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What should investors know before they invest in unlisted securities?

By Elmarie Kruger, Manager: Capital Markets Department, FSB

Unlisted securities are shares in public or private companies not listed on an exchange licensed by the FSB or not included in the list of securities kept by an exchange. Trading in these securities takes place over-the-counter.

Legislative background

The Companies Act, 1973

The trading of unlisted securities is regulated in terms of the Companies Act, 1973, which is administered by the Department of Trade and Industry. All companies in South Africa must be registered with the Registrar of Companies and must comply with all the relevant provisions of the Companies Act. The Registrar of Companies has the power to investigate any contraventions of this Act.

The Securities Services Act, 2004 (SSA)

The objects of the SSA are to —
• increase confidence in South African financial markets by requiring fair, efficient and transparent securities services which contribute to the maintenance of a stable financial market environment;
• promote the protection of regulated persons and clients;
• reduce systemic risk; and
• promote international competitiveness of securities services.

The SSA regulates "securities services", being services regarding the buying and selling of securities, the custody and administration of securities, the management of securities by a member of an exchange, and the clearing and settlement of transactions in listed securities.

The term "securities" includes shares, stocks and depository receipts in public companies and other equivalent equities, notes, derivatives instruments, bonds, debentures, participatory interests in a collective investment scheme and instruments based on an index, but specifically excludes money market instruments (except regarding the custody and administration of securities).

The SSA regulates the trading of unlisted securities to some extent. Section 20 of the SSA states that the Registrar of Securities Services may prohibit a person from buying or selling unlisted securities if such business defeats the objects of the Act. The Registrar may also impose conditions for the carrying on of such business or may prescribe conditions where specified types of unlisted securities may be bought or sold. This is a reactive approach compared to the regulation of listed securities as the FSB does not license such business up front.

Unlisted companies are entitled to facilitate the buying and selling of their own securities to investors. However, companies are not allowed to operate an exchange without being licensed by the FSB. The SSA defines an exchange as someone who constitutes, maintains and provides an infrastructure –
• for bringing together buyers and sellers of securities;
• for matching the orders for securities

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of multiple buyers and sellers; and
• whereby a matched order for securities constitutes a transaction.

Financial Advisory and Intermediary Services Act, 2002 (FAIS Act)

The FAIS Act regulates the rendering of financial advisory and intermediary services to clients. The Act's main objectives are to protect the interests of consumers and to professionalise the financial services industry.

In terms of the FAIS Act nobody is allowed to render financial services regarding financial products as a regular feature of his or her business without being authorised as a financial services provider or appointed as a representative of an authorised provider.

Shares in a company other than a "share block company" as defined in the Share Blocks Control Act, 1990, and any product issued by a foreign product supplier and marketed in South Africa which is similar to a "share in a company", qualifies as a financial product. Therefore, the FAIS Act regulates the rendering of financial services to clients with respect to unlisted shares in public and private companies (local or foreign).

Consumers who wish to conduct financial services business with an institution or person are advised to check beforehand with the FSB whether such an institution or person is authorised to render financial services, or if the institution or person is appointed as a representative of an authorised financial services provider.

Risks of trading in unlisted securities

There are a number of risks investors should take into consideration before investing in unlisted securities. A few important ones are discussed below.

Lack of a regulatory framework

• Investors do not enjoy the same protection by the SSA and the protection mechanisms provided by a licensed exchange, eg many deals are done by private placing companies which do not have to publish a prospectus.
• Unlisted securities are issued by companies that either choose not to, or are unable to meet the stringent listing requirements of licensed exchanges. Unlisted securities are not subject to the same substantive requirements. Listed companies must meet minimum listing standards such as having minimum amounts of capital. Conversely, unlisted companies do not have to meet any minimum standards. Disclosure requirements for unlisted securities are less stringent compared to listed securities.
• Since the market for unlisted securities are usually controlled by a single market maker, the securities are subject to price manipulation. The brokers on the inside can create false volume by trading among themselves, artificially raising the price on little volume and in the classic "pump and dump" scams, once they inflate the price, such brokers will dump their securities to unsuspecting investors. Such investors will find that once they buy these securities there are no other buyers, with the result that the price will plummet. The provisions of the SSA to take action against market abuse practices, such as insider trading, market manipulation and the publication of misleading statements, do not apply to the trading of unlisted securities.

Lack of a formal market

As there is no formal market for unlisted securities, the risks of such an investment are greater. Investors may have difficulty in selling their unlisted securities as they first have to find a buyer for these securities. Trade takes place directly between buyers and sellers.

Pricing and liquidity risks

• There may be little or no liquidity in unlisted securities and it may be difficult to establish a robust market price for them. Many unlisted securities are relatively illiquid or "thinly traded". This could enhance the volatility of the share price and make it difficult to sell the securities at a later date.
• The valuation of unlisted securities is more difficult to calculate than listed securities and the use of leverage may amplify a fund's volatility. Valuations may be misleading. Prices quoted in some unlisted securities may be historical only and may not reflect recent trading in the company concerned.
• Transparency of the unlisted securities market is not done through the systems of the exchanges. Prices are therefore not openly displayed. There is a risk that brokers and dealers are not aware of all the trading in unlisted securities and that customers are being disadvantaged by reliance on incomplete volume and price information.
• Exchange securities prices are quoted regularly in newspapers that allow investors to keep track of the prices of their securities. Since unlisted securities are not traded in an open market investors must rely upon their broker's information.

Difficult to realise profits

It is difficult to realise profits because the securities are thinly traded and the spread between the bid price and ask price is large. This is not the case with exchange traded securities since there is a real market, not controlled by brokers.

Higher business risk

Many OTC issuers are small to medium unlisted public and private companies with limited operating history. They may also be economically distressed and investment in these companies often leads to a total loss.

Guidelines for investing in unlisted securities

The following guidelines will assist investors to make an informed

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What constitutes 'advice' in terms of the FAIS Act?

By Louis Wessels, Senior Legal Consultant, FSB

On 29 January 2008 the FAIS Ombud released his determination in the matter of *Gumede v JDG Trading (Pty) Ltd (trading as Barnetts)*. The complainant was a domestic assistant with a standard 6 education earning a wage of R300 per week. The respondent is a wholly owned subsidiary of the JD Group which trades throughout the country via 928 outlets under different brand names. One of those outlets was Barnett's, a dealer in furniture and appliances in Port Shepstone.

On 14 October 2006 (before the National Credit Act, 2005, became operative) the complainant bought a television set and a mini-oven on credit for R2 799 and a television licence. The total amount payable in terms of the documentation given to her was R6 468, an increase in excess of 115%. That amount included finance charges of R1 668, insurance premiums of R1 344, a "contract fee" of R102 and delivery charges of R348. The package for which she signed included "a goods insurance policy", an "extended guarantee contract" and a "credit life policy", all of which, so she complained, were never explained to her and which she never intended or agreed to buy. In addition she herself took delivery of the goods at the store.

This case serves as a classic example of market misconduct in the furniture retail business and demonstrates the wide divergence that sometimes occurs between market conduct regulation and actual compliance. The reprehensible actions of the sales lady, asking the complainant to sign without properly explaining the documents, some with blank spaces, are governed by provisions in the Financial Advisory and Intermediary Services Act, 2002 (FAIS Act), and the General Code and were, in addition, contrary to directives from the respondent's head office. Yet it did and does happen.

The FAIS Ombud duly upheld the complaint. Having found that the complainant was never properly informed of the "add-ons" and that the loan agreement was of no force and effect, the entire transaction was treated as if it were a cash purchase, notwithstanding that neither party ever intended it to be a cash purchase.

The core of the determination was that the sales lady gave the complainant "advice" within the meaning of that term in the FAIS Act. To the extent that she was not a qualified and registered financial adviser, and purported in respect of a financial product to give advice that did not measure up to the requirements of the FAIS legislation, the respondent, *"in conducting this transaction failed to comply with the FAIS Act."*

There is little doubt that the transaction fell foul of the FAIS legislation in a number of ways, particularly because the complainant was never put in a

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in a position to make an informed decision about the entire sales package. But it is questionable whether it amounted to the giving of "advice" when, "*she was presented with a number of documents and was merely asked to sign the forms at designated places*". The respondent in its staff training manuals was rightly at pains to emphasize the vital distinction between "factual information" and "advice." It is with respect arguable that the FAIS Ombud gave too liberal an interpretation to "advice" and that the actions of the sales lady fell within the former rather than the latter category.

The respondent's case was that they did not give "advice" as defined in the FAIS Act. Whether or not the respondent was FAIS compliant, so the Ombud said, essentially turned on its interpretation of what "advice" as contemplated in the FAIS Act meant.

The Ombud then gave an analysis of the word "advice" as defined in section 1(1) of the Act, as well as of the exclusions in section 1(3)(a) of the Act, which set out activities not regarded as "advice", *inter alia*, factual advice given in relation to certain matters.

The Ombud rejected the respondent's version that, while admitting that it sold financial products to the complainant, it was not as a result of any "advice" given by members of its staff. *"One cannot imagine how one could possibly sell something as technical and intangible as a financial product without making any kind of recommendation, guidance, proposal, or inducement (these being the words used to define "advice"). This to a lay person or semi-literate person?"*

The "pointing" at a document containing a proposal or recommendation to buy a financial product, so the Ombud argued, is sufficient to bring it within the wording of the definition of "advice". *"Sub-section (3) was added to distinguish 'advice' from mere advertising and promotion, mere procedure and description of a financial product."*

It was accepted that the complainant did not request any financial products. It was also accepted that only the respondent could have raised the selling of financial products to the complainant. *"How they achieved this by merely 'pointing' the complainant in the right direction, without any advice, is beyond me".*

Thus the Ombud came to the conclusion that the respondent had given "advice" to the complainant and proceeded to list the contraventions of the Act and the General Code. The Ombud concluded that it was time for the FSB *"to intervene urgently to prevent circumvention of the FAIS Act by the 'point and sign' interpretation and practice carried out by the respondent".*

Assuming the correctness of the Ombud's findings of fact, he cannot be faulted that the respondent failed in its compliance with the FAIS Act and the General Code. At the point of sale where the interaction with the client took place, the respondent was not practising either the letter or spirit of the FAIS Act.

This is evidenced by many facts, the most salient being that the client was never informed that she had been sold insurance products, let alone being taken by the hand and having the exigencies of these transactions explained.

What is, with respect, questionable about the determination is the analysis of "advice" as defined in the Act and the conclusion that the respondent had given "advice" as contemplated by the Act and that its non-compliance with the FAIS Act lies in the fact that the "advice" was improper and did not serve the complainant's interests.

If the finding was that the complainant had never intended to buy insurance products and discovered only later that such products had been included in the overall transaction and her total indebtedness, the respondent cannot be held to have given advice to the complainant within the meaning of that expression in the FAIS Act.

However, what is more important is that the mere pointing to the client of terms of an agreement, including the terms of a policy, was regarded as being tantamount to the giving of advice. This conclusion, with respect, was arrived at by the Ombud giving an unacceptably wide interpretation to "advice" and a too narrow interpretation of the exclusionary provisions of section 1(3) of the Act.

The respondent's documentation placed before the Ombud consisting of directives and guidelines to its sales persons, in so far as they seek to draw a distinction between "advice" and "factual information" and cautioning that "advice" can only be given by FAIS authorised persons, cannot be faulted. What is missing in the documentation is the emphasis of the need to make sure that the client fully understands the terms and conditions of the transaction(s), to explain these if necessary, and to see that the documentation is fully completed before the client signs.

This is where the transaction in this matter went wrong. This case serves as a wretched example of how the FAIS Act was not complied with and how a customer should not be dealt with. Nothing appears to have been explained properly. The customer was merely asked to sign a multiplicity of documents, some of them uncompleted. When she queried an amount hugely in excess of the purchase price of the goods, she was fobbed off with the misleading remark that these were only "sums". Spurious charges were added to the total amount by way of a "contract fee" and "delivery charges".

The Ombud would have been fully justified in finding, as far as the insurance products were concerned, that for the reasons above, there had been gross non-compliance with the FAIS Act and the General Code by the respondent and that the complainant was entitled to redress, also in terms of the common law, because of the prejudice that she had suffered. It was, with respect, not necessary to take the loop of "advice" as the Ombud did, to justify his findings and conclusions. In doing so, the determination has set a wrong precedent of what is required of the conduct of salespersons on dealer floors selling

financial products. This may have the unintended consequence of inhibiting trade to the ultimate detriment of consumers.

When is an activity "advice" and when is it not?

• it is always a factual enquiry as to whether or not in a given case "advice" was given;
• it is not advice if in the course of explaining a credit agreement the client is told that one of the conditions is to take out credit life insurance;
• it is still not advice if the terms of the proposed credit life policy are thereupon explained to the client – what the insured risks are, the pre-conditions and exclusions, time barring clauses, who receives the benefits, etc. All this is factual information describing the product;
• pointing out to the client that he or she has the option to use an existing policy or to acquire a policy of own choice is still not "advice";
• it becomes "advice" when alternatives are weighed up against each other and the salesperson is asked to help in this regard. "Should I not rather arrange other security for the credit advanced instead of taking out a policy?"; "What are the advantages of the policy you propose as against those of an own policy?"; and in the case of goods insurance: "Will it not be better for me to incorporate this cover into my existing comprehensive insurance?"

FNB to reassess all bonds granted

On 5 August 2008, First National Bank (FNB) indicated that it proposes to individually reassess mortgage bonds that the bank had previously granted to successful borrowers in instances where the property had not been registered yet.

The reassessment is done to determine whether the customer still qualifies for the bond in the amount granted, in other words, whether the customer will not be over-indebted by the granting of the bond, and whether the bank will not be guilty of granting credit recklessly. This exercise is in compliance with the provisions of the National Credit Act, 2005.

While the Ombudsman for Banking Services (OBS), Advocate Clive Pillay, agrees that it is sound and prudent to reassess bonds granted, he has cautioned to reassess each matter in a way that does not unduly prejudice the customer.

Pillay cites the hypothetical example of a bond being granted to a prospective buyer. The buyer then pays a deposit to the seller and while the parties are awaiting registration, the bank withdraws the bond, either completely or offers the buyer a smaller bond. Because of the bank's decision, the buyer is unable to proceed with the transaction. The seller, however, insists that the buyer fulfils his contractual obligations. The seller retains the deposit paid and sues the buyer for the balance of the purchase price.

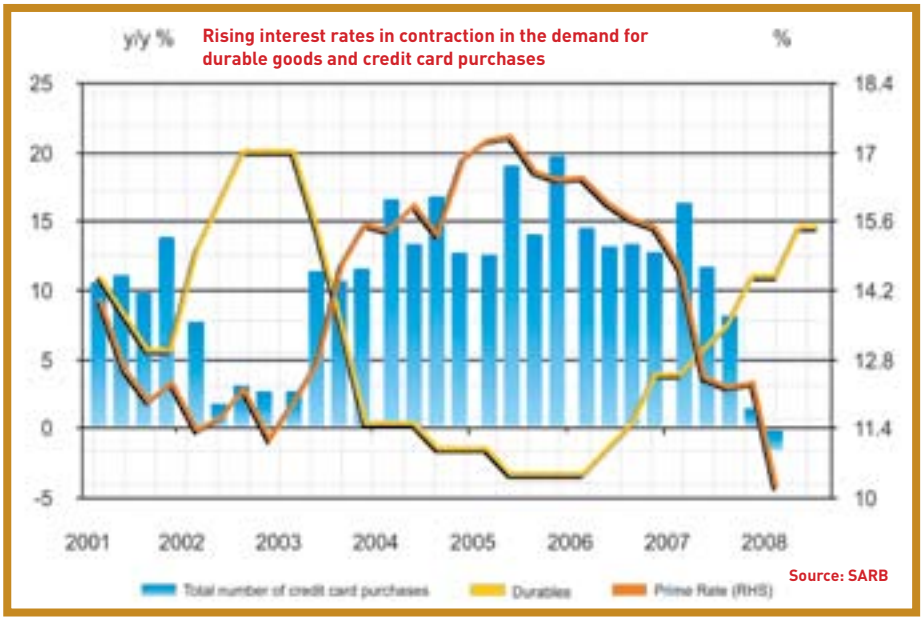
"Clearly, this scenario will severely prejudice the buyer and the bank should consider alternatives to help the customer," says Pillay.

Following a media statement issued by the OBS to this effect, a subsequent meeting was held with the CEO of FNB, Michael Jordaan, who assured the Ombudsman that FNB would handle the proposed reassessment as follows:
• The bank would honour all bonds approved
• Reassesses only those bonds that were granted more than a year ago
• And only in instances if a judgment had been granted against the borrower in that time.

The OBS is a free dispute resolving service to all bank customers. Customers that have lodged complaints with their banks and are not satisfied with the outcome are encouraged to approach the OBS. The Ombudsman can be contacted on 0860 OMBUDS (0860 662 837).

Comment Issued by the Ombudsman for Banking Services

Consumers will feel pinch until late 2009



Rising interest rates in contraction in the demand for durable goods and credit card purchases

Source: SARB

Although interest rates will not rise for the time being, the effects of previous increases in rates are visible. One of the signs is the economic slowdown in credit card transactions. The growth in households' credit card debt has declined from well over 35% throughout most of 2007 to a mere 8% currently, says Kevin Lings, chief economist of Stanlib.

Consumers have become more cautious, responding to the combination of higher interest rates, high debt levels and slow real income growth. The National Credit Act, 2005 (NCA) has also made it more difficult for consumers to get credit. The growth in household credit, especially annually, is expected to slow sharply in the first half of 2009.

During the second quarter of 2008 the disposable income on households in South Africa grew by a modest 2% when compared with the first quarter of 2008. Wage increases have been well below the official inflation rate. According to Andrew Levy, who does research on labour trends, wage increases on average have been 8, 3%. This is an average and does not paint the full picture.

Some wage and salary increases have been well over 10% because there are shortages in some skills.

In the first quarter of the year, the countrywide labour productivity rate eased further, which together with growth in nominal remuneration per worker surging to a six year high, raised some alarm bells over the country's rising unit labour costs. During the rest of the year, high inflation may promote further double-digit wage settlements, and with no, or little concomitant increases in labour productivity. This

By Flip Meyer, a financial journalist and analyst

may result in inflation persistence which will possibly reduce South Africa's international cost competitiveness. As it stands, the private sector increased its nominal wage settlements to 12.6% in the first quarter from 6.1% in the fourth quarter of last year.

The nominal wage increases do not take inflation into account. In real terms (after the adjustment for inflation) there probably would be a slight increase for the remainder of 2008. The public sector also settled at above-inflation rates of 11% in the first quarter of 2008 from 9.8% remuneration growth in the last quarter of 2007. The threat of falling productivity as labour markets adjust more slowly to the downshift in economic activity may render high wage awards inflationary. This development, if sustained, may bode ill to the inflation outlook and South Africa's trade competitiveness.

There has also been a slowdown in employment, says Lings.

Johann Rossouw, chief economist and strategist of Vuvani Securities, says the expected inflation rate for August 2008 will be 13, 2%. The inflation rate is an average for all items and does not tell the whole dismal story. The inflation rate for food in July 2008 was a massive 17%. Hopefully the recent decline in oil prices might dampen consumers' inflation expectations. However, sustained oil prices at lower levels as well as a relatively strong rand are necessary to show a meaningful decline in petrol and diesel prices. High oil prices are partly to blame for increases in food. Fuel is a huge input cost in the food industry.

There has already been a noticeable increase in provisions for bad debts among banks and retailers, while insolvencies are noticeably higher. The consumer remains under enormous pressure from a cash flow perspective with little relief in sight, until inflation starts to ease and interest rates are cut.

This is likely to benefit the consumer only towards the end of 2009, says Lings.

New passenger vehicle sales have been one of the hardest hit sectors in the economy. Economists predict that these sales could decline close to 20% in 2008. One can already see several car dealerships closing doors. Higher interest rates and record consumer debt levels have effected the financial ability of consumers to buy new cars, putting dealerships under immense pressure.

The motor industry is the most volatile manufacturing industry in South Africa, measured over any significant time. Hence the recent declines are not totally unexpected when one considers that in 2004 and 2005 sales of passenger cars rose by more than 20% (in volume terms).

In 2007, passenger car sales were down 9.9% compared with 2006, and are projected to decline by around 18% for 2008 as a whole. That would be the worst since 1998 when the prime interest rate soared to 25.5%, says Standard Bank in it latest economic review.

The Standard Bank median house price recorded a decline of 1, 8% in August 2008. The public sector also settled at the above inflation rate of 11% in the first quarter of 2008 - from 9.8% remuneration growth in the last quarter of 2007. However, over the short term, economic conditions are expected to continue weakening. Any improvement will only happen when interest rates start to decline. Normally there is a time lag of almost a year after a decline in interest rates before consumers regain optimism. Property markets worldwide are driven by consumer behaviour. But optimism seems far away.

The turmoil in international markets has taken a worldwide toll. This includes South Africa. South African consumers might see a interest rate decline sooner than expected. Already there is talk that the Fed, the US central bank and the European central banks will lower interest rates to prevent a global depression. Should this happen South Africa might follow international central banks.

Although the average expected growth rate of the South African economy as a whole does not look too bad, consumers feel the pinch and are the hardest hit. Sectors like public spending, long term construction projects and commodity exports seem positive, but not enough so to lift the spirits of consumers.

Consumer pessimism may prevail until late in 2009.

**Meyer is a veteran financial journalist and analyst. His website address is www.flipmeyer.com*

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investment decision:

- Investors should ensure that the company is reputable and is registered with the Office of the Registrar of Companies.
- Establish in which assets the company invests.
- Be aware of being offered spectacular returns. Remember if it is too good to be true, it usually is.
- Never buy any securities without first evaluating the fundamentals of the company. Investors should carefully review the financial statements, management background and other data before making an investment decision.
- Get a copy of the company's prospectus.
- Get information on the directors of the company and make sure that they are reputable persons who are fit and proper.
- Study the products and services being rendered by the company and make sure the company is not an empty shell.
- Make sure that the company exists by calling the company secretary and establishing whether it has a website.
- Get information on the auditors of the company and discuss the future prospects of the company with them.
- Study media releases issued by the company.
- Beware of promises that the unlisted company will soon be listed on an exchange and that investors will make big profits. Contact the exchange concerned and establish whether an application for a listing has been received.

CONTACT NUMBERS

Name:	Companies and Intellectual Property Registration Office (CIPRO)	JSE Limited	Bond Exchange of South Africa Limited	Financial Services Board
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Postal Address:	The DTI campus. (Block F - Entfutfukweni), 77 Meintjies Street Sunnyside, Pretoria	One Exchange Square, Gwen Lane, Sandown	Mezzanine Level, 30 Melrose Boulevard, Melrose Arch Johannesburg 2196	446 Rigel Avenue, Erasmusrand Pretoria 0048
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FAIS — Application of fit and proper requirements to key individuals

By Dr Franso van Zyl, Chief Counsel Legislation, FSB*

There seems to be some uncertainty as to the application of fit and proper requirements under the Financial Advisory and Intermediary Services Act, 2002 (FAIS Act) to key individuals, in particular regarding "competency and operational ability".

A key individual is defined in section 1(1) of the FAIS Act as:
"*Key individual*, in relation to an authorised financial services provider, or a representative, carrying on business as -
• a corporate or unincorporated body, a trust or a partnership, means any natural person responsible for managing or overseeing, either alone or together with other so responsible persons, the activities of the body, trust or partnership relating to the rendering of any financial service; or
• a corporate body or trust consisting of only one natural person as a member, director, shareholder or trustee, means any such natural person."

Section 8(1) of the FAIS Act determines:

"(1) An application for an authorisation referred to in section 7(1), including an application by an applicant not domiciled in the Republic, must be submitted to the registrar in the form and manner determined by the registrar by notice in the Gazette, and be accompanied by information to satisfy the registrar that the applicant complies with the requirements for fit and proper financial services providers or categories of providers, determined by the registrar by notice in the Gazette, after consultation with the Advisory Committee, in respect of -
(a) personal character qualities of honesty and integrity;
(b) the competence and operational ability of the applicant to fulfil the responsibilities imposed by this Act; and
(c) the applicant's financial soundness:
Provided that where the applicant is a partnership, a trust or a corporate or unincorporated body, the applicant must, in addition, so satisfy the registrar that any key individual in respect of the applicant complies with the said requirements in respect of -
(i) personal character qualities of honesty and integrity; and
(ii) competence and operational ability, to the extent required in order for such key individual to fulfil the responsibilities imposed on the key individual by this Act."

Must the key individual meet the same competency requirements as the FSP applicant?

The concluding words in the proviso to section 8(1) indicate that the measure of compliance required by a key individual only applies *"to the extent required in order for such key individual to fulfil the responsibilities imposed on the key individual by this Act."*

The word *"responsibility"* has a number of synonyms and in particular two basic meanings, namely *"the state of being reliable"* and *"of being accountable"* (Collins The New World Thesaurus s.v. *"responsibility"*). This second meaning is particularly stressed in *New Webster's Dictionary of the English Language*, referring to *"the state of being responsible; that for which one is responsible; a trust, obligation, or duty; ability to meet payments or obligations; trustworthiness."*

It is not necessary to consider all cases where the word *"responsibility"* is used in the FAIS Act. In section 8(1), one must note the verb used in connection therewith (*"impose"*) and bearing in mind that the word is used in a legal context, the word is simply used as a synonym for the commonly used expression "*duty*" or even "*function*".

The FAIS Act distinguishes between two types of statutory officials, namely financial services providers (FSPs) and

their key individuals. The FAIS Act makes it clear that they are two different types of functionaries and therefore their statutory functions and duties also differ.

Regarding the fit and proper requirement of *"competence and operational ability"*, the ambit and elements of the *"competence and operational ability"* required of an FSP will in several respects differ from the competence and ability required of a key individual, the latter being responsible for managing and overseeing *"the activities of the body, trust or partnership relating to the rendering of the financial service"* (paragraph (b) of the definition of "key individual"). These two functionaries do not necessarily have to meet the exact same fit and proper requirements where competence and "ability" are involved.

Must a key individual be appointed as a representative to render financial services on behalf of an FSP?

The relevant sections of the Act make it clear that when a key individual wishes to render financial services, he cannot, when acting as representative, retain status as key individual in respect of himself. This would imply that such a person must then also act as his own overseer and manager (paragraph (a) of the definition of "*key individual*"). The status of the person as key individual must in such case first be terminated, which would mean that when the person acts as representative, another key individual must act as his overseer and manager (see section 13(1)(b)(i) of the FAIS Act regarding the requirement that a person becomes a representative only in terms of a previous "*service contract or other mandatory agreement*"). Nothing will, however, prevent the person from remaining on as key individual in respect of representatives other than himself. To avoid the necessity of being appointed or mandated as a representative, such a person will have to make out a case of acting as the "arms and legs" (so to speak) of the corporate body under the common law in the rendering of financial services for and on behalf of the corporate body.

The unique situation of a corporate body with only one person as a member, director or shareholder (paragraph (b) of the definition of "*key individual*") who simultaneously is the only person who renders financial services for or on behalf of the corporate body (acting as "*representative*" as defined), is problematic. In such instance the rendering of financial services by the key individual will have to be as the "arms and legs" of the corporate body without having to be appointed or mandated as a "representative".

Must a key individual of a representative meet the same fit and proper requirements as the key individual of the FSP applicant or of the applicant?

The question refers to section 13(2)(a) of the FAIS Act, as amended by the Financial Services Laws General Amendment Act, 2008, resulting in the following wording:
"(2) An authorised financial services provider must –
(a) at all times be satisfied that the provider's representatives, and the key individuals of such representatives, are, when rendering a financial service on behalf of the provider, competent to act and comply with the requirements contemplated in paragraphs *(a)* and *(b)* of section 8(1) and subsection (1)(*b*)(ii) of this section, where applicable".

The only feasible interpretation of section 13(2)(a) of the FAIS Act is that key individuals of a representative only have to comply with the provisions in the proviso to section 8(1) which apply to the key individuals of the FSP applicant. The words in the proviso at the end, beginning with "*to the extent that...*" seem to be unnecessarily elaborate as the underlying intention seems to say the same as the more concise words appearing at the end of paragraph (b) of section 8(1), namely "*to fulfil the responsibilities imposed by this Act.*".

The "responsibilities" imposed by the FAIS Act respectively on FSPs and their key individuals differ materially and these two different classes of FAIS

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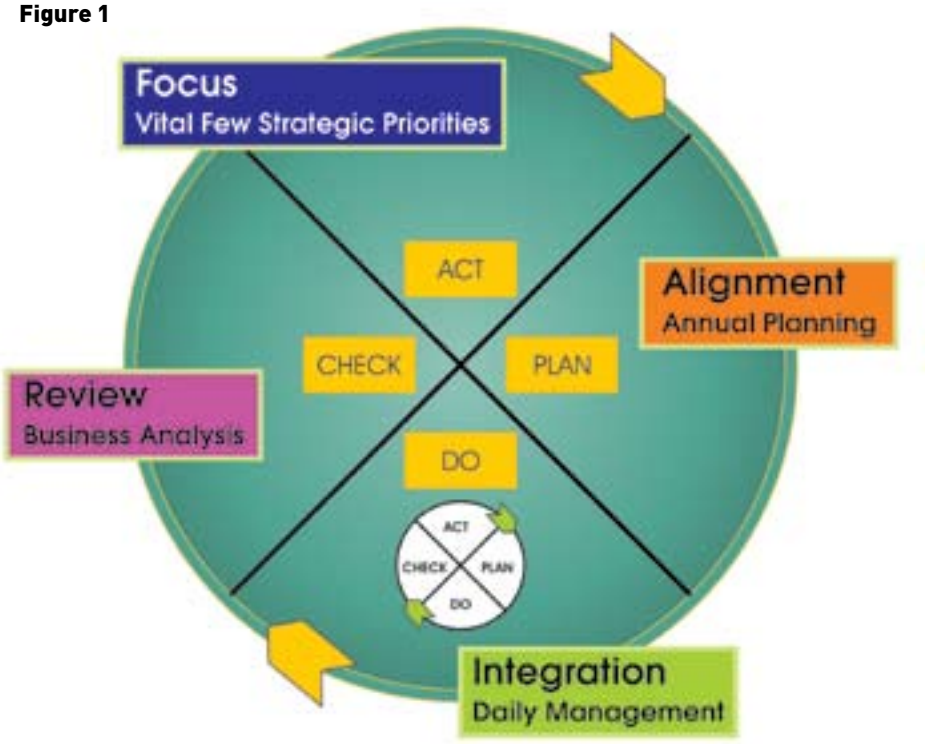
The FAIR approach to strategic management

By Paul Harding, TriQ Cooperation Business Development

This article is based on the Quality and Policy Deployment presentation given to the FSB earlier this year. It focuses on management's involvement in applying policy deployment (Japanese Hoshin Kanri) using the cycle of activities of focus, alignment, integration and review, referred to as FAIR.

Figure 1



This cycle takes a generic view of policy deployment including establishing, aligning and integrating new activities normally associated with strategic decisions into the daily management cycle of the organisation, normally associated with ISO 9001 quality management principles. The article puts a strong focus on the review part of the cycle by top executives (Figure 1).

What is Hoshin Kanri?

We define "Hoshin" as a strategic objective, which is expressed as a short statement of a senior management level policy or goal. This outlines the expected associated strategies and means. The basic principle is that everyone in the organisation should contribute to the achievement of Hoshins, so that at the end of an annual cycle, the organisation as a whole will have moved beyond what it might have achieved through normal working.

The Hoshin cycle starts with executives focusing on implementing the vital few strategies to give the organisation a competitive edge. Once the strategies have been agreed upon, a planning process is started to align them across the organisation. Kanri refers to the management of the Hoshin related activity. The method is used to align other systems, plans and activities. The linking of strategic goals to objectives in daily management is central to effective Japanese total quality management.

Consistency is the key to success

One of the expected outcomes of applying the FAIR model is to ensure that there is an alignment of activities in the cascading of strategic objectives and operating methods. It is an important part of Japanese management to be consistent in the application of each task, since it is difficult to improve a process that is out of control.

Therefore, one must limit any variation in a process. The first aim in limiting variation is to focus on the consistency of the daily management task being performed through working to procedures and work instructions, so any new tasks arising out of a strategic intervention must be integrated into daily work. The Hoshin Kanri method is aimed at being consistent in target setting and achievement, not just in the magnitude of the target but also in the overall relevance of the target to the organisation's strategic goals.

At operations level, once daily management is under control, through

ISO 9001 activities, one can use the Hoshin Kanri method to gain the improvements necessary to reach the competitive edge. The overall purpose of a subsequent improvement review is to confirm the status of the Hoshin Kanri method, the strategic objectives and to check the appropriateness of individual objectives and methods to the overall strategic objectives without disrupting the daily management activities.

Managed system for organisation-wide review

Learning from experience and developing the competencies to solve problems are essential aspects of the learning organisation. This applies as much to top level management as to everyone else. Review does not just involve strictly monitoring, but also a more considered evaluation of context, assumptions, as well as progress.

Reviews work most effectively if they are linked together as an organisation-wide managed system of review, which delivers an audit trail of how the organisation as a whole has been performing to achieve its purpose and longer-term strategic goals. This system provides an essential feedback loop for organisation-wide learning and an opportunity for strategically aligned evaluation, problem-solving and corrective action. Review provides the thread that knits a method such as Hoshin Kanri together.

The stress is on review as a method for investigating issues and not centred on who is to blame. At the same time, individuals who have ownership of objectives and plans must ensure that review is carried out. A managed system involves administrative tasks such as managing meetings, agendas, logistics, the provision of advice and even training to assist the reporting process, as well as post-review activities to ensure that follow-up action happens quickly.

Figure 2 shows that audits 1 – 4 only give consistency to an organisation, as you would expect from a typical ISO 9001 quality management certified organisation. To achieve ascendancy then ongoing managed systems of review, based on targets set and audited by senior management are recommended.

The Hoshin Kanri approach uses "review" to mean only the business (performance) excellence evaluation. This will include an appraisal of the annual strategic management process (Hoshin Kanri) itself. The participation of top management means that a wide involvement of people is likely and the relevance of the state of health and the company's operational effectiveness in relation to best practice will become more understood in the organisation.

The importance of this form of annual review is that it should involve top level management in a way that enhances its understanding of daily management. In fact, the Plan Do Check Act cycle is an essential principle for effective Hoshin Kanri target setting. The importance of feedback and review to strategic and general management goes back a long way, especially where strategic management is understood as a dynamic capability. Specifically, for the implementation and execution of strategic objectives, Kaplan and Norton observe, in the case of the balanced scorecard, that "a process to learn whether organisational strategy was working and being implemented effectively" for senior managers is missing.

The scorecard idea was originally developed out of hoshin kanri practice (Kaplan and Norton, 1993), but the business process basis for managing strategic decisions, which is the important feature of Hoshin Kanri, is not (usually) followed for the scorecard. The advantage of using executive audits, however, is that the highest level of management gains the understanding to which Kaplan and Norton refer. If executive audits were used for scorecard management, top management is likely to be more effective in its implementation and execution of strategic management because it will know more about experience at an operational level.

Top Executive Audit (TEA)

Senior management must review the operational effectiveness of the core organisation-wide management processes, including the effectiveness of strategic management itself. The review represents an annual in-depth check on how strategy and other cross-functional performance management activities have been managed during the year. The idea is not for the organisation to pass an exam, but to stimulate mutual discussion between senior management and people who implement top management goals by finding ways and means to improve the existing situation.

Typically a senior management team will provide an initial short report, and top-level management will draw up a

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Figure 2

Essential considerations by the FAIS Ombud

By Anton Swanepoel, Counsellor on FAIS

According to more than a thousand providers, including their representatives, the biggest risk they have to manage under the FAIS Act is client complaints.

Financial services providers would benefit from understanding the processes the FAIS Ombud's office has to follow in terms of the Financial Advisory and Intermediary Services Act, 2002 (FAIS Act), in the event of a complaint. As it only takes one client to ruin a provider's business, my first compliance tip for every practice is always to *"hope for the best, but plan for the worst."*

Real professionals in the financial services industry are proactive when it comes to considering risk management processes, especially those processes that must be in place to manage their biggest risks. Being fully prepared for any client complaint will separate the best from the rest and this is what this article aims to help providers with.

Financial services providers are not the only ones who have obligations under the FAIS Act. The Office of the FAIS Ombud also has a number of obligations under the Act. A better understanding of the Ombud's responsibilities will put providers in a good position to improve their processes and limit their potential liabilities in terms of the FAIS Act. The purpose of this article is to unpack the Ombud's responsibilities in terms of section 20(3) of the FAIS Act, which will put providers in a better position to be prepared for the worst.

20. Office of Ombud for Financial Services Providers

(3) The objective of the Ombud is to consider and dispose of complaints in a procedurally fair, informal, economical and expeditious manner and by reference to what is equitable in all the circumstances, with due regard to -
(a) *the contractual arrangement or other legal relationship* between the complainant and any other party to the complaint; and
(b) *the provisions of this Act.*

Section 27 of the FAIS Act regulates the receipt of complaints, prescription, jurisdiction and investigation by the FAIS Ombud's office. This article assumes that the Ombud is satisfied that the client complaint qualifies as a complaint in terms of the FAIS Act and that his office must consider and dispose of the complaint in terms of section 23 of the Act. The Ombud's office would then inform the provider of the complaint and request a response. When the provider responds, the Ombud must pay due regard to the provisions of the FAIS Act before making a decision. This article focuses on what this means in practice.

Providers should bear in mind that the only way that the FAIS Ombud's office can make a proper decision, is when it has all the facts. The best way to do this is to consider all the relevant evidence and the best evidence is represented by quality record-keeping.

Poor record-keeping is at the centre of our determinations, according to Charles Pillai[1]

What follows is a framework of the process that is generally followed by providers in the client engagements and what records the Ombud's office will investigate when considering a client compliant:

1. Introduction of the provider to his client

The General Code of Conduct prescribes the minimum information that providers need to disclose to clients at the earliest possible opportunity.[2] The Ombud will pay particular attention to whether the provider disclosed the areas he or she is licensed for and whether he acted in accordance with those licence conditions. In many of the Leaderguard cases, where the Ombud found against providers, the providers were not licensed to render financial services regarding Forex investments.

2. Gathering of client information

The General Code of Conduct makes specific reference to the obligation of providers to get certain minimum information from clients in the beginning

of the process.
A provider ..., must, prior to providing a client with advice-
(a) *take reasonable steps to seek from the client appropriate and available information regarding the client's financial situation, financial product experience and objectives to enable the provider to provide the client with appropriate advice*;[3]

This implies:

• *The gathering of sufficient personal information*
This applies to personal client details and FICA information[4] (if applicable)
• *A needs analysis*
The FAIS Act allows advisors to conduct a comprehensive financial needs analysis (a full FNA as the terms is known in the industry)[5] or a single need analysis (as the term is known).[6]
• *Risk profile*
The General Code of Conduct refers specifically to the obligation of a provider to do a client risk profile.
A provider ..., must, prior to providing a client with advice-
(c) *identify the financial product or products that will be appropriate to the client's risk profile and financial needs, subject to the limitations imposed on the provider under the Act or any contractual arrangement;*

Providers should note that, contrary to popular belief, the risk profile requirement is not limited to investments. It includes advice pertaining to long-term insurance products, short-term insurance products and health care benefits.

3. Defining and establishing the professional/contractual relationship between provider and client

When a provider renders a financial service-
the service must be rendered in accordance with the contractual relationship and reasonable requests or instructions of the client...[7]

It is only possible to define and establish a professional relationship between provider and client after gathering the required client information. In many cases providers and clients agree that, after an initial fact finding exercise, the provider is not the right person to render a particular service. In such case no professional relationship is established between the parties. However, if after gathering the necessary information the parties agree that the provider can offer a specific service, that agreement should be recorded in the interest of both parties.
The above section should be read with the FAIS Ombud's objectives in terms of the Act:
The objective of the Ombud is to consider and dispose of complaints in a procedurally fair, informal, economical

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FAIR approach continued from p 13

checklist of subjects to consider. At the end of the audit, top management will suggest recommendations, and these are likely to be considered at the next audit. The employees audited are also given opportunities to examine and to rearrange their daily work. Moreover, the internal audit contributes to the improvement of mutual understanding and human relations among employees.

The involvement of senior management at other levels acts to reinforce motivation with regard to company-wide issues. It can also play an important role for the dissemination of knowledge across the organisation, particularly when results are mostly relayed through the organisation's communication, media and specialist networks.

Conclusion

We see the implementation of the FAIR model and the role of review as important to the long term strategy and operational effectiveness of an organisation. In particular, the strategic reviews, such as top executive audits (TEAs), form not only an important component of the Hoshin Kanri practice, but are also an integrative managed system of strategic review, perhaps with the balanced scorecard to link knowledge of operational activities to CEO level plans.

But this is not all: the use of strategic reviews as part of Hoshin Kanri provides an improved form of monitoring and performance management frameworks that help to focus organisation-wide effort and improve operational effectiveness.

Fit and Proper continued from p 11

functionaries need only be "fit and proper" regarding "*competence and operational ability*" to the extent that their respective "responsibilities" (or their duties or functions) require them to be competent and have operational ability.

The only further difference between these two classes of functionaries is that in the case of FSPs, the qualification "*to fulfil responsibilities...*" applies, as formulated and structured in the Act, only to "*competence and operational ability*", but in the case of their key individuals, also in respect of "*honesty and integrity*".

Finally, the concluding words in section 13(2)(a) "*where applicable*" have no bearing on the above argument as they clearly only refer to the differences between paragraphs (a) and *(b)* of section 8(1) and section 13 (1)(*b*)(ii) (the last dealing with debarred representatives).

**The views expressed are those of the author and not the FSB.*

FAIS Ombud continued from p 15

and expeditious manner and by reference to what is equitable in all the circumstances, with due regard to - (a) the contractual arrangement or other legal relationship between the complainant and any other party to the complaint...

From these two sections, one cannot overemphasise the importance of the contractual relationship between the parties. The first contractual obligations of providers originate from any one of the following:

- reasonable client requests
- client instructions
- comprehensive terms and conditions of engagement

As mentioned in earlier articles, many providers, including compliance officers, still fail to recognise the significance of the first contract that is established between provider and client under the FAIS Act. It is very clear that the Ombud must pay due regard to the contractual relationship between the parties. But how will the FAIS Ombud be able to determine this contractual relationship if client requests, instructions or terms and conditions of engagements are not in writing or recorded via voice recording technology?

4. Conducting the analysis and preparing the proposal

A professional client proposal should contain:

- *A letter of thanks and confirmation of the purpose of the proposal*[8]

This is a standard introduction in any professional report. A thank you for being offered the opportunity of being of service and confirming the reason for the proposal are minimum requirements in any professional service offering.

- *Confirmation of the client's financial needs and objectives*[9]

Any provider should confirm at the outset of the report what the client's needs and objectives are. This is done to ensure that provider and client are on the same page right from the beginning of the process.

- *A summary of the client's current financial position*

A summary of the client's financial position before any recommendation is made would constitute evidence of compliance with the provisions of the FAIS Act.[10]

- *Calculations*

Although calculations do not form part of the definition of advice in the FAIS Act, they are important in establishing the client's financial needs and objectives. If these calculations are incorrect, it may constitute negligence on the part of the provider. If such negligence causes financial loss, the Ombud may very well hear the case. When a provider renders a financial service, representations made and information provided must be correct and if not, the provider may be liable based on negligence.[11]

- *Recommendation regarding the financial plan*

As stated, there is a difference between financial planning and financial services rendered under FAIS. Even in the case of short-term insurance and health care there may be recommendations or proposals that do not have anything to do with the product. It is recommended to even record these recommendations and/or proposals as they bring a clear perspective to the recommendation or proposal regarding the product, which represents the *advice* as defined in terms of the FAIS Act.[12]

- *Recommendation, guidance or proposal regarding a financial product*

The calculations, client needs and objectives lay the foundation for any recommendation, guidance or proposal regarding the financial product. Providers are required to select appropriate financial products based on the needs and risk profile of clients.[13] Common sense dictates that providers should record such recommendation, guidance or proposal regarding the financial product in writing. The reason(s) for the recommendation(s) or proposal(s) may just convince the Ombud that the proposal meets the suitability test or appropriate product test. Providers must record reason(s) for the specific product proposal over and above the specific obligation in the General Code of Conduct to record such reason(s).[14]

- *The key features and benefits of the recommended financial product*[15]

Providers must disclose the key features and benefits of the proposed product in the client proposal and explain the nature and material terms of the contract or transaction.[16]

- *The terms, conditions and exclusions of the recommended financial product*

The General Code of Conduct is very specific about disclosing the necessary terms, conditions and disclosures regarding the financial product and it is recommended to include these in the written proposal.[17] Non-disclosure of terms and conditions is one of the biggest risks providers face under the FAIS Act. The difference between amateurs and professionals often lies in the non-disclosure and disclosure of terms, conditions and exclusions pertaining to financial products.

- *The provider's service proposal*

When a provider gives a written service proposal to a client and he/she accepts, it forms part of a contractual arrangement.

Professional providers never have to shy away from their service commitments and they will do well by including their service value proposition in writing. Of course, providers should never over-promise or over-commit, because the moment there is an agreement the service must be rendered in accordance with such contractual arrangement.[18] A written service proposal helps providers to carefully think their service value proposition through before putting pen to paper.

• *Fees, commission and/or costs*

Providers must disclose to clients the nature and extent of any monetary obligations in favour of the provider[19] and product supplier.[20] Providers must also disclose the nature, extent and frequency of any incentive, remuneration, consideration, commission, fee or brokerages ("valuable consideration"), which will or may become payable to the provider, directly or indirectly, by any product supplier or any person other than the client, or for which the provider may become eligible, as a result of rendering the financial service. They must also disclose the identity of the product supplier or other person providing or offering the valuable consideration. Where the maximum amount or rate of such valuable consideration is prescribed by any law, the provider may (subject to section 3(1)(a)(vii)) choose to disclose either the actual amount applicable or such prescribed maximum amount or rate.[21]

5. Presenting the plan

The presentation to the client should be consistent with the written proposal as it will offer the client a better opportunity to understand the advice and to make an informed decision.[22]

6. Agreement on the essential terms of the proposal

In the case of Dr Birken and Fidentia Financial Advisors CC (not to be confused with the infamous Fidentia of Mr Brown) the FAIS Ombud recorded the importance of the contractual arrangement between the provider and Dr Birken. The Ombud wrote:

"An...advice agreement was entered into...between the complainant and the respondent. The agreement defines the contractual relationship between the parties."[23]

Later, when the Ombud found in favour of the provider, the key individual of Fidentia Financial Advisors CC, now Fidius, wrote:

The value of legal contracts in the process of financial planning has proved to be priceless in our case and we have good reason to believe that it should be embraced as a method of professional conduct by all professional financial planners. To us the above was absolutely evident from in the determination of the FAIS Ombud in our case versus Malcolm Arnold Birkin. Upon analyzing the determination in our favour, we found that the result has almost purely been founded on the contractual agreement that existed between ourselves and our client, the complainant in this case. Arno Burger CFP®, Finalist in the FPI/ Personal Finance Financial Planner of the year 2007.[24]

7. Implementation

The Ombud would investigate whether the application form of the product supplier was completed in full and whether it is a mirror image of what was proposed and agreed to by the parties. It is therefore recommended to disclose terms and conditions that appear on the application forms to clients. Clients should also sign the pages to confirm their agreement with those terms and conditions.

8. Ongoing advice and intermediary service process

If follow-up meetings were held, the Ombud would want to see what relevant material terms regarding the financial products were discussed and what was agreed during those meetings.[25] The most important recordings during those follow-up meetings are the essential terms of the agreement(s) between the parties.

References

[1]These comments were made by Mr. Pillai on the 30th of March 2006 at an IIR Compliance Symposium in Rosebank
[2]See sections 4 and 5
[3]See section 8(1)(a)
[4]See the Financial Intelligence Centre Act, 2001
[5]See Van Zyl, FSB Bulletin First Quarter 2006, p 3; Section 3(1)(d) of the General Code of Conduct
[6]See Van Zyl, FSB Bulletin First Quarter 2006, p 3; Section 3(1)(d) and 8(4) of the General Code of Conduct
[7]See section 3(1)(d) of the General Code of Conduct
[8]See sections 2 and 3(1)(a)(iii) of the General Code of Conduct
[9]See section 8(1)(a) of the General Code of Conduct
[10]See section 8(1)(a) of the General Code of Conduct
[11]See section 3(1)(a)(i) of the General Code of Conduct
[12]See section 1(1) of the FAIS Act
[13]See section 8(1)(c) of the General Code of Conduct
[14]See section 9(1)(c) of the General Code of Conduct
[15]See section 7(1)(a) of the General Code of Conduct
[16]See section 7(1)(c)(ii) of the General Code of Conduct
[17]See sections 7(1)(a), 7(1)(b) and 7(1)(c)(vii) of the General Code of Conduct
[18]See section 3(1)(d) of the General Code of Conduct
[19]See section 7(1)(c)(v) of the General Code of Conduct
[20]See section 7(1)(c)(iv) of the General Code of Conduct
[21]See section 7(1)(c)(vi) of the General Code of Conduct
[22]See section 8(2) of the General Code of Conduct
[23]See FOC 2629/05 GP(1) par 4
[24]As recorded in Swanepoel 2008. The fundamentals of FAIS compliance
[25]See section 3(1)(d) of the General Code of Conduct

This is the fourth article in a series of articles regarding trustees' duties in the regulation of occupational pension funds. This article focuses on enhancing governance and regulation of pension funds.

Enhancing governance and regulation of pension schemes

By Advocate Matome Thulare, Pension Funds Department, FSB

The governance and regulation of pension schemes is no longer a matter of choice: It is a necessity for all stakeholders to come together to create a framework to ensure the sustainability and profitability of pension schemes. How people's income security beyond their working years is provided for is a primary expression of society's long-term institutional stability, integrity and social solidarity.

Empowering the regulatory authorities

The study cases in the previous article showed a need to strengthen legislative oversight. The National Treasury[2] acknowledged the limited powers of the regulator and has already taken steps[3] to increase powers to penalise errant administrators and remove trustees from boards of management for maladministration.

Increased powers include the imposition of an administrative sanction by an enforcement committee in case of non-compliance with the Act.[4] The Registrar is empowered, after considering the interests of the members of a fund, to direct the removal of the board of trustees if the results of an inspection or investigation reveal that the fund was not managed in accordance with the Act or the rules of the fund[5]. These measures should bring about a sense of responsibility and accountability to those who look after members' interests.

The Registrar's surveillance and enforcement division must ensure[6] that pensions service providers and boards of trustees are in compliance with the rules of the fund and the law. The regulator's presence in the industry should serve as a deterrent to would-be schemers.

Establishing effective governance structures

As the primary structure of governance of pension funds is the board of trustees, it is important that the board ensures an appropriate division of operational oversight responsibilities, and the accountability and suitability of those with such responsibilities.

Most boards of management have a lack of knowledge and expertise as to what is required of them. The solution does not lie in the delegation of responsibilities to third parties. If a board of management delegates certain functions, it must remain responsible for ensuring that pension funds fulfil their objective to serve as the source of funds for retirement benefits.[7]

Le Grand[8] says the problem is that we need to create an environment in which lay trustees, who make major contributions to schemes, feel comfortable to operate. Effective training will play a central role by giving trustees confidence in their abilities to play their full part in running schemes effectively.

Pension schemes should have appropriate internal control, communication, and incentive mechanisms that encourage good decision-making, proper and timeous execution of duties, transparency and regular reviews and assessments. It is doubtful whether the Fidentia scam would have taken place if such measures were in place.

Managing conflicts of interest

The standard of care and prudence expected of a trustee is defined by the common law concept of a *bonus et diligens paterfamilias*[9]. A person in a trustee's position must show greater care in administering the property of others than would be the case with his or her own.

The trustee should conduct his or her duties impartially. This means that the must avoid a conflict of interest between their personal concerns and official duties.[10] In the case study of Mitchell Cotts, Mr Bailey placed himself in such a position that it became impossible to distance his personal objectives from that of the pension fund.

It has been argued that there is a further principle that requires a trustee to treat beneficiaries impartially regarding the distribution of trust income and/or capital[11]. Trustees have a responsibility, not only to ensure no conflict of interest among themselves, but also to ensure that they deal scrupulously with conflicts of interest

among the fund's service providers[12].

The board of trustees that fails to address the matter of conflict will suffer a serious credibility crisis and will find it hard to fulfil its duties. If there is a conflict between an interest or duty of a trustee and an interest of the pension fund in any transaction, the trustee must account to the pension fund for any benefit he or she receives from the transaction. This applies whether or not the pension fund sets aside the transaction.

Trustees must deal with their own remuneration, travel and subsistence allowance in a transparent way. They should preferably request the services of external specialists to formulate policies and should avoid determining their own allowances. Trustees should be guided by their conscience when dealing with fund money.

Implementing trustee education and training

Trustee training and education have become such buzzwords at pension fund conferences and meetings that it is difficult to assess whether there is a genuine appreciation there for and if so, to what extent training is implemented.

South Africa's system of democratic election of trustees poses unique challenges. The law does not set any qualifications or competency standards for qualification as trustee. Any person, regardless of education background or level of occupation can be nominated as a trustee. The result is the proliferation of lay trusteeship.

The system serves to strengthen the democratisation of fund governance and ensures that most fund beneficiaries have a say in the management of the fund assets.

The challenge is therefore to empower trustees so that the system does not become a mockery of sound economic and governance policy. Trustees of retirement funds have a host of duties and responsibilities imposed by statute. As a result, the board of trustees must develop a trustee training policy that will ensure that the "gaps in knowledge" are filled and trustees are able to control and manage funds in the best interests of members.

Encouraging fund member activism

A study on the role of institutional investors established that public pension funds and union pension funds are abandoning their traditional passive shareholder role to become more active in the governance of their corporate holdings.[13]

Members need to participate more actively in the governance of their funds. They must acquire the necessary knowledge and skills to be able to know what questions to ask regarding investments and other legal matters.

Trustees are aware that members of retirement funds are too busy to place what they do under the microscope. Communication to members is limited to annual benefit statements in well managed funds. There is a need to make members aware of the importance of retirement fund matters and their participation in ensuring proper fund governance. It cannot be left to trustees alone to decide what is good for members. There should be a greater interest by fund members in their future.

Conclusion

This series of articles has shown that being a trustee carries with it a collective and personal liability. Today's trustees must be dynamic, level-headed and well versed in retirement fund issues.

There are numerous challenges which the board of trustees must deal with. Apart from understanding the nature of the fiduciary duties that they must exercise, it is equally important that they are competent to execute their duties. It is particularly important for trustees to understand that even when they have delegated their functions, they remain responsible. The Fidentia matter has demonstrated that when trustees delegate duties and responsibility simultaneously, results are often unpalatable.

The challenge is for boards of trustees to identify the core competencies and necessary skills to perform their functions effectively and implement education and training measures to fill gaps in knowledge. They should take governance issues seriously. The regulator's powers must be sufficient to deal with the challenges faced by pension funds in a more efficient and effective manner.

More importantly, members of pension funds must become active in the governance matters of their funds. When pension fund members become apathetic to fund governance, corruption and maladministration can thrive. Fund members can help to strengthen governance through interrogation of financial statements and other statutory compliance documents.

References

[1]Social Security and Retirement reform discussion paper 2007
[2]Discussion paper issued by National Treasury on Retirement Fund Reform 2004
[3]The Pension Amendment Act 2007 and the Financial Services Laws General Amendment Act, 2008 (FSLGA Act)
[4]Section 43 of the FSLGA Act
[5]Section 26
[6]In terms of section 25(2), the Registrar may instruct any person to conduct a compliance visit of the business and affairs of a fund or administrator in order to determine compliance with the Act and the rules.
[7]Guidelines for Pension Governance OECD 2002
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