



p3

Consumer credit insurance: Nienaber Panel of Enquiry



p5

FSB and KAYA FM to educate the people



p7

Performance fees: Paying for what you get?



## BESA launched first binary options market in South Africa



## THE FSB BULLETIN IS PUBLISHED

quarterly free of charge. Views expressed by contributors are not necessarily those of the FSB. Reproduction, copying or extracting by any means of the whole or part of this publication may not be undertaken without the prior permission of the editor.

## EDITOR

Dr Franso van Zyl

## SUB-EDITOR

Bessie Venter

## EDITORIAL COMMITTEE

Russel Michaels  
Olivia Davids

## COVER AND GRAPHICS

IE Communications  
(012) 347 2882

## CARTOONS

Colin Daniel, *Personal Finance*,  
Independent Newspapers

## LAY-OUT

Chilli Communication Consultants  
(012) 332 3833

## SUBSCRIPTIONS

All subscriptions enquiries should be directed to Eunice Shikalange at the contact details below.

## CONTRIBUTIONS

Contributions to the FSB Bulletin are welcome and should be sent to the sub-editor at the address below. The editor reserves the right to edit contributions.

## POSTAL INFORMATION

PO Box 35655  
Menlo Park  
0102  
Republic of South Africa  
Tel: (012) 428 8155  
Fax: (012) 347 0669  
e-mail: eunices@fsb.co.za

## THE FSB BULLETIN

is available on the Internet:  
[www.fsb.co.za](http://www.fsb.co.za)

## 3 Consumer credit insurance: Conclusions and recommendations of the Nienaber Panel of Enquiry

*By Louis Wessels, Senior Legal Consultant, FSB and member of the Nienaber Panel*

## 5 FSB and KAYA FM 95.9 to inform the people

## 7 Performance fees... paying for what you get?

*By Abel Sithole, Deputy Chairperson of the FSB*

## 8 Dark picture for interest rates

*By Flip Meyer, a freelance journalist*

## 10 BESA launched first binary options market in South Africa

*By Elmarie Kruger, Manager: Capital Markets Department, FSB*

## 12 Consumers' voice: The next wave

*By Neville Melville, Institute for Financial Excellence*

## 14 The failure of regulation and governance of pension funds

*By Adv Matome Thulare, Pension Funds Department, FSB*

## 16 FSB secures slots with Dr Mukhari Hospital Radio

*By Elliot Modisa, Manager: Consumer Education Department, FSB*

## 17 International Forum for Financial Consumer Protection and Education to be restructured

*By Olivia Davids, Head: Consumer Education, FSB and a member of the steering committee of the International Forum for Financial Consumer Protection and Education*

## 18 Decline in consumer complaints

By Louis Wessels, Senior Legal Consultant, FSB and member of the Nienaber Panel

# Consumer credit insurance: Conclusions and recommendations of the Nienaber Panel of Enquiry

**Consumer credit insurance is the insurance a consumer takes out to cover a debt he or she has incurred. It is more often than not taken out at the insistence of the credit provider as a form of collateral security.**

The indebtedness can be to a finance house, retailer, motor car dealership or to some other credit provider in case the consumer should die, become disabled, suffer critical illness or is retrenched before the debt is repaid, and, in South Africa, in case the asset in respect of which the debt is incurred is lost, destroyed or damaged.

Credit insurance has a bad name - and not only in South Africa. This perception may be due to a variety of factors. So, for example, it is generally believed that consumers are not always told, when buying goods on credit, that they are paying for credit insurance. If they are told, they are not told of the hidden limitations and exclusions in the policy, or that insurers are inclined to look for technical reasons to decline claims in

the rare cases when claims are made. It is believed that consumers are also not informed that they are paying over the odds for insurance they don't need.

These assumptions are not necessarily valid. Credit insurance is a key element of the credit providing industry and can in many respects be the enabler of the credit transaction without which the transaction would not be possible. It creates a platform without which access to credit would be limited - restricted largely to those who have a lesser need for credit. A viable, sustainable credit insurance underpin is therefore essential for a sustainable credit industry which in itself feeds economic growth.

But of course the reality is that credit insurance serves the interests of the credit provider. It is the credit provider which is often the primary beneficiary of the insurance should the insured event occur, be it the death, disability or retrenchment of the life insured or the breakdown of a vehicle or the theft of household goods.

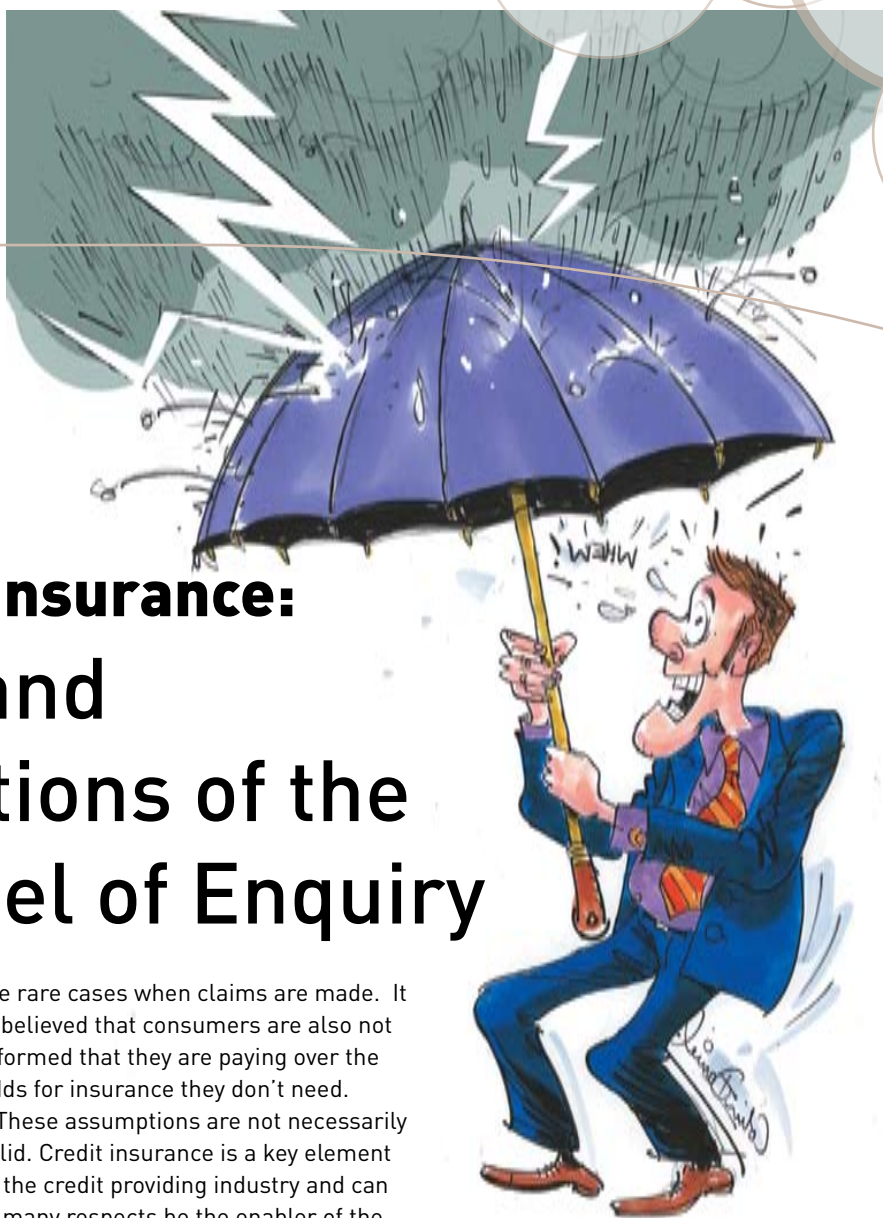
The Nienaber Panel of Enquiry investigated whether there is value in credit insurance for the consumer. It came to the conclusion that credit insurance does fulfil a real need. This is

hardly a surprise since credit insurance has proved itself over many decades and in many jurisdictions. But that there are imperfections in the system is also clear.

## Intermediary remuneration

On the issue of intermediary remuneration the Panel concluded:

- that the provisions of the Short-term Insurance Act, 1998 (STI Act) and the Long-term Insurance Act, 1998 (LTI Act) and the regulations relating to intermediary remuneration are complex and unclear; that this has given rise to confusion in the industry; and that legislation in this regard must be revised;
- that the main uncertainties relate to the payment of remuneration by insurers to third parties for the outsourcing of intermediary services; and to payments made pursuant to section 48(2) of the STI



*Continued on p 4*



## Credit insurance from p 3

Act;

- that as a result of, inter alia, an “interpretative note” by the FSB, insurers have put structures in place in terms of which intermediary services have been outsourced to third parties for additional payment. The third party can be either within the same group of companies as the insurer or independent. In either case the structure is not in conformity with a correct interpretation of the regulations if the result is that the aggregate of payments made for intermediary services exceeds the permitted maximum;
- when outsourcing took place to another company within the same group there was nevertheless no prejudice to the consumer in the same way that there would be no prejudice if the insurer rendered the services;
- that until the regulations have been reviewed and revised the insurers affected should liaise with the FSB on how to deal with matters in the interim.

### Regulation revision

Of greater importance are the recommendations the Panel makes about possible changes to the regulatory regime.

This involves a debate about a number of issues:

- Should there be any regulation of intermediary remuneration whatsoever?
- Should there be any regulation of intermediary remuneration regarding credit insurance at the lower income end of the market?
- Should only the introduction fee be regulated to prevent insurers from paying improper incentives to intermediaries to promote their business above that of their competitors?
- Should the servicing fee paid to an intermediary be regulated at all?

### First issue

On the first issue (whether there should be intermediary regulation at all), not

only the Panel but also insurers who responded to a questionnaire by the Panel are divided.

- The one view is that market forces should determine the proper level of intermediary remuneration between competitors and that commission regulation is anti-competitive and simply creates opportunities for commission regulation manipulation and contravention.
- The other view is that the time for complete deregulation has not yet arrived and that deregulation may lead to an increase in premiums, at least in the short term, to the detriment of consumers. Moreover, without any regulation of the introduction fee, there is no benchmark against which to measure improper incentives.
- This issue can only be determined as a matter of principle by discussion between the industry and various regulators.

### Second issue

On the second issue (commission regulation at the lower income end of the market) the Panel is unanimous.

- The Panel was initially of the view that in such cases at least premiums should be regulated which would dispose of the need to regulate the commission. Having heard the views of the National Credit Regulator (NCR) the Panel has been persuaded to support the view of no commission regulation at all at the lower income end of the market.
- This is in line with the approach in the LTI Act in the case of assistance business.
- The benefit level below which no commission should be payable should be determined by the various regulators in conjunction with the industry, represented by the Life Offices Association (LOA) and the South African Insurance Association (SAIA) and intermediary representatives.
- Those members of the Panel who support the regulation of the introduction fee above the predetermined benefit level are of the view that, as in the case

of assistance business, the amounts involved are so low that the perils of improper incentives are commensurately diminished.

### Third issue

The third issue (regulation of the introduction fee) is the one on which Panel members are divided.

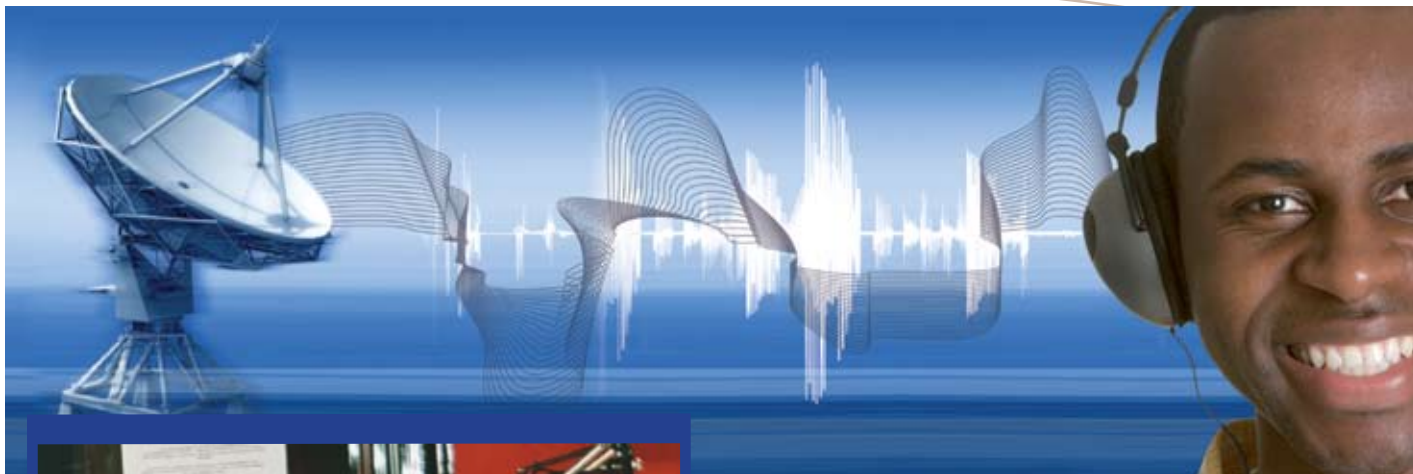
- The members of the Panel favouring the retention of a limit on the introduction fee believe that it is the only effective means of foiling a recognised mischief, namely, the payment by insurers to intermediaries of improper incentives.
- Improper incentives should be condemned. Not only does this practice increase the premiums since the cost is passed on to the consumer but it also means that the consumer does not necessarily get the best advice and service.
- The level at which the introduction fee should be pegged should be determined per product line by the various regulators in conjunction with the industry, represented by the LOA, SAIA and intermediary representatives.

### Fourth issue

On the fourth issue (should the servicing fee be regulated) there is no difference of opinion between Panel members.

- The Panel views that there is no logic for the regulation of the servicing fee. Since the insurer sees the paying of the premium as the consumer's only commitment, the outsourcing of administrative work to a third party is not to the detriment of the consumer.
- The source of most of the problems is the attempt in the STI Act and the LTI Act to regulate the fee for administrative work outsourced to third parties. If that problem is removed, as the Panel recommends, the difficulties with the regulations, even if commission regulation is to remain to a limited extent, will largely disappear.

***Continued on p 6***



**Gerry Anderson, the FSB's Deputy Executive Officer: FAIS and Consumer Education, discusses the role and function of the FSB on KAYA FM 95.9**



## **FSB and KAYA FM 95.9 to inform the people**

**By Olivia Davids, Head: Consumer Education, FSB**

**The FSB and KAYA FM 95.9, a Gauteng-based radio station, have embarked on a six-month partnership to promote the FSB's work and the importance of financial knowledge and skills.**

The objectives of the programme are to —

- inform the people of Gauteng about the FSB and its role in the protection and education of consumers;
- emphasise consumer rights and responsibilities in the marketplace; and,
- respond to presenters' questions

and the audience effectively, conveying information as completely as possible within the allocated time.

The programme was launched on 6 May at the KAYA FM 95.5 studios. It will run for six months (26 shows) until 26 October 2008. The programme comprises interviews followed by live call-ins. KAYA FM 95.9 broadcasts the programme on Tuesday evenings between 20h30 and 21h00.

### **Partners**

During the six months, the partners will organise an outside broadcast near a shopping mall as well as a seminar on financial matters with callers present to discuss concerns or important issues with the FSB and other financial sector bodies. The FSB has set up a special e-mail address to receive queries

and comments on the programme. Information from this address and recordings of the weekly programmes will form part of the basis for an in-depth evaluation report.

### **Participants**

Programme participants include FSB staff and staff from other financial regulators and ombuds offices. A schedule of broadcasts follows on p 6. Tune in to KAYA FM 95.9 on Tuesdays between 20:30 and 21:00 and send your comments to the FSB Contact Centre at 0800 20 20 87 or 0800 11 04 43, or send an e-mail to [consumer@fsb.co.za](mailto:consumer@fsb.co.za). This radio station is also accessible on DStv Music Channel 161.

## Credit insurance from p 4

- It is only in the case of credit life issued under the LTI Act that administrative work is specifically regulated at 15% of the Gross Written Premium (GWP). The Panel is unaware of any other instance

where it is necessary to regulate a fee corresponding to the servicing fee in South Africa.

### MARKET CONDUCT

The evidence of actual market

misconduct on the part of insurers was mostly general and anecdotal. It was the Panel's impression that individual insurers mostly strive to comply with market conduct regulation although it is not always achieved. One only has to read the Annual Reports of Ombudsman's organisations to realise that non-compliance with the standards of what is fair and appropriate conduct is far from rare. What is true for insurance is equally true for credit insurance.

In that respect South Africa is not unique. The parallels between market misconduct in South Africa and in countries like the UK, Australia and the USA are apparent. So too, are the efforts to contain them by regulation. South Africa, in the view of the Panel, is no worse than others and better than some.

### RECOMMENDATIONS

- Credit insurance should be seen as a unique insurance field with a variety of disparate products that are to be treated separately from other more customary forms of insurance.
- The provisions of the LTI Act, the STI Act and their regulations relating to intermediary remuneration should be thoroughly reviewed and revised, in line with decisions taken on the matters of principle outlined above.
- The LTI Act and the National Credit Act, 2007 (NCA) should be revised to allow for the NCR to assume market conduct control over credit insurance in conjunction with the control exercised by the NCR over credit.
- The LOA and SAIA should appoint a permanent standing committee dedicated to credit insurance matters.
- The standing committee should be the prime mover in co-ordinating and fostering consumer education and awareness of credit insurance. It should agitate for a separate budget allocation from the LOA and SAIA and liaise with the FSB and other governmental and non-governmental agencies active in the field of credit insurance and consumer education.

### Topics and interviewees continued from p 5

Week	Topic	Interviewee
6 MAY	FSB Role and function	Gerry Anderson
13 MAY	FAIS: a. Licensing process b. Fit and Proper	Felicity Mabaso Tefo Moashe
20 MAY	Pension Fund Adjudicator	Mamodupi Mohlala
27 MAY	Financial Sector Charter	Kennedy Bungane
3 JUNE	PENSIONS: a. Retirement fund trustee training b. Corporate governance	Wilma Mokupo
10 JUNE	NCR and the National Credit Regulator	Peter Setou
17 JUNE	Funeral assistance business	Jacky Huma Paxton Ramothata
24 JUNE	Collective investment schemes	Jacob Mahlangu, Annelize Jansen van Rensburg
1 JULY	Capital markets	Norman Müller
8 JULY	FAIS Ombudsman: role and responsibilities/ complaints handling process	Charles Pillai
15 JULY	Regulation of friendly societies	Fikile Mosoma
22 JULY	Consumer education	Elliot Modisa, Lyndwill Clarke, Olivia Davids
29 JULY	Over-indebtedness and debt counseling	Mpho Thekiso
5 AUGUST	Ombudsman for Short-term Insurance	Hendrik Vijoën, Karinien Kok
12 AUGUST	FAIS: a. General Code of Conduct b. Obligations of the FSPs	Manasse Malimabe
19 AUGUST	Ombudsman for Long-term Insurance	Justice Brian Galgut
26 AUGUST	JSE Limited. Consumer education	Maureen Dlamini
2 SEPTEMBER	Anti-money laundering in South Africa	Elias Phiyega
9 SEPTEMBER	Short-term insurance	Patrick Ward
16 SEPTEMBER	FSB Call Centre	Russel Michaels
23 SEPTEMBER	Long-term insurance	Suzette Vogelsang
30 SEPTEMBER	Credit Information Ombud	Caroline Buthelezi
7 OCTOBER	Pension fund surplus	Christian Ahlers
14 OCTOBER	Market abuse	Gerhard van Deventer
21 OCTOBER	Banking Ombud	Adv. Clive Pillay
28 OCTOBER	Reserve Bank	Errol Kruger

# Performance fees... paying for what you get?

This article is in response to the article by J Schreuder "Pay for what you get – the case for good performance fees" *FSB Bulletin*, second quarter 2007, p 9 (editor's note).

The trend for asset managers and collective investment schemes (unit trusts) to charge a performance fee has been growing in South Africa in line with the experience elsewhere in the world. The fact that it is common both here and abroad does not mean that it is correct.

The rationale for performance fees is given as the alignment of the interests of asset managers with those of investors. This would manifest itself in better investment performance. This intent of alignment of interests makes it difficult to argue against performance fees. As a result, the practice gets entrenched without due consideration and interrogation of its merit.

The current convention is for asset managers and collective investment schemes to charge a basic fee of a pre-negotiated or pre-determined percentage of assets under management for their services.

Other than the fact that this is historically how it has been done, there is no claim that this is necessarily the most appropriate way for charging for asset management services. There is no reason why a fixed rand amount could not be the basis for paying for the service, other than the fact that the providers of the service would be deprived of a certain and regular annuity income stream which increases as the assets grow, without the need to review the fee or increase the service provided.



**By Abel Sithole,  
Deputy  
Chairperson of  
the FSB**  
*(in his personal  
capacity)*

## Percentage of assets

The charging of a percentage of assets as a fixed or performance fee, or a combination of the two, is not immutable. The nature of the service provided does not depend on the method used to pay for it. Pension funds administrators used to charge a percentage of contribution until this changed to a fixed rand per member per month with the advent of defined contribution funds. It is doubtful if any direct attribution to deterioration of service as a result could be made.

When performance fees are discussed it is almost always the technicalities that are considered, their impact on performance, benchmarks and hurdle rates, affordability, size of the fee, fee cap, asset manager's revenue, operational complexity, etc. What

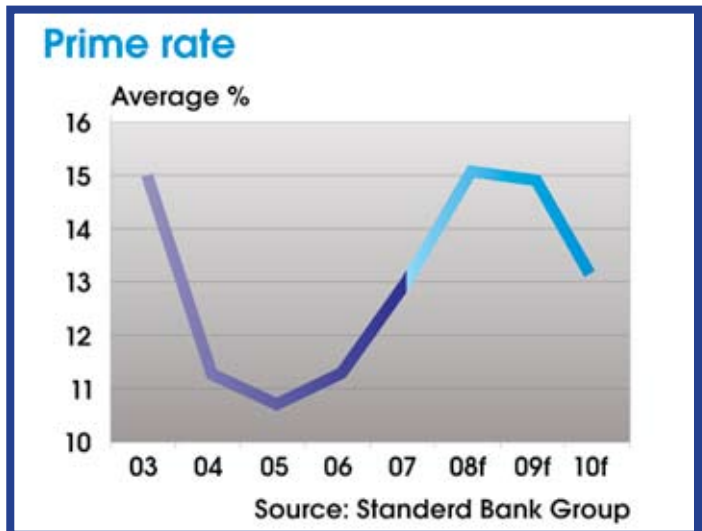
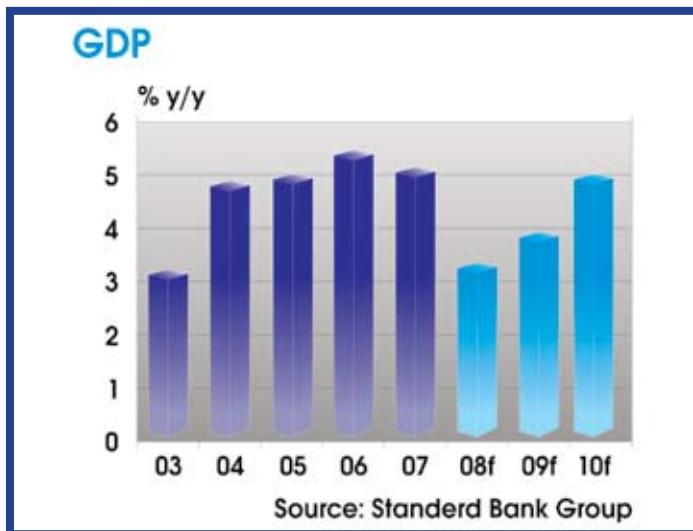
these purport to be and provide to those who subscribe to them are never interrogated.

It is almost a moot point to say that investors entrust their assets to asset managers and collective investment schemes to get the best investment returns they can, regardless of how the services providers charge for their services. It is also indisputable that when an asset manager accepts a mandate to look after an investor's assets, it is with the aim of achieving the best investment return on those assets. If this is not the case, the asset manager should not be offering his or her services to the public.

Performance fees put in my view in question the principles and decision-making process of asset managers. The charging of performance fees seems

***Continued on p 9***





# Dark picture for interest rates

By Flip Meyer, a freelance journalist

**Interest rates in South Africa will not decline for at least another year. It could even be worse.**

Ulrich Joubert, who won the *Sake24* Economist of the Year award three times, says interest rates will not decline before 2010. Joubert might be seen as a pessimist but he says South Africans have overspent and have been on a credit joy ride for too long. Pay back time has come. The inflation rate is out of control and the only way to get this rate back to single digits will be further increases in interest rates.

Some economists are predicting that the prime lending rate of banks could be 16,5% within the next year. This is 2% higher than the prime lending rate before June 12 2008 when this article was written.

The reason it will take so long for interest rates to decline is because the current inflation rate of over 10% is more than 4% above the upper end of the inflation targets set by the Reserve Bank. The inflation target is between 3% and 6%. The target should actually be in the

middle, at 4%.

It will take a long time for the inflation rate to decline to 4%. Tito Mboweni, governor of the Reserve Bank, has indicated that for consumers and businesses it will get worse before it becomes better.

Interest rates will let consumers spend less because disposable income will stay under pressure. Consumers have already started spending less. Therefore suppliers of goods and services will eventually not be able to hike prices because of the fall in the demand for their products. Higher interest rates will be with us for some time to close the gap between the actual inflation rate and the inflation targets.

Another rate hike was announced in June and more hikes are expected that would bring the total increase for 2008 to 2%.

This is far worse than economists expected at the beginning of 2008. What went wrong?

Many negative factors surfaced which were not expected at the beginning of 2008.

Fuel prices together with the cost of food have increased at a higher rate than forecasted in January. The oil price has soared to over \$140 a barrel. No South

African economist expected that the price of oil would reach such a level. Neither did anyone expect the petrol price to head for R10 a litre.

The value of the rand has softened against the major currencies like the euro, the Japanese yen and the US dollar. The value of the rand towards the dollar is expected to move between R7, 50 and R8 to the dollar for the rest of 2008.

Higher oil prices in US dollars and a weaker rand leads to rises in petrol prices. The cost of transport for 2008 could increase by 20% should oil prices escalate further and the rand weaken against the US dollar.

The cost of food has become a major concern. For lower income groups food items as a percentage of total expenditure is greater than for the higher income groups. This is a world-wide trend and not exclusive to South Africa. Although economists did forecast rises in food prices they did not foresee the intensity experienced a few months later.

The Standard Bank Group says in its latest economic forecast that a leading retail group expects food prices to climb by a further 20% over the next six months.



The electricity crisis was another unforeseen factor. The influence of the shortage of power can already be seen. The mining industry is under pressure. Besides the power crisis, production losses were aggravated by mineworker strikes. Gold production has fallen by 10% in the first quarter of 2008. Production of energy intensive platinum metals contracted sharply by 13% this quarter.

The huge influence of the electricity shortage was not on the cards when economists made their predictions for 2008. Most expected that interest rates would start declining by the fourth quarter of 2008.

Standard Bank says it also fears that the xenophobic violence which gripped South Africa in May could leave mines with negative growth repercussions in

the second quarter due to their high foreign labour contingent.

Dave Mohr of Citadel, who won the Economist of the Year competition twice, predicts that South Africa has already moved towards a recession. He has analysed what happened in periods when South Africa had recessions and says the circumstances at this stage shows that there is a 50% possibility of zero or negative growth. New passenger car sales already have a record of a recession. House prices are under pressure. Together with high inflation and soaring interest rates, Mohr reckons that the current situation is similar to past recessions.

However, most economists participating in the *Sake24* Economist of the Year competition do not foresee a full scale recession. A recession is

defined as two successive quarters of zero or negative growth.

Mohr says a recession is a normal part of the economic cycle. South Africa had a boom period for about four years and the time for a sharp correction has come.

Mohr says that the economic growth in the last quarter of 2007 was more than 5%. Should the average economic growth for 2008 decline to 2,5% there must be a period of economic recession because this statistic comes from a high base.

"It is not the end of the world. It will be a recession over a relatively short period," he says.

Prepare for a period of pain before better days arrive.

*(www.flipmeyer.com)*

### Performance fees continued from p 7

to me to attest to the fact that an asset manager will make a deliberate suboptimal decision on the basis that a fee is paid. Imagine that an asset manager, after rigorous research and analysis, arrives at the conclusion that a particular company has very good return prospects and should be included in his or her clients' portfolios. Would he or she then ensure that only those clients who pay performance fees benefit from this finding? If the answer is yes, it means that the portfolios of clients not paying performance fees are populated with counters that the asset manager knows do not have good return prospects.

In such instance, the asset manager should not be looking after these clients' assets at all. If the answer is no, then there is no benefit in paying performance fees as all clients benefit from the best decision that the asset manager makes. In such case, the clients paying performance fees are being charged under false pretenses. The argument would be made that

preference is given to clients on a relative rather than absolute basis but the cumulative effect would be the same. It can also be said that clients who are not prepared to pay performance fees should accept that they would be treated commensurately.

### Spell out clearly

Asset managers should spell out clearly then to investors that they would not be seeking the best possible investment returns on their behalf, on account of these investors not paying performance fees. More disturbingly, they will deliberately put them second in the queue in their investment decision-making processes. The question may be asked whether they would not be contravening the law where they are legally bound to act in the interest of clients.

Would this conundrum be resolved by an asset manager opting to charge all clients only performance fees? It would not be if there was any difference in the size of the performance fee. Logically speaking, a performance fee as it is currently justified, would mean

those who pay more would still get preferential treatment. If all clients were to pay the same performance fees, all clients would be treated equally and derive the same benefit. Performance fees would thus have no special incentive.

Performance fees are in my view fundamentally problematic, especially in those instances where asset managers (and collective investment schemes) intimate that they do not ordinarily, as a matter of course, do their best to achieve the best possible investment returns for their clients by seeking the additional incentive of a performance fee to do so.

In my opinion the proliferation of performance fees is probably more the result of sleek marketing and investor indifference, if not gullibility, than value added. Acquiescence on the part of asset/investment consultants, financial advisors and, may I say, regulators who have addressed, if at all, the technicalities rather than the substance of performance fees has also contributed to their credence.

# BESA launched first binary options market in South Africa

By Elmarie Kruger, Manager: Capital Markets Department, FSB

**During 2007 the Bond Exchange of South Africa Limited (BESA) entered into a joint venture with a third party to deliver a platform capable of trading event driven futures.**

The new BESA rule book, which incorporates rules relating to the binary options market, was published on 30 November 2007 in Board Notice 30533 of 2007. It came into operation on 17 December 2007, upon the approval by the Registrar of Securities Services.

## Definition

A binary option is defined as the right, but not the obligation, to receive a fixed pay-out at some agreed future time at a pre-specified price of the underlying instrument. It is a relatively new form of market in which event driven futures are traded where the instruments traded are determined by the outcome of a future event.

These instruments can be interpreted as "derivative instruments" which are included under the definition of "securities" in the Securities Services Act, 2004 (SSA).

## Characteristics

Binary options are characterised by

a discontinuous pay-off profile which only offers two payment outcomes that are certain to the counterparties to the trade, i.e. the option has a certain pay-out amount or it pays nothing. It is this risk/reward pay-off profile certain to either party that makes these instruments attractive.

Secondly, these are European style options which can be exercised through cash settlement on the expiry date of the option and no sooner.

If you agree that an event will take place, you would purchase a contract and the purchase price equals the probability of the event happening. If you disagree and do not think that the event will take place, you would sell the contract.

All binary option contracts will trade between zero and 100. When the contracts expire the underlying binary event determines whether the contract condition is true (contract is worth 100 to the buyer and zero to the seller) or false (contract is worth zero to the buyer and 100 to the seller).

Each contract has a data source and an arbitration agency. The data source is the objective, independent origin of the price or level of decision. The agency is the authority that issues the close-out price of the contract based on the underlying source.

## Target market

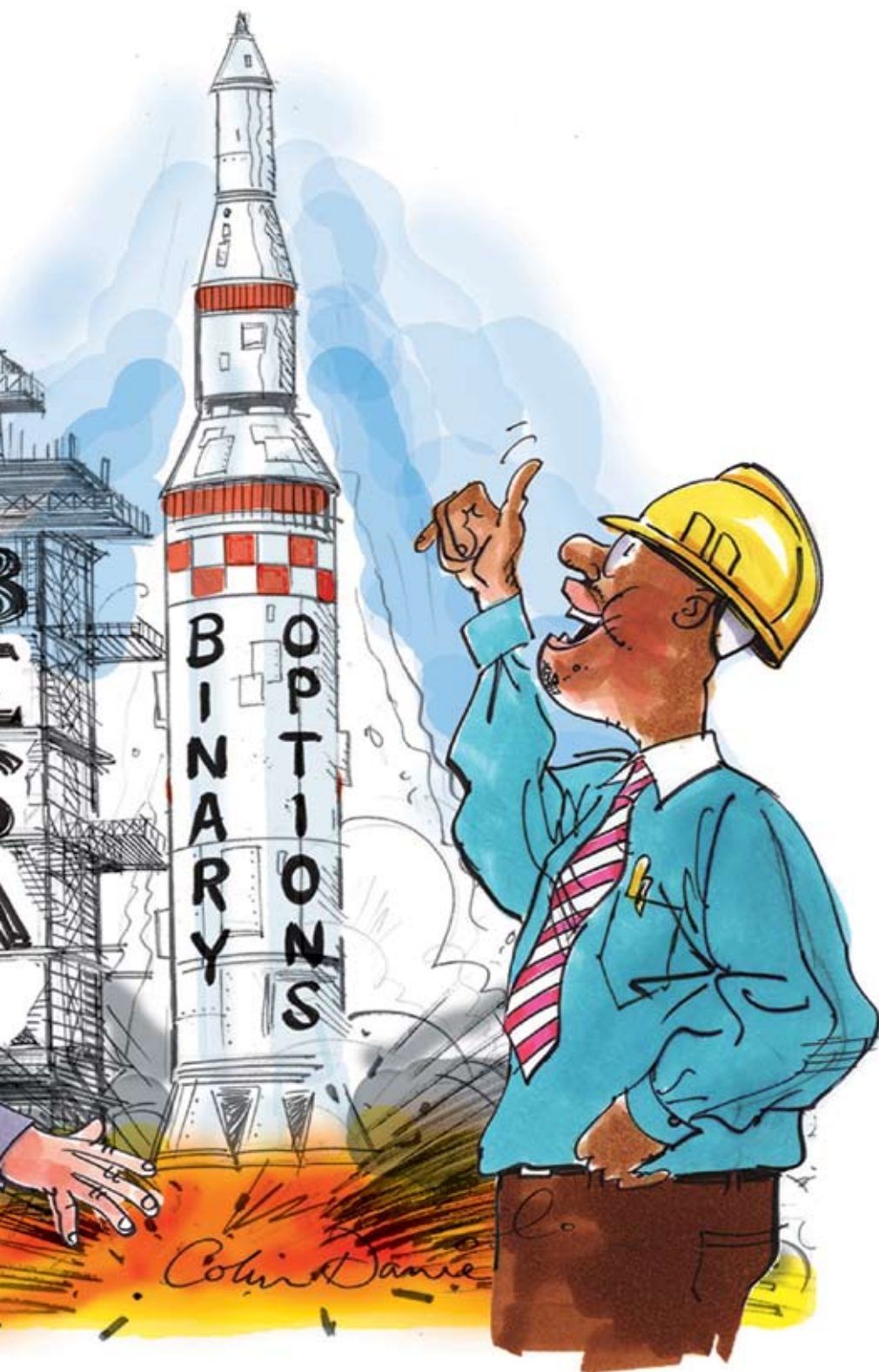
The target market segment will initially



be goal orientated risk takers (traders, bankers, economists and academics), eventually being rolled out to the general retail market. The target market also includes risk averters who may want to hedge a position that is dependent on a future event.

## Surveillance

All trading takes place online and in real time, making surveillance easier.



Surveillance algorithms are embedded in the system with real time flagging. Records are stored on databases with all positions being tracked real-time. All margin and cash flows must take place before a trade can be executed.

#### Asset classes

Binary options currently operate within the following asset classes:

- Economic indicators, e.g. CPI, CPIX

- Interest rates, e.g. repurchase rate, bond yields
- Individual equities

#### Example

The example in the table below illustrates the concept:

The example shows a Monetary Policy Committee (MPC) contract (since the repo rate is determined by the SARB's MPC). The contract expires on 7 June 2008 and has as arbitration criteria 50 basis points up. The contract is categorised as part of the "repurchase rate" underlying instrument. This rate is one of the underlying instruments in the class "interest rates".

The contract pays R100 if the SARB's MPC raises the repo rate by 50 basis points. The contract pays zero for any other result. An official SARB announcement applies. The data source is therefore SARB which would announce the decision of the MPC, and the agency is BESA that would determine, based on the decision, what the close-out price of the contract would be. Based on this decision and in terms of the conditions of the contract, the close-out price is either zero or 100.

In short, if the MPC raises the repo rate from 8% to 8.5% then the contract pays 100. If this does not happen, the contract pays zero.

Class	Interest rates
Underlying instrument	Repurchase rate (repo rate) of the South African Reserve Bank (SARB)
Contract	MPCM 080607P.050bpU
Strike	Repo rate + 50 basis points
Closing date	2008-06-07



# Consumers voice: The next wave

By adv. Neville Melville, Institute for Financial Excellence

The dust has hardly settled after the introduction of the National Credit Act, 2007 (NCA) and the next piece of consumer rights oriented legislation, the Consumer Protection Act is on its way. The Consumer Protection Bill (CPB) is in its third draft and will in all likelihood, be passed in 2008.

The CPB represents the jewel in the crown of the Department of Trade and Industry (DTI)'s efforts to bring about fairness in commercial dealings with consumers. Commentators have suggested that the CPB should have preceded and provided the foundation for other pieces of consumer protection legislation already promulgated. These include the Housing Consumer Protection Measures Act, 1998, the Financial Advisory and Intermediary Services Act, 2002 (FAIS Act), the Financial Services Ombud Schemes Act, 2004 and the National Credit Act, 2005.

The South African Government's admirable endeavours in the field of consumer protection have been motivated in part by its commitment to international consumer rights.

The eight consumer rights promoted by the United Nations are:

*1. The right to safety*

To be protected against products, production processes and services which are hazardous to health or life.

*2. The right to be informed*

To be given facts needed to make an informed choice, and to be protected against dishonest or misleading advertising or labelling.

*3. The right to choose*

To be able to select from a range of products and services, offered at competitive prices with an assurance of satisfactory quality.

*4. The right to be heard*

To have consumer interests represented in the making and execution of government policy, and in the development of products and services.

*5. The right to satisfaction of basic needs*

To have access to basic essential goods and services, adequate food, clothing, shelter, health care, education and

sanitation.

*6. The right to redress*

To receive a fair settlement of just claims, including compensation for misrepresentation, shoddy goods or unsatisfactory services.

*7. The right to consumer education*

To acquire knowledge and skills needed to make informed, confident choices about goods and services while being aware of basic consumer rights and responsibilities and how to act on them.

*8. The right to a healthy environment*

To live and work in an environment which is non-threatening to the well-being of present and future generations.

The objectives of the CPB include the promotion and protection of the economic interests of consumers,



improving their access to information to enable them to make informed choices, protecting them from safety hazards and developing effective means of redress.

With the advent of the CPB, that old adage, “*The customer is always right*,”<sup>1</sup> will become a lot closer to the truth.

The CPB will be welcomed by lawyers because it brings about radical changes to the pre-existing mercantile law where provisions often lack clarity as to how they are to be applied.

The CPB will have a far wider scope than the NCA as it will apply to every transaction between a supplier of goods or services and a consumer, other than transactions with the State or transactions with corporate entities where the value of the transaction exceeds a prescribed threshold (still to be determined). Unless it is changed before being passed by Parliament, the CPB will also apply to those entities covered by the NCA in addition to the NCA. It will also apply to advertisers of goods or services that fall within the CPB.

The CPB represents a fundamental change to the underlying philosophical approach of the law. Under the common law, the general position is summarised by the Latin phrase, *caveat emptor*, meaning let the buyer beware. According to this approach, the buyer is responsible to look out for his or her own interests. This is not to say that the buyer is totally unprotected: the common law for example implies a warranty against defects and protects the buyer against fraud. The common law will continue to govern transactions that fall outside of the CPB’s ambit.

If the CPB is passed in its present form, the position will be more accurately described as *caveat vendor* (let the seller beware).

Much of what is contained in the CPB is a codification or confirmation in statutory form of the common law, such as the provision in clause 19 (2) that it is an implied term of a contract that the supplier is responsible to deliver the goods or perform the services as agreed

or within a reasonable time.

In other areas, entirely new rights have been created, for instance, a consumer’s right to cancel an advanced booking or reservation for goods or services (clause 17 (2)). Other new rights are listed below.

Some of the new provisions have dramatically changed the position regarding the liability of suppliers of goods.

Under the common law, a supplier can only be held liable for damages arising as a consequence of supplying unsafe or defective goods if there was proof that the supplier has been negligent. Now, in terms of clause 61 (2), the supplier would be held strictly liable, i.e. it would not be necessary to prove fault or blame on the part of the supplier in order to succeed in a claim against it.

#### **May return goods**

A consumer may return goods to the supplier and receive a full refund if the consumer intended to use the goods to satisfy a particular purpose which was communicated to the supplier and the goods have been found (presumably by the consumer) to be unsuitable for that particular purpose (clause 20(2)(d)).

The risk, which was previously carried by the customer, has now been shifted to the supplier. An example of this is where a consumer accidentally breaks an item on display in a shop. Previously, if the shop owner had prominently displayed a notice stating that the customer would be held liable for such breakages, the consumer would have to pay the cost of the broken item. Now, clause 18 (1) prevents a supplier from charging a consumer or potential consumer for any loss or damage to any goods displayed by the supplier, unless the consumer was negligent or reckless, or acted maliciously or criminally.

A supplier may also not impose any cancellation fee in respect of a booking, reservation or order if the consumer is unable to honour it because of the death or hospitalisation of the person for whom, or for whose benefit the booking,

reservation or order was made (clause 17(5)).

A comprehensive analysis of the CPB is beyond the scope of an article of this nature.

These examples are given purely to alert those who are accustomed to operating in terms of the existing law that they will need to be vigilant in checking the new legal position.

The CPB will set up structures to regulate consumer protection, including a National Consumer Commission and a Tribunal, and it will, as the title of the Bill suggests, protect consumers in a variety of ways.

The harmful practices that consumers are to be guarded against include —

- discrimination
- breach of confidentiality
- unwanted telemarketing
- restriction of freedom of choice
- fixing of a price without providing an estimate
- provision of unsolicited goods
- negative option marketing

Consumers will also benefit from a number of rights including —

- the right to choose or examine goods
- the right to receive delivery of the goods/services
- the right to cancel a reservation/standing order/continuous service agreement
- the right to a cooling off period
- the right to return goods

Similarly as with the NCA, the CPB places an emphasis on providing means of dispute resolution. The options open to a dissatisfied customer are to —

- approach a court or consumer court

***Continued on p 15***



# The failure of regulation and governance of pension funds

By Adv Matome Thulare, Pension Funds Department, FSB

In a paper<sup>11</sup> presented at the annual convention of the Financial Planning Institute, the following was remarked:

*"Some of our funds have become so large that they have become the personal fiefdoms of their chief executives or principal officers. Remember the principal officer of the SACCAWU provident fund who managed to siphon some R14 million out of the fund's expense account to use in impressing his girlfriend."*

Pension fund governance is not a luxury, but a necessity. The following cases show what happens when governance is considered "a nice to have".

**This is the third article in a series of articles regarding trustees' duties in the regulation of occupational pension funds. The first article looked into the history of pension funds and pension funds as a form of "trust", while the second article examined the function of the management of pension funds with particular focus on the board of trustees. This article examines the current lapses in the governance of pension funds through an analysis of case studies.**

## The Fidentia scandal

The Fidentia saga represents one of the worst cases of the collapse of pension fund governance in our history - a national disaster, similar to Enron in the US. When the matter became public, Moneyweb<sup>21</sup> described Fidentia as "our worst nightmare".

In 2000, the Mineworkers Provident Fund (MPF) entered into an agreement with the Mercantile Asset Trust Company

(Mercantile) to invest and administer the benefits of deceased members of the MPF. The funds were held in the Matco Umbrella Trust and Mercantile provided the trustees of the trust.

In 2003, Mercantile was sold to an empowerment business called Mantadia Asset Trust Company (Mantadia). Neither the trustees of the MPF nor the trustees of other retirement funds that entrusted money to Mercantile were given a say in this sale.



In October 2005, the entire share capital of Mantadia was bought by Fidentia. Mantadia was renamed Living Hands (Pty) Ltd and the trust renamed Living Hands Umbrella Trust (Living Hands).

Fidentia appointed new trustees, including its own employees and the assets of R1.2 billion were withdrawn from Old Mutual Asset Managers and placed under the control of Fidentia Asset Management. Then the plunder started.

If one considers the Fidentia saga, it becomes clear that the trustees of MPF were nowhere near the scene of events and could not have influenced the events to prevent the plunder.

The Regulator was also absent when the plunder of assets started. The main victims of Fidentia's rape of the Living Hands were 46 000 widows and orphans.<sup>3]</sup>

To understand what went wrong with Fidentia, one needs to investigate the shortcomings in retirement fund legislation. The law provided a loophole for criminal activity to take place without detection.

Firstly, payment by a registered pension fund to a trustee contemplated in the Trust Property Control Act, 1988 for the benefit of a dependant or nominee contemplated shall be deemed to be a payment to such dependant or nominee.<sup>4]</sup>

Secondly, as soon as payment was made to a "trust", the trustees of the pension fund ceased to take responsibility for the administration of the benefit of the dependant or nominee. The trustees of the "trust" registered with the Master of the Supreme Court assumed full responsibility.

Due to structural and capacity issues, the office of the Master cannot exercise effective regulation of trustees of the trust.

Consequently, criminal schemes are perpetuated without detection, until the beneficiaries cry out. Simply stated, the weakness in legislative oversight provided a fertile ground for the Fidentia rape.

### **PPWAWU National Provident Fund v The Chemical, Energy, Paper, Printing, Wood and Allied Worker Union case**

In this case, the fund took the union to court and requested the court to set aside a resolution taken by the union on the grounds that it is unenforceable, contrary to law and/or public policy. The Resolution in question sought to impose obligations on trustees elected or appointed by the union or its members to manage benefit funds established by the union. If those trustees did not follow the union mandate, they would be in breach of their duties to the union and would face expulsion from the union and removal from the board.

The court held that all the fund's trustees owed a fiduciary duty to the fund, its members and other beneficiaries. The Court further held that

each of the fund's trustees is required to exercise an independent judgment as to what constitutes the best interests of the fund. Furthermore the Court found that a trustee's obligation to exercise an independent judgment, regardless of the views of the trade union (or employer) which appointed him, is similar to the director's (link trustee with director?) obligation to exercise an independent judgment, regardless of the views of any party which may have procured his or her appointment as a director. (see above – link)

PPWAWU illustrates the role and duty of a trustee. It undoubtedly confirms the independence of the board from those who appointed them. It is trite that trustees face heavy responsibilities when they accept appointments to the

*Continued on p 16*

### **Next wave from p 13**

- attempt to resolve any dispute with a supplier either directly, or through alternate dispute resolution
- approach the Commission
- go directly to the Tribunal.

### **Conclusion**

The CPB will undoubtedly change the business landscape in South Africa beyond recognition. Many of its provisions will benefit consumers (particularly those who are unsophisticated) and stamp out the heartless business practices still prevalent in certain industries.

It remains to be seen, however, how practical it will be to implement some of its provisions. One need only imagine a store assistant with a grade 6 education having to decide whether the displayed tea service was mistakenly broken as opposed to being broken due to the negligence of the

customer; or advise on the suitability of one of a thousand imported gizmos carried in stock by the store for the use to which the customer intends to put it. (Not to mention the challenge deciding who said what, should a dispute arise and the matters proceed to court or the Tribunal.) One cannot help but wonder whether every employee of an organisation will need to undergo some sort of "fit and proper" training and scrutiny.

Only time will tell how wise, from the point of view of a sustainable economy, some of the redistributions of risk (such as the imposition of strict liability for consequential loss arising from a faulty product) turn out to be.

We can but hope that the net effect of the CPB on business and customer relations will be positive.

<sup>1]</sup>The phrase is attributed to Harry Gordon Selfridge, of Selfridges Department store fame. Cynics have been quick to point out that Harry died insane and penniless ([www.phrases.org.uk](http://www.phrases.org.uk); [www.raphkoster.com](http://www.raphkoster.com).)

# FSB secures slots with Dr Mukhari Hospital Radio

By Elliot Modisa, Manager: Consumer Education Department, FSB

## The FSB's Consumer Education Department has secured slots on Wednesdays on the Dr Mukhari Hospital radio station.

The programme runs between 11:30 and 12:30. This radio station is unique as it broadcasts from the Dr Mukhari Hospital premises in Garankuwa (Gauteng). The show is called "Financial Matters" and is hosted by Mike Moruti Phahlane. It boasts listenership of approximately 4 000 staff members, 1 600 in-patients, 1 000 out-patients and 3 000 visitors per day. Speakers have been mounted in offices, wards and security check

points to ensure out-reach to listeners.

From 21 January 2008 to date, the FSB has participated in numerous radio interviews on the following topics:

- The role of the FSB;
- How to manage your money;
- Your rights when buying funeral cover;
- Financial Advisory and Intermediary Services;
- Retirement funds; and
- Shares.

Participants prepare and submit interview scripts to the host on certain topics. Subsequently, the producer prepares relevant questions based on the interview scripts. Participants are thereafter invited to the studio to do a live interview. The first phase of the interview is on the actual topic reflected in the script, followed by call-ins from listeners.

The Consumer Education Department will also invite other FSB line departments to participate, as these slots are guaranteed free of charge for the whole year. Those with information that needs to be conveyed urgently are advised to use this resource by contacting either Panama or Elliot at the FSB's Consumer Education Department.

Dr Mukhari Hospital has also applied for a wider broadcasting radius to the Independent Communications Authority of South Africa, which will cover all public hospitals in Gauteng. This is an opportunity not to be missed. The hospital authorities have invited the FSB to conduct capacity building workshops for their management and staff on financial matters. The FSB will also participate in future outside broadcasts organised by the Dr Mukhari Radio Station.

## Pension funds continued from p 15

boards. To be burdened with "loyalty considerations" will only serve to prejudice members of retirement funds. The decision of the court is to be welcomed by all concerned with governance and proper administration of pension funds.

There is personal and collective liability attached to the duty of a trustee and it therefore becomes important not to allow interference with the independent judgment of trustees.

### Art Medical Equipment Pension Fund

In this case, a widow of a deceased member of the Art Medical Pension Fund lodged a complaint with the Pension Funds Adjudicator. The sole trustee of

the fund was the managing director of the employer, M G Thobois. In terms of the rules of the fund, upon a member's death, an uninsured death benefit equal to the member's share of fund was payable. An insured benefit was also payable in terms of a policy of assurance between the fund with Liberty Life, a lump sum amount equal to three times fund salary and a spouse's pension equal to 50% of the member's fund salary at the date of death.

When a death claim was lodged with Liberty Life, the latter refused to pay because the policy had lapsed as a result of arrear payments by the employer. The employer had deducted contributions from the members' salaries but had not paid these over to the fund for a period of six months.

The complaint reached the Pension

Funds Adjudicator. He held that the issue was an appropriate case for holding the trustees of the fund personally liable for the loss suffered by the complainant. The Adjudicator found that the trustee was negligent, if not dishonest and breached his duties as a trustee when he allowed a group life assurance policy to lapse.

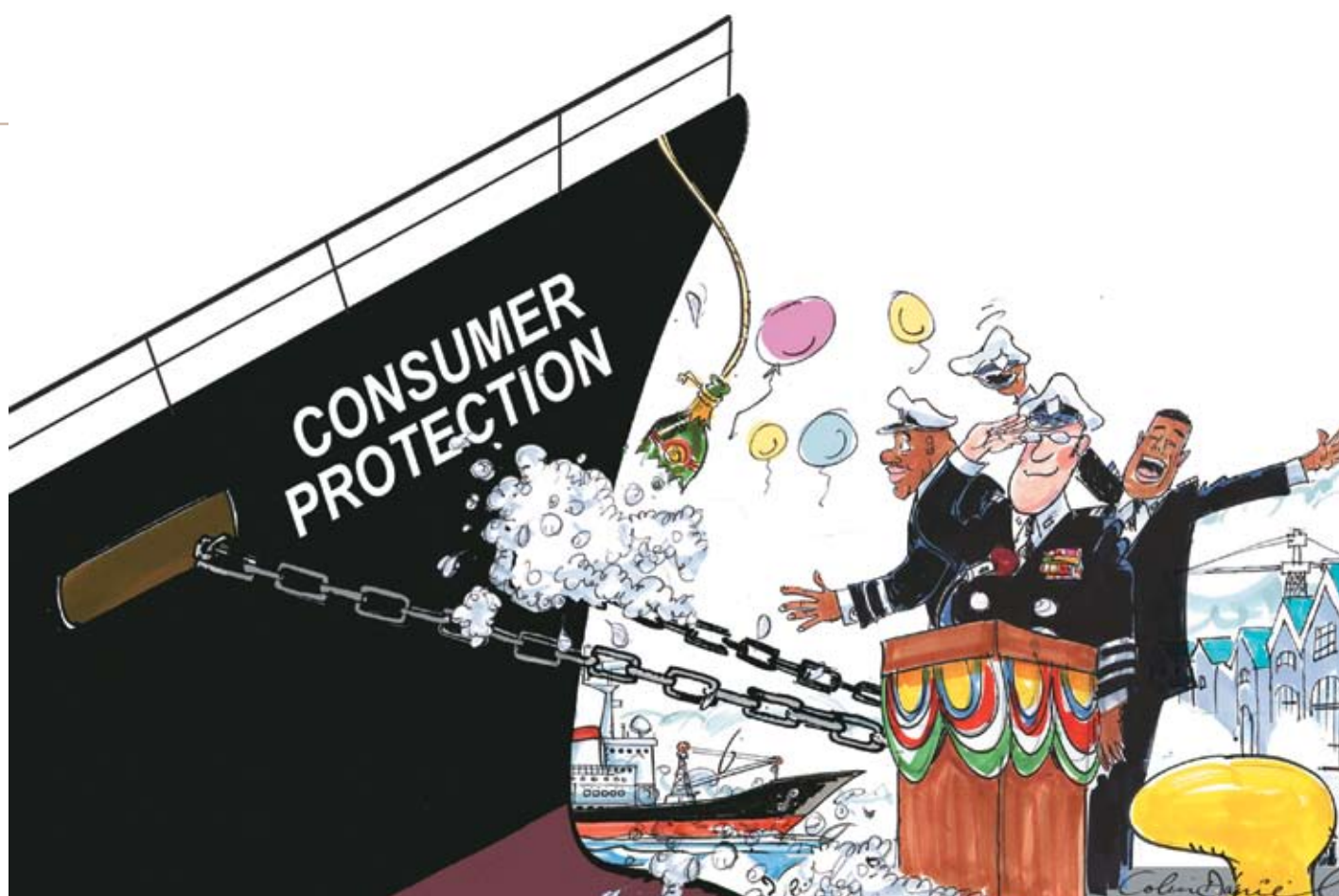
The determination represented a victory for members of retirement funds as it was the first of its kind. It also reminded trustees that they must exercise care and diligence in exercising their powers and duties.

<sup>1</sup>Rosemary Hunter The Governance of Pension Funds, annual convention of FPI, Durban 2002

<sup>2</sup>On-line publication of financial matters

<sup>3</sup>Bruce Cameron Court rules trustees must decide fund matters personal finance, 2007

<sup>4</sup>Section 37(2)



# International Forum for Financial Consumer Protection and Education to be restructured

**By Olivia Davids, Head: Consumer Education, FSB and a member of the steering committee of the International Forum for Financial Consumer Protection and Education**

**The International Forum for Financial Consumer Protection and Education was established in 2003 and held meetings in Ottawa, Dublin, Kuala Lumpur and Budapest.**

At the Forum's meeting in Budapest in October 2007, an informal discussion paper was tabled by the Hungarian Financial Services Authority, the

Financial Consumer Agency of Canada and the Financial Regulator of Ireland.

In the paper, the parties mention that there are many international regulatory bodies in place such as the International Association of Insurance Supervisors, the Basel Committee on Banking Supervision and the Organisation of Securities Commissions, focusing on prudential supervision. Apart from the Forum, there is no other international structure focusing on financial consumer education and protection.

The paper recommends the establishment of a more substantive structure, using the Forum as basis. As there is a growing focus on financial consumer education and an increase in cross-border financial services, there is a need to become aware of international best practice.

To establish a more substantive international body for consumer education and protection, a steering committee was established to —

- develop the Forum's vision and mission, defining its goals and its value

***Continued on p 18***



## **International Forum from p 17**

to members;

- develop a plan for achieving these goals;
- draft a constitution for the Forum including a consideration of defining its membership;
- examine the various legal structures to give the Forum a more coherent footing and legal personality;
- generate proposals on funding the forum;
- consider how to expand its membership; and
- explore the most efficient way of providing administrative capacity for the Forum.

The steering committee consists of the following members:

- Bill Knight: Chairman (Canada)
- Mary O'Dea: Consumer Director, Financial Regulator (Ireland)
- Jim Callon: Acting Commissioner, Financial Consumer Agency of Canada
- Mihaly Erdos: Deputy Director General, Hungarian Financial Supervisory Authority
- Jeanne Hogarth: Manager, Federal Reserve Board of the United States
- Olivia Davids: Head, Consumer Education, FSB (South Africa)
- Koid Swee Lian: Director, Bank Negara Malaysia
- Ghidre Hage Sleiman: Senior Associate, office of the Vice Governor, Banque de Liban (Lebanon)

### **OECD proposals**

The Organisation for Economic Cooperation and Development (OECD) proposed to the steering committee —

- to specify that its goals, objectives and focus are around consumer protection (rather than consumer protection and financial education). This would prevent duplication of financial education.

The OECD also mentioned that having narrowed terms of reference is helpful in setting up an association.

- that formal membership should

comprise mainly of government regulatory or supervisory bodies in charge of financial consumer protection. Experience has shown that it is easier to set up an association composed of similar members such as, for instance, the International Association of Insurance Supervisors (IAIS), the International Organisation of Pension Supervisors (IOPS), the International Organisation of Securities Commissions (IOSCO) and the International Association of Deposit Insurers (IADI). This is important when dealing with an issue as broad as consumer protection. This would not prevent the Forum from discussing and holding special sessions on consumer education.

- that the name of the Forum should reflect its terms of reference (i.e. remove "education" from the title). This would also recognise that financial education is an integral part of consumer protection rather than a distinct, unrelated element.

The OECD also indicated that they would provide technical support and assistance in setting up the association as well as hosting the secretariat for the association.

### **Meeting of the steering committee in Dublin 7 March 2008**

A meeting of the steering committee with OECD representatives took place in Dublin on 7 March 2008. The purpose of the meeting was to discuss the OECD proposals.

### **Points of agreement:**

- Member governments in the area of financial consumer education gave the OECD a mandate. The range of OECD activities on financial education, however, extends beyond OECD member countries to apply also to non-member economies;
- The Forum is a group of statutory agencies that have a particular interest and expertise in financial consumer protection (of which financial

consumer education is an essential part). The Forum seeks to identify best international practices and to promote fair and equitable treatment of financial consumers;

- The OECD, through its Insurance and Private Pension Committee and Committee on Financial Markets, is the lead organisation in the development of international standards (such as principles, guidelines and good practices) regarding financial consumer education;

- The OECD has recently established the International Network on Financial Education, with the objective of bringing together governmental financial education experts to exchange knowledge and to provide input on the OECD's financial education project. The Network will be open to all members of the Forum.

- The Forum will focus on the development of a network for statutory agencies with particular interest and expertise in financial consumer protection. It will also take the lead in the development of international standards in the area of conduct of business rules for retail financial services. The Forum will continue to discuss financial consumer education issues, and will contribute to the development of OECD's international standards regarding financial consumer education. The OECD welcomes this contribution.

- Until the Forum's next meeting in Jakarta during the week of 20 October 2008, the Forum and OECD will continue exploring how the OECD might provide administrative support. The meeting will consider the development of the relationship between the Forum and the OECD.

- The Forum will consider a new name that more accurately reflect its mission. For more information on the Forum, contact Olivia Davids at:

*Tel: +27 12 428 8123*

*Cell: + 27 82 852 2090*

*E-mail: oliviad@fsb.co.za*

# Decline in consumer complaints

## The Ombudsman for Long-term Insurance saw complaints from consumers decline for the first time in several years during 2007.

Reporting on complaints resolved by his office during 2007, Judge Brian Galgut, Ombudsman for Long-term Insurance, says 2007's case load had dropped by 1 311 cases or 15% compared to 2006.

"We received 7 923 complaints during 2007, significantly less than the 9 234 cases received in 2006. This decrease broke the seven-year trend of increasing volumes."

Galgut says of the cases finalised last year, 44% were resolved wholly or partially in favour of complainants, the same percentage as in 2006.

### Declining trend

Galgut says the main reason for the decline is improved investment returns delivered by the favourable stock market performance over the past three years.

"More than any other complaint category, complaints concerning maturity values, policy performance and surrender values have shown the steepest decline. A similar trend has been experienced by life insurers."

Other reasons for the reduction in cases include:

- The introduction of the FAIS Ombudsman, who has jurisdiction over complaints relating to advice given from October 2004.
- With the internal arbitrators at two of the biggest life companies firmly

established, fewer (first instance) complaints reach the Long-term Insurance Ombudsman.

- Many insurers have boosted their complaints handling staff and have streamlined their procedures, meaning more complaints are internally resolved to the satisfaction of the consumer.

### Nature of complaints

Galgut says the nature of complaints received has produced no surprises in recent years, with claims declined remaining the biggest category at 43%.

He says a large percentage of complaints in this category are related to funeral policies and consumer credit life policies. Other reasons for complaints from low income earners include problems with waiting periods, exclusion clauses for pre-existing health conditions, and the time frame within which claims need to be lodged.

Administrative problems made up 26% of cases received during 2007, with dissatisfaction with policy performance having shrunk to 7% as is to be expected when markets perform well.

Galgut says misselling complaints are down to 8%, because more of them fall within the jurisdiction of the FAIS Ombud and because investment performance has improved.

"Many of the misselling complaints over the past few years have come from policyholders who took on offshore exposure when the Rand was at its weakest. The subsequent strengthening of the Rand coupled with poor stock market performance in Europe and the US had a devastating effect on the rand maturity value of these policies.

However, most of these policies have now matured and we expect these complaints to disappear completely."

Galgut says improving consumer awareness of the service rendered by the Office of the Long-term Insurance Ombudsman has always been a priority.

"In 2007 we doubled the amount spent on consumer awareness during 2006, and the 2008 budget caters for double the amount spent in 2007."

He also points out that the majority of complainants are from previously disadvantaged backgrounds, with a large proportion living in the rural areas and townships. "With this in mind we have enhanced all consumer awareness activities, having learnt that the target market we are trying to reach is less receptive to mass media campaigns than face-to-face contact."

In addition, says Galgut, his office allows complainants to submit complaints in their own language. Such complaints are then translated into English before they are investigated and passed on to the life company concerned.

### Co-operation from life insurers

Galgut says it is worrying that his office still has to categorise 10% or 492 of finalised cases as incompetent, meaning that the life insurers involved responded to the office in a tardy or inadequate manner.

"Of these, 73% are surprisingly attributable to only five insurers. We maintain that poor service to the Ombudsman is often indicative of poor service to policyholders. For some insurers, particularly those serving the lower income groups, good service and customer care are simply not a priority."

The above figures nevertheless show that there is favourable co-operation by most of the insurers.

**Source: Media Release, Ombudsman of Long-term Insurance, 15 April 2008, 2007 Annual Report, Ombudsman of Long-term Insurance**

**FSB** Bulletin *second quarter 2008*

