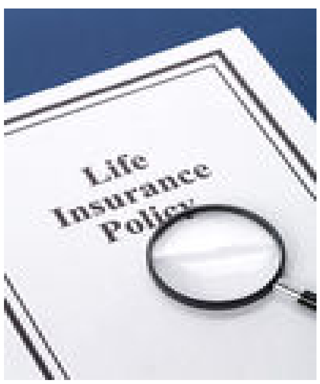
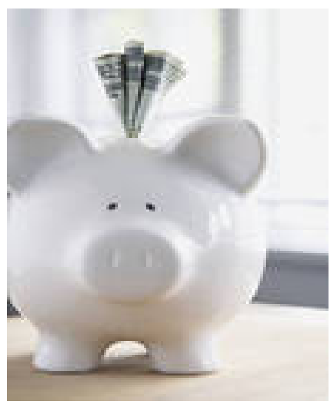
Cession of Life Insurance Policies *in securitatem debiti*: A Practical Perspective





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Cession of Life Insurance Polices *in securitatem debiti*: A practical Perspective

by

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Abstract

Cession of Life Insurance Policies *in securitatem debiti*: A Practical Perspective

The security cession of the rights under life policies marries two separate areas of the law: The Law of cession and the Law of Insurance. This makes for a complex union since varying common law and statutory principles find application, and in reality trade practices also play a role.

In theory a cession *in securitatem* debiti may take one of two possible constructions, namely a pledge or a fiduciary security cession, and each has its own advantages and disadvantages. Disparity arose when judicial preference was given to the pledge construction while academics preferred the other.

The problem, however, was larger than a disagreement as to the better construction. The underlying problem was that there was a lack regarding clarity as to the practical operation of security cession of life policies, in addition to the problems surrounding the construction thereof.

As a solution to this problem some academics have suggested legislative intervention. The South African Law Reform Commission, nevertheless, advised against it in 1991 and was of the opinion that the issue was one which our courts would eventually solve.

In the 22 years since then, our courts have merely confirmed its preference for the pledge construction. The intricacies of security cessions of life policies have seen no further judicial development. It is probable that the courts do not have enough practical information at hand to advance this area of the law.

An investigation into the operation of such cessions in practice was thus necessary. The outcome of the practical investigation reveals that legislative intervention is indeed a viable solution especially since the issues are too complex for the courts to solve. As part of this work, legislation has been drafted and it is recommended that this is inserted into the Security by Means of Movable Property Act .

Opsomming

Cession of Life Insurance Policies *in securitatem debiti*: A Practical Perspective

Die sessie ter sekerheidstelling van regte voortspruitend uit 'n lewensversekeringspolis betrek twee aparte onderafdelings van die rege naamlik die reg insake sessie en die versekeringsreg. Die gevolg van hierdie dualisme is dat 'n magdom gemeenregtelike en statutêre regsbeginsels van toepassing is wat sessies van hierdie aard kompliseer. Daarbenewens speel handelspraktyke ook ‘n rol.

Teoreties kan 'n sessie *in securitatem debiti* een van twee moontlike konstruksies aanneem, naamlik sessie van pandgewing en fidusiêre sekerheids sessie, en elk het sy eie voor- en nadele. Onenigheid was aan die orde van die dag nadat die howe aan die pandgewings konstruksie voorkeur verleen het, terwyl akademiese skrywers die alternatiewe konstruksie verkies het.

Die probleem was egter veel eerder weens ‘n gebrek aangaande duidelikheid oor die praktiese toepassing van die sessies ter sekerheidstelling van lewenspolisse, as die onenigheid oor welke van die twee konstruksies teoreties die beter een sou wees .

Om die probleem te oorkom, het sommige akademiese skrywers voorgestel dat die wetgewer moes ingryp. Die Suid-Afrikaanse Regskommissie het egter in 1991 daarteen besluit en die mening gehuldig dat die probleem uiteindelik deur die howe opgelos sou moes word.

Sedertdien het die howe egter telkens hul voorkeur ten opsigte van die pandkonstruksie uitgespreek, en derhalwe het daar geen verdere deurslaggewende juridiese ontwikkeling rondom die kwelpunte van sessies ter sekerheidstelling plaasgevind nie. Dit is waarskynlik daaraan te wyte dat die howe oor ontoereikende praktiese inligting beskik het om hierdie gebied van die reg noemenswaardig uit te bou.

Dit was gevolglik nodig om 'n ondersoek aangaande die toepassing in die praktyk van hierdie tipe sessies te loods. Die resultaat van dié ondersoek toon dat 'n statutêre ingreep inderdaad 'n lewensvatbare oplossing kan bied, aangesien die kwessies te ingewikkeld is vir die howe om te oorkom. Deel van hierdie studie bevat voorgestelde wetgewing met die aanbeveling dat dit in die Wet op Sekerheidstelling deur middel van Roerende Goed 57 van 1993 opgeneem word.

Plagiarism Declaration

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The very first person that I am privileged to thank is my supervisor, Prof Birgit Kuschke. I was so blessed to have this angel as my supervisor! She offered me encouragement when I was disillusioned and wise counsel on many occasions. She went above and beyond what is ordinarily expected of a supervisor. Thank you!

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I am deeply indebted and thus grateful beyond words for the assistance given by the participants representing the banks and insurance companies. The non-disclosure agreements prevent me from naming certain people, but you know who you are! I am fully aware that without your co-operation this thesis could not have been written.

To my dear brothers and sisters at St Pauls, who continually prayed so earnestly for me, I will be eternally grateful.

And above all, thank you to my husband and my family.

THE VALLEY OF VISION

Lord, high and holy, meek and lowly,
Thou has brought me to the valley of vision,
Where I live in the depths but see Thee in the heights;
Hemmed in by mountains of sin I behold Thy glory.
Let me learn by paradox
That the way down is the way up,
That to be low is to be high,
That the broken heart is the healed heart,
That the contrite spirit is the rejoicing spirit,
That the repenting soul is the victorious soul,
That to having nothing is to possess all,
That to bear the cross is to wear the crown
That to give is to receive,
That the valley is the place of vision.
Lord, in the daytime stars can be seen from deepest wells,
And the deeper the wells the brighter thy stars shine;
Let me find thy light in my darkness,
Thy life in my death,
Thy joy in my sorrow,
Thy grace in my sin,
Thy riches in my poverty,
Thy glory in my valley.

Arthur Bennett

To my parents, Richard and Gail Sunkel, whose love and support springs eternal.

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CHAPTER ONE
INTRODUCTION

Confucius say:

"Needing life insurance is like needing a parachute.

If it isn´t there the first time,

chances are you won´t be needing it again."

1.1 Background

Life insurance cannot prevent death or prolong life. Life insurance is, however, a source of monetary consolation in the face of an adverse event, such as death or early death. Being a source of monetary consolation, life insurance is a valuable asset in the policyholder's estate.

Because life insurance is also an asset, it can be used as security for credit facilities. Most financiers (or credit providers) extend credit only on the strength of some kind of security. Security serves to protect the financier in the event that the loan is not repaid. If the loan is not repaid, the financier can look to the security to satisfy the remaining indebtedness. Financiers would not be able to exist without a system of security.

Life insurance policies have been used to secure loans almost from the time that life insurance was legally recognised, and today this is still one of the most popular methods of securing credit. When a life insurance policy is used as security, the financier acquires the right to claim the policy proceeds. Should the policyholder default on loan repayments, the financier may use the policy proceeds to satisfy the outstanding balance under the loan.

The use of life insurance as a means to secure credit brings together three diverging legal concepts: First, the principles of Insurance Law are involved because the object of the security is a life policy. Secondly, the principles of the Law of Cession play a prominent role since cession is the vehicle by which the asset (that is the rights under the life policy) is transferred from the estate of the policyholder to the estate of the financier. Thirdly, because the transfer of the rights under the life policy is intended to be temporary and for security purposes only, principles of security are also involved.

In addition to the diverging legal concepts, trade practices also play a part. The trade practices of the insurance industry, as well as the trade practices of the banking industry, make the already complex situation even more complex.

Consequently, there is much disparity and legal uncertainty when a life policy is used as security for credit facilities. There is even disparity as to how a security cession should be constructed. Academics have attempted to solve some of these issues and a large body of theory has emerged. Much of this theory does not consider trade practices and has caused discontentment amongst practitioners. The unsatisfactory state of affairs prompted the South African Law Reform Commission to investigate whether legislative intervention was necessary. The Commission was of the opinion that the issue was one which our courts would eventually solve.

Two decades on and the intricacies of security cessions of life policies have seen no further judicial development. The rationale for this work is based on the premise that judicial advancement has been hindered due to a lack of practical information. It is for this reason that an empirical exploration was undertaken.

The goal of such an investigation was not only to provide answers to a handful of theoretical questions, but also to reveal whether the Commission's decision against legislative intervention was short-sighted.

1.2 Methodology

1.2.1 Overview

The type of study undertaken was that of a case study in the form of questionnaires.[1] The questionnaires were distributed over the months of June to October 2013. All the participants voluntarily participated after being informed of the nature and significance of the case study. The

[1] The author completed the postgraduate module Survey Methods POP811 at the University of the Western Cape in order to acquire the knowledge necessary to design the questionnaire. The questionnaire was vetted by an expert in the field, Dr Nancy Stiegler, from the University of the Western Cape, who confirmed its validity before distribution.

participants were assured of anonymity and that the data collected would be held in strict confidence.

The issue of security cessions of life policies necessitated an investigation into the insurance industry as well as the banking industry since studying just one industry tells only half a story. For this reason two separate questionnaires were designed for each industry (see appendix A and B).

1.2.2 Research question

The aim of the empirical exploration was to discover the divergence between theory and practice. It endeavored to answer the question: Can the existing theoretical ideas of security cessions of life policies be supported in light of contemporary practices in the insurance and banking industries?

1.2.3 Data collection method

(i) A case study

A case study was selected as the type of study because it allowed an in-depth examination into the operation of an individual insurance company or bank. Studying two cases per industry was done to add confidence to the findings and to allow for comparison between the cases.

(ii) The respondent

The institutions that were approached are some of the largest and most established in their respective industries. The respondents of the questionnaires were originally intended to be the senior legal advisor of each institution. However, after some initial enquiries, it became apparent that the subject matter of the questions spanned over multiple departments (such as product, legal and compliance). The questionnaire was consequently circulated among several legitimate respondents.

(iii) The questionnaire

The case study was conducted by way of unassisted questionnaires due to the time constraints of the respondents as well as logistical considerations due to there being multiple respondents involved. The applicable questionnaire was sent by email to the senior legal advisor of the institution, who managed the circulation thereof to the relevant respondents in other departments. The responses were typed directly onto the questionnaires and the questionnaires were returned via email once completed.

The questionnaires were preceded by a definition of the terminology used to ensure clarity and accuracy of responses. The questionnaires were clearly divided into categories labelled by a heading to establish the context of the questions that followed.

The questionnaires were kept as short as possible to ensure the quality of the responses. The questions were structured as "yes" or "no" where possible to prevent fatigue and to save time. Some questions were also open-ended to allow the respondent to give a more detailed explanation and to possibly discover the unexpected answer.

1.2.4 Delimitations

In this study the "financier" was restricted to banks. Banks very commonly accept life policies as security for credit facilities and are by far the largest and most popular type of credit provider. Other credit providers and micro-lenders thus fell outside the scope of this study.[2]

1.3 Structure

An overview of the South African Law of Cession and Law of Insurance is set out in Chapters 1 and 2 respectively. The content of these Chapters was limited to only those aspects which were relevant to the topic of this work, and form the framework for the critical discussion of cessions *in securitatem debiti* that follows in Chapter 4. Chapter 5 provides a comparative study for a foreign perspective of the issues under discussion. The responses to the questionnaires and an analysis thereof follow in Chapter 6. The recommendation to legislate culminates in the draft legislation proposed in Chapter 7. The final conclusion appears in Chapter 8.

1.4 Findings

Since an empirical investigation of this nature has never been undertaken, the data collected provided new information and indeed made an invaluable contribution to this body of law.

The results of the study exposed inconsistencies in banking and insurance trade practices. It also came to light that the complex problems should rather be remedied by statute than by a court. The feedback from the questionnaires further revealed that practitioners in the banking industry were

[2] As an aside, it is submitted that the practice of other credit providers and micro-lenders is in all likelihood very similar to that of the banks.

supportive of legislative intervention. This is also in line with academic thinking, since the implementation of legislation has been advocated for many years.

As far as can be ascertained, no academic has drafted a detailed proposal of effective legislation. This work analyses and discusses the problems in theory, as well as the problems in practice, and proposes legislative provisions that endeavour to solve these problems fairly and logically.

CHAPTER TWO
CESSION

2.1 The nature of cession

Cession fulfills a very useful and convenient commercial function.[1] Besides being a method of payment, cession is often used as a mechanism to provide security for credit facilities.

The transfer method of a real right depends on the object of the right. Where the object of the real right is movable corporeal property, transfer takes place by delivery coupled with an intention to pass and receive ownership.[2] Where the object is of the real right is immovable corporeal property, transfer takes place by registration together with an intention to pass and receive ownership.[3]

Personal rights are also capable of transfer, but not in the same manner as real rights. The reason for this is that the object of a personal right is performance, often the payment of a sum of money.[4] Since this object is incorporeal in nature neither delivery nor registration can be employed to effect a transfer of a personal right. As Joubert JA explains below, personal rights are uniquely transferred by way of cession.

In *First National Bank of SA Ltd v Lynn NO and Others*, Joubert JA explains that cession is:

> … [A] particular method of transferring rights in a movable incorporeal thing in the same manner in which delivery (*traditio*) transfers rights in a movable corporeal thing. It is in substance an act of

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[1] Christie RH & Bradfield GB *Christie's The Law of Contract in South Africa* (2011) 6ed 482 where the authors point out that cession: "…[F]acilitates commerce by enabling a creditor to turn his rights to account by selling them instead of enforcing them himself, it avoids circuity of actions and it has a number of other practical uses".

[2] *Air-Kel (Edms) Bpk h/a Merkel Motors v Bodenstein en 'n Ander* 1980 (3) SA 917 (A) 922E-F and *Commissioner of Customs & Excise v Randles Brothers & Hudson Ltd* 1941 AD 369 398: "Ownership of movable property does not in our law pass by the making of a contract. It passes when delivery of possession is given accompanied by an intention on the part of the transferor to transfer ownership and on the part of the transferee to receive it". The passing of ownership is always subject to the rule *nemo plus iuris ad alium transferre potest quam ipse haberet* which, loosely translated by the writer, means that no one can transfer more rights than he himself has.

[3] This is established by the Deeds Registries Act 47 of 1937. See also *Legator McKenna Inc and Another v Shea and Others* 2010 (1) SA 35 (SCA) 44C-H; *Middleton v Middleton and Another* 2010 (1) SA 179 (D) 183F-G.

[4] As observed by Nienaber PM in "Cession" in *LAWSA* 2ed (2003) para 3-4. The performance may be positive or negative and the duty to perform may arise from any source, for example, contract, delict, unjustified enrichment or statute. Performance may consist of *dare*, *facere* or *non-facere*. The legal nature of cession has given rise to confusion over the years and common misconceptions are considered in Scott S "Object of cession" 2000 *TSAR* 774-776.

> transfer ('oordragshandeling') by means of which the transfer of a right *(translatio juris)* from the cedent to the cessionary is achieved. [5]

The performance which constitutes the object of a personal right is owed by a party called the "debtor" to a party called the "creditor". The creditor's right to claim performance from the debtor is considered an asset in the creditor's estate which he may transfer to a third party. The need for cession thus arises when the creditor desires to transfer the personal right instead of enforcing it himself.[6]

2.1.1 Cession in Roman and Roman-Dutch law

The modern concept of cession was not known in Roman law. The transfer of a personal right was not recognised as Roman lawyers considered an obligation as something highly personal.[7] In fact, Roman lawyers adhered to the maxim *nomina ossibus inhaerent*, which meant:

> [T]he action arising from an obligation hinges on the bones and entrails of the creditor and can be no more separated from his person than the soul from the body.[8]

There was, however, a practical need for cession, so Roman lawyers achieved a similar result by using *novatio* and later *procuratio in rem suam*.[9] Both legal institutions had shortcomings, mainly because the intended cessionary could not sue in his own name.[10]

In response to this, an action called the *actio utilis* was developed to allow the *procurator in rem suam* to sue in his own name.[11] The introduction of the *actio utilis*, however, did not solve the

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[5] 1996 (2) SA 339 (A) 345F-G.

[6] As discussed by Nienaber para 9; Scott S *The Law of Cession* (1991) 2ed 5 [hereinafter referred to as "*Cession*"]; Scott 2000 *TSAR* 774-776. It is important to point out here that cession transfers rights and not duties – see *Estate Fitzpatrick v Estate Frankel and Others; Denoon and Another v Estate Frankel and Others* 1943 AD 207.

[7] *LTA Engineering Co Ltd v Seacat Investments (Pty) Ltd* 1974 (1) SA 747 (A) 762B. Zimmermann R *The Law of Obligations: Roman Foundation of the Civilian Tradition* 2ed (1995) 58 examines the historical development more closely.

[8] As translated by Zimmermann 58.

[9] *LTA Engineering v Seacat Investments* 762B-C; *Johnson v Incorporated General Insurances Ltd* 1983 (1) SA 318 (A) 331B-C.

[10] *J McNeil v Insolvent Estate of R Robertson* (1882) 3 NLR 190 193; *Johnson v Incorporated General Insurances* 331B-C. This is also confirmed in Zimmermann 60-62.

[11] *J McNeil v Insolvent Estate of R Robertson* 193; *LTA Engineering v Seacat Investments* 762C-D. See also the explanation in Zimmermann 62 and Scott *Cession* 13-20.

problem entirely since it did not bring about transfer of the personal right.[12] The creditor still retained the *actio directa* as this action was too personal to transfer. As a result, the purported cessionary was not completely protected.[13]

A positive progression was made in Roman-Dutch law.[14] Jurists began to recognise that a personal right was a species of property that could be transferred. Sande, one of the foremost authorities on cession, wrote that "[a]s a general rule every action real as well as personal, is competent to be ceded".[15] He explains that actions are ceded by mere consent, provided that a valid cause for the cession exists revealing the intention to transfer.[16] Sande's writings clearly explain that cession brings about a complete transfer of the personal right.[17] This development is also echoed by Voet, whose works are also accepted as authoritative.[18]

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[12] *LTA Engineering v Seacat Investments* 762D. An insightful critique can be found in Scott 2000 *TSAR* 765 769, 771-773

[13] Above.

[14] *LTA Engineering v Seacat Investments* 762F-763C; *Regional Factors (Pty) Ltd v Charisma Promotions* 1980 (4) SA 509 (C) 511. In early South African Law this concept had already been firmly established as trite law as exemplified by Mason J in *McLachlan v Wienand* 1913 TPD 191 194: "There is nothing especially sacrosanct about rights of action. They are property as much as land or corporeal movables". See too Scott 2000 *TSAR* 771-773.

[15] Johannes *à* Sande *De Cessione Actionum* (1623) 5.1. Translation Anders PC *Commentary on Cession of Actions by Johannes à Sande* (1906) 58. This is also accepted in the case law: *J McNeil v Insolvent Estate of R Robertson* 193; *Consolidated Finance Co Ltd v Reuvid* 1912 TPD 1019 1024; *McLachlan v Wienand* 194-195.

[16] Sande *De Cessione* 2.2 translation Anders 14-15. This reflects the requirements in the modern law of cession of an obligationary agreement (containing the *causa*) and a transfer agreement. See 2.1.3 and 2.1.4 below for a further discussion.

[17] Sande 5.3, 9.2 translation Anders 59, 170-171. Cases referring to Sande's views include: *McLachlan v Wienand* 194-195, 198: "…[T]he Roman Dutch authorities whom we follow hold that the cession absolutely destroys any rights of action of the cedent". *Fick v Bierman* (1883-1884) 2 SC 26 34: "One of these consequences is that all the rights of the cedent are extinguished by the cession, so that the cessionary only, and not the cedent, can compel an unwilling debtor to discharge his debt." *Waikiwi Shipping Co Ltd v Thomas Barlow & Sons (Natal) Ltd and Another* 1978 (1) SA 671(A) 675D: "Today a cession, absolute in terms, does serve to divest a cedent completely of his right of action". Also: *Barclays Bank and Another v Riverside Dried Fruit Co (Pty) Ltd* 1949 (1) SA 937 (C) 945; *Guman and Another v Latib* 1965 (4) SA 715 (A); *Jerome Investments (Pty) Ltd v Gluckman* 1970 (3) SA 67 (W) 69C-D. Scott 2000 *TSAR* 771-773 makes mention of this as well.

[18] Johannes Voet *Commentarius ad Pandectas* (1698), see especially 18.4.15, 18.4.17. Translation Gane P *The Selective Voet being the Commentary on the Pandects by Johannes Voet and the Supplement to that work by Johannes van der Linden* (1955). The history for the law of cession can be summarised in the words of *Regional Factors v Charisma Promotions* 511H-512A: "The general development since Roman times has been to give the cessionary a right of action independent of the cedent".

As an aside, it may be noteworthy to mention the following: In the modern law of cession the phrase "cession of a right of action" is technically incorrect and should be avoided – although it is still seen in contracts and in case law from time to time.[19] This expression was born from the fact that in Roman law the prohibition on cession was overcome by giving the intended cessionary actions with which he could sue (the *actio utilis* and then later the *actio directa*). Since cession brings about a complete transfer of a personal right, this terminology should be avoided.

2.1.2 A method of transfer

As explained above, corporeal property is transferred from the estate of one person to the estate of another by delivery or registration as the case may be. Likewise, cession transfers the right to claim performance against a debtor from the estate of one person to the estate of another.[20] Just as delivery and registration is not a contract, so cession is also not a contract, but a mode of transfer.[21]

Upon the transfer the creditor is called the "cedent" and the third party who receives the personal right is called the "cessionary".[22] After a cession has taken place, the cedent ceases to be the

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[19] A handful of such cases include the following: *Moola v Estate Moola* 1957 (2) SA 463 (N) 464B-D; *Lief NO v Dettmann* 1964 (2) SA 252 (A) 271; *Muller NO v Trust Bank of Africa Ltd and Ano*ther 1981 (2) SA 117 (N) 122 *et seq*; *First National Bank v Lynn; Headleigh Private Hospital (Pty) Ltd t/a Rand Clinic v Soller & Manning Attorneys and Others* 2001 (4) SA 360 (W) 366 *et seq*; *Moonsamy and Another v Nedcor Bank Ltd and Others* 2004 (3) SA 513 (D) 517H; *Homes for South Africa (Pty) Ltd v Rand Building Contractors (Pty) Ltd* 2004 (6) SA 373 (W) 376D; *SA Breweries Ltd v Van Zyl* 2006 (1) SA 197 (SCA) 200 *et seq*. See also Scott 2000 *TSAR* 774-776 and Scott *Cession* 13 *et seq* where the use of this phrase has been extensively considered. This tendency appears to have dwindled in the most recent cases such as *Van Staden NO and Another v Firstrand Ltd and Another* 2008 (3) SA 530 (T); *Picardi Hotels Ltd v Thekwini Properties (Pty) Ltd* 2009 (1) SA 493 (SCA); *Grobler v Oosthuizen* 2009 (5) SA 500 (SCA); *Retmil Financial Services (Pty) Ltd v Sanlam Life Insurance Co Ltd* 2013 JDR 0864.

[20] *Uxbury Investment (Pty) Ltd v Sunbury Investments (Pty) Ltd* 1963 (1) SA 747 (C) 752A; *Hippo Quarries (Tvl) (Pty) Ltd v Eardley* 1992 (1) SA 867 (A) 873E; *Goudini Chrome (Pty) Ltd v MCC Contracts (Pty) Ltd* 1993 (1) SA 77 (A) 87G-H; *Purchase v De Huizemark Alberton (Pty) Ltd t/a Bob Percival Estates* 1994 (1) SA 281 (W) 285*; Standard General Insurance Co Ltd v SA Brake CC* 1995 (3) SA 806 (A) 814; *Aussenkehr Farms (Pty) Ltd v Trio Transport CC* 2002 (4) SA 483 (SCA) 492D-E.

[21] *White v Collins* 1914 WLD 35 37 made the following remark in this regard: "I am afraid I do not understand the meaning of the phrase 'contract of cession'. Cession is a method of transfer…". See in addition *First National Bank v Lynn* 45F-G; *Uxbury Investment v Sunbury Investments* 752A; *Hippo Quarries v Eardley* 873E; *Standard General Insurance Co v SA Brake* 814; *Purchase v De Huizemark Alberton* 285; *Goudini Chrome v MCC Contracts* 87G-H.

[22] *LTA Engineering v Seacat Investments* 762A: "A cession is…a bilateral juristic act (agreement) whereby the cedent transfers his right of action to the cessionary, the latter taking the place of the former as creditor".

creditor and the cessionary becomes the creditor in his stead.[23] Where the debtor had to perform to the cedent before the cession, he now has to perform to the cessionary after the cession.[24]

It has been aptly said that cession "straddles the law of property and the law of obligations".[25] This dual nature of cession can be explained as follows: The legal relationship between the creditor and the debtor in terms of which the debtor has a legal duty to render performance and the creditor has a right to receive performance falls under the law of obligations.[26] The right to receive performance, on the other hand, is an asset in the creditor's estate, which he can transfer should he wish to do so.[27] The transferring of assets thus falls under the law of things or the law of property.[28]

2.1.3 The obligationary agreement

As mentioned above, cession is a method of transfer and, although it is brought about by agreement, it is not itself a contract.[29] The agreement which brings about a cession is called an "obligationary agreement".[30] It is the agreement whereby the cedent undertakes to cede the personal right, and constitutes the underlying *causa* or reason for the cession.[31] Were it not for the obligationary agreement, cession would take place in a vacuum, absent of purpose.

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[23] *Katz v Katzenellenbogen and Others* 1955 (3) SA 188 (T) 191A*; Fick v Bierman* 34; *Johnson v Incorporated General Insurances* 331A, 331F; *LTA Engineering v Seacat Investments* 762A. A similar statement is made by Van der Merwe S, Van Huyssteen LF, Reinecke MFB & Lubbe GF *Contract General Principles* 3ed (2008) 450.

[24] *Rothschild v Lowndes* 1908 TS 493 499; *Johnson v Incorporated General Insurances* 331A; *LTA Engineering v Seacat Investments* 762A; *Katz v Katzenellenbogen* 190H-191A.

[25] As put by Nienaber para 9.

[26] See further Scott *Cession* 3-5; Scott S "Cession of whole life insurance rights" 2003 *Stell LR* 89 93.

[27] *Anglo-African Shipping Co (Rhod) (Pvt) Ltd v Baddeley and Another* 1977 (3) SA 236 (R) 238H-239A.

[28] See further Scott *Cession* 3-5.

[29] *White v Collins* 37; *Republikeinse Publikasies (Edms.) Bpk v Afrikaanse Pers Publikasies (Edms) Bpk* 1972 (1) SA 783A-D where the court correctly pointed out that cession flows from a contract. See also *First National Bank v Lynn* 345H; *Standard General Insurance Co v SA Brake* 814. The courts sometimes confuse cession and contract as illustrated in *Uxbury Investment v Sunbury Investments* 751H where it was stated that a cession was also a form of contract. Similarly, the court in *Aussenkehr Farms v Trio Transport* 492D referred to the "contract of cession". Other cases where this mistake is evident include: *Jeffery v Pollak & Freemantle* 1938 AD 1 22; *Spies v Lombard* 1950 (3) SA 469 (A) 481E; *Big Sixteen (Pty) Ltd v Trust Bank of Africa Ltd* 1978 (3) SA 1032 (C) 1036C; *Standard Bank v Ocean Commodities Inc* 1980 (2) SA 175 (T) 180F; *Bank of Lisbon v The Master* 1987 (1) SA 276 (A) 294E; *Kalil Decotex (Pty) Ltd* 1988 (1) SA 943 (A) 970J.

[30] *First National Bank v Lynn* 345I and *Johnson v Incorporated General Insurances* 331B-C; *Standard General Insurance v SA Brake* 814;

[31] *Hayward, Young & Co v Glendinning* 1933 EDL 288 295; *Botha v Fick* 1995 (2) SA 750 (A) 762C, 778F-G; *Johnson v Incorporated General Insurance* 331B-C; *Purchase v De Huizemark Alberton* 285; *McLachlan v Wienand* 195. Some courts have made an effort to spell out exactly what this means, for instance the court in

The obligationary agreement can manifest itself in a number of ways, for example, in contracts of sale, lease, security or donation.[32]

No additional substantive or formal requirements for the validity of the obligationary agreement are necessary. The obligationary agreement is governed by the legal principles of the specific agreement that evidences the *causa*, as well as by the terms agreed upon by the parties.[33] The obligationary agreement, however, does not bring about actual transfer of a personal right. This requires a separate agreement called a "transfer agreement" or "real agreement" as discussed below.

2.1.4 The transfer agreement

The agreement that constitutes the actual transfer of a personal right is the cession itself and is known as a "transfer agreement".[34] The transfer agreement and the obligationary agreement often take place simultaneously in one transaction, although they are two separate acts with different functions.[35] This is likely the reason why a cession is often mistaken as being a contract.[36] A

White v Collins 37 stated that: "Cession is a method of transfer and not a *causa*, sale is a *causa* for transfer and not a method of transfer." Joubert JA in *First National Bank v Lynn* 345H-I explained that: "…[T]he agreement of transfer can coincide with, or be preceded by, a *justa causa* which can be an obligatory agreement, also called an obligationary agreement ('verbintenisskeppende ooreenkoms'), such as a contract of sale, exchange or donation…. Even an agreement to provide security by means of a cession *in securitatem debiti* is in itself adequate *justa*".

[32] *McLachlan v Wienand* 195; *White v Collins* 37; *Johnson v Incorporated General Insurance* 331B-C; *First National Bank v Lynn* 345H-I; *Standard General Insurance Co v SA Brake* 814. The obligationary contract may even arise *ex lege* as noted by Nienaber para 28 and Van der Merwe *et al* 454.

[33] *Jeffery v Pollak & Freemantle* 22; *Sadar Investments (Pty) Ltd v Caldeira* 1971 (1) SA 193 (O) where the obligationary agreement was governed by the terms agreed upon by the parties in the lease. In *Glen Anil Finance (Pty) Ltd v Joint Liquidators, Glen Anil Development Corporation Ltd (In Liquidation)* 1981 (1) SA 171 (A) the obligationary agreement was governed by the provisions in the deed of sale.

[34] *Johnson v Incorporated General Insurances* 331B-C; *Purchase v De Huizemark Alberton* 285; *Botha v Fick* 762C; *Standard General Insurance Co v SA Brake* 814 and *First National Bank v Lynn* 345G-H per Joubert JA: "The transfer is accomplished by means of an agreement of transfer ('oordrags-ooreenkoms') between the cedent and the cessionary arising out of a *justa causa* from which the former's intention to transfer the right *(animus transferendi)* and the latter's intention to become the holder of the right *(animus acquirendi)* appears or can be inferred".

[35] *Ex Parte Strydom: In re Central Plumping works (Natal) (Pty) Ltd* 1988 (1) SA 616 (D) 621; in *Kessler v Krogmann* 1908 TS 290 295 the court described how the plaintiff refused to take cession in discharge of the obligation undertaken earlier by the defendant *White v Collins* 37; *Johnson v Incorporated General Insurance* 331B-C; *First National Bank v Lynn* 345H-I; *Purchase v De Huizemark Alberton* 285; *Botha v Fick* 762C, 778F-G and *Muller v Trust Bank* 1981 (2) SA 117 125D-E; *Hippo Quarries v Eardley* 887F.

[36] *Uxbury Investment v Sunbury Investments* 751H; *Aussenkehr Farms v Trio Transport* 492D.

transfer agreement is furthermore not dependent upon the existence of a valid obligationary agreement between the parties.[37]

The act of cession (in the context of the transfer agreement) does not generally require formalities, as it is a mental act.[38] A written deed of cession does not have to be drawn up, unless it is prescribed by statute or if it is the intention of the parties that writing is a requirement for validity.[39] Where the cession happens to be evidenced in a document, the document itself does not have to be delivered to the cessionary.[40]

The only substantive requirement for a valid cession is a duly constituted agreement, either orally or in writing, in a manner that indicates that the parties are *ad idem*.[41] This means that the cedent must have the intention to cede the personal right and similarly, the cessionary must have the

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[37] *Kriel v Terblanche NO en 'n Andere* 2002 (6) SA 132 (NC) 140C *et seq*; *Rabinowitz and Another v De Beers Consolidated Mines Ltd and Another* 1958 (3) SA 619 (A) 637A-B; *Legator McKenna v Shea* 45 *et seq*.

[38] *Wright & Co v The Colonial Government* (1891) 8 SC 260 269; *Botha v Carapax Shadeports (Pty) Ltd* 1992 (1) SA 202 (A) 214F; *Muller v Trust Bank Ltd* 124F-G; *Aussenkehr Farms v Trio Transport* 492D-E; *Hippo Quarries v Eardley* 873E; *First National Bank v Lynn* 345.

[39] *Dykman v Die Meester en 'n Ander* 2000 (1) SA 896 (O) 906A-B, 906D-E; *Wright & Co v The Colonial Government* 269. Section 2 of the Alienation of Land Act 68 of 1981 requires all transfers of land to be in writing and signed.

[40] The position was well stated in *Jacobsohn's Trustee v Standard Bank* (1899) 16 SC 201 203: "Where a right of action exists independently of any written instrument, the cession of such right may be effected without corporeal delivery of any document. Where, however, the sole proof of a debt is the instrument which records it, the cession of the debt is not complete until the instrument is delivered to the cessionary". This now-established principle has a rather controversial history. For many years it was uncertain as to whether delivery of the deed of cession was required for a valid cession. In the cases of *Smuts v Stack, Vendue-Master, Van Reenen & Karnspeck* (1828) 1 M 297; *Morkel v Holm* (1883-1884) 2 SC 57; *Buyskes v Hurley's Executor and Heirs* (1894) 11 SC 294; *Standard Bank v Union Boating Co* (1889-1891) 7 SC 257; *Jeffery v Pollak & Freemantle* 1; *Rabinowitz v De Beers Consolidated Mines* - to name a few – the courts were of the opinion that the document evidencing the cession must be delivered to the cessionary in order for it to be valid. Authority for the contrary view includes: *Van der Merwe v Franck* (1885) 2 SAR 26; *Jacobsohn's Trustee v Standard Bank* 201; *Wright & Co v The Colonial Government* 260; *Smith v Farrelly's Trustee* 1904 TS 949; *The Merchants' Trust Ltd v Rosin* 1927 TPD 285; *Goode, Durrant & Murray Ltd v Hewitt & Cornell NNO* 1961 (4) SA 286 (N). The issue was firmly and finally settled by the Appeal Court in *Botha v Fick* 778G-I, 779A-B.

[41] *Botha v Carapax Shadeports* 214F; *Aussenkehr Farms v Trio Transport* 492D-E; *Hippo Quarries v Eardley* 873E; *Fick v Bierman* 33 where De Villiers CJ highlighted that a "loose understanding" between parties cannot amount to a cession. In the case of *Wright & Co v The Colonial Government* 269 the court held that: "The law of this Colony requires no particular form of words for the purpose of effecting a complete cession of action. What it does require is that the intention to effect the cession should be clear and beyond doubt."

intention to acquire it.[42] The concurrence of the parties' intentions brings about the cession.[43]

2.2 The debtor's involvement

Although a cession involves a "triangle of parties"[44] the debtor is not a party to the cession. Cession involves only the cedent and the cessionary, who takes the former's place as creditor. Consequently, the debtor's consent is not needed for a valid cession.[45] The debtor need not be aware of the cession, and the cession may even occur against his will.[46] Cession must not, however, adversely affect or prejudice the debtor.[47] Although the exact content of this rule is not settled, it is generally accepted that the prejudice which is envisaged here is related to extra costs and payment inconvenience.[48]

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[42] Stratford J in *National Bank v Marks & Aaronson* 1923 TPD 69 74 confirmed this principle clearly: "But in my view the intention to cede the judgment for the untaxed costs is clear from a reading of the whole document, and once that conclusion is reached the cession must be held to be valid". Also *PG Bison Ltd v The Master* 2000 (1) SA 859 (SCA); *J McNeil v Insolvent Estate of R Robertson* 193; *Wright & Co v The Colonial Government* 269; *Hayward, Young & Co v Glendinning* 295; *Aussenkehr Farms v Trio Transport* 492D-E; *Hippo Quarries v Eardley* 873E; *Muller v Trust Bank* 124F-G; *First National Bank of SA Ltd v Lynn* 345; *Lief v Dettman* 271G; *Jeffery v Pollak & Freemantle* 22.

[43] *Muller v Trust Bank* 124F-G; *First National Bank of SA Ltd v Lynn* 345; *Lief v Dettman* 271G and *Jeffery v Pollak & Freemantle* 22 *et seq* where the court had to determine whether a cession had indeed occurred by closely considering the intentions of the parties to transfer and receive cession of shares. This is further illustrated in Floyd T "Cession" in Hutchinson D & Pretorius C (Eds) *The Law of Contract in South Africa* 2ed (2012) 355.

[44] In the words of Nienaber para 4.

[45] *London & SA Bank v Official Liquidator of Natal Investment Co* (1871) NLR 1 3; *Milner v Union Dominions Corporation (SA) Ltd and Another* 1959 (3) SA 674 (C) 676E-F; *Northern Assurance Co Ltd v Methuen* 1937 SR 103 108; *Paiges v Van Ryn Gold Mine Estates Ltd* 1920 AD 600 608; *Illings (Acceptance) Co (Pty) Ltd v Ensor NO* 1982 (1) SA 570 (A) 578F; *J McNeil v Insolvent Estate of R Robertson* 193; *Cullinan v Pistorius* 1903 ORC 33 37; *Van Staden v Firstrand* 538H-I; *Rothschild v Lowndes* 499.

[46] *Britz NO v Sniegocki and Others* 1989 (4) SA 372 (D) 378, 379-380; *Agricultural & Industrial Mechanisation (Vereeniging) (Edms) Bpk v Lombard en Andere* 1974 (3) SA 485 (O); *Pillay v Harichand* 1976 (2) SA 681 (D) 684E-H; *Cullinan v Pistorius* 37; *Paiges v Van Ryn Gold Mine Estates* 608; *Illings (Acceptance) Co v Ensor* 578F; *Van Staden v Firstrand* 538H-I; *Rothschild v Lowndes* 499.

[47] *Cullinan v Noordkaaplandse Aartappelkernmoerkwekers Koöperasie Bpk* 1972 (1) SA 761 (A) 771; *Goodwin Stable Trust v Duohex (Pty) Ltd and Another* 1998 (4) SA 606 (C) 616G; *Anglo-African Shipping v Baddeley* 238G-H.

[48] *Corinth Properties (Pty) Ltd v Firstrand Bank Ltd* 2002 (6) SA 540 (W) 546B-C; *Van Der Merwe v Nedcor Bank Bpk* 2003 (1) SA 169 (SCA) 175A-176B; *Anglo-African Shipping v Baddeley* 238G-H and *Lief v Dettman* 256B. Extra costs would likely arise if the right to claim money was split and ceded to a number of cessionaries without the debtor's consent – see *Kotsopoulos v Bilardi* 1970 (2) SA 391 (C) 396E-G; *Spies v Hansford & Hansford, Ltd* 1940 (TPD) 1; *Blaikie & Co Ltd v Lancashire NO* 1951 (4) SA 571 (N) 576; *Segal and Another v Segal and Others* 1977 (3) SA 247 (C) 252A-254D; *Schoultz v Potgieter* 1972 (3) SA 371 (E). A helpful discussion is also found in Van der Merwe *et al* 479.

In South African law, the general rule is that the debtor need not be given notice of the cession, although this has been the subject of much debate.[49] As a protection mechanism, performance to the cedent by mistake would amount to a good discharge of the debtor's obligation. To enjoy this protection, the debtor must have been unaware of the cession, or if aware thereof, he must have acted in good faith when performing to the cedent.[50]

2.3 Consequences of a cession

The consequences of a cession are broadly twofold: First, because cession is a method of transfer, the personal right will consequently vest in the estate of the cessionary. Cession brings about complete transfer of a right and the cedent will be wholly divested thereof.[51] This means that the cessionary is the only person who may administer the right or enforce it.[52]

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[49] *Barry v Barnes & Needham* (1828-1849) 3 Menz 473**;** *Keeler v Butcher & Sons* (1907) 28 NLR 43 49; *Morkel v Holm* 65; *London & SA Bank v Official Liquidator of Natal Investment Co* 3; *Jacobsohn's Trustee v Standard Bank* 201; *Paiges v Van Ryn Gold Mine Estates* 608; *Rothschild v Lowndes* 499; *J McNeil v Insolvent Estate of R Robertson* 193; *Katz v Katzenellenbogen* 190H-191A; *Botha v Carapax Shadeports* 214; *Van Staden v Firstrand* 548H-I. The general rule has not gone without some criticism – see Booysen J in *Britz v Sniegocki* 378, 379-380. See also Scott S "Die rol van kennisgewing van die sessie aan die skuldenaar" 1979 *THRHR* 155.

[50] *Estate van Den Heever v Greyling* (1907) 24 SC 414 421; *Opperman v De Beer* 1915 TPD 92 96; *Brook v Jones* 1964 (1) SA 765 (N) 767; *Clark v Van Rensburg and Another* 1964 (4) SA 153 (O) 160H-161A; *Momentum Group Ltd v Van Staden NO and Another* 2010 (2) SA 135 (SCA); *London & SA Bank v Official Liquidator of Natal Investment Co* 3; *Keeler v Butcher & Sons* 49; *Agricultural & Industrial Mechanisation v Lombard* 485 *et seq; Pillay v Harichand* 684E-H; *Van Staden v Firstrand* 548H-I, 539B-C, 541G-H; *Rothschild v Lowndes* 499 and *Katz v Katzenellenbogen*190H-191A. These cases (amongst others) as well as most academics (notably, Nienaber para 48 and Van der Merwe *et al* 486) take the view that the cessionary should give the debtor proper notice in good time to avoid the problems that may arise if the debtor pays the cedent.

[51] *Trust Bank of Africa Ltd v Standard Bank of South Africa Ltd* 1968 (3) SA 166 (A) 166 173D, 186H; *Rand Building Contractors v Homes for South Africa (Pty) Ltd* 1999 (4) SA 77 (W); *Britz v De Wet* 1965 (2) SA 131 (O) 133E; *McLachlan v Wienand* 194-195, 198; *Fick v Bierman* 34; *Goudini Chrome v MCC Contracts* 87G-H; *Purchase v De Huizemark Alberton* 285; *Lief v Dettman* 271; *Standard General Insurance Co v SA Brake* 814; *Moola v Estate Moola* 464E; *Katz v Katzenellenbogen* 190H; *LTA Engineering v Seacat Investments* 762A and *Johnson v Incorporated General Insurances* 331B-C, 331F-H. It is noteworthy to mention here that many cases (specifically *National Bank of South Africa Ltd v Cohen's Trustee* 1911 AD 235 and the cases that follow this *ratio*) have held that after a security cession where the pledge construction is applicable, the cedent is not wholly divested of the personal right because the intention of the parties is that the right is transferred only temporarily for as long as the need for security exists. It is submitted that because cession brings about a complete transfer of the personal right, the cedent is wholly divested of the personal right and that a security *cession* using a pledge construction is not possible. Chapter 4 below thoroughly examines this submission.

[52] *African Consolidated Agencies (Pty) Ltd v Siemens Nixdorf Information Systems (Pty) Ltd* 1992 (2) SA 739 (C); *Grindrod (Pty) Ltd v Seaman* 1998 (2) SA 347 (C) 354F-G*; National Bank v Marks & Aaronson* 69; *Mergold Beleggings (Edms) Bpk v Bhamjee en 'n Ander* 1983 (1) SA 663 (T) 675E-F; *Paiges v Van Ryn Gold Mine Estates Ltd* 608; *Rand Building Contractors v Homes for South Africa* 77; *Purchase v De Huizemark Alberton* 285; *Standard General Insurance Co v SA Brake* 814. Academic discussions of this can be found in Scott 2000 *TSAR* 765; Van Niekerk JP "Life insurance: cession" 1997 *Annual survey of South African Law* 588 591.

Secondly, in accordance with the *nemo plus iuris* rule,[53] the cessionary only steps into the shoes of the cedent and cannot be in a better or weaker position than that in which the cedent was.[54] Consequently, the personal right is transferred with all its attributes, be they benefits and privileges or defects and disadvantages.[55]

2.4 Types of cession

In general, a cession may take the form of an outright cession, or "out-and-out" cession as it is sometimes called; or a security cession.

2.4.1 Outright cession

When a personal right is ceded outright, it is completely transferred. No rights remain vested in the cedent and the cedent has no expectation of a re-cession. The preceding discussion in this Chapter has focussed on the principles that apply to an outright cession.

2.4.2 Security cession

A personal right may also be ceded as security in exchange for credit facilities. In reality a financier (or credit provider) will usually insist on some security or collateral if money has been loaned.[56] The financier can enforce performance against the debtor in the event that the loan cannot be repaid. In this way the cession of the personal right provides security to the financier. In the case

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[53] *Walker v Syfret, NO* 1911 AD 141 162; *Viljoen v SIK Investment Corporation (Pty) Ltd* 1969 (3) SA 582 (T) 585D; *Adams v SA Motor Industry Employers Association* 1981 (3) SA 1189 (A) 1200A-C*; Sechold Financial Services (Pty) Ltd v Gazankulu Development Corporation Ltd* 1997 (3) SA 391 (SCA); *Opperman v De Beer* 97. *Nemo plus iuris ad alium transferre potest quam ipse haberet* which, loosely translated by the writer, means that no one can transfer more rights than he himself has.

[54] *Anderson's Assignee v Anderson's Executors* (1894) 11 SC 432 440; *Van Den Heever v Cloete* (1904) 21 SC 113 115-116; *Biggs v Molefe* 1910 CPD 242 250; *National Bank v Marks & Aaronson* 71. In the case of *Grindrod v Seaman* 354F-G the court explained that the cessionary takes the place of the cedent where legal proceedings were instituted by the cedent before the cession. See in addition *Van Zyl v Credit Corporation of SA Ltd* 1960 (4) SA 582 (A) 587H; *Adams v SA Motor Industry Employers Association* 1200B-C; *Mergold Beleggings v Bhamjee* 675E-F; *Paiges v Van Ryn Gold Mine Estates* 616; *Katz v Katzenellenbogen* 191A; *LTA Engineering v Seacat Investments* 762A; *Retmil Financial Services v Sanlam Life Insurance Co* para 51.

[55] *Guinsberg & Pencharz v Associated Press* 1916 TPD 156 159; in *Scottish Rhodesian Finance Ltd v Olivier* 1965 (2) SA 716 (SRA) 719H-720A the court explained that: "A cessionary obtains no greater rights against the debtor than the cedent enjoyed; consequently the debtor may raise against the cessionary any defences to the original debt that he could have taken against the cedent…". See too *Biggs v Molefe* 251; *London & SA Bank v Official Liquidator of Natal Investment Co* 3; *Mergold Beleggings v Bhamjee* 675F-G; *Van Zyl v Credit Corporation* 587H; *Adams v SA Motor Industry Employers Association* 1200B-C; *National Bank v Marks & Aaronson* 71; *Retmil Financial Services v Sanlam Life Insurance Co* para 51.

[56] The topic of security is discussed extensively in Chapter 4 below.

of a security cession, the personal right is not necessarily transferred completely. Furthermore, the cedent always has the expectation that the personal right will be re-ceded or be re-vested in his estate once the loan has been repaid. In South African law a security cession may take one of two constructions:

(i) Pledge construction

If a personal right is ceded in a similar manner to which movable corporeal property is pledged, the personal right is ceded using the pledge construction. Ownership or *dominium* of the personal right remains in the cedent and only the entitlement to enforce the right upon non-payment is transferred to the financier. Once the loan has been satisfied the personal right is re-vested in the estate of the cedent.[57]

(ii) Fiduciary security cession

If a personal right is transferred as security using the fiduciary security construction, it is ceded to the financier completely in the same manner as an outright cession. The parties, however, intend the cession to be temporary only, because the cession occurs in conjunction with an undertaking that the financier will re-cede the personal right once the loan has been repaid.[58]

[57] See Chapter 4 below.

[58] See too Chapter 4.

CHAPTER THREE
INSURANCE

3.1 Introduction

The system of insurance is aimed at managing the risks that people are exposed to throughout their lifetimes. Insurance cannot prevent these risks from materialising, but seeks to mitigate the loss suffered once a risk occurs.[1] The loss is mitigated when parties agree that one will carry the loss of the other after the insured event (the perceived risk) has materialised, in exchange for regular payments of a sum of money.[2]

Insurance has been defined as:

> A contract between an insurer and an insured whereby the insurer undertakes in return for the payment of a price or premium, to render to the insured a sum of money or its equivalent, on the happening of a specified uncertain event in which the insured has some interest.[3]

3.1.1 Indemnity insurance

An insurance policy may be classified as either indemnity insurance or non-indemnity insurance. Indemnity insurance is governed by the principle of indemnity,[4] which dictates that the insured will

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[1] *Prudential Insurance Co v Commissioners of Inland Revenue* [1904] 2 KB 658 663: "Where you insure a ship or a house you cannot insure that the ship shall not be lost or the house burnt, but what you do insure is that a sum of money shall be paid upon the happening of a certain event". In *Lake and Others NNO v Reinsurance Corporation Ltd and Others* 1967 (3) SA 124 (W) 127D-E the court held that "…it is a basic principle of the law of insurance that the insurer assumes the risk upon the conclusion of the contract…". See also *Sydmore Engineering Works (Pty) Ltd v Fidelity Guards (Pty) Ltd* 1972 (1) SA 478 (W) 480F-G.

[2] *Prudential Insurance Co v Commissioners of Inland Revenue* 663; *Undertaker v Commissioner of Taxes* 1946 SR 123 124**;** *Lake v Reinsurance Corporation Ltd* 128H: "…insurance is a contract whereby in consideration for a price, i.e. the premium, the insurer undertakes to make good the losses from the unforeseen danger".

[3] *Lake v Reinsurance Corporation* 127A. This definition was followed in *Sydmore Engineering Works v Fidelity Guards* 480F-G. In *Prudential Insurance Co v Commissioners of Inland Revenue* 663 it was explained that insurance "must be a contract whereby for some consideration, usually but not necessarily for periodical payments called premiums, you secure to yourself some benefit, usually but not necessarily the payment of a sum of money, upon the happening of some event. Then the next thing that is necessary is that the event should be one which involves some amount of uncertainty. There must be either uncertainty whether the event will ever happen or not, or if the event is one which must happen at some time there must be uncertainty as to the time at which it will happen." Channell J adds (664) that the uncertain event "must be of a character more or less adverse to the interest of the person effecting the insurance". See also *Undertaker v Commissioner of Taxes* 124.

[4] *Castellain v Preston* (1883) 11 QBD 380 (CA) 386; *Malcher & Malcomess v Kingwilliamstown Fire and Marine Insurance & Trust Co* (1883-1884) 3 EDC 271 284: "The very essence of the contract of insurance is, that it is a contract of indemnity; its sole and exclusive object is to procure for the insured indemnity, in the strictest sense of that word, for any losses he may sustain… [p]rinciples of public policy, moreover, restrict the

be covered up to the amount of the financial loss that he suffers as a result of the occurrence of the risk insured against. The insured has an insurable interest up to the amount of his loss and therefore is entitled to be indemnified to that extent.[5] The insured may not generate a profit from insurance, as the aim is to put the insured into the position he would have been in had the risk not materialised. Further, the generating of a profit from "insurance" is usually perceived as a wager which is valid, but unenforceable.[6]

3.1.2 Non-indemnity insurance

Non-indemnity insurance is non-patrimonial and has nothing to do with restoring the insured to the financial position he was in before the risk materialised.[7] Non-indemnity insurance is aimed at providing a sum of money to the insured on the occurrence of a specified risk that functions as consolation for a loss or impairment of a personal interest, which the law deems worthy of protection.[8] It has been submitted that the type of loss in non-indemnity insurance is comparable to the non-patrimonial loss that is recoverable in the law of delict.[9]

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indemnity to the actual loss suffered". See in addition *Norwich Union Fire Insurance Society Ltd v South African Toilet Requisite Co Ltd* 1924 AD 212 222; *Van Immerzeel and Another v Santam Ltd* 2006 (3) SA 349 (SCA); *Truck & General Insurance Co Ltd v Verulam Fuel Distributors CC and Another* 2007 (2) SA 26 (SCA) 31B-E, 32C-D; *Jonnes v Anglo-African Shipping Co* 1972 (2) SA 827 (A).

[5] *Castellain v Preston* 386; *Malcher & Malcomess v Kingwilliamstown Fire and Marine Insurance & Trust Co* 284; *Prudential Insurance Co v Commissioners of Inland Revenue* 663; *Truck & General Insurance Co v Verulam Fuel Distributors* 31B-E, 32C-D; *Jonnes v Anglo-African Shipping Co* 834 *et seq* (see also the arguments of counsel).

[6] In *Dodd v Hadley* 1905 TS 439 442 Innes CJ confirmed that "our courts of law, for reasons of public policy, will not enforce wagers". The position is also evident in *Joffe v Goldstein* 1942 WLD 183 186; *Manderson t/a Hillcrest Electrical v Standard General Insurance Co Ltd* 1996 (3) SA 434 (D); *Steyn v AA Onderlinge Assuransie Assosiasie Bpk* 1985 (4) SA 7 (T); *Dalby v The India & London Life Assurance Co* [1854] 15 CB 365 389-391; *Castellain v Preston* 399, 406-407. See also Reinecke MFB, Van der Merwe S, Van Niekerk JP & Havenga P *General Principles of Insurance Law* (2002) para 9.

[7] *Gould v Curtis* [1913] 3 KB 84 89, 95: "A policy of life insurance is not a policy of indemnity". This is discussed in more detail in Reinecke et al para 9.

[8] In *Gould v Curtis* 95 Buckley LJ describes the concept by highlighting that "[death is not an event] in the sense that it occasions pecuniary loss…. The obligation in a policy of life insurance is not based upon any doctrine of compensating the person for the event. Money is no compensation for death."

[9] As pointed out in Reinecke et al para 42.

3.2 The nature of life insurance

Life insurance has been described as:

> [A]n undertaking by the insurer, in consideration of premiums received, to pay the sum insured or the eventual maturity value to the party entitled thereto in the event, primarily, of [but not limited to][10] the death of the life insured. [11]

Life insurance is classified as non-indemnity insurance.[12] It has been aptly described as "insurance on the subject of life".[13] As mentioned above, the nature of the interest being protected with non-indemnity insurance is non-patrimonial and is not concerned with restoring the insured to the financial position he was in before the insured event materialised.[14] The insured event envisaged here concerns any life event experienced by the life insured.[15]

Life insurance or a "life policy"[16] is regulated under section 1 of the Long-term Insurance Act as long-term insurance business. "Long-term insurance business" provides or undertakes to provide policy benefits[17] under long-term policies as set out in the Long-Term Insurance Act.[18]

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[10] The phrase "but not limited to" has been added to the definition by the authors, because as will be seen below the event that obliges the insurer to pay the policy benefits depends on the occurrence of a "life event" (as defined in s 1 of the Long Term Insurance Act) of which death is but one of the possible life events.

[11] In the words of Nienaber PM & Reinecke MFB *Life Insurance in South Africa: A Compendium: A Perspective from the Office of the Ombudsman for Long-term Insurance* (2009) 67-68. Similar definitions are found in the case law such as in *Prudential Insurance v Commissioners of Inland Revenue* 665 and *Dalby v The India & London Life Assurance Co* 387. Further, in *Gould v Curtis* 97 the court explained that life insurance: "…may be defined to be 'that in which one party agrees to pay a given sum upon the happening of a particular event contingent upon the duration of human life.' It is an insurance on the subject of life…it may be expanded to being an insurance, in one sense, upon a life; that is, either where the payment is upon that life ending, or in reference to the duration of the human life."

[12] *Dalby v The India & London Life Assurance Co* 387 – this case is the *locus classicus* that distinguishes life policies as a form of non-indemnity insurance from indemnity insurance.

[13] In the words of Reinecke et al para 596. See also *Gould v Curtis* 89 *et seq* where a comparable phrase is discussed and considered

[14] *Gould v Curtis* 95: "Money is no compensation for death."

[15] See below for the definition of "life event" as set out in s 1 of the Long-term Insurance Act.

[16] The word "policy" means an insurance contract. It is accordingly an unnecessary repetition to speak of a "life insurance policy" as is commonly done both colloquially and academically. Although the contents of this work avoids reference to "life insurance policy", the title of this work, "Cession of Life Insurance Policies *in securitatem debiti*: A Practical Perspective" has retained this redundancy because this term is used so frequently. See the explanations in Reinecke et al para 209; Reinecke & Nienaber 3; Gehle G & La Grange L "The Long-term Insurance Act" in Marx GL & Hanekom K (Eds) *The Manual on South African Retirement Funds and other Employee Benefits* (2009) vol 1 510.

[17] "Policy benefits" is defined in s 1 of the Act as: "…one or more sums of money, services or other benefits, including an annuity".

[18] Section 1 of the Long-Term Insurance Act 52 of 1998.

A "life policy" is described in section 1 of the Act as:

> [A] contract in terms of which a person, in return for a premium, undertakes to –
> (a) provide policy benefits upon, and exclusively as a result of, a life event; or
> (b) pay an annuity for a period;
> and includes a reinsurance policy in respect of such a contract.

The duty of the insurer to provide policy benefits is accordingly dependent on the occurrence of a "life event". Section 1 of the Long-Term Insurance Act in turn defines a "life event" as:

> [T]he event of the life of a person or an unborn –
> (a) having begun;
> (b) continuing;
> (c) having continued for a period; or
> (d) having ended.

The "life insured" is the person or the unborn whose life, mind or body is insured under the policy. The word "policy" can be used to refer to the insurance agreement and this is usually the primary meaning of the word.[19] Alternatively, "policy" can be used to refer to the document that evidences the insurance agreement, but this is usually the secondary meaning of the word.[20] Because insurance contracts are typically recorded in more than one document, often the phrase "main policy document" is used. This phrase denotes the document that contains the core elements of the insurance contract, for example, the parties, the premium, the policy benefits and so forth.[21]

The person contracting with the insurer, and who consequently is obliged to pay the policy premiums, is commonly referred to as the "insured". The life insured under the policy, however, may or may not be that of the person contracting with insurer. To limit the room for confusion the term "policyholder" is preferred in practice when the life insured is not the life of the person contracting with the insurer.[22]

Further, the word "policyholder" is described in section 1 of the Long Term Insurance Act as "the person entitled to be provided with the policy benefits". On the contrary, the policyholder need not be the beneficiary under the policy as he may nominate a third party as a beneficiary.[23] In other

[19] Gehle & La Grange 510.

[20] Above.

[21] Above.

[22] *Pieterse v Shrosbree NO and Others; Shrosbree NO v Love and Others* 2005 (1) SA 309 (SCA) 313D-F. These terms are consistently applied in Reinecke & Nienaber 194.

[23] *Pieterse v Shrosbree* 313D-F.

words a married man may be the policyholder paying the policy premiums, his wife may be the life insured, and their daughter may be the nominated beneficiary entitled to the policy benefits upon the death of her mother.

3.3 Types of life insurance products

A variety of life insurance products are sold in the industry and these products are continuously being developed. It has, however, been noted that the variety of products available is a modification and/or a combination of the following five basic types:[24]

3.3.1 Term life insurance

At the time when the policy is concluded the insurer and the policyholder decide on a specified period or date that serves as the term. If the life insured dies within the specified period or before the specified date, the insurer is obliged to pay the policy benefits.[25] If the life insured survives beyond the specified term, the policy automatically terminates and the insured is not entitled to a refund of premiums paid during the term.[26]

The obligation of the insurer to pay the policy benefits is thus uncertain because it is unknown whether the insured life will die within the specified period or before the specified date.[27] Furthermore, with term life insurance the policy contains only an element of risk. It does not have a maturity value since it is uncertain whether the life insured will survive the specified term. Accordingly, the policy also has no surrender value if it is terminated before the expiry of the term.[28]

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[24] Van Niekerk JP "The nature of life insurance contracts: A matter of death or life" 2007 *SA Merc LJ* 302 305. For an account of the history and development of the policy types available in the insurance market see Reinecke & Nienaber 73-79.

[25] Van Niekerk 2007 *SA Merc LJ* 305.

[26] In the case of *Robin v Guarantee Life Assurance Co Ltd* 1984 (4) SA 558 (A) 573A-B Nicholas AJA held that: "A term life insurance policy is one which is issued upon the terms that death is to be the sole contingency upon which payment is due but the policy is only to run for a specific period so that nothing is payable if the insured survives the period". Van Niekerk 2007 *SA Merc LJ* 306 *et seq* examines term life insurance more closely.

[27] *Robin v Guarantee Life Assurance Co* 573C: "Term insurance has been described as an *if* type of insurance…[t]he purpose of term insurance is to provide against loss during the term of the insurance, *if* death occurs" [Judge's emphasis].

[28] This has been pointed out by Reinecke & Nienaber 76.

3.3.2 Whole life insurance

With this type of life insurance, the insurer agrees to pay the policy benefits when the life insured dies.[29] Because the death of the life insured is inevitable, it is certain that the insurer will be obliged to pay the policy benefits. The only uncertainty therefore concerns when the life insured will die.[30] Since the policy benefits (the sum to be paid at death) are usually fixed at the time the policy is concluded, there is no investment element to this type of policy.[31] A surrender value may usually be claimed should the policyholder terminate the policy before the death of the insured life.[32]

3.3.3 Pure endowment insurance

This form of life insurance can be seen as the opposite of term life insurance. A particular period of time or date is specified in the policy at the time of its conclusion (known as the maturity date). The insurer is obliged to pay the policy benefits only if the insured life lives beyond the specified period or date.[33] Pure endowment is considered to be an investment or savings policy as the life insured must survive in order to receive the policy benefits.[34]

Further, benefits so paid would not normally be used for purposes of maintaining dependents, but for maintenance of the policyholder during retirement and old age.[35] Because it is unknown whether the insured life will survive beyond the maturity date, the obligation of the insurer to pay

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[29] *Robin v Guarantee Life Assurance Co* 573B-C: "A whole life insurance policy, on the other hand, is one in terms of which the insurers undertake, in consideration of premiums being continually payable throughout the life of a particular person, to pay a specified sum of money on the death of that person". Van Niekerk 2007 *SA Merc LJ* 308 *et seq* and Scott S "Cession of whole life insurance rights" 2003 *Stell LR* 89 92 *et seq* provide a further discussion of whole life insurance.

[30] *Robin v Guarantee Life Assurance Co* 573C: "[W]hole life insurance [is] a *when* type…[and] the sum insured will become payable whenever death occurs - the only question is *when* it will become payable" [Judge's emphasis].

[31] Van Niekerk 2007 *SA Merc LJ* 308.

[32] In the view of Reinecke & Nienaber 74.

[33] *Gould v Curtis* 85.

[34] The court in *Mungal v Old Mutual Life Insurance Co SA Ltd; Freeman v Old Mutual Life Insurance Co SA Ltd* 2010 (6) SA 98 (SCA) 102F remarked that: "Endowment policies are linked directly or indirectly to a particular portfolio of investment assets. The premium is invested in the portfolio and the returns on the investment accrue to the benefit of the policyholder." In *Dykman v Die Meester en 'n Ander* 2000 (1) SA 896 (O) 902 the court describes an endowment policy as an investment policy ("beleggingspolis"). See in addition *Burgess v Commissioner for Inland Revenue* 1993 (4) SA 161 (A) for a further illustration of the investment value of an endowment policy.

[35] As noted by Van Niekerk 2007 *SA Merc LJ* 309-310. A common illustration of pure endowment insurance is a retirement annuity policy which enjoys the benefit of tax relief. A retirement annuity is therefore not classified as an annuity policy, as its name may lead one to believe – see 3.3.5 below.

the policy benefits is consequently uncertain.[36] If the life insured dies before the maturity date, the insurer is only liable to pay the surrender value of the policy.[37]

3.3.4 Life endowment insurance

Life endowment insurance (or endowment insurance) has become quite popular in the insurance industry.[38] This type of policy is a combination of term insurance and pure life endowment.[39] The insurer and the policyholder determine a particular period or date (the maturity date) and agree that if the life insured survives beyond the maturity date, the insurer is obliged to pay the policy benefits. This is the pure endowment feature of the policy. Added to this agreement is the further agreement that should the life insured die prior to the expiry of the maturity date, the insurer is also obliged to pay the policy benefits. This is the term insurance feature of the policy.[40]

Life endowment insurance therefore, contains elements of both investment and risk.[41] The obligation of the insurer to pay the policy benefits under this policy is certain: The insurer must pay the policy benefits if the life insured survives beyond the maturity date. If the life insured does not survive beyond the maturity date, the insurer is still obliged to pay the policy benefits.[42] Life endowment policies are popular because the beneficiary receives policy benefits in either eventuality.[43]

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[36] This is highlighted in *Mungal v Old Mutual Life Insurance Co* 102G-H – the exact amount that the insurer is obliged to pay is also uncertain since the value of the investment portfolio will fluctuate daily depending on the market. See also Van Niekerk 2007 *SA Merc LJ* 316.

[37] *Mungal v Old Mutual Life Insurance Co* 106 *et seq* .

[38] This has been observed by Van Niekerk 2007 *SA Merc LJ* 313. In *Prudential Insurance Co v Commissioners of Inland Revenue* 659 Channell J stated that such policies were gaining popularity at the time.

[39] The court in *Gould v Curtis* 85 described it as policies "under which the right to payment on reaching a certain age was combined with the right to payment on death".

[40] As put by the court in *Mungal v Old Mutual Life Insurance Co* 102C: "The nature of an endowment policy is that in return for a premium the insurer undertakes to pay to the policyholder a sum of money on a fixed date in the future or a sum of money (not necessarily the same amount) upon death of the life assured". See also *Bailey v South African Liberal Life Insurance Co* 1928 CPD 463 for a further illustration.

[41] *Mungal v Old Mutual Life Insurance Co* 102C-D. This is confirmed by Reinecke & Nienaber 75.

[42] As highlighted in *Mungal v Old Mutual Life Insurance Co* 102G-H above, the exact amount to be paid on maturity is uncertain due to the investment element of this type of policy.

[43] In the opinion of Van Niekerk 2007 *SA Merc LJ* 311: "A life-endowment policy fulfils two needs: it provides insurance cover against an early death during the agreed term, and enables saving towards a lump sum at the end of the term should the life insured survive".

3.3.5 Annuity

There are various types of annuity policies,[44] but this work limits the scope to a discussion of the two most common types of annuities. The beneficiary of an annuity policy enjoys fixed payments at periodic intervals either for his life-time (known as a life annuity policy)[45] or for a pre-determined period of time (known as a fixed term annuity policy).[46] In return for the annuity payments, the policyholder usually pays a single lump sum, which the insurer invests to raise the income used for the annuity payments.[47]

3.4 Beneficiary nomination

3.4.1 General

If the policyholder nominates a person to be the beneficiary of a life policy, the beneficiary does not become the new policyholder, but is entitled to the policy proceeds only.[48]

A beneficiary nomination takes the form of a *stipulatio alteri* or contract for the benefit of a third party.[49] According to the general principles of *stipulatio alteri*, the beneficiary acquires no rights

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[44] Annuities do not possess the benefit of tax relief and are therefore taxable – *contra* retirement annuities that are not annuities, but rather pure endowment policies and not taxable. See 3.3.3 above.

[45] This is equivalent to a pension. This point is further considered in Reinecke & Nienaber 345.

[46] As explain by Reinecke & Nienaber 345, 348.

[47] Reinecke & Nienaber 345.

[48] Provision can be made for a new policyholder by a "nomination of ownership". This describes the situation where another person receives the rights and obligations under a policy as a successive policyholder. A nomination for ownership may be necessary when the life insured is not that of the policyholder and when there is a possibility that the policyholder may die before the life insured. Reinecke MFB & Nienaber PM "A suggested template for beneficiary nominations" 2009 *SA Merc LJ* 1 13 and Reinecke & Nienaber 220-221 elaborate on this concept.

[49] *Ex Parte Calder Wood NO: In Re Estate Wixley* 1981 (3) SA 727 (Z) 734. In *Pieterse v Shrosbree* 313F-H the appeal court explained the operation of a *stipulatio alteri* as follows: "The legal nature of such a nomination is a *stipulatio alteri* (a contract for the benefit of a third person). In such a case, the policy holder (the *stipulans*) contracts with the insurer (the *promittens*) that an agreed offer would be made by the insurer to a third party (the beneficiary) with the intention that, on acceptance of the offer by that beneficiary, a contract will be established between the beneficiary and the insurer. What is required is an intention on the part of the original contracting parties that the benefit, upon acceptance by the beneficiary, would confer rights that are enforceable at the instance of the beneficiary against the insurer, for that intention is at the 'very heart of the *stipulatio alteri*'." See Davis DM in *Gordon & Getz on The South African Law of Insurance* 4ed (1993) 327; Reinecke & Nienaber "A suggested template for beneficiary nominations" 2009 *SA Merc LJ* 2; Scott S "Once more beneficiary appointments and security cessions: Mulaudzi v First Rand Bank Ltd" 2007 *SA Merc LJ* 517 524 for a comparable discussion.

until death or maturity of the policy.[50] Even then, to be entitled to the policy proceeds, the beneficiary must accept the benefit.[51] Once the policy matures or death has occurred and the beneficiary has accepted the benefit, a new contract arises between the insurer and the beneficiary which obliges the insurer to pay the policy proceeds.[52]

3.4.2 Irrevocable beneficiary nomination

A beneficiary nomination can be either revocable or irrevocable. A nomination is irrevocable if it is clear from the policy that the policyholder must acquire the consent of the insurer before revoking a prior nomination.[53] A nomination made without the consent of the insurer is thus ineffective.[54] If the policy is silent on the issue of revocation, the nomination may be considered irrevocable.[55]

It is submitted that if the policy is silent on the issue, the policyholder should be entitled to revoke the beneficiary nomination up until the maturity date or death without first obtaining the consent of the insurer. A policyholder should have the freedom to unilaterally revoke a prior beneficiary nomination, unless a policy expressly provides that a nomination may only be revoked with the consent of the insurer.

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[50] *Crookes NO and Another v Watson and Others* 1956 (1) SA 277 (A) 288A *et seq* ; *Hofer and Others v Kevitt NO and Others* 1998 (1) SA 382 (SCA); *Hees NO v Southern Life Association Ltd* 2000 (1) SA 943 (W) 951A-B; *Wessels NO v De Jager en 'n Ander NNO* 2000 (4) SA 924 (SCA) 928D-E; *Moonsamy and Another v Nedcor Bank Ltd and Others* 2004 (3) SA 513 (D) 518A; *PPS Insurance Co Ltd and Others v Mkhabela* 2012 (3) SA 292 (SCA) 294C-G, 295A-B.

[51] Above. In the recent case of *PPS Insurance Co v Mkhabela* 294C-G, 295A-B the court authoritatively explained that until the beneficiary accepts the *policy proceeds*, the beneficiary has only a *spes* that would not pass to the executor of her estate if she died before the policyholder, and would instead evaporate. The court also made a distinction here between accepting the beneficiary *nomination* and accepting the *benefit*, being the policy proceeds. Accepting the nomination gives the beneficiary no enforceable right to the policy proceeds and he or she would continue to have only a mere *spes* until the time is ripe for acceptance of the policy proceeds.

[52] *Pieterse v Shrosbree* 313F-H; *Crookes v Watson* 288A *et seq* ; *Hofer v Kevitt* 382; *Hees v Southern Life Association* 951A-B; *Wessels v De Jager* 928D-E; *Moonsamy v Nedcor Bank* 513.

[53] *Crookes v Watson* 285A-B.

[54] *Crookes v Watson* 285A-C.

[55] *Mutual Life Insurance Co of New York v Hotz* 1911 AD 556 567; *Dykman v Die Meester* 902. Reinecke & Nienaber 2009 *SA Merc LJ* 17-19 have observed that usually life policies expressly stipulate the terms governing beneficiary nominations and are not silent on this issue.

3.4.3 Revocable beneficiary nomination

If it is clear from the policy that the right to revoke a nomination lies with the policyholder, then the nomination is revocable. It has been noted that nominations in most modern policies are revocable.[56] In such a case the policyholder may unilaterally revoke a prior beneficiary nomination.[57] Revocation may be achieved expressly or by implication.

(i) Express revocation

Express revocation occurs when the policyholder conveys this intention to the insurer at any time before maturity or the death of the life insured or acceptance by the beneficiary.[58] As will be seen from the discussion below, there is some uncertainty as to whether express notification is a requirement for the validity of a revocation, or whether it merely has protective function.

If a life policy permits the revocation of a beneficiary nomination, but does not prescribe the manner in which the revocation should occur, the policyholder should be free to revoke a nomination either expressly or by implication.

If a life policy permits the revocation of a beneficiary nomination, but provides that the revocation must occur expressly through notification, then any revocation not done expressly cannot be valid since it has not been done in accordance with the policy provisions. If the policyholder fails to adhere to the requirement of express notification, the revocation should indeed be invalid since this is how the insurer is practically protected.

(ii) Revocation by implication

From the case law it seems that a prior beneficiary nomination may be revoked by implication even if the insurer required notice.[59] In *Curtis Estate v Gronningsaeter* a husband had nominated his wife as beneficiary of a life policy taken out on his life. The couple subsequently divorced and the

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[56] As submitted by Reinecke & Nienaber 216 and Reinecke & Nienaber 2009 *SA Merc LJ*.

[57] As stated by Reinecke et al para 330; Reinecke & Nienaber 215 and Muller E "Life insurance benefits: The setting aside of cessions and nominations in terms of the insolvency law and other related aspects" 2005 *De Jure* 361 364.

[58] In *Crookes v Watson* 288A the court emphasised that revocation is acceptable up until this stage because there is no *vinculum juris* between the beneficiary and the insurer. This was confirmed in *Hofer v Kevitt*. See too *Ex Parte Calder Wood NO: In Re Estate Wixley* 727. Reinecke & Nienaber 2009 *SA Merc LJ* 15 add that "[t]o be fully effective the policyholder's revocation must be brought to the insurer's attention".

[59] *Curtis Estate v Gronningsaeter and Another* 1942 CPD 531.

husband died some time thereafter. The husband's will provided that his children were the sole heirs of his assets including the life policy.

The court held that the prior beneficiary nomination had been impliedly revoked by the will (which was also strengthened by the divorce).[60] Even though the insurer required written notification of a revocation, the court highlighted that written notification is "wholly for the protection" of the insurer and failure to supply such written notice does not affect the validity of the revocation.[61]

The *ratio* in *Curtis Estate v Gronningsaeter* was followed in *Wolmarans en 'n Ander v Du Plessis en Andere*,[62] but both cases have not gone unchallenged.

In *Hees NO v Southern Life Association*, Mr Hees had nominated his brother as a beneficiary of two life policies taken out on his life. Mr Hees subsequently married in community of property and the spouses effected a joint will whereby each nominated the survivor to be the sole heir of the joint estate. When Mr Hees died a dispute arose as to whether the prior nomination of Mr Hees's brother was revoked by implication due to the provisions in the joint will. The court held that because Mr Hees had not provided the insurer with written notice, the will had not revoked the prior beneficiary nomination.[63]

The court held that the requirement for notification establishes certainty as to the rights arising from a beneficiary nomination and is thus for the benefit of the insurer as well as the beneficiary.[64] If it were otherwise the insurer would be exposed to the risk of double payment if it mistakenly

[60] *Curtis Estate v Gronningsaeter* 540.

[61] *Curtis Estate v Gronningsaeter* 537. *Cf Ex parte MacIntosh NO: In re Estate G Barton* 1963 (3) SA 51 (N) 57E-F; *Hees v Southern Life Association* 943. In *Ex Parte Calder Wood NO: In Re Estate Wixley* 736-737 the court also looked to the divorce settlement to establish the possibility of revocation, yet disagreed with *ratio* in the *Curtis* case.

[62] 1991 (3) SA 703.

[63] *Hees v Southern Life Association* 954 *et seq* and 958.

[64] *Hees v Southern Life Association* 954B-955F-H the court relied on *Ex parte MacIntosh* 57E-F (also followed in *Ex Parte Calder Wood NO: In Re Estate Wixley* 736-737) in this regard where Caney J stated that he could not agree that notification functions merely for the protection of the insurer. The judge expressed the opinion that notification forms a part of the policy and provides certainty, which functions as protection for the insurer, but also for the nominated beneficiary.

pays the nominated beneficiary without being aware of a testamentary revocation that was not brought to its attention by notification.[65]

(iii) Revocation by cession

Apparently, there is a belief in the insurance industry that ceding the rights under a life policy as security for a debt implies that a prior beneficiary nomination is thereby revoked (provided such nomination was revocable).[66] Probably as a protection mechanism, life policies commonly contain a clause providing that a previous beneficiary nomination will be rendered automatically invalid in the event of cession.[67]

In *Moonsamy and Another v Nedcor Bank Ltd and Others,*[68] the deceased policyholder had taken out a life policy with Fedlife Assurance Ltd and had nominated a beneficiary of the proceeds. During the subsistence of the policy the deceased policyholder ceded the rights under the life policy as security to Nedcor Bank Ltd. Once the bank had settled the remaining indebtedness with the policy proceeds, it paid the balance to the beneficiary. The executors of the deceased policyholder's estate sued the bank for the net proceeds, and argued that the bank was wrong to pay the beneficiary. The executors were of the opinion that the nomination had been either expressly or impliedly revoked when the deceased policyholder ceded the rights thereunder as security.

[65] *Hees v Southern Life Association* 956G-H, 957D-958C.

[66] This belief has been brought to light by Nienaber PM "Some problems involving security cessions of life insurance policies" 2004 *SA Merc LJ* 83 100; Reinecke & Nienaber 2009 *SA Merc LJ* 30-31; Reinecke & Nienaber 230. The position is otherwise if the life policy has been ceded outright, for in such a case the beneficiary nomination is revoked due to the finality of the cession. In *Hart v African Mutual Life Assurance Society Ltd and Others* 1926 CPD 38 41-42 the issue at hand was whether the policyholder (Mathie) had ceded the life policy to the plaintiff or whether he had appointed her as a beneficiary. In considering both possibilities the court remarked as follows: "It is rightly contended that if the policy was first ceded, then Mathie put it out of his power subsequently to nominate a beneficiary. On the other hand, if the nomination of a beneficiary came first, then it was put an end to by the cession…. A person who cedes a policy parts with his right to nominate a beneficiary, or to change a nomination made."

[67] As suggested by Reinecke & Nienaber 230; Reinecke & Nienaber 2009 *SA Merc LJ* 30; Nienaber 2004 *SA Merc LJ* 101. See in addition Nel C "Security cessions of insurance policies" 2009 *Insurance & Tax* 3. This was indeed the case in the policy in question in *Ex Parte Calder Wood NO: In Re Estate Wixley* 729. In fact, the policy went so far as to provide that not only an outright cession, but even a security cession would nullify a prior beneficiary nomination.

[68] 2004 (3) SA 513 (D).

Presiding judge Levinsohn noted that the life policy document allowed for the revocation of a beneficiary, but required notification in writing to the insurer.[69] Since the deceased policyholder had failed to notify the insurer, it could not be said that he expressly revoked the beneficiary nomination. The judge accordingly held that it was not open for the executors to argue express revocation as the deceased policyholder failed to comply with the requirement stipulated in the policy document.[70]

On the question of whether it could be said that a nomination could be revoked by implication, the judge held that unlike an outright cession where the beneficiary's expectation of the policy proceeds is extinguished, such an expectation remains intact with a security cession, since *dominium* of the life policy still vests in the policyholder's estate.[71] Accordingly, Levinsohn J concluded that a security cession cannot revoke a prior nomination by implication.[72]

It is the opinion of some authors that, in the absence of a provision stating otherwise, a revocable beneficiary nomination cannot be impliedly revoked by a security cession.[73] The first reason for this is because a cession of the rights under the policy and the revocation of a beneficiary are two separate and distinct acts.

The second reason is that a cessionary must take cession subject to any contingencies. This means that a security cessionary of a life policy takes cession of the right to claim the policy proceeds subject to the right of any beneficiary already nominated, or who may be nominated in the future.

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[69] *Moonsamy v Nedcor Bank* 518C.

[70] *Moonsamy v Nedcor Bank* 519F.

[71] *Moonsamy v Nedcor Bank* 519G-J.

[72] *Moonsamy v Nedcor Bank* 519-520A. The judge came to this conclusion with the pledge construction in mind. The judge failed to clarify what the position would be if the cession had taken the fiduciary security cession construction, since in such a case the policyholder is completely divested of any *dominium* in the life policy. It is submitted that in the case of a fiduciary security cession, the beneficiary nomination is likewise not revoked. Even though *dominium* of the policy passes to the cessionary, the policyholder (cedent) retains an interest in the policy since the cession is intended to be temporary for security purposes; and the policyholder has the right to demand re-cession once the underlying debt has been satisfied. See Chapter 4 below.

[73] The authors include Reinecke & Nienaber 230; Reinecke & Nienaber 2009 *SA Merc LJ* 30-31; Nienaber 2004 *SA Merc LJ* 100.

The cessionary's right, it is said, may have to "yield" to that of the beneficiary depending on the policy provisions.[74]

Although this view is in accordance with the *ratio* in the *Moonsamy* case, the reasons submitted therefor are not entirely convincing.

Pertaining to the first reason, it must be pointed out that while a security cession and a beneficiary nomination are no doubt two separate and distinct acts, the eventual outcome of both is very much the same. With a security cession, the policyholder cedes the right to claim the policy proceeds. With a beneficiary nomination, the policyholder appoints a third party to be entitled to the policy proceeds on death or at maturity should the third party accept.

In both cases the cessionary and beneficiary are given rights in respect of the same policy proceeds, and in this sense the cessionary can also be viewed as a beneficiary.[75] This may explain why an insurer would insert a clause in a life policy providing for the invalidation of a prior beneficiary nomination upon cession. Were it otherwise, the insurer would not know which "beneficiary" to pay on death or at maturity.

Pertaining to the second reason, even though a cession is subject to contingencies, the right of the beneficiary to the policy proceeds cannot trump the rights of the cessionary. The idea that the cessionary's right may have to "yield" to that of the beneficiary can only mean that the beneficiary nomination is not invalidated upon a security cession and that the beneficiary is entitled to the balance of the policy proceeds (if any) after the cessionary's claim has been satisfied.

Furthermore, the right of the beneficiary to claim the policy proceeds cannot be seen as a contingency that places a defect on the right that the cessionary takes. It must be kept in mind that at the time of the security cession, the beneficiary has no right to the policy proceeds as his right arises only on death or at maturity of the policy should he accept the benefit.[76] The security

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[74] Above.

[75] The difference is that the cessionary may claim the surrender value if necessary to satisfy an unpaid debt, but the beneficiary has no rights until death or maturity of the policy.

[76] Until acceptance the beneficiary has only a *spes* – see *Crookes v Watson* 288A *et seq*; *Hees v Southern Life Association* 951A-B; *Wessels v De Jager* 928D-E; *Moonsamy v Nedcor Bank* 518A; *PPS Insurance Co v Mkhabela* 294C-G.

cessionary will always be first in time and must accordingly be preferred in right.[77] Were this not the case, a cessionary may refuse to accept a life policy as security since it would hold little value.[78]

To sum up, cession and revocation are two separate and distinct acts and a security cession should not cancel or revoke a prior beneficiary nomination unless otherwise provided in the policy. The nomination should remain in force, but should be subject to the cession. This means that upon death or at maturity (or surrender), the cessionary's claim must first be satisfied from the policy proceeds, and any excess thereafter must be paid to the nominated beneficiary upon his acceptance.[79]

3.4.4 Surrender of a policy subject to a beneficiary nomination

When a policyholder demands the surrender value of a policy, he effectively cashes in the policy before death or the date of maturity of the policy.[80]

The surrender value is calculated as a portion of the premiums so far paid, minus certain costs incurred by the insurer.[81] The Supreme Court of Appeal in *Mungal v Old Mutual Life Insurance Co* remarked that the entitlement of a policyholder to be paid on the surrender of a policy is not one of the benefits of a policy.[82] It was clarified that surrendering a policy "…is no more than a separate entitlement that arises if the undertaking to pay benefits is terminated before the benefits accrue".[83]

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[77] In accordance with the maxim "*prior tempore potior iure"* which, loosely translated by the writer, means that he who is first in time is strongest in right.

[78] This point was made within a similar context in *Development Bank of Southern Africa Ltd v Van Rensburg and Others NNO* 2002 (5) SA 425 (SCA) 433I-434C.

[79] This was also the court's opinion in *Moonsamy v Nedcor Bank* 519H-I.

[80] The Supreme Court of Appeal in *Mungal v Old Mutual Life Insurance Co* 104D-E, 104H explained the surrender of a policy as terminating a policy before it has run its full course or term. See also Muller 2005 *De Jure* 365 where this issue is also briefly discussed.

[81] *Mungal v Old Mutual Life Insurance Co* 106F the life endowment policy *in casu* stipulated that the surrender value would be calculated by the insurer at the time of surrender taking into consideration disinvestment costs, the recovery of recouped expenses, as well as any debts against the policy.

[82] *Mungal v Old Mutual Life Insurance Co* 106C.

[83] *Mungal v Old Mutual Life Insurance Co* 106C-D. In the recent case of *Nedbank Ltd v Cooper NO and Others* 2013 (4) SA 353 (FB) Van Zyl J may have inadvertently taken a contrary view when he stated that "[i]n my view, the money – in the form of the surrender values of the policies – does *not* stand on a different footing from the policies themselves" [emphasis added].

A policy subject to a revocable nomination allows the policyholder to demand the surrender value of the policy, thereby revoking a prior nomination by implication.[84] A policyholder may not demand the surrender value of a policy without the consent of the beneficiary where the beneficiary nomination is irrevocable because such a demand amounts to a revocation by implication.[85]

84 *Contra* the position on a security cession. This point is also reflected in Reinecke & Nienaber 2009 *SA Merc LJ* 28; Reinecke & Nienaber 229 and Nel 2009 *Insurance & Tax* 3.

85 According to Reinecke & Nienaber 2009 *SA Merc LJ* 28 and Reinecke & Nienaber 229.

CHAPTER FOUR
SECURITY CESSION OF A LIFE POLICY[1]

4.1 Security

The word "security" should not be confused with the term "securities" as the latter is usually attributed to investment securities, most commonly shares.[2] The concept of security, as the name implies, attempts to reduce the risk of a financier when extending finance.[3]

4.1.1 Types of security

Two kinds of security rights can be distinguished in South African law: Personal security rights and real security rights. A right of personal security allows a financier to look to a person, who is not the debtor, but who bound himself in this respect, to satisfy a debt if the debtor is unable to do so.[4] A suretyship contract is the most common example of personal security.[5]

A right of real security provides a financier with a limited real right over any property that the debtor has offered as security for the re-payment of a debt.[6] This property is known as the object of the security. The real security right lies in the fact that the financier may realise the object of security to satisfy any unpaid debt if the debtor defaults on payment or becomes insolvent.[7]

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[1] It is technically incorrect to speak of a security cession of a "life policy". A life policy cannot be ceded; only the *rights* under a life policy can be ceded. A concerted effort has been made to avoid this expression in the content of this work. The title of this work, "Cession of Life Insurance Policies *in securitatem debiti*: A Practical Perspective" has, however, retained this technical error because it has become common parlance to speak of the "cession of a life policy". The point is also made by Van Niekerk JP "The cessionary's duty on the security cession of a life insurance policy" 2007 *Juta's Business Law* 47 48 and Scott S "Cession of whole life insurance rights" 2003 *Stell LR* 89 93.

[2] Goode R *Legal Problems of Credit and Security* 3ed (2003) 1. The term "collateral" is generally used in United States law.

[3] Goode 1; Mostert H, Pope A, Badenhorst P, Freedman W, Pienaar J & Van Wyk J *The Principles of The Law of Property in South Africa* (2010) 296.

[4] *Warricker and Another NNO v Senekal* 2009 (1) SA 509 (W) 513D-F. Similar statements may be found in Mostert *et al* 297 and Van der Walt AJ & Pienaar GJ *Introduction to the Law of Property* 6ed (2009) 258.

[5] The case of *Warricker v Senekal* is a recent case illustrating the creation and operation of suretyship.

[6] As explained in Mostert *et al* 297.

[7] *Land-en Landboubank van Suid-Afrika v Absa Bank Bpk en Andere* 1996 (4) SA 543 (A) 551J-552B where it was pointed out that a real security right is equivalent to the value of the security object. See also Mostert 297 and PJ Badenhorst, Pienaar JM & Mostert H *Silberberg and Schoeman's The Law of Property* 5ed (2006) 357.

A personal security right provides the financier with a personal right against a person, yet a real security right provides the financier with a limited real right in property – the latter, it is said, constitutes a stronger form of security.[8]

4.1.2 Purpose of security

A real security right is invaluable to a financier if the debtor becomes insolvent before the debt has been discharged. Upon insolvency a financier may look to the object of security to meet the outstanding balance.[9] As explained by Mostert *et al*, besides the latter purpose of real security, there are at least three other functions of real security:

First, real security fulfils a so-called "signalling function". This means that a debtor who is willing and able to offer security for credit facilities signals the fact that he is creditworthy. This accordingly improves the debtor's access to finance that may not otherwise have been accessible, or accessible only on less favourable terms. Furthermore, the financier saves time and avoids the cost associated with establishing the debtor's creditworthiness.[10]

Secondly, real security achieves a so-called "hostage function". The debtor is figuratively held hostage by the security as there is a real danger that the secured object may be realised by the financier in order to discharge the debt should the debtor default. For this reason the debtor makes repayment of the secured debt a priority over repayment of unsecured debts.[11]

Thirdly, real security fulfils a so-called "preservative function". The object of security is preserved when the debtor offers it as security because he is prevented from disposing it. This ensures that the financier's rights and interests in the object of security are protected.[12]

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[8] In the words of the Supreme Court of Appeal in *Contract Forwarding (Pty) Ltd v Chesterfin (Pty) Ltd and Others* 2003 (2) SA 253 (SCA) 258B: "Real rights are stronger than personal rights…".

[9] In the South African law of insolvency, a secured creditor is the highest-ranking creditor as the claim against the insolvent estate is not paid from the free residue, but is paid by realising the property over which the security was granted. See Sharrock R, Van der Linde K & Smith A *Hockley's Insolvency Law* 8ed (2006) 168. See also s83 of the Insolvency Act 24 of 1936.

[10] Mostert *et al* 299.

[11] Above.

[12] Above.

4.1.3 Rights under a life policy as the object of security

In South African law a policyholder can freely cede his rights under a life policy as security.[13] This may be done without the consent, and even without the knowledge of the insurer.[14] The right that is transferred is the personal right to claim the policy proceeds from the insurer when the insured event occurs, or to claim the surrender value of the life policy if the policyholder defaults on loan repayments.[15]

It is important to mention here that in this work the obligation of the insurer to pay the policy proceeds on death or at maturity of the life policy (to either the policyholder or a nominated beneficiary) is called "principal debt" as it is the primary debt upon which any later security transaction will depend. The obligation of the policyholder to repay the financier for the credit that has been extended is called the "secured debt" because it is secured by the cession of the principal debt.[16]

When the rights under a life policy are offered as security for credit facilities this security transaction may take the form of either a pledge or a cession.[17] Three parties are involved in such a

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[13] See generally Nienaber PM & Reinecke MFB *Life Insurance in South Africa: A Compendium: A Perspective from the Office of the Ombudsman for Long-term Insurance* (2009). See also Reinecke MFB, Van der Merwe S, Van Niekerk JP & Havenga P *General Principles of Insurance Law* (2002) para 435 who mention that the cession may occur before or after death the or maturity date. This is also confirmed by Davis DM in *Gordon & Getz on The South African Law of Insurance* 4ed (1993) 267. It is important to note that it is technically incorrect to say that a life policy has been ceded as that may imply that a substitution of policyholders has occurred. What should rather be said is that the rights under the life policy are ceded.

[14] *Rothschild v Lowndes* 1908 TS 493 499; *Paiges v Van Ryn Gold Mine Estates Ltd* 1920 AD 600 608; *Cullinan v Pistorius* 1903 ORC 33 37; *Van Staden NO and Another v Firstrand Ltd and Another* 2008 (3) SA 530 (T) 538H-I. See too Van Niekerk JP "Van Staden NO and Another v Firstrand Ltd and Another" 2008 *Juta's Insurance Law Bulletin* 76 80-81; Scott S "Representation, cession in securitatem debiti and notice: Bankers and insurers beware!: Van Staden NO & Another v Firstrand Ltd & Another: Case comments" 2008 *SA Merc LJ* 530. Reinecke *et al* para 436 are of the opinion that although this principle is quite true in theory, in practice policy provisions either prohibit cession without the consent of the insurer first being obtained or regulate the cession by insisting that the policyholder give notice thereof.

[15] As correctly observed by Nienaber & Reinecke 320-321. The financier may also make use of an on-cession of the policy rights to satisfy any outstanding balance. Note the possible restriction against on-cessions when a life policy is ceded using the fiduciary security cession construction (see 4.4.2 below).

[16] This is also in line with the terminology as used in the case law. See for instance *Grobler v Oosthuizen* 2009 (5) SA 500 (SCA) 507G-H: "According to this theory a cession *in securitatem debiti* is in effect an outright or out-and-out cession on which an undertaking or *pactum fiduciae* is superimposed that the cessionary will re-cede the principal debt to the cedent on satisfaction of the secured debt". See in addition *Trust Bank of Africa Ltd v Standard Bank of South Africa Ltd* 1968 (3) SA 166 (A) 189A-B; *Solomon NO and Others v Spur Cool Corporation (Pty) Ltd and Others* 2002 (5) SA 214 (C) 224B; *Kilburn v Estate Kilburn* 1931 AD 501 505-506.

[17] These two forms are discussed below.

transaction. Various titles are used to describe the parties, depending on the perspective from which they are viewed:

1. One party is called the "financier" or "principal creditor" as he extends credit and has a claim for repayment.[18] He may also be called the "pledgee" if the rights under the life policy are pledged to him as security. Alternatively, the title "cessionary" may be used if the rights under the life policy are ceded to him as security.

2. The second party is called the "principal debtor" as he takes up credit from the financier and is thus obligated to repay it. He may also be called the "pledgor" if he pledges the rights under the life policy as security. The title "cedent" may also be used if the rights under the life policy are ceded as security. In addition, this party may also be referred to as the "policyholder" because he is the owner of the life policy which has been offered as security.

3. The third party is called the "insurer" or insurance company as it has undertaken to pay the policy proceeds either on death or at maturity (or surrender).

As illustrated here, the titles of the parties may cause confusion. To minimise the room for confusion the titles "financier", "policyholder" and "insurer" have been used as far as possible in this thesis when referring to a security cession of the rights under a life policy.

As stated above there are two possible ways in which a personal right may be used as security:
(1) Cession by pledge;[19]
(2) Fiduciary security cession.[20]

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[18] Usually the financier is a bank and not an individual. This thesis has thus been written on the premise that the financier is a bank. The same principles would nonetheless apply to financiers who are other juristic persons or natural persons.

[19] *Grobler v Oosthuizen* 507: "The one theory is inspired by the parallel with a pledge of a corporeal asset and is thus loosely referred to as 'the pledge theory'". See also (note that this is not a closed list): *National Bank of South Africa Ltd v Cohen's Trustee* 1911 AD 235; *Muller v Trust Bank Ltd* 1981 (2) SA 117 (N); *Leyds NO v Noord-Westelike Koöperatiewe Landboumaatskappy Bpk en Andere* 1985 (2) SA 769 (A); *Bank of Lisbon & South Africa Ltd v The Master* 1987 (1) SA 276 (A); *Millman NO v Twiggs and Another* 1995 (3) SA 674 (A); *Van Zyl NO v Look Good Clothing CC* 1996 (3) SA 523 (SE); *Van Staden v Firstrand* 541I-542A; *Moonsamy and Another v Nedcor Bank Ltd and Others* 2004 (3) SA 513 (D) 517G-J; *African Consolidated Agencies (Pty) Ltd v Siemens Nixdorf Information Systems (Pty) Ltd* 1992 (2) SA 739 (C); *Land en Landboubank van Suid-Afrika v Die Meester en Andere* 1991 (2) SA 761 (A); *Development Bank of Southern Africa Ltd v Van Rensburg and Others NNO* 2002 (5) SA 425 (SCA); *Thekweni Properties (Pty) Ltd v Picardi Hotels Ltd* 2008 (2) SA 156 (D); *Picardi Hotels Ltd v Thekwini Properties (Pty) Ltd* 2009 (1) SA 493 (SCA).

Over the years there has been much debate[21] as to which construction should prevail, even though most courts, including the Supreme Court of Appeal, have shown a general preference for a pledge construction.[22]

The Appeal Court has again confirmed its preference for the pledge construction in the recent case of *Grobler v Oosthuizen.*[23] The pledge construction was once again preferred in the case of *Retmil Financial Services (Pty) Ltd v Sanlam Life Insurance Co Ltd* decided only a few months ago in the Western Cape High Court.[24]

One would have thought that this would have been the final word on the issue. However, due to the previous decisions to the contrary handed down by the Appeal Court and the lack of doctrinal soundness of the pledge construction, the issue has not been completely resolved. This is also

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[20] *Grobler v Oosthuizen* 507G-H: "According to this theory a cession *in securitatem debiti* is in effect an outright or out-and-out cession on which an undertaking or *pactum fiduciae* is superimposed that the cessionary will re-cede the principal debt to the cedent on satisfaction of the secured debt. In consequence, the ceded right in all its aspects is vested in the cessionary". See also (this, too, is not a closed list): *Lief v Dettmann* 1964 (2) SA 252 (A); *Holzman NO and Another v Knights Engineering & Precision Works (Pty) Ltd* 1979 (2) SA 784 (W); *Mercatrust Bpk v Keepers Hosiery Suid-Afrika (Edms) Bpk (In Voorlopige Likwidasie)* 1980 (3) SA 411 (W); *Illings (Acceptance) Co (Pty) Ltd v Ensor NO* 1982 (1) SA 570 (A) 578E; *Spendiff NO v JAJ Distributors (Pty) Ltd* 1989 (4) SA 126 (C); *Rothschild v Lowndes* 493; *Trust Bank of Africa v Standard Bank of South Africa* 166.

[21] As highlighted in the recent case of *Grobler v Oosthuizen* 506I. In the literature this debate has often come under scrutiny; a *capita selecta* is as follows: Harker JR "Cession in securitatem debiti" 1981 *SALJ* 56; Harker JR "Cession in securitatem debiti: In the nature of a quasi-pledge" 1986 *SALJ* 200; Scott S "Verpanding van vorderingsregte: Uiteindelik sekerheid?" *THRHR* 175; Clarke B & van Heerden BJ "Cession in securitatem debiti" 1987 *SALJ* 238; Scott S "Airco Engineering v Ensor 1988 2 SA 367 (W): Sessie in securitatem debiti" 1988 *De Jure* 367; Scott S "Algehele sekerheidsessies" 1988 *THRHR* 434; Scott S "Algehele sekerheidsessies. (Vervolg)" 1989 *THRHR* 45; Lubbe GF "Sessie in securitatem debiti en die komponente van die skuldeisersbelang" 1989 *THRHR* 485; Nienaber PM "'n Regterlike perspektief"sessie in securitatem debiti - quo vadis?" 1989 *THRHR* 244 (also "'n Regterlike perspektief" in Scott S (Ed) *Sessie in securitatem debiti - quo vadis*? 1989); Scott S *The Law of Cession* (1991) 236 (see also fn 20) [hereinafter referred to as "*Cession*"] and the South African Law Reform Commission *The Giving of Security by Means of Movable Property Report (Project 46)* February 1991 2-3 [hereinafter referred to as "SALC *Project 46*"].

[22] For instance, *Louw v WPF Koöperatief Bpk en Andere* 1994 (3) SA 434 (A); *First National Bank of SA Ltd v Lynn NO and Others,* 1996 (2) SA 339 (A)*; National Bank of South Africa v Cohen's Trustee* 235; *Leyds v Noord-Westelike Koöperatiewe Landboumaatskappy* 769; *Bank of Lisbon & South Africa v The Master* 276; *Millman v Twiggs* 674; *Development Bank of Southern Africa v Van Rensburg* 425; *Picardi Hotels v Thekwini Properties* 493*; Grobler v Oosthuizen* 507I-508B: "But despite the doctrinal difficulties arising from the pledge theory, this court has in its latest series of decisions - primarily for pragmatic reasons - accepted that theory in preference to the outright cession/*pactum fiduciae* construction….".

[23] 508B: "…[T]he doctrinal debate must, in my view, be regarded as settled in favour of the pledge theory".

[24] *Retmil Financial Services (Pty) Ltd v Sanlam Life Insurance Co Ltd* 2013 JDR 0864 (WCC) para 26.

evident by the "strong pressure" that was placed on the South African Law Reform Commission by the public when the Commission proposed that the fiduciary security cession be abolished in favour of pledge.[25]

There is indeed a plethora of cases and literature considering this topic. For the purposes of this thesis, the aim has never been to analyse this in any great detail. Only a handful of cases and academic works have thus been cited as authority for the principles expounded herein. What follows in this Chapter is a brief discussion of these two forms of security cession.

4.2 Traditional pledge

When parties employ the use of pledge for security purposes, the intention of the parties at all times is that the object of security should vest in the financier only temporarily. The aim is for the object of security to revert to the debtor upon satisfaction of the debt.[26]

In order to effect a traditional pledge, movable corporeal[27] property, belonging to the debtor (now called the pledgor), is pledged and delivered to the financier (now called the pledgee). This is done in order to secure the repayment of the credit advancement.[28] The pledgee is thereby granted a limited real right in the object of security.[29] The content of the limited real right that the pledgee acquires is an entitlement to realise the object of security if the pledgor defaults on repayments or becomes insolvent.[30]

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[25] See 4.5 below.

[26] *Vasco Dry Cleaners v Twycross* 1979 (1) SA 603 (A) 611F. In *Freeman Cohen's Consolidated Ltd v General Mining & Finance Corporation Ltd* 1907 TS 224 the pledgee's realisation of some of the pledged articles prematurely and without the knowledge or consent of the pledgor was held to be wrongful.

[27] Traditionally only movable corporeal property could be pledged, but this traditional approach has been extended to allow for the pledge of movable incorporeal property such as rights (see 4.3 below).

[28] The property cannot belong to the financier because once the property has been pledged, the financier would effectively acquire a limited real right in his *own* property – property in which he already has a real right, since he is the owner thereof. Mostert *et al* 301 provide a further discussion in this regard. This raises the question of whether an insurer can accept a pledge of a life policy as security that was issued by it, in exchange for credit facilities (if the insurer is also in the business of extending finance). See 4.3.4 below.

[29] *Land en Landboubank van Suid-Afrika v Die Meester* 771D-E. Mostert *et al* 314 and Van der Walt & Pienaar 259 elaborate on this concept.

[30] *Rothschild v Lowndes* 448; *Vasco Dry Cleaners v Twycross* 611F-G.

It must be emphasised that even though the pledgee is given possession of the object of security, the pledgor retains ownership at all times.[31] To give the pledgee possession, the object of security must be physically delivered to him and if it is not delivered as such, a valid pledge has not been constituted.[32] Besides fulfilling the requirement that the pledgee be in possession of the security object, delivery also serves to publicise the fact that the pledgee enjoys a limited real right over the object.[33]

Furthermore, the pledgee must retain possession and remain in control of the security object until the secured debt has been extinguished. If the pledgee voluntarily loses possession or control, the limited real right that he enjoys in the object of security is automatically terminated.[34]

4.3 Cession by pledge[35]

When a personal right under a life policy is ceded as security, most courts take it for granted that the security cession takes the form of a pledge.[36] Notwithstanding the cession, it is said that the

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[31] *Rothschild v Lowndes* 448**;** *Vasco Dry Cleaners v Twycross* 611F.

[32] *Holwich v Penny* 1886 5 EDC 270 275; *Payn v Yates* 1892 9 SC 494 497; *Lighter & Co v Edwards* 1907 TS 442 444; *Contract Forwarding v Chesterfin* 258B; *Vasco Dry Cleaners v Twycross* 611G-H. In *Bank Windhoek Bpk v Rajie en 'n Ander* 1994 (1) SA 115 (A) 150B-C the Appeal Court ventured the view that there may be a commercial need for recognising a non-possessory pledge, but was not prepared to take the matter further and instead confirmed that such a pledge did not currently exist in South African law. This sentiment was later echoed by Judge Cloete in *Nedcor Bank Ltd v Absa Bank Ltd* 1998 (2) SA 830 (W) 838G-839B. As to the importance of possession in effecting a pledge see Van der Walt & Pienaar 260; Badenhorst *et al* 391-392 and Mostert *et al* 317.

[33] In *Lighter v Edwards* 445 the court explains the importance of publicity in preventing fraud; *Vasco Dry Cleaners v Twycross* 612A-C; *Thienhaus NO v Metje & Ziegler Ltd and Another* 1965 (3) SA 25 (A) 31E-G: "…[D]elivery of pledged movable property serves as notice to the world at large that such movable property is similarly subject to a *jus in re aliena*".

[34] *Holwich v Penny* 275; *Lighter v Edwards* 444; *Vasco Dry Cleaners v Twycross* 611H. Wessels ACJ in *Kilburn v Estate Kilburn* 506 explains that this is because the security obligation is accessory to the principal obligation. A similar statement was made in *Thienhaus v Metje & Ziegler* 32G: "…[If a pledgee] fails to establish an enforceable claim which it was intended should be secured by the hypothecation, the bond or the pledge, as the case may be, falls away".

[35] Although it is accepted that a security cession may take the form of pledge, upon further scrutiny (see below) it is submitted that no actual cession occurs. For this reason the term "cession by pledge" has not been utilised in this work. Instead the term "pledge" has been used even though it is theoretically impossible to pledge that which is incorporeal. Since the Appeal Courts have accepted that a personal right may be pledged, it becomes not only acceptable, but appropriate to refrain from referring to a "cession by pledge".

[36] Innes CJ in *National Bank of South Africa v Cohen's Trustee* 251-252 stated that although judicial recognition has been given to the *pactum fiduciae* construction (using *Sutherland v Elliot Bros* 2 Menzies 349 as an example), he and the other judges still preferred the pledge construction. This case is considered to be the *locus classicus* for the pledge construction. The court in *Muller v Trust Bank* 123G, 124E-F held that the right of parties under a cession *in securitatem debiti* must be determined according to the law of pledge. In *Leyds v*

policyholder still retains the "bare *dominium*" or ownership of the personal right. While the cession is operative, however, the policyholder is precluded from exercising his rights against the insurer,[37] unless the parties agree otherwise.[38]

The case of *National Bank of South Africa Ltd v Cohen's Trustee* is the *locus classicus* on the pledge construction.[39] This influential decision has been confirmed and followed by most subsequent

Noord-Westelike Koöperatiewe Landboumaatskappy 780E-G the Appellate Division was of the opinion that there was no reason for it to deviate from the decision in *National Bank of South Africa v Cohen's Trustee* as the rule laid down therein had not lead to any injustice or practical problems, and had been consistently applied for over 70 years and hence believed it was unnecessary to re-consider. The Appellate Division in *Millman v Twiggs* 671G authoritatively held that "when a right is ceded with the avowed object of securing a debt, the cession is regarded as a pledge of the right". It was held in *Van Zyl v Look Good Clothing* 526D-E that: "A cession *in securitatem debiti…*is more aptly described as a pledge to secure a debt owing by the cedent to the cessionary". Brandt JA in *Grobler v Oosthuizen* 508B declared that: "…[T]he doctrinal debate must, in my view, be regarded as settled in favour of the pledge theory". See most recently *Retmil Financial Services v Sanlam Life Insurance Co* para 26.

[37] *Van Staden v Firstrand* 541I-542A: "A cession *in securitatem debiti* has the effect that the ceded right remains an asset in the estate of the cedent, but that the cedent is incapable of exercising any of the capacities of the creditor. The cedent cannot institute action or exercise a right to cancel the contract….The purpose of the cession is to confer on the cessionary, as a pledgee, a real right of security to provide full protection in the event of the cedent's insolvency". *Van Zyl v Look Good Clothing* 526D-E: "In the case of a cession of this nature the cedent retains a reversionary interest in the ceded right, which entitles him to recover it when the secured debt is paid and gives him the right to recover from the cessionary any excess received by the cessionary from the debtor". See in addition the cases of *Moonsamy v Nedcor Bank* 517G-J*; African Consolidated Agencies v Siemens Nixdorf Information Systems* 742B-D; *Land en Landboubank van Suid-Afrika v Die Meester* 771C-F and *National Bank of South Africa v Cohen's Trustee* 256; *Retmil Financial Services v Sanlam Life Insurance Co* para 28. Similar statements can be found in the literature: Van der Merwe S, Van Huyssteen LF, Reinecke MFB & Lubbe GF *Contract General Principles* 3ed (2008) 500-501; Floyd T "Cession" in Hutchinson D & Pretorius C (Eds) *The Law of Contract in South Africa* 2ed (2012) 371; Scott S "Cession in securitatem debiti once again!" 1993 *THRHR* 478; Scott S "Verpanding van vorderingsregte"1996 *THRHR* 319; Davis 272-273; Scott S "Evaluation of security by means of claims: Problems and possible solutions: Section A: Problems" 1997 *THRHR* 179 182 *et seq*; Van Niekerk 2008 *Juta's Insurance Law Bulletin* 80 *et seq*; Scott 2008 *SA Merc LJ* 530.

[38] *Louw v WPF Koöperatief* 443F-G: "'n Sessie *in securitatem debiti* het dus tot gevolg (tensy die partye anders ooreenkom) dat die sedent ontdoen word van sy reg om die gesedeerde skuld in te vorder, en gevolglik geen *locus standi* het om dit af te dwing nie". *Solomon v Spur Cool Corporation* 219I-220J: "…[T]he ordinary or usual consequences of a cession *in securitatem debiti* may be varied in the context of the parties' agreement". In *Retmil Financial Services v Sanlam Life Insurance Co* para 37 the court said that there would have to be an express or tacit term in the obligationary agreement between the policyholder and the financier (cessionary) allowing the latter to collect the policy proceeds on death in a case where the loan agreement was not yet due and payable and where the policyholder had not defaulted on repayment. See too S Scott "Locus standi en prosedures by sessie van vorderingsregte" 1984 *TSAR* 186; Van Niekerk JP "Life insurance: cession" 1997 *Annual survey of South African Law* 588 591; Scott S "Security cession – locus standi" 2005 *THRHR* 691; Scott 1996 *THRHR* 319; Scott 1997 *THRHR* 182; Scott 2000 *TSAR* 765.

[39] Domanski A "Cession in securitatem debiti: National Bank v Cohen's Trustee reconsidered" 1995 *SA Merc LJ* 427 429 points out that upon a closer inspection of the judgments in *National Bank v Cohen's Trustee*, the five concurring appeal judges were in fact only concurring on the outcome of the judgment and not with the reasons therefor. According to the author, Lord De Villiers and Dove Wilson JP were of the opinion that the

Appeal Courts. On the one hand, the judgment emphasised that the financier does not obtain ownership, but only obtains a *jus in re aliena* or right in another's property.[40] The *jus in re aliena* allows the financier to enforce the right should the policyholder default with repayment (this is known as the maturing of the pledge).[41]

On the other hand, the decision in *National Bank of South Africa v Cohen's Trustee* points out that the policyholder retains the bare *dominium* or the "reversionary interest" as it has also been described.[42] The retention of the bare *dominium* ensures that once the debt has been discharged the personal right reverts to the policyholder.[43]

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pledge construction should apply as the default construction when rights are ceded as security. On the other hand, Innes J and Laurence J were of the opinion that the applicable construction should be based on the intention of the parties. The author explains that the fifth judge, Maasdorp JP, who had the power to sway a majority either way, simply stated that he concurred without mentioning with whom or for which reasons. The author concludes that the case of *Cohen's Trustee* is not clear authority for the pledge construction, and that subsequent cases which have relied on *Cohen's Trustee* as authority must be considered as suspect. It is submitted that the impact of this discovery (whether correct or not) is negligible due to the weight of cases, especially appeal court cases, in favour of the pledge construction.

[40] *National Bank of South Africa v Cohen's Trustee* 242 (per Lord De Villiers CJ), 259 (per Laurence J). See in addition Scott 1996 *THRHR* 319;

[41] This is illustrated in *Development Bank of Southern Africa v Van Rensburg* 447E-G; *Grobler v Oosthuizen* 506A-B; *Thekweni Properties v Picardi Hotels* 160H: "Generally speaking the consequences of such a cession are that it is the cessionary alone who has the necessary *locus standi* to sue for enforcement of the ceded debt". *Picardi Hotels Ltd v Thekwini Properties* 496C-D it was held that: "It is settled law that unless otherwise agreed, a cession *in securitatem debiti* results in the cedent being deprived of the right to recover the ceded debt, retaining only the bare dominium or a 'reversionary interest' therein". Harker 1981 *SALJ* 59-60 further elaborates on the position.

[42] It appears that the term "reversionary interest" may be preferable to that of "bare *dominium*" since the latter applies more accurately to corporeal property. The courts in *Moola v Estate Moola* 1957 (2) SA 463 (N) 464B and *Grobler v Oosthuizen* 507C-D have expressed such a preference. This preference is also observed in Floyd 370-371; Harker 1981 *SALJ* 63; Scott 1987 *THRHR* 176-177, 183-186; Scott *Cession* 239, 240-241; Scott 1996 *THRHR* 319. In *Retmil Financial Services v Sanlam Life Insurance Co*, which is the most recent case dealing with cession *in securitatem debiti* of the rights under a life policy, Davis AJ used both terms interchangeably. As an aside, and without upsetting the apple cart, using the term "bare *dominium*" is probably a more helpful description of what the policyholder retains after a security cession, albeit the term may be associated with corporeal property. The reason for this is because the *jus in re aliena* is the only right transferred to the financier, and the other rights under the policy remain in the policyholder's estate. The expression "reversionary interest" may create the impression that all the rights under the life policy are transferred to the financier subject only to the reversion thereof upon satisfaction of the loan, which closely resembles the operation of a fiduciary security cession and may cause confusion.

[43] *National Bank of South Africa v Cohen's Trustee* 246-247: "Upon payment by Cohen [policyholder] of the debt due by him to the defendant [financier], the former could have demanded the return of the policy as his property, and no re-cession from the Bank to him would have been necessary in order to complete his title".

It must also be noted that the real security in the personal right is accessory to the principal debt.[44] This means that the real security is "inextricably linked" to a valid underlying principal debt.[45] Once the principal debt has been extinguished, the real security is automatically terminated.[46]

4.3.1 Doctrinal soundness

Admittedly it becomes jurisprudentially challenging to apply the general principles of a pledge of corporeal property to the pledge of a personal right which is incorporeal in nature. Van den Heever JA in *First National Bank of SA Ltd v Lynn NO and Others* describes this challenge as follows:

> The fiction [of the pledge construction] has its origin in the practical needs of modern commerce but has caused much strenuous intellectual gymnastics on the part of scholars and lawyers in trying to prise one legal concept into the garb of another not ideally suited.[47]

The main jurisprudential challenges are set out as follows:

(i) Pledge of personal right creates a new form of security

It has been contended that recognising a pledge or "*quasi* pledge" establishes a new form of security.[48] A better viewpoint is that the pledge of an incorporeal as security merely extends or adapts the already existing principles of traditional pledge as a form of security and does not create a new form of security.

(ii) Pledge of personal right does not actually involve cession

The lack of doctrinal soundness may have arisen because the extension or adaptation of the pledge construction may have been stretched too far in order to accommodate traditional pledge and cession. In the pledge construction the concepts of pledge and cession have been integrated by notional force because they are completely different concepts. The result of this awkward union makes little theoretical sense.

While the idea of pledging incorporeals is flawed, insisting that a cession occurs when such an incorporeal is pledged makes it more so.[49] Hence, a criticism that may accordingly be levelled

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[44] *Solomon v Spur Cool Corporation* 224B.

[45] *Kilburn v Estate Kilburn* 505-506.

[46] In the view of Van der Walt & Pienaar 259; Mostert *et al* 300.

[47] 350A. See further the discussion in Scott 1996 *THRHR* 319.

[48] Notably put forward by Harker 1981 *SALJ* 68; Harker 1986 *SALJ* 200.

[49] *Cf* Harker 1981 *SALJ* 61.

against this construction is the lack of clarity as to whether a cession actually occurs; and, whether a cession is indeed necessary to bring about a valid pledge.

On the one hand it has been held that a cession is necessary to "perfect" a pledge of incorporeal property.[50] Viewed in this manner, cession has been equated with the requirement of delivery for the pledge of corporeal property.[51]

On the other hand, it seems as though this was not what the court had in mind in the case of *Cohen's Trustee*. It was held that the policyholder "need only demand the return of his property and a re-cession is not necessary to complete his title".[52] It follows that if a re-cession is not necessary to terminate the real security right, then a cession could not have occurred to establish it in the first instance. The words of the court in *Cohen's Trustee* thus support the view that with a security "cession" by pledge, a cession in the true sense of the word does not actually take place.

In addition, it appears as though the early practice of pledging personal rights for security purposes did not require a cession. Relying on Voet, Innes J in *Cohen's Trustee* held that:

> Incorporeal rights could by the law of Holland, be freely pledged (*Voet*, 20, 3, 1). At the same time, they were, from their very nature, incapable of physical delivery; nor do I gather that a formal cession of the pledged right was by Dutch practice essential to the validity of the *pignus.*[53]

Further, cession brings about complete transfer of a right with the result that the cedent is wholly divested thereof.[54] Yet, according to pledge, ownership or a bare *dominium* of the personal right is retained by the supposed cedent, and only the entitlement to realise the object of security, or to

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[50] In *Moonsamy v Nedcor Bank* 517H the court makes the following statement: "Since an incorporeal right was being pledged, a cession had to be executed to perfect that pledge".

[51] This is done especially by Scott *Cession* 238-239, 242; Van der Merwe *et al* 489 fn 344.

[52] *National Bank of South Africa v Cohen's Trustee* 246-247. In *MEC for Local Government & Finance, Kwazulu-Natal v North Central & South Central Local Councils, Durban and Others* [1999] 3 All SA 5 (N) 23 the court confirmed this as follows: "On payment of the debt dominium is *automatically restored* to its full vigour" [emphasis added].

[53] *National Bank of South Africa v Cohen's Trustee* 250.

[54] *First National Bank of SA v Lynn* 45H-I per Joubert JA: "[Cession] is an agreement to divest the cedent of the right and to vest it in the cessionary". See also *LTA Engineering Co Ltd v Seacat Investments (Pty) Ltd* 1974 (1) SA 747 (A) and *Johnson v Incorporated General Insurance Ltd* 1983 (1) SA 318 (A) 331B-C, 331F-H.

enforce it in the case of a personal right (the *jus in re aliena*), is transferred to the supposed cessionary.[55]

Is it possible to cede part of a personal right, that is, only the entitlement to realise or to enforce it?[56] Does this not defy the essence of cession? It has been submitted that "a right cannot, at one and the same time, be transferred and retained".[57] Similarly, the view has been expressed that ownership of a personal right cannot theoretically be split or be "fragmented" and "distributed between various holders".[58]

Assuming that the personal right cannot be fragmented and that no cession occurs, the question which then comes to mind is how the *jus in re aliena* is divested from the estate of the policyholder and vested in the estate of the financier. Because the concept of pledging an incorporeal is like defying the laws of nature, there is no satisfactory way to explain how the financier becomes vested with the *jus in re aliena*. It simply has to be accepted that upon a pledge of the rights under a life policy, the financier has the right to enforce the policy until the secured debt has been satisfied.

The acceptance of the pledge construction, however, does not eliminate the probability that no cession occurs. For this reason, the transaction should perhaps not be referred to as a security

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[55] *MEC v North Central & South Central Local Councils* 23: "His [the policyholder's] rights are merely subjected to the rights of the pledgee or cessionary [the financier]. In a sense his rights are in abeyance pending the repayment of the debt secured by the pledge or the cession". Scott *Cession* 239 explains it as follows: "The cession is the act of transfer in terms of which the power to realise the right is transferred to the pledgee, but the *dominium* remains with the pledgor".

[56] In the case of *Johannesburg Municipal Council v Rand Townships Registrar and Others* 1910 TS 1314 1319 the court gave some attention to the content and meaning of the word "*dominum*". The context of this discussion, however, was in relation to ownership of immovable property and the leasing thereof. This cannot be considered as authority for the view that a personal right may be split into component parts since ownership in corporeal property is a real right. In *MEC v North Central & South Central Local Councils* 21 *et seq* the court extensively considers the concept of ownership in corporeal as well as incorporeal property in the context of pledge. The judge's exploration ignores this theoretical dilemma because he treats the pledge construction in cession no differently from the pledge of corporeal property.

[57] Nienaber PM in "Cession" in *LAWSA* 2ed (2003) para 53 fn 15.

[58] In the words of Nienaber para 53 fn 15. Similar views are expressed by Floyd 371: "[I]t is difficult to explain how a *personal* right (or claim against another person) can similarly be split into component parts" [author's emphasis]. Harker 1981 *SALJ* 62 states that: "In the case of incorporeal property…there exists only one right, namely, the personal right to compel the debtor to perform" which he concludes, is impossible to split. *Cf* Lubbe 1988 *THRHR* 485 and Van der Merwe *et al* 497-498 where a "limited cession" of a "particular component" of a personal right is considered. This limited cession is most likely what Scott *Cession* 239 (fn 55 above) describes as consisting only of the "power to realise" the personal right.

cession by pledge. Accordingly, it may be a misnomer to refer to the parties as "cedent" and "cessionary".

(iii) Possession and delivery of the personal right is impossible

It must be remembered that, according to the principles of traditional pledge, possession of the security object is required for the purpose of publicity. Publicity not only aims to prevent the pledgor from selling the object of security himself, but also informs any interested parties of the financier's real security right.[59]

The pledge construction thus faces the obvious criticism that the physical impossibility of delivery and possession causes it to fall short of meeting the requirements of a traditional pledge.

It may, however, be argued that possession can be achieved by delivering the life policy to the financier.[60] Delivery of the document would not fulfil the requirement of true possession (and publicity) because the life policy document does not embody the contract of life insurance, but merely evidences it.[61] It would at least be indicative of the pledge, and the financier may further strengthen its security and achieve publicity by notifying the insurer thereof.[62]

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[59] Scott S "Pledge of personal rights and the principle of publicity" 1989 *THRHR* 458, 459. The author is of the opinion that our courts have neglected the principle of publicity when a personal right is ceded as security by pledge.

[60] As has been done by Scott *Cession* 238.

[61] *Botha v Fick* 1995 (2) SA 750 (A) 778G-I, 779A-B. Scott 1989 *THRHR* 459 expresses the view that delivery of the document or notification as well as requiring the pledge to be registered may prove to be a deterrence for a person considering a pledge of a life policy.

[62] This is strongly advocated by *Britz NO v Sniegocki and Others* 1989 (4) SA 372 (D) 378, 379-380, although notification is not a requirement for the validity of an outright cession or a security cession. Notification has also been suggested by Harker 1981 *SALJ* 61; Scott *Cession* 238 and Scott 1989 *THRHR* 458. Scott clarifies that notification is not a requirement to establish a pledge in South Africa and that some pledgors may in fact object to the debtor being aware of their financial affairs. However, in the context of pledging life policies for credit facilities, the policyholder's objection to notification is less convincing. In this context the debtor is an insurer and it is difficult to see how its knowledge of the pledge would hamper the policyholder's business affairs. An interesting perspective is offered by d'A Ussher C "Problem areas encountered in practice" in S Scott (Ed) *Sessie in securitatem debiti - quo vadis*? 1989 97 102 where the author proposes that besides the publicity aspect, not giving notice suggests that the parties had no serious intentions to effect a cession unless the cedent defaults on his obligations toward the cessionary.

(iv) No historical basis

The practice of pledging incorporeal property has also been criticised for having no historical basis.[63] The *Digest* contains a detailed account of the operation of pledge or *pignus* in Roman law.[64] It seems as though an incorporeal could not be pledged in Roman law: "…[O]ne cannot take a mortgage over property which cannot be bought, because it is outside the private sphere".[65]

This practice apparently became an established one in Roman-Dutch law. Voet wrote that "things can be given in pledge which are movable and immovable, corporeal and incorporeal…".[66] His writings have subsequently been followed in the case law.[67]

There is accordingly some historical basis for the pledging of incorporeals. Since there seems to be a need in contemporary commercial practice to accommodate the pledge of a personal right, a shift in perspective may be called for. This shift should not be frustrated by a scant historical basis.

(v) The financier acquires a real right of security in a personal right to performance

Once a pledge of the secured object has occurred, the financier effectively has a real right of security in a personal right for performance.[68]

It must be kept in mind that a real right of security arises when corporeal property is pledged. It is against the realisation of the pledged *corporeal* property that a financier acquires a real right of security. A personal security right arises when a financier can look to a person to account for an unsatisfied debt. With pledge the financier is given a real security right, even though he looks to a

63 De Wet JC & Van Wyk AH *Kontraktereg* 4ed (1993) 417 *et seq*.

64 *Digest* 13.7.1 – 13.7.43 and 20.1.1 – 20.6.15. See translation Mommsen T, Krueger P & Watson A *The Digest of Justinian* (1985) 406-413 (vol 1) and 518-590 (vol 2).

65 *Digest* 20.3.1.2 translation Mommsen *et al* 589. This is also confirmed in Voet *Commenarius ad Pandectas* 20.3.1 see translation Gane P *The Selective Voet being the Commentary on the Pandects by Johannes Voet and the Supplement to that work by Johannes van der Linden* (1955) 550-551.

66 *Commentarius* 20.3.1 translation Gane 551. The difference in the Roman and Roman-Dutch law position may be attributed to the fact that in Roman-Dutch law cession became a recognised construction and was thus no longer outside the private sphere.

67 The Appellate Division in *National Bank of South Africa v Cohen's Trustee* 246 relies on Voet 20.3.1 as authority for its finding. So too, do the courts in: *Smith v Farrelly's Trustee* 1904 TS 949 954; *Munro NO and Others v Didcott NO and Another* (1908) NLR 249 272-273; *Sandilands v Sandilands' Trustee & Paul* 1913 CPD 632 636.

68 *Grobler v Oosthuizen* 507C where the court stated that "[c]ritics of the pledge theory have difficulty with the concept of a real right of pledge over the personal rights arising from the principal debt".

person to satisfy the secured debt.[69] This criticism has indeed proved to be the most problematic to overcome.

4.3.2 Payment of policy proceeds

(i) Payment in a case of policy surrender

If the policyholder pledged the rights under the life policy and the policyholder defaults on loan repayments, the payment and distribution of the surrender value can become tricky.

As discussed in Chapter 3 above, the beneficiary nomination is not revoked by a subsequent pledge.[70] The beneficiary nomination remains in force but is subject to the pledge. The financier, on the other hand, is entitled to enforce the security in terms of the loan agreement by surrendering the life policy.[71] Thus, the insurer's first duty is to pay the financier the amount outstanding under the loan agreement. The financier is not entitled to payment of the full surrender value of the policy because the right to claim the full surrender value still vests in the estate of the policyholder since only a pledge of the rights had occurred. Similarly, the policyholder's right to payment of the full surrender value of the policy is subject to the financier's claim under the pledge, but the pledge extends only so far as the remaining indebtedness under the loan agreement.

The insurer's second duty is to pay the remaining balance either to the policyholder or to the nominated beneficiary. If no beneficiary has been nominated, the insurer must pay the balance to the policyholder due to its obligation to do so arising from the life insurance policy.

The insurer must pay the balance to the beneficiary if one has been nominated as governed by the principles of *stipulatio alteri*. In accordance with the operation of a *stipulatio alteri*, the insurer must offer the nominated beneficiary the balance of the proceeds.[72] Once the beneficiary has

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[69] De Wet & Van Wyk 415-417 especially object to this absurdity. Harker 1981 *SALJ* 61 also comments that this is "notionally" and "jurisprudentially" impossible. Similar statements appear in the discussion of pledge by SALC *Project 46* 100 and Van der Merwe *et al* 496-497.

[70] As discussed in *Moonsamy v Nedcor Bank* 513.

[71] The financier may always decide to wait until the policy matures before using the proceeds to discharge the loan agreement where the policyholder has defaulted on repayments. This may be a strategic move where the life policy is near to its maturity date, but of course would be unpredictable if the policy becomes payable on death.

[72] The insurer would be in breach of the *stipulatio alteri* that was concluded between it and the policyholder and this would give the policyholder grounds to sue the insurer for damages or specific performance or both. It will be remembered that in *Pieterse v Shrosbree NO and Others; Shrosbree NO v Love and Others* 2005 (1) SA

accepted the benefit, a new contract arises between beneficiary and the insurer.[73] This means that the beneficiary can sue the insurer for payment of the remaining proceeds once he has accepted the benefit.

The insurer, therefore, cannot and should not pay the full surrender value to the financier and expect the latter to distribute the balance. In doing so, the insurer opens itself to be sued by the policyholder or the nominated beneficiary since it is they who are entitled to the balance and it is the insurer who is obliged to pay such balance.

(ii) Payment in case where the policy matures before the loan is due and payable

The position is trickier still if the policyholder dies or the policy matures before the secured debt has been satisfied because, in such an instance, the loan is not yet due and payable.[74]

Davis AJ was faced with this scenario in *Retmil Financial Services v Sanlam Life Insurance Co*.[75] In this case the policyholder had pledged the rights under his life policy to Retmil Financial Services for a loan advanced to a Close Corporation and was being paid off over 3 years. It was common cause that the Close Corporation had at all times kept up with the loan repayments. Before the expiry of the 3 year period, the policyholder died and the policy proceeds became due and payable. Retmil Financial Services demanded immediate payment of the policy proceeds from the insurer, but the executor of the policyholder's deceased estate objected since the loan was not yet due and payable.

309 (SCA) 313F-H (as discussed in Chapter 3), the appeal court explained the operation of a *stipulatio alteri* as follows: The legal nature of such a nomination is a *stipulatio alteri* (a contract for the benefit of a third person). In such a case, the policy holder (the *stipulans*) contracts with the insurer (the *promittens*) that an agreed offer would be made by the insurer to a third party (the beneficiary) with the intention that, on acceptance of the offer by that beneficiary, a contract will be established between the beneficiary and the insurer. What is required is an intention on the part of the original contracting parties that the benefit, upon acceptance by the beneficiary, would confer rights that are enforceable at the instance of the beneficiary against the insurer, for that intention is at the 'very heart of the *stipulatio alteri*'."

[73] *Crookes NO and Another v Watson and Others* 1956 (1) SA 277 (A) 288A *et seq*; *Hofer and Others v Kevitt NO and Others* 1998 (1) SA 382 (SCA); *Hees NO v Southern Life Association Ltd* 2000 (1) SA 943 (W) 951A-B; *Wessels NO v De Jager en 'n Ander NNO* 2000 (4) SA 924 (SCA) 928D-E; *Moonsamy v Nedcor Bank* 513.

[74] If the loan is due and payable at this time then the same principles should apply as in a case of surrender, since surrender is in essence an early payment of the policy proceeds.

[75] *Retmil Financial Services (Pty) Ltd v Sanlam Life Insurance Co Ltd* 2013 JDR 0864 (WCC).

Davis AJ explained that since the life policy was pledged, the position must be governed by the applicable principles: While the secured debt remained unpaid only the cessionary (Retmil Financial Services in this case) had *locus standi* to enforce the policy and receive payment. However, it is also true that because the policyholder retains the bare *dominium*, he retains an interest in the life policy even if he cannot for the time being enforce the policy.[76] That having been said, the judged urged that it should also be kept in mind that Retmil Financial Services was only entitled to demand payment of the policy proceeds if the policyholder defaulted with loan repayments. And, this was not the case here.[77]

The judge confirmed that this kind of issue is a factual one and not a legal one. He pointed out that the matter would usually have been addressed expressly or tacitly in the obligationary agreement between the policyholder and the cessionary.[78] The obligationary agreement (the loan agreement *in casu*) was silent on the issue and Davis AJ held that Retmil Financial Services was therefore not entitled to demand the policy proceeds *in order to discharge* the loan all the while there had been no default on the part of the Close Corporation.[79]

Davis AJ concluded that because there was nothing in the loan agreement providing for the matter in dispute, he decided that Retmil Financial Services should be paid the policy proceeds, but not in order to discharge the loan. Retmil Financial Services should be obliged to hold the proceeds in trust as security for the due performance of the Close Corporation's obligations under the loan, and to return the proceeds with interest to the executor upon satisfaction thereof.[80]

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[76] *Retmil Financial Services v Sanlam Life Insurance Co* para 28-29.

[77] *Retmil Financial Services v Sanlam Life Insurance Co* para 34.

[78] *Retmil Financial Services v Sanlam Life Insurance Co* para 35 where the court referred to *Development Bank of Southern Africa v Van Rensburg* 447J-448E. It would be fairly simple to deal with this kind of possibility if the loan agreement makes provision for it.

[79] *Retmil Financial Services v Sanlam Life Insurance Co* para 37-40. The court added that it would be difficult to infer that the parties had tacitly come to this conclusion since the court considered it “unlikely that the deceased would have consented to the forfeiture of an asset which would otherwise be returnable to the estate on discharge of the loan, for the benefit of the deceased's chosen heirs”. It may, however, be the intention of the parties that the policy proceeds should be applied to discharge the loan even if the repayments are up to date. This is perfectly acceptable, but would, as the court explained, have to be apparent in the loan agreement.

[80] *Retmil Financial Services v Sanlam Life Insurance Co* para 39. The only downside to this is that it may delay the final winding up of the deceased estate.

The only problem with the financier holding the policy proceeds in trust is that once the secured debt has been satisfied, it becomes the duty of the financier to pay the policyholder (or executor) or nominated beneficiary as the case may be. As explained above it is not the function of the financier to pay and distribute the policy proceeds, and the beneficiary has no *locus standi* against the financier. It makes more sense if the insurer holds the policy proceeds in trust. In this way the insurer can pay the policyholder (or executor of his deceased estate) or the nominated beneficiary the full policy proceeds once the secured debt has been satisfied. Alternatively, the insurer can pay the bank if the policyholder defaults on loan repayment and can pay the balance to the policyholder (or executor) or nominated beneficiary as the case may be.

To sum up, if the policyholder dies or the policy matures before the secured debt has been satisfied, the solution is to be found in the obligationary agreement where the issue is usually expressly or tacitly addressed. If the obligationary agreement is silent on the issue, the insurer should hold the policy proceeds in trust until either the loan is repaid or the policyholder defaults on loan repayments.[81]

4.3.3 Effect of insolvency

The most obvious reason why courts prefer to style a security cession in the form of a pledge, is because the policyholder is protected from the financier's insolvency. If the financier becomes insolvent before the secured debt has been satisfied, the personal right will not fall into the insolvent estate of the financier because the policyholder retains *dominium* at all times.[82]

Likewise, if the policyholder becomes insolvent before the secured debt has been satisfied, the personal right falls into the policyholder's insolvent estate. The financier on the other hand,

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[81] Another option that the financier may wish to consider if the obligationary agreement is silent on the issue is to agree with the policyholder (or the Close Corporation in this case since the policyholder had died) that the insurer should pay the policy proceeds to policyholder or his nominated beneficiary and pledge a new life policy for the remainder of the loan indebtedness.

[82] *National Bank of South Africa v Cohen's Trustee* 242 (per Lord De Villiers CJ); *Van Staden v Firstrand* 533C-D: "With regard to the standing of the trustee, my understanding is that he proceeds on the basis that a cession *in securitatem debiti* takes the form of a pledge and accordingly the residual right (or bare *dominium*) remains an asset in the insolvent estate of the cedent despite the cession…". Academics also seem to be in agreement on this point: Floyd 371; Scott *Cession* 232-233; Scott 1996 *THRHR* 319; SALC *Project 46* 98-99; Van Niekerk 2008 *Juta's Insurance Law Bulletin* 80 *et seq*; Scott 2008 *SA Merc LJ* 530. For the sake of completeness it is worth mentioning that s 63 of the Long-Term Insurance Act 52 of 1998 protects a portion of the policy proceeds in the event of insolvency, but protection is expressly excluded where the policy has been used for security purposes regardless of the construction.

acquires a secured claim for repayment against the insolvent estate.[83] In this manner the trustee may either enforce the claim against the insurer or sell it to a third party.[84] Either way the proceeds will be used to discharge the secured debt and the balance (if any) is either distributed amongst the other creditors of the policyholder's insolvent estate, or paid to the beneficiary if one was nominated.[85]

Although the case law seems to favour the approach that upon insolvency the trustee is entitled to the policy proceeds, it is submitted that this is the incorrect procedure. After a pledge of the rights under a life policy, the policyholder retains *dominium*, but is not entitled to the policy proceeds unless and until the secured debt has been satisfied. This means that in the event of the policyholder's insolvency, the insurer should pay the financier that which is outstanding under the loan agreement and should pay the balance to the insolvent estate or nominated beneficiary as the case may be. A trustee merely steps into the shoes of an insolvent, thus allowing the insurer to pay the policy proceeds to the trustee effectively places him in a better position than that of the policyholder.

However, it is worth pondering whether it makes a substantial difference if the financier surrenders the policy and is paid directly from the insurer; or if the trustee surrenders the policy and pays the outstanding amount to the financier. The financier would likely receive payment

[83] Section 2 of the Insolvency Act 24 of 1936 contains a closed list of claims that would be secured against the insolvent estate – a pledge is one such secured claim. In further support see *Van Staden v Firstrand* 533D-E where the court stated that in a pledge "the cessionary… would be the holder of a real right of security and normally would be protected" and *Van Zyl v Look Good Clothing* 526G-H: "The effect of the cedent retaining *dominium* in the right ceded in the case of a cession *in securitatem debiti* is that, in the event of the sequestration or liquidation of the cedent during the currency of the cession, the trustee or liquidator in the insolvent estate has the right to recover and administer the claim which has been ceded on the basis of it being an asset in the estate being administered by him". The cases of *Free State Consolidated Gold Mines (Operations) Bpk v Sam Flanges* 1997 (4) SA 644 (O) 654G-J; *National Bank of South Africa v Cohen's Trustee* 242, 248 (per Lord De Villiers CJ), 250, 254 (per Innes J); *Development Bank of Southern Africa v Van Rensburg* 447G; and *African Consolidated Agencies v Siemens Nixdorf Information Systems* 742E also confirm this.

[84] *Brewis v Fedlife Assurance Ltd* [1999] JOL 5646 (SE) 5: "[I]n the case of the insolvency of the cedent a right ceded by him *in securitatem debiti* reverts to the trustee of his estate who may enforce it…."

[85] *National Bank of South Africa v Cohen's Trustee* 248 (per Lord De Villiers CJ), 250 (per Innes J), 259 (per Laurence J); *Dykman v Die Meester* 904J-905B. In *Van Staden v Firstrand* 543C Murphy J pointed out that "[t]he trustee is accordingly the person entitled to recover the proceeds as part of his duty to realise the assets of the estate, but subject to the real right of pledge held by Nedbank [the cessionary] who consequently remains fully protected". In *Leyds v Noord-Westelike Koöperatiewe Landboumaatskappy* 780F-G the Appellate Division held that on the insolvency of the cedent, the pledge construction operates in the interest of both the cessionary and the creditors of the insolvent estate because the cessionary enjoys a preference in the proceeds of the personal right and any proceeds in excess thereof are distributed amongst the creditors.

much sooner if paid directly by the insurer since this eliminates the trustee as the "middle man". In either case if payment under the life policy is insufficient to satisfy the secured debt, the financier has a claim against the insolvent estate for the shortfall.

4.3.4 Pledge of life policy to the insurer

Another advantage of using the pledge constructions is that a policyholder may pledge the rights under a life policy to an insurer if it is also a financier.[86] It may at first seem impossible in principle for an insurer to have a pledge over its own performance. It should, however, be remembered that the personal right to claim the insurer's performance is a right that at all times vests in the estate of the policyholder. This means that the policyholder pledges his own property and merger does not occur.[87] In the event that the policyholder defaults on loan repayments, the insurer may simply set-off the secured debt against its prior obligation to pay under the life policy (the principal debt).[88]

4.3.5 Multiple pledges

Multiple pledges of the same personal right for security purposes would appear to be another advantage of the pledge construction. Since *dominium* of the policy always vests in the policyholder, he is free to pledge his personal right under the life policy to the balance of the proceeds that are not needed to secure his prior secured debt.[89]

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[86] Section 44(4) of the Long-Term Insurance Act actually allows insurers to accept their own life policies as security.

[87] *Roman Catholic Church (Klerksdorp Diocese) v Southern Life Association Ltd* 1992 (2) SA 807 (A). In this case the Appeal Court obviously interpreted the security cession under consideration as a pledge (although this was not spelt out) since the court's finding was that the cession was not made with the intention to bring about a merger. Reinecke MFB "Sessie in securitatem debiti en skuldvermenging" 1992 *TSAR* 677, Scott S "Cession in securitatem debiti and merger" 1993 *THRHR* 686 690-691 and Nienaber PM "Some problems involving security cessions of life insurance policies" 2004 *SA Merc LJ* 83 90 offer further discussions.

[88] In the case of *Roman Catholic Church v Southern Life Association* 815A-D, 815F-G Grosskopf JA correctly emphasises that set-off is only helpful in a case where the policyholder has not become insolvent. A *concursus creditorum* occurs once a final order of sequestration has been granted. This means that if the policy proceeds was not yet due and payable by the date of sequestration, set-off cannot be used. It is for this reason that an insurer should effect a security cession in addition to providing that the loan be set-off against the proceeds of the policy. Southern Life Association indeed took cession *in securitatem debiti* of the right to claim the policy proceeds in addition to providing for set-off, and upon the policyholder's insolvency it was able to fall back on the security cession as protection. See *Standard Bank of SA Ltd v SA Fire Equipment (Pty) Ltd and Another* 1984 (2) SA 693 (C) 696F-H for a succinct summary of the operation of set-off.

[89] *Van Staden v Firstrand* 541F. This possibility is also considered in Henckert H "Cession in securitatem debiti: A problematic case" 1993 *Insurance & Tax* 33; Reinecke *et al* para 438; SALC *Project 46* 99. It is interesting to note that multiple pledges are not possible with traditional pledge of corporeals.

4.4 Fiduciary security cession

The more popular view amongst academics is that a security cession takes the form of a fiduciary cession.[90] This construction has also been favoured by a handful of courts, including the Appeal Court.[91]

In terms of this construction the policyholder cedes a personal right to the financier as an ordinary out-and-out cession as described in Chapter 2 above. This cession, however, takes place in conjunction with a contractual undertaking, called a *pactum fiduciae*. The *pactum fiduciae* obliges the financier to re-cede the personal right to the policyholder once the secured debt has been satisfied. The policyholder is consequently left with a personal right against the financier to enforce re-cession once the secured debt has been repaid.[92]

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[90] The Supreme Court of Appeal in *Grobler v Oosthuizen* 507F-G mentioned that: "In the light of these problems associated with the pledge theory, an alternative theory had been preferred by the majority of academic authors and even in some earlier decisions of this court". Academics who support this construction include De Wet & Van Wyk 415 *et seq* especially 420-421 where the authors describe the pledge construction as a false doctrine ("dwaalleer"); Scott *Cession* 246; Van der Merwe CG *Sakereg* (1979) 475-478, 480; Sonnekus JC "Sessie van saaklike sekerheidsregte?" 1997 *TSAR* 772. *Cf* Harker 1981 *SALJ* 61-62, 67 as well as Harker 1986 *SALJ* 201. Harker's objection is that a fiduciary security cession fails as a workable system of security. He is of the opinion that it does not provide the policyholder with adequate protection, not only in the case of the financier's insolvency, but also if the financier refuses to re-cede the personal right.

[91] *Nell v Barry* 1958 (2) SA 687 (O) 693; *Rothschild v Lowndes* (Innes J in *National Bank of South Africa v Cohen's Trustee* 252, however, pointed out that he had stated the law too widely in *Rothschild*); *Lief v Dettmann* 252; *Trust Bank of Africa v Standard Bank of South Africa* 166; *Holzman v Knights Engineering & Precision Works* 784; *Mercatrust v Keepers Hosiery Suid-Afrika* 411; *Illings v Ensor* 578E; *Spendiff v JAJ Distributors* 216.

[92] These principles are illustrated in the case as follows: *Grobler v Oosthuizen* 507H where the court noted that after a security cession using this construction the "cedent has no direct interest in the principal debt". *Lief v Dettmann* 271E-H: "Where the cession is said to be made as security for a debt, it does not, in my opinion, signify that the cedent in fact retains any right in the subject matter of the cession; his continued interest therein flows from the agreement, either express or implied, with the cessionary that the right of action will be ceded back to him upon the discharge of his debt…. [T]he cedent retains no vestige or right, but relies on his agreement with the cessionary that it will be ceded back to him on the discharge of his debt". In the case of *Trust Bank of Africa v Standard Bank of South Africa* 189A-B the court held that "while a right of action may properly be used to secure a debt, it can effectively be so used only by way of a cession of the right of action to the creditor coupled with an agreement, as between cedent and cessionary, that, on payment of the 'secured' debt, the cessionary shall be obliged to re-cede to the cedent the ceded right of action. The effect of such a cession, generally known as a cession *in securitatem debiti*, is in all respects the same as that of an ordinary cession, but coupled with the agreement mentioned". Similar explanations may be found in Floyd 369-370; Nienaber para 53; Van der Merwe *et al* 495; Davis 271-272; Scott 1988 *THRHR* 439; Scott 1997 *THRHR* 197.

In *Holzman v Knights Engineering & Precision Works*,[93] a company by the name of PM Hunt Engineering Works (Pty) Ltd had ceded the debt owed to it by Knights Engineering and Precision Works (Pty) Ltd to a bank as security. Holzman, the liquidator for the winding up of PM Hunt Engineering Works, made an application for Knights Engineering to be wound up also due to unpaid debts. The latter company opposed the application on the basis that since its debt had been ceded *in securitatem debiti*, and since PM Hunt Engineering Works was not a creditor as envisaged in s346(1)(b) of the Companies Act,[94] Holzman had no *locus standi* to bring the application.

In his judgment, Nestadt J considered the construction of a security cession and by relying *inter alia* on earlier Appeal Court decisions,[95] held that:

> …[I]t seems to me that it is now established that the effect of a cession *in securitatem debiti* is the same as far as the debtor is concerned as an out-and-out cession. If reference is still to be made to the cedent retaining *dominium*, it must be confined to the ownership of a personal right that he has against the cessionary arising from the contract between them, *inter alia*, that, on payment of the secured debt, the ceded right will be returned to the cedent. [96]

Nestadt J thus expresses the opinion that the right to demand re-cession is the only "*dominium*" that remains with a cedent after a security cession. The judge accordingly concluded that the *vinculum iuris* between PM Hunt Engineering Works and Knights Engineering was destroyed upon the security cession to the bank. A *pactum fiduciae* entitling the cedent to demand re-cession once the debt has been repaid is "insufficient to constitute or maintain the *vinculum iuris*".[97] Because the effect of the cession *in securitatem debiti* was to destroy the *vinculum iuris* between PM Hunt Engineering Works and Knights Engineering, the former did not constitute a creditor in terms of s346(1)(b) of the Companies Act and consequently had no *locus standi* to apply for its winding up.[98]

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[93] Although books debts were ceded for security purposes in this case, the *ratio* regarding the fiduciary security cession construction also holds true for the security cession of life policies.

[94] Companies Act 61 of 1973. Section 346(1)(b) provided that an application for the winding-up of a company may be made by one of its creditors including a "contingent" or "prospective" creditor.

[95] Namely *Lief v Dettmann* 252 and *Trust Bank of Africa v Standard Bank of South Africa* 166.

[96] *Holzman v Knights Engineering & Precision Works* 791H-792A.

[97] *Holzman v Knights Engineering & Precision Works* 793B-D.

[98] *Holzman v Knights Engineering & Precision Works* 795H. The *ratio* in this case was followed in *Spendiff v JAJ Distributors* 137I-J-138A: "With respect, nothing which was said in either the *Leyds* or the *Bank of Lisbon* cases *supra* persuades me that there is any reason to doubt the correctness of the finding in *Holzman's* case *supra* that cession destroys the *vinculum juris* between the cedent and his debtor, at least during the subsistence of the cession".

4.4.1 Doctrinal soundness

As illustrated in *Holzman v Knights Engineering & Precision Works* this construction of security cession brings about a complete transfer of the personal right and causes it to vest in the estate of the financier, who becomes the only party entitled to administer it.[99] Although the ultimate purpose of the fiduciary security cession is that the personal right vests with the financier only temporarily, an actual cession occurs. Consequently, the policyholder and financier may be correctly referred to as cedent and cessionary respectively.

4.4.2 The pactum fiduciae

It has been pointed out that the law governing the policyholder and financier largely depends on the terms they themselves have come to agree upon.[100] Because the cession is intended for security purposes and is intended to be only temporary, the rights of the financier are normally restricted by agreement.[101]

Unfortunately, the exact details of the operation of a *pactum fiduciae* have not been extensively discussed in the case law. The restrictions arising from a *pactum fiduciae* may be inherent therein[102] or may have to be expressly included by agreement.[103] These restrictions would necessarily be ones that support the parties' intention to effect a security cession and may include:

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[99] Floyd 369-370; Nienaber para 53; Van der Merwe *et al* 495 and Davis 271-272 confirm this position.

[100] *Merchant Bank of Central Africa Ltd and Others v The Liquidators of Tirzah (Pty) Ltd, Belmont Leather (Pvt) Ltd, G & D Shoes (Pvt) Ltd, PB Shoes (Pvt) Ltd* (All In Liquidation)[2000] JOL 7523 (ZH) 12; *Van der Merwe NO v Hollard Life Assurance Co Ltd* [2003] JOL 12256 (T) 8-9**;** *ABSA Bank Bpk v Fourie* [2004] JOL 13048 (T) 8; *Spendiff v JAJ Distributors* 133D-E. Scott *Cession* 249 makes this observation, although nowhere in the case law is this expressly stated.

[101] In *Merchant Bank of Central Africa v The Liquidators* 12 the court agreed with and applied the following statement to its judgment: "…If the parties intended to effect an out and out cession, there are certain modifications *which they will have to bring into effect by agreement*. These are a *pactum fiduciae,* an agreement against further cession, and an agreement to that the cessionary himself will not institute action before the cedent's debt is due" [emphasis added]. See also *Van der Merwe v Hollard Life Assurance Co* 8-9 and *ABSA Bank v Fourie* 8.

[102] *Frankfurt v Rand Tea Rooms Ltd & Sheffield* 1924 WLD 253 256; *Alexander and Another NNO v Standard Merchant Bank Ltd* 1978 (4) SA 730 (W) 741H; *Marais en Andere NNO v Ruskin NO* 1985 (4) SA 659 (A) 669E-G; *Proflour (Pty) Ltd and Another v Grindrod Trading (Pty) Ltd T/A Atlas Trading & Shipping and Another* [2010] JOL 24787 (KZN) 13; *Trust Bank v Standard Bank* 173D-F, 189A-C; *Lief v Dettmann* 271E-F; *Grobler v Oosthuizen* 507G-H; *Holzman v Knights Engineering & Precision Works* 793B-D; *Spendiff v JAJ Distributors* 132E *et seq*; *Illings v Ensor* 572F-H; *Van der Merwe v Hollard Life Assurance Co* 8-9; *ABSA Bank v Fourie* 7.

[103] *Merchant Bank of Central Africa v The Liquidators* 12 (see fn 101 above).

(i) A *pactum de non cedendo*

A *pactum de non cedendo* may be included to ensure that the financier does not cede the right to another cessionary.[104] While an on-cession of the personal right in the absence of a *pactum de non cedendo* would be a breach of the *pactum fiduciae*, it would entitle the policyholder to the ordinary contractual damages that arise from a breach of contract.[105] If the parties, however, inserted a *pactum de non cedendo* any further cession by the financier would be void and of no effect.[106]

(ii) Reaching a compromise with or enforcing performance from the insurer

An additional restriction may be to prohibit the financier from reaching a compromise with the insurer, or from enforcing the personal right unless the policyholder defaults on repayments.[107] Although not mentioned in the case law, it may also be worthwhile to stipulate that if or when the policy proceeds are paid to the financier on death or at maturity (or surrender), the balance will be transferred to the beneficiary.[108]

It may be reasoned, and indeed has been so contended, that the abovementioned restrictions need not be expressly incorporated into the *pactum fiduciae* as an addition thereto, as they are implicitly inherent therein.[109]

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[104] Above.

[105] Scott 1988 *THRHR* 447 and De Wet & Van Wyk 416-417 take the view that the *pactum fiduciae* operates *inter partes* only.

[106] *Paiges v Van Ryn Gold Mine Estates* is the *locus classicus* on the validity and effect of a *pactum de non cedendo*. See generally Sunkel KD *The pactum de non cedendo: A re-evaluation* (2009) LLM Dissertation, University of the Western Cape. Since the *pactum de non cedendo* would be placed on a personal right that previously exists without restrictions (the "*Paiges* departure" construction), the policyholder would first have to show that he has an interest in the *pactum* for it to be valid. Further, it is suggested by Scott and Sunkel (although for different reasons) that the remedy for breach of a *pactum de non cedendo* should not be that the cession is void, but should rather afford the policyholder with a claim for contractual damages – see Scott *Cession* 213-214 and Sunkel KD "A comprehensive suggestion to bring the pactum de non cedendo into the 21st century" 2010 *Stell LR* 463 469.

[107] *Merchant Bank of Central Africa v The Liquidators* 12 (see fn 101 above).

[108] These suggestions have been put forward by Scott 1988 *THRHR* 447; Scott *Cession* 249-250; Nienaber para 56 fn 8.

[109] *Lief v Dettmann* 271E-F: "Where the cession is said to be made as security for a debt, it does not, in my opinion, signify that the cedent in fact retains any right in the subject-matter of the cession; his continued interest therein flows from the agreement, either express or implied, with the cessionary that the right of action will be ceded back to him upon the discharge of his debt". Judge Viljoen's remark in *Alexander v Standard Merchant Bank* 741H is similar but not as revealing: "… [T]he cessionary cannot freely dispose of the property but is under an obligation to cede the rights back to the cedent upon payment of the debt". See also *Frankfurt v Rand Tea Rooms* 256; *Trust Bank v Standard Bank* 173D-F, 189A-C; *Grobler v Oosthuizen* 507G-H; *Holzman v Knights Engineering & Precision Works* 793B-D; *Marais v Ruskin* 669E-G; *Spendiff v JAJ Distributors*

The word "*fiducia*" means "the transference of property on trust".[110] The term "*pactum fiduciae*" can thus be loosely translated as an agreement to transfer property on trust. When South African Courts use this phrase they are generally referring to the specific obligation to re-cede the personal right once the secured debt has been extinguished.[111] This indeed makes sense since complete *dominium* in the personal right is transferred to the financier and the policyholder has to place his trust in the financier honouring the agreement to re-cede.

This agreement of trust, however, may be perceived as a relatively broad term that may very well require additional obligations that includes, but is not limited to the restrictions discussed above. The better view, and also the one with the most support, is that all the restrictions that are necessary to bring about a cession for the purpose only of security, are inherently included in the concept of a *pactum fiduciae*.[112]

Any provision in a contract that indicates that the parties intend a complete transfer of the personal right, but only until such time as the secured debt has been repaid, should be interpreted as a fiduciary security cession. In such an instance the *pactum fiduciae* and all the restrictions that it encompasses to achieve this objective should find application. Pending judicial clarification on this point the policyholder would be prudent to expressly include additional restrictions.

4.4.3 Payment of policy proceeds

(i) Payment in a case of policy surrender

If the policyholder defaults on loan repayments, and the financier is forced to surrender the life policy, the state of affairs becomes rather complicated.

132E *et seq*; *Illings Co v Ensor* 572F-H; *Van der Merwe v Hollard Life Assurance Co* 8-9; *ABSA Bank v Fourie* 7; *Proflour v Grindrod Trading* 13. Nienaber para 56, Van der Merwe *et al* 496, Scott *Cession* 249 and Nienaber & Reinecke 322 are of the opinion that a *pactum de non cedendo* is either included impliedly in every *pactum fiduciae* or is included as a tacit term.

[110] Glare PGW (Ed) *Oxford Latin Dictionary* 2ed (2012) vol 1 767.

[111] *Frankfurt v Rand Tea Rooms* 256; *Alexander v Standard Merchant Bank* 741H; *Trust Bank v Standard Bank* 173D-F, 189A-C; *Lief v Dettmann* 271E-F; *Grobler v Oosthuizen* 507G-H; *Holzman v Knights Engineering & Precision Works* 793B-D; *Marais v Ruskin* 669E-G; *Spendiff v JAJ Distributors* 132E *et seq*; *Illings v Ensor* 572F-H; *Van der Merwe v Hollard Life Assurance Co* 8-9; *ABSA Bank v Fourie* 7; *Proflour v Grindrod Trading* 13.

[112] The cases supporting this view include: *Lief v Dettmann* 271E-F; *Alexander v Standard Merchant Bank* 741H; *Frankfurt v Rand Tea Rooms* 256; *Trust Bank v Standard Bank* 173D-F, 189A-C; *Grobler v Oosthuizen* 507G-H; *Holzman v Knights Engineering & Precision Works* 793B-D; *Marais v Ruskin* 669E-G; *Spendiff v JAJ Distributors* 132E *et seq*; *Illings Co v Ensor* 572F-H; *Van der Merwe v Hollard Life Assurance Co* 8-9; *ABSA Bank v Fourie* 7; *Proflour v Grindrod Trading* 13.

There is no authority which considers a fiduciary security cession as a revocation of the beneficiary nomination. Thus, like in the case of a pledge, the beneficiary nomination would be subject to the security cession. [113] However, unlike a pledge, a fiduciary security cession occurs in the same manner as an outright cession except with the addition of the *pactum fiduciae*. Strictly speaking, this means that the financier is entitled to the full surrender value of the policy since a complete transfer has occurred and *dominium* of the policy vests in the financier. On the other hand, because the fiduciary security cession is intended to be temporary for security purposes only, and because it is subject to the *pactum fiduciae*, the security extends only as far as the loan indebtedness.

Thus, if the principles of a fiduciary security cession were to be strictly applied, the insurer would be obliged to pay the full surrender value of the policy to the financier because the security cession brings about a complete transfer of the rights under the life policy, and at the same time destroys the *vinculum juris* between the policyholder and the insurer.[114] Because the financier is only entitled to the outstanding indebtedness as per the loan agreement and not the full surrender value of the policy, the financier would be obligated to pay the balance to the policyholder or his deceased estate.

A problem however arises if a beneficiary has been nominated. The nominated beneficiary has no *locus standi* to sue the bank for the balance of the surrender value. The nominated beneficiary is entitled to payment of the balance from the insurer which arises from the *stipulatio alteri* and the beneficiary therefore does not have *locus standi* to sue the financier.[115] The beneficiary would have to sue the insurer, but the insurer would not be in possession of such proceeds if it had already paid the full surrender value to the financier.

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[113] *Moonsamy v Nedcor Bank* 519-520A.

[114] See *Holzman v Knights Engineering & Precision Works* 793B-D; *Spendiff v JAJ Distributors* 137I-J-138A as discussed above.

[115] In the case of *Mulaudzi v Firstrand Bank Ltd* 2006 JDR 1048 (T) the insurer had paid the full value of the policy to the financier. The nominated beneficiary sued the financier for the balance of the policy proceeds. Although the court correctly decided that the financier was obliged to pay the balance to the nominated beneficiary, the legal basis of this obligation was not revealed. Scott S "Once more beneficiary appointments and security cessions: Mulaudzi v First Rand Bank Ltd" 2007 *SA Merc LJ* 517 who provides a helpful discussion of the issue. *Cf* Van Niekerk 2007 *Juta's Business Law* 47-48.

It has been proposed that the beneficiary "steps into the shoes of the policyholder as far as the proceeds are concerned" and consequently has the right to demand payment from the financier.[116] This cannot be supported in light of the principles pertaining to *stipulatio alteri* which causes a new contract to come into existence between the insurer and the beneficiary upon his accepting the balance of the surrender value.[117] This new contract, born of the *stipulatio alteri,* is the source of the beneficiary's right to claim the proceeds against the insurer.[118] The policyholder has no role to play and does not feature at this stage of the process, so it makes no sense for the beneficiary to attempt to fill the policyholder's shoes.

In light of the difficulties mentioned above, the correct procedure should rather be more logical and practical than academically perfect. In fact, an academically perfect solution does not exist. The only way to ensure fairness is by placing the burden on the insurer to distribute the surrender value. Once the insurer is satisfied as to the remaining indebtedness of the loan agreement, it should pay only that amount to the financier. This discharges the insurer's duty towards the financier as security cessionary. The balance should be paid to the policyholder or nominated beneficiary as this discharges the insurer's duty in terms of the life insurance policy or *stipulatio alteri* respectively.[119]

(ii) Payment in case where the policy matures before the loan is due and payable

There is no reason why the position should not be dealt with in the same way as pledge as discussed above and inspired by the case of *Retmil Financial Services (Pty) Ltd v Sanlam Life Insurance Co Ltd*: If the policyholder dies or the policy matures before the secured debt has been satisfied, the solution is to be found in the obligationary agreement where the issue is usually expressly or tacitly addressed. If the obligationary agreement is silent on the issue, the insurer

[116] Van Niekerk 2007 *Juta's Business Law* 47-48.

[117] *Crookes v Watson* 288A *et seq*; *Hofer v Kevitt* 382; *Hees v Southern Life Association* 951A-B; *Wessels v De Jager* 928D-E; *Moonsamy v Nedcor Bank* 513.

[118] It is important bear in mind the *ratio* of the appeal court in *PPS Insurance Co Ltd and Others v Mkhabela* 2012 (3) SA 292 (SCA) 294C-G, 295A-B. The court spelled out that accepting a beneficiary *nomination* does not give the beneficiary an enforceable right to the policy proceeds. The beneficiary has only a mere *spes* until he accepts the *benefit* being policy proceeds.

[119] This view is also favoured by Scott 2007 *SA Merc LJ* 517 *cf* Van Niekerk 2008 *Juta's Insurance Law Bulletin* 76. It is only in the event of insolvency that the financier gains a benefit by relying on the fact that it is vested with *dominium* of the life policy.

should hold the policy proceeds in trust until either the loan is repaid or the policyholder defaults on loan repayments

(iii) Conclusion

In a case where either the financier is forced to surrender the policy, or the life policy becomes due and payable before the loan has been satisfied, the payment procedure and distribution of the proceeds should be the same regardless of whether a pledge or fiduciary security cession has been effected. This may not win academic favour, but it is the solution which makes the most practical sense.

4.4.4 Effect of insolvency

From the viewpoint of the financier, a fiduciary security cession has the advantage that it affords the financier a stronger position in the event of the policyholder's insolvency. This is so because complete *dominium* of the personal right vests squarely in the estate of the financier, and the insolvency of the policyholder will thus be of no consequence.[120] The financier is thus free to surrender the life policy in order to satisfy the outstanding debt.

As explained above, the financier is technically entitled to be paid the full surrender of the policy if it decides to surrender due to the fact that *dominium* has been completely transferred. The fact that the financier is entitled only to the amount outstanding must be kept in mind here. Thus, if the full surrender value is paid to the financier the problem once again is that the duty to pay and distribute the policy proceeds falls on the financier, and in addition, the beneficiary has no *locus standi* against the financier.

In accordance with the submissions above, the correct payment procedure in the event of the policyholder's insolvency is for the insurer to pay the financier only the amount outstanding under the secured debt and to distribute the balance to the insolvent estate or the nominated beneficiary as the case may be.

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[120] *Rothschild v Lowndes* 501 summed up the position as follows: "The matter, therefore, stands in this way. The cession of a right of action *in securitatem debiti* transfers that right to the cessionary as completely, so far as third parties are concerned, as an absolute cession would do. While the cession stands no right remains vested in the cedent which he can enforce against the debtor. His remedy is against the cessionary for payment of the balance, or for cancellation of the cession". See also *Mercatrust v Keepers Hosiery Suid-Afrika* 412. This is also unchallenged by academics including Floyd 370; Nienaber para 53; Van der Merwe *et al* 495-496; Davis 271-272 and Scott *Cession* 232-233.

Conversely, the drawback to this type of security cession from the policyholder's perspective is that in the event of the financier's insolvency, the policyholder is left in an undesirable position. Because the right to claim the policy proceeds falls into the insolvent estate of the financier, the policyholder only acquires a personal right against the insolvent estate for re-cession once he has satisfied the secured debt.[121]

If the trustee breaches the promise to re-cede the personal right, which decision may well be to the benefit of the general body of creditors, the policyholder would have a claim for contractual damages arising from the trustee's breach of the *pactum fiduciae*. What the policyholder receives as damages would be much less than the value of the personal right ceded as security. A claim for contractual damages against an insolvent estate is classified as a concurrent one and such creditors are usually paid only a dividend of their actual claim from the free residue of the insolvent estate.[122]

It has been suggested that it is unfair to treat the policyholder as an ordinary creditor of the financier's insolvent estate once he has satisfied the secured debt.[123] The reason for this is that it affords the trustee a stronger right than that which the financier had. As aforementioned, the financier is usually not permitted to cede the personal right or to enforce it unless the policyholder fails to repay the loan. Yet, on the financier's insolvency, even though the policyholder repays the debt, the trustee is permitted to do so.[124] The policyholder then acquires a mere concurrent claim for the value as damages once he has satisfied the secured debt.[125] In reality the policyholder will likely receive only a dividend of this value as damages.

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[121] *Trust Bank v Standard Bank* 189A; *Holzman v Knights Engineering & Precision Works* 792F and *Leyds v Noord-Westelike Koöperatiewe Landboumaatskappy* 771H; *Alexander v Standard Merchant Bank* 739A. See also Scott 1997 *THRHR* 184 *et seq*.

[122] See generally *Clark v Denny* (1884-1885) 4 EDC 300 and *Affinity Logic (Pty) Ltd v Fourie NO and Others* [2005] JOL 14898 (T). The free residue is the funds remaining after secured and preferent creditors respectively have been paid – this is confirmed in Sharrock *et al* 167; Floyd 370; Harker 1981 *SALJ* 67; Harker 1986 *SALJ* 205; Clarke & van Heerden 1987 *SALJ* 242; Scott *Cession* 232-2 and SALC *Project 46* 98-99.

[123] Harker 1981 *SALJ* 67 and Harker 1986 *SALJ* 205.

[124] A *pactum de non cedendo* does not bind the trustee on insolvency so including it in addition to the *pactum fiduciae* is unhelpful. See *Paiges v Van Ryn Gold Mine Estates* 616; *Estate Fitzpatrick v Estate Frankel and Others; Denoon and Another v Estate Frankel and Others* 1943 AD 207 218-219; *Lithins v Laeveldse Koöperasie Bpk and Another* 1989 (3) SA 891 (T) 895H and *Any Name 451 (Pty) Ltd v Capespan (Pty) Ltd* 2007 JOL 19402 (C) 26. *Cf Capespan (Pty) Ltd v Any Name 451 (Pty) Ltd* 2008 (4) SA 510 (C) 512J, 518A-C where it was explained that the trustee may not necessarily be unbound to a *pactum de non cedendo* in every case. See in addition Sunkel 176-183 and Sunkel 2010 *Stell LR* 466 where this issue is fully considered and criticised.

[125] This is because a claim for damages is only a concurrent one upon insolvency. This is also considered in Harker 1981 *SALJ* 67 and Harker 1986 *SALJ* 205.

This point may be countered by the argument that the *pactum fiduciae* is binding *inter partes* only; therefore it would not affect the trustee on the financier's insolvency.[126] The issue of the financier's insolvency has not been discussed in much detail in the case law, and the exact intricacies are not yet settled. That having been said, it may be helpful to keep in mind that while the policyholder is not strongly protected on the financier's insolvency, this eventuality is usually not an issue if the financier is an established and reputable bank or lending institution.

4.4.5 Fiduciary security cession of life policy to insurer

If the insurer is also in the business of extending credit facilities, it would not be able to extend credit to the policyholder on the security of its own policy. Because a fiduciary security cession brings about a complete transfer of the personal right, a merger would result, as the insurer would effectively be accepting its own property as security.[127]

4.4.6 Multiple cessions

From the point of view of the policyholder, the disadvantage of a fiduciary security cession is that it does not allow a subsequent cession of the personal right to secure an additional debt in the way a pledge would. This is because the policyholder is wholly divested of the right.[128] Nothing stops the policyholder from ceding the personal right to demand re-cession as security for additional credit, yet the value of this personal right may be negligible.[129]

4.5 Recommendation by the South African Law Reform Commission

In 1982 the South African Law Reform Commission embarked on an investigation that considered not only the use of corporeal property as a means of security, but also the use of incorporeal property as security. As far as the latter issue was concerned, one of the main considerations of the Commission was whether this area of the law of cession should be codified. In 1987 the

[126] This argument was put forward in Scott 1988 *THRHR* 446.

[127] In *Roman Catholic Church v Southern Life Association* the Appeal Court adopted the pledge construction since it found that merger had not occurred. Reinecke 1992 *TSAR* 677 and Scott 1993 *THRHR* 686 690-691 confirm this.

[128] This is emphasised in Henckert 1993 *Insurance & Tax* 33 and Reinecke *et al* para 438.

[129] Above.

Commission published a working paper, known as "Working Paper 23". This Paper contained its draft proposals, which was then open for public comment.[130]

A proposal in the working paper was that a pledge should be recognised and regulated by statute to the exclusion of the fiduciary security cession construction.[131] Furthermore, it was proposed that only notification in writing could bind a debtor (in this context the insurer) to a security cession and that delivery of any documents functioned merely as evidence of the security cession. Although the personal right was to vest in the cedent's estate on his insolvency, it was suggested that the cessionary should acquire a secured claim against the insolvent estate.[132]

In 1991, after evaluating the comments received, the Commission compiled a report with its findings and recommendations. According to the Commission, the proposal to abolish the fiduciary security cession was not well received. The Commission reported that "…neither the academics nor the commercial world is amenable to such a step".[133] Apparently, there was "strong pressure" from public comment to preserve the fiduciary security cession that "could not be ignored".[134]

In response to this, the Commission considered the possibility of codifying the law governing a pledge, without also abolishing the option of a fiduciary security cession.[135] The Commission eventually decided that if the fiduciary security cession should not be done away with, it was pointless to regulate only one construction by statute and not the other.[136]

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130 SALC *Project 46* 1-2. Van der Linde A "Sessie in securitatem debiti: Verslag van Suid-Afrikaanse Regskommissie: Aanbeveling" 1997 *De Jure* 338 provides a helpful overview of the investigation by the Commission.

131 The proposed legislation that was to govern a security "cession" by pledge was the Security by Means of Movable Property Act.

132 SALC *Project 46* 124 (annexure A para 4 of the working paper as contained in the proposed Giving of Security by Means of Movable Property Bill).

133 SALC *Project 46* 128.

134 Above.

135 SALC *Project 46* 124. This was considered because, according to the Commission's report, "the response of the commercial world was mainly positive" to the proposed codification of the pledge construction.

136 SALC *Project 46* 128.

The report consequently concluded that no statutory intervention should take place.[137] The reason seems to be that legislation would interfere with the "natural development" of security cessions. Accordingly the natural development should rather unfold under the scrutiny of the courts where the needs of practice can influence this development.[138] When the Security by Means of Movable Property Act[139] came into effect in 1993 the use of incorporeal property as a form of security was excluded from its scope of application.

4.6 Policyholder Protection Rules

In 2004 the Policyholder Protection Rules were added as a schedule to the Long-Term Insurance Act in accordance with s 62(5) of the Act requiring such rules to be enacted.[140] The Policyholder Protection Rules, as stated in Rule 1, seek to achieve the following objective:

> [T]o ensure that policies…are entered into, executed and enforced in accordance with sound insurance principles and practice in the interests of the parties and in the public interest.

In respect of policy loans and cessions, Rule 18(f) provides that upon receiving notice of a cession, an insurer must inform the policyholder of the following:

1. The fact that the cession is recorded in the insurer's records;
2. The nature of the cession, in other words, whether it is an outright cession or a cession *in securitatem debiti*; and
3. The name of the cessionary.[141]

It is important to note that if notice of cession was not sent, the insurer would be unable to comply with Rule 18(f). Unfortunately, the Policyholder Protection Rules make no reference to a preferred construction of a security cession, and neither do the Rules shed any light on any of the questions and uncertainties raised in this Chapter.

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[137] SALC *Project 46* 29.

[138] SALC *Project 46* 128-129.

[139] Security by Means of Movable Property Act 57 of 1993.

[140] In GN 1129 *GG* 26854 of 30 September 2004. The Policyholder Protection Rules deal with the following issues: basic rules for direct marketers; agreements with intermediaries; cancellations of policies and cooling-off; fund policies; assistance business group schemes; additional insurer duties; miscellaneous matters.

[141] Rule 20 provides that a contravention or failure to comply with the Policyholder Protection Rules is an offence punishable by the imposing of a fine as set out in s 67(1)(c) of the Long-Term Insurance Act.

4.7 National Credit Act

The National Credit Act[142] regulates credit agreements primarily where credit was given for the purchase of corporeal property, although it does find application to a limited extent where a loan has been secured by the rights under a life policy.[143]

Section 106(1) of the Act stipulates that a financier may require the consumer (the money-lender) to maintain credit life insurance during the term of the credit agreement. Section 106(4)(a) allows the financier to arrange a particular policy that the consumer should take out a new, but also allows the consumer to use an already existing life policy as security.

The Act regulates the position slightly differently depending on whether a life policy was taken out a-new or was pre-existing. In the former case section 106(5)(d) stipulates that the financier:

> ...[M]ust be a loss payee under the policy up to the settlement value at the occurrence of an insured contingency only and any remaining proceeds of the policy must be paid to the consumer.

In other words, the section provides that the financier must be nominated as a kind of beneficiary, but only to the extent of the outstanding indebtedness under the loan agreement. Since the life policy would have been arranged for the sole purpose of securing the loan, the policyholder (the consumer) would not have nominated a beneficiary and any remaining balance is to be paid to the policyholder.

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[142] Act 34 of 2005.

[143] In section 1 of the Act "credit insurance" is defined as "an agreement between an insurer, on one hand, and a credit provider or a consumer or both, on the other hand, in terms of which the insurer agrees to pay a benefit upon the occurrence of a specified contingency, primarily for the purpose of satisfying all or part of the consumer's liability to the credit provider under a credit agreement as at the time that the specified contingency occurs, and includes a credit life insurance agreement...". A "credit life insurance agreement" includes "cover payable in the event of a consumer's death, disability, terminal illness, unemployment, or other insurable risk that is likely to impair the consumer's ability to earn an income or meet the obligations under a credit agreement". See also the section 1 definition of "secured loan" which is defined as "an agreement, irrespective of its form...in terms of which a person advances money or advances credit to another, and retains, or receives a pledge or cession of the title to any movable property or other thing of value as security for all amounts due under that agreement".

In a case where the consumer uses a pre-existing life policy as security, section 106(6)(b) permits the financier to require the consumer to notify and instruct the insurer in writing as follows:

> …[N]aming the credit provider as a loss payee under the policy up to the settlement value at the happening of an insured contingency, and requiring the insurer, if an insured event occurs, to settle the consumer's obligation under the credit agreement as a first charge against the proceeds of that policy at any time during the term of the credit agreement.

Section 106(6) regulates the position in the same manner as section 106(5) barring one difference: Section 106(6) provides that the financier as loss payee must be a first charge against the policy proceeds. Since the consumer uses a pre-existing life policy, a beneficiary may have already been nominated. Due to this possibility subsection 6 ensures that the financier will be paid any outstanding amount in priority to the nominated beneficiary. In this way the bank is a kind of preferred beneficiary to the extent of the indebtedness.

Section 106 does nothing more than oblige the insurer to pay the applicable portion of the policy proceeds to the financier upon death or at maturity, if this occurs before the loan has been repaid in full. From a practical perspective, section 106 is an unnecessary duplication, since the obligationary agreement (the loan agreement) would usually provide for an instance where the policy matures or death occurs before the loan has been repaid.[144]

Furthermore, in a case where the consumer defaults on loan repayments, section 129 of the National Credit Act prescribes the procedure that the financier must comply with before enforcing the policy. The financier is required to send notice before enforcing the policy but may also, *inter alia*, negotiate with the consumer or propose debt counselling.

Once notice has been sent, section 130 allows the financier to approach the court in order to enforce the policy. Sections 129 and 130 had to be created in order for the financier to enforce the policy since the Act places the financier in the position of a beneficiary, who does not have the power to enforce the life policy.

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[144] In reality the financier may, however, not wish to settle the indebtedness at the death or maturity of the policy as was the case in *Retmil Financial Services v Sanlam Life Insurance Co*.

When the rights under a life policy have been pledged or ceded as security, the intention of the parties is that the life policy may be enforced if the policyholder defaults on loan repayments. It is not necessary for the financier to waste time and incur the costs of a lawsuit in order to enforce the life policy, since the financier automatically receives this right.

The provisions in the National Credit Act effectively muddy the waters of security cessions by providing that the financier, who is already a pledgee or cessionary of the rights under the life policy, must also be made the loss payee. Furthermore, the Act touches on one or two issues pertaining to security cessions, but is silent on all the other areas of legal uncertainty.[145]

Since the National Credit Act addresses some issues which are already found in the common law principles of security cession it results in duplication. Duplication of legal principles usually arises to compensate for existing principles which are problematic. This indicates that the law of security cession needs attention. If the principles governing security cession enjoyed the legal certainty that is lacking, there would be no need for this kind of duplication. It would have been better if the Legislator had made no reference to security cessions the National Credit Act and had instead drafted specific legislation dealing solely with security cessions as done in Chapter 7 below.

4.8 Conclusion

There should in theory be two distinct methods of using the rights under a life policy for security purposes: A security cession or a pledge. There should be only one construction of a security *cession*, that is, a fiduciary security cession. In other words, if parties wish to *cede* the rights under a life policy as security, the principles of a fiduciary security cession should govern the transaction.

If parties wish to use the rights under a life policy as the object of security, but do not intend that the rights should vest in the estate of the financier, such rights should be pledged as security. Accordingly, the traditional principles of pledge should, as far as possible, govern the transaction.[146]

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[145] Because the National Credit Act adds little to the common law principles of security cession, practitioners in the banking industry welcome legislation of security cessions – see Chapter 6 below.

[146] This analogy should, however, not be stretched too far since it can lead to illogical results (see 4.3.1(ii) above as well as 5.4 in Chapter 5 below). South African Courts are sometimes guilty of this – for instance in the case of *MEC v North Central & South Central Local Councils* 21 *et seq* where the court treated a "cession" by pledge in exactly the same manner as traditional pledge.

CHAPTER FIVE
FOREIGN PERSPECTIVE

5.1 Introduction

The *lex mercatoria* pertaining to insurance dealt mainly with marine insurance and never became established in South African in its entirety.[1] As a consequence thereof, South African courts have often made use of English Law, and to a lesser extent, United States Law, to supplement the South African Law of Insurance.[2]

South African Appeal Courts consider both English and United States Law to be sources of strong persuasive authority where the South African law is lacking.[3] Since English and United States Law are sources of strong persuasive authority it made sense to examine these legal systems.

In addition to being persuasive authority, this Chapter explores the approach of English Law for the reason that the South African Law of Insurance has over the years been supplemented by English Law as explained above, and thus an English solution could be easily adopted into our law.

Further, although the law of the United States of America is very different from South African Law, it is also for this reason that it has been considered. The Unites States legal system seems to be one that is much over-looked by South African academics and not really discussed in the literature. The United States often adopts an interesting approach to legal issues which is well worth considering. The state of New York was selected because it is the commercial hub of the United States of America.

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[1] Reinecke MFB, Van der Merwe S, Van Niekerk JP & Havenga P *General Principles of Insurance Law* (2002) para 25.

[2] *Law Union & Rock Insurance Co Ltd v De Wet* 1918 AD 663 668; *Scottish Union & National Insurance Co Ltd v Native Recruiting Corporation Ltd* 1934 AD 435 469; *Mutual & Federal Insurance Co Ltd v Oudtshoorn Municipality* 1985 (1) SA 419 (A).

[3] *Lewis Ltd v Norwich Union Fire Insurance Co Ltd* 1916 AD 509 520-522; *Scottish Union & National Insurance v Native Recruiting Corporation* 469; *Law Union & Rock Insurance v De Wet* 668: "The American Reports no doubt constitute a storehouse of learning upon questions connected with insurance… [however] there is no need to examine them; for the English rule….is clear, and we shall do well to follow it." Reinecke et al para 26 add that English and United State Law are persuasive authority "even where these jurisdictions do not apply by force of law".

For interest sake, it is worth mentioning that the legal position in civil law jurisdictions such as German Law and Dutch Law have been examined quite extensively over the years.[4] These systems have furthermore not been included in this comparative Chapter due to the inaccessibility of sources.

5.2 English Law

(i) Overview

Traditionally, the English common law did not make provision for the assignment of choses in action (personal rights).[5] Being a chose in action, assignment of the rights under a life policy was thus included in this restriction. The law of equity, on the other hand, did recognise an assignment of a chose in action and rights under a life policy could thus be assigned at equity.[6]

The common law later made a specific allowance in the form of the Policies of Assurance Act 1867 for the assignment of rights under a life policy only as an exception to the prevailing rule. The general common law eventually caught up to the more flexible approach taken in equity in 1873 with the enactment of the Judicature Act, which was later replaced by the Law of Property Act 1925.[7]

In present English law, the Law of Property Act applies to the assignment of all choses in action, but the Policies of Assurance Act is applicable only to the assignment of rights under life policies. Accordingly the (legal) assignment of the rights under a life policy may be assigned in accordance with either Act. The Law of Property Act, however, only applies to "absolute assignments", so if the

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[4] See the earlier works by Scott S "Algehele sekerheidsessies" 1988 *THRHR* 434; Scott S "Evaluation of security by means of claims: Problems and possible solutions: Section A: Problems" 1997 *THRHR* 179; Scott S "Evaluation of security by means of claims: Problems and possible solutions: Section B: Possible solutions" (continued) 1997 *THRHR* 434; Scott S "Evaluation of security by means of claims: Problems and possible solutions: Section C: Codification of the law of cession" (continued) 1998 *THRHR* 88; Scott S "Evaluation of security by means of claims: Problems and possible solutions: Section C: Codification of the law of cession" 1997 *THRHR* 633.

[5] *Torkington v Magee* [1902] 2 KB 427 430-431. A brief historical background is discussed in Hempel C & Brown MA (1998) *International Insurance Law Review* 252.

[6] *Torkington v Magee* 430-431*; In re Moore* [1878] 8 Ch D 519 520; *Raiffeisen Zentralbank Österreich v Five Star Trading and Others* [2001] QB 851. See also the discussion in McGee A *The Modern Law of Insurance* (2001) 197-198 and Bridge M (2009) *Law Quarterly Review* 671

[7] *Torkington v Magee* 430-432 and Hempel & Brown (1998) *International Insurance Law Review* 254.

rights under a life policy are partially assigned as security, this Act will not find application.[8] The Acts do not regulate every aspect of security assignments and in such instances regard must be had to the case law.[9]

(ii) Forms of security

The rights under a life policy may be used to secure a loan by mortgage or charge. The use of this terminology is not always consistently used in English law.[10] The word "charge" has at times been indiscriminately used without specifying whether it is intended to be understood in the broad or narrow sense of the word.[11] "Charge" in the broad sense of the word refers to an entitlement to appropriate an asset in satisfaction of a debt, which includes "charge" in the narrow sense of the word as explained below, as well as mortgage.[12]

The use of the word in the narrow sense refers to a type of security where a life policy is encumbered in favour of a financier. Ownership of the policy remains vested in the estate of the policyholder and the financier may look to the asset to discharge the secured debt if necessary.[13] A mortgage is a form of security where ownership is transferred to the financier and does not remain vested in the policyholder. For the sake of clarity, the word "charge" has been used here only in the narrow sense of the word.

Pledge of the rights under a life policy as we know it in South Africa, is not possible in English law because the use of pledge as a security measure may only be used with corporeal property as it

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[8] For the sake of clarity, a partial assignment is where the right to claim the proceeds of the life policy is assigned only to the extent of the policyholder's indebtedness. An absolute assignment does not preclude a security assignment – *Raiffeisen Zentralbank Österreich v Five Star Trading* 856. See also Legh-Jones N, Birds J & Owen D (Eds) *MacGillivray on Insurance Law (relating to all risks other than marine)* 11ed (2008) 712, 715 and Merkin R *Collinvaux's Law of Insurance* 9ed (2010) 778.

[9] The Acts are concerned more with the creation of a legal assignment and the priority of assignees where there has been more than one assignment of the rights under the same policy. Most other aspects of a security assignment is left up to the courts to develop.

[10] For example in *Walter & Sullivan v J Murphy & Sons* [1955] 2 QB 584 588 where Parker LJ spoke of "an equitable assignment by way of charge".

[11] Goode R *Legal Problems of Credit and Security* 3ed (2003) 37 and Tolhurst G *The Assignment of Contractual Rights* (2006) 50-51 are but two academics that have articulated this discrepancy.

[12] As explained by Goode 36-37 and Tolhurst 50-51.

[13] See Goode 36-37 and Tolhurst 49-52.

requires possession.[14] A negotiable instrument (or a "documentary intangible") is an exception to this rule as the rights therein are embodied in a document. The document (as a piece of paper) embodying the rights can thus be validly pledged and delivered as security.[15] Since English law does not recognise a life policy as a documentary intangible, a life policy may not be pledged as security.[16]

A more detailed discussion of mortgage and charge follows.

5.2.1 Mortgage

The rights under a life policy may be used as security by way of mortgage. A mortgage is a means of transferring ownership of an asset for reason of security and does not require delivery or possession.[17] Mortgage of a life policy is effected simply by way of assignment, and therefore the assignment of the rights under a life policy for the purpose of security is called a mortgage.[18] The concept of mortgage in English Law very closely resembles a fiduciary security cession in South African Law.

If a life policy has been mortgaged, the policyholder is entitled to a re-assignment of the rights under the life policy on repayment of the secured debt.[19] This is referred to as the "right of redemption".[20]

The right or equity of redemption is an essential element of mortgage despite any provision in a mortgage to the contrary.[21] Accordingly, there must be no "clogs or fetters" on the right or equity of

[14] The position is set out in Goode 31-32, 34.

[15] Above.

[16] Above.

[17] *Santley v Wilde* [1899] 2 Ch 474; *Noakes & Co v Rice* [1902] AC 24 28. See also Jefferies T "Mortgage" in Lord Mackay (Ed) *Halsbury's Laws of England* 5ed (2010) vol 77 para 101: "A mortgage is a disposition of property as security for a debt…[and] may be effected by…an assignment of a chose or thing in action". A mortgage can also be used as a measure of security in the case of immovable property which is actually where this security measure has its roots.

[18] As confirmed in the literature Birds J *Birds' Modern Insurance Law* 8ed (2010) 366; Goode 35, 88; Legh-Jones *et al* 727.

[19] *Santley v Wilde* 474-475. See further Birds 366; Jefferies para 101, 107.

[20] The right of redemption is sometimes referred to as the "equitable right of redemption" since the right was first recognised by the Courts of Equity. See *G & C Kreglinger v New Patagonia Meat and Cold Storage Co* [1914] AC 25 for a detailed discussion.

redemption.[22] Any provision which acts as a clog and prejudicially affects the policyholder's right to re-assignment is void and unenforceable.[23]

Further, the policyholder may sell his right or equity of redemption, in which case it can be considered as extinguished.[24] The policyholder's right to re-assignment is also extinguished if the financier is forced to sell or surrender the life policy.[25]

Upon the policyholder's insolvency, the life policy falls into the insolvent estate, but if the life policy has been mortgaged, the right of redemption nonetheless falls into the insolvent estate.[26] It seems as though the trustee may redeem the rights under the life policy after satisfying the secured debt. Thereafter, the trustee may then surrender or sell the life policy and distribute the proceeds amongst the creditors. [27]

The English concept of mortgaging a life policy is very similar to a fiduciary security cession in South African law. In both instances the policyholder is completely divested of the rights under the life policy, but with the goal that he will be re-vested therewith upon satisfaction of the secured debt.

The difference is that in English law mortgaging a life policy is not accompanied by many of the problems experienced in the South African law of security cessions. This is mainly because a legal

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[21] *Santley v Wilde* 475; *Noakes & Co v Rice* 28; *G & C Kreglinger v New Patagonia Meat and Cold Storage Co* 25 *et seq*; *Jones v Morgan* [2001] 82 P & CR DG20 38.

[22] *Santley v Wilde* 475; *Noakes & Co v Rice* 28; *G & C Kreglinger v New Patagonia Meat and Cold Storage Co* 25 *et seq*; *Jones v Morgan* 38.

[23] *Santley v Wilde* 475; *Noakes & Co v Rice* 28; *G & C Kreglinger v New Patagonia Meat and Cold Storage Co* 25 *et seq*; *Jones v Morgan* 38. Jefferies para 317 adds that no agreement between the financier and the policyholder can make the life policy "irredeemable".

[24] *Pearce v Morris* [1869] 5 Ch App 227; *John Charles Salt & Sir Henry Whatley Tyler v The Marques of Northampton* [1892] AC 1 19. The issue is also addressed in Jefferies 313, 334 and Davies BPA *Houseman's Law of Life Assurance* 9ed (1978) 152.

[25] Jefferies para 334-335, but of course in such a case the policyholder is entitled to any surplus in the policy proceeds once the secured debt has been satisfied.

[26] Section 283(1)(a) of the Insolvency Act 1986. Cases illustrating this include: *Cohen v Mitchell* [1890] 25 QBD 262 268; *Weddell and Another v JA Pearce & Major and Another* [1988] Ch 26 32; *Krasner v Dennison and Others, Lawrence v Lesser* [2001] Ch 76. See further Jefferies para 314 and Davies 171.

[27] Above.

assignment is regulated by statute.[28] Likewise, an equitable assignment (which is not regulated by statute) does not appear to be problematic, since in modern English law the difference between a legal and an equitable assignment is mainly procedural.[29]

5.2.1.1 Equitable mortgage

Due to the two parallel English systems of common law and equity, a life policy may be assigned as security at law or in equity[30] by mortgage.[31]

Most mortgages of life policies are made in accordance with legislation, but the legislation has not abolished the possibility of an equitable mortgage.[32] In fact, a purported legal mortgage that does not comply with the statutory requirements will nonetheless give rise to a valid equitable mortgage.[33]

The main difference between a legal and an equitable mortgage is that the statutory recognition of legal mortgage has afforded the financier (assignee) better procedural remedies should it become necessary to institute legal action against the insurer. In such circumstances the financier may sue the insurer in its own name.[34] The financier of an equitable mortgage cannot sue the insurer in its own name, but can either request permission from the policyholder to bring proceedings in his name, or the financier can join the policyholder to the proceedings as plaintiff or defendant as the case may be.[35]

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[28] Problems may, however, creep in with successive mortgages of the rights under the same life policy – see below for a further discussion.

[29] This may be illustrated in *Walter & Sullivan v Murphy* 588; *Burlinson v Hall* [1884] 12 QBD 347; *In re Steel Wing Co* [1921] 1 Ch 349.

[30] As mentioned above, the difference between an assignment in law and one in equity has very little significance in practice, especially as far as competing assignments are concerned. See below for a more detailed discussion.

[31] Since mortgage occurs by a security assignment, the terms "mortgage" and "assignment" may rightly be used interchangeably. For the sake of consistency, in this work the term "mortgage" has been used as far as possible.

[32] *William Brandt's Sons & Co v Dunlop Rubber Co* [1905] AC 454 461.

[33] Section 5 of the Law of Property Act 1925; *Newman v Newman* (1884) 28 Ch D 647; *William Brandt's Sons & Co v Dunlop Rubber Co* 461; *Raiffeisen Zentralbank Österreich v Five Star Trading* 855. See also Bridge M (2009) *Law Quarterly Review* 671.

[34] *Walter & Sullivan v Murphy* 588; *Burlinson v Hall* 349; *In re Steel Wing Co* 352.

[35] *Walter & Sullivan v Murphy* 588. *Cf Weddell v JA Pearce & Major* 40-41 and *Raiffeisen Zentralbank Österreich v Five Star Trading* 850. The latter two cases illustrate that in modern practice, if there is no risk of the

(i) Methods of effecting an equitable mortgage

If the policyholder and financier have intended that the rights under a life policy be legally mortgaged, an equitable mortgage may occur instead if, *inter alia*:[36]

(a) The rights under a future life policy are assigned;

(b) No transfer agreement or actual transfer has been effected;

(c) There is an agreement indicating an intention to transfer if necessary, but no transfer presently occurs;

(d) A transfer is effected, but is not made in accordance with statutory requirements (such as an absence of writing or notice to the insurer);

(e) A transfer is effected, but is made to a third party who acts as trustee for the financier;

(f) Only a partial assignment has occurred insofar as it is required for security purposes and not assignment of the complete right.

To effect an equitable mortgage the policyholder must merely manifest a clear intention to assign.[37] This intention may be expressed orally or in writing.[38] The intention may also be implied by the surrounding circumstances, most typically if the policy document is delivered to the financier.[39] The intention to assign, however, need not be accompanied by notice to the insurer, or delivery of the policy document to the financier, or any other act.[40]

The possibility of creating a trust as a mechanism of security is something that deserves brief mention here. To create a trust, the policyholder declares himself a trustee of the life policy to be

policyholder bringing his own claim against the insurer, then the assignee need not sue in the policyholder's name or join him to the law suit.

[36] Policies of Assurance Act 1867 sections 1, 3 and 5 and section 136 of the Law of Property Act. This is also discussed in Merkin 646 and Hempel & Brown (1998) *International Insurance Law Review* 254.

[37] *Edward Tailby v The Official Receiver (Trustee of the Property of HG Izon, A Bankrupt)* [1888] 13 App Cas 523 543; *William Brandt's Sons & Co v Dunlop Rubber Co* 462. See also *Crossley v City of Glasgow Life Assurance Co* [1876] 4 Ch D 421 where the life policies were delivered to the financier, but he was content to keep the policies and did not take assignment. Here Jessel MR held that because the financier had no intention to take assignment, an equitable mortgage had not come into existence.

[38] *Row v Dawson* [1749] Ves Sen 331 332; *Gurnell v Gardener* [1863] 4 Giff 626. In *William Brandt's Sons & Co v Dunlop Rubber Co* 462 the Judge explained that the language use is immaterial if the meaning of it is plain, and that the most important question is whether the debtor understood that the personal right was mortgaged to another

[39] *Row v Dawson* 333. This is well documented by academics, notably Goode 96; Merkin 646 and Legh-Jones *et al* 716-718.

[40] Above.

held for the financier. Alternatively, the life policy is transferred to a third party who acts as trustee and holds the policy for the financier. The creation of a trust is not an additional form of security in English law, but simply an alternative form of an equitable mortgage.[41]

(ii) Notice and effect of equitable mortgage

An equitable mortgage is valid between the policyholder and financier *inter se*, but the insurer obviously cannot be expected to abide by the mortgage until it has knowledge thereof.[42] Notwithstanding this, the financier would be prudent to give notice of the mortgage to the insurer – even if the mortgage is intended to be an equitable one, as an absence of notice affects the priorities of mortgagees in the case of successive mortgages of the same right.[43]

(iii) Surrender and maturity

Obviously, without notice the insurer will pay the policyholder when the policy matures. If the policyholder has not discharged the debt by this time, then he is accountable to the financier for the remaining indebtedness. Furthermore, without notice of the equitable mortgage, the insurer may rightly refuse any attempt by the financier to surrender the policy.

(iv) Right of redemption

As mentioned above, the mortgage of a life policy is subject to a right of redemption. If the policyholder manages to discharge the debt before the policy matures, he is entitled to a re-assignment so that his estate is re-vested with ownership of the life policy.[44]

(v) Position of the nominated beneficiary

The nominated beneficiary's right to receive the policy proceeds must be subject to the financier's right to receive the policy proceeds, since the rights under life policy vest in it after a mortgage has taken place. Once the outstanding debt has been discharged, any surplus fund should be paid to the beneficiary.

[41] As pointed out by Goode 37.

[42] *In re Hennessy* [1842] IR 5 Eq 259; *In Re Foster* [1873] IR 7 Eq 294; *In re Weniger's Policy* (1910) 2 Ch 291.

[43] *In re Hennessy* 259; *In Re Foster* 294; *In re Weniger's Policy* 296.

[44] *Whitely v Delaney* [1914] AC 132; *Spencer v Clarke* (1978) 9 Ch D 137; *Dearle v Hall* (1828) 3 Russ 1; *Newman v Newman* 674; *Re Weniger's Policy* 291.

(vi) Priority in multiple equitable mortgages

Where all competing mortgages are equitable, the financier whose mortgage was created first has priority. This rule applies unless a financier of a subsequent equitable mortgage, who at the time of creating the mortgage, had no actual or constructive knowledge of the earlier equitable mortgage, and was the first to give the insurer notice.[45] See 5.2.1.2 (viii) below for a discussion on competing legal and equitable mortgages.

(vii) Bankruptcy

Upon bankruptcy, the mortgagor's estate, including the right of redemption, vests in his trustee.[46] The trustee takes the rights under the life policy subject to all encumbrances existing at the commencement of bankruptcy and is not put in a better position than that of the bankrupt mortgagor.[47]

5.2.1.2 Legal mortgage

The legal mortgage of the rights under a life policy may occur if the assignment complies with the requirements as set out in the Law of Property Act or the Policies of Assurance Act. To be effective, a legal mortgage may comply with the provisions in either Act as an alternative to accomplish the same outcome.[48]

(i) Methods of effecting a legal mortgage

The requirements for a valid legal mortgage under the Policies of Assurance Act are as follows:

1. The financier who claims to be the mortgagee must be entitled to the rights under the life policy in equity.[49] This requirement simply means that the financier must also be the mortgagee in equity in priority to any other equitable mortgages, if any exist. This

[45] *Spencer v Clarke* 137; *Dearle v Hall* 1; *Newman v Newman* 674; *In re Weniger's Policy* 291.

[46] Section 283(1)(a) of the Insolvency Act 1986 states that the bankrupt's estate comprises of all property belonging to or vesting in the bankrupt at the commencement of bankruptcy. Section 306(1) states that the bankrupt's estate vests in the trustee immediately upon his appointment. The cases of *Cohen v Mitchell* 268; *Weddell v JA Pearce & Major* 32; *Krasner v Dennison* 76 illustrate this.

[47] As laid down in *Newman v Newman* 674; *In re Wallis* [1902] 1 KB 719 720; *In re Anderson* [1911] 1 KB 896 903-904.

[48] This is noted by Merkin 778 and Birds 337.

[49] Section 1 of the Policies of Assurance Act.

requirement functions to rank competing mortgagees of the same right by not ignoring a prior equitable mortgage.[50]

2. The mortgage must be made either by endorsement on the actual life policy or by a separate instrument to the effect of the words set out in the schedule of the Act.[51] Invariably, this requirement forces the mortgage to be in writing.

3. Written notice of the mortgage must be given to the insurer.[52] The onus of notice rests on the financier (mortgagee). Although the Act does not impose any penalties for failure to give notice, the insurer cannot be held liable by the financier if it pays the policy proceeds to the wrong party in the absence of notice.[53]

The requirements for a valid legal mortgage under section 136(1) of the Law of Property Act are similar to those under the Policies of Assurance Act and are also made subject to prior equitable mortgages:

1. The assignment must be absolute and in writing and must not purport to be by charge only.[54] If the rights under a life policy are assigned as security for a debt, a complete assignment must take place, albeit the assignment is subject to the express or implied provision of redemption.[55] This requirement serves to prohibit a purported legal "assignment" where the true transaction is actually one of charge where no rights are transferred.[56]

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[50] See below for a further discussion of competing assignments of the same right.

[51] Section 5 of the Policies of Assurance Act.

[52] Section 3 of the Policies of Assurance Act. In terms of section 6 of the Act the insurer is obliged to furnish the financier with a written receipt of notice if so requested. This is an effective way of allowing the financier to keep an indisputable record of the fact that notice was duly sent and received.

[53] Merkin 779 and McGee 202 highlight this obvious consequence of no notice.

[54] Section 136 of the Law of Property Act; *Burlinson v Hall* 349-350; *Tancred and Others v Delagoa Bay & East Africa Railway Co* [1889] 23 QBD 239 242; *In re Steel Wing Co* 352,354; *Jones v Link Financial Ltd* [2012] EWHC 2402 QB 257.

[55] *Raiffeisen Zentralbank Österreich v Five Star Trading* 856; *Jones v Link Financial Ltd* 257. See in addition Hempel & Brown (1998) *International Insurance Law Review* 254.

[56] *Forster v Baker* [1910] 2 KB 636; *In re Steel Wing Co* 352, 354.

2. Express notice in writing must be given to the insurer. Again, notice to the insurer must be given by the financier (assignee).[57]

In addition to the compliance with either of the abovementioned Acts, the life policy may be delivered to the financier with a memorandum of deposit that sets out the extent and conditions of the security for which it functions.[58] If the life policy is delivered without a memorandum, the extent and conditions of the security will be determined by the intentions of the parties and surrounding circumstances.[59]

(ii) Effect of legal mortgage

After a legal assignment in compliance with either Act, the financier is entitled to enforce its rights against the insurer if necessary, as the rights under the life policy are no longer an asset in the policyholder's estate.[60] Accordingly, any lawsuit against the insurer should be brought in the name of the financier.[61]

Although the premiums would usually still be paid by the policyholder, any dispute arising from non-payment is of no concern to the insurer. Non-payment of premiums is a breach of the mortgage agreement and the financier may surrender the life policy or sell it to discharge the remaining indebtedness.[62]

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[57] Section 136 of the Law of Property Act. See also *Raiffeisen Zentralbank Österreich v Five Star Trading* 856; *Jones v Link Financial Ltd* 257.

[58] Legh-Jones *et al* 728.

[59] Legh-Jones *et al* 728. *Cf* McGee 436 who points out that this does not appear to be usual practice. The extent and conditions may just as well be stated in the transfer agreement.

[60] The whole right has been transferred as required by the Law of Property Act and the Policies of Assurance Act. McGee 202 also emphasises this.

[61] Policies of Assurance Act s3. *Raiffeisen Zentralbank Österreich v Five Star Trading* 856; *Jones v Link Financial Ltd* 257. See also Bridge M (2009) *Law Quarterly Review* 671 *et seq*.

[62] Section 103 Law of Property Act. *Dormay v Borrodaile* [1847] 10 Beav 335. The court in *Weldon v GRE Linked Life Assurance Ltd* [2000] WL 1741480 QB para 19 *et seq* stated that if a life policy is wholly transferred then the duty to pay the premiums usually follows. If the rights under the life policy are merely assigned then the implied intention, which is often expressly stipulated, is for the assignor to continue paying the premiums. This is all the more the case in a security assignment, since the policyholder mortgagor always retains the intention to redeem the policy once the security has been discharged. See also Legh-Jones *et al* 733 *et seq* for a more detailed discussion of the various remedies available to the financier upon default of the policyholder.

(iii) Notice

Until notice of the assignment has been given to the insurer, it is not obliged to deal with the financier and should insist on dealing with the policyholder with whom it has contracted.[63] If the insurer pays the policyholder when notice was duly given, it does so at its own peril.[64] Should the insurer pay the policy proceeds to the policyholder where notice was not sent, such payment amounts to a good discharge and the financier will then have to look to the policyholder for payment.[65]

(iv) Surrender and maturity

If the life policy is surrendered or matures before the loan has been repaid, the insurer must pay the policy proceeds to the first financier of which it has knowledge.[66] If any balance remains, it is the financier who is obliged to pay this balance to the policyholder. The insurer is consequently required to account to the financier alone and is not concerned with the amount of the policyholder's indebtedness.[67]

(v) Right of redemption

The same principles applying to an equitable mortgage apply here.

(vi) Position of the nominated beneficiary

The same principles applying to an equitable mortgage apply here.

(vii) Priority in multiple mortgages

If the rights under the same life policy have been mortgaged to more than one financier, problems may arise when the life policy matures or when it becomes necessary to sell or surrender the policy.

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[63] Policies of Assurance Act s3; *Walter & Sullivan v Murphy* 588.

[64] *Walter & Sullivan v Murphy* 588.

[65] Section 3 of the Policies of Assurance Act. See in addition McGee 203.

[66] Law of Property Act sections 101-107, especially section 105. *Banner v Berridge* [1881] Ch D 254; *Thorne v Heard* [1895] AC 495. See in addition McGee 437. *Simmons Gainsford LLP v Arvind Raichand Shah* [2008] EWHC 2554 (Ch) – if the loan is repaid in full, then the policyholder has the choice of surrendering the policy or keeping it alive until it matures.

[67] McGee 437.

Where all competing mortgages are legal, the financier who notifies the insurer first will enjoy priority.[68] In such an instance payment by the insurer to the financier who gave notice first will be a good discharge.[69]

The position is more complex where one of the mortgages was legal and the other equitable. Because all legal mortgagees must have a good title in equity or must take the assignment subject to equities, an earlier equitable mortgage (where notice was not given) may enjoy priority over a subsequent legal mortgage for which notice was given.[70]

The applicable rule is that first notice will not give a financier of a subsequent legal mortgage priority over an earlier equitable mortgage (where no notice was given to the insurer) if the financier had actual or constructive knowledge of the earlier equitable mortgage at the date it took legal assignment.[71]

English courts consider constructive knowledge to be any facts or circumstances that would put a prudent financier on enquiry. In the case of *In re Weniger's Policy*, a policyholder who mortgaged the rights under the same life policy numerous times could not hand over the life policy to any of the subsequent financiers upon request, as the policy was in the possession of the financier who was first to take assignment of it.[72] The court held that the absence of the policy was constructive notice to each of the subsequent financiers that the rights thereunder had been previously mortgaged.[73]

A financier's knowledge (actual or constructive) of an earlier mortgage – or the genuine lack thereof, involves an inquiry into the prevailing circumstances and the state of mind of the financier. For the insurer, deciding to whom it should pay in order to receive a good discharge of its

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68 Section 3 of the Policies of Assurance Act. This point is also illustrated in the case law: *Dearle v Hall* 1; *Spencer v Clarke* 140; *Newman v Newman* 647*; In re Dallas* [1904] 2 Ch 385.

69 *Newman v Newman* 647; *In re Dallas* 385.

70 *Spencer v Clarke* 140-141; *Newman v Newman* 647; *Mutual Life Assurance Society v Langely* [1886] 32 Ch D 460; *In re Dallas* 385.

71 *Spencer v Clarke* 140-141; *Newman v Newman* 647; *Mutual Life Assurance Society v Langely* 468; *In re Dallas* 385.

72 [1910] 2 Ch 291.

73 295-296. See too *Spencer v Clarke* 137.

obligation, may become almost insurmountable. To relieve the insurer of this burden and to avoid the risk of paying the wrong financier, the insurer is permitted to pay the policy proceeds to the court under the Life Insurance Companies (Payment into Court) Act 1896.[74]

Section 4 of the Life Insurance Companies (Payment into Court) Act deems such payment as a good discharge by the insurer. In this way the competing financiers are able to settle the dispute before the court, which will then be responsible for making an order of entitlement to the policy proceeds. In South African Law, a similar provision is found in Rule 58 of the Uniform Rules of Court. The English approach to handling a dispute of this nature could thus be easily accommodated in South African Law.[75]

(viii) Bankruptcy

The same principles that apply to an equitable mortgage apply here.

5.2.2. Charge

A charge[76] is a form of security that places an encumbrance on certain property and allows a financier to look to that property if the secured debt has not been repaid.[77] In our context a life policy may be charged as security for credit facilities. The English Law charge shares many similarities with the South African concept of pledge, yet there are some subtle differences as discussed below.

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[74] Section 3 of the Act reads as follows: "…[A]ny life assurance company may pay into the Supreme Court any moneys payable by them under a life policy in respect of which, in the opinion of their board of directors, no sufficient discharge can otherwise be obtained". This is illustrated in the case of *In re Weniger* where there were a handful of mortgagees and much uncertainty around the issue of priority.

[75] See Chapter 7 where this is discussed and is drafted into the proposed legislation.

[76] A charge is sometimes referred to as an "equitable charge" as it is only found in equity (except if provided for by statute) – Goode 36.

[77] *National Provincial & Union Bank of England v Charnley* [1924] 1 KB 431 449-450; *Swiss Bank Corporation v Lloyds Bank Ltd and Others* [1982] AC 584 594-595; *Carreras Rothmans Ltd v Freeman Mathews Treasure* [1985] Ch 207 227; *In re Charge Card Services Ltd* [1987] Ch 150 176 *In re Cosslett (Contractors) Ltd* 1998 Ch 495 508.

(i) Creation

A charge is typically created by contract[78] and does not require delivery or possession of the property so charged.[79] A charge merely gives the financier (chargee) a proprietary interest in the life policy and this interest vests in the financier.[80] No transfer or assignment of any rights occurs.[81] A charge is merely an encumbrance or a "weight hanging on the asset".[82]

(ii) Position where the policyholder defaults on loan repayments

The security of a charge is found in the fact that the financier may sell the life policy should the policyholder default on repayments. Because the financier may be not in possession of the life policy, and because ownership has not passed to it, the financier must apply to the court for the sale of the life policy in its favour, or an order directing the policyholder to assign the rights under the life policy to the financier.[83]

It would not be correct to think of the financier's security right as being merely potential. While the financier's right of enforcement only arises once the policyholder has defaulted, the financier indeed acquires a secured position before the policyholder has defaulted.[84]

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[78] No special words need be used as long as the parties' intentions are clear – *Cradock v Scottish Provident Institution* [1893] 69 LT 380 and *National Provincial & Union Bank of England v Charnley* 440, 445, 449.

[79] *National Provincial & Union Bank of England v Charnley* 449-450; *Swiss Bank Corporation v Lloyds Bank Ltd* 594-595; *Carreras Rothmans Ltd v Freeman Mathews Treasure* 227; *In re Charge Card Services Ltd* 176 *In re Cosslett Ltd* 508.

[80] *National Provincial & Union Bank of England v Charnley* 449-450; *Swiss Bank Corporation v Lloyds Bank Ltd* 594-595; *Carreras Rothmans Ltd v Freeman Mathews Treasure* 227; *In re Charge Card Services Ltd* 176; *In re Cosslett Ltd* 508.

[81] *In re Bond Worth Ltd* [1980] Ch 228 250 "…a charge conveys nothing and merely gives the chargee certain rights over the property as security for the loan". See also *Burlinson v Hall* 347; *Tancred v Delagoa Bay & East Africa Railway Co* 242; *Provincial & Union Bank of England v Charnley* 449-450; *Swiss Bank Corporation v Lloyds Bank Ltd* 594-595; *In re Charge Card Services Ltd* 176.

[82] In the words of Goode 36.

[83] In *Swiss Bank Corporation v Lloyds Bank Ltd* 595 the court described the security given by way of charge as "a right of realisation by judicial process". *In re Bond Worth Ltd* 250; *Burlinson v Hall* 347; *Tancred v Delagoa Bay & East Africa Railway Co* 242; *Provincial & Union Bank of England v Charnley* 449-450; *Swiss Bank Corporation v Lloyds Bank Ltd* 594-595; *In re Charge Card Services Ltd* 176.

[84] The court in *Provincial & Union Bank of England v Charnley* 450 clarified that the financier immediately obtains a legal right, even though it may only be enforced in the future upon default. This is confirmed by *In re Bank of Credit* [1998] AC 214 226. The point is well explained in Tolhurst 51 and Goode 36.

(iii) Priority and bankruptcy

A charged life policy grants the financier (chargee) a priority against unsecured creditors as well as subsequent encumbrances.[85] This means that the financier enjoys a preferential claim in the policyholder's bankrupt estate. The financier's interest also remains intact if the life policy is assigned to a third party (except *bona fide* third parties who have given value and who had no notice of the charge) or if the policyholder becomes insolvent.[86]

(iv) Position of the nominated beneficiary

A charge on a life policy has no effect on the beneficiary, other than ensuring that the financier is paid first out of the policy proceeds on surrender or maturity, if the debt remains outstanding.

(v) Differences between mortgage and charge

The main difference between a mortgage and a charge is that the former brings about an actual transfer of the rights under a life policy, whereas no transfer occurs in the case of a charge.[87] Also, in respect of a charge, a new security interest in property is created, but a mortgage involves the transfer of an existing right.[88] Further, if a life policy is mortgaged the financier may sell or surrender it if the policyholder defaults, whereas in the case of a charge, these remedies are not available to a financier until a court order to this effect has been granted.[89]

The differences between a mortgage and a charge are quite significant, but in practice it may become difficult to establish which form of security is under consideration, especially if the financier was given possession of the life policy. Where a life policy is mortgaged, the financier is

[85] Goode 36.

[86] *Swiss Bank Corporation v Lloyds Bank Ltd* 594. See further Tolhurst 51.

[87] *Swiss Bank Corporation v Lloyds Bank Ltd* 594; *Ladup Ltd v Williams & Glyn's Bank* [1985] 2 All ER 577.

[88] *Swiss Bank Corporation v Lloyds Bank Ltd* 594; *In re Bond Worth Ltd* 250; *Tancred v Delagoa Bay & East Africa Railway Co* 242; *Provincial & Union Bank of England v Charnley* 449-450; *In re Charge Card Services Ltd* 176.

[89] *Carreras Rothmans Ltd v Freeman Mathews Treasure* 227; *In re Cosslett Ltd* 508; In *Swiss Bank Corporation v Lloyds Bank Ltd* 595; *In re Bond Worth Ltd* 250; *Burlinson v Hall* 347; *Tancred v Delagoa Bay & East Africa Railway Co* 242; *Provincial & Union Bank of England v Charnley* 449-450; *Swiss Bank Corporation v Lloyds Bank Ltd* 594-595; *In re Charge Card Services Ltd* 176.

entitled to possession, but is not required to take possession.[90] Where a life policy is charged, possession is not required, but sometimes the life policy is nonetheless delivered.[91]

Ultimately, the determination of the form of security employed by the parties occurs by examining the intention of the parties, as well as the surrounding circumstances at the time the security was created.[92]

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[90] In the case of *Flour Maids Ltd v Dudley Marshall (Properties)* [1957] Ch 317 320 the court commented that until otherwise agreed, the mortgagee may take possession "before the ink is dry on the mortgage." The cases of *Western Bank v Schindler* [1977] Ch 1 17 and *National Westminster Bank v Skelton and Another* [1993] 1 WLR 72 77 further support this.

[91] As noted by McGee 437-438.

[92] *Cradock v Scottish Provident Institution* 380; *National Provincial & Union Bank of England v Charnley* 431; *Swiss Bank Corporation v Lloyds Bank Ltd* 594.

5.3 United States Law: New York

(i) Overview

The law pertaining to security assignments of life policies is relatively uncomplicated in the United States, barring the inconsistent and sometimes incorrect use of terminology.[93]

Article 9 of the New York Commercial Code regulates secured transactions, but does not find application here because article 9-109(d)(8) expressly excludes life policies[94] from the ambit of its application.[95]

The common law thus governs the security assignment of the rights under life policies. This exploration focuses on the law applying in the state of New York, although the common law is quite similar to all states. According to the common law, the rights under a life policy are freely assignable even before the risk has materialised.[96] A life policy is regarded as property and is treated as such when used as security.[97]

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[93] The courts are mainly to blame for this, but this problematic terminology has found its way into the literature to some extent. For example, an assignment of the rights under a life policy is confused with being a contract. To illustrate the careless use of terminology, some texts refer to a "pledgee/pledgor" while other texts refer to an "assignee/assignor". It would be more correct to refer to a "pledgee/pledgor" because no assignment or transfer actually takes place. As far as possible the terms pledgee/pledgor have been used in this discussion. See Anderson RA *Couch Cyclopedia of Insurance Law* 2ed (1983) 737; Lord RA *A Treatise on the Law of Contracts* 4ed (2000) 103.

[94] Article 9-1-9(d)(8) states that this article does not apply to "…a transfer of an interest in or an assignment of a claim under a policy of insurance or contract for an annuity…". The New York Commercial Code has adopted the general position as set out in the Uniform Commercial Code, which has the same exclusion.

[95] *PPG Industries Incorporated v The Hartford Fires Insurance Co* (1976) 531 F2d 58 60. In the case of *In re Barton Industries Incorporated v Jardine Insurance Services Texas Inc* (1997) 104 F3d 1241 1246-1247 Anderson J held that because insurance policies are excluded by article 9, the applicable governing law is to be found in state law including statutes and pre-code case law. Similarly in the case of *In re Long Chevrolet Incorporated* (1987) 79 BR 759 767 the court clarified that although article 9 does not apply to life insurance policies, such policy could still be used as collateral security and would be governed by existing non-UCC law. Henson RD *Handbook on Secured Transactions Under the Uniform Commercial Code* 2ed (1979) 229 observes that the exclusion of insurance may have been politically pressured, although points out that the official comment to the UCC (comment 7) states that using insurance as collateral is a special type of transaction that does not easily fit under a general commercial statute and is adequately covered by existing law.

[96] *Valton v The National Fund Life Assurance Co* (1859) 20 NY 32 38; *Olmsted v Keyes* (1881) 85 NY 593 598, 600; *Foryciarz v Prudential Insurance Co of America* (1916) 158 NYS 834 837; *Baginska v Metropolitan Life Insurance Co* (1937) 296 NYS 502 503.

[97] *Mutual Life Insurance Co of New York v Armstrong* (1886) 117 US 591 597; *Grigsby v Russell* (1911) 222 US 149 156: "…[L]ife insurance has become in our days one of the best recognized forms of investment and self-compelled saving. So far as reasonable safety permits, it is desirable to give to life policies the ordinary characteristics of property". See also Cook Carmichael JT & Coltoff PM *et al New York Jurisprudence* 2d "Insurance" s1167 (updated May 2013) available on Westlaw International accessed via http://www.up.ac.za (24/09/13).

5.3.1. Pledge

A life policy may be assigned as collateral security for a debt by pledge.[98] These principles are practically identical to those governing pledge in South African law. Once a pledge occurs the pledgee acquires a lien over the life policy to the extent of the debt.[99] A lien is merely an encumbrance on property, and thus encompasses the right to have a debt satisfied out of a particular thing.[100] The policyholder is accordingly not divested of his rights under the life policy and the pledgee only acquires a lien to the extent of the debt.[101] Once the debt has been satisfied, the lien is extinguished and the life policy continues as if there had been no pledge.[102] It is interesting to note that this concept of pledge is practically identical to the English charge.

(i) Creation: writing, delivery and notice

The pledge agreement need not be reduced to writing to be valid because the intention to effect a pledge may be established by the parties' oral agreement as well as surrounding circumstances.[103] If the pledge agreement is reduced to writing no particular words need be used.[104]

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[98] *Tioga County General Hospital v Tidd* (1937) 298 NYS 460 475; *In re Stafford's Will* (1950) 98 NYS 2d 714 717; *Mercantile Trust Co v Gimbernat* (1911) 143 AD 305 308; *Meridian Trading Corporation v The National Automobile & Casualty Insurance Co* (1964) 258 NYS 2d 16 18; *Duty v First State Bank* (1985) 693 P2d 1308. In addition see *Perkins v Meyer* (1951) 302 NY 139 150-151 where Conway J explains the operation of a pledge in New York. The principles are practically identical to those governing pledge in South African law. The position is also reflected in the literature, notably in Lord 115-116 and Anderson 809-810. See in addition Cook Carmichael & Coltoff *et al* s1167.

[99] *In re Stafford's Will* 717; *Males v New York Life Insurance Co* (1975) 367 NYS 2d 575 579; *Duty v First State Bank* 1308; *Rohrbach v The Germania Fire Insurance Co* (1875) 62 NY 47 56: "A lien, in its most extensive signification, is a charge upon property, for the payment or discharge of a debt or duty… in priority to the general debts or duties of the owner".

[100] *In re Walton's Estate* (1964) 247 NYS 2d 21 24: "A lien is nothing more than a charge or security or incumbrance upon property"; *Rohrbach v The Germania Fire Insurance Co* 56: "A lien, in its most extensive signification, is a charge upon property, for the payment or discharge of a debt or duty… in priority to the general debts or duties of the owner". A lien is indeed practically identical to the English charge.

[101] *Tioga County General Hospital v Tidd* 475; *In re O'Meara's Estate* (1948) 81 NYS 2d 388 390; *Mercantile Trust Co v Gimbernat* 308; *Males v New York Life Insurance Co* 579; *Duty v First State Bank* 1308. This is further explained in Cook Carmichael & Coltoff *et al* s1167.

[102] *Males v New York Life Insurance Co* 579; *Duty v First State Bank* 1308. See further the discussion by Anderson 809-810 and Cook Carmichael & Coltoff *et al* s1167.

[103] *Barnett v Prudential Insurance Co of America* (1904) 86 NYS 842 843; *In re Walsh's Estate* (1936) 288 NYS 865 866; *In re Pastore's Estate* (1935) 279 NYS 200 205 (and the cases cited therein); *Baginska v Metropolitan Life Insurance Co* 503; *Considine v Considine* (1938) 7 NYS 2d 834 836; *In re Brickford's Estate* (1942) 38 NYS 2d 785 787; *Cornell v Cornell* (1945) 54 NYS 2d 434 436. This is confirmed in Cook Carmichael & Coltoff *et al* s1171.

[104] As long as the parties' intentions are clear. *Angel v Chase National Bank of City of New York* 279 NY 250 254; *Azrak v Manufacturer's Trust Co* (1953) 120 NYS 2d 855 858.

In a case where there is no written pledge agreement, the pledge may validly occur by delivering the life policy to the financier with the intention that it serves as security.[105] In a case where the pledge agreement has been reduced to writing, the written agreement may be delivered to the financier (pledgee) to effect a valid pledge.[106] A valid pledge may therefore occur by either delivering the policy or the pledge agreement to the financier.[107]

Although the provisions of a life policy may require that notice be given to the insurer for its protection, the failure to give notice will generally not invalidate the pledge.[108] It is advised, however, that the financier nonetheless gives notice to the insurer to protect itself against a subsequent assignment or pledge of the life policy to a *bona fide* party with no knowledge of the pledge.[109]

Generally, provisions in a life policy restricting assignments do not apply to the pledge of a life policy because the pledging thereof does not divest the policyholder of his rights thereunder.[110]

(ii) Surrender of the life policy

The general rule is that the financier is permitted to surrender the policy if the policyholder defaults on loan repayments, or causes the policy to lapse by non-payment of premiums.[111] No problems arise if the pledge agreement expressly permits surrender, and it may be done in accordance with the provisions thereof. [112]

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105 *In re Brickford's Estate* 787; *Cornell v Cornell* 436; *Bourne v Haynes* (1962) 235 NYS 2d 332 334. See further Cook Carmichael & Coltoff *et al* s1171 and Glaser SJ "Life insurance policies as collateral in New York" (2011) available at http://www.healthlawtoday.com/articles/files/NYCollateralInsurancePolicies.pdf (24/09/13).

106 *Bourne v Haynes* 334.

107 *In re Brickford's Estate* 787; *Cornell v Cornell* 436; *Bourne v Haynes* 334.

108 As is evidenced by the case law: *Griffey v The New York Central Insurance Co* (1885) 100 NY 417; *Frensdorf v Stumpf* (1941) 30 NYS 2d 211; *Senese v Senese* (1953) 121 NYS 2d 498; *Miller v Wells Fargo Bank International Corporation* (1976) 540 F2d 560 as well as in the literature: Anderson 812-813.

109 *Griffey v The New York Central Insurance Co* 417; *Frensdorf v Stumpf* 211; *Senese v Senese* 498; *Miller v Wells Fargo Bank International Corporation* 560.

110 *Griffey v The New York Central Insurance Co* 422 *et seq* confirmed and followed in *Mahr v Norwich Fire Insurance Society* (1889) 23 Abb N Cas 436 and *Males v New York Life Insurance Co* 578-579.

111 *Toplitz v Bauer* (1900) 161 NY 325 332; *Conlew Incorporated v Kaufmann* (1936) 269 NY 481 487. See further The Yale Law Journal Company Inc, Calhan JD (Ed) "The assignment of life insurance as collateral security for bank loans" 1949 *Yale LJ* 743 756.

112 The Yale Law Journal Company Inc, Calhan JD (Ed) 1949 *Yale LJ* 756.

The position is otherwise where the policy is silent on the financier's right to surrender the policy. In the state of New York, if the financier gives sufficient notice that affords the policyholder a reasonable opportunity to prevent the enforcement of the lien, the surrender of the policy will be valid.[113]

Notwithstanding reasonable notice and the opportunity to prevent surrender of the policy, the financier is also required to follow the proper procedure by applying to the court for an order permitting the surrender or selling of the policy.[114] The reason for this is because the right of surrender is not considered to be a power that is inherently included when a life policy is pledged, unless otherwise indicated.[115]

(iii) Position of the nominated beneficiary

If a life policy is pledged as security for credit facilities, the policyholder is not divested of his rights therein. Similarly, the general rule is that the nominated beneficiary is also not divested of his or her right to receive the policy proceeds when due.[116]

It is widely accepted that the pledgee's lien extends only to the amount of the indebtedness. Once the policy proceeds or surrender value has satisfied such indebtedness, the balance must be paid to the beneficiary as if there had been no pledge.[117]

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[113] *Furber v National Metal Co* (1907) 103 NYS 490 494; *Small v Housman* (1913) 208 NY 115 124**;** *County Trust Co v Finck* (1950) 215 NYS 2d 888 891-892; The Yale Law Journal Company Inc, Calhan JD (Ed) "Power of pledgee of life insurance policy to exercise surrender options" 1938 *Yale LJ* 319; The Yale Law Journal Company Inc, Calhan JD (Ed) 1949 *Yale LJ* 757.

[114] *Travelers' Insurance Co v Healy* (1898) 49 NYS 29; *Conlew Incorporated v Kaufmann* 481. The Yale Law Journal Company Inc, Calhan JD (Ed) 1949 *Yale LJ* 756-757. This point is considered in Cook Carmichael & Coltoff *et al* s1186.

[115] The Yale Law Journal Company Inc, Calhan JD (Ed) 1938 *Yale LJ* 317. See too Cook Carmichael & Coltoff *et al* s1186.

[116] *Davis v Modern Industrial Bank* (1939) 279 NY 495 409; *Chamberlin v First trust & Deposit Co* (1939) 15 NYS 2d 168 170-17; *Auburn Cordage Incorporated v Revocable Trust Agreement of Treadwell* (2006) 848 N.E.2d 738. See in addition Cook Carmichael & Coltoff *et al* s1183. For interest sake it may be mentioned that the policyholder may revocably or irrevocably nominate a beneficiary. The policyholder makes his nomination irrevocable where the policy provides that the nomination may not be revoked without the consent of the beneficiary. A nomination is made revocable if the policy reserves the right of the policyholder to revoke. A life policy may only be assigned outright if the policyholder has obtained the consent of the beneficiary or has reserved the right to revoke the nominated beneficiary. Whether the beneficiary was nominated revocably or irrevocably is of no consequence where the life policy is pledged – see *Davis v Modern Industrial Bank* (1939) 279 NY 495 409-410.

[117] *In re O'Meara's Estate* 390; *In re Stafford's Will* 717; *In re Goudiss' Estate* (1963) 239 NYS 2d 907 909 (and cases cited therein); *Auburn Cordage Incorporated v Revocable Trust Agreement of Treadwell* 738; *Bourne v Haynes* 333-334 where the court made it clear that the rights of the financier take precedence over that of the

When the policy falls due or is surrendered, it appears that the policy proceeds are generally paid to the financier who takes it to satisfy the remaining indebtedness.[118] Any surplus is held in trust for the beneficiary.[119] It is for this reason also, that it is advisable for the financier to notify the insurer of the pledge, so that the insurer is aware thereof and can pay the policy proceeds directly to the financier.[120]

(iv) Priority in multiple pledges

In the absence of any contractual prohibition, the policyholder may make another pledge of the remaining interest in the life policy.[121] If the rights under the life policy have been pledged to more than one financier, the general prevailing principle is that the pledge which is first in time enjoys priority.[122]

(v) Effect of bankruptcy

According to the section 282 of the Debtor and Creditor Law found in the New York Commercial Code, property falling outside of the bankrupt estate includes "insurance policies and annuity contracts and the proceeds and avails thereof as provided in section 3212 of the Insurance Law".[123] Section 3212 of the New York Insurance Law permits life policies and annuities to be exempt from

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nominated beneficiary; *Chamberlin v First trust & Deposit Co* 170-17. In *Davis v Modern Industrial Bank* 409 the court explained that although the beneficiary has an interest in the policy, this interest is in the nature of a mere expectancy or inchoate right.

[118] *Hirsch v Mayer* (1901) 165 NY 236 239; *McNerney v Aetna Life Insurance Co* (1954) 130 NYS 2d 152 153; *Bourne v Haynes* 333-334; *Davis v Modern Industrial Bank* 409

[119] Above.

[120] *McNerney v Aetna Life Insurance Co* 154 (confirmed on appeal in 308 NY 916). The case illustrates that payment of the policy proceeds to the beneficiary in good faith and in absence of any knowledge of the pledge is considered a good discharge by the insurer (although this was not the direct issue under consideration).

[121] This is illustrated in the case law: *Payne v Wilson* (1878) 74 NY 348; *Metropolitan Life Insurance Co v US* (1959) 194 NYS 2d 168; *Savings & Loan Association of Kingston v Berberich* (1965) 264 NYS 2d 989; *Rappaport-Weiss Poultry Corporation v Exchange Mutual Insurance Co and Others* (1974) unreported 1974 WL 2799; *City & County Savings Bank v Oakwood Holding Corporation* (1976) 387 NYS 2d 512; *Marine Midland Bank, NA v A & M Warehouse Incorporated* (1983) 461 NYS 2d 200.

[122] *Metropolitan Life Insurance Co v US* 172; *Rappaport-Weiss Poultry Corporation v Exchange Mutual Insurance Co* 1974 WL 2799; *City & County Savings Bank v Oakwood Holding Corporation* 514. Some types of liens take priority over other types even though they may have been created subsequently. However, in this context, multiple pledges of a life policy gives rise to the same type of lien, so the general principle of first in time first in right applies (see section 13 of the Lien Law for priority of types of liens).

[123] *In re Lowe* (2000) 252 BR 614 618-619; *In re Tappan* (2002) 277 BR 491; *In re Lynch* (2005) 321 BR 114.

falling into a bankrupt estate.[124] The section not only includes the life policy, but also the surrender value of the policy.[125]

In a case where a life policy has been pledged as security for credit facilities, such a policy would be unaffected by the bankruptcy of the policyholder. In reality should the policyholder be unable to repay the loan – which would be likely due to the bankruptcy – the bank could sell or surrender the policy.

If the cash surrender value is inadequate to satisfy the outstanding balance on the loan, the financier would logically become a creditor of the policyholder's bankrupt estate. Any amount received in excess of the outstanding balance would be paid to the nominated beneficiary according to the usual governing principles as explained above.

5.4 Conclusion

English Law does not recognise a pledge of incorporeals since delivery and possession is an impossibility. The English concept of mortgage is similar to the South African fiduciary security cession and is effectively regulated by legislation.

As an alternative to mortgage, English law recognises the notion of a charge upon incorporeal property. The New York concept of pledge is very similar to a charge in English Law, even though the terminology differs. Both a charge and a pledge do not involve a transfer of any kind, but are merely an encumbrance on an asset. Both are governed by sound and established common law principles.

In Chapter 4 it was submitted that the South African concept of pledging the rights under a life policy does not involve an actual transfer and should thus not be considered as a cession. The main points of argument are summarised and repeated here for convenience:

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[124] Specifically section 3212(b)(1)-(3). See in addition *In re Lowe* 619; *In re Tappan* 491; *In re Lynch* 114; *In re Rundlett* (1992) 142 BR 649 651 *et seq* (here the court also looked at the position where the parties involved are husband and wife). As an aside it may be added that s 3212 does not appear to be free from certain interpretation ambiguities as illustrated by *In re Jacobs* (2001) 264 BR 274.

[125] See section 3212(a)(1).

- The extension or adaptation of the pledge construction has been stretched too far in order to accommodate traditional pledge and cession. In the pledge construction the concepts of pledge and cession have been integrated by notional force because they are completely different concepts. The result of this awkward union makes little theoretical sense.

- It is flawed to insist that a cession occurs when a personal right has been pledged for security purposes. Support may be found in the case of *Cohen's Trustee*. In this case it was held that the policyholder "need only demand the return of his property and a re-cession is not necessary to complete his title". It follows that if a re-cession is not necessary to terminate the real security right, then a cession could not have occurred to establish it in the first instance.

- Cession brings about complete transfer of a right with the result that the cedent is wholly divested thereof. Yet, according to pledge, ownership or a bare *dominium* of the personal right is retained by the supposed cedent, and only the entitlement to realise the object of security, or to enforce it in the case of a personal right (the *jus in re aliena*), is transferred to the supposed cessionary.

- The possibility of ceding part of a personal right, that is, the entitlement to realise or to enforce it is doubtful since it defies the essence of a cession.

- Assuming that the personal right cannot be fragmented and that no cession occurs, the question which then comes to mind is how the *jus in re aliena* is divested from the estate of the policyholder and vested in the estate of the financier. Because the concept of pledging an incorporeal is like defying the laws of nature, there is no satisfactory way to explain how the financier becomes vested with the *jus in re aliena*. It simply has to be accepted that upon a pledge of the rights under a life policy, the financier has the right to enforce the policy until the secured debt has been satisfied.

- The transaction should not be referred to as a security *cession* by pledge. Accordingly, it may be a misnomer to refer to the parties as "cedent" and "cessionary".

As can be observed from the criticisms above, the concept of splitting a right and transferring only a part of it (being the *jus in re aliena*) is the main problem. This problem has been caused by the fact that the concepts of traditional pledge and cession may have been stretched too far in order to accommodate the pledging of incorporeals.

If it is correct that no cession occurs, how is the *jus in re aliena* divested from the estate of the policyholder and vested in the estate of the financier? In Chapter 4 it was concluded that there was no satisfactory way of explaining this and that it simply had to be accepted that the financier acquires the right to enforce the life policy if necessary.

After exploring the English Law charge and the New York Law concept of pledge, it seems as though the development of the South African Law approach was distorted by the principles of traditional pledge and cession in an attempt to make sense of this method of security. Perhaps the explanation of how the policyholder becomes divested of the *jus in re aliena* is that he in fact is not divested of it.

In accordance with the submission that no transfer occurs, it logically follows that the policyholder is not divested of any of the rights under the life policy. The South African pledge construction would make more sense if the pledge of the rights under a life policy created an encumbrance over the life policy, thereby affording the financier a security interest therein.
The financier's interest in the English and New York Law is practically identical to that which is received after the rights under a life policy has been pledged in South African Law. The main difference, however, is that in terms of the South African approach, the financier is usually entitled to surrender the life policy without recourse to the court, which is not the case under the English and New York Law.

In the final analysis the difference between the approaches is essentially one of rights versus interests. In the South African Law approach the financier acquires a right, whereas in English and New York Law the financier acquires an interest. Suggesting that the South African Law of pledge should rather be viewed as an English Law charge or New York Law pledge may be a paradigm shift that is a bridge too far considering that the pledge construction is now widely accepted in South African Law.

CHAPTER SIX
RESULTS, CONCLUSIONS & RECOMMENDATIONS

6.1 Introduction

An academic once said:[1]

> …I would like to remark on the generally employed cliché of practitioners that "that may be the position in theory, *but in practice it does not work that way*". This is a fallacy generally endorsed by practitioners. Contrary to this belief, a solid knowledge of the theory is indispensable for a proper understanding of the law and makes its practical application easier. Theory is not an abstract set of rules functioning in a vacuum, it is the foundation for solving practical legal problems which has been worked out over the centuries for similar practical problems. Therefore, the practitioner must have a sound knowledge of the theory to apply it successfully to practical situations. [Author's emphasis]

While there is, no doubt, much truth in this opinion, academics should not choose to turn a deaf ear to the "cliché of practitioners" when they complain that the theory is not working in practice – this concern should rather be addressed.

Sometimes problems cannot be solved by merely looking at more theory. In such a case it would be advisable for academics to listen to and learn from practitioners in order to find a solution. This may, however, necessitate a shift in perception and/or changes to the existing theory. A prime example illustrating this is cession by pledge. Theoretically, cession by pledge is impossible. Nevertheless, because such a practice was frequently occurring in the industry, our courts and later most academics, have come to accept that the "impossible" is a reality.

Law-makers, academics and practitioners should work in unity in order to improve the law of security cession. This entails finding a balance between law which is jurisprudentially sound and law that is workable in practice.

In this Chapter the results from the questionnaires have been set out in tabulated form for ease of reference and to allow for comparison. A discussion of the results follows thereafter. This Chapter has been further supplemented by case reports from the office of the Ombudsman for Long-Term Insurance.

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[1] S Scott "Object of a cession" 2000 TSAR 765 768-769.

The office of the Ombudsman for Long-Term Insurance is an independent office which is accountable to an independent council and functions to provide a free service to disgruntled policyholders concerning disputes involving a long-term policy with insurance companies who are subscribing members. The Office has received statutory recognition as provided by the Financial Services Ombud Schemes Act[2] and its rulings are binding on its member insurers. The complainant policyholder is still at liberty to refer the dispute to a court if unsatisfied with the ruling.

It was decided that since the office of the Ombudsman for Long-Term Insurance deals with practical day-to-day problems with life policies and since the finding of the Office are available only on the website and have not been widely published, it would be helpful to mention some relevant cases here.[3]

As far as can be ascertained, an empirical investigation of this nature has never been undertaken and makes an invaluable contribution toward the advancement of security cessions of the rights under life policies.

[2] Act 37 of 2004.

[3] The case reports are abbreviated as "CR" and can be found on the website available at http://www.ombud.co.za (24/09/13).

6.2 Insurance companies

6.2.1 Construction

Question	Insurer A	Insurer B	Congruency with theory[4]
1. Are you familiar with the law governing security cessions of life policies?	YES	YES	✗
2. Where the insurer is also in the business of providing credit, does it typically accept a cession of a life policy issued by itself as security?	YES	N/A[5]	✓
3. Does the insurer typically deliver the life policy or copy to the bank once notice of a security cession has been received?	NO	NO	✗
4. Would the insurer consent to the policyholder ceding part of the rights under the policy to different cessionaries (ie a splitting of claims)?	YES	NO	✗
5. Is the insurer concerned with the construction of a security cession of its life policy?	NO	NO	✗
6. Is the issue of a security cession addressed in the main policy document? If so, please state how.	YES It is addressed as part of the general terms of the policy contract.	YES It depends on the specific contract and the specific contractual clauses governing the position around cessions.	✓
7. Do the insurer's life policies contain *pacta de non cedendo*?	NO	NO	✓

[4] The tick indicates that the feedback from practice was consistent with theoretical assumptions, the cross indicates that it was not, and the question mark indicates information that was unknown or uncertain.

[5] Insurer B was not in the business of extending credit.

6.2.2 Notice

Question	Insurer A	Insurer B	Congruency with theory
1. Do the life policies require notice from the bank in the event that the policy is ceded as security?	YES	YES	✓
2. After receiving notice of a security cession does the insurer henceforth send all notices relating to the policy both to the bank *as well as* the policyholder?	YES	NO The insurer has a primary obligation to the policyholder in terms of s52 of the Long-Term Insurance Act.	?
3. Do the life policies require notice from the bank when the secured debt has been satisfied?	YES	YES	✓
4. Does the insurer typically receive notice from the bank when the secured debt has been satisfied?	NO	YES	?
5. Does the insurer typically notify the bank in the event of non-payment of policy premiums?	YES	NO We only inform the policyholder as required by the Long-Term Insurance Act.	?
6. Does the insurer typically notify the policyholder that a claim has been made against the policy for the proceeds or surrender value?	YES	YES	✓
7. Does the insurer notify the bank when the policy matures?	YES	NO	?

6.2.3 Beneficiary nomination

Question	Insurer A	Insurer B	Congruency with theory
1. Do the insurer's life policies provide that a beneficiary nomination is revocable by default?	YES	This depends on the underlying contract.	✓
2. Do the life policies prescribe certain formalities with which the policyholder must comply in order to revoke a prior beneficiary nomination, or does a security cession automatically cancel a previous beneficiary nomination? If formalities are to be followed, please mention them.	A security cession does not cancel a beneficiary nomination. The beneficiary nomination is suspended until the cession is cancelled.	This is dependent on the contract.	✗
3. What is the effect of a revocation where formalities are prescribed in the policy, but not complied with?	All revocations must be in writing. If this is not complied with then the nomination is not revoked, except if the policy is ceded as security.	The formality required is notification in writing. If there is no revocation in writing, there is no revocation.	✓
4. Where the insurer has received notification that the life policy has been ceded as security, does the insurer consider the bank as the new beneficiary (at least for the time being)?	YES	NO	✓
5. Is a previous beneficiary nomination automatically revived once the secured debt has been satisfied?	YES	This is dependent on the contract.	✓

6.2.4 Payment of policy proceeds

Question	Insurer A	Insurer B	Congruency with theory
1. How does the insurer go about confirming the validity of a security cession where a claim for the surrender value or policy proceeds has been made, but where it has not received a prior notice of the security cession?	The insurer will demand proof of indebtedness on the bank's letterhead.	We require to be provided with the underlying cession agreement between the cedent policyholder and the cessionary bank.	?
2. When a life policy has been ceded to a bank as security, to whom does the insurer pay the policy proceeds on maturity?	Generally payments are made to the cessionary bank. The balance is paid to beneficiary.	Full payment will be made to the bank. The bank needs to refund the difference between the secured debt in the underlying agreement and the maturity proceeds to the policyholder or nominated beneficiary.	?
3. What is the insurer's view in respect of its liability in a case where it pays the policy proceeds to the policyholder / nominated beneficiary before the secured debt has been satisfied?	The insurer would always pay the cessionary when a cession is noted.	It would depend on whether the insurer received notice of the security cession. If the notice is not received the insurer is at liberty to make payment to the policyholder.	✓
4. On the insolvency of the policyholder, where the secured debt has not been satisfied, to whom does the insurer pay the policy proceeds or surrender value (the bank or trustee)? Does the construction of the security cession play a role (Y/N)?	The bank. No, the construction does not play a role.	We would pay to the bank. No, it would not play a role.	✗

6.2.5 Problems and solutions

Question	Insurer A	Insurer B
1. What problems or difficulties does the insurer encounter when its life policies are ceded as security for credit facilities?	It occasionally happens that the bank does not inform the insurer that the cession is cancelled. This can create problems in the death claims department.	None
2. How does the insurer attempt to resolve these problems or difficulties?	Nothing is done currently because the problems are not that material.	N/A
3. From the insurer's perspective, what would be the ideal manner in which to clarify uncertainties or remedy problems encountered when a life policy is ceded as security (ie statutory intervention or the like)?	Appropriate disclosures in simple understandable language.	Clarity on the various cessions is left to the contractual construct by parties through the life contract and the cession agreement. There will always be different results due to the freedom of contracting.
4. Would the insurer be in favour of an amendment to the Policyholder Protection Rules; or legislation (or both) in order to develop and better regulate the law surrounding security cessions of life policies (Y/N)? Please provide reasons for your answer.	Not required.	No. If the contractual arrangement is clear then the correct process will follow.

6.2.6 Comments and conclusions

(i) Construction

From the insurers' feedback, it seems to be standard practice for the life policy to address of the issue of a security cession and this much is assumed in theory. Unfortunately, the responses did not explain exactly how the policy deals with security cessions. Insurer B, however, indicated that the provisions dealing with security cessions may not be exactly the same for each life policy. Also, both insurers confirmed that their life policies do not contain *pacta de non cedendo*. This is in line with theory since an insurance policy loses much of its appeal if it cannot be used for security purposes. Further, the results confirm that it is an acceptable practice in the industry for an insurer to take a security cession of its own policy if the insurer is also in the business of extending credit.

It was surprising to discover that insurers do not deliver a copy of the life policy to the financier once a security cession has occurred. The reason for this is probably due to the fact that the financier does not require and request a copy of the life policy (see below). In effect it appears that the financier blindly takes a security cession of a life policy.

Theory takes the view that the insurer would not, as a general rule, be willing to consent to a splitting of claims since it may pose an undue hardship on the insurer if faced with multiple cessionaries to whom it must account. To discover that the insurer A readily permits the splitting of claims was unexpected. The splitting of claims, however, is a practice that apparently differs from insurer to insurer since insurer B is not prepared to sanction it. It therefore does not appear to be a standard norm in the insurance industry.

It was initially puzzling to learn that the insurer is not concerned with the construction of the security cession. Ignoring the construction may cause problems when the time comes to pay the policy proceeds or surrender value. As discussed in Chapter 4 above, the construction plays in important role in determining whether the insurer pays only the outstanding balance on the secured debt (in a pledge) or whether it pays full value to the financier (in fiduciary security cession).

The insurer's disregard for the construction makes sense when the feedback from the banks is considered (see below). The banks report that all security cessions take the pledge construction. There is consequently no reason for the insurer to be concerned with the construction if only the pledge construction is being used by the banks.

(ii) Notice

It was expected that life policies would stipulate that the insurer should be notified in the event of a security cession and indeed this is the case. The insurer would otherwise have no way of knowing if the policy had been used as security. The tendency of the banks to give notice of all security cessions suggests that knowledge of the existence of a security cession is not a problem in practice (see below).

Once the insurer has knowledge of the security cession it was unknown whether the insurer continued to send policy-related notices to the policyholder after the security cession. It would make theoretical sense to do so because regardless of the construction of the security cession, the policyholder always intends to be re-vested with all the rights under the life policy and thus retains an interest therein. It is observed that the industry is divided on this matter. Insurer A errs on the side of caution by sending notices in duplicate,[6] while Insurer B effectively ignores the existence of a cessionary and accounts only to the policyholder.

Theory speculates that the insurer would require some notification once the loan has been satisfied. It was not alarming that this was indeed the case because notice enables the insurer to amend its records so that it pays the correct person on death or at maturity. It is surprising to discover that even though the insurer requires notice, the financier does not always sent notice. How would the insurer know that the security cession has come to an end if it is not informed by the financier? The feedback from the banks verify that banks do not habitually notify the insurer once the secured debt has been satisfied (see below). The view of the office of the Ombudsman for Long-Term Insurance is that upon notification by the policyholder, the insurer should obtain proof from the financier that the secured debt has been paid.[7]

In a case brought before the Office, a dispute had arisen between the insurer and the policyholder as to whether the secured debt had been paid. The policyholder had notified the insurer that it was paid and demanded the surrender value. The insurer on the other hand, insisted that mere notification was insufficient and that the policyholder had a duty to furnish proof thereof. The office decided that once the insurer was notified by the policyholder with *prima facie* proof that the secured debt had been satisfied, the duty was on the insurer to confirm as much with the financier.

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[6] As an aside, it would be interesting to learn the cost implication of this duplication.

[7] CR55.

The duty of proof should not rest on the policyholder and/or the insurer. It makes much more sense if this duty rests on the financier. It is much easier for the financier to send this notice to the insurer than for the policyholder to submit proof and for the insurer to make enquiries. The financier, after all, sends notice once the security cession has taken place in order to safe guard its security and should be thus obliged to inform the insurer once its interest in the security has come to an end.

In the event that a dispute arises between the policyholder and the bank as to whether the secured debt has been repaid, the Office was of the opinion that the insurer should make its own decision and act accordingly.[8] The concluding remark of the Office was that:

> The rights and obligations of an insurer, policyholder and cessionary where there is a dispute as to whether the secured debt has been fully repaid remains a murky one. Clarification awaits another day.

If the policyholder is not up to date with the life policy premiums, it puts the financier's security in jeopardy. This is obviously information that the financier would want to know in order to take appropriate steps to safeguard the security if necessary. It appears that there is no common practice in the insurance industry to give notice of non-payment of policy premiums. The financier should consider itself lucky if notice is received. Otherwise, the duty rests on the financier to keep following up on this matter (see below). It is much easier for the insurer to send this notice than for the financier to constantly follow up.

The policyholder should be notified if a claim has been lodged against the life policy in order to afford the policyholder an opportunity to challenge the claim. This is especially important where fraudulent claims are lodged.

The insurers reported that notification is sent to the policyholder where a claim has been submitted, but this notification may not be sent in every case. The office of the Ombudsman for Long-Term Insurance handled a case where the insurer had paid the surrender value of a fraudulent claim lodged against the policy and had failed to notify the policyholder before paying.[9] The Office remarked that although there is no duty in law for the insurer to notify the policyholder in such a case, there is a duty in fairness to do so.

[8] This advice is not entirely helpful since the insurer could still end up paying the wrong party.

[9] CR3.

In another case before the office of the Ombudsman for Long-Term Insurance,[10] the bank surrendered the life policy in error even though the policyholder was up to date with loan repayments. Although the policyholder was not afforded an opportunity to object to the surrender, the Office decided that the insurer was not at fault because no law obliges the insurer to send such notice. These kinds of disputes could undoubtedly be avoided if the insurer simply sends notice to the policyholder.

If the policy matures while the loan is still in effect, it is essential that the financier be made aware of this. As was discussed in *Retmil Financial Services (Pty) Ltd v Sanlam Life Insurance Co Ltd,*[11] in Chapter 4 above, the loan agreement would usually have stipulated how the matter should be dealt with. Failing that, it is submitted that the insurer should hold the policy proceeds in trust until either the loan is repaid or the policyholder defaults on loan repayments.

The questionnaire enquired whether the insurers in fact give the financier notice when the policy matures. The responses reveal that there is no established norm in the insurance industry to do so.[12] Not receiving notice prevents the financier from exercising any right it may have under the loan agreement to claim the policy proceeds on maturity and apply it to the amount indebted. Further, if the insurer does not give the financier notice, nothing prevents the policyholder from attempting to collect the proceeds (whether in good faith or fraudulently) to the detriment of the financier. In such a case the insurer would be liable to make good the financier's loss and would have to carry this loss if it were unable to recoup it from the policyholder.

In conclusion, knowing to whom it must pay is arguably one of the most important pieces of information for the insurer. The feedback from the insurance industry suggests that there is inconsistency in the area of notice since some notices are sent but others are not.

(iii) Beneficiary nomination

It was speculated that beneficiary nominations are usually structured as revocable by default. The responses confirm that this is in fact the case in practice. It may, however, be worth mentioning that

[10] CR56. See CR125 where the office was once again in favour of the sending of such notice.

[11] 2013 JDR 0864 (WCC).

[12] If the policy matures on the death, the financier would usually be informed of this by the executor of the deceased estate.

insurer B's response leaves open the possibility that a beneficiary nomination in a particular life policy could be structured as an irrevocable one.

It was suggested by academics[13] that there was a common, but incorrect, understanding among practitioners that a security cession cancelled a prior beneficiary nomination. The responses fortunately debunk this. Practitioners do not seem to hold this view unless the contract in fact provides that the security cession should cancel the prior nomination.

Since a prior beneficiary nomination is not cancelled by a security cession, the general view is that the nomination is revived once the secured debt has been satisfied. The attitudes of the insurers' are in line with this view. Insurer B once again adds that a security cession can finally cancel a prior beneficiary nomination if this was the intention of the parties. In such a case, once the secured debt is satisfied, the policyholder would have to nominate a beneficiary afresh if he does not wish to receive the proceeds himself.

There is some uncertainty as to whether express notification is a requirement for the validity of a beneficiary revocation, or whether it merely has a protection function.[14] These results corroborate the view that express notification is indeed a requirement in order to validly revoke a beneficiary nomination.

The questionnaire enquired whether the insurer considers the financier as the new beneficiary (at least for the time being) to ascertain how the insurer views the financier. Insurer A gave the practical answer[15] and Insurer B gave the theoretical answer.[16] Theoretically the financier does not become the new beneficiary since it was not nominated as such and merely accepted the life policy as security. In

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[13] Nienaber PM & Reinecke MFB *Life Insurance in South Africa: A Compendium: A Perspective from the Office of the Ombudsman for Long-term Insurance* (2009) 230; MFB Reinecke & PM Nienaber "A suggested template for beneficiary nominations" 2009 *SA Merc LJ* 1 30-31 and Nienaber PM "Some problems involving security cessions of life insurance policies" 2004 *SA Merc LJ* 83 100.

[14] Notably in *Curtis Estate v Gronningsaeter and Another* 1942 CPD 531 and *Wolmarans en 'n Ander v Du Plessis en Andere* 1991 (3) SA 703. *Cf Hees v Southern Life Association* 2000 (1) SA 943 (W); *Ex parte MacIntosh NO: In re Estate G Barton* 1963 (3) SA 51 (N) 57E-F and *Ex Parte Calder Wood NO: In Re Estate Wixley* 1981 (3) SA 727 (Z) 736-737. See also Reinecke & Nienaber 2009 *SA Merc LJ* 15.

[15] This is consistent with Insurer A's practice of sending policy-related notices to both the policyholder and the financier.

[16] This is also consistent with Insurer B's approach of not duplicating its notices by only sending policy-related notices to the policyholder.

reality, the effect is similar since the financier is entitled to receive the policy proceeds – the same proceeds that the beneficiary is entitled to receive. In both cases the cessionary and beneficiary are given rights in respect of the same policy proceeds, and in this sense the cessionary can also be viewed as a beneficiary.

(iv) Payment of policy proceeds

It was undetermined how the insurer validated a security cession when it had no prior notice of it. Both methods of obtaining proof as described by the insurers are acceptable, but once again the procedure is not uniform.

In Chapter 4 the procedure for paying the policy proceeds (on maturity, surrender and insolvency) was discussed in detail. It was concluded that regardless of which construction is used, the insurer should pay the financier only the amount outstanding under the loan agreement and should pay the balance to the policyholder or nominated beneficiary. It is noteworthy to consider the diverging responses from the insurers: Insurer A pays only the outstanding balance to the financier as recommended. On the other hand, Insurer B pays the full policy value to the financier and expects the financier to distribute the balance thereof as applicable.

If the construction was a fiduciary security cession, the approach of Insurer B would be understandable; however, the banks make exclusive use of the pledge construction (see below). In addition, the feedback from the banks does not support the idea that the bank would pay the balance to the nominated beneficiary. The bank reports that on death, any balance remaining is paid to the executor of the deceased estate (see below).

The office of the Ombudsman for Long-Term Insurance was faced with a situation where the insurer had paid the full policy proceeds to the financier and the financier had failed to pay the excess to the beneficiary since there was no provision in the loan agreement that dealt with the issue of surplus payment.[17] The Office ruled that the bank had a duty to restore the excess to the beneficiary directly. The problem was that the Office does not have jurisdiction over third parties, so it could not order the bank to pay the surplus to the beneficiary and suggested that the matter be referred to the Ombudsman for Banking Services.

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[17] CR2.

It is submitted that the bank should not be paid the full proceeds of the life policy because it is not the duty of the bank to pay the balance to the beneficiary. The financier has no dealings with the beneficiary and as pointed out above, it is not even sent a copy of the life policy. This kind of dispute can be avoided if the insurer pays only the outstanding balance to the financier and the surplus to the beneficiary.

In accordance with the case law dealing with pledge,[18] the insurer should pay the trustee in the event of the policyholder's insolvency since *dominium* vests in his estate. The financier in turn has a secured claim against the insolvent estate for the outstanding amount owing under the loan agreement.

From the feedback it emerges that the insurers follow a different procedure since both insurers pay the bank and not the trustee. Even though the procedure as discussed in the case law is not adhered to, it is submitted that the practice in the insurance industry is the correct approach. In Chapter 4 above it was explained that the trustee only steps into the shoes of the policyholder and should not be in a better position. Accordingly, the policyholder retains *dominium* of the policy, but does not have the right to claim the policy proceeds before the secured debt is paid or to the surrender the policy. This too, must be the position of the trustee.

(v) Problems and solutions

Both insurers were not in favour of legislative intervention or the like in this area of the law. This was an unexpected and intriguing response. They reportedly have little problems with the present legal position and are of the opinion that if the life insurance contract and loan agreement are drafted simply and clearly, no problems should arise. As will be discussed below, the banks hold the opposite view and support legislative intervention.

[18] To name a few cases: *National Bank of South Africa Ltd v Cohen's Trustee* 1911 AD 235; *African Consolidated Agencies (Pty) Ltd v Siemens Nixdorf Information Systems (Pty) Ltd* 1992 (2) SA 739 (C); *Van Zyl NO v Look Good Clothing CC* 1996 (3) SA 523 (SE); *Free State Consolidated Gold Mines (Operations) Bpk v Sam Flanges* 1997 (4) SA 644 (O); *Development Bank of Southern Africa Ltd v Van Rensburg and Others NNO* 2002 (5) SA 425 (SCA); *Van Staden NO and Another v Firstrand Ltd and Another* 2008 (3) SA 530 (T).

6.3 Banks

6.3.1 Construction

Question	Bank A	Bank B	Congruency with theory
1. Are you familiar with the law governing security cessions of life policies?	YES	YES	?
2. Do you keep up to date with case law and academic literature on security cessions?	YES	YES	?
3. Briefly explain what you understand about the pledge construction	The principal debt is pledged to the cessionary, while the cedent only retains the bare dominium or a reversionary interest in the claim against the principal debtor.	A pledge is a limited real right over a third party's movable property given by the third party as security for a debt.	?
4. Briefly explain what you understand about the fiduciary security cession (*pactum fiduciae* construction)	In effect it is an out-and-out cession on which an undertaking or *pactum fiduciae* is applied in that the cessionary will re-cede the principal debt to the cedent upon satisfaction of the secured debt.	It is an out and out cession to the cessionary but as security for a debt which means that the cessionary will have to cede back to the cedent once the debt has been repaid.	?
5. In 2012 how many security cessions (number) of life policies took either construction:	Pledge construction: All Fiduciary construction: None	Pledge Construction: All Fiduciary construction: None	✗
6. Does the bank require delivery of the original life policy in order to effect a security cession?	NO	NO	✗
7. Are all of the following types of policies (or variations thereof) accepted by the bank as security: (a) Whole life polices; (b) Term Life policies; (c) Pure endowment; (d) Life endowment and (e) Annuity?	YES	NO Only (a) and (b)	?
8. Does the bank accept a short-term insurance policy as security?	YES	NO	?

6.3.2 Notice

Question	Bank A	Bank B	Congruency with theory
1. Does the bank give notice of the security cession to the insurer?	YES	YES	✓
2. Does the bank acknowledge receipt of any correspondence received by the insurer in respect of the life policy?	NO	YES	?
3. Does the bank give notice to the insurer once the secured debt has been satisfied?	NO	YES	✗
4. Does the bank give notice to the policyholder of its intention to surrender the life policy?	YES	YES	?
5. In all the instances of notice above, what form does the notice take?	Email and telephonic.	Notice to policyholder is by way of registered letter.	?
6. What does the bank do with correspondence received by the insurer?	We file it and record it on data systems as required by legislation.	Once the bank receives the policy schedule that reflects the bank as loss payee then we put it in the customer's file.	✓
7. Is the bank prepared to take a secret security cession where notice of the security cession is expressly prohibited?	NO	NO	?
8. If the bank does *not* notify the insurer of the cession and the insurer pays the policy proceeds in ignorance to the policyholder / nominated beneficiary, what course of action would the bank take and against whom?	We would consult a legal expert in the insurance field to assess our rights. We would approach and negotiate with the insurer and policyholder or beneficiary.	We do not accept a cession that does not reflect the bank as loss payee.	?
9. If the bank *does* notify the insurer of the cession and the insurer incorrectly pays the policy proceeds to the policyholder / nominated beneficiary, what course of action would the bank take and against whom?	We would consult a legal expert in the insurance field to assess our rights and would take legal action against the insurer.	If the policy reflected the bank as the loss payee and the policyholder was paid, then we would institute a claim with the insurance company.	?

6.3.3 Beneficiary nomination

Question	Bank A	Bank B	Congruency with theory
1. Does the bank, as a formality, make enquiries as to whether the security cession was intended to revoke a prior beneficiary nomination? If yes, please stipulate how the enquiry is made.	No answer	NO	?
2. Would the bank accept a stand-alone nomination in security – that is – where the bank is nominated as the beneficiary, without a cession also taking place? If so, please stipulate the number of stand-alone nominations in security accepted in 2012.	NO	NO	?

6.3.4 Payment of policy proceeds

Question	Bank A	Bank B	Congruency with theory
1. What is the general practice of the bank if the secured debt has been satisfied, but the insurer mistakenly pays the policy proceeds to the bank?	We would transfer the proceeds to the executor of the relevant estate.	The proceeds are reversed to the insurer.	?
2. If the policy proceeds exceed the amount of the secured debt and the insurer pays the total proceeds to the bank, what is the general practice of the bank in such a case?	We would transfer the proceeds to the executor of the relevant estate.	The extra funds are paid to the policyholder.	?

6.3.5 Non-payment of premiums or loan and surrender of the policy

Question	Bank A	Bank B	Congruency with theory
1. What course of action does the bank take if the policyholder defaults on loan repayments?	It would depend on the particular case and our rights in terms of the loan agreement. The default would be managed.	We follow the dictates of the National Credit Act.	✗
2. If the bank is forced to surrender the life policy due to non-payment of the loan, and the surrender value is insufficient to satisfy the outstanding balance, how does the bank recover this shortfall?	It would depend on the particular case and our rights in terms of the loan agreement. We would recover other security where applicable.	Depends on the circumstances.	✓
3. How would the bank know if the policyholder stopped paying the life policy premiums?	Some insurers notify the bank. Otherwise, we follow-up.	We ask for a revised schedule with every major transaction/interaction with the customer depending on whether it is an annual or monthly premium.	✗
4. If the policyholder stops paying the life policy premiums, what becomes of the security arrangement between the policyholder and the bank?	We would exercise our rights in terms of the loan agreement.	There is no security, we still have the property as additional security but the obligation to provide security remains as a term and condition of the loan.	✓
5. Do the bank's security cession agreements specifically state that the bank has the right to surrender the policy upon default of the loan repayments?	YES	YES	?
6. Does the bank require the consent of the policyholder before it realises the security. If yes, how is the consent obtained?	NO	NO	✓

6.3.6 Insolvency

Question	Bank A	Bank B	Congruency with theory
1. If the policyholder becomes insolvent *before* the secured debt has been paid, does the bank prefer to surrender the policy, cede it to a third party, or prove their claim in the insolvent estate? Is the choice influenced by whether the life policy has a surrender value?	We would prefer to prove our claim against the insolvent estate.	Policy falls within the insolvent estate.	?
2. In 2012 how many times (number) was the bank faced with a case where the policyholder's estate was placed under sequestration?	No answer	No answer	?
3. In the bank's view, what would be the position should the bank become insolvent?	The bank would have to consult an insolvency expert.	The cession *in securitatem debiti* is not invalidated by the liquidation of the bank	?

6.3.7 Multiple cessions and on-cessions

Question	Bank A	Bank B	Congruency with theory
1. Assuming that the value of the policy is sufficient, is it common practice for the bank to allow multiple security cessions of the same policy to itself (ie cessions within the *same* bank)?	YES	NO	✓
2. Assuming that the value of the policy is sufficient, is it common practice for the bank to allow multiple security cessions of the same policy between *different* banks?	YES	NO	?
3. Would the bank accept a security cession of a reversionary interest in the case of the pledge construction or a *pactum fiduciae* (ie the right to enforce re-cession) as the case may be?	No answer	YES, although we might reconsider based on what processes and resources we had to install to make this happen.	?
4. Are on-cessions of life policies a common practice?	NO	NO	?

6.3.8 Satisfaction of secured debt

Question	**Bank A**	**Bank B**	**Congruency with theory**
1. How are the rights under the life policy re-vested with the policyholder once the secured debt has been satisfied?	The rights are reversed due to the pledge construction.	We advise the insurance company to issue a new policy document to the customer and cancel the cession	**?**

6.3.9 Problems and solutions

Question	**Bank A**	**Bank B**
1. What problems or difficulties does the bank encounter when taking a security cession of a life policy?	The non-payment of the premiums by the policyholder is a risk. The specific wording and policy terms of policies differ and are sometimes not clear. The law is ambiguous. Obtaining noted cessions and policy schedule updates also remain a challenge.	The cancellation of policies.
2. How does the bank attempt to resolve these problems or difficulties?	We require notification by the insurer. And obtain expert advice where necessary.	No further lending without proof of insurance cover.
3. From the bank's perspective, how could the uncertainties or problems encountered in this area of the law be ideally remedied?	Legislation.	The cessions could be registered and the cessionary could be notified if the policy is cancelled.
4. Would the bank be in favour of an amendment to the Policyholder Protection Rules; or legislation (or both) in order to develop and better regulate the law surrounding security cessions of life policies? Please provide reasons for your answer.	Legislation would govern the practice surrounding cessions of life policies and could clearly stipulate the rights and obligations of insurers, cedents and cessionaries.	The bank would welcome legislation.

6.3.10 Comments and conclusions

(i) Construction

The message that is sometimes conveyed in the literature is that practitioners have a flawed understanding of cessions *in securitatem debiti*. From the explanations by the banks, practitioners appear to understand how the different constructions operate.

The feedback revealed a considerable amount of discrepancies between the banks. Bank A confirmed that all types of life policies as well as annuities are accepted for security purposes. In fact, Bank A is even prepared to accept a short term policy security. Bank B on the other hand, only accepts whole life and term life policies and does not accept short-term policies for security purposes.

What is more interesting is that the banks disclose that they do not require a copy of the life policy when the rights thereunder have been ceded as security. As was discussed above, insurers sometimes pay the full policy value to the bank and expect the bank to pay the balance to the policyholder or beneficiary if one was nominated. If the bank does not receive a copy of the policy, the bank must surely have to make additional enquiries to acquire information about the beneficiary.[19]

The most astonishing fact disclosed is that in 2012 every single security cession took the form of a pledge. Most academics suspected that the pledge was used more frequently. Evidently, however, it appears that in the banking industry the pledge construction is used to the exclusion of the fiduciary security cession. The question necessarily arises whether there is need for a fiduciary security cession and whether it should be regulated since it is so infrequently used. The fiduciary security cession is probably used more frequently in private transactions where the cessionary's need for protection is greater.

(ii) Notice

Giving notice of the security cession is the simplest way for the bank to safe guarding its security, thus it was expected that notice would be given, and the insurers' feedback confirmed this. From the responses, notice of the security cession is considered so important that neither of the banks is prepared to take a secret security cession where notice is prohibited. Further, it was expected that notice would be in written form, but unknown whether this meant letters by registered post. It can be

[19] However, as will be discussed below, it seems as though the banks do not pay the balance to the beneficiary but to the executor of the deceased estate or to the policyholder. In either instance the executor or policyholder seems to be responsible for transferring the proceeds to the beneficiary if one was nominated.

observed that email is an acceptable manner of sending written notice and it appears that telephonic notice is also acceptable.[20]

It is understandable that the banks would not in every instance acknowledge receipt of policy-related documents (especially where the insurer duplicates all its notices as discussed above), but it could save the financier the expense and inconvenience of lawsuits if it were mandatory that certain notices required acknowledgment. In this manner if acknowledgement was not forth-coming the insurer could assume that notice was not sent, or if sent, then missed and could be sent again. That having been said, the cost implication as well as the administrative burden may outweigh the benefit. It appears that there is no established practice in the industry on this issue since Bank A does not acknowledge correspondence, yet Bank B is prepared to do so.

On the question of whether the banks send notice to the policyholder on surrender of the policy, it appears to be a common practice for such notice to be sent as indicated by both banks.

Lastly, it was interesting to learn that if the insurer pays the policy proceeds to the wrong party because the bank had not sent notice of the security cession, Bank A does not target one particular party in order to recover the proceeds, but negotiates with the insurer and the person to whom payment was made. On the contrary, if the insurer pays to the wrong party where notice of the security cession was sent, Bank A takes legal action against the insurer being the party obliged to pay the proceeds and not the party who received the proceeds.[21] Bank B on the other hand has additional protection by insisting that it be nominated as loss payee, but as discussed in Chapter 4, this is unnecessary if the principles governing security cessions enjoyed legal certainty.[22]

[20] The use of telephonic notice could be problematic due to the lack of documentary record.

[21] The intention must be that the insurer can recoup the loss from the party who the received payment in error. As an aside, it may be worth mentioning that there appears to be no consistency as to who should be sued: The one who received payment or the one who was obliged to pay? If the insurer errs in payment, the bank sues the insurer who is the party obliged to pay, and not the party who received payment. In contradistinction, where the insurer has paid the full policy proceeds to the bank, the beneficiary often claims the balance from the bank believing it is the duty of the bank to perform this function (this tendency is facilitated by the attitude of the courts – see Chapter 4) and the office of the Ombudsman for Long-Term Insurance (see above). Thus the beneficiary claims payment from the bank who is the party who received payment, and does not claim it from the insurer who is the party obliged to pay.

[22] See the National Credit Act 34 of 2005 section 106(5)(d) and section 106(6)(b) as discussed in Chapter 4.

(iii) Beneficiary nomination

Unfortunately Bank A did not answer the question of whether enquiries are made regarding the revocation of beneficiaries. Bank B's answer was that it does not make such enquiries. Considering the response of the insurers' who indicated that nominations were revocable by default unless the parties' intentions were otherwise, it can be concluded that Bank A in all likelihood does not make such enquiries either.

Evidently both banks refuse to accept a stand-alone beneficiary nomination as security. This refusal is indeed a prudent one, because merely nominating the bank as a beneficiary places the bank in a risky position. On the one hand nominating the bank as a beneficiary is advantageous in that it would be entitled to the full policy proceeds regardless of the amount outstanding.

On the other hand, at any point before the secured debt has been paid the policyholder can cede the rights under the life policy. If the cession was an outright one, the bank's right as a beneficiary would be extinguished. If the cession was for security purposes, the bank would receive only the amount which remained once the debt to the cessionary has been satisfied. If this were not sufficient the bank would have to resort to others methods of debt collection. In addition, the bank would not be able to enforce the policy if the policyholder defaults loan repayments since a beneficiary does not have the right to do this. Once again, the bank would have to resort to others methods of debt collection.

(iv) Payment of policy proceeds

If the secured debt has been satisfied, but the insurer mistakenly pays the policy proceeds to the bank, the procedure of Bank A is to transfer the policy proceeds to "the executor of the deceased estate". If the policy proceeds were paid at maturity and not on death, can it be assumed that Bank A would probably transfer the proceeds to the policyholder? Assuming that the bank would pay the policyholder at maturity, if a beneficiary had been nominated, would the bank still pay the proceeds to the policyholder with the intention that the latter should transfer it to the beneficiary?

It would be somewhat peculiar if these assumptions are in fact correct. If the secured debt has been paid then the loan agreement has come to an end and the *vinculum juris* between the policyholder and the financier no longer exists. Consequently, if the financier should receive an undue payment it should return the payment to the entity from whom it was received. In this manner the insurer can distribute the proceeds as necessary. This makes more sense, especially when a beneficiary has been appointed. Further, this procedure should be followed regardless of whether the policy proceeds were paid on death or at maturity. The financier should accordingly not transfer the proceeds to the executor of the deceased estate, but rather to the insurer.

The approach of Bank B is thus the correct one. Bank B returns such undue payment to the insurer. In this manner the insurer can distribute the proceeds as necessary.

From the discussion above, it is evident that sometimes the insurer will pay the financier only the outstanding balance under the loan agreement, and other times it will pay the full value or surrender value of the policy as the case may be. In the latter instance, insurer B was under the impression that the bank would subtract the indebtedness from the amount received and pay the balance to the policyholder or the nominated beneficiary.

Bank A states that it would pay the balance to the executor of the deceased estate. Bank B states that it would pay the balance to the policyholder. The general practice of the banks can likely be interpreted as follows: If the policy pays out on death, the executor would be paid the balance, but if the policy pays out at maturity the policyholder is paid the balance. In both cases, it appears that either the executor or the policyholder becomes responsible for transferring the balance to the beneficiary if one was nominated. Again, this is not an issue if the insurer pays only the outstanding amount to the financier.

(v) Non-payment of premiums or loan and surrender of the policy

It appears that Bank A prefers to manage a situation where the policyholder defaults on loan repayments and will not immediately turn to the policy for payment. This is understandable since the surrender value may be insufficient to satisfy the loan at the time of default. Bank B stated that it would "follow the dictates of the National Credit Act" but unfortunately did not give any further information as to the particular provisions followed.

If the surrender value of the life policy is insufficient to satisfy the amount outstanding under the loan agreement both banks handle the situation depending on the circumstances of the case. Bank A added that it would "recover other security where applicable". This sounds as though the bank may insist on back-up security in order to avoid a loss. This practice is indeed supported in the case law since it sometimes happens that a third party stands surety for a loan in addition to the bank taking a security cession.[23]

The feedback of the banks corresponds to that of the insurers in that sometimes notice regarding the non-payment of policy premiums is sent and at other times it is not. It is obviously important for the financier to know whether the premiums are up to date since therein lies its security. According to the banks, if the policyholder stops paying the policy premiums, the life policy is surrendered. The duty thus falls to the bank to follow up if the particular insurer is not in the habit of sending such notices. Bank B added that the frequency of follow ups depended on whether the premiums were paid monthly or annually. Questions as to the time and cost involved come to mind. Unfortunately the respondents did not comment on these issues.

Theoretically, the very nature of a security cession allows the financier to enforce the security (that is, surrender the policy) upon default of the secured debt. However, some confusion crept in where it was thought that in order for the financier to enforce the life policy it had to obtain the consent of the policyholder, obtain a power of attorney or conclude a *parate executie*.[24] It appears as though the banks do none of this and merely stipulate their right to surrender the policy in the loan agreement, which is a necessary and obvious provision in a security agreement.

(vi) Insolvency

The banks were requested to disclose the number of times that a policyholder had been placed under sequestration in 2012 in order to learn how frequently the banks are faced with this eventuality. Unfortunately neither bank was in a position to answer this question.

According to the general principles of the pledge construction, the insolvency of the financier would have no effect on the policyholder since *dominium* of the policy at all times remains with the policyholder. The opposite is true with a fiduciary security cession and this is why the courts favor the pledge construction. Bank B is correct in that the insolvency of the financier would indeed not

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[23] For example, in the cases of *Solomon NO and Others v Spur Cool Corporation (Pty) Ltd and Others* 2002 (5) SA 214 (C) and *Van Staden NO and Another v Firstrand Ltd and Another* 2008 (3) SA 530 (T).

[24] The confusion came about due to the fact that with a traditional pledge, the pledgee is not permitted to sell the pledged article without the pledgor's consent or consent from a court. Nienaber PM "Some problems involving security cessions of life insurance policies" 2004 *SA Merc LJ* 83 94-96 discusses this issue fully.

invalidate the pledge, but the policyholder is protected to the extent that the insolvency would have no effect on the policyholder.

In the instance where the policyholder becomes insolvent before the secured debt has been paid, both insurers above responded that they would pay the surrender value to the bank. When asked the same question, the banks' response was that they prefer to prove their claim against the insolvent estate.

According to the general principles of insolvency and security cession, the trustee cannot force the insurer to surrender the life policy because he merely steps into the shoes of the insolvent, who is never entitled to surrender the policy while the secured debt remains unpaid. The instruction to surrender can only come from the financier since it is the cessionary. If the banks report that they prefer to prove their claim against the insolvent estate, then on whose instruction are the insurers acting when surrendering the policy to the bank?

Two possible explanations come to mind: First, once the bank has proved its claim against the insolvent estate, the trustee permits the bank to surrender the policy. If the insurer pays the full surrender value the bank transfers the balance to the insolvent estate where it may be transferred to a beneficiary if applicable. If the insurer pays only the amount outstanding the balance is paid by the insurer to the insolvent estate or nominated beneficiary as the case may be.

Secondly, assuming that in practice the insurer is willing to take instructions from the trustee (who is not the cessionary), the trustee gives the instruction to the insurer to surrender the policy and requests that the insurer transfer the outstanding amount to the financier and the balance to the insolvent estate or nominated beneficiary as the case may be.

The first explanation is likely the correct one since it is in harmony with the principles of Insolvency Law which puts the trustee in control of all aspects of the policyholder's insolvent estate. It is also in harmony with the principles of security which seek to preserve the object of security.

(vii) Multiple cessions and on-cessions

If the rights under a life policy were ceded as a fiduciary security cession, it is widely accepted that the policyholder cannot use the life policy to secure further credit. Since *dominium* of the policy passes to the financier nothing is left in the estate of the policyholder which he can offer as security.

On the other hand, academics are generally of the opinion that if the value of the policy is more than enough to satisfy the secured debt, an additional pledge is possible. It seems that this practice is not settled in the banking industry. Bank A permits multiple cessions to itself, and is prepared to go one step further by taking a pledge of a life policy that was already pledged as security with another bank. Bank B on the other hand does not permit any kind of multiple cessions.

There was some speculation amongst authors as to whether a policyholder could cede *in securitatem debiti* the reversionary interest (in a case where a pledge occurred) or the personal right to demand re-cession (where a fiduciary security cession occurred).[25] Bank A did not answer the question. Bank B's answer was in the affirmative but added that it also depends on the facts on the particular cases. The conclusion can be drawn that some banks may be open to this possibility, although it may not be a common banking practice.

As to the question of whether on-cession is a common practice in the banking industry, both banks responded that it was not. An on-cession would of course not be possible in a case where the policy has been pledged because *dominium* does not pass to the financier. Since the rights under a life policy are always pledged to the bank, the banks' response can be easily accepted.

An on-cession is indeed possible where the rights under the policy were ceded as a fiduciary security cession since *dominium* would have passed to the financier. In such an instance, the academic uncertainty is whether an on-cession would breach the *pactum fiduciae.* It is not clear if the *pactum fiduciae* inherently prohibits on-cessions considering that the intention of the parties is that the rights should vest with the financier only temporarily; or whether a *pactum de non cedendo* has to be concluded.[26] Unfortunately, due to the fact that banks do not make use of this construction this enquiry hit a dead end.

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[25] Reinecke MFB, Van der Merwe S, Van Niekerk JP & Havenga P *General Principles of Insurance Law* (2002) para 438 and Henckert H "Cession in securitatem debiti: A problematic case" 1993 *Insurance & Tax* 33.

[26] *Frankfurt v Rand Tea Rooms Ltd & Sheffield* 1924 WLD 253 256; *Alexander v and Another NNO v Standard Merchant Bank Ltd* 1978 (4) SA 730 (W) 741H; *Trust Bank of Africa Ltd v Standard Bank of South Africa Ltd* 1968 (3) SA 166 (A) 173D-F, 189A-C; *Lief NO v Dettmann* 1964 (2) SA 252 (A) 271E-F; *Grobler v Oosthuizen*2009 (5) SA 500 (SCA) 507G-H; *Holzman NO and Another v Knights Engineering & Precision Works (Pty) Ltd* 1979 (2) SA 784 (W) 793B-D; *Marais en Andere NNO v Ruskin NO* 1985 (4) SA 659 (A) 669E-G; *Spendiff NO v JAJ Distributors (Pty) Ltd* 1989 (4) SA 126 (C) 132E; *Illings (Acceptance) Co (Pty) Ltd v Ensor NO* 1982 (1) SA 570 (A) 572F-H; *Van Der Merwe NO v Hollard Life Assurance Co Ltd* [2003] JOL 12256 (T) 8-9; *ABSA Bank Bpk v Fourie* [2004] JOL 13048 (T) 7; *Proflour (Pty) Ltd and Another v Grindrod Trading (Pty) Ltd T/A Atlas Trading & Shipping and Another* [2010] JOL 24787 (KZN) 13.

(viii) Satisfaction of secured debt

When the rights under a life policy have been ceded by a fiduciary security cession an actual transfer of rights occurs. Once the secured debt has been satisfied, the only mechanism of re-vesting the policyholder with the rights is for the financier to re-cede the rights.

In Chapter 4 it was submitted that the pledge construction should not be considered a "cession" at all since no actual transfer occurs. In fact, the court in *Cohen's Trustee* stated that the policyholder "need only demand the return of his property and a re-cession is not necessary to complete his title".[27] The feedback from the banks appears to be in line with this. Bank A stated that "the rights are reversed due to the pledge construction" thus the bank does not effect a re-cession. Bank B merely cancels the cession and requests the insurer to issue a new life policy document that is free of any encumbrance.

(ix) Problems and solutions

It is interesting to note that like the insurers, Bank A also complains about the unclear wording of life policies. The rectification of this problem is not in the control of the financier and in this respect, the financier is at the mercy of the insurer to amend the unclear wording in its policies. It is, however, in the power of the banks to ensure that the loan agreement is couched in the clearest of words.

Bank A identified default in paying policy premiums as a one of the problems encountered with a security cession. Bank B pointed out that cancellation of the life policy was also problematic. Unfortunately the non-payment of premiums and the cancellation of life policies are risks that the financier is faced with and cannot be solved by legislation or the like. That having been said, notification of premium default by the insurer can assist the financier in preserving its security and reducing its risk. In fact, many of the uncertainties and problems encountered can be reduced, if not eliminated, through notification. Although the responses reveal that the banks may request notification, the insurer does not always send the necessary notices, and this is also confirmed by the insurers themselves as discussed above.

The banks disclosed that they are in favour of legislation while the insurers are of the opinion that it is not necessary. According to the insurers, any problems may be solved by using clear and simple provisions in the loan agreement as well as in the life policy.

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[27] *National Bank of South Africa v Cohen's Trustee* 246-247.

While clear and simple language can certainly reduce the problems and uncertainties that may arise, the following important fact must be kept in mind: The life policy is a contract between the policyholder and the insurer and the bank is not a party thereto. Similarly, the loan agreement is concluded between the policyholder and the financier and the insurer is not a party thereto. The policyholder is the common party in both contracts, but nothing binds the insurer and the financier to each other. It is for this reason that legislative intervention is necessary.

CHAPTER SEVEN
SOLUTION: LEGISLATION

7.1 Introduction

In this Chapter legislation is recommended as a possible solution to the problems experienced in this area of the law. Over the years, many academics have suggested codification of particular aspects of the Law of Cession, or codification of the Law of Cession as a whole.[1] These suggestions have sometimes accompanied discussions of the changes that should be made. As far as can be ascertained, no academics has formulated a detailed a piece of workable legislation. The legislation that is proposed below is thus a new step in the advancement of using the rights under a life policy for security purposes.

Each provision has been drafted with the feedback from practice in mind, as well as the main interests of the applicable parties. The underlying rationale was to balance the interests of all three – and sometimes four – parties involved, depending on whether a beneficiary or trustee is involved.

The most important interest to the insurer is that it pays the correct person(s) and pays the correct amount to such person(s). The financier's main interest is that the loan is repaid and this necessitates preserving the object of its security. From the policyholder's point of view, repayment of the loan is important because the rights under the life policy will re-vest in his estate once all indebtedness has been extinguished. Preserving the life policy is also of great importance to the policyholder because not only does it function as security for the loan, but it is also an asset in his estate and a *spes* for his nominated beneficiary. The beneficiary or trustee on insolvency is mainly interested in being paid the net proceeds of the life policy once the loan has been repaid.

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[1] Some include: Domanski A "Cession in securitatem debiti: National Bank v Cohen's Trustee reconsidered" 1995 *SA Merc LJ* 427; Scott S "Verpanding van vorderingsregte: Uiteindelik sekerheid?" 1987 *THRHR* 175; Scott S "Pledge of personal rights and the principle of publicity" 1989 *THRHR* 458; Scott S "Cession in securitatem debiti and merger" 1993 *THRHR* 686; Scott S "Verpanding van vorderingsregte"1996 *THRHR* 319; Scott S "Evaluation of security by means of claims: Problems and possible solutions: Section A: Problems" 1997 *THRHR* 179; Scott S "Evaluation of security by means of claims: Problems and possible solutions: Section B: Possible solutions" (continued) 1997 *THRHR* 434; Scott S "Evaluation of security by means of claims: Problems and possible solutions: Section C: Codification of the law of cession" (continued) 1998 *THRHR* 88; Scott S "Evaluation of security by means of claims: Problems and possible solutions: Section C: Codification of the law of cession" 1997 *THRHR* 633; Scott S "Security cession – locus standi" 2005 *THRHR* 691; Sonnekus JC "Sessie van saaklike sekerheidsregte?" 1997 *TSAR* 772; Van der Linde A "Sessie in securitatem debiti: Verslag van Suid-Afrikaanse Regskommissie: Aanbeveling" 1997 *De Jure* 338.

In light of the fact that the fiduciary security cession is reportedly not used by the banks, it was tempting to conclude that only the pledge construction should be codified. However, it does not make sense to ignore the uncertainties experienced with fiduciary security cessions merely because it is not used in the banking industry. A fiduciary security cession is still a valid method of acquiring security and may be more appealing to private financiers, because it offers better security in the event of insolvency.

The simplest method of introducing the proposed legislation is to add it to the Security by Means of Movable Property Act.[2] The South African Law Reform Commission had intended to regulate the pledge of personal rights in this manner and it still makes sense to do so.[3]

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[2] Security by Means of Movable Property Act 57 of 1993.

[3] See Chapter 4. Scott S "Evaluation of security by means of claims: Problems and possible solutions: Section B: Possible solutions" (continued) 1997 *THRHR* 434 who also supports the amendment of the Security by Means of Movable Property Act.

7.2 Proposed legislation

Definitions
(1) Unless the context indicates otherwise –

(i) "Financier" means any person or institution that extends credit on the strength of a life policy having been pledged or ceded as security for such credit facilities as the case may be;

(ii) "Insurer" is any company registered with a recognised authority to undertake the business of insurance;

(iii) "Life policy" is any policy contingent on the occurrence of a life event having begun, continued, having continued for a period, or having ended and includes an annuity;

(iv) "Maturity of the policy" is the elapse of a particular period of time or the arrival of a specific date as provided in the life policy at the time of its conclusion;

(v) "Nominated beneficiary" is the person who is nominated by the policyholder to receive the policy proceeds as and when it becomes due and payable;

(vi) "Notice" means written notice and includes electronic notice via email;

(vi) "Pledge" means that the right to claim the policy proceeds has been temporarily alienated by the policyholder to the financier in order to secure credit facilities;

(vii) "Pledge agreement" is the agreement evidencing the pledge and may or may not be incorporated into the credit agreement concluded between the financier and the policyholder;

(ix) "Policyholder" is the person who contracts with the insurer and who is consequently obliged to pay the policy premiums, but who may or may not be the life insured and/or the beneficiary of the life policy;

(x) "Policy proceeds" is the sum of money to be paid by the insurer on the death of the life insured or at maturity of the policy;

(xi) "Security cession" means an out-and-out cession coupled with an agreement to re-cede once the secured debt has been satisfied;

(xii) "Secured debt" means the credit facilities granted to the policyholder by the financier that has been secured by the pledge or security cession of the rights under the life policy as the case may be;

(xiii) "Surrender" is when the life policy is terminated before death or maturity.

Life policy pledged as security for credit facilities
Construction
(2) If the rights under a life policy are pledged as security for credit facilities –
- (a) the pledge agreement must be in writing and signed by the parties thereto;
- (b) a copy of the life policy must be delivered to the financier;
- (c) a copy of the pledge agreement must be delivered to the insurer, who shall record the pledge;
- (d) an insurer may accept the pledge of a life policy issued by it;

(e) subject to the provisions of the life policy in question, the rights under a life policy may be pledged to more than one financier, provided that the value of the life policy is sufficient to satisfy the total indebtedness;
(f) on-pledges or on-cessions by the financier are not permitted;
(g) unless otherwise provided, upon satisfaction of the secured debt, the pledge agreement automatically lapses and the policyholder is re-vested with all rights under the life policy.

Notice

(3) Notice must be given –
(a) by the insurer–
(i) to the financier upon non-payment of life policy premiums;
(ii) to the financier upon maturity of life policy;
(iii) to the policyholder once a pledge has been recorded against the life policy
(iv) to the policyholder when a claim for surrender or the policy proceeds has been lodged against the policy;
(v) to the financier on any material issue relating to the life policy;

(b) by the financier -
(i) to the insurer upon the creation of the pledge
(ii) to the insurer once the secured debt has been satisfied;
(iii) to the insurer and the policyholder upon non-payment of the secured debt;
(iv) to the insurer and the policyholder upon the financier intending to surrender the life policy or to request payment of the policy proceeds.

Beneficiary nominations

(4) A beneficiary nomination shall be validly revoked in the manner as stipulated by the life policy. Unless otherwise provided in the life policy, the pledge of the rights under a life policy shall not revoke a prior beneficiary nomination or invalidate any future beneficiary nomination –
(a) a beneficiary nomination shall be subject to the pledge for the duration thereof;
(b) a beneficiary nomination shall be free of the pledge once the secured debt has been satisfied.

Payment of policy proceeds

(5)(1) Unless otherwise provided, upon surrender of the policy by the financier, the insurer shall –
(a) pay the financier the outstanding balance owing under the secured debt once the financier has furnished proof thereof to the satisfaction of the insurer;
(b) pay any remaining funds to the beneficiary if one has been nominated, or to the policyholder, or the executor of the policyholder's deceased estate, or to the trustee of the policyholder's insolvent estate as the case may be.

(5)(2) Unless otherwise provided, should the life policy mature before the secured debt has been satisfied, the insurer shall –
(a) hold the policy proceeds in trust until the secured debt has been satisfied or until the financier surrenders the life policy;
(b) pay the policy proceeds to the beneficiary if one has been nominated, or to the policyholder, his deceased estate or insolvent estate as the case may be upon satisfaction of the secured debt;
(c) pay the policy proceeds in the manner as set out in s5(1)(a)-(b) upon the financier's surrender of the life policy.

(5)(3) Unless otherwise provided, if dispute arises as to the amount outstanding under the secured debt, the insurer shall, as a stakeholder, not release the policy proceeds or surrender value, but shall in accordance with Rule 58 under the Uniform Rules of Court, give notice and deposit such policy proceeds or surrender value with the Registrar of the High Court.

Surrender of the policy

(6) The financier has the exclusive right to surrender the policy during the subsistence of the pledge and may, without the consent or co-operation of the policyholder, or an order of the court, surrender the life policy upon non-payment of the secured debt, provided this right has been reserved in the pledge agreement.

Life policy ceded as security for credit facilities

Construction

(7) If the rights under a life policy are ceded as security for credit facilities –

(a) the cession must be in writing and signed by the parties thereto;
(b) a copy of the life policy must be delivered to the financier;
(c) a copy of the cession must be delivered to the insurer, who shall make a record of the cession;
(d) an insurer may not take cession of a life policy issued by it;
(e) the rights under a life policy may not be ceded to more than one financier;
(f) unless otherwise provided, upon satisfaction of the secured debt, the rights under the life policy shall be re-ceded in writing to the policyholder
(g) the financier shall not cede the rights under the life policy, or surrender the life policy or reach a compromise with the insurer during the subsistence of the security cession unless the policyholder defaults on re-payments of the secured debt.

Notice

(8) Notice must be given –

(a) by the insurer–
(i) to the financier upon non-payment of life policy premiums;
(ii) to the financier upon maturity of life policy;
(iii) to the policyholder once a cession has been recorded against the life policy
(iii) to the policyholder when a claim for surrender or the policy proceeds has been lodged against the policy;
(iv) to the financier and the policyholder on any material issue relating to the life policy;
(v) to the nominated beneficiary upon security cession of the life policy.

(b) by the financier -
(i) to the insurer upon the security cession
(ii) to the insurer once the secured debt has been satisfied and a copy of the re-cession document shall accompany such notice;
(iii) to the insurer and the policyholder upon non-payment of the secured debt;
(iv) to the insurer and the policyholder upon intending to surrender the life policy or to request payment of the policy proceeds.

Beneficiary nominations

(9) A beneficiary nomination shall be validly revoked in the manner as stipulated in the life policy. Unless otherwise provided, a security cession of the rights under a life policy shall not revoke a prior beneficiary nomination –

(a) a beneficiary nomination shall be subject to the security cession for the duration of thereof;
(b) a beneficiary nomination shall be free of the security cession once the secured debt has been satisfied.

Payment of policy proceeds

(10)(1) Unless otherwise provided, upon surrender of the life policy by the financier, the insurer shall –

(a) pay the financier the outstanding balance owing under the secured debt once the financier has furnished proof thereof to the satisfaction of the insurer;

(b) pay any remaining funds to the beneficiary if one has been nominated, or to the policyholder, or the executor of the policyholder's deceased estate as the case may be.

(10)(2) Unless otherwise provided, should the life policy mature before the secured debt has been satisfied, the insurer shall pay the policy proceeds in the manner as set out in s5(2).

(10)(3) Unless otherwise provided, if dispute arises as to the amount outstanding under the secured debt, the insurer shall, as a stakeholder, not release the policy proceeds or surrender value, but shall in accordance with Rule 58 under the Uniform Rules of Court, give notice and deposit such policy proceeds or surrender value with the Registrar of the High Court.

Insolvency

(11)(1) Unless otherwise provided, upon the insolvency of the policyholder, the insurer shall –

(a) pay the financier the outstanding balance owing under the secured debt once the financier has furnished proof thereof to the satisfaction of the insurer;

(b) pay any remaining funds to the nominated beneficiary or to the trustee of the policyholder's insolvent estate if no beneficiary was nominated.

(11)(2) Unless otherwise provided, upon the insolvency of the financier, the trustee/liquidator of the insolvent estate –

(a) shall observe the policyholder's right to enforce re-cession of the rights under the life policy;

(b) must re-cede the rights under the life policy once the policyholder has satisfied the secured debt.

7.3 Discussion of legislative provisions: Pledge

(i) Definitions

It is usual and necessary for legislation to include a list that defines and explains the terms used. An attempt was made to describe the terminology used in the proposed legislation as clearly and as simply as possible.

(ii) Construction

This section sets out the basic requirements for a valid pledge of the rights under a life policy. It is a requirement that the pledge agreement be in writing and signed by the policyholder and financier. It would become too difficult to regulate if oral pledges were permitted. It is required that a copy of the life policy be delivered to the financier since it is not wise for the financier to blindly accept the life policy without having reviewed its provisions. So too, should the insurer receive a copy of the pledge agreement, since it regulates how and to whom the insurer should pay in any given eventuality.

The proposed legislation expressly permits the insurer to extend credit on the strength of its own life policy and allows for multiple pledges of the same policy to maximise the security value of a life policy. Of course subsequent pledges or on-cession of the rights under the life policy cannot be allowed since *dominium* of the life policy always remains with the policyholder and the financier receives only the *jus in re aliena*. This sections also explains that once the secured debt has been satisfied and the need for security has consequently come to an end, the policyholder is simply re-vested with all rights under the policy once the pledge agreement lapses. No formalities need be complied with in order to re-vest the policyholder with such rights.

(iii) Notice

The intention behind the duty to send the various notices was to ensure that all parties, including the policyholder, are informed of important occurrences. As can be seen from the cases submitted to the Ombudsman for Long-Term Insurance, many of the disputes could have been prevented had proper notices been sent. The results of the questionnaires proved that notification was a contentious issue. Some notices are sent, but others are not. Sometimes notices are not sent even if required. Parties were forced to resort to following up and having to make enquiries if notice was not given. There was no common practice in the industries in this regard.

Because it is much easier for a party to give notice of a particular occurrence falling within its scope of knowledge, than for another party to constantly follow up or make enquiries, the sending of certain notices needed to be obligatory.
Based on the feedback from the questionnaires, important occurrences warranting notification include the creation of a pledge, non-payment of life policy premiums, non-payment of the secured debt, maturity of life policy, claiming the surrender value or policy proceeds and satisfaction of the secured debt.

The insurer cannot be expected to duplicate all notices regarding the life policy. However, in addition to the specifically mentioned occurrences where notice is obligatory, the insurer should send notice concerning material issues. A material issue is any issue which, according to the reasonable person, ought to be brought to the attention of the financier. That which is material will differ from case to case and will necessarily depend on the facts of each case.

(iv) Beneficiary nomination

The proposed legislation enables the provisions of the life policy to govern whether and how a beneficiary nomination can be revoked. This provision makes it clear that if a beneficiary nomination is capable of revocation, such revocation is only valid if done in accordance with the manner prescribed by the insurer.

This section also clarifies that a prior beneficiary nomination is not revoked if the rights under the life policy is pledged. The section explains that the beneficiary nomination remains in operation but is subject to the pledge. Once the secured debt has been paid the beneficiary nomination is no longer subject to the pledge and should continue to operate as if no pledge had occurred.

The provision goes one step further by allowing the policyholder to nominate a beneficiary at a time subsequent to the pledge of the rights under the life policy. Since the rights of the beneficiary are subject to the rights of the financier, it makes no difference whether a beneficiary was nominated before or after the pledge occurred. The policyholder should consequently be permitted to nominate a beneficiary at any given time.

(v) Payment of policy proceeds

As discussed in Chapters 4 and 6, the payment of the policy proceeds can be tricky. It was explained that the payment and distribution of the policy proceeds, or the surrender value as the case may be, is the function of the insurer. Not only is it in fact the function of the insurer, but placing this duty to the full extent on the insurer is the simplest way to regulate this issue and prevent disputes.

In terms of section 3(b)(ii) the financier has a duty to notify the insurer upon satisfaction of the secured debt. Where the financier surrenders the life policy, section 5(1)(a) places a duty on the financier to prove the outstanding amount. It is not the duty of the policyholder to inform or furnish proof that the secured debt has been satisfied. It is similarly not the duty of the insurer to verify whether the secured debt has been satisfied or the amount still owing thereunder. The suggestions of the office of the Ombudsman for Long-Term Insurance have not been followed in this respect.

For this reason it was suggested that in all cases the insurer pays the financier only the amount that is outstanding under the loan agreement. The balance should be paid by the insurer to the nominated beneficiary. If no beneficiary has been nominated then the policyholder is entitled to payment. If the policyholder is deceased, the balance should be paid to the executor of the deceased estate. If the policyholder is insolvent, the balance should be paid to the trustee of the insolvent estate.

It must be added that in the event of insolvency, the financier cannot escape the *concursus creditorum* that is brought about by the policyholder's insolvency. While it is true that only the financier, and not the trustee, has the right to surrender the life policy, the financier would first have to prove its claim against the insolvent estate. Once such claim is successfully proved, the financier may then proceed to surrender the life policy. This is also in line with section 83 of the Insolvency Act[4] and the procedure in the banking industry (see Chapter 6 above).

The provisions in section 5(2) cover an instance where the policy matures before the secured debt has been paid. As was suggested by the court in *Retmil*,[5] if the loan agreement makes provision for this eventuality then the situation can be dealt with accordingly. If the loan agreement is silent on the matter then the financier should hold the policy proceeds in trust until either the loan is repaid or the policyholder defaults on loan repayments.

[4] Act 24 of 1936. Section 83(8)(c) provides that a creditor who holds a claim as security shall not realise it except with the approval of the trustee or the Master. Section 83(10) states that once a creditor has realised the security, the net proceeds must be paid to the trustee provided that the creditor has successfully proven its claim. Although this sections speaks of "realising" the claim, it naturally also means enforcing the claim as in the case of a life policy which is usually surrendered on insolvency.

[5] *Retmil Financial Services v Sanlam Life Insurance Co*.

It is submitted that it is the duty of the insurer and not the financier to hold the policy proceeds in trust. Should the policyholder default on loan repayments, the insurer should pay only the amount outstanding and the insurer should distribute the surplus as necessary. If the suggestion in *Retmil* were to be followed, the financier would be performing the task of the insurer and the nominated beneficiary would again be faced with the problem of *locus standi* if he wished to sue the financier.

If there is a dispute as to the whether the secured debt has been fully paid or regarding the amount outstanding under the loan agreement, the office for the Ombudsman for Long-Term Insurance took the view that the insurer should make its own decision on the matter. This is not particularly helpful since the insurer may still pay the wrong party and/or the wrong amount.

Section 5(1) obliges the financier to furnish proof of the amount outstanding under the loan agreement. The policyholder is, of course, still at liberty to furnish proof that rebuts the financier's assertion. If the insurer can clearly establish the party(ies) to whom it must pay and the amount(s) of payment, then the insurer should pay accordingly. If the insurer is still uncertain, it cannot be expected that the insurer act as a kind of adjudicator. This is not the function of the insurer. The insurer is a debtor in this arrangement, obliged only to make a performance and not to delve into the merits of and settle factual disputes. It is unfair and inappropriate that the insurer should be caught in the middle of a dispute between the financier and the policyholder. This is the function of a court.

It is helpful to follow an approach similar to that adopted in the English Law. In English Law, where the rights under a life policy are mortgaged and the insurer is not sure to whom it should pay, the Life Insurance Companies (Payment into Court) Act 1896[6] permits the insurer to pay the policy proceeds to the court and this is deemed a good discharge. The dispute is then settled in court and correct party(ies) are paid.

Rule 58 of the Uniform Rules of Court makes provision for a situation where a person who is holding payment (usually referred to as a stakeholder) cannot make such payment due to a dispute concerning the person(s) to be paid. By making use of the Rule 58 interpleader proceedings, the insurer is permitted to make payment to the Registrar pending a court order on the merits of the

[6] Section 3 of the Act reads as follows: "…[A]ny life assurance company may pay into the Supreme Court any moneys payable by them under a life policy in respect of which, in the opinion of their board of directors, no sufficient discharge can otherwise be obtained".

dispute. Section 5(3) thus incorporates this already existing practice in order to create a fair and logical solution when disputes arise.

(vi) Surrender of the policy

Section 6 makes it clear that the pledge agreement is the basis whereupon the financier may exercise its right to surrender the life policy. As long as the pledge agreement mentions that default of the loan repayments entitles the financier to surrender the life policy, no further provisions or agreements are necessary. Such an obvious provision as this is usually a standard feature.

7.4 Discussion of legislative provisions: Security cession

(i) Definitions

The same rationale as above applies here.

(ii) Construction

As in the case of a pledge, this section sets out the basic requirements for a valid security cession. Some of these requirements, such as writing, are exactly the same as for pledge for the reasons explained above. There are, however, a few differences:

According to section 7(d) the insurer may not take a security cession of its own life policy if it is also in the business of extending credit. As discussed in Chapter 4 above, complete *dominium* passes once a security cession has occurred which would result in merger and the financier-insurer would consequently have security over its own property.

The legislation also prohibits the rights under a life policy from being ceded to more than one financier. This is in accordance with the general operation of a security cession, since the policyholder is wholly divested of any rights under the life policy once a security cession has occurred.

Once the secured debt has been satisfied, the financier is required to re-ceded the rights under the life policy and this cession must be evidenced in writing. Since it is a requirement that the security cession be recorded in writing, it makes sense that the re-cession should be in writing as well.

The provision in section 7(g) was inserted to bring about clarity in this area. In Chapter 4 it was explained that the operation of the *pactum fiduciae* has not been extensively discussed in the case law. It is unclear whether the restrictions arising from a *pactum fiduciae* are inherent therein or whether they must be expressly included by agreement.

Although the policyholder is wholly divested of his rights under the life policy, the cession is intended to be temporary since it is for security purposes only. For this reason the legislation stipulates that the financier may only surrender the life policy if the policyholder has defaulted on loan repayments, and provided the notices in sections 8(b)(iii) and (iv) have been sent. In the same vein, the financier is also prohibited from reaching a compromise with the insurer.

In addition, a *pactum de non cedendo* was drafted into this section so that any cession of the policy rights is prevented. As can be observed, the financier is only prevented from ceding the rights under the policy all the while the policyholder keeps up with loan repayments. The financier is, however, at liberty to cede the rights under the life policy if the policyholder defaults on repayments – provided the prescribed notice has been sent as stipulated in section 8(b)(iii).

(iii) Notice

The same rationale as above applies here.

(iv) Beneficiary nomination

The same rationale as above applies here.

(v) Payment of policy proceeds

The provisions governing the payment of policy proceeds in the case of a security cession and a pledge are almost identical for the reasons explained in Chapter 4 and 7.3(v) above. The slight difference is that no reference is made to a case of insolvency because insolvency is addressed in section 11.

(vi) Insolvency

As explained in Chapter 4, a fiduciary security cession places the financier in a strong position if the policyholder becomes insolvent. This is so because *dominium* of the rights under the life policy vests squarely in the estate of the financier, and the insolvency of the policyholder is thus of no consequence.[7] The financier is accordingly free to surrender the life policy in order to satisfy the outstanding debt and should pay any balance to the relevant party.

[7] *Rothschild v Lowndes* 1908 TS 493 501 summed up the position as follows: "The matter, therefore, stands in this way. The cession of a right of action *in securitatem debiti* transfers that right to the cessionary as

On the other hand, it was pointed out that if these principles were to be strictly applied, the insurer's obligation to distribute the proceeds is bypassed and the duty to distribute the policy proceeds would fall on the financier. This causes the problem of *locus standi* for the beneficiary if he wished to sue the financier. It was submitted that the correct payment procedure in the event of the policyholder's insolvency is for the insurer to pay the financier only the amount outstanding under the secured debt and to distribute the balance to the insolvent estate or the nominated beneficiary as the case may be. This submission was thus put into effect in section 11(1).

According to the principles of this construction, if the financier becomes insolvent before the secured debt has been satisfied the right to claim the policy proceeds falls into the insolvent estate of the financier. The policyholder only acquires a personal right against the insolvent estate for re-cession once he has satisfied the secured debt.

The problem with this is that if the policyholder has satisfied that the secured debt, nothing prevents the trustee from breaching the promise to re-cede. Although the policyholder acquires a claim for damages due to the breach, such a claim against an insolvent estate is classified as a concurrent claim. Concurrent creditors are usually paid only a dividend of their actual claim from the free residue of the insolvent estate. This means that the policyholder would generally be paid significantly less than the value of the policy.

It is unfair if the trustee is able to breach the promise to re-cede because the intention of the financier and the policyholder is always that the policyholder should be re-vested with all the rights under the life policy once the loan has been satisfied. To combat this unfair result, section 11(2) obliges the trustee to re-cede the rights under the life policy once the policyholder has satisfied the secured debt.

completely, so far as third parties are concerned, as an absolute cession would do. While the cession stands no right remains vested in the cedent which he can enforce against the debtor. His remedy is against the cessionary for payment of the balance, or for cancellation of the cession". See also *Mercatrust Bpk v Keepers Hosiery Suid-Afrika (Edms) Bpk (In Voorlopige Likwidasie)* 1980 (3) SA 411 (W) 412. This is also unchallenged by academics including Floyd T "Cession" in D Hutchinson & C Pretorius (Eds) *The Law of Contract in South Africa* (2009) 367-368; Nienaber PM in "Cession" in *LAWSA* (2003) 2ed para 53; Van der Merwe S, Van Huyssteen LF, Reinecke MFB & Lubbe GF *Contract General Principles* 3ed (2008) 495-496; Davis DM in *Gordon & Getz on The South African Law of Insurance* 4ed (1993) 271-272; Scott S *The Law of Cession* 2ed (1991) 232-233.

7.5 Conclusion

As can be observed, the legislation has been structured so that the pledge construction and the fiduciary security cession construction are retained as separate methods of using a life policy as security. As discussed in Chapter 4, the pledge construction does not resemble a cession since no transfer of rights occurs. Consequently, while not stretching the analogy too far, the pledge construction was treated as a traditional pledge.

The fiduciary security cession was retained but the word “fiduciary” was dropped since if there is only one type of security cession, it becomes unnecessary to identify it beyond the term “security cession”.

In most of the provisions the parties’ freedom of contract has been preserved by the phrase “unless otherwise provided”. If the parties do not wish a particular provision to apply, they need only stipulate otherwise.

CHAPTER EIGHT
CONCLUSION

"We shall not cease from exploration
And the end of our exploring
Will be to arrive where we started
And know the place for the first time"

TS Elliot

There is no escaping the fact that the pledge construction thrives in practice. Considering its doctrinal unsoundness, the recommendation of this work is that the pledge construction should not be considered as a type of security cession. Instead, two distinct methods for using the rights under a life policy for security purposes should be possible: Either pledge or security cession.

There should be only one construction of a security *cession*, that is, a fiduciary security cession. If parties wish to cede the rights under a life policy as security, the principles of a fiduciary security cession should govern the transaction. Because only one type of security cession should be recognised, there is no reason to retain the word "fiduciary" when referring to a security cession.

If parties wish to use the rights under a life policy as security, but do not intend that a cession should occur, then the rights under the life policy should be pledged as security. Accordingly, the principles of a traditional pledge should, as far as possible, govern the transaction.

Pledge and security cession should be considered as two legitimate and beneficial methods of using the rights under a life policy as security for credit facilities. Both methods have advantages and disadvantages which parties should bear in mind before contracting. Parties should, however, always have the freedom to choose how they wish to set up their security arrangement and neither method should be done away with.

Recognising a pledge of an incorporeal has many challenges and some questions that can be raised against it cannot be satisfactorily answered. In Chapter 5 the English Law charge and the New York Law concept of pledge was examined. It was tempting to suggest that the South African Law of pledge should be adjusted in line with the foreign law approach, since the pledge theory would make more theoretical sense if viewed in this manner.

The main difference between the two approaches is that in English and New York Law the financier acquires an interest, whereas in South African Law, a right is supposedly transferred to the financier. Considering the many years that it took for the pledge construction to gain acceptance, suggesting a paradigm shift of this nature was probably a bit too adventurous.

The English Law did, however, provide a solution for the situation where the insurer cannot determine to whom it must pay. In such a case the English Law allows the insurer to pay the policy proceeds into court. This was found to be a fair and straightforward solution and was thus incorporated into the legislation.

Since a major paradigm shift seemed out of the question, the alternative was to clarify and address the problem areas as thoroughly as possible. After a careful analysis of the problems in theory and in practice, legislation appeared to offer the best solution. Academics have been in support of this idea for many years. As it turned out, practitioners in the banking industry revealed that legislative intervention would greatly assist with the problems experienced in practice. For these reasons it is submitted the South African Law Reform Commission was indeed short-sighted in its decision against legislative intervention.

The final conclusion and recommendations of this work culminate in draft legislation. Drafting the proposed legislation is essentially a juggling act. It is not easy to balance the interests of all the relevant parties involved, while at the same time ensuring that the provisions are theoretically sound, and still trying to keep the needs of practice in mind. Because so many diverging principles are involved, it is unrealistic expect a perfect solution. There is no perfect solution. The recommended legislation, however, strives to come as close to perfection as possible.

The proposed legislation separates pledge and security cession as two distinct methods of using the rights under a life policy for security purposes. It addresses the problematic issues clearly and simply, and could be inserted into the Security by Means of Movable Property Act 57 of 1993 with relative ease.

Hopefully the contribution of this work opens the door for future legislative intervention.

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UNIVERSITEIT VAN PRETORIA
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2013

Security Cession Questionnaire

For the insurer

Compiled by Adv KD Sunkel

Terminology

In this questionnaire the terms below should be understood as follows:

"Bank" is any one of the banking institutions in South Africa

"Cessionary" is the bank taking a security cession of a life policy

"Formality" is the official procedure(s) carried out

"Insurer" is the respondent insurer

"Life policy" is any policy contingent on the occurrence of a life event having begun, continued, having continued for a period, or having ended

"Loan" is the credit extended to a policyholder by a bank

"Main policy document" the document that contains the core elements of the insurance contract **such as** the parties, the premium, the policy benefits and so forth

"Maturity of the policy" is the elapse of a particular period of time or the arrival of a specific date as provided in the life policy at the time of its conclusion

"Nominated beneficiary" is the person who is nominated by the policyholder to receive the policy proceeds as and when it becomes due and payable

"Occurrence of the insured event" is when a life event, as stipulated in the policy, has begun, continued, has continued for a period, or has ended

"Participant" is the individual who has agreed to respond to the questions in this questionnaire on behalf of a bank or insurer as the case may be

"Policyholder" is the person who contracts with the insurer and who is consequently obliged to pay the policy premiums, but who may or may not be the life insured and/or the beneficiary of the life policy

"Policy proceeds" is the sum of money to be paid by the insurer once the insured event has occurred, or once the policy matures

"Secured debt" is the loan granted to the policyholder by the bank that has been secured by cession of the life policy

"Security cession" is a cession of the rights under a life policy in order to secure a loan

"Surrender" is when the life policy is enforced or "cashed in" before its maturity date, or occurrence of the insured event

A. GENERAL:

1. Respondent Insurer:

____

2. Name(s) of participant(s):

____

B. CONSTRUCTION:

1. Are you (participant) familiar with the law governing security cessions of life policies?
(Y/N)

2. Where the insurer is also in the business of providing credit, does it typically accept a cession of a life policy issued by *itself* as security?
(Y/N)

3. Does the insurer typically deliver the life policy or copy to the bank once notice of a security cession has been received?
(Y/N)

4. Would the insurer consent to the policyholder ceding part of the rights under the policy to different cessionaries (ie a splitting of claims)?
(Y/N)

5. Is the insurer concerned with the construction of a security cession of its life policy (Y/N)?

6. Is the issue of a security cession addressed in the main policy document (Y/N)? If so, please state how.

____

____

7. Do the insurer's life policies contain *pacta de non cedendo*?
(Y/N)

C. NOTICE:

1. Do the life policies require notice from the bank in the event that the policy is ceded as security?
   (Y/N)

2. After receiving notice of a security cession does the insurer henceforth send all notices relating to the policy both to the bank *as well as* the policyholder?
   (Y/N)

3. Do the life policies require notice from the bank when the secured debt has been satisfied?
   (Y/N)

4. Does the insurer typically notify the bank in the event of non-payment of policy premiums?
   (Y/N)

5. Does the insurer typically notify the policyholder that a claim has been made against the policy for the proceeds or surrender value?
   (Y/N)

6. Does the insurer typically receive notice from the bank when the secured debt has been satisfied?
   (Y/N)

7. Does the insurer notify the bank when the policy matures
   (Y/N)

D. BENEFICIARY NOMINATIONS:

1. Do the insurer's life policies provide that a beneficiary nomination is revocable by default?
   (Y/N)

2. Do the life policies prescribe certain formalities with which the policyholder must comply in order to revoke a prior beneficiary nomination, or does a security cession automatically cancel a previous beneficiary nomination? If formalities are to be followed, please mention them.

   ____

   ____

3. What is the effect of a revocation where formalities are prescribed in the policy, but not complied with?

   ____

   ____

4. Where the insurer has received notification that the life policy has been ceded as security, does the insurer consider the bank as the new beneficiary (at least for the time being)?
   (Y/N)

5. Is a previous beneficiary nomination automatically revived once the secured debt has been satisfied?
   (Y/N)

E. PAYMENT OF POLICY PROCEEDS:

1. How does the insurer go about confirming the validity of a security cession where a claim for the surrender value or policy proceeds has been made, but where it has not received a prior notice of the security cession?

 ____

 ____

2. When a life policy has been ceded to a bank as security, to whom does the insurer pay the policy proceeds on maturity?

 ____

 ____

3. What is the insurer's view in respect of its liability in a case where it pays the policy proceeds to the policyholder / nominated beneficiary before the secured debt has been satisfied?

 ____

 ____

4. On the insolvency of the policyholder, where the secured debt has not been satisfied, to whom does the insurer pay the policy proceeds or surrender value (the bank or trustee)? Does the construction of the security cession play a role (Y/N)?

 ____

 ____

F. PROBLEMS AND SOLUTIONS:

1. What problems or difficulties does the insurer encounter when its life policies are ceded as security for credit facilities?

____

____

2. How does the insurer attempt to resolve these problems or difficulties?

____

____

3. From the insurer's perspective, what would be the ideal manner in which to clarify uncertainties or remedy problems encountered when a life policy is ceded as security (ie statutory intervention or the like)?

____

____

4. Would the insurer be in favour of an amendment to the Policyholder Protection Rules; or legislation (or both) in order to develop and better regulate the law surrounding security cessions of life policies (Y/N)? Please provide reasons for your answer.

____

____

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2013

Security Cession Questionnaire

For the bank

Compiled by Adv KD Sunkel

Terminology

In this questionnaire the terms below should be understood as follows:

"The bank" denotes the respondent bank

"Cessionary" is the bank taking a security cession of a life policy

"Formality" is the official procedure(s) carried out

"Insurer" is any registered insurance company in South Africa

"Life policy" is any policy contingent on the occurrence of a life event having begun, continued, having continued for a period, or having ended

"Loan" is the credit extended to a policyholder by a bank

"Main policy document" the document that contains the core elements of the insurance contract such as the parties, the premium, the policy benefits and so forth

"Maturity of the policy" is the elapse of a particular period of time or the arrival of a specific date as provided in the life policy at the time of its conclusion

"Nominated beneficiary" is the person who is nominated by the policyholder to receive the policy proceeds as and when it becomes due and payable

"Occurrence of the insured event" is when a life event, as stipulated in the policy, has begun, continued, has continued for a period, or has ended

"Participant" is the individual who has agreed to respond to the questions in this questionnaire on behalf of a bank or insurer as the case may be

"Policyholder" is the person who contracts with the insurer and who is consequently obliged to pay the policy premiums, but who may or may not be the life insured and/or the beneficiary of the life policy

"Policy proceeds" is the sum of money to be paid by the insurer once the insured event has occurred, or once the policy matures

"Secured debt" is the loan granted to the policyholder by the bank that has been secured by cession of the life policy

"Security cession" is a cession of the rights under a life policy in order to secure a loan

"Surrender" is when the life policy is enforced or "cashed in" before its maturity date, or occurrence of the insured event

A. GENERAL:

1. Respondent Bank:

____

2. Name(s) of participant(s)

____

B. CONSTRUCTION:

1. Are you (participant) familiar with the law governing security cessions of life policies?
(Y/N)

2. Do you (participant) keep up to date with case law and academic literature on security cessions?
(Y/N)

3. Briefly explain what you (participant) understand about the pledge construction:

____

____

4. Briefly explain what you (participant) understand about the fiduciary security cession (*pactum fiduciae* construction):

____

____

5. In 2012 how many security cessions (number) of life policies took either construction:

Pledge construction: ________________________ Fiduciary construction: ______________________

6. Does the bank require delivery of the original life policy in order to effect a security cession?
(Y/N)

7. Are *all* of the following types of policies (or variations thereof) accepted by the bank as security: (a) Whole life polices; (b) Term Life policies; (c) Pure endowment; (d) Life endowment and (e) Annuity?
(Y/N)

8. Does the bank accept a short-term insurance policy as security?
(Y/N)

C. NOTICE:

1. Does the bank give notice of the security cession to the insurer?
(Y/N)

2. Does the bank acknowledge receipt of any correspondence received by the insurer in respect of the life policy?
(Y/N)

3. Does the bank give notice to the insurer once the secured debt has been satisfied?
(Y/N)

4. Does the bank give notice to the policyholder of its intention to surrender the life policy?
(Y/N)

5. In all the instances of notice above, what form does the notice take?

____

6. What does the bank do with correspondence received by the insurer?

____

7. Is the bank prepared to take a secret security cession where notice of the security cession is expressly prohibited?
(Y/N)

8. If the bank does *not* notify the insurer of the cession and the insurer pays the policy proceeds in ignorance to the policyholder / nominated beneficiary, what course of action would the bank take and against whom?

____

____

9. If the bank *does* notify the insurer of the cession and the insurer incorrectly pays the policy proceeds to the policyholder / nominated beneficiary, what course of action would the bank take and against whom?

____

____

D. BENEFICIARY NOMINATION:

1. Does the bank, as a formality, make enquiries as to whether the security cession was intended to revoke a prior beneficiary nomination (Y/N)? If yes, please stipulate how the enquiry is made.

____

2. Would the bank accept a stand-alone nomination in security – that is – where the bank is nominated as the beneficiary, without a cession also taking place (Y/N)? If so, please stipulate the number of stand-alone nominations in security accepted in 2012:

____

E. PAYMENT OF POLICY PROCEEDS:

1. What is the general practice of the bank if the secured debt has been satisfied, but the insurer mistakenly pays the policy proceeds to the bank?

____

____

2. If the policy proceeds exceed the amount of the secured debt and the insurer pays the total proceeds to the bank, what is the general practice of the bank in such a case?

____

____

F. NON-PAYMENT OF PREMIUMS OR LOAN AND SURRENDER OF POLICY:

1. What course of action does the bank take if the policyholder defaults on *loan* repayments?

____

2. If the bank is forced to surrender the life policy due to non-payment of the loan, and the surrender value is insufficient to satisfy the outstanding balance, how does the bank recover this shortfall?

____

____

3. How would the bank know if the policyholder stopped paying the life policy *premiums*?

____

____

4. If the policyholder stops paying the life policy premiums, what becomes of the security arrangement between the policyholder and the bank?

____

5. Do the bank's security cession agreements specifically state that the bank has the right to surrender the policy upon default of the loan repayments?
   (Y/N)

6. Does the bank require the consent of the policyholder *before* it realises the security (Y/N)? If yes, how is the consent obtained?

____

G. INSOLVENCY:

1. If the policyholder becomes insolvent *before* the secured debt has been paid, does the bank prefer to surrender the policy, cede it to a third party, or prove their claim in the insolvent estate? Is the choice influenced by whether the life policy has a surrender value?

____

____

2. In 2012 how many times (number) was the bank faced with a case where the policyholder' estate was placed under sequestration?

____

3. In the bank's view, what would be the position should the bank become insolvent?

____

H. MULTIPLE CESSIONS AND ON-CESSIONS:

1. Assuming that the value of the policy is sufficient, is it common practice for the bank to allow multiple security cessions of the same policy to itself (ie cessions within the *same* bank)?
(Y/N)

2. Assuming that the value of the policy is sufficient, is it common practice for the bank to allow multiple security cessions of the same policy between *different* banks?
(Y/N)

3. Would the bank accept a security cession of a reversionary interest in the case of the pledge construction or a *pactum fiduciae* (ie the right to enforce re-cession) as the case may be? (Y/N)

4. Are on-cessions of life policies a common practice?
(Y/N)

I. SATISFACTION OF THE SECURED DEBT:

1. How are the rights under the life policy re-vested with the policyholder once the secured debt has been satisfied?

____

____

J. PROBLEMS AND SOLUTIONS:

1. What problems or difficulties does the bank encounter when taking a security cession of a life policy?

____

____

2. How does the bank attempt to resolve these problems or difficulties?

____

____

3. From the bank's perspective, how could the uncertainties or problems encountered in this area of the law be ideally remedied?

____

____

4. Would the bank be in favour of an amendment to the Policyholder Protection Rules; or legislation (or both) in order to develop and better regulate the law surrounding security cessions of life policies? Please provide reasons for your answer.

____

____

Declaration of Originality

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Cession of Life Insurance Policies *in securitatem debiti*: A Practical Perspective

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