 2013 (from here onward referred to as the "2013 discussion paper").[15]

On 3 July 2018, the FSCA and PA published Joint Communication 2 of 2018, "Update on regulatory policy proposals mooted in the Third-party Cell captive Insurance and Similar Arrangements Discussion Paper, 2013"[16] (from here onward referred to as "Joint Communication 2 of 2018"). This recent publication provides an update on the proposals made under the 2013 Discussion paper as well as responses to key issues that were raised by the insurance industry. It is the stated intention of the FSCA and PA to issue draft Prudential and Conduct Standards for consultation to address the remaining uncertainties highlighted in this report. The Joint Communication 2 of 2018 largely confirms the findings of this report.

2.1. Evolution of the market

A proven track-record. The first cell captive insurer entered the South African insurance sector in 1993 due to a clear need for self-insurance on the part of corporates at the time. Retailers had also expressed an interest in participating in the insurance profits of products which they sold to clients[17]. Since that time, the market has expanded significantly, and cell captives have been established as a viable way to ensure both first- and third-party risks. The cell captive thus has a proven track record as a mechanism to obtain insurance underwriting, whilst sharing in both the profits and risks/losses generated.

Two main cell captive insurers. There are currently eight long-term and five short-term cell captive insurance licences[18] (Table 1, below). Guardrisk, followed by Centriq, is the largest cell captive provider. One of the long-term insurers will soon be exiting the cell captive market, leaving seven long-term cell captive insurers.

14 Restructuring or separation officially took place on 1 April 2018. The Prudential Authority is responsible for the regulation and supervision of all prudential risks, while the Financial Services Conduct Authority is responsible for the regulation and supervision of all market conduct risks.

15 See the 2013 Discussion paper (Financial Services Board, 2013a). See Section 2.2 below for a discussion on the concerns outlined in the Discussion paper.

16 Joint Communication 2 of 2018 by the FSCA and PA https://www.fsca.co.za/Regulatory%20Frameworks/Pages/Industry-Communication.aspx.

17 Confidential document shared by Guardrisk

18 At the end of 2009, there were seven long-term insurers and 11 short-term insurers engaged in cell business (Pead & Witten 2010) compared to the current number of providers. Thus, there seems to have been a consolidation of the short-term number of providers doing cell captive business. According to the FSB, however, the 2009 number included all short-term insurers doing cell captive business and not only those registered to do so. Therefore, the number has stayed largely constant, but there has been a move out of "similar arrangements" recently.

Table 1. Cell captive insurers

Long-term insurers	Short-term insurers
1. Absa Life Limited	1. Unitrans Insurance Limited
2. AIG Life South Africa Limited	2. Centriq Insurance Company Limited
3. Bryte Life Company Limited (exiting)	3. Guardrisk Insurance Company Limited
4. Centriq Life Insurance Company Limited	4. Old Mutual Insure (previously Mutual & Federal Risk Financing Ltd)
5. Guardrisk Life Limited	5. Regent Insurance Company Limited
6. Momentum Ability Limited	
7. Old Mutual Alternative Risk Transfer Limited	
8. Regent Life Assurance Company Limited	

Source: List supplied by FSB, February 2018

2.2. Regulatory framework

Although cell structures have been used as an alternative risk transfer mechanism since 1993, the legal definition of a cell structure as quoted above was only introduced under the Insurance Act.

Becoming a cell captive insurer. Not all insurers can conduct cell captive business. First, the insurer's Memorandum of Incorporation (MOI) must authorise it to issue preference shares or some other special class of shares in addition to its ordinary shares. The rights and privileges attached to these classes of shares are set out in the insurer's MOI. Second, the insurer must be specifically licensed[19] by the Prudential Authority[20] (PA) as a cell captive insurer. Under the Insurance Act, "cell captive insurer" is defined as "an insurer that only conducts insurance business through cell structures". This was not always the case: in the past, some cell captive insurers conducted insurance business directly on their own licence, as well as through cell structures. Similarly, some insurers who were not authorised to conduct insurance through cell structures had been doing so.[21] In addition to licensing an insurer as a cell captive insurer, the PA also makes the cell captive insurer's licence subject to several conditions.

Regulatory overhaul. In the 2013 discussion paper, the regulator raised several concerns with regards to risks posed by third-party cell captives and made regulatory proposals aimed at addressing these risks. The risks which gave rise to the regulatory proposals are discussed in Section 4.2.

19 Note that under the LTIA and STIA insurers are registered as insurers. The Insurance Act refers to insurers being licensed to conduct insurance business. For the purposes of this report reference to "licence" or "licensing" must be read, where applicable to include reference to "register" or "registration" and vice versa.

20 Under the LTIA and the STIA, the regulator responsible for registration and supervision of insurers is the Registrar of Insurance. Under the Insurance Act and the FSRA, the authorities regulating and supervising the conduct of insurers are referred to as the Prudential Authority (PA) and the Financial Sector Conduct Authority (FSCA). For the purposes of this report reference to "PA" or "FSCA" must be read, where applicable to include reference to "Registrar" and/or "Financial Services Board (FSB) and vice versa.

21 Source: Financial Services Board (2013a)

Table 2. Main 2013 discussion paper proposals and Joint Communication 2 of 2018 updates

Third-party cell captive discussion paper proposals	Implementation	Remaining questions
Prudential: **Licensing and business to be conducted** • Dedicated licence for cell captive business & cell captive business may not be combined with other forms of insurance business • First-party and third-party[22] business may not be conducted in the same cell[23] • Similar arrangements not allowed (Prudential and Conduct of business issue)	Dedicated licence: Insurance Act effective 1 July 2018.[24] Section 25(6)(b)(i) of the Insurance Act – cell captive insurer may not insure first-party risks and third-party risks in the same cell structure. Providers of similar business ceased similar arrangements[25]	n/a
Prudential: **Governance and risk management** • Prescribing provisions in shareholder/cell agreements • Licensing conditions to be amended	Governance and operational requirements for cell captive insurers: Insurance Act effective 1 July 2018 Already greater awareness in market of what a good shareholders agreement should look like. The detail regarding governance and risk management will be addressed in a Prudential Standard to be issued for consultation post 1 July 2018. Proposed effective date 1 January 2019.[26]	n/a
Prudential: Capital • Insurers accountable for the financial soundness of each third-party cell arrangement • Minimum capital requirement of R1m per cell rent-a-cell[27] outlawed	Solvency requirements and Minimum capital requirement determined under Prudential Standards[28] In terms of Prudential Standards – rent-a-cell not allowed.	n/a
Market conduct: **Reporting and monitoring** • Reporting on cell arrangements • Ongoing monitoring	Cell insurers already reporting to regulator at cell level (Information request 5/2016 notification on all third-party cells – market conduct and prudential)	n/a
Market conduct: **Who may be a cell owner** • Cell owner to be restricted to binder holder (UM or an affinity NMI – no non-affinity NMIs) • Approval required for NMI affinity cell owners • Criteria set for affinity scheme	Cell ownership will be addressed in a Conduct Standard. Cell ownership will not be limited to binder holders. Cell ownership by NMI will be subject to conditions set out in planned Conduct Standard. Approval will not be required for NMI affinity cell owners but notification to FSCA required via "file and use" system. Provision will be made for exemptions[29].	Who qualifies as a cell owner and who qualifies as an affinity?
Market conduct: Products • Enhanced disclosure and restrictions on "white labelling" • Affinity cells may only sell products in which it has a direct interest	Market conduct regulations under LTIA and STIA and PPRs effective 1 Jan 2018. Cell captive insurers responsible for conduct of third-party service providers. Specific requirements for white-labelling already effective. Products offered through affinity cells will be addressed in a Conduct Standard. Per Joint Communication 2 of 2018, products offered through affinity cell must result in "enhanced value proposition" to the customer, must be suitable and not compromise TCF principles. The "direct interest" proposal is maintained .	What products may affinity cells provide?

Source: Authors' own, based on regulatory review

22 See definitions of "first-party" and third-party" risks under the definitions of the Insurance Act.
23 This requirement already forms part of the licence conditions of some cell captive insurers. See Appendix B. The Joint Communication 2 of 2018 states that the reason for this prohibition is "because of the unacceptable conflict of interest inherent in these types of arrangements" and to address operational risks associated with combining first-party and third-party business.
24 Also see definitions of "cell captive insurer" and "cell structure" in the Insurance Act.
25 Joint Communication 2 of 2018.
26 Joint Communication 2 of 2018. The PA will consult on a proposed Prudential Standard
27 "Rent-a-cell" is defined in the 2013 discussion paper as a situation where the "cell promoter's capital is advanced to start up the cell arrangement" (Financial Services Board, 2013a). The term "rent-a-cell" may have different interpretations in the insurance industry but in this document the 2013 discussion paper definition is used.
28 See Prudential Standard FSI 4.
29 Joint Communication 2 of 2018. See also proposed exemption criteria on page 12 of the Joint Communication.

Table 2, on the previous page, provides a summary of the key regulatory proposals mooted by the 2013 discussion paper, how these proposals are being implemented, as well as proposals raised by the discussion paper which must still be addressed under the Prudential and/or Conduct Standards[30] and which have been highlighted in the Joint Communication 2 of 2018. Some proposals thus remain open-ended.

Many of the proposals already implemented. It is clear from Table 2 that, since the release of the discussion paper, numerous regulatory interventions have been made to improve the regulation of cell captives, also as part of broader insurance market regulatory reforms. Notable changes include:

- **Standardisation of licence conditions.** Up to the implementation of the Insurance Act on 1 July 2018, cell captives operated under the "normal" insurance regulatory framework, with special licence conditions. The licence conditions in respect of cell captive insurers that were registered under the Long-term Insurance Act, 1998 (LTIA) and the Short-term Insurance Act, 1998 (STIA) have evolved over time and currently not all cell captive insurers' licensing conditions are the same. These inconsistencies created an unlevel playing field and contributed to regulatory uncertainty. In terms of the LTIA and the STIA, the regulator's authority to amend an insurer's existing licensing conditions were limited to specific situations circumscribed under the LTIA and STIA. Under the Insurance Act, the PA has the power to vary licence conditions when, among other things, it is in the public interest or in the interest of policyholders or potential policyholders.[31] The LTIA and STIA have recently been amended to align with the Insurance Act, which will allow for the amendment of existing registered insurers' licence conditions. Under the Insurance Act, all existing registered insurers will be licensed by the PA and all cell captive insurers will then be subject to the same licence conditions.[32] The conversion process is already underway and licensing will happen over a two-year period following the implementation of the Insurance Act on 1 July 2018.
- **"Similar arrangements" phased out.** Although the main areas of concern raised by the 2013 discussion paper were related to third-party cell captives, concerns were also raised about similar arrangements[33]. Similar arrangements mimic cell captive insurance business in many respects and have in the past been structured as joint venture agreements between, for example, a distribution partner and an insurance company, with the partner entitled to a profit share on any profits made on a specific pool of clients. Sometimes, the joint venture partner would acquire shares in the holding company of the insurer. One of the main differences between a cell captive and a similar arrangement is that a similar arrangement generally does not require the partner to capitalise or recapitalise the arrangement; that is, the partner does not share in either profits or

30 Draft Conduct Standard will be published by the FSCA for consultation. See Joint Communication 2 of 2018.
31 Section 26 of the Insurance Act.
32 See Appendix B for a list of typical licensing conditions.
33 The Joint Communication 2 of 2018 defines a similar arrangement as:
"(a) an arrangement under which an entity performs certain functions on behalf of the insurer in respect of specific insurance policies underwritten by the insurer (the business) and holds a specific type of share –
(i) In the direct or indirect holding company of an insurer (the shareholding); or
(ii) In a related or inter-related person of the direct or indirect holding company of an insurer, or
(b) an arrangement which governs the contractual sharing or profits and losses between the entity and the insurer."

losses. Similar arrangements are not subject to any of the regulatory safeguards pertaining to cell captive arrangements.

The regulator stated in the 2013 discussion paper that these arrangements will no longer be permitted. Along with the formal definition of a cell structure, the Insurance Act also introduced a provision that all cell captive business must be done by licensed cell captive insurers. This requirement, together with the definition of cell structure means that "similar arrangements" are no longer allowed. From the interviews conducted, it has been confirmed that these arrangements are being phased out. Hollard, who was the main insurer offering similar arrangements, recently acquired Regent Life Insurance Company and Regent Insurance. Both these companies are licensed to conduct cell captive business.

- **Minimum capital requirement imposed.** With the implementation of the Insurance Act and the Prudential Standards issued under it, a minimum capital requirement of R1 million is instituted for all cells. According to the consultations, most cell captive arrangements already adhere to this minimum capital requirement or are in the process of implementing it. Generally, the R1 million minimum capital, or the basis for calculation of the additional capital over and above the MCR, is not questioned. The PA argues that cell owners must have "skin in the game", and meetings confirm that this is preferred.
- **Several market conduct reforms.** The past few years has seen a substantive strengthening of the market conduct regulatory framework in line with the treating customers fairly (TCF) framework. Relevant recent market conduct provisions with a bearing on market practices in the cell captives space include the implementation of the policyholder protection rules (PPRs) and the regulations under the LTIA and the STIA that became effective on 1 January 2018, which address market conduct risks and enhances policyholder protection.

Remaining uncertainties. As highlighted in Table 2, two main areas of regulatory uncertainty remain:

- **Who may be a cell owner?** The 2013 discussion paper proposed that only binder holders should be cell owners. It was proposed that cell ownership should be restricted to underwriting managers (UM)[34] or, in the case of non-mandated intermediaries (NMI)[35], should be only in terms of an approved affinity scheme[36]. Currently, cell ownership is not restricted as proposed in the 2013 discussion paper. The different types of cell ownership structures present in the market are discussed in Section 3.1.
- **What products may be provided by affinity cells?** The 2013 discussion paper proposal was that products provided by an affinity cell must be related to the core/main business of the affinity. During the consultations, it was argued strongly that it is reasonable for the affinity (e.g. retailer) to market products that serve the needs of their client base, even if such financial needs are not limited to the primary business

34 See Appendix D for definition.
35 See Appendix D for definition.
36 An "affinity scheme" is defined in the 2013 paper of the Financial Services Board (2013a) as an arrangement where "the following conditions need to be in place: [a] there is a clear and direct relationship between the sale of the insurance and the protection of the underlying brand, and [b] there should not be a reasonable expectation in the customer's mind that they are being provided with independent advice in the purchase of the insurance, as in fact the advice and sale by the intermediary will be clearly directed towards a particular insurance product."

of the affinity (for example, a retailer selling an education endowment). Section 3.1 sets out the different affinity and non-affinity cell modalities currently found, and the product range provided.

In Joint Communication 2 of 2018, the FSCA confirmed that a draft Conduct Standard will be issued for consultation which will, among other things, set out requirements for cell ownership and criteria for an affinity relationship. The FSCA also confirmed that cell ownership will not be limited to binder holders as originally proposed, and that exemptions will be considered where there is a demonstrable transformation benefit. Until a final Conduct Standard has been issued, the issues highlighted above will remain unresolved.

Prohibition of rent-a-cell arrangements also seen as contentious by some. Some interviewees suggested that it has, in the past, been the practice for the insurer to fully capitalise the cell initially. The cell then pays a fee, known as a solvency fee, for this service and is only able to start drawing dividends (which is a return on its capital investment in the cell structure) when it has built up its own capital base. This practice, sometimes referred to as "rent-a-cell"[37] was specifically highlighted by the 2013 discussion paper as a concern. The PA has confirmed that the initial capital investment of R1 million minimum must be the cell owner's own capital and this intention is carried over into the Prudential Standards. That means that current so-called rent-a-cell market practices would need to change. This was raised as a potential constraint in some interviews, though it was noted that the minimum risk capital does not pose a major barrier to most prospective entrants, meaning that rent-a-cell is not needed for the majority of cells. Section 2.3.5 considers the financing of cells in more detail.

"Cell ownership will not be limited to binder holders as originally proposed, and exemptions will be considered where there is a demonstrable transformation benefit."

37 This is defined in the 2013 discussion paper as a situation where the "cell promoter's capital is advanced to start up the cell arrangement." (Financial Services Board, 2013a).

2.3. How a cell captive arrangement is created and operates

The inner-workings of a cell captive arrangement are not known to the general public. This section provides an overview of how a cell captive structure is created and operates, the main cash flows and the various roles and parties that are typically involved in a cell structure.

2.3.1. The establishment of a cell

Shareholder participation agreement sets the parameters. A cell structure is created by an agreement between a cell owner and a cell captive insurer. This agreement is commonly referred to as a participation agreement or shareholder's participation agreement (SPA). The SPA will typically cover operational and other governance issues. In Joint Communication 2 of 2018 the PA confirmed that a draft Prudential Standard will be issued for consultation, which will address the governance and risk management of cell structures. Terms and conditions of SPAs will also be prescribed. SPAs typically cover the following matters:

- Number of shares issued and share price
- Accounting records that will be maintained by the cell captive insurer in respect of the cell (i.e. types of accounts and the entries)
- Dividend payments and requirements for dividends to be paid, namely approval by the cell captive insurer's board and solvency of the cell structure
- Fees and charges payable from the cell accounts
- Capital adequacy requirements and other financial requirements, to ensure that the cell is financially sound. It is industry practice for the cell captive insurer to treat each cell as if it were a separate mini-insurer.
- Circumstances under which the cell owner may be required to recapitalise the cell
- Circumstances under which the cell may be terminated and the exit strategy to ensure policyholders are protected

Creating a cell structure entails that the cell captive insurer issues a special class of shares to the cell owner for which the regulator's prior consent must be obtained.[38]

Prior due diligence. At the outset, as part of its decision on whether to enter into an SPA, the cell captive insurer determines the feasibility of a cell structure. Some of the salient issues that are considered are: the business idea, the product and benefits to be provided, the market at which the product is aimed, the expected premium and claims ratio, and reinsurance requirements. The ownership structure of the cell owner, as well as those of all third-party service providers to the cell, are interrogated. This is a critical step in setting up a cell structure as the cell captive insurer is responsible for the governance and oversight of the parties to the cell. The cell captive insurer must also ensure that its licence conditions are not transgressed, especially the condition that an independent intermediary may not own a cell structure or be related to the cell owner.[39]

38 Under s24(a)(ii) of the LTIA and s23(a)(ii) of the STIA the consent of the Registrar is required before an insurer may issue preference shares, debentures or share warrants, or convert any of its shares to these, or reduce its share capital. In terms of Information Letter 4/2016, dated 12 September 2016, standing approval was granted for the issuance of shares by a cell captive insurer or for a change in the capital structure of cell captive insurers (Financial Services Board, 2016b). This standing approval allows cell captive insurers to establish cell structures without undue delays. The Insurance Act allows the PA to prescribe the circumstances in which approval will not be required.

39 See typical licence conditions for cell captive insurers in Appendix B.

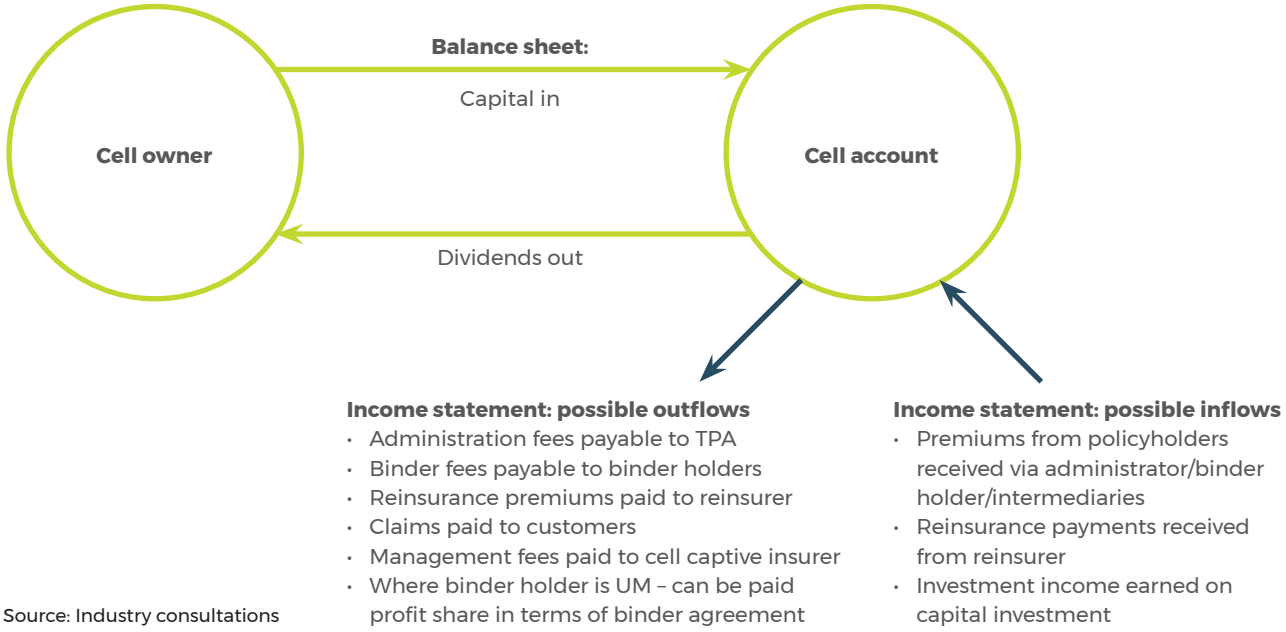
2.3.2. Financial flows

The cell structure provides the cell owner the opportunity to participate in the economic benefits of the insurance conducted under the cell structure. The main cashflows of a cell structure can be illustrated as depicted in Figure 3 below.

The cash flows of each cell structure are underpinned by an income account (and therefore income statement flows) and a capital account (associated with balance sheet changes). The accounting entries are set out in the SPA and debits and credits can only be made as authorised under the SPA.

It is important to emphasise that profit sharing will only occur where the binder holder is an underwriting manager. All profits will then be paid as per the profit-sharing terms in the binder agreement. All cells will, however, be entitled to dividends as a risk return for capital provided in the capitalisation of the cell structure. This is considered a reward for their willingness to take on risk or having "skin in the game". In return, the cell owner carriers the responsibility to recapitalise the cell, should more capital be required.

Figure 3. Financial flows into and out of the cell account

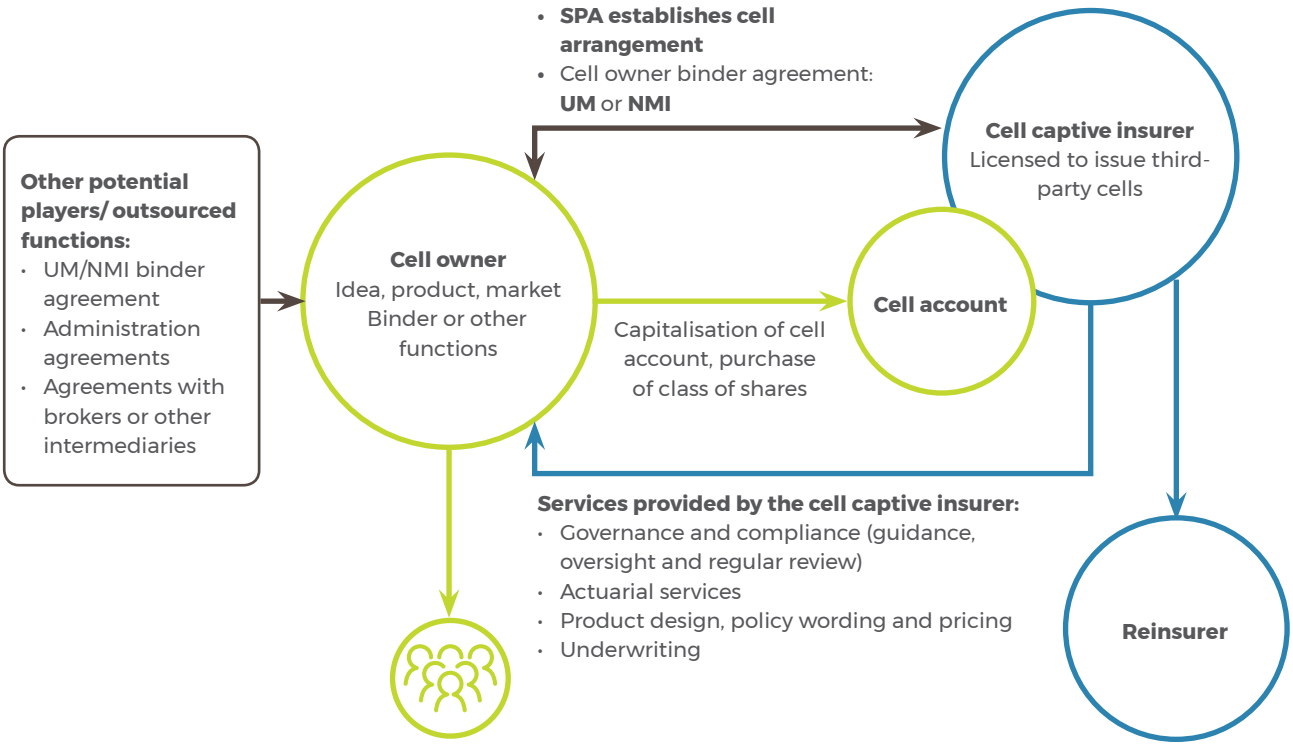


Source: Industry consultations

2.3.3. Parties and roles

A cell structure will always have a cell captive insurer and a cell owner. Most cell structures also involve a reinsurer and third-party service providers. Figure 4 outlines the main parties and roles in the cell captive structure:

Figure 4. How does a cell captive structure operate?



Source: Authors' own, interviews and regulatory interpretation

Insurer renders services to the cell, assumes compliance accountability. As depicted in Figure 4, the cell captive insurer renders various services to the cell owner, depending on what is agreed in the SPA. These services include administration, product design and underwriting, as well as actuarial services. Arguably the most important function is that the insurer assumes the accountability for the actions of all the players in the arrangement from a regulatory compliance point of view. The insurer conducts thorough due diligence on all parties involved before entering into an SPA or service agreement.[40]

Cell owner runs the daily operations. The cell captive insurer reduces the operational and compliance burden for the cell owner. In return, the cell owner capitalises the cell initially and provides the idea, product, and market or distribution channel that form the heart of the cell value proposition. The cell owner often acts as binder holder. This can take the form of an Underwriting Manager (UM) or a Non-Mandated Intermediary (NMI). A UM conducts underwriting and administration functions on behalf of the insurer, but it is not allowed to sell directly to the public. An NMI may distribute insurance to the public. It also fulfils various binder functions on behalf of the insurer other than underwriting binder functions. Even if not a binder holder, the cell owner can still act as an administrator.

Thus, the cell owner must decide how the insurance products offered under the cell structure will be distributed to customers, what role it will take on and what roles will be outsourced to third parties.

Outsourcing to third parties. Where the cell owner does not act as binder holder and/or administrator, the cell captive insurer will appoint other third-party service providers to perform services in respect of the cell structure. There could also be more than one binder holder and/or administrator performing different functions in respect of the cell structure. The appointment of third-party service providers by the cell captive insurer to perform services in respect of the cell structure is known in insurance terminology as outsourcing.[41] Outsourcing by an insurer of any insurance business to third-party service providers must be done in a responsible manner and not expose the insurer to any reputational and/or operational risks.[42]

Appendix C discusses each of the main parties involved in the cell structure and the regulatory requirements that apply to different parties in more detail. The role of reinsurers is considered separately, below.

“Outsourcing by an insurer of any insurance business to third-party service providers must be done in a responsible manner and not expose the insurer to any reputational and/or operational risks.”

40 See Appendix D for a discussion of binder services rendered as well as an overview of the various regulatory requirements.
41 See section 1 of the Insurance Act and section 1 of the Financial Sector Regulation Act, 2017 (FSRA).
42 Regulation 6.2A sets out the governance and oversight requirements in respect of binder agreements. These requirements must be met before the binder agreement is entered into and for the duration of the binder agreement.

2.3.4. The role of reinsurers

The cell captive insurer can decide to underwrite the risks under the cell structure on its own or may enter into one or more reinsurance[43] arrangements. Reinsurance means that the insurer takes out an insurance policy with a reinsurer to transfer some of the risks it has undertaken to underwrite under policies issued under a cell structure. There are two broad types of reinsurance available to cell captive insurers: treaty reinsurance[44] and facultative reinsurance[45].

Reinsurers play a market-making function in the cell structure. Although the reinsurance arrangement is a contract between the cell captive insurer and the reinsurer, the reinsurer in many instances also has a direct relationship with the cell owner outside the reinsurance relationship described above. From the interviews conducted with reinsurers, cell owners, and binder holders, it is evident that reinsurers could play a significant role in a prospective cell owner's decision to set up a cell structure. One new cell owner indicated that it was a reinsurer who suggested that they were ready to transform from a pure administrative entity to a cell owner. From interviews with reinsurers, it seems that they tend to play a strategic role in the cell captive market.

Like cell insurers, reinsurers provide capacity and compliance support. From the cell owner's perspective, the reinsurer provides access to specialist skills especially in underwriting[46], product design and claims management. Because reinsurance agreements are often long-term agreements, reinsurers are prepared to assist prospective cell owners with their products and pricing before the cell structure is finally established. This is illustrated in Figure 5 on the next page.

43 It must be noted that reinsurance and the management thereof is the sole responsibility of the insurer notwithstanding the fact that the cell owner and the reinsurer may have an existing business relationship. Also see Joint Communication 2 of 2018 and Prudential Standard GOI 3.3 "Reinsurance and Other Forms of Risk Transfer by Insurers, and the Insurer's Reinsurance and Other Risk Transfer Policy."

44 Treaty reinsurance is the most common type of reinsurance. This type of reinsurance covers an agreed percentage of a defined class of an insurer's business. In the case of a cell captive insurer, the business written under a specific cell structure would qualify as a defined class of business for purposes of a reinsurance treaty. The part of an insurer's business that is not reinsured under the treaty is called the insurer's net retention.

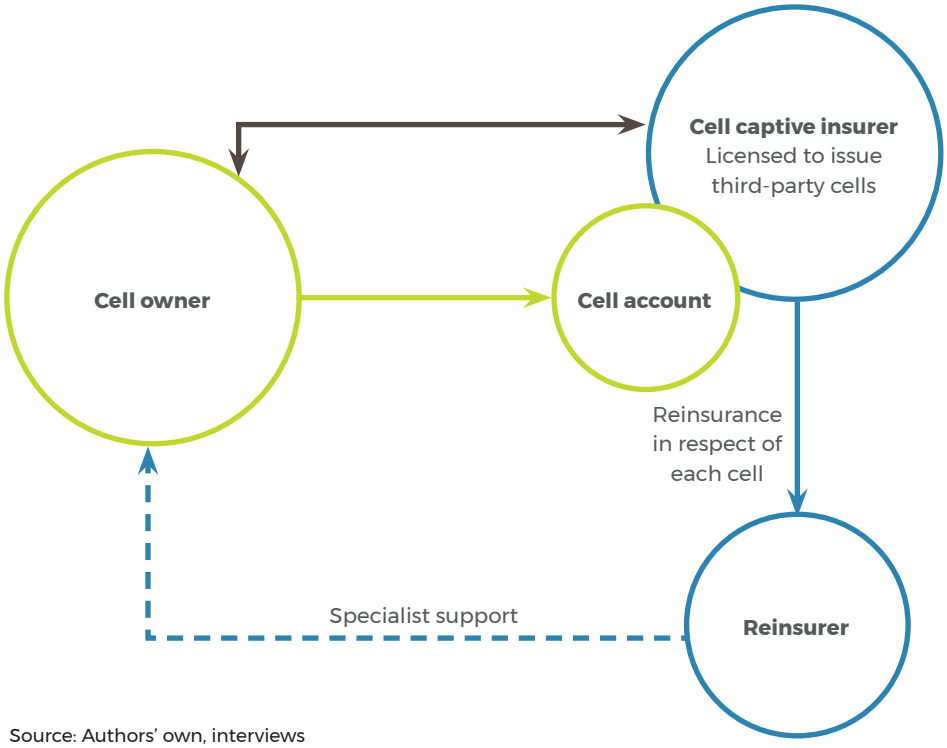
45 Facultative reinsurance is typically used for large, unusual or catastrophic risks. A facultative reinsurance contract covers all or part of a single specific insurance policy. Each time an insurance is presented to the reinsurer, the reinsurer has a reserved power known as a "faculty" to accept or decline all or part of the presented insurance policy. The insurer, in turn, chooses whether to reinsure a policy. Each time the insurer enters into a policy, the insurer and the reinsurer will negotiate the terms of the facultative certificate pertaining to that specific policy. Facultative reinsurance can also only apply to an insurer's net retention.

46 "Underwriting" is defined by Santam Limited as the process of examining, accepting or rejecting insurance risks and classifying or segmenting the accepted risks to charge the proper premium for each – page 62 Short-term Insurance in South Africa 2016 Liz Still & Gareth Stokes Published by S&S Analytica Limited.

Financial reinsurance a form of operational capital for new cell structures. Another form of reinsurance, which (from the interviews) appears to play a role in the cell captive insurance space, is what is known as financial or finite reinsurance (finre). Two types of reinsurance financing are provided: that for a future block of business or per new policy sold.[47] This type of reinsurance allows for the payment of a premium by the reinsurer to the insurer in the form of a loan or advance.

The size of the premium is determined with reference to the financial strains expected to be experienced by a cell structure in the start-up phase, i.e. before profits from the cell are sufficient to cover financial risks. The details on the transaction is captured as part of the reinsurance treaty. This type of financing is typically only provided to cell structures who reinsurers view as having the potential to disrupt the market.

Figure 5. The role of the reinsurer in a cell captive arrangement



Source: Authors' own, interviews

47 "Block of business" finre: The reinsurers pay an allowance (recorded as a loan or advance in a deficit account) to the cell structure for an estimated volume ("block") of future business. Per policy finre: For each new policy sold, the reinsurers extend an allowance (recorded as a loan or advance in a deficit account) to the cell structure. This accumulates over a period.

2.3.5. Financing of cells

Cell ownership sets quite a high bar. It was clear from the interviews that becoming a cell owner requires significant capacity, skills and capital. As one interviewee noted "not everybody with a good idea can become a cell owner". The requirements to be met can be grouped according to whether they relate to capital outlays (prudential or operational) or are entry requirements set by cell captive insurers, as outlined in Table 3 below.

Apart from the R1 million needed to capitalise the cell, interviewees suggested that acquiring the necessary systems and infrastructure to operate a cell entails a layout of at least R5 million to R6 million. Thus, the need for operational capital overshadows the statutory risk capital requirements.

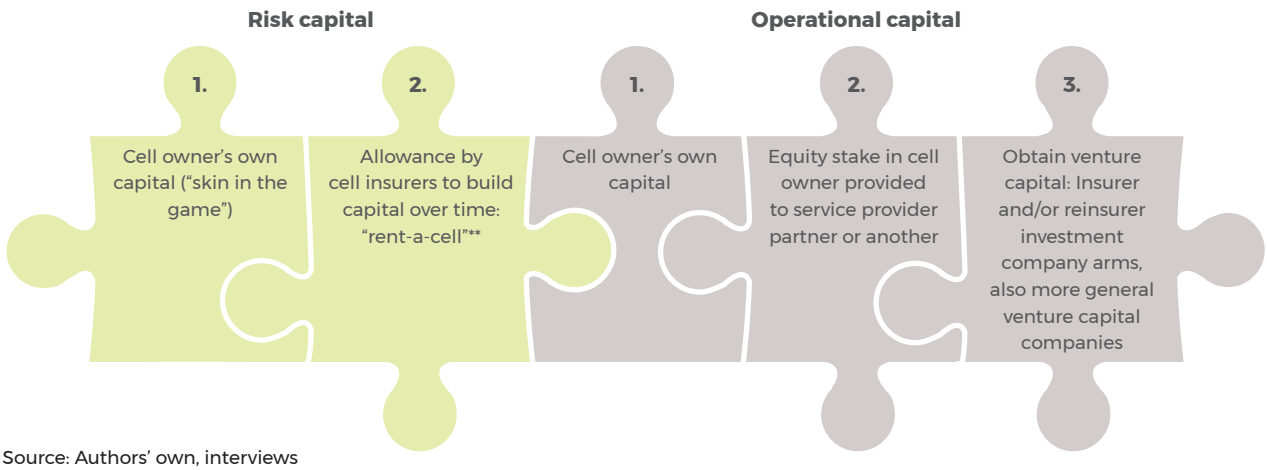
Various sources of capital. The cell owner must either put up its own capital to meet the risk and operational capital requirements or draw on external financing. Figure 6, on the next page, outlines the different potential sources of risk and operational capital, respectively, which emerged from the consultations.

Table 3. What does it take to be a cell owner?

Cell owner capital required	Call captive insurer requirements
Minimum statutory capital: R1m – must be own capital	**Due diligence:** Legal entity structure; financials; risk management – governance and compliance
Solvency capital: Determined by insurer – only 15% of insurer's own solvency capital may be taken into account (Prudential Standards)	**Value proposition:** Idea/product/market; cost; expected claims ratio
Operational capital: For start-up add additional infrastructure/operational capital – from interviews conducted this could range from a minimum of R5m – R6m	**Distribution method:** Insurtech/social media/call centre/intermediaries Operational requirements: IT infrastrucutre; automation; value chain service providers

Source: Industry consultations

Figure 6. Different sources of risk and operational capital



Source: Authors' own, interviews
** The term "rent-a-cell" is used here as per the meaning assigned in the 2013 discussion paper

> The cell owner must either put up its own capital to meet the risk and operational capital requirements or draw on external financing.

Own and insurer provision for cell capitalisation. Where the risk capital sources are concerned, the cell owner's own capital is the main source. In addition, as discussed in Section 2.2, there has also traditionally been a market practice, whereby the cell captive insurer initially fully capitalises the cell at a fee to the cell owner, which is now no longer permissible.

Equity or venture capital investors supply operational capital. For the operational capital component, the cell owner can again draw on its own capital. This is typically the case for well-established players in the insurance industry, e.g. insurance executives exiting insurance companies to start their own new businesses. However, new players – especially when viewed from a transformation or fintech point of view – may not always be in the position to use their own capital. Such prospective cell owners look to either equity or venture capital investors for their operational capital needs:

1. **Equity participation not widespread, but possible.** The cell owner first has to prove its viability before it is able to start selling equity. More general sources of equity funding are available from service provider partners; for example, from an intermediary, if the cell owner is an underwriting manager.
2. **Obtain venture capital:** Some insurers and reinsurers have investment company arms, for example, Lireas Holdings of Hannover Re in South Africa. There are also more general venture capital or private investment companies (e.g. Leapfrog Investments, Quana Capital) and donor-linked investors (or development finance institutions), such as that of the International Finance Corporation (World Bank), that could provide funding to cell captives. ASISA has an Enterprise and Supplier Development Fund that would fall under this source of operational funding. It has funded at least one cell, Meerkat (see Box 3 for a description of the fund)[48] . There was a strongly expressed preference for fintech or insurtech investments, but also with recognition that these types of investments tend to be cash hungry in the initial stages. We conducted a few interviews with capital/venture capital providers – although they had been approached by quite a few entrepreneurs interested in providing insurance through a cell structure, they had made limited investments in these structures. They have also not pursued a specific transformation agenda through their cell captive investments to date but acknowledge that this is a potential area of interest.

48 Source: ASISA, (n.d)

3 The cell landscape

3.1. Cell owner landscape and types

From industry figures obtained for this study, there were approximately 300 cells (long- and short-term) between the two largest cell captive insurers at the time of writing, of which 210 (more than 70%) were third-party cells (Figure 7). About two-thirds of these cells were short-term cells.

Should we assume that the remaining cell captive insurers between them have another 50 cells, bringing the total number of cells to 350, it implies that the market has almost doubled in terms of the total number of cells since the 2013 discussion paper, where the FSB reported the total number of third-party cell captives to be 180, of which 130 were short-term cell arrangements and 50 were long-term. The ratio between the number of long-term and number of short-term cells has remained more or less two-thirds to one-third.

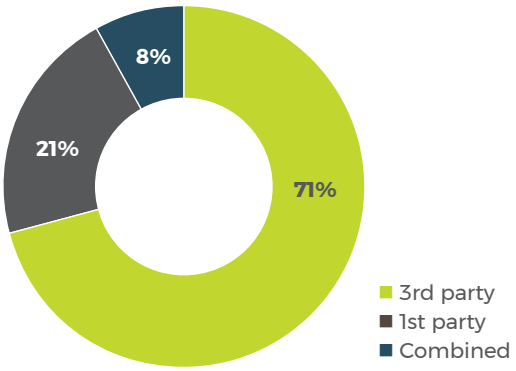
3.1.1 Typology

In this section, we describe the different cell structure arrangements, as well as the criteria used to arrive at the classification.

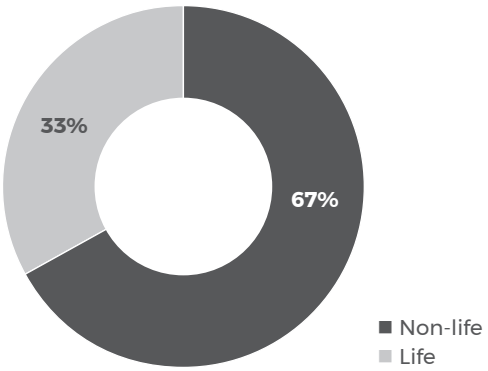
Four main types or categories of cell structure ownership were identified from the interviews. The four types were constructed using regulatory characteristics highlighted in the 2013 discussion paper. This allows for the mapping of cells in terms of how they meet (or do not meet) regulatory criteria, while also highlighting cell structures that will have to revisit their models once the FSCA's conditions under the proposed Conduct Standards are published.

Figure 7. Breakdown of the cell landscape

Largest cell captive insurers: first vs third party
n ≈ 300



Largest cell captive insurers: LT vs ST
n ≈ 300



Source: Data supplied by industry players

The criteria used in constructing the ownership typology are:

- Whether the cell owner is a binder holder;
- Whether the cell owner is an underwriting manager;
- Whether the cell owner is a non-mandated intermediary; and
- Whether the cell owner has an existing affinity relationship with clients at the time of establishing the cell structure.

> Four main types or categories of cell structure ownership were constructed using regulatory characteristics. This allows for the mapping of cells in terms of how they meet (or do not meet) regulatory criteria.

Table 4. Cell owner types

	Underwriting manager cell (UM)	Affinity cell (NMI)	Non-mandated intermediary (NMI) cell	Silent partner cell
Cell owner is binder holder	✓	✓	✓	×
Cell owner is underwriting manager	✓	×	×	×
Cell owner is non-mandated intermediary (NMI)	×	✓	✓	×
Affinity relationship with clients	×	✓	×	×

Source: Authors' own, based on interviews

The main parties to a cell structure, as discussed in Section 2.3.3 and Appendix C, also apply to the four models described below, but in each case there is a slightly different role configuration or different regulatory limits placed on the functions that they can fulfil.

Model A: The cell owner as underwriting manager

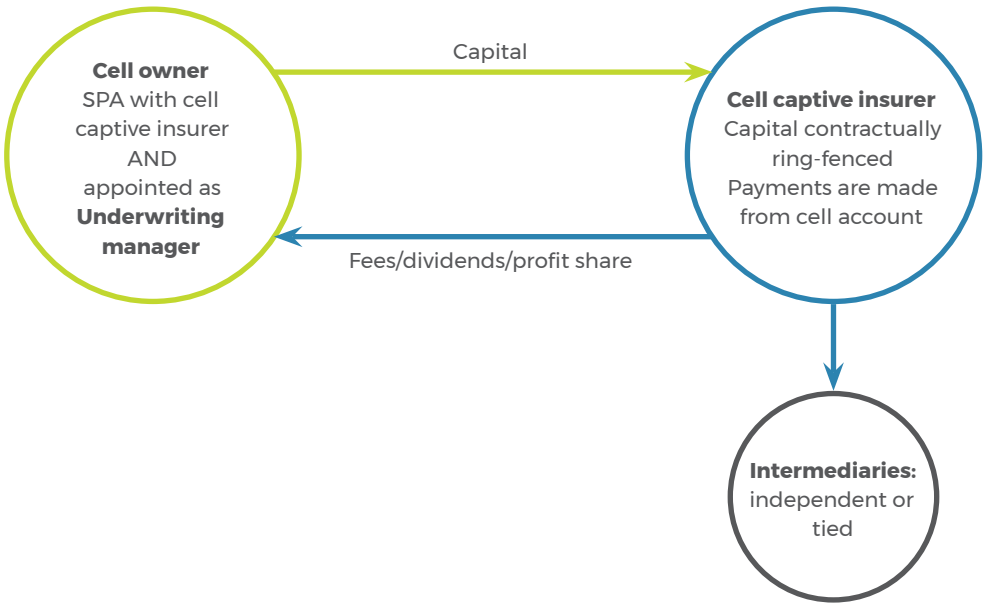
Under this model the cell owner also acts as the cell captive insurer's binder holder. In this model, the binder holder is an underwriting manager.

As underwriting manager, the cell owner may not sell the products provided through the cell structure to the public. An intermediary is therefore appointed to market and sell the products. As binder holder, the cell owner will perform binder functions as agreed between the cell owner and the cell captive insurer and will be entitled to a binder fee for the services provided. It may also share in underwriting profits. This model is more common in the short-term insurance space than in the long-term space, in absolute numbers. It represents a minority share of total cells.

Examples of these types of cell structures, as identified through our interviews, include: Axxis Insurance, a provider of specialised commercial asset insurance; Mohlokomeli Financial Services, the owner of a cell structure that provides funeral insurance to farm workers on sugarcane farms in rural KwaZulu-Natal; and Natsure, a specialised short-term insurance business.

Mohlokomeli is particularly relevant from a transformation perspective. Together with a consortium of partners, it provides funeral insurance to under-serviced farm workers on sugarcane farms in rural Kwazulu-Natal. It does so through financial education workshops and a fast and simplified claims process, which has been enabled through technology. More information on the business model and transformation characteristics of Mohlokomeli Financial Services can be found in Appendix F.

Figure 8. The cell owner as underwriting manager



Source: Authors' own, based on interviews

Model B: The cell as affinity

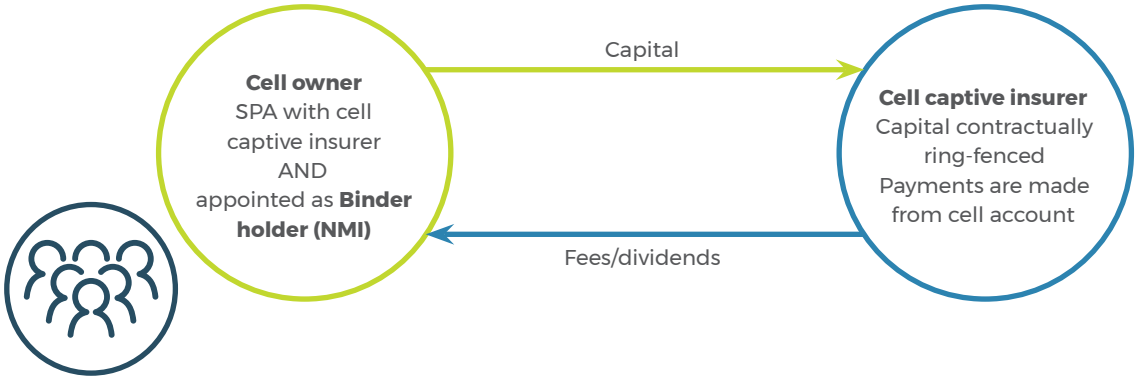
Under this model the cell owner has an existing relationship with an identifiable customer base which is regarded as an "affinity group" (see the clear line around the customer base in Figure 9).

These customers are often account holders or club members of the cell owner. The cell owner also acts as the cell captive insurer's binder holder and is a non-mandated intermediary. As non-mandated intermediary, the cell owner is also mandated to market and sell the products provided under the cell structure and the cell products are directly marketed to the affinity's customers/members. For a retailer or an entity with an existing relationship with potential clients, this is important since their rationale for entering the cell captive market lies in their ability to intermediate products directly. It is, however, also possible that another distribution model may be used, such as independent intermediaries or agents of the cell captive insurer.

A good example of an affinity cell that informs this study is SA Taxi. SA Taxi provides credit to finance the purchase of minibus taxis. It was a logical next step for the firm to also provide short-term insurance (asset cover) and credit life insurance to the owners of these taxis. These products also support the financial viability of their credit business model. Given SA Taxi's proximity to its clients, it has further expanded its product range to suit the needs of taxi drivers. It now also provides life insurance cover to the beneficiaries of taxi drivers. More information on SA Taxi and the transformation role it is playing in the South African cell captive space can be found in Appendix I.

Also see Box 1 on the role of retailers in insurance distribution in general (beyond just the cell captive model).

Figure 9. The cell as affinity



Source: Authors' own, based on interviews

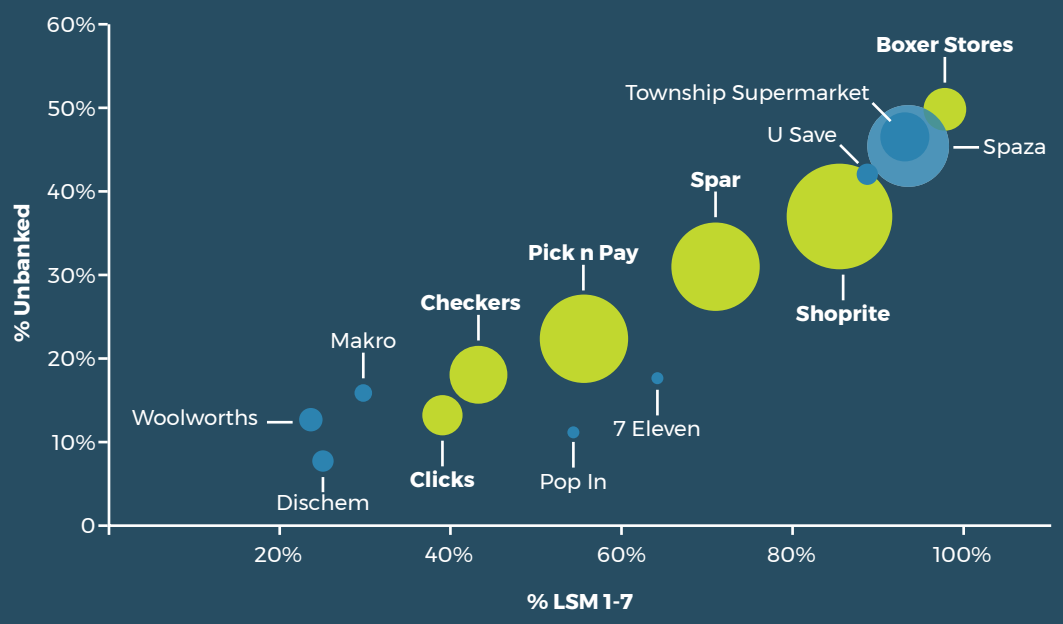
Box 1. Facilitating insurance distribution through the retail footprint

Retail insurance distribution, commonly known as "brandassurance" or affinity arrangements, is widespread – globally and in South Africa. Of the 6,000 major retail brands researched by Finaccord across 60 countries in 2014, 281 (4.4%) distribute at least one insurance or assistance product (Finaccord, 2014). This was an increase from the 232 retailers that were found to be selling insurance or assistance products in 2010. Department stores and variety retailers are the most likely (12.5%) to provide insurance, followed by supermarkets and hypermarkets (10.5%), and specialty retailers (3.9%).

In South Africa in 2010, 19% of retailers sold some form of mainstream insurance; and, in 2014, 10.8% of retail brands in South Africa sold insurance (Arnfield, 2010). There are a number of well-known existing examples of insurance distribution partnerships through retailers in South Africa – some of them through cell captive models. The insurance products distributed do not relate only to the underlying business of the retailer. For example, a number of clothing chains sell funeral insurance.

Retailers and inclusion. The use of retailers to distribute insurance helps facilitate trust in intangible products, such as insurance. In addition, the retailers often have well-developed existing distribution systems and hence can sell insurance policies at low marginal cost. This results in a greater reach for the insurer at a relatively low cost.

Figure 10. Customer characteristics of large retailers in South Africa



Source: Eighty20, 2014: 4

Figure 10 shows the share of the customers in the bottom seven of the ten Living Standards Measure (LSM) groups along the x-axis. The y-axis shows the share of customers that are unbanked. Thus, the further up and the further to the right on the graph, the more of the retailers' customer base are likely to be financially excluded. The size of the bubbles represents the size of the client base. A number of retailers have a substantial reach in the lower-income, relatively unbanked market.

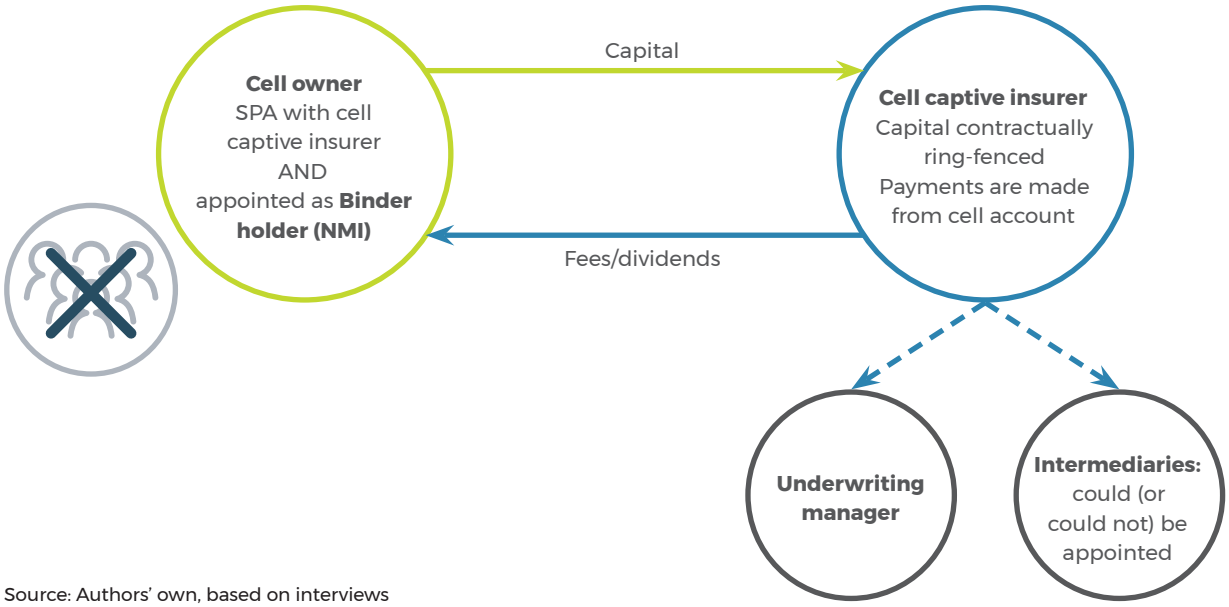
Model C: The cell owner as non-mandated intermediary

Under this model, the cell owner[49] is typically an entrepreneur with a specific distribution platform or IT solution. The cell owner has a value proposition and distribution model to market products to an identified market, e.g. people under debt review, the employers of domestic workers or small businesses. However, unlike the second model, (the affinity cell,) the cell owner does not have an existing affinity relationship with this market.

The cell owner could play the role of an NMI if it fulfils binder services in addition to being the owner of the cell structure. As NMI, the cell owner would usually market and sell the products under the cell structure as the tied agent of the cell captive insurer, though in principle it is possible for the cell captive insurer to also appoint a third-party intermediary (see Figure 11 below).

The difference between model C and model B is that, in the case of the non-affinity NMI cell, the cell is established to create its own pool of clients over time, but there is no pre-existing affinity relationship. This type of cell structure would not meet the "affinity" criterion proposed in the 2013 discussion paper and would be at risk of being disallowed, should the proposals be implemented.

Figure 11. The cell owner as non-mandated intermediary



Source: Authors' own, based on interviews

49 Note that, in some instances encountered, the cell owner is a different legal entity to the NMI, but the two organisations are in the same holding company structure. Such arrangements exhibit features of Model D, but we have classified them as Model C because, from the customer's perspective, the model is that of the cell as NMI.

Examples of these cell structures, as identified through our interviews, include: Simply, a provider of simplified, affordable long-term insurance products (life, funeral and disability) through digital marketing channels to lower-income individuals, domestic workers and small businesses; Meerkat, a debt-restructuring provider that also providers credit risk cover (life, disability and critical illness) to clients[50]; and Platinum Life, a "referral only" or network market provider of accidental disability and niche critical illness (cancer only) health insurance products. A further example of such a cell structure is Paramount Life, a niche provider of enhanced and impaired life annuity products.

A detailed case study on Simply is contained in Appendix G. Box 2 provides more details on Paramount Life.

> The difference between model C and model B is that, in the case of the non-affinity NMI cell, the cell is established to create its own pool of clients over time, but there is no pre-existing affinity relationship.

Box 2. Paramount Life

Paramount Life, a registered financial services provider, specialises in the design and sale of insurance products for individuals at or after retirement.

Paramount Life sells two insurance products: a living annuity and a guaranteed life annuity. Paramount Life was the country's first provider of a type of guaranteed annuity product known as an enhanced or "impaired" annuity – a guarantee for life even if circumstances change.

Through the cell captive arrangement, an entrepreneur was afforded the opportunity to provide a unique retirement product which was previously not available in the market by identifying and targeting a niche need in the insurance market.

Paramount Life Cell Company owns a cell in Guardrisk Life. Paramount Life Pty (Ltd) is an NMI binder holder performing the functions of entering into contracts and claims settlement. Both companies are owned by Paramount Holdings. Thus, though the cell owner itself is not the NMI, the model, from the customer's perspective, is still that of the cell as NMI.

Independent/third-party brokers are responsible for the marketing and selling of all products.

Source: http://www.paramountlife.co.za/

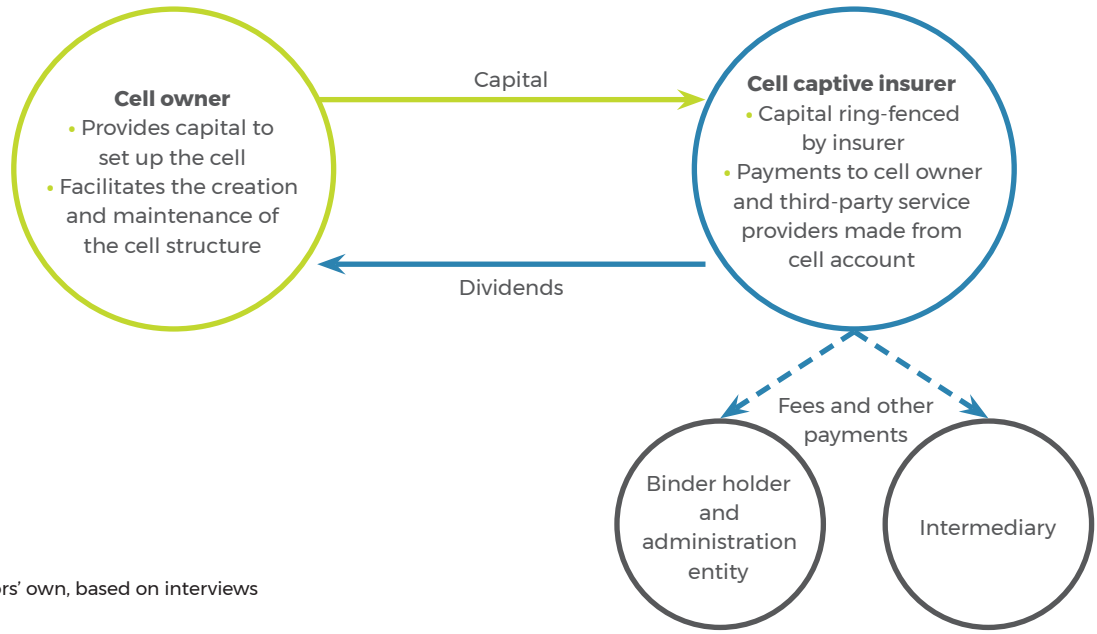
50 Note that, while Meerkat is the "face" of the cell captive arrangement, it is an NMI binder holder and the cell owner is a different entity, Zalpen. Zalpen would classify under Model D.

Model D: The Silent partner cell owner

From the interviews, it emerged that there are instances where the cell owner does not perform any services directly related to insurance provision under the cell structure. The cell owner capitalises the cell and is responsible for ensuring the continued solvency of the cell. The cell owner facilitates the entire cell arrangement and risks its own capital. It therefore has a vested interest in the success of the cell structure. While it may provide inputs or suggestions to product development, it does not perform any underwriting or client-facing functions directly. F this model to work, third-party service providers will be appointed by the cell captive insurer to perform the various insurance-related functions, such as binder functions and other administration services. The distribution of the cell products could be done by independent intermediaries or agents appointed by the cell captive insurer. Because of the cell owner's limited role in performing insurance functions, we refer to this model as the "silent partner" model. Figure 12 depicts the various roles.

According to the 2013 regulatory proposals, this type of cell was at risk of being disallowed as the cell owner is not also a binder holder. On 3 July 2018, the FSCA confirmed that there may be good reasons why this model should be allowed.[51] The FSCA has however not expanded on what, in their view, would constitute "legitimate" reasons for this type of cell and it is expected that this will be covered in the draft Conduct Standard to be published for consultation.

Figure 12. The silent partner cell owner



Source: Authors' own, based on interviews

51 Joint Communication 2 of 2018.

An example of this type of cell owner, as identified through our interviews, is the Public Servants Association (PSA). PSA, through the cell captive, offers personal line insurance (motor and household insurance) to clients[52]. It has a vested interest in ensuring value-for-money products for its members and has facilitated the availability of these products through the cell captive structure.

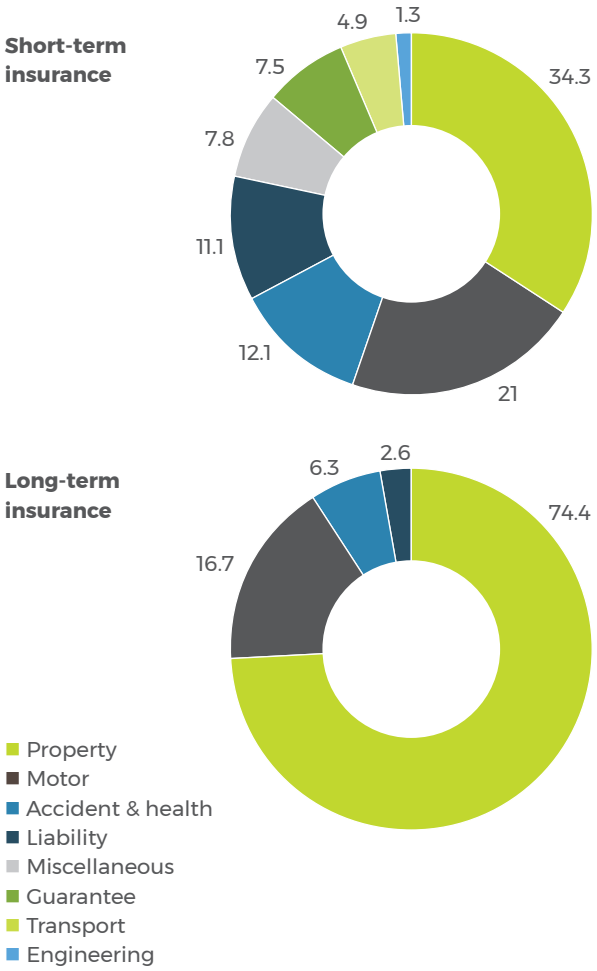
3.1.2 Product offering

Cell structures can provide any insurance business which the cell captive insurer is licensed to offer. In 2017, the main product categories by gross written premium for long-term cell captive insurers were life and health, while the main short-term cell captive product categories were property and motor (see Figure 13).

From our interviews, which were focused on cells with transformation potential, the following main product types were identified:

- A number of cells we spoke to provide funeral cover under either the assistance business or life product classes, underwritten on an individual or group basis. Funeral cover is the most popular product option for cells more focused on the low-income end of the market.
- Credit life
- Life cover packaged as dread disease cover against cancer
- Low-cost/low-cover life and disability products
- Corporate asset or niche short-term insurance products, including products in the engineering, aviation and renewable energy sectors

Figure 13. Premium breakdown (in %) for cell captive insurers



Source: FSB quarterly report, September 2017

52 PSA also distributes funeral and life insurance to members outside of the cell arrangement.

4 Why go the cell route?

One of a number of options. It is important to note that a cell is only one of a few options available to a business wishing to provide insurance products, which ranges from a situation where the business obtains underwriting from an insurer and purely acts as a financial service provider (FSP) intermediary or binder holder, to the attainment of a full insurance licence. Each of these options is described in Table 5: ranging from no minimum prudential capital or "skin in the game" required (e.g. FSPs or binder-holder only) to minimum prudential capital of R15 million required for a full insurance licence. The different options are also associated with varying levels of prudential and governance compliance:

Table 5. Cell ownership compared to other options for participation in the insurance market

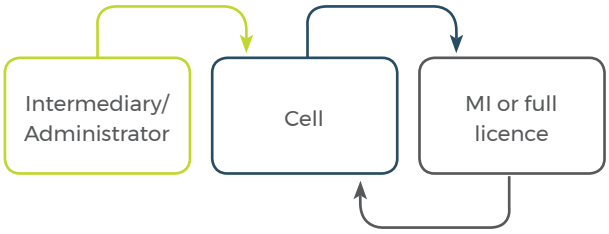
Type of Licence		Type of entity	Types of policies	Prudential and governance compliance by entity	Minimum capital
Insurance licence under Insurance Act 2017		Must be a public company or co-operative	Full range of policies as per the legislation can be underwritten	Strict compliance with prudential and governance requirements for insurers	R15 million
Microinsurance licence under Insurance Act 2017		Profit company, non-profit company or co-operative	Limited types of policies. Limited in value, simple design and subject to prescribed product standards. Both life and non-life available.	Proportionate regulatory framework to facilitate financial inclusion	R4 million
Cell under captive insurer licence	Compliance by cell owner under Insurance Act	Corporate structure of cell owner not prescribed	Full range of policies as applicable to cell captive insurer	Insurer bearing full burden of regulatory compliance. Insurer must oversee cell owner's and other service providers' compliance with governance requirements and all applicable legislation.	R1 million
Microinsurance cell structure under Microinsurance licence		As directly above	Limited range of policies as allowed for microinsurers	Insurer must comply with regulatory requirements for microinsurers and must oversee cell owners' and other services providers' compliance and governance with all applicable legislation.	R250,000
FSP or binder holder-only		Any entity acting as intermediary with underwriting by an insurer	No restrictions, but also limited scope to tailor product offering to own client base	FSP or binder holder compliance only	None

Source: Regulatory review

The cell structure is able to provide the full range of policies that the cell insurer is licensed to provide and requires minimum prudential capital of R1 million. The insurer is the regulated entity and is required to ensure that the cell owner and other service providers comply with all regulatory and governance requirements.

The cell graduation path. The cell ownership option, as "lower-bar" entry point into the insurance market than a full insurance licence, can be part of a graduation path towards a full insurance licence. However, this is not always the case – the cell structure itself may also be the destination.

Figure 14. The cell graduation path



Source: Authors' own based on interviews and market information

We interviewed two current cell owners (SmartMI and The Best Funeral Society) who grew from an intermediary/administrative capacity into a cell owner, both in the funeral insurance space (see Appendices E and H). The time spent as an administrator allowed them to get to know and comply with binder holder and intermediation regulatory requirements, and to start to understand the business requirements in the insurance space. There is at least one cell captive who decided to downscale from a full insurance licence into a cell structure (Natsure), while we are aware of a funeral parlour network who transformed into a cell, then acquired an insurance licence and eventually was integrated as part of a larger insurance group (Covision). We also interviewed a B-BBEE long-term insurance company (Bophelo Life) who grew from a cell into a fully fledged insurer.

Thus, as depicted in Figure 14, there is movement between different levels of participation in the market, with business owners choosing a regulatory form or entity depending on their risk appetite and experience/competency at the time. Not every entrepreneur wants to be the owner of a large insurance company and other structures that enable participation in the insurance market may better suit their needs.

Why, then, choose the cell route? The sub-sections below discuss the benefits and risks, respectively, associated with the cell structure.

4.1. Benefits

While it may seem that the main reasons for choosing a cell structure rather than another way to participate in the insurance market would be financial, the interviews suggest that there are also several other reasons for choosing the cell option. There are several cell owners that expressed philanthropic objectives and have a sincere desire to achieve a more inclusive financial services industry. Some of the reasons provided by interviewees include:

- It is too onerous to set up an insurance company
- The lower capital requirements or less stringent capital requirements
- Innovative products and control over those products by the cell owner
- Can exercise control over a single value chain which ultimately saves money for the customer
- Unique and modern distribution models which in turn facilitates better access to financial products
- More cost-effective way to distribute products with savings being reflected in lower premiums for customers
- The costs savings and surpluses can be ploughed back into community programmes, such as literacy and financial education
- Technology allows for better administration and claims experience and less red tape
- Can focus on things they are good at without having to comply with all regulatory requirements for licensed insurers
- Not interested in the corporate world of an insurance company, wants to focus only on the underwriting side of insurance
- Can make a real difference in the lives of underserved market, i.e. can take cognisance of customary laws and traditions and meet real client needs in the design of products
- Can design products that are relevant and ensure they are distributed to target market in an appropriate manner and in the language of the customers
- It is an opportunity to test the market and grow the book
- It is comforting that an insurer "acts like a big brother" and has the expertise to mentor, guide and oversee the operations of the cell

From the above, the benefits of the cell structure can be categorised as follows:

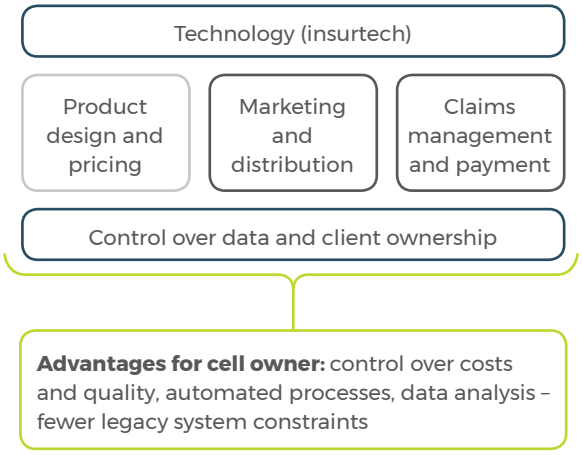
- **Autonomy and control over the value chain:** the cell owner can make his/her own decisions about how to deliver a product to clients and can tailor products to the needs and realities of its client/membership base. This places the cell owner at an advantage to a "pure" intermediary. They can also choose an option (UM or NMI binder holder; administrator or intermediary) that allows them to fulfil the functions that they are good at. The advantage of a cell structure in view of a microinsurance licence is, apart from the lower minimum capital requirement, the fact that the cell structure allows for greater opportunity for innovative product offerings whereas the product parameters under a microinsurance licence will be prescribed.
- **Nimbleness:** the cell owner is not subject to the systems and processes of the insurer. They have their own IT infrastructure, can make decisions more quickly than in a bureaucratic corporate set-up and can often get closer to the client, potentially through a shorter value chain. This makes the cell structure attractive in view of the own licence options.

- **Share in economic benefits:** the cell owner may feel that they "own" the client base or brand. Unlike a pure intermediary, it then shares in the benefits from such ownership as it is entitled to a return on investments in the form of dividends on its shares in the cell captive provider. It has an incentive for cost-savings, which contribute to the surplus build-up in the cell account.
- **Compliance and business support:** the cell captive provider is the regulated entity with regards to insurance legislation, takes the compliance responsibility upon itself and can provide the cell owner with access to a wide variety of compliance services[53]. Thus, it is less onerous to set up a cell than to obtain and maintain an insurance licence. Moreover, as described in Section 2.3, the cell captive insurer provides various business support services to the cell, plus the cell owner takes advantage of the strength of the cell captive insurer's balance sheet, as well as its reputation.

Two specific drawcards of the cell captive structure are worth highlighting. These benefits are not specific to the cell captive structure, but it was clear from the interviews that the cell captive structure does lend itself to such benefits:

Control over the value chain. From the cell owner's perspective, a large part of the attractiveness of the cell route lies in the ability to structure and integrate the value chain in a way that meets its business purposes, as illustrated by Figure 15. A point repeated by multiple individuals interviewed for this study is that the cell owner can structure the value chain while not being constrained by the legacy IT and other systems and processes typically found in traditional insurance companies.

Figure 15. The cell owner-controlled value chain



Source: interviews

53 For example, the insurer must comply with the FSRA, the Insurance Act, the LTIA and STIA and all the regulations thereunder. Insurers are also required to have the following control functions in place: a risk management function; a compliance function; an internal audit function and an actuarial function. Insurers are subject to frequent reporting to the relevant regulator, for example, insurers must submit quarterly returns to the Authority as prescribed and annual financial audited statements. The cell owner is not subject to these requirements.

The cell owner has a vested interest in the success of the cell structure. The success of the cell structure depends on several factors, such as the reputation of the cell to process and pay claims, value for money products, quick turn-around times and resolution of complaints and queries. Thus, it is in the cell owner's interest to ensure that the value chain operates optimally and delivers value for money products to policyholders. While the cell owner's control over the value chain can lead to cost-savings throughout, there was a consensus among individuals interviewed and at the stakeholder workshops that the biggest cost-savings are likely to emanate from lower-cost intermediation and client interactions.

Facilitative structure for insurtech ventures. The benefits from value chain integration as outlined above are especially true for cell owners basing their idea on an innovative technology. Thus, the cell structure is increasingly used for so-called "insurtech" ventures. In so doing, it has a number of cost-effectiveness and competition benefits. New technology developments attract new types of entrants (e.g. engineers, programmers or general tech entrepreneurs) to the insurance space. The direct effect of the market entry of these new types of players is the introduction of new ideas and the more innovative use of technology (e.g. chatbots, smartphone-based client interaction) that directly lowers the costs for clients.

4.2. Risks

Section 2.2 provided an overview of the regulatory framework and the main regulatory proposals mooted in 2013. Above, we discussed the benefits of the cell captive structure to cell owners and customers. But, as is apparent from the concerns expressed in the 2013 discussion paper, there are also several risks – to the cell captive insurer, the cell owner and the consumer – inherent to the cell captive structure. The risks identified as well as developments over the past five years that contribute to mitigating such risks are discussed below.

It is important to note that the risks discussed here are not unique to cells. These are risks posed by all insurers, but that may be more pronounced because of the outsourcing arrangements that characterise most cell captive arrangements, and the fact that cell owners are also often outsourced service providers themselves.

"The risks are not unique to cells. These are risks posed by all insurers, but that may be more pronounced because of the outsourcing arrangements that characterise most cell captive arrangements."

Insurance-related risks

At least six types of risk relate to the provision of insurance via the cell captive structure:

Table 6. Risks relating to insurers in the cell captive space

Contractual & exit strategy risk	The termination of the cell structure, which could be by means of policy run-off or a section 37 of the LTIA or section 36 of the STIA transfer of business to another insurer, creates the risk that policyholders will be left without cover if sound procedures are not followed.
Operational risk	This risk relates to the outsourcing of operational function to third-party service providers. If they do not meet operational requirements, the cell captive insurer is at risk, as well as policyholders.
Insurance risk	Insurance risk can manifest in terms of: • Insufficient liquidity to pay claims, which would impact negatively on consumers; • Timing of cash flows into cell; • Lapses on policies; and • Inadequate access by the insurer to policyholder data and systems. Insurance risks also refer to the impact of large claims under one cell on other cells.
Credit risk	A cell owner's failure to meet its contractual obligations or the deterioration of a cell owner's credit worthiness creates credit risk for the insurer, as the insurer must then absorb the losses or call for recapitalisation (if the cell owner is not credit worthy, however, it cannot recapitalise).
Reputational risk	Poor market conduct by the cell owner or third-party service providers may negatively affect the reputation of the insurer. Likewise, the brand of the cell owner may suffer due to poor market conduct practices, service or products from the insurer.
Regulation & supervision risks	The fact that cell captive arrangements are not regulated individually, but that the cell captive insurer is accountable for compliance, may mean that the supervisor does not have full sight of the activities and financials of individual cells.

Source: Authors' own, based on 2013 discussion paper and market and regulatory review

Mitigation. All of these risks are mitigated or managed either via regulatory requirements such as Board Notice 158 of 2014 "Governance and Risk Management Framework for Insurers ("BN 158") issued by the regulator in 2014 or, with effect from 1 July 2018, via the provisions under the Insurance Act[54] (including Prudential Standard GOI 3 "Risk management and internal controls for Insurers"), or business practices of cell captive insurers within the cell captive structure:

- **Contractual and exit risks** are mitigated through detailed shareholder participation agreements covering essential terms regarding, among other things: change of shareholding of cell owner; sale of shares held by cell owner in the insurer; recapitalisation; termination; policy run-off; and transfer. The regulator proposed in 2013 that it will monitor shareholder agreements on an ongoing basis to ensure compliance with all regulatory requirements. Joint Communication 2 of 2018 reiterated the regulator's stated intention to prescribe provisions for shareholder agreements. A draft Prudential Standard will be published for consultation with a planned implementation date of 1 January 2019.[55] From interviews conducted, one provider reported that it has only ever had two cells terminated due to the cell owner's business going under. No policyholder was prejudiced in this process. Post 1 July 2018, the FSCA will be issuing a Conduct Standard addressing notification to the FSCA of the termination of cell structures.[56]
- Where **operational risk** is concerned, requirements for outsourcing of services are prescribed by the binder regulations under the LTIA and the STIA. Up to 1 July 2018, the general requirements prescribed under Directive 159 A.i of 2012 also applied and outsourcing agreements were required to comply with this Directive. Explicit provision must be made for termination of agreements. Notification of termination must be given to the regulator, with reasons for termination, and it must be stated how services will be continued during and after finalisation of termination. Furthermore, compliance by insurers with BN 158 further strengthened their governance and risk management systems.[54] With effect from 1 July 2018, insurers must comply with the governance, risk management and outsourcing requirements under the Insurance Act and the Prudential Standards issued thereunder.[57]

  From the interviews conducted, insurers advised that they hold regular finance and operational meetings with binder holders and/or cell owners. The performance of binder holders and other TPA is regularly reviewed and measured against agreements. Provision is made for remedial actions and/or penalties which may be imposed by the insurer on the TPA.

  It is generally accepted that total operational risk is spread more optimally in a cell captive environment as the insurer does not only rely on one system or set of internal processes – in other words, the operational risk in a cell captive is well diversified.

54 See: (Financial Services Board, 2014c)
55 Joint Communication 2 of 2018.
56 Joint Communication 2 of 2018.
57 See section 30 of the Insurance Act and Prudential Standard GOI 1 "Framework for Governance and Operational Standards for Insurers" and GOI 5 "Outsourcing by insurers".

- From the interviews conducted, **insurance risk** is managed in that cell captive insurers conduct regular (monthly) underwriting results reviews, claims monitoring and solvency calculations. Systems are being updated to enable daily updating of data on the insurer's system. Insurers have direct access to binder holders' records to access data. Regular cell committee meetings are held (consisting of the insurer, cell owner, binder holders and reinsurer) to monitor and review the cell business. There is also regular reporting by the binder holders on lapses. Under the PPRs the insurer must have access to policyholder data.[58] The Prudential Standards for ring-fenced funds further enhance protection for cell captive insurers against insurance risk. In terms of Prudential Standard GOI 3 "Risk management and Internal Controls for Insurers" an insurer must have an investment policy and a liquidity management policy in place. A cell captive insurer must therefore ensure that the investment strategy and investment mandate of cell structures are aligned to the cell captive insurer's overall investment strategy and mandate.[59]

  The insurer cannot decline claims due to insufficient funds in the cell. The funds in the cell are only contractually ring-fenced and policyholders' claims would have to be settled from the insurer's own funds or from other cell owners' funds. From the interviews conducted there was no evidence that insufficient capital has ever resulted in claims not being paid.
- **Credit risk** is managed through the Prudential Standards FSI 4[60] and Prudential Standard GOI 3[61]. The cell owner is required to contribute a minimum capital requirement (MCR). Ongoing solvency requirements apply under a formulaic approach as per the Prudential Standards. Furthermore, the cell owner is continuously undergoing due diligence by the cell captive insurer, not only at inception, to ensure compliance.[62] From interviews conducted, insurers confirmed that they perform regular reviews on cell owners' business, including of their credit worthiness. In some instances, monthly solvency calculations are also being performed to ensure continuous compliance with solvency requirements.
- In terms of **reputational risks**, the insurer is responsible for oversight and ensuring compliance with PPR and regulations by service providers. The TCF principles have been incorporated into the PPRs. Rules are also prescribed for white labelling, for example, the insurer must be clearly identified on all marketing material. Insurers also report to the regulator on the number of complaints that they receive, and binder holders must keep a complaints register. Statistics from the 2017 annual report of the Long-term insurance Ombudsman[63] regarding complaints received in respect of the two largest long-term cell captive insurers indicate that 83% of complaints were resolved in favour of the insurers. Cell captive insurers do not seem to perform worse than conventional insurers. This is also true for the Short-term insurance Ombudsman's statistics[64].

58 See also Joint Communication 2 of 2018.
59 Joint Communication 2 of 2018.
60 "Calculation of SCT using the standardised formula"
61 "Risk management and internal controls for insurers"
62 See also Joint Communication 2 of 2018.
63 Source: Ombudsman for Long-term Insurance (2018)
64 Source: Ombudsman for Long-term Insurance (2018)

- The fact that individual cells are not subject to direct supervision generates risks related to **effective regulation and supervision**. This is currently managed through the licensing conditions, conduct of business returns and the fact that co-mingling of insurance business by cell captive insurers is not allowed as specified in the Insurance Act. The provisions of FAIS legislation that requires FSPs to be fit and proper (including having the necessary operational capability and capacity) also acts as risk mitigator. Moreover, these risks will increasingly be mitigated through the alignment of licensing conditions across cell captive insurers. This will occur over a two-year period from 1 July 2018[65].

  Furthermore, cell captive insurers are required to report to the regulator at the cell structure level, which helps to manage supervisory risks. Reporting has become more granular with the introduction of conduct of business returns. This requires cell captive insurers and their binder holders/TPAs to keep more detailed records for reporting purposes. The FSCA will issue a determination under section 44 of the Insurance Act to address information that the PA requires from insurers for supervisory purposes.[66] One cell owner interviewed mentioned that changes had to be made to his IT system to accommodate the detailed information requested from him. A view was also expressed that in some cases insurers' standards for reporting and compliance may exceed that of the regulator.

"The fact that individual cells are not subject to direct supervision generates risks related to effective regulation and supervision."

65 The Insurance Act 2017 became effective on 1 July 2018.
66 Joint Communication 2 of 2018.

Risks that arise for policyholders

While most of the risks outlined above may also have implications for policyholders, two risks warrant special attention for their potential impact on customer outcomes:

Table 7. Risks relating to policyholders

Conduct of business risk	Poor market conduct by the cell owner or third-party service providers may result in poor customer outcomes, such as policyholders being sold more policies than needed or sold an inappropriate policy given their needs.
Conflicts of interest	The 2013 discussion paper highlighted the potential for conflicts of interest in the cell captive structure as an important concern in the market. While conflict of interest (COI) risks can lead to unfair market conduct, it is discussed separately given the prominence thereof in the 2013 discussion paper. Because the cell owner controls the value chain, it may structure both the underwriting and intermediation components in such a way as to maximise profit. In cases where the cell owner is an NMI (i.e. there is no other independent intermediary), information given to clients may attempt to drive sales without consideration of policyholders' real needs. COI may also indirectly arise where there is an independent intermediary in the cell owner's company structure, for example where the independent intermediary is a subsidiary company or an associate of the cell owner and where such independent intermediary markets and sells the products under the cell and receives commission from the cell captive insurer. In such a case the independent intermediary may not be truly independent and "advice" provided by the intermediary may be driven by profit incentives.

Source: Authors' own, based on 2013 discussion paper and market and regulatory review

Mitigation. Since 2013, the market conduct regulatory framework has seen a number of reforms to strengthen conduct of business in line with the Treating Customers Fairly (TCF) principles. The regulatory analysis and interviews suggest that these risks are mitigated as follows:

- **Conduct of business risks** are managed through the conduct of business returns used to monitor the market conduct of cell captive insurers. The PPRs expressly provide that the insurer remains responsible for compliance, regardless of the fact that services have been outsourced Insurers in turn require their binder holders to comply with all legislation including FAIS and particularly the disclosure requirements under the General Code of Conduct. On 3 July 2018, the FSCA advised that it will be issuing a Conduct Standard which will address disclosures that must be made to policyholders before policies are concluded. These will include disclosure of the exact nature of the relationship (i.e. existence of the cell structure) and remuneration and profit share arrangements that are in place.[67]

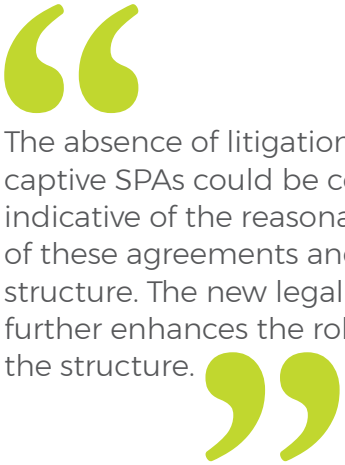
- **Conflicts of interest:** The thoroughness of the market conduct regulatory framework, including the regulation pertaining to the outsourcing of business, is the main mitigant of conflicts of interest (COI) risk. In terms of the regulations under the LTIA and the STIA, the binder agreement between the insurer and the NMI must explicitly provide that the NMI must comply with all applicable legislation, which include the PPRs. The full conduct of business framework therefore applies to the NMI and the insurer must ensure compliance. The FAIS Code of Conduct, as well as the binder regulations set strong limits on the profits that can be made from insurance provision and sales by binder holders. The binder regulations set caps on the fees of binder holders and bans profit sharing in relation to binder function in the case of NMI acting as binder holder.

  The cell captive insurer is required to sign-off on all communication material used by the NMI in order to ensure that appropriate disclosures are included. The PPRs also prescribe standards for marketing material that must be complied with. The NMI must disclose two critical potential areas of conflict of interest to the potential client: 1) it must disclose its relationship with the cell owner/cell structure in a very clear manner in all communication with the policyholder, i.e. that it is not an independent intermediary; and 2) it must disclose all remuneration, including entitlement to dividends.

67 See Joint Communication 2 of 2018.
68 See FAIS Board Notice 58 of 2010 (Financial Services Board, 2010)

COI risk is currently also mitigated through the inclusion of a definition on COI in FAIS[68], as well as the requirement of FAIS that a financial services provider must have a COI management policy in place which customers must be able to access. Disclosure requirements to clients have also been significantly enhanced.[69]

From the interviews, as well as discussions at the stakeholder workshops, insurers advised that their representatives/NMIs never purport to be independent. Once the regulatory process of ensuring that all cell captive insurers have the same licensing conditions has been completed, the COI that arise from an independent intermediary NMI owning a cell or being associated or related to the cell owner is unlikely to be a remaining issue., so long as the NMI is not an independent intermediary.[70]



The absence of litigation around cell captive SPAs could be considered indicative of the reasonable robustness of these agreements and the cell structure. The new legal framework further enhances the robustness of the structure.

In conclusion: risks and the cell captive structure

Although cell captive business has been conducted since 1993, there have been no reported cases specifically dealing with the robustness of cell captive structures, apart from BMW Financial Services (South Africa) (Pty) Limited v Harding and another ([2007] 4 All SA 716 (C))[71]. The absence of litigation around cell captive SPAs could be considered indicative of the reasonable robustness of these agreements and the cell structure. The new legal framework further enhances the robustness of the structure. As discussed above, ombudsmen ruling statistics also do not indicate any particular concerns in the cell captive market.

While all of the risks described above are significant and there are certain elements of the cell captive structure that may make these risks more pronounced in the cell captive space, we found no clear evidence in the public domain that cell captives pose risks that cannot be contained and managed by both the business practices of cell captive providers and the increasingly nuanced and specific prudential and market conduct regulatory frameworks.

69 See FAIS General Code of Conduct (Financial Services Board, 2003)

70 Currently, the licence condition applicable to some cell captive insurers prohibits shares to be issued to an independent intermediary (directly through cell ownership or indirectly through the cell owner's business structure).

71 Where the court considered among other things the status or validity of the shareholder agreement between Guardrisk, the cell captive insurer and BMW Financial Services, the cell owner.

5 Transformation and cell captives

Now that the working, players, benefits and risks in the cell captive structure have been described, we turn our attention to the core problem statement of this study: the current and potential role of cell captives in transformation.

On paper, cell captives support all transformation pillars. Though the cell captive structure provides a way for ownership-based participation in the insurance market, interviews with cell owners confirmed that transformation in the cell captive market is about more than ownership. Cell captives also play a significant role in improving access to financial services and facilitating skills transfer and capacity development. Table 8 describes the potential role of third-party cell captives for each of the transformation pillars introduced in Section 1.

Table 8. Transformation and cell captives

Transformation pillar	Description	Potential role of third-party cell captives
Ownership	Effective ownership of enterprises by black people	Ownership of cells by black entrepreneurs and small black businesses and access to the economic benefits of an own licence
Management and control	Effective control of enterprises by black people	Cells as structures where management can be transformed outside of prevailing corporate culture
Skills development	The extent to which employers contribute to improving the skills of black employees and black people in society generally	Cell structure as a vehicle for capacity-building, skills transfer, incubation and mentorship by incumbent cell captive insurers to cell owners and by cell owners to their representatives
Enterprise and supplier development	Implementation of supplier development and enterprise development initiatives that assist the growth and sustainability of black enterprises	Potential of cells to support local, black-owned suppliers or providers of outsourced services in the value chain
Access to financial services	The extent to which enterprises provide appropriate retail financial services, affordably priced and through appropriate and accessible physical and electronic infrastructure	Cell ownership as a market participation option for organisations/businesses serving previously excluded target markets

Source: Authors' own

If this is the potential role for cell captives in each transformation pillar, how are cells performing in practice?

There are four emergent transformation typologies. The cell owners interviewed for this study fulfil different transformation roles. For the purpose of this study, we classified the cell landscape into four "transformation categories", based on how they meet four transformation objectives – namely ownership, management and control, financial inclusion, and capacity development. Figure 16 identifies the four emergent categories:[72]

Figure 16. Emergent transformation typologies in the cell captive industry

	Call captive	Ownership	Management	Financial inclusion	Skills transfer
Black-owned and managed	Cell A	✓	✓	✓	-
	Cell B	✓	✓	✓	✓
	Cell C	✓	✓	✓	✓
	Cell D	✓	1/2	✓	✓
Transformative in its capacity development and financial inclusion role	Cell E	-	-	✓	✓
	Cell F	1/2	1/2	✓	✓
Tranformative largely via financial inclusion focus	Cell G	-	-	✓	-
	Cell H	-	-	✓	-
	Cell I	-	-	✓	-
	Cell J	-	-	✓	-
No explicit transformation	Cell K	-	-	-	-
	Cell L	-	-	-	-

Source: Authors' own

72 Criteria for our indicative classification: based on interviews and desktop research, we identified whether each of the 12 cell arrangements displayed or reported on aspects that related to any of the transformation pillars described earlier. Where the transformation aspect was clear, they received a point. Where the extent of the cell's transformation performance was not very clear, we awarded half a point. The limited sample is not intended to be representative of all cells; neither is it based on a formal transformation audit. However, the classification exercise was useful in determining indicative "transformation typologies". Due to the indicative nature, we do not provide the names of cells here.

Each category can be described as follows:

1) **Black-owned and managed cells.** In our sample, black-owned cells were also typically managed by their owners, plus embodied the financial inclusion and skills transfer pillars. Black ownership or management need not always be directly linked to other transformation objectives.
2) A handful of cells are transformative in both their **capacity development and financial inclusion roles**, even though they do not have explicit black ownership or management.
3) Many of the cells we encountered are **transformative largely via their financial inclusion focus**. That is, they are not black-owned or managed, neither do they fulfil an explicit capacity development role. Yet they serve a previously excluded target market in a way that is designed to meet this target market's needs. Many non-traditional insurance players with product or process innovations (often linked to retailers and insurtech) classify here.
4) There were also some cells that had **no explicit transformation characteristics** at present. They were interested in the cell arrangement as an appropriate business model for their venture.

The classification above, while not representative of the cell landscape, shows that, although cells are not always transformative, the structure certainly has potential as a transformation vehicle (especially when considered together with the lower entry barriers for this vehicle, its nimbleness and the scope for mentorship and incubation that the cell captive structure offers). There are already a number of examples in the market that attest to this. Some of these examples can be read about in greater detail in the Appendices. The remainder of this section further explores the transformation potential of cell captives according to each of the four transformation pillars.

5.1. Ownership

Scope for direct business ownership. Direct ownership in the traditional insurance sector requires large capital investments and is not always broad-based. Moreover, as directly owned insurers grow, the direct ownership is typically diversified and diluted by the investment capital committed by larger investors. Hence, the current ownership profile of traditional insurance companies in South Africa is largely institutional (Thomas, 2017) and, while progress is being made towards transformation of ownership as set out in Figure 2 and Appendix A, ownership in the insurance sector will not be transformed overnight. Cell captives enable easier entry to the insurance market relative to a full insurance licence. They thus provide a mechanism for black entrepreneurs and businesses to acquire an ownership stake in the insurance market that also allows them management and control, as well as access to the economic benefits usually enjoyed by insurance investors.

5.2. Management and control

Owners retain management control. A review of the industry results relative to the FSC targets suggests that middle to senior management transformation – and in particular technical management transformation – is a big challenge for long- and short-term insurers alike (Figure 2 and Appendix A). The cell captive mechanism offers a vehicle for management control for black professionals or black-owned businesses wishing to set up an insurance business, be they ex-corporate insurer employees or entrepreneurs from other sectors, such as retail or technology, who are interested in entering the insurance sector. This in no way replaces the need for transformation of management and control in corporate, traditional insurance companies. However, the consultations indicated that cells do offer another, and potentially overlooked, vehicle for transformation of management control.

> The cell captive mechanism offers a vehicle for management control for black professionals or black-owned businesses wishing to set up an insurance business, be they ex-corporate insurer employees or entrepreneurs from other sectors.

5.3. Skills development

Insurance requires specialist skills. The cell owners who participated in this study entered the cell captive insurance market from different walks of life: some were seasoned former insurance company executives, while others were new insurance market participants with limited or no prior insurance experience. As outlined in Section 2.3.5, it is not an insubstantial process to become a cell and many new insurance market entrants lack the technical, administrative, and managerial skills required to set up a cell. For those seeing the cell as a stepping stone towards a full insurance (as discussed in Section 44), further upskilling and capacity-building is required.

Mentorship via the cell structure. Cell captive insurers, reinsurers, and existing cell owners are well positioned to provide mentorship and support to potential cells in reaching the point where they can acquire a cell, as well as for experienced cell owners who are interested in walking the road towards full insurance licensing. Though the level of mentorship provided differs between cell captive insurers, all provide some level of skills transfer via the support services that they render to cells. Industry consultations suggest that the cell structure could be a particularly suitable vehicle for mentorship and incubation, as vertical integration between the cell owner and the cell operator is likely to limit some of the competition issues that may arise, should one insurer provide support to another new insurance licensee.

Can serve transformation. While this skills-transfer need is not unique to black-owned cells or candidate cells, skills development is one of the core transformation targets. Hence the fact that the cell captive structure is conducive to skills transfer is relevant for transformation.

5.4. Enterprise development

Existing industry initiatives to support enterprise development also open to black-owned prospective cells. ASISA and SAIA provide support to small black business owners, who are typically suppliers to association members, towards their transformation commitments[73]. Financial support may come in the form of loans at low or no interest, business investments, and grants. Non-financial support could include training, marketing and administrative assistance. Box 3, below, outlines the ASISA Enterprise Development Fund as a means for long-term and short-term insurers to further collaborate to enhance the prospects of supply chains. This fund already funds cell owners and can be further positioned as funding vehicle for cell enterprise development.

Extending enterprise development support to cells' affinity clients. The cell captive mechanism can also be a vehicle for capacity-building of the community-facing affinities (such as labour unions or churches) and businesses (such as funeral parlours) that cells provide insurance to. At least two of the cell owners interviewed proactively link community affinities and funeral parlours into the formal system by capacitating them to be able to become FAIS compliant.

Box 3. ASISA Enterprise and Supplier Development Fund

The ASISA Enterprise and Supplier Development Fund (EDF) is an independent, open trust, managed by Edgegrowth. The fund was established in 2013 with the objective of assisting SMEs along the supply chain with commercial funding sources from industry.

The fund provides pre-investment grant funding to suppliers identified by ASISA members – working with small and medium enterprises (SMEs) ranging from panel beaters to high-tech companies. Growth investment funding is provided to enterprises with a highly differentiated competitive advantage, strategic fundamentals and / or supply chain alignment. The Fund invests in equity, debt, or combined structures into deals of R1m – R20m in size in high growth potential businesses requiring expansion capital with a focus on job creation and social impact. In addition to funding, an end-to-end business development solution is provided to support enterprise and supplier development. The fund provides post-investment management support and specialist expertise to ensure the viability of the businesses in the portfolio.

Funders can contribute equity, debt, or grant funding to the ASISA EDF; earning a return of between 6% and 10%, while optimising their Enterprise Sector Development (ESD) spend in line with Financial Sector Code (FSC) requirements. Funders include players in both the long-term and short-term insurance sectors, respectively.

According to its website, the fund has funded at least one cell captive structure (Meerkat). It is currently reviewing the application of another cell structure.

With increased awareness of the fund and guidance provided to prospective cell owners in accessing financial and non-financial support, the ASISA EDF presents an opportunity to unlock the potential of cell captives in transformation in South Africa.

Sources: Stakeholder interview, ASISA EDF Fund brochure, Edgegrowth website

73 Going forward, outsourcing arrangements for appointed providers need to explicitly consider transformation objectives.

5.5. Access to financial services

Cell captives enable and extend access.
As discussed in Section 4.14.1, cell structures are agile and lean relative to traditional insurers and have been used to implement product and process innovations that create value for clients. A number of the cells interviewed for this study target the previously excluded market. Those with pre-existing affinities are trusted by and have direct access to these target market segments, while others use technology-based platforms to reduce distribution cost to underserved market segments. Yet others (see, for example, the case study on Mohlokomeli Underwriting Managers in Appendix F) deliberately take the previously disadvantaged target market's unique profile and varying levels of financial literacy into account. Thus, cell captives already help the insurance market to extend its reach. This role will develop further with the development of the market.

> Cell captives already help the insurance market to extend its reach. This role will develop further with the development of the market.

6 Conclusion: Cell captives as transformation enabler

From the overview presented above, it is clear that cell captives have important benefits that position them well as vehicles for insurance sector transformation by reducing barriers to entry, encouraging entrepreneurship and building capacity. Below we conclude on the current role of cell captives in transformation, as well as the market and regulatory imperatives to unlock the full potential.

6.1. Opportunities and challenges

Cells structures allow for a greater diversity of players beyond current insurance licence holders to participate in the market and share in the economic benefits of the provision of insurance via a direct ownership stake. As discussed in Section 5, the nature of the structure lends itself well to transformation:

- **Ownership, management and control.** The cell structure is a complement, rather than a substitute, to corporate insurer ownership transformation. Whether as stepping stone or end-destination, the analysis shows that the cell captive structure is suitable for (black) entrepreneurs or businesses wishing to enter the insurance market in a way that allows them control over the product offering and value chain, while not being subject to the full compliance burden and operational requirements of a fully-fledged insurer.
- **Capacity and skills development.** The cell captive structure also allows the insurer to provide the cell with establishment support, ongoing capacity-building support and mentorship[74].
- **Access.** The cell captive structure also benefits transformation via the inclusion angle, though the cell structure is of course not the only avenue for enhancing inclusion.

74 In the funeral insurance market, the cell captive structure can also offer a potential formalisation tool alongside the microinsurance licence: a number of cells already focus on the provision of funeral insurance and support community-facing organisations such as burial societies and funeral parlours in regulatory compliance as FAIS representatives.

6.2. Imperatives to unlock true transformation potential

The transformation potential of cell captives is not only about incubation to a full insurance licence. It lies even more so in the capacitation/incubation into cell ownership, as well as the capacity-building role that cells themselves play in view of the community-facing organisations or affinities that they deal with.

But the cell captive is not a panacea – it requires high levels of business acumen and capacity to establish a cell. Thus, cell ownership is not an instant solution for increasing the number of small black businesses in the market. Moreover, many cells are not 'transformed' and may not soon become so. There is currently no concerted effort by industry to deliberately use the cell captive structure as a transformation vehicle.

What, then, can be done to ensure that the full transformation potential of the cell captive market is unlocked?

> Cell ownership is not an instant solution for increasing the number of small black businesses in the market.

Market imperatives: Cell captive insurers are in a position to institutionalise the potentially transformative role of cells into a substantive contribution towards industry-wide transformation commitments. The build-up phase to the next Financial Sector summit provides a good opportunity to make the potential transformation role of cells explicit, and to commit to targets in this regard, so that focus and support can be dedicated to unlocking the full potential. Specific transformation commitments that can be considered include:

- **Capacity-building and mentorship.** To advance cell captives as a vehicle for transformation there would need to be an explicit objective for knowledge sharing and capacity-building. An "incubation plan", with formal targets, milestones and a timeline for picking transformation candidate cells and supporting them to become viable cells (and potentially to graduate to full insurers) may assist in making the transformation commitment of the cell captives industry explicit. Further, coordination between industry and organisations like the Insurance Sector Education and Training Authority (INSETA) could enhance initiatives geared towards those interested in participating in cell captives. In particular, INSETA could sponsor mentorship programmes for those interested in participating in cell captives.
- **Funding.** While ASISA's Enterprise and Supplier Development Fund can potentially support cells, more awareness raising can be done about the Fund as source of funding and support for transformation in cells. Other financiers can also consider specific initiatives for funding of B-BBEE cells.

Regulatory imperatives. The regulatory framework is part and parcel of the market. A large part of the document has been dedicated to outlining the regulatory framework for cell captives in South Africa and how the framework mitigates the risks that are inherent in the structure. Given the mitigating factors outlined in Section 4.2, market participants interviewed expressed concerns regarding potential unintended consequences, should the outstanding 2013 discussion paper proposals be implemented. Two main uncertainties require clarification:

- **Who may be a cell owner?** In an attempt to mitigate the COI risks outlined in Section 4.2, the 2013 discussion paper argued that NMIs that are not approved affinity schemes should not be allowed to own cells. Examples of affinity relationships in the market include retailers, cell phone companies and rental car companies. However, there are also a number of distribution models, including network marketing and online brands, where there is no pre-existing affinity. Some of these business models are building customer loyalty and own types of affinity relationships over time. By limiting ownership of NMI-type cells to traditional affinities, new, innovative insurtech models will be required to restructure or exit the market. While the Joint Communication of 2018 paves the way for reconsideration of the affinity definition and for exemptions to be allowed, the matter remains unresolved until the draft Conduct Standards are issued.

  We propose that NMIs be allowed to offer insurance as cells even if they are non-affinities, if the necessary requirements to mitigate conflicts of interest (see Section 4.2) are met. Non-binder holder cells can also be considered as long as no independent intermediaries are cell owners and the full protection of the insurance regulatory framework applies. To ensure regulatory certainty, it would be important to extend this position to the whole market, not just through case-by-case discretion or exemptions applied through the licensing and approval process. Should assessments be made on a case-by-base basis, clear guidelines or criteria need to apply on the basis for the exemptions.

- **What products may be sold?** The 2013 discussion paper proposed limiting products of affinity cells to the underlying business of the affinity, a position that is maintained in the Joint Communication of 2018. There exists a clear precedent of products not related to the underlying affinity relationship being offered through retailer distribution models. Many retailers have built up a track record of providing products that not only address risks associated with the core business. Rather, retailers have become large distribution platforms that extend financial inclusion and identify specific financial needs of customers that they can serve to help build client loyalty and also ensure the financial sustainability of their client base.

  The analysis suggests that it does not make a material difference whether the retailer is a cell owner. The affinity does not state that it is providing a competitive product offering: it is simply a (white-labelled) channel for the products provided via the cell. Similar to insurers who sell products directly to the market, the affinities are acting in a direct agency relationship to their cell structure. As long as this relationship is fully disclosed to the potential client, there is no clear unfair market conduct associated with products that extend beyond the affinity relationship. Thus, we propose that the product offering of cell captive structures should not be limited, but that the protection provided by the market conduct framework should be relied upon to inform policyholders of the non-independence of the intermediary.

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Appendix A:
Transformation in the insurance sector summary statistics

Element	2015 Target (%)	2015 Actual (%)	
		Life offices	Short-term insurance
Black ownership	25	31	18.97
Management control			
Board	50	49	28.57
Executive directors	50	47	36.36
Senior top management	40	39	25
Senior managment	60	35	25.83
Middle management	75	48	42.36
Junior management	80	75	70.14
Skills Development			
Skills development spend	3	4.9	2.26
Learnerships	5	10.6	7.42
Procurement			
All suppliers	70	91	79.72
Small suppliers	15	29	23.71
Black-owned	12	15	12.52
Black-women-owned	8	5	4.41
ESD spend	(Life – varied, STI – 3%)	95	4.91

Source: ASISA (2017), SAIA (2017)

Life office statistics	2015 Target	2015 Actual
Access to financial services (points)		
Appropriate products	3	1.5
Penetration	7	6.3
Transactional access	2	2
Consumer education	2	1.5
Empowerment financing (points)		
Targeted investment	12	12
BEE Transaction Financing	3	2.8

Source: ASISA (2017), SAIA (2017)

Short-term statistics	2015 Target	2015 Actual
Financial Inclusion (No. of policies)		
Number of commercial line policies	167,474.00	12,696.75
Number of persoaml line policies	389,942.00	159,911.00
Financial Inclusion (No. of policies)	0.4	0.43
Socio-economic development spend (% of NPAT)	0.6	2.62
Educayion and youth development programmes		64.36
Job creation		7.14
Arts and culture		1.71
Food/Agricultural livelihoods/Health/other		26.75

Source: ASISA (2017), SAIA (2017)

Appendix B:
Licensing conditions for a cell captive insurer

Typical licensing conditions

a) Surplus assets in one cell may not be used to offset liabilities in another cell;
b) The SPA must cover how shortfalls are dealt with;
c) First-party[75] and third-party business cannot be combined in the same cell;
d) Actuarial assumptions for valuation of the cells must be similar;
e) Dividends can only be paid to the cell owner if the cell is solvent;
f) In the case of a third-party cell, benefits to policyholders cannot be limited to performance or financial position of the cell;
g) Third-party policyholder obligations are retained by the insurer upon termination of the cell agreement (on the same terms and conditions and the same price);
h) Surplus assets in cells may not be included in the total assets of the insurer (with reference to the insurer's annual statutory returns);
i) Loans to the cell owner using cell assets are prohibited;
j) No shares may be issued whether directly or indirectly to any independent intermediary (as defined under the Regulations to the LTIA or STIA) or its associates through cells except for the purposes of providing cover for such intermediary's own risks (corporate self-insurance) in that cell.[76]

75 First-party business is defined under the Insurance Act and means, "in respect of a cell captive insurer, the operational risks of the cell owner and the operational risks of (i) the group of companies of which the cell owner is a part, (ii) any associated of a company that is part of the group of companies referred to in subparagraph (i); or (iii) any joint arrangement that a company that is part of a group of companies referred to in subparagraph (i) participates in;"

76 The reason for this restriction is to prevent conflicts of interest in the cell structure i.e. an independent intermediary cannot own a cell structure or be associated with the parties to the cell structure.

Appendix C:
Parties, roles and regulatory requirements across the cell captive structure

The cell captive insurer

Provision of risk cover. Under the SPA the cell owner and cell captive insurer agree that the cell captive insurer will insure the risks under the cell structure. Although insurance policies written under the cell structure are often white-labelled,[77] all insurance policies are issued in the name of the cell captive insurer and must therefore comply with the cell captive insurer's terms and conditions.

Carries the burden of compliance. The cell captive insurer must ensure that the cell structure is solvent and that all parties that are involved in the cell structure are compliant with all laws including, but not limited to:

- In the case of a long-term cell captive structure, the Long-term Insurance Act, 52 of 1998 (LTIA), the regulations thereunder and the Policyholder Protection Rules (PPRs) or
- In the case of a short-term cell captive structure, the Short-term Insurance Act, 53 of 1998 (STIA), the regulations thereunder and the PPRs;
- With effect from 1 July 2018, the Insurance Act, 18 of 2017;
- The Financial Sector Regulation Act, 9 of 2017; and
- The Financial Advisory and Intermediary Services Act, 37 of 2002 (FAIS) – especially the conflicts of interest provisions in the General Code under FAIS and the Fit and Proper requirements.

Other legislation that may impact insurance products and related financial services that must also be complied with are:

- Medical Schemes Act, 131 of 1998;
- Pension Funds Act, 24 of 1956;
- Friendly Societies Act, 25 of 1956;
- Protection of Personal Information Act, 4 of 2013;
- National Credit Act, 34 of 2005; and
- Financial Intelligence Centre Act, 38 of 2001.

Due diligence. From the interviews conducted, the insurers confirmed that an in-depth and stringent due diligence process is performed on all parties involved in the cell structure. This process includes, among other things, financial information, the risk management framework, governance and compliance requirements, including the market conduct such as the regulator's treating customers fairly (TCF) regulatory and supervisory approach in respect of insurers. The due diligence extends to operational systems, software and hardware and processes that will be used to perform services under the cell structure.

77 Under the PPRs rules are prescribed for white labelling. The name of the insurer and that of the white label must be given equal prominence and the insurer must undertake due diligence assessment in respect of the governance, resources and operational capability of the persons with whom the insurer has white labelling arrangements and ensure compliance with Rule 2.2(b) of PPR.

Several services rendered to the cell. From our interviews it was clear that not all cell captive insurers provide the same set of support services to cell captive structures. Part of the process of creating a cell captive structure is for the cell owner and the cell captive insurer to decide how the insurance business and other administrative functions will be conducted by the cell owner and other third parties. This is then included in the SPA. Typically, the cell insurer provides the following services to the cell:

- Access to the cell captive insurer's infrastructure
- Access to actuarial services of the cell captive insurer
- Access to the reinsurance market
- Lower administration costs

The cell captive insurer is remunerated by means of different types of fees for services rendered: it receives management fees for running the insurance business, investment fees on the funds managed on behalf of the cell owner and underwriting profits on the share of underwriting risk carried by the cell captive insurer which is not reinsured.

The cell owner

The cell owner's obligations in view of the cell structure, are set out in the SPA. The cell owner is responsible for capitalising the cell at the outset and when recapitalisation is required as determined by the cell captive insurer. The cell owner's rights to dividends are also set out in the SPA. In addition to be a cell owner, the cell owner can wear different hats. It can also act as a binder holder to the cell structure (as described under paragraph (c)) and/or it can act as an administrator (as described under paragraph (d)). It can also act as representative of the cell captive insurer (as described under paragraph (e)). In each case, an agreement is concluded between the cell captive insurer and the cell owner which sets out the capacity in which the cell owner is acting for the purposes of that agreement, its obligations to perform the services and the remuneration to be paid by the cell captive insurer.

The binder holder(s)

A binder holder is a third-party service provider who is authorised (in writing) by a cell captive insurer to perform specific functions which contractually bind the insurer on behalf of the insurer. For example, the cell captive insurer can authorise the third-party service provider to accept policy applications from customers without first referring the application to the cell captive insurer. Once the application has been accepted, the cell captive insurer will be liable to pay a legitimate claim under such a policy. This function of accepting policy applications is known in insurance terminology as a binder function and more specifically as a function "to enter into" insurance policies on behalf of the cell captive insurer. For a complete list of all the binder functions and their associated activities which an insurer may outsource to a third-party binder holder, refer to Appendix D.

When an insurer outsources an aspect of its insurance business to another entity, attention must be paid to the following:

- The binder regulations[78] under the LTIA and the STIA
- The requirements of Directive 159.A.i ("outsourcing directive") issued by the FSB and with effect from 1 July 2018, section 30 of the Insurance Act and Prudential Standard GOI 5 "Outsourcing by Insurers".

78 Part 6 of the regulations under the LTIA and the STIA.

The cell captive insurer must ensure that the binder holder is always fit and proper[79] and that it has the governance, risk management, internal controls and information technology systems in place to provide the services.[80]

There are two types of binder holders relevant for the purposes of this study: an underwriting manager or a non-mandated intermediary[81]. Both are described in greater detail below.

The Underwriting Manager[82]

The Underwriting Manager (UM) is authorised by the cell captive insurer to perform binder services[83] in exchange for a binder fee[84] but may not sell the products that are offered under the cell structure directly to the public, i.e. the UM may only distribute products through an intermediary.

The regulations under the LTIA[85] define an underwriting manager as follows:

"underwriting manager" means a person that –

(a) Performs one or more binder function; and

(b) If that person renders services as an intermediary…-

(i) Does not perform any act directed towards entering into, maintaining or servicing a policy on behalf of an insurer[86] …; and

(ii) Renders those services (other than the services referred to in paragraph [i] above) to and on behalf of an insurer only; and

(c) Does not have any relationship with an insurer (including secondment of that person's employees to an insurer or an associate of an insurer, the outsourcing of that person's infrastructure to an insurer or an associate of an insurer, or any similar arrangement) which may result in that person or its employees de factor, directly or indirectly, performing any act directed towards entering into, varying or renewing a policy on behalf of an insurer, a potential policyholder or policyholder; …"

The main characteristics of a UM can be summarised as follows:

- The UM is the agent of insurer.
- The UM is not allowed to sell directly to the public, i.e. it may not interpose between the insurer and the potential policyholder and bring about the conclusion of a policy.
- The UM is authorised by the insurer to accept classes of risk on the insurer's behalf as if it was the insurer.
- The UM is a specialist underwriter and does underwriting on behalf of the insurer. The UM

79 For the latest fit and proper requirements under FAIS see Financial Services Board (2017).
80 See regulation 6.3(d) of the LTIA and STIA.
81 There is also a third type, i.e. the administrative FSP.
82 It must be noted that the designation "underwriting manager" in respect of a third-party services provider referred to under the LTIA and the STI is not the same as the underwriting manager agency, or UMA. Although they share similar characteristics and perform similar services, the UMA is typically a structure used by insurers to offer complex and niche classes of short-term insurance solutions such as renewable energy risk products, aviation, construction etc. See for example http://www.natsure.co.za/.
83 See Appendix D for a list of binder services.
84 The binder fee for an underwriting manager is agreed to between the cell captive insurer and the underwriting manager and is currently not prescribed by the regulator.
85 The definition under the regulations to the STIA is slightly different but this does not significantly impact on this section.
86 The underlined actions are regarded as intermediary services i.e. the person that interposes between the policyholder and the insurer which then results in a policy being concluded is regarded as an intermediary. See also TriStar Investments vs The Chemical Industries Provident Fund (455/12) [2013] ZASCA (16 May 2013).

may thus share in underwriting profits as per the binder agreement.

- The UM interposes between the insurer and the independent intermediary or representative (i.e. the independent intermediary/representative markets and sell the insurer's products to potential policyholders and receives commission/remuneration from the insurer).

From the interviews conducted it emerged that the UM could also have a relationship with a reinsurer quite independent of its relationship with the cell captive insurers. The reinsurer could provide support to the UM with respect to development of the product and pricing of the product.

There are no caps on fees paid to a UM per the regulations under the LTIA and STIA. Fees must, however, always be reasonable and commensurate with the actual cost of providing the services and considering the nature of the functions, the resources, skills and competencies reasonably required. Fees are monitored by the regulator by requiring cell captive insurers to report quarterly on all binder agreements and the fees payable to binder holders.

The Non-mandated intermediary (NMI)

The NMI is a tied agent of the insurer.

The regulations under the LTIA and the STIA defines an NMI as follows:

"non-mandated intermediary" means a representative or an independent intermediary other than a mandated intermediary or an underwriting manager.

A mandated intermediary is defined as follows:

"mandated intermediary" means an independent intermediary that holds a written mandate from a potential policyholder or policyholder that authorises that intermediary, without having to obtain the prior approval of that potential policyholder or policyholder, to perform any act, including termination, in relation to a policy, that legally binds that potential policyholder or policyholder, other than an act directed only at changing the underlying investment portfolio of a policy;"[87]

The main characteristics of an NMI can be summarised as follows:

- The NMI is a tied agent of the cell captive insurer.
- The NMI is mandated in writing by the insurer to sell products under the cell structure directly to the public.
- The NMI is authorised by the cell captive insurer to accept classes of risks on the insurer's behalf as if it is the cell captive insurer.
- The NMI is not a specialist underwriter but may be authorised to perform limited underwriting. Limited underwriting means that the cell captive insurer authorises the NMI to apply certain defined risk factors, underwriting criteria or rating methodologies.
- The NMI receives remuneration from the cell captive insurer for marketing and selling the products under the cell structure.

87 The underlined bold section of the definition only appears in the definition under the regulations to the LTIA, i.e. does not apply to a short-term policy and can be ignored for the purposes of this report.

- To address potential conflicts of interest[88], the remuneration of an NMI authorised[89] to give advice and an NMI associated[90] with an NMI authorised to give advice, is limited as set out in Appendix D.
- The remuneration of a non-advice NMI is not limited but must be reasonable and commensurate with the cost of providing the services.

Administrator

Any other services that are required for the operation of the cell structure and that are not binder services or intermediary services,[91] can be outsourced to an independent third-party administrator (TPA). It is also possible that the cell owner will perform some or all the administration functions. The outsourcing agreement with the TPA must be in writing and must comply with the outsourcing directive. Where the same party acts as administrator and binder holder, separate agreements must be entered into as the binder regulations specifically prohibit combined agreements. The remuneration paid by the cell captive insurer to the TPA must be set out in the administration agreement and must be reasonable and commensurate with the cost to provide the services.

Independent intermediaries or representatives[92]

The cell owner must decide how the insurance products offered under the cell structure will be distributed to customers. In some instances, a cell owner may also act as the representative of the cell captive insurer and may for example use a call centre or a technology platform to distribute their products directly to their identified customer base. In other instances, independent intermediaries and/or other representatives may be mandated in writing by the cell captive insurer to distribute the products under the cell structure.

An independent intermediary and a representative are defined under the regulations to the LTIA and the STIA respectively. Both are intermediaries i.e. they act as the go-between between the insurer and the customer. The main difference between them is that the representative acts as a tied agent of the insurer whereas the independent intermediary is, as its name indicates, independent and the insurer does not exercise control over the independent intermediary. Another difference is that the independent intermediary's remuneration is limited to commission as determined in terms of the commission regulations under the LTIA and the STIA whereas the remuneration of the representative must comply with the principle of "Equivalence of Reward" This simply means the remuneration must be reasonable in relation to the service provided. The commission regulations are often used as a guide to determine what reasonable remuneration would be.

88 See section 4.2

89 "Authorised" refers to authorised under FAIS.

90 In terms of the regulations, "associate":

(a) Has the meaning assigned to it in the General Code of Conduct; and

(b) In addition to paragraph (a), includes, in respect of a juristic person, -

Another juristic person that has a significant owner or member of its governing body that is also a significant owner or member of the governing body of the first mentioned juristic person.

91 See next paragraph "Independent Intermediaries or representatives" below.

92 These naming conventions will change once the FSB's retail distribution review is implemented.

Appendix D:
Binder functions and fees – Extract from regulations

Binder functions

Summary of Information Letter 3/2013 issued by The Registrar of Insurance on 1 July 2013: Activities that constitute binder functions and activities that are incidental to binder functions.

Binder function	Main activities	Incidental activities
(a) **Enter into, vary or renew a policy… on behalf of an insurer**	• Concludes a new policy with a policyholder • Conclude a renewal policy with a policyholder • Vary a policy by way of endorsement • Vary insurer liabilities under a group policy by varying the extent of risks or number of policyholders covered In addition, underwriting managers may undertake the following activities: • Cancel a policy • Declare a policy void • Refuse to renew a policy	• Issuing a policy to a policyholder • Keep records, accounts, books, ledgers, etc. • Reconcile premiums received from intermediaries during a month • Maintain appropriate policy management system • Keep record of all policyholder information • Update the insurer's data with policyholder details • Have appropriate risk management system and controls in place to support adequate management and administration of the policies entered into, varied or renewed, including maintenance of IT systems, etc. • Advertising and marketing and any other documentation used in managing and conducting the authorised business.
(b) **Determine the wording of policies**	Determine the wording of material amendments to the wording of a policy with limited or full discretion.	• Ensure legal requirements are met • Ensure alignment with any limitation on discretion pertaining to risk or other factors • Facilitate training material and programmes in relation to policy wording developed
(c) **Determine premiums under a policy**	This can be done either by using the insurer's underwriting criteria and rating methodology or with discretion with respect to the client segmentation and actuarial pricing	• Financial soundness of the business and policies as well as fair treatment of customers in setting the actuarial pricing must be considered • Ensure alignment with limitations on discretion pertaining to underwriting • Policy screening actions • Sign-off and record-keeping of underwriting exceptions • Perform ITC scoring of new business • Perform client life time value scoring of existing business • Develop remedial measures for management of unprofitable policyholders • Manage unprofitable clients through various screening techniques and underwriting interventions

Binder function	Main activities	Incidental activities
(d) **Determine the value of policy benefits under a policy**	This is done either using the underwriting criteria and benefit limits determined by the insurer or with discretion with respect to the client segmentation and actuarial pricing	• Consider financial soundness and sustainability of the insurance products and associated policies, as well as the fair treatment of customers, in the determination of policy benefits • Ensure alignment with any limitations on discretion pertaining to policy benefits • Policy screening actions • Sign-off and record-keeping of underwriting exceptions • Perform ITC scoring of new business • Perform client lifetime value scoring of existing business • Manage unprofitable clients through various screening techniques and underwriting interventions
(e) **Settle claims under a long-term policy**	• Determine and accept liability for claims In addition, underwriting managers may undertake the following activity: • Reject claims • Repudiate liability under a policy	• Receive claims from intermediary • Categorise claims • Assess merits/determine liability of insurer and quantum of claim • Attend to all administration regarding settlement of the claim • Pay claims • Maintain claims register • Submit claims bordereaux • Pay service providers • Calculate and manage data and ratios • Keep records • Ensure controls and governance over claims handling process.
OR IN THE CASE OF A SHORT-TERM POLICY **(e) Settle claims under a short-term policy**	SAME AS DIRECTLY ABOVE	• SAME AS DIRECTLY ABOVE PLUS • Appoint loss adjusters and investigators • Revise claims estimates • Manage motor and non-motor salvage • Manage third-party recoveries • Consideration of contributory negligence in third-party claims and third-party recoveries • Manage third-party recoveries • Recovery of any paid amounts to which the insurer is entitled • Manage or handle third-party claims • Manage claim float • Ensure that repairs or replacements are authorised • Pay assessors and service providers • Ensure that excesses, deductibles and recoveries are effectively accounted for in final quantum

Binder fees

Binder function		Maximum payable
Enter into, vary or renew a policy -s49A(1)(a)[93] – "function (a)	Function (a) only	3.5%
Determine the wording of a policy – s49A(1)(b) – "function (b)"	Function (a) and one or more of functions (b) – (d)	5%
Determine premiums under a policy – s49A(1)(c) – "function (c)"		
Determine the value of policy benefits under a policy – s49A(1)(d) – "function (d)"	One or more of (b) – (d) only	0%
Settle claims under a policy – s49A(1)(e)		4%

93 Section 48A(a)-(d) of the STIA sets out the binder functions for short-term insurers.

Appendix E:
smartMI: an administrator cell in the funeral insurance space

smartMI started their insurance journey as a category IV assistance business financial services provider (FSP) also commonly referred to as an administrator. smartMI spent 20 years distributing and administering Sanlam and Assupol-underwritten group funeral insurance policies through funeral parlours. By 2016, it was ready to take the next step in their insurance growth journey and become a cell. smartMI's eventual reinsurer, Swiss Re, played a key role in this journey suggesting they consider the cell captive route as well as introducing them to multiple cell providers. One of these providers was Guardrisk who they eventually chose as their cell provider.

This choice was motivated by the support Guardrisk was willing to provide smartMI, including explaining the often very technical requirements associated with being a cell. This was specifically helpful as the step up from administrator to cell captive required quite a big adjustment, with different reporting requirements and terminology applying to cell captives (compared to administrators). The adjustment to new requirements and terminology has been highlighted by smartMI as a specific challenge they experienced in their cell captive journey.

smartMI has branches in three provinces: Western Cape, Eastern Cape and Free State. Their head office is situated in Cape Town with eight physical branches situated in Beaufort West, Dunoon (Table View), George, Kroonstad, Port Elizabeth (Pier14 & Kenako Mall), Thabong and Uitenhage.

Financial inclusion. smartMI sells microinsurance products in the form of funeral insurance direct to the public, as well as funeral group schemes. It has grown its own individual insurance book to 50% of its current total membership, therefore now generating 80% of their income from individual business. smartMI has shown 20% year over year growth in their individual business the past three years. smartMI has innovative policy add-ons that speak directly to the financial inclusion of their clients in the nature of the add-ons that are offered, listed in Table 9.

smartMI focuses on ensuring their clients have a clear understanding of the financial products they have chosen through one-on-one contact at their branches. This is facilitated by communicating, marketing and selling in a client's first language, as well as providing all documentation in "plain language" English. Events are held at smartMI branches to engage with their communities around key dates such as Easter and Mother's Day. In recognition of the cash constraints of their clients, claims are paid within eight working hours after receipt of the required claims documentation from the client (smartMI, 2017).

Table 9. smartMI policy add-ons

Add-on offered	Description
Tombstone policy	Cash benefit to acquire a tombstone
Meat policy	Cash benefit for meat to ensure that there is sufficient food when families gather during a funeral.
Grocery policy	Cash or voucher benefit that ensures the deceased's family can access groceries in the deceased's access.
Repatriation benefit	Transport for the deceased from place of death to the place of burial

Staff development and empowerment. All decisions are made centrally by the head office to decrease staff costs at branch-level. All branches are currently privately owned, with the view to create future empowerment opportunities for qualifying staff members. Staff development and empowerment is currently done with a keen focus on personal and skill development. This includes their intern/learnership programme which has a resulted in the successful appointment of approximately 60% of the interns/learners as staff. Successes include previous interns having advanced to Team leaders, playing a key role in the organisation.

One of the opportunities that the chief executive officer (CEO) of smartMI's, Mari van Rooyen, sees for further development and empowerment of people in the financial sector is the use of mentorships organised by the industry associations. In the case of cell captives, she argues that some of the best-placed mentors would be those individuals that have gone through the process of growing into and registering a cell captive.

Regulatory compliance and the funeral insurance market. Compliance with the Financial Advisory and Intermediary Services (FAIS) Act has traditionally been difficult in the highly contested funeral market. It is widely known that there are many funeral parlours who sell insurance without having obtained underwriting or if they have underwriting, are not fully compliant with FAIS. It is, however, possible, if not easy, for a cell to play in this market and be compliant with the necessary regulations. smartMI has taken a no-tolerance approach to non-compliance due to the increased pressures for the market to comply. This has forced them to review certain business relations with group schemes, which were not aligned with their long-term view to increase compliance. This decision was only made after several years of investing time and energy into helping as many as possible of their group funeral policyholders become FAIS compliant.

Appendix F:
The SA Canegrowers' story: providing funeral insurance to sugarcane farm workers

In 2017, Mohlokomeli Underwriting Managers (Mohlokomeli), a cell owner together with a consortium of partners, was appointed to assist the SA Canegrowers Association (SA Canegrowers), which represents sugarcane farmers in South Africa, realise financial inclusion in the sugarcane industry. At its core the SA Canegrowers story illustrates how cell captive structures, leveraged by technology and agile administration, can be transformative. The solution is a long-term insurance cell that provides affordable and appropriate funeral and life insurance products.

A consortium of partners. A custom solution was provided by Mohlokomeli with its cell captive capacity, alongside a consortium of partners that enable marketing, administration and servicing for the scheme. As the binder holder, MIMA Mihr Integrated Membership Administration (Mihr), a registered financial services provider (FSP), is the intermediary services and administration provider. Mihr has extensive experience in streamlining financial services administration and uses the MASSS platform to configure processes around the scheme. Full automation translates into fewer requirements and improved administration turnaround times. Ulwembu, a registered FSP, provides financial advice and education to potential members in their home languages. Benefits are affordable, relevant, easy to understand and clearly communicated, with a user-friendly onboarding process and rapid claim payments. The consortium partners are themselves fully transformed, benchmarking a Level 1 empowerment status. Mihr is 100% women owned and Ulwembu is 100% black-owned.

Cell captive model. The consortium has features of multiple cell models, in terms of the classifications of different cell ownership structures presented in this document. This cell arrangement is categorised as a Cell Owner being the Underwriter (Model A), while sharing many of the characteristics of the Silent Partner (Model D) cell arrangement, as the binder holder arrangements are outsourced.

Insurance products offered. The consortium has been able to provide group funeral and life insurance products to farm workers, including small-scale farmers, by setting up benefits at industry level and then taking these down to individual farm owners and farm workers. The standardisation of terms and conditions across an industry scheme, as well as the pooling of risk makes the product viable from a design and pricing perspective. Premiums are collected as part of payroll deduction. The product is designed with a minimum benefits package that all members must choose. Over and above the compulsory base (minimum benefits), members can add extended family and group life benefits. Benefit design was informed by research done in the agricultural sector and the product has several unique features. For example, rules have more flexible definitions that consider traditional family structures and rural lifestyles. Flexibility is a major advantage of a cell captive structure compared to conventional insurance solutions.

Financial inclusion through outreach. The entire value chain is characterised by highly active outreach, assisting in a market where literacy and numeracy are major challenges. Once the farm owner approves scheme participation, a workshop is held for farm workers, introducing the product and initiating a financial education process. This is followed with an individual session of 10 to 15 minutes with each farm worker. During member sign-up, on-boarding teams immediately start the system load process, which enables incomplete or problematic data to be rectified immediately, as the client is still present. Product explanations, all advice functions, (provided by Ulwembu) membership certificates and disclosures (issued by Mihr) are available in mother tongue. Moreover, farm administrators and members are supported by Mihr's multi-lingual contact centre.

To date, eight months after the product was launched, there is a total membership of approximately 6,000. The scheme aims to reach 10,000 policies by the end of 2018. This will provide financial services to almost 80,000 South Africans, who previously would have had little or no insurance cover. During this period, the scheme had 17 claims. Part of the Mihr service offering is a three-hour turnaround time on claims from submission of all documents. Claim requirements for the scheme are approximately half the number that would be required by traditional insurers; made possible by the customisability of the cell arrangement and the fact that employers validate facts together with members before submitting claims. The SA Canegrowers' model contributes to transformation through financial inclusion, with the cell captive arrangement offering affordable products that are easily accessible and competitively priced, to reach financially marginalised farm workers.

Investments made to become a viable cell. The investment required in onboarding a greenfield project is substantial and requires an alternative approach, a long-term vision and substantial capital commitment. Mohlokomeli estimates that R5 million was spent to set up the cell structure, excluding the mandatory minimum capital requirement. It is thus not inexpensive to become a cell. Time and logistics barriers in getting out into rural areas impact on distribution. Farm worker literacy and numeracy, a history of problematic experiences with other financial products, and labour relations challenges are all hurdles that need to be addressed for successful implementation. Overcoming these significant barriers to entry in developing new markets require long-term vision and commitment from all parties.

Graduation. Within the ambit of a cell captive Mohlokomeli is still exploring the insurance opportunities with the support of its cell provider, Guardrisk. With no plans to consider moving out of the cell arrangement at present, there is a clear interest to support financial inclusion more broadly with a key constraint being clients who have finances available for insurance. The SA Canegrowers story demonstrates how even the most marginalised members of society can benefit from cell captive structures.

Appendix G:
Simply – financial inclusion through technology and simplicity

Simply is a cell that was founded in 2015 by three partners from quite diverse backgrounds: an engineer with an MBA, an actuary with extensive life insurance experience and an actuary who had previously left the world of life insurance to start up an education technology business.[94] By focusing on product design, data analytics, software development and digital marketing, Simply aims to materially reduce the cost and complexity of life insurance and by so doing facilitate the inclusion of lower income individuals that currently cannot afford insurance.

Simply's cell provider is Old Mutual Alternative Risk Transfer Limited (OMART). OMART's established brand was important to them when they selected a cell provider as Simply, as a start-up, wanted to give their clients the assurance that their claims would be paid. Simply obtained reinsurance from Reinsurance Group of America (RGA). According to the categorisation of cells presented in this document, Simply is a non-mandated intermediary (Model C) as the cell sells policies directly to the public. The policy administration was done by IUA but is in the process of being taken in-house as Simply has expanded their capacity to do so and aims to gain a better understanding of their clients and take control of the client experience.

Financial inclusion through technology, data analytics and innovative distribution. Simply offers relatively affordable, simple-language life, disability and funeral insurance through digital marketing and an online sales process. This is done for both individuals, as well as groups. Simply also sells "Domestic cover", a product that provides life, disability and funeral cover for domestic workers paid for by their employers. The domestic worker is the policyholder and the policy benefits are paid directly to the domestic worker.

According to Simply's website (n.d.) it has achieved a number of South African firsts in the insurance sector:

- Straight-through online sign-up – this means there is no need for a consultant to speak to you to go through standard sign-up forms
- Instant cover in the retail market – as the entire process is automated end to end there is no need to wait for information to move along the value chain
- Chat bot quoting – with quotes being generated automatically online without any human intervention
- Fully online group life cover – group cover that is possible without needing to approach a broker who would be incentivised to target larger organisations

Their unique selling point is the completely online sign-up process which decreases the costs required to service clients and extends their reach to everyone with internet access. As smartphone usage in South Africa is estimated at 18.5 million and is expected to continue growing, this provides access to a large proportion of the South African population.[95] The key driver of the use of technology at Simply is to make their product cheaper. With cheaper products Simply can offer affordable products to low-income individuals thus facilitating financial inclusion.

Simply furthers financial inclusion through their product range as well as their Domestic cover product which aims to provide insurance cover to otherwise financially excluded individuals

94 Simply (n.d.)
95 Statista (2018)

by leveraging off the financial stability of their employers. Additionally, Simply's group cover is sold to small and medium enterprises (SMEs) to provide life, disability and funeral cover to their employees. These employers are generally a client type that would be too small for brokers to pursue and would otherwise struggle to obtain group cover.

Use of behavioural science and data analytics: Simply is open about having built in a specific choice architecture in the way they offer the products to clients online. They offer a default mix of insurance (life, funeral and disability) to interested individuals based on what they can afford. Basic client data is collected for simple risk pricing. Which is analysed in real time as clients sign-up. Having a better understanding of their users' experience on their platform is also part of the reason policy administration has been taken in-house. They hope by analysing clients' actions on their platform they can facilitate better uptake of their policies.

The cell structure provides a nimble platform: The small size of the organisation allows it to take full advantage of a fast-changing technological environment in which larger corporates are not able to react as quickly. Additionally, as a relatively new organisation, it does not suffer from the legacy issues that established organisations do.

Graduation. As a relatively new player in the insurance market, there are no clear plans for graduation to a full licence at this stage. However, Simply's founders do not believe they will still be a cell captive in 10 years' time. The exact avenue of graduation or growth is yet to be decided.

Appendix H:
Mocking Bull – Financial inclusion through innovative product offerings and transformation through enterprise development

Mocking Bull is in a cell owner with Centriq as cell provider and administration services provided by The BEST Funeral Society (Pty) Limited (TBFS). In addition to administrating Mocking Bull's policies, Mocking Bull holds an ownership interest in TBFS.[96]

Non-cash products. Multiple expenses and costs arise when arranging a funeral. Families often use cash pay-outs for unexpected expenses and not for the planned expenses the cover was meant to be used for. Non-cash products provide more control to the policyholder on what their life cover provides for by selecting how their beneficiaries receive the policy pay-out. With multiple family members involved in arranging a funeral, inexperienced and expensive decisions may be made if they are provided with cash.

Mocking Bull products focus on commodity – payouts, which are considered a key selling point for financially-excluded individuals. Instead of cash, several services are provided directly by service providers whom Mocking Bull contracts with, to ensure quality service. These products include:

- Airtime vouchers
- Makro voucher
- Access to a rental car
- Grocery (food) voucher
- Butcher account
- Body repatriation
- Prepaid electricity

These products provide indirect financial support, through avoiding certain expenses, to the deceased's family.

Providing access to services through non-cash benefits. People in lower LSM groups typically have less access to financial facilities such as bank accounts or comprehensive banking services. This may impede the speed of insurance pay-outs that are essential to arranging a funeral. Working with service providers enables Mocking Bull to overcome this hurdle.

The services provide negotiation power to clients that would otherwise be excluded from certain products. This is most notable in the case of accessing a rental car which requires a credit card which means that clients from LSM 1-5 would not be able to access a rental car, even if they had the funds to do so. Mocking Bull serves as an informed mediator for their clients and service providers. Furthermore, the service providers are held accountable to ensure service delivery to clients that would otherwise lack any negotiating power.[97]

Enterprise and skills development. Mocking Bull plays an important role in enterprise sector development by aiding its customer-facing affinities to register as financial service providers. Mocking Bull has worked with different organisations and organised groups including churches, unions and other partners with client bases in order to distribute their products as subsidiaries of the cell. Partnering with these organisations, Mocking Bull work on empowering the organisations to establish a financial services provider according to John Turnbull (2018, personal communication). In addition, by providing front-end insurance services, Mocking Bull helps ensure regulatory compliance in the funeral sector which has traditionally struggled with compliance.

Mocking Bull provides the technical skills required to manage the underlying risks involved of providing insurance. According to Mocking Bull, they can provide the front-end insurance services to clients at approximately a third of the cost of traditional insurers as they do not struggle with the legacy issues of larger established insurers.

96 The Best Funeral Society (n.d.)
97 Mocking Bull (2016)

Appendix I:
SA Taxi: supporting entrepreneurs and meeting real client needs

SA Taxi is a division of the Transaction Capital group of companies, which listed on the JSE in June 2012. The Transaction Capital group focuses on non-deposit-taking financial services, more specifically, risk services and asset-backed lending in traditionally underserved market segments. Transaction Capital's subsidiaries operate in market segments perceived to be of higher risk, in which they apply specialised credit, risk, analytics and capital management competencies to achieve scale and leading positions (SA Taxi, 2018).

One way through which SA Taxi services the underserved market is through a cell captive arrangement with Guardrisk. The insurance is sold directly through SA Taxi Protect (Pty) Ltd, a registered FSP and non-mandated intermediary. This allows SA Taxi Protect to earn commission and a binder fee. Guardrisk provides underwriting and legal support in various ways, including through workshops, to ensure legal compliance. Guardrisk and SA Taxi have regular operational meetings.

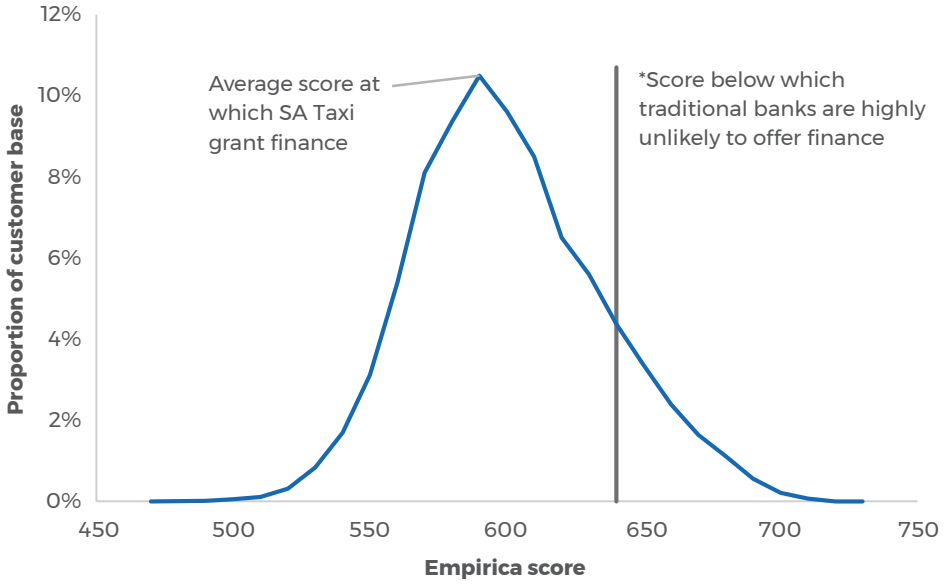
Founded in 1996 and currently having over 1,000 employees, SA Taxi is a shared-value, opportunity and collaboration platform focused on enhancing the sustainability of the minibus taxi industry and the entrepreneurs who run the taxi operations. Of the estimated 250,000 minibus taxis on the roads in South Africa, SA Taxi finances over 28,000 taxis, all of which are black-owned (Transaction Capital, 2018).

Insurance products offered. SA Taxi's cell captive arrangement provides a range of products to its clients with 35,948 policies on its book. Over 5,000 of the policies are for clients who are not financed with SA Taxi (non-financed clients), while the balance of the book is for financed clients. However, it has expanded its product offering to better meet its customers' needs to include passenger liability cover that provides life cover to taxi drivers and their passengers.

SA Taxi Protect's product offering includes Comprehensive Taxi Business cover (financed) and Comprehensive Taxi Insurance Cover (non-financed). In addition, a Credit Life cover has been launched, which is mandatory for financed clients. The Credit Life cover provides for settlement of the outstanding capital amount and arrears following the death of the policyholder, with R20,000 Beneficiary Assist payable to the nominated beneficiary. The Beneficiary Assist is doubled should the policyholder pass away as a result of an accident involving the vehicle insured. In addition, there are value-added products that are optional and could be added to the main comprehensive cover. For example, under non-financed policies, there is Business Protect, which caters for loss of income. SA Taxi has a strong focus on end-to-end service delivery. This includes, among others, simplifying the wording of the SMSs that clients receive after a payment was missed and reminding them that non-payment could result in claims going unpaid. This is considered a necessary step in supporting its clients' continued claims payment. As SA Taxi understands the cash flow of taxi operators, they believe that a few days may make the difference in the affordability of premiums. In response, SA Taxi provides a 30-day grace period in comparison to the industry norm of 15 days.

Financial inclusion. SA Taxi plays a significant role in enabling financial inclusion, as 90% of its clients are classified as previously financially excluded, as shown in Figure 17 on the next page. The figure shows that the credit rating (Empirica score) of SA Taxi's clients falls significantly below the credit ratings at which most traditional banks would be willing to provide finance.

Figure 17. SA taxi clients' credit scores



Source: Transaction Capital, 2018, p. 38

Enterprise development. All taxis in the SA Taxi portfolio are black-owned, including a significant share (21%) being owned by women. This indicates a clear support for transformation through the development of its clients. As an organisation that focuses on a niche market, it understands its clients' needs better than normal vehicle financiers do.

Graduation. The organisation has no clear plans to graduate to a full insurer at this stage, as it is still relatively new to the insurance market and sees the cell captive model as a sustainable solution for its business model. SA Taxi may consider getting a microinsurance licence, as its clients are clearly in the correct LSM target groups to pursue this lower-cost (from a capital perspective) regulatory vehicle for microinsurance provision.

Appendix J:
List of stakeholder meetings

	Organisation	Person(s)	Designation	Date
1.	Financial Services Board (FSB)	Jo-Ann Ferreira	Head: Regulatory Framework	13 February 2018
2.	Centriq	Peter Jennett	Chief executive	14 February 2018
3.	Inclusivity Solutions	Nigel Bowman	Actuary	14 February 2018
4.	The Best Funeral Society (holdings)	John Turnbull	Managing Director	15 February 2018
5.	Old Mutual	An-Ria Schreuder	Head: Legal Services	20 February 2018
6.	SAIA	Viviene Pearson	CEO	22 February 2018
		Nico Oosthuizen	General Manager: Insurance Risks	
7.	Financial Services Board (FSB)	Farzana Badat	Head: Insurance Compliance (Conduct of Business Supervision)	26 February 2018
8.	Smart MI	Mari van Rooyen	Managing Director	28 February 2018
9.	Simply	Anthony Miller	CEO	28 February 2018
10.	ASISA	Leon Campher	CEO	28 February 2018
		Anna Rosenberg Rosemary Lightbody	Senior Policy Advisors	
11.	AXXIS	Andre van der Merwe	Managing Director	1 March 2018
12.	FSB	Dube Tshidi	Executive Officer	2 March 2018
13.	Old Mutual Alternative Risk Transfer (OMART)	Elsa Beytell	Managing Director	5 March 2018
14.	Public Servants Association	Johan Uys	National Benefit Officer	6 March 2018
15.	South African National Treasury	Lesego Mashigo	Acting director: Financial inclusion	7 March 2018
		Dino Lazaridis	Economist: insurance	
		Raymond Masoga	Acting Chief Director: Financial Investments & Savings	
16.	SA Taxi	Solomon Mphofu	Head of Legal and Client Services	9 March 2018
17.	Meerkat	David O'Brien	Founder and Managing Director	13 March 2018
18.	Independent actuary	Rob Rusconi	Former CEO of Lombard Life	19 March 2018

	Organisation	Person(s)	Designation	Date
19.	FIA	Colin Daries	Assistance Business Committee	19 March 2018
20.	Natsure	Tersia Davey	MD	22 March 2018
21.	Platinum Life	Martin Kalmek	Financial Director	22 March 2018
22.	Mohlokomeli Underwriting Managers (Canegrowers)	Donnie Walker	Representative	27 March 2018
23.	Financial Services Board (FSB)	Suzette Vogelsang	Head, Insurance Prudential	28 March 2018
24.	Old Mutual Insure Risk Finance Solutions	Liza Harmse	Head of Risk Department	3 April 2018
25.	Bophelo Life	Petros Chimanga	Managing Executive	9 April 2018
26.	Swiss Re	Rohan Coetzer	Solutions Manager	16 April 2018
27.	Hollard	Werner Behrens	Head of legal	13 April 2018
28.	Hannover Re	Wesley Clay	Managing Director	16 April 2018
29.	Lireas Holdings	Isaac Chindtona	Senior Portfolio Manager	17 April 2018
30.	Leapfrog Investments	Raimund Snyders	Partner: Leapfrog Investments	4 May 2018
31.	Qunoa Capital	Johan Bosini		8 May 2018
32.	Guardrisk	Ryno van den Berg	Managing Executive: Guardrisk Insurance	10 May 2018
33.	IFC	Elom Lassey	Investment Officer	11 June 2018

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About Cenfri

The Centre for Financial Regulation & Inclusion (Cenfri) is a global think tank and non-profit enterprise that bridges the gap between insights and impact in the financial sector. Cenfri's people are driven by a vision of a world where all people live their financial lives optimally to enhance welfare and grow the economy. Its core focus is on generating insights that can inform policymakers, market players and donors seeking to unlock development outcomes through inclusive financial services and the financial sector more broadly.