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# On the move *On the move*



**Dube Tshidi**

## **The FSB's two new Deputy Executive Officers (DEOs), Dube Tshidi and Jurgen Boyd, are ready for the challenges their new positions hold.**

Tshidi's appointment as DEO: Investment Institutions, and Boyd's appointment as DEO: Retirement Funds and Friendly Societies, came about to fill the vacancy left by Rob Barrow's appointment as Executive Officer last year. Tshidi succeeded Barrow, and Boyd succeeded Tshidi. Their appointments came into force on 1 May 2006.

Tshidi, who trained to become an advocate, joined the FSB in 1994. He held various positions until his appointment as DEO: Retirement Funds and Friendly Societies in 2001. He said his new appointment was a beneficial progression.

"After spending so many years as Deputy Registrar of Pension Funds and seeing the industry grow into a R1 trillion giant, I think it is high time that I work in the field of investment institutions to see what has been happening to all these retirement funds when they are invested in the capital markets," he said.

Boyd, who qualified as a chartered



**Jurgen Boyd**



**George Beyl**



**Dawood Seedat**

accountant in 1987, joined the FSB in 2000 as Head: Collective Investment Schemes. He was very excited about his new position. "The industry is experiencing interesting times. I will face many challenging issues, such as the effect of the Pension Funds Adjudicator rulings, the bulking of funds and secret profits issues, and the reform process of the legislation that governs the industry."

George Beyl, was appointed Head of the Information and Communication Technology Department of the FSB with effect from 1 June 2006. He worked in the IT Division of the Department of Finance as an analyst programmer before he joined the FSB.

"I worked with and developed the IT systems used by the then Financial Institutions Division of the Department of Finance. I was asked to join them when they privatised and started the FSB.

"We are a service department and one of my first challenges would be to get systems and agreements in place to deliver a better service to our clients," Beyl said about the challenges of his appointment.

Dawood Seedat was appointed Head: Inspectorate of the FSB with effect from 1 April 2006. He moved to Pretoria from Durban during 2000. He is a chartered accountant and has spent the last six years in the law enforcement and regulatory compliance sectors concentrating on the forensic and investigative accounting fields. His most recent appointments were at the Directorate of Special Operations (Scorpions), the South African Revenue Service and Gobodo Forensic Accounting.

On why he joined the FSB, Seedat said: "I believed that I would be able to contribute to the vision and mission of the FSB. My role as I understand it fits perfectly with my passion for forensic and investigative accounting."

He regards his main challenge to provide leadership to a multidisciplinary team of experts to ensure that the FSB as a whole benefits from the successes of the Inspectorate Department.

# Effective supervision of pension funds

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

## Why adequate supervision?

Adequate supervision is needed to -

- reach the level of quality and professionalism required to fulfil the necessary tasks to run a pension fund;
- ensure the continuous well-functioning of pension funds;
- protect members/beneficiaries and to avoid malpractice and abuses.

## What is needed for effective supervision?

The regulatory authority, the Registrar of Pension Funds, needs -

- good, timely information which is appropriate in form and quantity;
- an efficient office with staff with required knowledge and experience;
- staff members who are good observers, analysts and communicators; they need to be alert to signals/information and use this information properly;
- good regulation, that is, regulation it can apply to monitor the whole process of asset and liability management of pension provision;
- the authority to take appropriate and timely action and to be able to decide about appropriate sanctions where required.

## How can the regulatory authority best intervene?

The Registrar, in a "best practice" approach, is part and parcel of what can be called "good pension governance".

It is assumed that all preliminary conditions are fulfilled: That the Registrar's office has high quality information at its disposal and operates in an environment where the board of the pension fund and its delegates (including pension fund administrators) act responsibly and are accountable for their doings. It is also assumed that compliance officers, auditors/actuaries and external professional advisers, are obliged to report irregularities to stakeholders.



## Adequate supervision: how to act when irregularities are reported

### 1 Help Desk /Call Centre

- Action: discussion with the reporter and/or fund
- Result: likelihood of several cases stopping there

### 2 For the remaining cases

- Action: investigate
- Result: no further action required
  - Or action: case work with fund
  - Result: compliance achieved
  - If no result: appropriate measures or sanctions

The objective is not necessarily to impose sanctions but to put the pension fund on the right track. Minor irregularities should lead to warnings and more serious ones to an agreed remedial plan which is executed by the fund and closely supervised.

## The chain could be as follows:

Discussion on the spot checks

If that does not work



Inform stakeholders, for instance contributing employers.



If that does not work



Publish information in the press  
(public censorship)

If that does not work



Impose fines or use other  
administrative sanctions (suspension/  
cancellation or registration; removal  
of persons who are not fit and proper)

If that does not work



Take appropriate legal action

It should be easy to get information from the Registrar's office. The best regulatory authority is a well-informed one which should intervene as little as possible. But the Registrar's office should make pension funds aware that it supervises appropriately and continuously. Therefore, the Registrar must be alert to signals, for example those given by compliance officers, auditors, actuaries and other stakeholders. An effective regulatory authority does not require a huge operational structure, but one that is highly efficient and adequately staffed. The action to be taken must be proportionate to the irregularity. The regulatory authority is not a "police force" in the negative sense of the word, but refer rather a protector of rights.

The Registrar should always act in the best interest of the pension fund, and therefore of its members and beneficiaries, and should be less concerned with broader market or other risks. The aim of the Registrar's intervention must be to create the least possible damage, but at the same time to find a quick and efficient solution. To

accomplish this the Registrar's office should have various measures at its disposal.

The guiding principles for the Registrar should be "written on the wall", so to speak:

- Help to rectify;
- do not make matters worse;
- be decisive and at the same time, fair and patient;
- distinguish between remedies, because the causes of problems will range from mere sloppiness, omissions and trivial problems to serious misconduct which requires court action.

If the problem is due to individuals, that is sloppy management, omissions, and so on, the Registrar should be empowered to take action, such as:

- removal of a trustee or the whole board;
- appointment of another trustee or board;
- withdrawal of the approval of an auditor or actuary or the authorisation of an investment intermediary (adviser, administrator), or before that impose fines where appropriate.

In these cases an appeal procedure should be available. For serious problems the Registrar should be directly involved and work closely with the fund and even take charge. If fraud or other criminal behaviour is involved, the Registrar should go to court to recover assets and ensure appropriate punishment.

In the event of insolvency it is important that the Registrar makes sure that the assets of the fund are taken care of in the best interests of the members and beneficiaries. In a worst case scenario, should the fund itself be in grave difficulty, the Registrar should take all appropriate measures, including the commencement of liquidation proceedings should transfer of the assets to another fund, curatorship or

judicial management not be a solution.

### Which feedback by the regulatory authority to the pension fund?

A pension fund can always have discussions with the Office of the Registrar or vice versa. However, the Registrar should not be obliged to give feedback on all individual cases.

The Registrar publishes an annual report on activities which contains general statistical and other information on the pension fund industry supervised and the solutions applied. The report itself could be a possible reference for "good practice" as it should facilitate comparisons and provide useful information.

Such a report will usually receive a lot of attention not only from the funds, but also in the media. The regulatory authority should not be obliged to provide more specific reports as the industry should do this. The national associations of pension funds, (e.g. the Institute of Retirement Funds) professional persons (e.g. the Pension Lawyers' Association) and investment intermediaries (e.g. SA Financial Services Intermediaries Association), are better placed to provide specific reports and also have the advantage of providing such information faster. The report of the Registrar will usually be broader and more representative than private surveys. It could, therefore, serve as a benchmark for general policy evaluation and future policy development.

*Reference: European Commission: Rebuilding Pensions: Security, Efficiency, Affordability (1999)*

# JSE self-lists: What are the regulatory challenges?

**Recently, international capital markets have seen an increased interest from exchanges in demutualising and either immediately, or shortly thereafter, seeking a primary listing on the exchange. One of the principle issues when an exchange self-lists is whether it can, and should, function as its own regulator. The regulatory responses to such listings vary according to circumstances, and there is no universal supervisory best practice.**

When drafting the Securities Services Act, 2004 (SSA), the FSB recognised the need for a legislative framework within which an exchange could demutualise and subsequently include securities issued by it in its own list. Such a framework was subsequently established through sections 12(6)(c) and 53 of the SSA.

Recognising the need to provide guidance to self-regulatory organisations that may wish to demutualise, the FSB published a set of conditions applicable to the demutualisation of self-regulatory organisations. On 27 May 2005, the JSE Securities Exchange applied to the FSB for approval to demutualise. The FSB conducted further extensive research on the regulatory implications for an exchange to become a for-profit entity and investigated the regulatory responses of a number of foreign regulators who had already considered and approved the demutualisation of the relevant exchanges within their jurisdiction. The Financial Markets Advisory Board (FMAB), the board that acts in an advisory capacity to the Registrar of Securities Services and



**By Norman Müller, Head of the Capital Markets Department, FSB**

the Minister of Finance in respect of administrative and technical matters concerning regulated persons or the provision of securities services, also debated the demutualisation application at length.

The FSB approved the demutualisation application of the JSE Securities Exchange effective from 1 July 2005, the same date when the exchange lost its tax-exempt status and the JSE Limited (JSE) was established. During the review of the application, the FSB approved a number of amendments to the JSE Rules to provide for the demutualisation.

On 14 March 2006, the JSE applied to the FSB to be listed with effect from 5 June 2006. The FSB acknowledged that the proposed listing would introduce other potential conflicts of interest in addition to those brought about by a demutualisation. These relate to the question of who should be responsible for the JSE's initial listing and ongoing supervision under the JSE Listing Requirements and trading in JSE shares. International practice regarding the listing of an exchange on itself was thoroughly researched and the FSB's regulatory responses to these conflicts of interest were debated in the FMAB. To prevent any conflict of interest, the FSB proposed and the FMAB unanimously agreed that the supervision of the JSE in terms of the JSE Listing Requirements should be transferred to the FSB.

In terms of section 12(6)(c) of the

SSA, the Registrar prescribed a number of conditions with which an exchange must comply when it includes securities issued by it in its own list. These conditions require, among others:

- The function of the exchange referred to in section 11(1)(f) of the SSA, namely to supervise compliance by issuers of listed securities with that exchange's listing requirements, the exchange's rules and the Act, will, in relation to the exchange in its capacity as an issuer, be assumed by the Registrar under section 11(2) of the Act;
- the function in terms of the exchange's rules to supervise all transactions effected through the exchange so as to ensure compliance with the exchange rules, will, in relation to transactions in listed securities issued by the exchange, likewise be assumed by the Registrar;
- the sponsor (if the listing requirements require such an appointment) must liaise with the Registrar, as the person responsible for the supervision of the exchange's listing, in accordance with its obligations as a sponsor in terms of the exchange's listing requirements;
- the controlling body (the board of directors in the case of the JSE) of an exchange must, regarding the inclusion of securities issued by the exchange in its own list –
  - implement adequate procedures and controls to ensure that no real



It is not foreseen that the listing of the JSE will affect the regulatory powers and duties of the JSE.



**Norman Müller, Head of the Capital Markets Department, FSB**

or potential conflict of interest arises regarding such inclusion;

- consider all complaints by affected persons relating to a conflict of interest;
- determine whether a conflict of interest has arisen or may arise;
- report all complaints received in connection with a conflict of interest to the Registrar as soon as possible after receipt of the complaint. The controlling body's report must include all material facts, together with proposals for the resolution of any conflict of interest;
- the exchange must include in its annual report a section on the regulatory and supervisory structure applicable to, and the role of the Registrar in supervising the exchange's own listing,

which section must include -

- a statement to the effect that in the opinion of the controlling body, the exchange has complied with all its rules, listing requirements and procedures in a manner which warrants the continued listing of the exchange's securities; and
- a confirmation that all complaints relating to a conflict of interest were referred to the Registrar during the year under review.
- In addition to the above conditions, the Registrar also determined certain specific requirements relevant to the JSE's listing application. These will allow for the practical supervision of the JSE in terms of the JSE Listing Requirements. In considering the JSE's listing

application, the Registrar was assisted by a Registrar's Advisory Committee, a specific committee appointed to advise the Registrar on the listing application of the JSE as well as on the continuous listing obligations of the JSE relative to its listing. A number of industry professionals are represented on the Committee which played an important role during the consideration of the JSE's listing application.

Subject to the above conditions and requirements, the Registrar formally approved the JSE's listing application on 11 April 2006 in terms of section 12(6)(c) of the SSA, for the listing to take place on 5 June 2006. The FSB's regulatory approach in supervising the JSE includes:

- attendance and participation in certain JSE meetings;
- approval of amendments to JSE rules;
- annual renewal of the JSE licence;
- restriction to 15% of the ownership of the JSE without the Registrar's prior approval;
- the Registrar's involvement in the appointment of members of the JSE's controlling body; and
- the FSB's insistence that the JSE at all times complies with the King Codes on Corporate Governance,

As a result of the FSB's current regulatory approach in supervising the JSE, it is not foreseen that the listing of the JSE will affect the regulatory powers and duties of the JSE as a self-regulatory organisation. The FSB remains committed to ensuring efficient, fair and transparent capital markets and will continue to apply this objective in the application of the JSE Listing Requirements. With the application of the various supervisory and regulatory tools available to the FSB, the listing of the securities issued by the JSE in its own list and the potential inherent conflicts of interests, will not lead to an increase in the risk profile of the capital markets in South Africa.

# Collective investment legislation supports consumer protection

By Di Turpin, Association of Collective Investments

**The Collective Investment Schemes Control Act, 2002 (CISCA), which replaced the Unit Trusts Control Act, 1981 in March 2003, introduced a modern, supportive and unambiguous legislative framework for investors in collective investments such as unit trusts. Investors will also enjoy enhanced consumer protection.**

Although in the past unit trust management companies followed industry laid down guidelines on disclosure, the new law entrenches these guidelines. Before concluding a transaction with an investor, the manager must disclose details such as investment objectives, calculation of the net asset value, dealing prices, charges, risk factors, distribution of income accruals, and all other information necessary to make an informed decision.

CISCA has facilitated the introduction of new vehicles not previously on offer in South Africa, such as exchange traded funds. In addition, more flexible investment limits and structures for investment managers have been introduced, which could enhance performance of investments in line with investment manager mandates.

One of the Act's best features is its structure. Fundamental principles are entrenched in law, surrounded by the Registrar's conditions. The latter provide the mechanics of operation, allowing flexibility to develop the industry to keep pace with international best practice and in line with consumer protection trends.

Trustee duties have been significantly increased and tightened. Investors in unit trusts have always enjoyed great protection as assets are held in a trust, which is closely administered on the investor's behalf by an independent trustee. In the unlikely event of a management company being liquidated,

the assets are not affected in any way and therefore unit holders' investments are protected. Trustee obligations have been further enhanced under the new Act and they will, for example, have to ensure that collective investment scheme portfolios are compliant with the new Act and the deed which governs the individual fund.

Investors also have rights to claim losses or damages in relation to their assets from the trustees, if due to negligence and wilful conduct. Previously the investor only had common law to rely on for a claim. The investor's right is now recognised and statutorily entrenched.

Investors have also benefited from enhanced financial protection in terms of how their investment portfolios are managed, while many sound principles found in the old legislation have once again been entrenched. For example, investors are guaranteed redemption of their investment within 24 hours if they wish to redeem an amount of less than R50 000.

The legislation also determines the instruments that may be included in a portfolio, thereby protecting the unit holder from risky underlying holdings, as well as the amount that may be held in any one counter, thereby avoiding overexposure to any one share or instrument.

If a company in the portfolio is placed in liquidation or under curatorship, industry standards require that the asset value be written down to zero immediately. This prevents any manipulation of prices or hiding of poor investments.

The smaller investor is also protected from large withdrawals that could materially influence the fund. In extreme circumstances assets may be ring-fenced and sold separately to repay a large investor wishing to withdraw money from a portfolio. This ensures that a large withdrawal won't cause a liquidity squeeze or force the manager to sell assets at an inopportune time.

CISCA has also delivered simplified reporting. Compulsory charges such as marketable securities tax are paid out of the fund itself. Reporting has moved



to single pricing, that is, based on the actual net asset value of the assets in the fund. This makes evaluating true fund performance easier and facilitates the way for direct comparison of the fees and charges of different products offered.

Although manager duties have remained fairly consistent, some new principles have been introduced to avoid conflict of interest, disclose interests of directors and management, and maintain adequate financial resources to meet liabilities. Previously there was no statutory obligation for investor education and this has been built in, although the industry has already engaged in investor education initiatives for many years.

Capital requirements of managers have also been enhanced to provide additional investor protection. They include providing enough liquid assets to ensure there are sufficient resources to continue operation of a scheme for three months in the event of winding up of a manager, providing initial seed money of R1 million at a portfolio's inception and holding an additional amount invested in a portfolio to provide liquidity in adverse market conditions.

Another win for consumers is that the regulatory authority is now in a better position to penalise errant financial services players, although so far the collective investment industry has managed to maintain a clean and untarnished image which it jealously guards and upholds.

The new Act is testimony to the fact that legislation has increased collective investments such as unit trusts' ability to be flexible and client friendly savings vehicles within the bounds of full disclosure.

# New member on FSB Board

**Tshidi Mokgabudi, Executive Director of infrastructure, government and healthcare at KPMG Services (Pty) Ltd, has recently joined the FSB's Board.**

Her appointment to the Board follows the departure of Nosipho Molohe, who joined the FSB as Chief Financial Officer last year.

A chartered accountant, Mokgabudi holds a BCom degree in industrial psychology and economics, an honours degree in accounting science and a higher diploma in tax law. Her fields of expertise include strategic management, business process re-engineering, auditing and organisation review and

development, accounting advisory services and project management.

Mokgabudi has spent 26 years auditing and consulting in the public and private sector, gaining valuable experience in the banking, airlines and transport, telecommunication, postal services and local government sectors.

She has been a lead audit partner for large public entities as well as advising on management and business issues.

She was on the first board of directors of the Association of Black Accountants of South Africa, and founder member of the African Women Chartered Accountants, an organisation that seeks to develop women role models for the community.

Her experience is not only in auditing major public entities. She also has wide management consulting experience.



## FSB suspends pension administrator

**The FSB has suspended the approval of IME Actuaries and Consultants (Pty) Ltd (IME) to act as professional benefit administrators of pension funds.**

The move by the Registrar of Pension Funds follows a complaint from a pension fund that IME had charged the fund R2 561 238 to extract data needed for its surplus apportionment scheme from their records. Quotations subsequently requested by the FSB from six different administrators for similar work, varied between R116 000 and R540 000.

FSB Deputy Registrar of Pension Funds, Jurgen Boyd, says IME was asked to give a detailed breakdown of the professional services rendered by the firm that would justify an account of R2, 56 million.

"IME, as a benefit administrator

approved in terms of section 13B of the Pension Funds Act, 1956, is a financial institution in terms of section 1 of the Financial Services Board Act, 1990.

"A pension fund administrator, as a financial institution, as well as its directors, officials and employees, have certain fiduciary duties towards the pension funds for whose administration they are responsible, including the requirement at all times to observe the utmost good faith and to exercise the care and diligence required of a trustee in the exercise or discharge of his or her powers and duties.

"The seriousness of this obligation in relation to financial institutions is underlined by the wide powers given to the Registrar by section 6(2) of the Financial Institutions (Protection of Funds) Act, 2001. For the purposes of ensuring compliance with the requirements of the law in general and more specifically in this instance,

the requirement of utmost good faith, the Registrar may by notice direct the institution to furnish information within a specified period or to appear before the Registrar for questioning.

"Under these circumstances, where an approved administrator of pension funds charges an amount of R2 561 238 for 'services' which should not exceed, at best, R540 000, the question arises whether or not such an administrator should be allowed to continue in business, irrespective of any pending litigation or 'commercial dispute' between the administrator and any fund.

"The registrar has instructed IME not to enter into any new contracts and make appropriate arrangements for the transfer of its present work to other administrators by not later than 29 September 2006. IME must also advise the board of management of each of their funds of this suspension."

Source: FSB media release 22 June 2006

# Formidable line-up shows it can pro

**Any financial services company that in future attempts to hoodwink consumers, by either lawful or “not lawful” means, is just plain stupid. A formidable line-up of institutions and people is now effectively tackling the excesses.**

This line-up is headed by Finance Minister Trevor Manuel and includes his competent teams at the National Treasury and the South African Revenue Service.

Other members of the line-up are:

- Parliament’s portfolio committee on finance;
- The FSB, which regulates most parts of the financial services industry, under the capable leadership of Rob Barrow, and supported by people such as Dube Tshidi, a deputy executive officer;
- The offices of Pension Funds Adjudicator Vuyani Ngalwana and Charles Pillai, the Ombud for Financial Services Providers, as well as, to a lesser extent, the various voluntary ombudsmen and adjudicators;
- The Council for Medical Schemes under Patrick Masobe, the Registrar of Medical Schemes;
- The Department of Trade and Industry’s consumer protection division; and
- Importantly, the media.

The R380 million acknowledgement of wrongdoing by Alexander Forbes, one of the most powerful financial services companies in South Africa, for the “not lawful” secret profits it made by bulking the bank accounts of the retirement funds it administers, is proof that times have changed.

Many of the people on my above list, from Manuel down, played a role in supporting Personal Finance in ensuring this significant payback by Alexander Forbes took place. This payback to retirement funds will ultimately benefit the pensions of many thousands of fund members.

Alexander Forbes did not seem to realise that it was not taking on only

**By Bruce Cameron, Personal Finance**



*Personal Finance* when we exposed the bulking practice on March 18.

Prior to publication, Alexander Forbes tried to pretend the issue was not serious, it turned nasty and made legal threats. When we published nevertheless, it dismissed our reports, particularly in letters to retirement fund trustees, as vindictive, sensational and biased.

Alexander Forbes has also continually refused to answer, or avoided answering, our questions on the bulking issue and many other unacceptable practices that we have since revealed about its operations.

Perhaps if the formidable line-up of institutions and people were not in place, Alexander Forbes might have got away with it.

Alexander Forbes has now done the right thing by admitting guilt and paying up.

The admission of guilt comes on the heels of the virtual R2.6 billion admission of guilt Manuel wrung out of the life assurance industry last year.

Manuel’s action followed rulings by Ngalwana that the confiscatory penalties levied by the life assurance industry on ordinary people who, for one reason or another, could no longer afford to maintain their premiums on their retirement annuity policies, were unacceptable.

These paybacks do not mean that other nefarious schemes will not continue to take place or that Alexander Forbes now has a clean bill of health.

It has set aside a further R100 million to cover any other unacceptable practices that may come to light.

Many unanswered questions remain about Alexander Forbes’s current, and particular its past, operations. Peter Moyo, the chief executive of Alexander

# protect you

The much improved consumer protection we currently enjoy does not mean you can sit back and take it for granted that your investments will be safe. There are many dubious schemes out there.



Forbes's operations in Africa, has given a public undertaking that he will not accept the unacceptable, and Moyo has invited his staff to provide him with information about these practices.

I also think it is about time that Rael Gordin, the chief executive of Alexander Forbes, started to take a higher profile instead of placing the responsibility on Moyo, who had nothing to do with it. Gordon has been with Alexander Forbes/Investment Solutions for quite a while. He should tell us what he knows about all the issues that have been revealed and how much money he made when Investment Solutions listed on the JSE.

The FSB's investigation into bulking practices in the retirement fund administration industry will reveal that other companies (a number of which are known to *Personal Finance*) have been involved in scandalous behaviour.

One thing that concerns me is that

if, as Alexander Forbes's lawyers, Routledge Modise Moss Morris, put it, "not lawful" actions took place with regard to bulking — or any other practices — surely some sort of action must be taken against the individuals who initiated and maintained these "not lawful" practices?

It is simply not acceptable to say they were "common industry practice", as if this is a valid excuse. Moyo has given me an undertaking that Alexander Forbes will review the actions of all individuals involved.

The much improved consumer protection we currently enjoy does not mean you can sit back and take it for granted that your investments will be safe. There are many dubious schemes out there, not least of which is the flourishing property syndication market.

Most of these property syndications are riddled with major problems that

are likely to explode into the open as property markets cool off, leaving thousands of people, particularly pensioners, out of pocket.

Deon Basson, the award-winning, independent journalist who has done much to expose the excesses of the property syndication industry, is currently fighting a R2 million libel action from Sharemax, a property syndication company. The surprising thing about this action is that only Basson is being sued and not the publications that have printed his exposés. This reeks of intimidation.

Incidentally, the 1st quarter 2006 edition of *Personal Finance* magazine also tackled Sharemax, but the company has not had the courage to attempt to intimidate us with threats of legal action.

I have also heard that it is telling brokers that I have retracted the statements I made about Sharemax in the magazine. For the record, I have not retracted anything, and I stand by every word I wrote in that article.

And I notice that Blue Everest Investments of Pretoria, another property syndication company I dealt with in the magazine article, has had its application for a Financial Services Provider licence turned down by the FSB. This should serve as a warning sign to potential investors in property syndication schemes.

Finally, it is great to know that with the Alexander Forbes settlement, *Personal Finance* has been vindicated, yet again, for taking up the cudgels on behalf of our readers and consumers of financial services products.

*This article was published in Personal Finance, a publication of Independent Newspapers, published in Saturday Star, The Saturday Argus, The Independent on Saturday and the Pretoria News.*

# Measuring consumer spending not an easy task



**How to measure the success of consumer education programmes is a new area for regulators and is generating immense discussion worldwide. It is more complicated than it might seem. It is for instance difficult to define exactly what success is in terms of a consumer education project, says Olivia Davids, head of Consumer Education at the FSB.**

“The FSB is keen to measure the success of its consumer education programmes as it is important to establish if we spend our money well,” says Olivia Davids, head of the Consumer Education Department of the FSB.

“Although we plan to measure the success of all consumer education programmes continuously it is difficult to measure the effect of, for example, a television programme on consumer behaviour. Is a consumer’s awareness of a television message success or is success only the action taken by consumers after being exposed to such a message?” she asks.

According to Davids consumer

## Consumer behaviour is complex and there is no agreement among consumer educators on what exactly constitutes success.

behaviour is complex and there is no agreement among consumer educators on what exactly constitutes success. "If consumers buy more insurance after being exposed to a message on insurance this may indicate a successful campaign. Research has shown however, that many consumers only use the information obtained in a consumer-related message at a later stage and not immediately upon receiving the message. This kind of action may also indicate success," says Davids.

"An indirect response such as knowledge among consumers on how, why and where to complain may also be an indication that the message of a campaign has successfully been received," she says.

Davids says what complicates the problem is that there is no consensus among those involved in consumer education on what exactly consumer education is. "One school of thought believes that awareness is in fact education. Other consumer educators believe that education can only start after awareness."

Davids says that the FSB is monitoring closely what is happening in other countries in order to keep its finger on the pulse on the success of its consumer education programmes. "We have some form of assessment built into all our projects and market research at grassroots level by research experts is often the ideal tool to measure the success of a campaign," she adds.

She points out that the FSB conducted thorough market research on the success of its teacher education programme earlier this year. The Enviro Teach Project was launched in July last year to educate teachers on financial literacy. This project consisted of workshops that were presented countrywide.

"Market research by an independent evaluator proved that our money was well spent and also provided us with valuable information on how

to streamline the project in future," Davids says. "A multi-method approach was used to gather information. This included on-site observation by the evaluator, interviews with educators, feedback from participants at the end of workshops, feedback from facilitators of the workshops, as well as feedback from the project underwriters and project executors."

Davids says that because the education of consumers is a relative new concept in South Africa there is consensus among consumer educators that it is a more practical to analyse the success of an individual programme at this point in time than to measure consumer education in general thoroughly. The evaluation of the Enviro Teach Project was particularly relevant.

"Research on consumer education programmes must also be longitudinal. A period of at least two to three years is necessary to establish if a specific project has influenced the consumer's behaviour," Davids says.

She says that, after conducting a comprehensive study on a strategy for consumer education, the National Consumer Council of Ireland recently concluded that any consumer education strategy by the Council will have to be long-term. The report states that the pursuit of a culture characterised by informed consumers and consumer-friendly business practices must be considered a long-term objective, with an associated strategic development programme which may take ten years or more to realise," she says.

She says that this study acknowledges the difficulty to monitor the effect of consumer education projects as a range of other factors other than education influence consumers' decision-making. The National Consumer Council of Ireland however advised that an evaluation tool should be developed within the consumer education strategy to monitor accurately and realistically and evaluate consumer education

projects. The Council recommended that specialist educational research techniques be employed that measure skills, actual knowledge, understanding and attitudes.

It was also proposed that a national strategy should be able to state what exactly it wants to evaluate and how it intends doing that.

Davids says that it is widely acknowledged that the electronic mass media is cost-effective in reaching large audiences and usually guarantees a great measure of success. It becomes important for the FSB to utilise Media experts to continuously be involved in planning and evaluating the FSB's consumer education programmes.

About 92% of South Africans have access to radio, 71% to television and 17% read daily newspapers. "The success of the electronic mass media was recently illustrated by the success of the Government's successful Soul City project which aimed to empower people on matters such as HIV/Aids, smoking, tuberculosis and land and housing. Extensive market research was done to evaluate the project which has been running since 1992. The project comprised an entertaining television series, radio, booklets, newspapers, public relations, advertising and advocacy.

Almost 61% of all respondents were exposed to the media that carried Soul City messages. Awareness of, for instance, the transmission of the HIV virus as a result of these messages increased significantly among consumers. The study also concluded that the multi-media approach was appropriate for reaching rural and urban areas and was effective in reinforcing messages.

Davids says that the FSB is also in the process of reviewing its educational material to keep the information current and meaningful. "This will ensure that our consumer education material is tailor-made for our audience," she says.

# When is extended warranty insurance business?

There are various types of warranties available to protect consumers, such as those found in the motor vehicle, furniture and retail appliance industries. These distinctive warranties should not be confused with one another and may be one of the following:

- Manufacturer's warranty

The manufacturer's warranty is a guarantee whereby the manufacturer warrants the purchaser that loss caused by the manufacturer's own negligence during manufacturing such as latent defects, poorly fitted or defective parts and bad service workmanship will be made good.

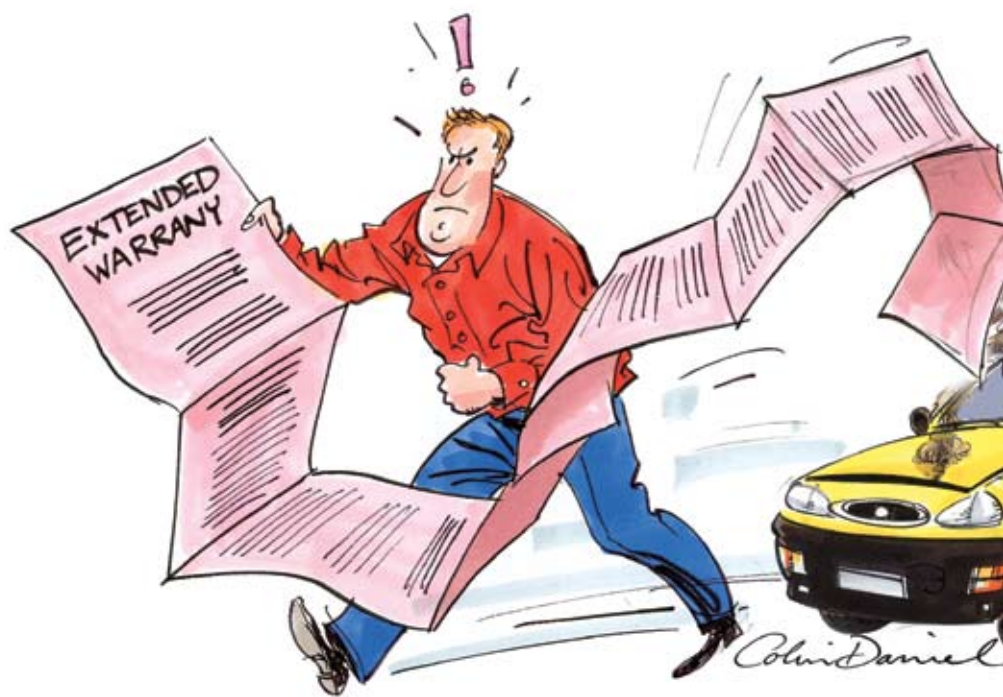
- The seller's warranty

This is a guarantee given by the seller as part of a contract of purchase or instalment sale agreement to the purchaser. It states that a product is reliable and free from defects and that the seller will repair or replace any defective parts within a given period and under certain conditions. The seller does not charge a fee for that service. He also warrants that the goods are as represented. If the seller does not make good on that obligation the purchaser has the option, depending on the circumstances, to institute action and claim for either restitution or a reduction in price.

- Extended warranty

Extended warranties in general will be offered to the consumer for cover against loss relating to a product for a period of 24 months. In most cases it will commence after the manufacturer's warranty has lapsed. It is offered to the consumer not by the manufacturer, but

By Marinus Mans, Legal Department, FSB



by a third party such as a motor dealer or furniture and appliance retailer.

Most extended warranties in the motor vehicle industry indemnify the consumer against, for instance, the risk of specified parts of the motor vehicle becoming defective (mechanical breakdown) and can thus be described as insurance business. The Registrar of Short-term Insurance (the Registrar) has issued Directive 97.A.i (ST) of 30 January 2004 relating to those warranties offered by persons other than the manufacturers. That directive was issued in terms of section 4(7)(a) of the Short-term Insurance Act, 1998 (the SIA) whereby the Registrar may determine that a policy shall form part of a particular class of policies as defined in the SIA. The Registrar determined that motor vehicle extended warranties fall under the definition of 'motor policy', which necessitates that those products be underwritten by a registered short-term insurer.

An extended warranty may also take the form of a contract of service. Some products offered to consumers by retailers are styled extended warranties but are, in essence, a contract of service or, what can be described in laymen's terms, a maintenance contract. (See Benetton *The South African Guide to Short-term Insurance* (2000) 2-43 to 2-44)

## Interpretation of extended warranties as insurance business

The SIA

The SIA does not contain an exact definition of insurance business. Therefore, to determine whether an extended warranty should be regulated by the Registrar, the following definitions in section 1 of that Act must be read collectively:

Such determination must clearly indicate which elements an extended warranty under the SIA should contain before it can be regulated and make it apparent that extended warranties of that type will be regarded as unregistered insurance business if offered to consumers without it being underwritten by a registered short-term insurer.

“Short-term insurance business” is broadly defined as “the business of providing or undertaking to provide policy benefits under short-term policies”.

“Policy benefits” are defined as “one or more sums of money other than an annuity, or services or other benefits”.

The definition of “short-term policies” includes *inter alia* liability policies.

A “liability policy” is described in section 1 of the SIA as “a contract in terms of which a person, in return for a premium, undertakes to provide policy benefits if an event, contemplated in the contract as a risk...occurs”.

A “premium” is defined as “a consideration given or to be given in return for an undertaking to provide policy benefits”.

To be classified as insurance business an extended warranty must fall under the definition of “liability policy”, the benefits it provides must be of the type contemplated in the definition of “policy benefits” and the insurer must undertake to provide those benefits in return for a premium.

There can be no doubt that the SIA empowers the Registrar to oversee insurance business that originates from insurance contracts and not any other type of contract.

### Complaints from the National Consumer Watch (NCW)

The FSB has recently received complaints from The National Consumer Watch (“NCW”) that unregistered institutions exploit consumers by offering ‘unlawful extended warranties’ in the furniture and retail appliance industry.

The NCW has requested the FSB to provide their opinion on whether extended warranties in general are

insurance business or not. If the answer is positive, it would mean that a large amount of furniture and appliance retailers offering extended warranties to consumers are currently rendering unregistered insurance business.

Yet, the answer to this question is not as simple in terms of the law as one might think.

### Essentialia of an insurance contract

To determine whether a person is conducting unregistered insurance business, the Registrar must assess the contract as a whole and be mindful of the nature, content and purpose of the contract. The Registrar cannot simply accept that the heading or name of the contract will result in it being typified as an insurance contract.

Before an insurance contract can be identified the following elements (essentialia) must all be present:

- The insurer must indemnify the insured for a loss incurred by him or her. That loss must be the result of the risk event insured against, which should also be an uncertain event. One of the clauses in the contract should state that the insurer will indemnify the insured on the occurrence of that risk event. If an insurance contract does not contain such an indemnity clause it is extremely difficult to determine whether indemnification was intended by the parties to the contract.
- The insured must undertake to pay a *premium* for the insurance cover to the insurer.
- The insurer’s obligation must be dependant on the occurrence of the *risk event*. The risk inherent in this is that the event insured against might indeed materialise, thereby causing damage or loss.
- The risk must be *insurable*. The contract must determine exactly what can be insured and the relationship between the indemnity and the loss or damage will have to be determined (see Reinecke et al *General Principles of Insurance Law* (2002) 59-78).

### Application of the abovementioned elements to the various types of warranties

#### The manufacturer’s warranty:

This guarantee contains no element of uncertain risk. The manufacturer had control over the quality of the product during the production and could have prevented such defects by ensuring the necessary quality control. No premium is payable because the cost of the repairs forms part of the purchase price of the product. This type of contract is therefore not an insurance contract but one in terms of which a manufacturer warrants its own product.

#### The seller’s warranty:

There is no element of uncertain risk and the seller merely guarantees the product sold to the purchaser. There is no premium and no fee is charged for this warranty. This type of warranty is therefore not an insurance contract but an incidence of a contract of purchase.

#### Extended warranties:

Most extended warranties in the motor vehicle industry will contain all of the essentialia of an insurance contract and can be described as insurance business.

Within the furniture and appliance retail sectors there are a variety of contracts styled as “extended warranties”, some of which could be seen as insurance against risk while others offer a maintenance service. It is not always easy to make that distinction.

#### Conclusion

The Registrar can only supervise insurance business, and may therefore

*continued on p 16*

## When is extended warranty insurance business? ... from p 15

oversee only extended warranties that originate from insurance contracts offered to consumers by persons other than the manufacturer. Any other form of extended warranty should not be regulated under the SIA.

Under the current provisions of the SIA it is not possible to generally classify all extended warranties as insurance business.

When investigating unregistered insurance business the Registrar must assess each contract individually and the *essentialia* of an insurance contract would have to be present before such an

extended warranty can be classified as insurance business under the SIA.

Some retail and furniture dealers offer a maintenance service to consumers and there is no intention on the part of the retailer to indemnify the consumer against a loss. Those products offered to consumers in the furniture and retail business sectors are not insurance business.

The Registrar could issue a further directive or make a further determination, the latter being the correct term provided for in the SIA, focusing on the furniture and retail

industry. Such determination must clearly indicate which elements an extended warranty under the SIA should contain before it can be regulated and make it apparent that extended warranties of that type will be regarded as unregistered insurance business if offered to consumers without it being underwritten by a registered short-term insurer.



## OBS hopes to expand its mandate to cover policy issues and charges

**“We welcome the enquiry of the Competition Commission into bank charges. It is an issue that has long been the subject of public debate.” This was the response of the Ombudsman for Banking Services (OBS) to media queries following the Competition Commission’s announcement that it will be holding a public enquiry into bank charges.**

In keeping with the rules of financial ombudsman schemes internationally, the OBS may not consider a complaint or dispute that relates to a practice or

policy of a bank (for example, a bank’s general interest rate policy or fees and charges policy), unless it relates to a fee or charge which the bank applies incorrectly regarding any scale of charges.

The role of the OBS is to provide individual and small business bank customers with a fair, quick and effective dispute resolution process, free of charge. It provides an informal alternative to other remedies, such as court proceedings. The OBS deals with complaints in which bank customers have suffered monetary loss, distress or inconvenience as a result of maladministration by the bank.

Fees and charges are regulatory issues. The statutory regulators in South

Africa that have a say over the banks and their conduct are the Reserve Bank, the FSB and, to a lesser extent, the Department of Trade and Industry.

Notwithstanding this, the OBS has been and continues to be approached by bank customers who wish to complain about bank fees or penalties. In a competition to provide tips for the banking industry, such consumers have also commented on the need to address banks fees and charges.

To provide a comprehensive service to bank customers, the OBS is exploring the possibility of expanding its mandate to cover policy issues and charges. It will make representations to the Competition Commission.

# SARB launches project 2010 for national payment system

**In 1995 the South African National Payment System (NPS) Framework and Strategy document (“The Blue Book”) was published. This document was the end result of much discussion and consultation between the Reserve Bank, the banking industry and other major stakeholders in the NPS. The document contained the principles, critical success factors and strategies required to reduce the risk in, and achieve a modern world class NPS in South Africa over a ten year period.**

All the strategies identified in the Blue Book have been achieved and major Milestones include, among others:

- In March 1998 the South African Multiple Option Settlement (SAMOS) system was introduced. This real-time gross inter-bank settlement system provides the banks with multiple settlement options, including liquidity-optimising functions. The SAMOS system also caters for the settlement of financial market transactions emanating in the bond and equity markets to achieve delivery-versus-payment (DVP).
- The NPS Act, 1998 (the Act) was promulgated in October 1998. The Act enhanced the regulatory and supervisory powers of the Reserve Bank to manage and control payment system risks and provided a sound legal foundation for the NPS. Further major developments required a revised NPS Act which was promulgated in October 2004. The objectives of the amendments were

mainly to further enhance the regulatory and supervisory powers of the Reserve Bank and to address the inclusion of the Rand currency in the Continuous Linked Settlement (CLS) system.

- During the period 2001 to 2004 risk reduction measures were implemented to reduce the values processed in the retail payment streams, including the implementation of item limits. In this period new Payment Clearing House (PCH) agreements were concluded between participants to further strengthen the legal foundation and same-day settlement and same-day square-off were introduced.
- On an international level the Rand was officially accepted as a Continuous Linked Settlement (CLS) currency in December 2004. The objective of CLS is to reduce foreign exchange settlement risk. This is achieved by the synchronisation of the settlement of the two legs (Payment-versus-Payment (PvP)) of a foreign exchange transaction in a single time-zone within CLS Bank, in Central European Time (CET). CLS results in liquidity and efficiency benefits for the country. As an additional benefit, the status of the Rand was greatly enhanced, as one of only 15 CLS settlement currencies in the world.
- On a regional level South Africa has continued to play a major role in assisting the SADC region to successfully develop national payment systems including the implementation of automated clearing and electronic, mostly RTGS, settlement systems.



# Financial services providers plea to product suppliers

By Anton Swanepoel, Director,  
Crux Consulting



the required information that should be disclosed to the client before point of sale is contained in the product suppliers' contract/policy schedule.

This is only sent to the client after the transaction has been concluded. Therefore most providers are not complying with the FAIS Act requirements as a result of non-disclosure by the product supplier

**Most financial services providers are trying hard to implement advice processes to enable them to comply with the Financial Advisory and Intermediary Services Act, 2002 (FAIS Act). In many cases they have succeeded but at least one issue remains a challenge. Product suppliers only send clients relevant and material information, that needs to be disclosed before concluding a transaction, some weeks after the transaction has been concluded.**

## Statutory obligations of the provider

The FAIS Act obliges providers to disclose relevant and material information regarding the advice, intermediary service and transactions and to keep adequate and appropriate records;<sup>1</sup>

In terms of the General Code of Conduct a provider other than a direct marketer, must -

(a) explain the nature and material terms of the relevant contract or transaction to a client, and make full and frank disclosure of any information that would enable the client to make an informed decision;<sup>2</sup>

(b) whenever appropriate, give the client any material contractual information and any material illustrations, projections or forecasts in his/her possession;<sup>3</sup>

(c) as soon as possible, give where applicable, full and appropriate information of:

*(vii) concise details of any special terms or conditions, exclusions of liability, waiting periods, loadings, penalties, excesses, restrictions or circumstances in which benefits will not be provided.<sup>4</sup>*

## Problem

Providers depend on product suppliers to disclose the relevant and material terms and conditions of their financial products so that providers can disclose these to their clients. Unfortunately very limited versions of all these conditions are in the product suppliers' quotations, brochures or marketing material. In fact, most of

before the transaction is concluded, the exception being a product suppliers which is a provider self dealing with other providers.<sup>5</sup> This problem exists in the long-term, short-term, investment, health care, and employee benefit industries.

## Providers' dilemma

In a fairly short time the FAIS Ombud has earned a sound reputation of applying the law. As seen above, there is a clear duty on the provider to disclose specific information to clients and the Ombud is very likely to expect the provider to comply with that obligation. This means that regardless of the fact that product suppliers do not disclose all the information to providers, the latter will remain accountable for such disclosures. Therefore the provider will have to take an extra step where the quotations or product brochures of product suppliers are not comprehensive enough. He/she will have to request additional information in the insurance or investment contract from the product supplier in order to disclose the necessary information to clients as required in terms of the FAIS Act. This

Although the industry has come a long way since 30 September 2004 when the FAIS Act was implemented, full compliance in practice under the Act remains a work in progress.

situation adds to the complexity and onerous nature of rendering financial services under the FAIS Act.

### **Product suppliers' dilemma**

Historically providers asked product suppliers to simplify their quotations and marketing material to simplify the sale. As a result, most of the specific terms and conditions were excluded and an abbreviated document was prepared that mainly contained the key features of the product. After the introduction of the FAIS Act legislation, with specific reference to the disclosure requirements in terms of section 7 of the General Code of Conduct, some providers understand their obligations and would welcome product suppliers to disclose the necessary terms and conditions in their quotations. On the other hand, there are still providers who do not fully understand the implications of just presenting standard quotations of product suppliers to their clients – quotations that are non-compliant as far as the FAIS Act is concerned.

### **Dilemma of compliance officers**

Compliance officers have to report any acts of non-compliance with the FAIS Act by financial services providers. Non-disclosure of relevant and material information and specific terms and conditions of financial transactions are acts of non-compliance. As seen above, many providers believe that they comply with the Act if they provide their client with a product supplier's quotation.

Although some of the terms and conditions are in existing quotations, they do not contain all the relevant and material terms of the contract. Compliance officers that do point out the problem may be seen as people trying to complicate the provider's advice process instead of helping providers. Compliance officers that appear not to be adding value to providers by simplifying the process, may find themselves

without a contract. Fortunately there are some providers that see the value of compliance officers being conservative, but unfortunately at this stage they seem to be in the minority.

### **Unlisted property investments to take the lead on disclosures**

The Minister of Trade and Industry has published Notice 459 of 2006 in *Gazette* No. 28690 on 30 March 2006, which compels public property syndication scheme promoters to disclose full details of relevant and material information to investors that invest in these unlisted property investment schemes.

The minimum information to be contained in property syndication documents should be welcomed as it puts financial services providers in position to comply with the requirements in terms of section 7 of the General Code of Conduct. It also puts investors in a good position to make well-informed decisions.

The disclosure requirements, as set out in *Gazette* No. 28690, have aligned the obligations of product suppliers with those of financial services providers under the FAIS Act. This simplifies the advice process procedures of providers under the FAIS Act significantly. If there is one lesson other financial product suppliers should learn from the unlisted property investment industry, it is to align its disclosures with those of the financial services providers that promote their products. After all, if properly complied with, the FAIS Act does align the interests of all stakeholders in the interest of consumers.

### **Policyholder Protection Rules**

Rules 5.2 and 7.1 (d) of the Policyholder Protection Rules (Long-term Insurance), 2004 (Notice 1129 of 2004 in the *Gazette* 26854 of 30 September 2004) and Policyholder Protection Rules (Short-term Insurance), 2004 (Notice 1128 of

2004 in the *Gazette* 26853 of 30 October 2004), respectively, oblige insurers to provide intermediaries with information reasonably required by intermediaries to comply with applicable disclosure requirements under the FAIS act. This obligation will solve the dilemma of the provider for information on insurance products in so far as the insurer complies with the request thereof. However, the problem to get all relevant information in respect of other financial products remains.

### **Solution**

Product suppliers that want to take the lead under the FAIS Act are going to be those who:

- simplify their financial products;
- reduce the number of terms, conditions and exclusions;
- pro-actively align their quotations with the disclosure obligations before conclusion of the transaction of financial services providers;
- offer providers full disclosure of the relevant contract information for the client to consider before the transaction is concluded.

Although the industry has come a long way since 30 September 2004 when the FAIS Act was implemented, full compliance in practice under the Act remains a work in progress. Despite a relatively slow reaction initially, I am confident that product suppliers will come to the party in simplifying the advice and intermediary process for the benefit of all stakeholders.

<sup>1</sup> Section 16(2) of the Act.

<sup>2</sup> Section 7(1)(a) of the General Code of Conduct.

<sup>3</sup> Section 7(1)(b) of the General Code of Conduct.

<sup>4</sup> Section 7(1)(c) of the General Code of Conduct.

<sup>5</sup> Section 4(2) of the General Code of Conduct.

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