

IN THE FINANCIAL SERVICES TRIBUNAL

HELD AT PRETORIA

Case No PA3/2023

In the matter between:

CENTRIQ INSURANCE COMPANY LTD

Applicant

and

THE PRUDENTIAL AUTHORITY

Respondent

Tribunal Panel: Retired Judge C Pretorius, Adv M Le Roux SC and Adv
KD Magano

For the applicant: Adv BH Swart SC

For the respondent: Adv M A Chohan SC and Adv M Lengane

Hearing: 8 April 2024

Decision: 6 May 2024

Reconsideration application – licence variation application under Insurance
Act – whether reinsurance business constitutes the underwriting of
first-party risks or third-party risks for purposes of cell captive insurers

DECISION

[1] This matter concerns an application for reconsideration of a decision of the Prudential Authority in terms of section 230 of the Financial Sector Regulation Act No. 9 of 2017. The central question is whether the Prudential Authority correctly interpreted the provisions of the Insurance Act No. 18 of 2017 (“**the Insurance Act**”) when conditionally approving the application by

Centriq Insurance to vary its licence conditions. In its decision, the Prudential Authority precluded Centriq from underwriting inwards reinsurance business through a cell captive structure.

[2] Centriq is a licenced non-life insurance cell captive insurer in terms of the Insurance Act. It sought the amendment of its insurance licence so that it could conduct reinsurance business in the same class and subclasses of business for which it already holds a licence from the Prudential Authority as a primary insurer. Centriq wishes to reinsure the risks of the insurance obligations of other primary insurers located outside of the Republic of South Africa and wishes to do so utilising the first-party risk cell captive structures already set up for certain of its clients. The risks to be reinsured are contended to be the risks of those cell owners.

[3] The core question for the tribunal is whether the proposed reinsurance business constitutes the underwriting of first-party risks or third-party risks. This is because section 25(6)(b) of the Insurance Act provides that:

“A cell captive insurer may not insure:

(1) First-party risks and third-party risks in the same cell structure;

or

(2) The risks associated with the insurance obligations of another insurer without the approval [of] the Prudential Authority.”

- [4] It is common cause between the parties that, if the contemplated reinsurance risks are third-party risks, they cannot be pooled with the first-party risks administered by Centriq Insurance on behalf of the respective cell owners.
- [5] Several definitions in the Insurance Act must be interpreted and applied together in order to give effect to the now-trite tripartite approach to statutory interpretation, namely that the “text, context and purpose” of the provisions to be interpreted and applied is considered by the tribunal. This is the approach in *Natal Joint Municipal Pension Fund v Endumeni Municipality*.¹
- [6] The SCA in *Telkom SA SOC Ltd v Commissioner South African Revenue Service*² confirms that “*the statement in Endumeni that ‘a sensible meaning is to be preferred to one that leads to insensible or unbusinesslike results’, meant that in the process of attributing meaning to the words used in the legislation (having regard to the words used, the context and the purpose of the legislation) one possible meaning will be preferred over another possible meaning, because the one meaning yields a commercially insensible result, for all subjects and in the appropriate context.*”
- [7] The tribunal thus is enjoined to give a purposive and contextual interpretation to the Insurance Act in accordance with the *Endumeni* approach.

¹ 2012(4) SA 593 (SCA) at para 18, see also *Airports Company South Africa v Big 5 Duty Free (Pty) Ltd and Others* 2019(5) SA 1 (CC)

² 2020(4) SA 480 (SCA) at paragraph 15

[8] We begin with the definition of “first-party risks” and “third-party risks”. “First-party risks” are defined to mean:

“In respect of a cell captive insurer, the operational risks of the cell owner and the operational risks of:

- (1) The group of companies of which the cell owner is a part;*
- (2) Any associate of a company that is part of the group of companies referred to in subparagraph (1); or*
- (3) Any joint arrangement that a company that is part of the group of companies referred to in subparagraph (1) participates in.”*

[9] “Third-party risks” are defined to mean:

“In respect of a cell captive insurers, risks other than first-party risks.”

[10] The next relevant definition is that of “operational risks” which are defined to mean:

“For the purposes of the definition of first-party risks, means the risk of incurring losses as a result of inadequate or failed internal processes, people and systems, or from external events and excludes any risks associated with the insurance obligations of an insurer.”

[11] “Insurance obligations” are defined to mean *“all obligations (other than the obligations of the policy holder), whether those obligations constitute an*

obligation to pay one or more sums of money, render services or meet any other obligations, under or arising from insurance policies ...”

[12] *“Insurance business” is defined to mean “... non-life insurance business conducted or regarded as being conducted in the Republic, and includes reinsurance business”.*

[13] *“Insurer” “means a person licenced to conduct insurance business under this Act, and includes, unless specifically otherwise provided for in this Act, Lloyds, a Lloyds underwriter and a reinsurer”.*

[14] *A “reinsurer” “means a person licenced to conduct (a) only reinsurance business; or (b) only reinsurance business and the business referred to in section 35(7)(b) in the insurance class and sub-classes set out in schedule 2, and, unless specifically provided for otherwise in this Act, includes a branch of a foreign reinsurer so licenced”.*

[15] *Finally, “reinsurance business” “means (a) insurance business conducted by an insurer with another insurer, where the first-mentioned insures the risks associated with the insurance obligations of the last-mentioned insurer; or (b) business similar to the insurance business referred to in paragraph (a) conducted by a person that is authorised by a regulatory authority to perform business similar to insurance business under the laws of a country other than the Republic, with an insurer”.*

[16] *Centriq Insurance argues that:*

- 16.1. If a cell owner based in South Africa has a subsidiary in another country, the operational risks of that subsidiary will fall within the ambit of the definition of first-party risks in the Insurance Act. This is said to be the result of the definitions of operational risk and first-party risks since the risks of the cell owner and the group of companies of which the cell owner is a part, which would include the foreign subsidiary, all are said to constitute first-party risk.
- 16.2. Centriq Insurance relies for this proposition on LAWSA 2nd edition, volume 12, part 2, paragraph 178 where reinsurance is categorised into being *“either a first-party indemnity insurance, so that it takes on the nature of the primary insurance (the reinsurance is then a further, fixed contract on the same object or objects of risk as covered by the direct insurance; a further policy on the direct risk or on the original object of risk), or a third-party indemnity or liability insurance (the reinsurance is then a distinct insurance covering the primary insurer’s liability)”*.
- 16.3. In essence, Centriq Insurance argues that the reinsurance agreement between a foreign primary insurer and Centriq Insurance when it is structured on a first-party indemnity insurance basis will constitute first-party risk under the relevant and applicable definitions of the Insurance Act, because the subject matter of the reinsurance agreement is the same operational risk of the subsidiary.

- 16.4. Centriq Insurance further contends that the exclusion in the definition of operational risk of *“any risks associated with the insurance obligations of an insurer”* does not make it impossible for reinsurance to be categorised as a first-party risk. This is so, Centriq Insurance contends, because the exclusion only pertains to the risk associated with the insurance obligation of an “insurer” and it is submitted that an “insurer” cannot include a foreign insurer.
- 16.5. Centriq Insurance reaches this contention through the definition of insurer in the Insurance Act quoted above, coupled with section 5(1) of the Insurance Act which provides that no person *“may conduct insurance business in the Republic unless that person is licenced under this Act”*. According to Centriq Insurance, this means that an insurer in the Insurance Act can refer only to a local insurer obliged to obtain a licence under the Insurance Act before it is allowed to conduct insurance business here.
- 16.6. Centriq Insurance then refers to the use of the term “insurer” in the definition of “reinsurance business” to submit that the distinction drawn in the definition of reinsurance business means that the legislature wished to include in the definition of reinsurance business a reinsurance agreement between a local and a foreign insurer, but limited the first part of the reinsurance business definition to only include local insurers.

- 16.7. Accordingly, Centriq Insurance argues that the exclusionary provision in the definition of operational risk must be interpreted to reflect the legislature's intention to only refer to a domestic insurer.
- 16.8. Therefore, so the argument goes, any risks of a cell owner or a company in its group associated with the insurance obligations of a foreign direct or primary insurer would not trigger this exclusionary provision in the definition of operational risk.
- 16.9. Accordingly, Centriq Insurance submits that the unqualified assumption underpinning condition 3.3 of the licence variation decision that is challenged in these proceedings, namely that *"inward reinsurance business is insurance business conducted between insurers and relates therefore to the risk of the insurance obligations of another insurer which is a third-party risk"* is incorrect.

[17] In response, the Prudential Authority submits that reinsurance business concerns the insurance of the insurance obligations of the primary foreign insurer. It contends that such risks are excluded from the definition of first-party risks and as a result, can only be construed to be third-party risks for purposes of reinsurance.

[18] The Prudential Authority then contends that section 25(6)(b)(i) prohibits cell captive insurers from insuring both first-party and third-party risks under the same cell structure and that while Centriq Insurance may reinsure the risks of these foreign primary insurers, it must do so in a separate cell structure from those which house the first-party risks of the cell owners.

- [19] In addition, the Prudential Authority relies on section 25(6)(b)(ii) which prohibits cell captive insurers from insuring the risks associated with the insurance obligations of another insurer without the approval of the Prudential Authority.
- [20] The Prudential Authority contends that the correct and purposive interpretation of the relevant provisions of the Insurance Act requires a delineation between first-party risks and third-party risks, that these two categories of risks must be housed under different cell structures and that reinsurance business contemplates insuring the risks associated with the insurance obligations of a primary insurer whether domestic or foreign, and that this risk necessarily comprises third-party risk.
- [21] The Prudential Authority makes this argument because it draws a distinction between the operational risks covered in the insurance arrangements between the cell owner itself and its primary insurer, and the reinsurance risk insured against in the arrangement between Centriq Insurance and the foreign primary insurer.
- [22] In sum, the Prudential Authority contends that a foreign primary insurer's risk that would be reinsured does not become a first-party risk merely because it pertains to a contingency arising that is insured against with reference to the operational risks of the cell owner.
- [23] In the licence variation application, Centriq Insurance contemplated that it would conduct both first-party risk business and third-party risk business. In subsequent meetings between the Prudential Authority and Centriq

Insurance, these two possibilities were confirmed. No argument was made as to why this contemporaneous factual representation made by Centriq Insurance to the Prudential Authority should be ignored by the Tribunal.

[24] Instead, Centriq Insurance urges the Tribunal to focus on the object of the risk insured against, contending that in both the insurance relationships with the cell owner and the reinsurance relationship with the foreign primary insurer, these ought to be considered to be the operational risks of that cell owner. Centriq Insurance urges the Tribunal not to focus on the identity of the parties to the insurance arrangement, but rather to focus on the nature of the risk that is the subject of the two insurance relationships.

[25] Unfortunately, the distinction that Centriq Insurance wishes to draw is a false one and the nature of the risks in these two insurance relationships is not the same risk. The reinsurance arrangement ensures against the risk that an insurance claim will be made by the foreign subsidiary of the cell owner against its foreign primary insurer. This is a reinsurance claim. In the language of the Act it is insurance against the insurance obligations of that foreign primary insurer. While it is true that that risk will only materialise if an operational risk covered by the primary insurance relationship between the foreign subsidiary and the foreign direct insurer arises, that does not convert the nature of the first claim into a first-party risk. It remains a third-party risk. And those two risks may not mingle in the same cell structure.

[26] The Act's policy underpinning the prohibition on a cell captive insurer insuring first-party and third-party risks in the same cell structure is so as to avoid the

inevitable conflict of interest that may occur between the interests of the cell owner as an insured in respect of first-party risks and the competing interests of third parties which are not associated with the cell owner or its group of companies. This is a sound policy consideration.

[27] While some reinsurance contracts may well be first-party indemnity insurance, this is not what was proposed by Centriq Insurance in its licence variation application. That application on its terms contemplated that cell owners will be insured by other foreign direct insurers and those insured parties would seek to conduct reinsurance business with Centriq Insurance. This is not congruent with Centriq Insurance's arguments to the Tribunal that it seeks to insure the same operational risk.

[28] To approach this dispute from another angle, the agreement between Centriq Insurance as the reinsurer and the primary foreign insurer manages a third-party risk that is distinct from the operational risks managed in the insurance arrangement between the foreign primary insurer and the foreign subsidiary of the cell owner.

[29] In argument, Centriq Insurance's counsel could not provide a commercial rationale for why it wishes to include the reinsurance risks in the same cell structure as the operational risks of the cell owner. Indeed, the Act is clear in its purpose and objective of trying to keep first- and third-party risks separate to avoid the obvious risks and potential conflicts of interest that may arise if both extraneous and internal risks arising from a business' organisation are mingled in a cell structure.

- [30] It is this commercially sensible purpose and policy choice that the Tribunal must uphold when interpreting the provisions of the Act in line with the *Endumeni/Telkom* approach. The legislative choice of a protective separation of risks into their distinct and regulated cell structures must be upheld by our interpretation of the Act.
- [31] The ringfencing of first-party and third-party risks and the differentiation between the insurance obligations between a cell owner and its primary insurer for operational risks and between that primary insurer, even if foreign and its reinsurer, is the only sensible and businesslike interpretation in these circumstances and on the facts set out in the application lodged by Centriq Insurance. For these reasons, each of the grounds on which Centriq Insurance challenges the Prudential Authority's decision must fail.
- [32] The second issue raised by Centriq Insurance relates to section 25(6)(b)(ii) in which it contends that the condition 3.4 in the licence variation decision, that requires an application to be submitted for prior approval from the Prudential Authority before a reinsurance arrangement can be entered into, is challenged on the basis that the insurer can only be a local insurer and therefore section 25(6)(b)(ii) is said not to be applicable where a local insurer concludes a reinsurance agreement with a direct foreign insurer.
- [33] For the reasons set out above, this ignores the interrelationship in the definitions between insurer, reinsurer and reinsurance business and insurance obligations, such that where a local insurer concludes a

reinsurance agreement with a direct foreign insurer, this is not excluded from section 25(6)(b)(ii).

[34] The third challenge made here is to the requirement in condition 3.4 of the licence variation decision that foreign insurers must enter into a separate third-party cell arrangement with Centriq Insurance. This is challenged on the basis that it would be impossible for Centriq Insurance to accept reinsurance from foreign insurers where these pertain to the operational risks of large corporates or any other business on a basis other than through the promotor cell. Centriq Insurance contends that this requirement conflates cell ownership with the business that is in the cell, which business is said to have an ordinary insurer policy holder relationship. Again, this ignores the interpretation of the definitions in the Insurance Act set out above.

[35] Accordingly, each of the challenges made in the reconsideration application do not succeed.

ORDER:

The application for reconsideration is dismissed.

Signed on behalf of Tribunal



MM LE ROUX SC