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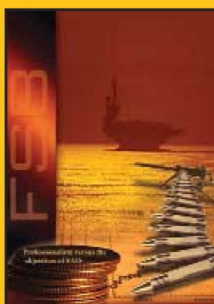

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The highs and lows of the Ombudsman for Long-term Insurance during 2001

By the Hon J H Steyn - Ombudsman for Long-term Insurance

The Office of the Long-term Insurance Ombudsman anticipated improvements in certain areas during the past year. Sadly, the outcomes fell short of expectations on two fronts.

In 2000, the long-term insurance industry showed evidence of an improvement in the quality of service to the public. The Office of the Ombudsman expected that this improvement would be maintained and even accelerated during 2001. However, this did not occur, and the industry's service levels fell short of both the expectations of this Office and the expectations of the general public.

Symptomatic of the malaise experienced by the industry were the following:

- A significant increase in the number of complaints received.
- A marked deterioration in the quality of the responses submitted to us by some members of the industry.
- Unacceptable delays in responding to complaints.
- A tendency by some subscribers, albeit a minority of them, to avoid meeting valid claims on spurious or unsustainable grounds.

The second level at which expectations were not met was in the delivery of legislative changes directed at enhancing policyholder and investor protection. It was anticipated that a new legislative framework for the industry and financial services intermediaries would be enacted during the past year. It was also anticipated that the statutory recognition of voluntary ombudsman schemes would have been put in place during the course of the year. Unfortunately, legislative delays rendered this objective unachievable.

Despite the issues mentioned above, there were developments that demonstrated the government's commitment to greater investor protection on the legislative front. It also appears that the steps already in place via the Policyholder Protection Rules, and those contemplated in the various enactments referred to below, will create a balance between enforceable investor protection on the one hand, and avoid over-regulation and a distortion of costs over benefits on the other. It would seem that the authorities have recognised the risks of imposing a regulatory framework that is either unaffordable or will bring into effect the law of unintended consequences. The legislation referred to includes the following :

Long-term Insurance Act, 1998

There are proposed amendments to this Act that will create greater certainty as to the legal position regarding the circumstances in which an insurer can repudiate a policy due to non-disclosure.

Policyholder Protection Rules

These Rules became effective on 1 July 2001 and are part of the Long-term Insurance Act legislation. The purpose of the Rules is defined as follows: To enable the policyholder to make informed decisions in regard to transactions involving long-term policies and to ensure that intermediaries and insurers conduct business honestly and fairly, and with appropriate care and diligence.

Additional measures

These objectives are to be achieved by means of disclosure and by regulating the conduct of insurers and intermediaries. It involves a cooling-off period and there are rules in respect of replacement policies. There are also the following measures :

- Intermediaries must have a written mandate from the insurer to sell a product.
- The insurer must give the reason to the policyholder or claimant for not paying a claim.
- The practice of signing blank forms and allowing someone else to fill in details at a later stage will be an offence by the insurance parties.

Impact on the Ombudsman's Office

No complaints linked to the Policyholder Protection Rules have yet been received. It is too early to predict what the effect of the new legislation will be on the operations of the Office of the Long-term Insurance Ombudsman. The rule of greater disclosure should benefit policyholders. It will also assist the Office of the Ombudsman in factual

disputes regarding the sales process as documentary proof of what was negotiated should now be available and will facilitate the dispute resolution process.

Certain categories of complaints that fall under the Ombudsman's jurisdiction could have components that mandate the Financial Services Board (FSB) to intervene. When such complaints arise the Office of the Ombudsman will have to interact with the FSB regarding the resolution of such complaints.

Ombud for Financial Services Providers (FAIS Ombud)

Before dealing with the aspects of the Bill that impact on the dispute resolution process, it must be recorded that the Office of the Long-term Insurance Ombudsman regrets that political correctness should have prevailed in delegitimising the internationally respected 'Ombudsman' institution. It has no international gender significance.

The FAIS Bill establishes an 'Ombud' in respect of financial services providers. This means that complaints in respect of independent financial advisers will fall under the jurisdiction of such an ombud. With the exception of a few larger intermediary firms, independent long-term insurance intermediaries did not fall under the jurisdiction of this Ombudsman's Office. However, agents/representatives do fall under its jurisdiction and will presumably continue to do so.

The distinction made above is of considerable importance. Financial institutions and major long-term intermediaries are voluntarily and contractually bound by any rulings that the Ombudsman may make. They also have the capacity to meet the obligations that may flow from such rulings. Accordingly it has never been necessary for the Ombudsman to resort to any legal process directed at securing a compliance with a ruling. This applies to both long-term insurers – some 98% in asset value of all life offices subscribe to the rules of the Ombudsman - and to the major large intermediary institutions.

The position would be different in respect of the general intermediary community. Here an enforcement process would of necessity be resorted to should an intermediary fail to comply with a ruling made by an ombudsman. It is the view of the Ombudsman that legislation to cater for the lacuna in the consumer protection safety net is both desirable and necessary. The Bill as it is currently drafted does in the opinion of the Ombudsman level the playing fields and does provide David with some weapons in the contest he might have with Goliath.

Please note that the comments on the FAIS Bill set out above are restricted to those aspects that deal with the dispute resolution provisions only.

Financial Services Ombudschemes Bill (FSOS)

The above draft legislation is another step in the process to create more effective protection for the consumer. It also strengthens the capacity of the voluntary schemes to give an effective service to the general public. The criteria with which they have to comply include the creation of accountability structures, as well as capacity to enable the FSB, through the mechanisms created by the Bill, to monitor the compliance of a truly independent ombudsman with the maintenance of fair administrative procedures.

In the opinion of the Office of the Long-term Insurance Ombudsman, this legislation is essential in order to bring about an acceptable framework within which voluntary schemes should operate. It has the added advantage of lending statutory recognition to and enhancing the standing and credibility of such institutions.

Concluding statements

It is clear that some progress has been made in creating a more acceptable statutory regime for the financial services industry. To steer the ship between the Scylla of over-regulation and the Charybdis of a laissez faire regime is a very difficult course to map and moni-

tor. Viewed as a whole, the pending legislation may well prove to have achieved this result. In the end, however, unless the consumer public is sufficiently educated and informed concerning its rights and is proactive in pursuit of the enforcement of such rights, no legislative provision can on its own bring about effective change.

It was not a good year as far the delivery of quality service by the industry to the general public is concerned. Whilst there were companies that performed at the expected level of customer care, the Office of the Ombudsman can only express the hope that the year 2002 will see a dramatic improvement in service across the board. It is an essential requirement for the industry to maintain the highest standards of competency and integrity in its service to the public. The industry carries the onerous responsibility of managing and protecting the savings of South Africans: the rich, the poor and every man and woman.

Amlac referred to prosecutor

The FSB has referred its price manipulation investigation into Amlac Limited to the Director of Public Prosecutions. The FSB investigation followed an inquiry by the JSE earlier this year into what was believed to be unusual transactions in the shares of Amlac from July to September 2000.

Source: FSB Media Release, 3 December 2001.

Looking Back

by Banking Adjudicator Neville Melville

Over the past year the Office of the Banking Adjudicator took a hard look at issues relating to the Code of Banking Practice and auto-teller machine (ATM) losses. Although these were by no means the only areas of concern to the Banking Adjudicator, they enjoyed major attention.

The Office of the Banking Adjudicator came into being as a section 21 company on 10 February 2000. Its predecessor was the Office of the Banking Ombudsman. The incumbent Banking Adjudicator, Neville Melville, was appointment by the Banking Adjudicator Commission on 1 May 2000. For the first time the appointment was not controlled by the banks. The change was implemented to ensure that bank customers felt confident that complaints against their banks would be handled by an impartial, independent body.

The Office has an important role in holding banks to their new Code of Banking Practice. While the Adjudicator's Office welcomed the Code as a public undertaking by banks to treat their customers fairly and reasonably, it identified various shortcomings in the code in its report for 2000 (read all about it on www.oba.org.za).

Of particular concern was the failure by most banks to meet the deadline, set by themselves, to ensure that all their documents were rendered in plain language and made fair to customers. No new deadline for compliance was set. One of the most problematic areas for the office was that of ATM related losses. The general approach of the banks was that as their customers had contractually agreed that they would be liable for losses arising from compromising their personal identity numbers (PINs), they (the banks) were therefore not prepared to accept liability.

The Adjudicator's concern was that a statistically significant number of complaints it received related to ATM losses and that such losses affected bank customers from all walks of life. Many bank customers had been persuaded, somewhat reluctantly, to 'migrate' from savings books to ATM cards. The elderly and illiterate seem, in general, to have difficulties in operating ATM facilities and are most vulnerable to scams.

The Adjudicator's Office treated the ATM issue as a special project and conducted extensive research into the topic. It interfaced with the banks at various levels regarding this situation, including top management. The important understanding that emerged from the process was that, in terms of section 4.4.7 of the code, the banks had in effect undertaken liability for ATM losses, unless there was proof that a claimant had acted fraudulently or with gross negligence.

However, in some cases the Adjudicator's Office did recommend that the complainants bear a percentage of the ATM losses. These were instances where the Office was convinced that complainants had contributed to the loss through carelessness.

As a result of the Office's initiative, the banks have started to honour their undertakings in the Code in this regard. One bank recently received considerable media attention as a result of its announcement that it had modified its ATM card readers to prevent fraudulent jamming of cards and that it had adopted a new approach to dealing with ATM related complaints.

As a result of the Office's intervention and suggestions over the past year, banks have altered certain procedures to ensure better protection of customers against fraud or loss and to ensure fairness in certain contracts, such as sureties. Furthermore, the Office has pinpointed particular banking practices that can unfairly expose customers to risk of loss through internet banking and electronic fund transfers. In most cases, banks have taken steps to minimise customer risk.

The Office also alerted members of the public to the existence of certain risks by way of media releases. These alerts concerned ATMs, debit orders, investment and mortgage-related insurance.

A consumer journalist recently commented that she had tried in vain for years to establish from the banks the rules relating to debit orders. If the Office of the Banking Adjudicator helped to wring some answers in this regard from the industry in the past year, it has made proud progress.

New dispensation for Short-term Insurance Ombudsman

By Michael Bennett

The office of the Short-term Insurance Ombudsman kicked off in 2001 armed with a new dispensation inspired by the envisaged introduction of the Financial Services Ombud-schemes Bill, 2001 (FSOS). It brought about positive changes in the industry, and gave rise to continued efforts to improve the workings of the Ombudsman even further. In this article, outgoing Short-term Insurance Ombudsman, Michael Bennett, shares his views on 2001 with Bulletin readers.

Over the past two years, the Ombudsman's office has maintained close contact with the Financial Services Board (FSB) officials who have been charged with the preparation of the FSOS Bill. The Bill seeks to grant recognition, subject to certain criteria, to voluntary ombudsman arrangements in the financial services industry. Provision is made in the Bill for a statutory ombudsman that will deal with customer complaints in cases where no other ombudsman is able to exercise jurisdiction over such complaints.

Contact and co-operation between the Ombudsman and the FSB were also extended to include debate and discussion regarding the Financial Advisory and Intermediary Services Bill (FAIS) legislation. This new Bill includes proposed control over short-term insurance brokers.

Until the end of 2000, the Short-term Insurance Ombudsman's Office was a creation of, and administered and controlled financially by the industry through the South African Insurance Association (SAIA). All members used to make contributions to the Association to defray the cost of running the office.

While the independence of the Ombudsman to make decisions was recognised by the industry, difficulties arose regarding consumer confidence. There was specific criticism that the Ombudsman was an extension of the industry, and therefore not able to be completely independent. Not only was the Ombudsman's staff employed by the SAIA, but decisions in respect of complaints against members of the industry could not be enforced legally.

It took the Ombudsman five to six years to obtain undertakings from its members that his formal recommendations, made on a strictly legal basis, would be accepted and acted upon by the member concerned. Eventually every SAIA member conducting short-term 'personal lines' business committed to the undertaking. Still, this did not entirely allay public and consumer concerns.

The result was a completely new dispensation which came into force at the beginning of 2001. It had the following effect:

a) It placed the Ombudsman, including his employees, under the control of a council, made up of appointees from the industry and the public, and consumer and State representatives.

b) The Ombudsman will be appointed by and be responsible to the council, with obligation to report regularly to the Council on its duties, and will abide by the directions and control of the Council.

c) The creation of a non-profitable section 21 Association, which sets out in its association of agreement and articles of association the full mandate and jurisdiction of the Ombudsman, including:

- Increased financial limits in respect of complaints submitted.
- The power to make recommendations or rulings based either on legal grounds, or on grounds of equity, or fair insurance practice, which would be binding on all SAIA insurers and have the same effect as a court decision. However, recommendations against a claimant would still not be binding on the claimant who could in any case pursue his claim in a Court of Law.
- To create a duty to assist the public and consumer organisations in education programmes, and to encourage the industry in all forms of improvement of staff/consumer relationships.

d) To co-operate with the Registrar of Short-term Insurance regarding undesirable insurance practices and compliance with the provisions of all relevant legislation including the regulations made by the Minister of Finance.

The purpose of the new dispensation, which was fully discussed with the FSB, is hopefully that the new Ombudsman Office will achieve statutory recognition once the new legislation comes into force. In this way it will be able to carry on with its functions, subject to any control which may be included in the new Act.

It is to the credit of the short-term insurance industry that all insurers conducting personal lines business have in fact through SAIA, and through their membership of the Section 21 Association, become part of the new dispensation. In doing so, they have created a completely independent Ombudsman body with full powers to assist with public and consumer complaints within its jurisdiction, and one that can make binding rulings in favour of complainants, either on legal or equitable merits.

Bennett bows out

By Isabel Jones
Chairperson of the Council of the Ombudsman for Short-term Insurance

The man who made it possible for disgruntled South African short-term insurance consumers to voice their problems and be heard has retired from his post at the end 2001.

Attorney Michael Bennett retired from the position of Ombudsman for Short-term Insurance on 31 December 2001. He took up office in 1995. He stalwartly and valiantly supported dissatisfied consumers in their battles against short-term insurance companies in this time, often making it possible for the little man to stand up against the corporate giant.

When Michael Bennett took up this office in 1995, only three companies out of a total of more than forty in the industry had agreed to accept the Ombudsman's ruling. The only co-operation promised to him by the rest of the insurance companies that were members of SAIA (the South African Insurance Association) and that gave personal line insurance, was an undertaking to 'seriously consider' recommendations made by the Ombudsman. This undertaking, of course, gave no real guaranteed consumer protection.

Over the next five years, however, Bennett embarked on a campaign to persuade all the relevant insurers to give the Ombudsman an undertaking to accept his office's rulings, i.e. rulings made on a legal basis. By the end of 1999, his efforts finally paid off. Every member of SAIA that conducted personal lines business had by then given the undertaking to accept all of his decisions based on legal ruling, with a further proviso of agreeing to seriously consider any recommendation made on grounds of equity, or fairness. It was a great step forward for the disgruntled consumer!

During his term of office, Michael Bennett has managed the difficult task of persuading the industry that equity was a critical factor for a healthy, profitable market place. Despite his reputation as a tough negotiator, he has succeeded in building up the confidence of the major and minor insurers through patience, fairness and charm. He has an equal number of supporters in the ranks of the media with whom he shared a close and frank relationship.

He will be sorely missed.

Van Zijl takes the Helm as new Ombudsman

The Council of the Ombudsman for Short-term Insurance has appointed Helm van Zijl as successor to Michael Bennett, who retired at the end of 2001.

Helm van Zijl assumed responsibility as Ombudsman on 1 January 2002.

Isabel Jones, Chairperson of the Council of the Ombudsman, said: 'Michael Bennett will certainly be a hard act to follow. However, the Council feels fortunate that Mr Van Zijl with his vast experience and respected reputation has agreed to take over this highly important office.'

Helm Van Zijl has been practising law since 1967. For more than 30 years he has specialised in litigation and insurance law in the Litigation Department of Herold Gie & Broadhead in Cape Town.

He is one of the ten chairmen of the Taxing Committee appointed by the Law Society Cape of Good Hope for the assessment of fees rendered by attorneys.

He is a member of the Review Committee, which considers appeals against decisions made by the Taxing Committees. He also served as President of the Committee of the Cape Town Attorneys' Association.

Mr Van Zijl said of his new role that it would be a major challenge to continue the work of his predecessor. He added that 'the Ombudsman has the unique opportunity to instil confidence in the insurance industry and to limit misconceptions'.

FSB successful in long dispute with Pepkor Ltd re Pepkor Pension Fund

On Friday 14 December 2001 the Cape High Court handed down judgment in an important case regarding pension fund surpluses.

The Financial Services Board and the Registrar of Pension Funds asked the Court to declare invalid the Registrar's approval of the unbundling of the Pepkor Pension Fund between October 1993 and November 1995 into defined benefit and defined contribution funds for each of the main operating companies in the Pepkor Group (Ackermans, Pep Stores and Shoprite).

The unbundling process left the Fund with a very large surplus, currently just under R100 million, no active members and only 14 pensioners. The court found in favour of the FSB and the Registrar and ordered the defendants to pay them their costs.

In 1996 the trustees of the Fund, who were all nominated by Pepkor Ltd, placed the Fund into liquidation and applied for a rule amendment which would have allowed the payment to Pepkor of the bulk of the surplus. The proposed liquidation account showed that at that stage the Fund had 17 members (all drawing pensions), representing actuarial liabilities of some R2,43 million, but at the same time had assets valued at R52,33 million. The liquidation account proposed to pay the surplus assets of R49,9 million to Pepkor. The Chief Actuary considered that this situation could not have arisen from the normal, natural development of the Fund. On reviewing the FSB's files, the Chief Actuary discovered that the actuary to the Fund had misstated the funding level of the Fund after the initial unbundling at 137% - the correct funding level was 606%. The actuary also incorrectly described certain "special reserves" as liabilities. This amount, plus an additional amount of interest, was later transferred out of the Fund without the consent of the Registrar in contravention of section 14 of the Pension Funds Act, 1956.

The trustees were unable to explain satisfactorily what the Fund had intended to do with the surplus after the unbundling. The trustees also did not disclose the accumulation of the surplus to members of the Fund who were being "unbundled" into the new funds. The Registrar accordingly refused to register the amendment or to approve the proposed liquidation account. The Financial Services Board persuaded the Court to set aside the Registrar's initial approvals for the unbundling. The order given by the Court has been suspended in order to afford all of the parties an opportunity to arrive at a more equitable distribution of the surplus.

Mr Jeff Van Rooyen, the Executive Officer of the Financial Services Board and the present Registrar of Pension Funds, expressed his satisfaction with the outcome of the case. He considers the judgment to be a milestone in the advancement of a more equitable dispensation in the pension fund industry in which the rights of members of pension funds are accorded more weight.

Source: FSB Media Release, 14 December 2001.

RECKITT & COLMAN APPEAL DISMISSED

In a judgment handed down by the FSB Board of Appeal on 20 December 2001, the appeal by the Reckitt & Colman Retirement Fund against the decision of the Registrar of Pension Funds not to register a proposed amendment to the Fund's rules, was dismissed.

The appeal yet again raised the vexed question of how a surplus in a pension fund may be dealt with.

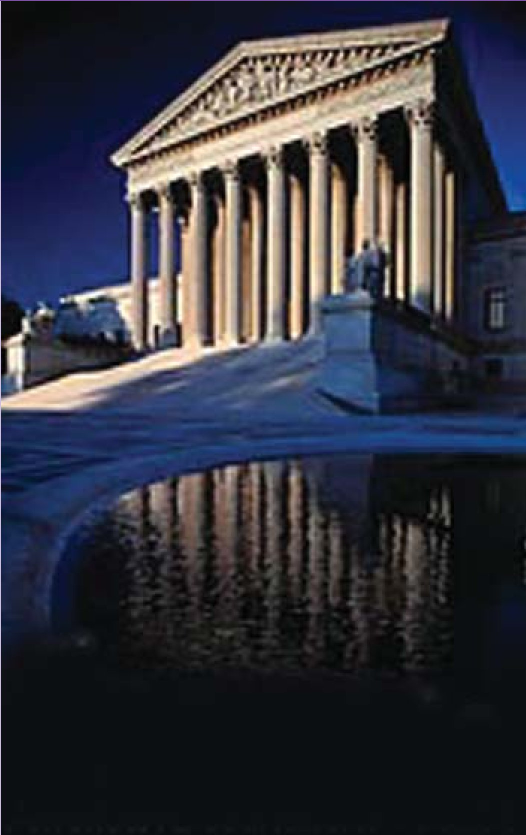
In stating his reasons for declining the rule amendment, the Registrar contended that the proposed amendment was not financially sound, as it would permit the repatriation to the employer of all the residual surplus remaining in the defined benefit fund, after the fund had converted to a defined contribution arrangement. Only pensioners remained in the defined benefit fund. This view was upheld by the Board of Appeal and the appeal was dismissed on the ground of financial soundness.

The Registrar's contention that the rule amendment would also be inconsistent with the Act in that it would permit the repatriation of surplus funds in an ongoing situation, was not upheld.

The entire question as to how pension fund surpluses may or may not be appropriated, either by members or employers, henceforth falls to be dealt with by the Pension Funds Second Amendment Act, No. 39 of 2001, which came into effect on 7 December 2001.

FSB loses its appeal in the Aldum matter

Louis Wessels
Head: Legal Department of the FSB



The dismissal with costs by the Supreme Court of Appeal (SCA) of the appeal by the Registrar of Stock Exchanges in the matter against CS Aldum and his trading firms (Onecor, Cash for Africa, Bankwise, Number One and Simunye), was a severe blow to the regulatory efforts of the FSB and the enforcement of the laws under its administration.

The matter concerned section 3 of the Stock Exchanges Act, 1985 (SECA), which provides that no person shall carry on the business of buying and selling listed securities, either on his own account, or on behalf of other persons, unless he is a member of an exchange, or an officer or employer of such member, and authorised under the rules of the exchange to do such buying and selling. It was common cause that Aldum and his firms were no such persons. Regulatory legislation of this kind is passed by the legislature and administered by a public entity such as the FSB, in the public interest. The conduct of members of an exchange, like the JSE Securities Exchange of South Africa, is under strict surveillance. Rules applicable to these members are subject to the approval of the FSB. All these measures are in place for the protection of the public.

Through section 3 the legislature has expressed that the buying and selling of listed shares (therefore the trading in such shares as a business) should not be conducted outside the regulatory net. In the event of a contravention of section 3, two law enforcement avenues are available to the Registrar. He may apply to court for an order interdicting such trading in listed shares by the unauthorized party. Or the Registrar may refer the matter for criminal prosecution. A contravention of section 3 is criminalized by section 48 of the Act. Imprisonment for a period not exceeding five years is provided for.

In either the civil or criminal remedy course, the regulatory process feeds into a judicial process over which the FSB has no control, other than to present the facts of the case to the court and to argue the matter to the best of its ability.

The FSB perceived the operations of Aldum and his firms to be in conflict with section 3. This followed an in-depth inspection of his business in terms of the Inspection of Financial Institutions Act, 1998. The views of the FSB were strongly supported by the JSE, Sanlam and Old Mutual, the listed shares of the latter two companies being the subject of Aldum's business activities.

Due to the urgency of the matter, as seen by the FSB and the other supporting parties, the route opted for by the Registrar was to apply for an interdict restraining the respondents from conducting business in contravention of section 3. This option carried the risk of litigation costs, but at least the application was under the FSB's control and could well have resulted in a quick solution at moderate costs. Criminal prosecution held no risks of direct costs for the FSB but then the time factor was beyond the FSB's control.

The activities of Aldum were first inspected during the first half of 1999 just after Sanlam had demutualised. Aldum was not bemused by the inspection and instituted an action against the FSB for a declarator that his activities in Sanlam shares did not constitute a contravention of section 3. His modus operandi at the time was to grant loans to Sanlam shareholders against the pledge of their shares. If the loans were not repaid (as both parties had anticipated) the pledge would become effective and the shares vested in and were transferred to Aldum and sold by him through a stockbroker. Some 23 000 transactions to the value of R46 million were concluded in this fashion during the first seven months after Sanlam had demutualised.

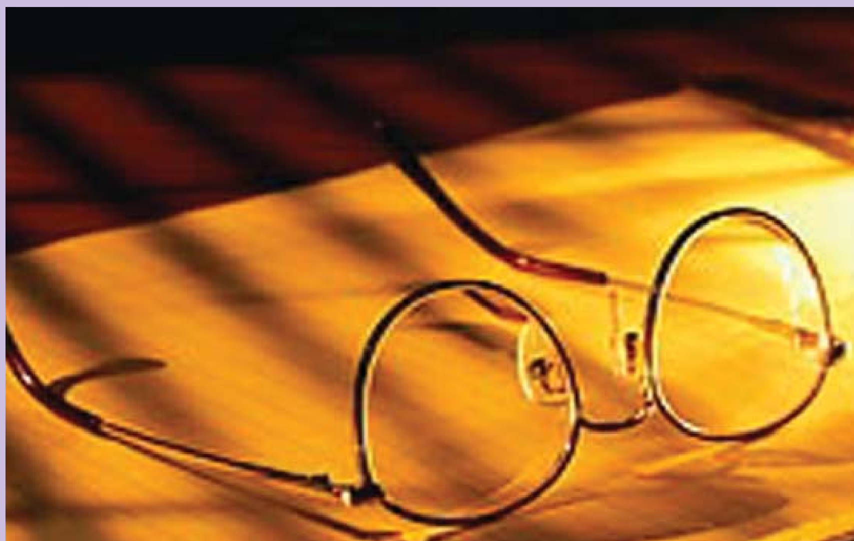
The FSB opposed the action and simultaneously issued an urgent application against Aldum for a provisional order restraining him to conduct business in listed shares of both Sanlam and Old Mutual (which had by then also demutualised), pending the outcome of the action instituted by Aldum. Having been served with the Registrar's application, Aldum backed off, withdrew his action and never opposed the application. The interim interdict was granted on 23 July 1999 with costs, but because of the withdrawal of the action, it became ineffective.

Aldum then changed his methods by amending the underlying documentation. A loan document was constructed providing for repayment of the loan within seven days. The amount of the loan related to Aldum's assessment of the value of the shares which was always below the true market value of the shares. If the borrower wanted to repay the loan, a surcharge of 34% was

payable in addition to the amount loaned to cover interest, contract fees, valuation fees and administration costs. The borrower's shares were ceded to Aldum as security for repayment of the loan.

Already at the signing of the agreement, the borrower was required to sign a blank share transfer form with a mandate in favour of a registered stockbroker to sell the shares and to pay the proceeds to Aldum. Provision was made in the agreement that if the sale of the shares yielded an excess over what was owing, such surplus was to be paid in a "trust" account from which the borrower could claim the excess within 90 days.

In the event, nothing or very little materialised from the perspective that Aldum's agreement with his clients was in fact a loan. Only twelve of the 23 000 borrowers repaid what was owing by them. All the rest had allowed, and in all probability had from the outset intended, their shares to be forfeited for the benefit of Aldum, thereby expunging the loan amount. The "trust" account to carry any excess of proceeds of sales also never came into being. This account was just an ordinary business account conducted by Aldum.



What the SCA was called upon to adjudicate was whether these activities of Aldum amounted to a contravention of section 3 of the SECA. Having regard to the wording of section 3 and the intention of the legislature as may be inferred therefrom, was Aldum as an unauthorised entity conducting the business of buying and selling of listed shares, thereby contravening these provisions?

Instead, the approach of the SCA was to investigate whether the agreements between Aldum and his clients were loan agreements or whether they were agreements of sale; and whether the parties had intended a sale of shares, simulated as a loan. The SCA furthermore, with respect, appeared to have laboured under the misapprehension that if the agreements were to be branded agreements of sale, what was required was evidence of a sale of the shares to Aldum. Section 3 in fact also impacts on the buying and selling of shares "on behalf of other persons", not only on own account.

The SCA appeared to overlook a vital concession made by Aldum in both his answering affidavit and in his heads of argument: "When I came to know that Sanlam and Old Mutual were demutualising, I started to think of methods whereby it could be made possible for the enormous number of new shareholders of Sanlam and Old Mutual which suddenly would be there as a result of the demutalisation process, to obtain money for their shares without cumbersome processes" (free translation of a paragraph in the heads).

Does this not say it all? At least the admission militates against Aldum's evidence that he had truly intended that the agreements with the shareholders should be loan agreements.

As to the intention of the shareholders (if that should be relevant): two affidavits of shareholders were attached to the court papers. Both were to the effect that the shareholders had intended to sell their shares and not to borrow money. This evidence was not challenged by Aldum and was never contradicted by any other evidence. The SCA does not refer to these affidavits. On the contrary, the judgment states that no evidence of the intention of the other parties to the agreement was presented. Aldum conducts his business at the less sophisticated end of the market. His clients are private individuals from the ranks of shareholders who were either unable to or unaware of the fact that they could dispose of their shares by dialing a toll-free number without paying any brokerage and at minimal costs. Their intention is clearly manifested by the fact that 99.99% of them never bothered to repay their loans, thereby reconciling themselves with the fact that the papers which they had been requested to sign brought about a final disposal of their shares at the amount of the loan.

To add insult to injury the FSB was ordered to pay Aldum's costs in both courts, and it will of course have to pay its own costs as well: an estimated total of R750 000. This is a most undesirable end for a public regulator who made a genuine effort to protect the integrity of the law administered by him. Ironically these costs will spiral down to the members of the public in whose interest this particular law was passed.

The FSB has no option but to live with this judgment. The judgment does not augur well for the large privatizations, such as Telkom's, which are on hand. Once again shares will be issued to unsophisticated persons who may fall prey to traders operating outside the regulatory net.

Notwithstanding this setback, the FSB will do everything within its power to protect the public from exploitation by unregistered persons operating in the market place.

Probably fuelled by Aldum's success, more than a dozen other unauthorised entrepreneurs are operating in the market place with all sorts of schemes to buy and sell Sanlam shares. The FSB can only caution the public to stay away from parties who cannot prove that they are members of a securities exchange, should they wish to dispose of any listed shares. In the final instance members of the public must guard their own interests.

Professionalism vs the Objectives of FAIS

By Ben Rossouw, Executive Director of the FPI

The words 'profession' and 'professional' are used quite widely in society today. But what do these terms signify and how will professionalism help to achieve the goals of FAIS (the Financial Advisory and Intermediary Services Bill, 2001)? In the article that follows, Ben Rossouw, Executive Director of the FPI (Financial Planning Institute of South Africa), shares his thoughts on the issue.

In the sporting arena a professional is someone who receives payment for the sporting activity he is involved with, as opposed to an 'amateur', who does not receive payment for participating in a particular sport. One continuously hears about professional golfers, soccer players, tennis players, cricketers, etc, but it is a pity that the connotation with the word 'professional' is that it refers to someone who receives payment for the activity that he is engaged in. What is of even greater concern is the total misuse of the word 'professional' in the sporting world, for instance when a sportsman commits a 'professional' foul. Somehow the two words 'professional' and 'foul' should never be used in conjunction with each other.

What then is a profession and what is a professional? Dr Aubrey Wilson describes the six attributes of a profession as follows:

Intellectual base
An intellectual discipline capable of formulation on theoretical, if not academic, lines, requiring a good educational background and tested by examination.

Private practice
A foundation in private practice so that the essential expertise and standards of the profession derive from meeting the needs of individual clients on a person-to-person basis with remuneration in fees from individual clients rather than a salary or stipend from one source.

Advisory function
An advisory function, often coupled with an executive function in carrying out what has been advised, or doing ancillary work such as supervising and negotiating, or managing. In exercising both these functions, full responsibility is taken by the person exercising them.

Tradition of service
An outlook that is essentially objective and disinterested with the motive of making money is subordinated to serving the client in a matter not inconsistent with the public good.

Representative institute
One or more societies or institutes representing members of the profession, particularly those in private practice, and having the function of safeguarding and developing the expertise and standards of the profession.

Code of conduct
A code of professional ethics, laid down and enforced by the professional institute or body. From the description of the six attributes of a profession it becomes clear that professionalism rests on two pillars – competence and ethical behaviour. Professionalism cannot exist if one of the two pillars is missing. Someone who is competent but unethical will very likely maximise personal gain at the expense of the client. Someone who is ethical but incompetent will make mistakes.

Financial advice and financial planning
Entrusting someone to look after your personal financial affairs is one of the most important decisions that an individual will make in a lifetime. People engaged in providing financial advice and doing personal financial planning for their clients should therefore be highly ethical in dealing with their clients, and should be highly competent in the way they handle their clients' financial affairs. Incompetent and unethical practices in providing financial advice and in doing personal financial planning could have very serious consequences for clients long after the event. A good example of this would be when an adviser advises a client on retirement planning. Unless the adviser is competent in putting together a well-structured retirement plan, the client may end up in a position where he/she cannot afford to maintain a reasonable lifestyle after retirement.

Qualification versus professional status
In the past, South African consumers seemed to attach a lot of value to qualifications. Qualifications, however, only convey that the holder had sufficient knowledge at a particular point in time to pass a specific examination. Professional status, on the other hand, is subject to maintenance and requires members of professional bodies to –

- maintain ethical standards on an ongoing basis;
- meet with ongoing educational requirements in order to ensure that the holder remains competent; and
- continuously confirm that the holder is fit and proper, i.e. solvent, and has not been subject to offences involving dishonesty in any form.

Consumers are therefore best served by 'professionals' who have to maintain their professional status by persistently meeting competency and ethical requirements. ➔

FAIS and professionalism

The objective of FAIS is to protect consumers by creating an environment wherein financial services will be provided in a professional manner, i.e. competently and ethically. Professionalism will ensure that financial services are delivered with 'honesty, fairness, due skill, care and diligence and in the best interest of the client' – the principles on which FAIS has been built.

In order to achieve professionalism in the business of financial services delivery, all stakeholders must 'buy in' and believe that professionalism leads to sound long-term relationships with clients, and that it is profitable in the long run. The ideal embodied in FAIS will be achieved when all stakeholders embrace 'professionalism' in the belief that it will result in a 'win/win' situation.

The Financial Planning Institute of South Africa (FPI) is an independent professional association acting to benefit and protect the public in its dealings with persons engaged in providing financial advice by establishing educational, ethical and disciplinary standards.

Director quits after paying fine

Grant Ramsay, non-executive director of Bridgestone Firestone Maxiprest, has tendered his resignation after paying a R55 000 fine to the FSB following an insider trading investigation.

Ramsay allegedly traded in Bridgestone shares during a closed period in which directors were prohibited from dealing in the company's shares. He paid the fine to the FSB's Insider Trading Directorate without admitting any misdemeanour.

Source: FSB Media Release,

3 December 2001.

The FIC Bill

Government's solution to the money laundering racket

On 6 November 2001, after four years of deliberation, research and drafting, the Financial Intelligence Centre (FIC) Bill was finally approved and passed by Parliament. Its approval came in the wake of the September 11 terrorist attacks in the USA and renewed international concern about who dips into money laundering pools, and for what purpose.

The FIC Bill is believed to compare with some of the best and most comprehensive anti-money laundering legislation in the world. It was carefully drafted after exhaustive consultations involving the South African Law Commission, a special task team appointed by the Finance Ministry, all major stakeholders in the country, and international bodies with thorough insights into money laundering issues.

The Bill complements the Prevention of Organised Crime Act, 1998 that criminalises money laundering and enforces the reporting of threshold and suspicious transactions. But it goes a bit further. It allows for a dedicated financial intelligence unit with built-in mechanisms to interpret reports of transactions and to refer contraventions of the Bill to investigation authorities and supervisory bodies.

Speaking at the National Assembly on 14 October 2001, Finance Minister Trevor Manuel estimated that about R75 billion was laundered in South Africa annually. He said money laundering corroded the country's economy, its government and its social wellbeing. He said it harmed the country's reputation and exposed its people to crime syndicates, drug trafficking, smuggling and other criminal activities.

Crime syndicates specifically target less regulated emerging markets because they lack the mechanisms to expose the hiding and moving of proceeds from unlawful activities. The purpose of the FIC Bill is to armour the government with the necessary mechanisms to effectively interrupt the cycle of money laundering and its associated illegitimate operations.

The FSB is one of the supervisory bodies listed in the FIC Bill. The FSB's Dr Franso van Zyl, Head: Legislation and Research, says the FIC Bill would certainly impact on the activities and resources of the FSB as regulator. The Bill not only opens up channels for the FSB to report suspected cases of money laundering. It also adds the responsibility of scrutinising accountable institutions under its supervision for compliance with the Bill. ➔

It is foreseen that the FIC Bill will introduce a mechanism for the reduction of financial crime to the FSB as a further function. It may well be that the FSB will have to deny authority to conduct business to institutions that do not have appropriate money laundering control systems in place.

It will be the responsibility of the FSB to investigate matters referred to it by the Financial Intelligence Centre. Likewise, the FSB will have to enforce whatever provisions are made by the Bill in the same way as it does with any other law administered by the FSB, with the full range of remedies.

Dr Van Zyl furthermore suggested the establishment of a task team to look into issues such as amendments to legislation, extra funds and manpower, co-operation with other supervisory bodies such as the Reserve Bank and the JSE, and the establishment of a Financial Crime Liaison Forum.

According to the Finance Ministry, full implementation of the FIC Bill will probably take three years to complete. First on the agenda will be the establishment of a Financial Intelligence Centre and a Money Laundering Advisory Council. The latter will facilitate public and private co-operation and advise on the development of anti-money laundering activities. The intelligence centre will fall outside the public service, but within the public administration. It will be headed by a director and supported by a relatively small staff complement with specialised skills. The centre will not be a law enforcement body. It will collect and process data and pass it on for investigation and prosecution where necessary.

The Bill provides for categories of 'accountable institutions' and 'reporting institutions'. These represent companies and businesses that are vulnerable to money laundering activities. The first phase of the new legislation is expected to be implemented by June 2002. By then banks will be required to know their customers and start reporting suspicious and unusual transactions. Heavy penalties could be instituted against institutions that do no comply with the provisions of the FIC Bill.

New risk management intelligence technology

By George Marx, actuary and erstwhile academic

The financial services industry is acutely challenged to cope with many kinds of risks. It is no surprise that the term 'risk management' has developed to mean different things to different bodies. Conceptually the term will carry distinctly different meanings to, for example:

- A short-term insurance broker
- A banker
- An investment fund manager
- A life assurer
- An auditor
- The person appointed to the post of risk manager in a large industrial manufacturing company
- A mathematician

The FSB, as another example, distinguishes between the following:

- The risks faced by an entire industry, which is referred to as system risk (such as HIV / Aids for life assurance).
- The risks of individual players, for example, excessive exposure to equity investments by a retirement fund.

What is common in risk management is that there are events that happen unexpectedly. Once such an event has happened, it may cause a loss, monetary or otherwise. For example, you may be involved in a motor vehicle accident that causes damage to your vehicle and possibly injuries to yourself and to other passengers.

Risk management theory dictates that the following four steps are fundamental to any risk management process:

- Identification
- Evaluation
- Control
- Financing

It is further recognised that failure to attend diligently to each of these four steps inevitably results in some form of disaster. The disaster may happen to the party exposed to the risk, or the insurer of the risks that were insured or both.

It is now history that the introduction of the medical expenses for common ailments do not meet the criteria for risks to be insurable. To treat them as part of the insurance pool as was done by traditional schemes, contravenes the prin-

ciple that one cannot insure risks that are not fortuitous. It follows that one can expect to find allegations, and proofs, of fraud in the traditional dispensation.

Risk identification and evaluation form the foundation from where the rest of the risk management process is driven. Identification and evaluation essentially require analytical skills. The better these skills are, the more able the organisation is to apply its risk management effectively and efficiently. Modern computer capabilities enable the identification and evaluation to be conducted in vastly better scientific and accurate ways than before.

It is against this background that a team of actuaries and doctors set about to develop a stochastic (multi-simulation) computer-based risk management model that is specifically designed and developed to assist medical schemes, on an ongoing basis, to model, monitor and assess the multitude of risks (financial and other) facing these schemes within the ambit of the 'new' Medical Schemes Act, 1998.

With the aid of the model a medical scheme is able to:

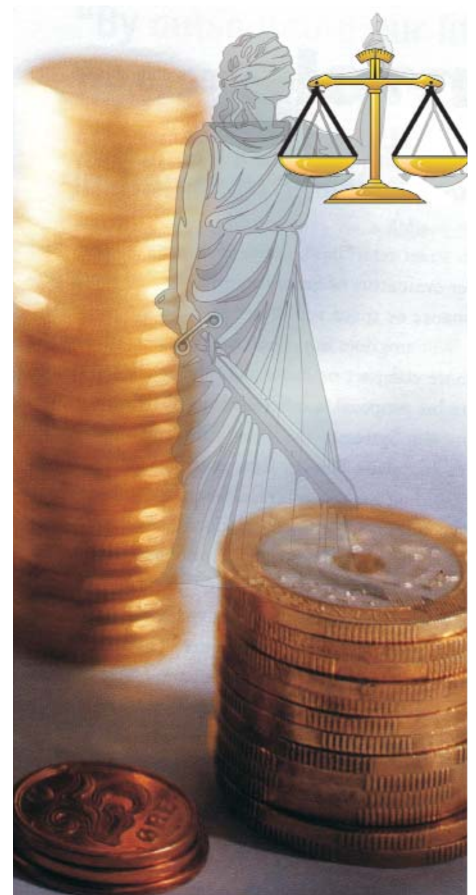
- Compile an annual budget and assess the risks of incurring underwriting and operating losses or going insolvent. The approved budget and variance (to budget) are reviewed on a monthly basis by the model.
- Monitor and measure the effects of contribution and/or benefit changes as well as membership (i.e. demographics) changes associated with the in- or outflow of members on the scheme's budget, financial position and cash flow.
- Identify variances in actual versus budgeted claims per provider and/or service category.
- Calculate the scheme's incurred but not reported (IBNR) claims on a monthly basis.
- Identify and evaluate the scheme's need for re-insurance.

Short-term and long-term insurers are allowed to charge premiums commensurate with the expected cost of the risk. Yet they often have great difficulty in achieving consistent positive underwriting results.

Medical schemes, on the other hand, are put in an extremely precarious position through the statutorily required community rating and open enrolment dispensation. Health care and its financing is arguably one of the most complex risk environments. Whereas it is believed that providers, such as hospitals, should start to carry more of the financial risks than hitherto, the product is uniquely set up to also assist in their risk management.

In fact, the product is designed generically so that it can easily be adapted to facilitate identification and evaluation of risks in other environments. Its methodologies are already used by players in the short-term insurance industry, as well as in industrial corporations.

For more information, please contact George Marx on 083 227 8177.



Legislation on SA accounting standards to be revamped

A conference commissioned by the FSB and held under the auspices of the SA Institute of Chartered Accountants has given its unanimous support for the legal backing of accounting standards and the establishment of a compliance and monitoring body.

During the conference held at the Rand Afrikaans University in Johannesburg at the end of last year, delegates indicated that the industry would welcome legislative changes that could reshape corporate governance in South Africa.

New legislation will bring South Africa in line with other markets operating on International Accounting Standards.

Proposed amendments to the Companies Act, 1973 relating to compliance to financial reporting standards and new draft legislation for the establishment of a financial reporting standards council, were also welcomed. General and limited purpose financial reporting standards, supervision of compliance and penalties for non-compliance were also discussed.

The FSB is likely to be closely associated with these new developments.

Source: Business Report, 9 December 2001.

Renewed focus on funeral assistance business

If the first half of 2001 is something to go by, 2001 has not been a good year for the insurance industry. Not only did increased taxes and greater losses limit the industry's overall income growth to 7% over that period (compared to first six months in 2000), but the industry has also suffered from a poor image. Nowhere else were the problems as acutely evident as in the funeral assistance business.

Accusations of who are to blame are flying. On the one hand regulators are accused of not fulfilling their roles as protectors, and on the other law enforcement agencies are blamed for sluggish action. In the middle are the opportunists, those who are taking advantage of other people's misfortunes, especially now that Aids-related deaths are on the upswing, and the only ones to benefit from the situation.

The Financial Services Board (FSB) has definite viewpoints on the state of the funeral assistance business and has made concerted efforts to bring about positive changes. Already it is evident that the Policyholder Protection Rules, which came into effect on 1 July 2001, are progressively changing the face of the industry. Early signs are that the number of intermediaries, ostensibly the illegal ones, has dwindled. Expectations are that the Financial Advisory and Intermediary Services Bill, 2001 (the FAIS Bill), when it becomes law, will further protect consumers against the risks of failing institutions, poor advice and misselling.

A database of assistance administrators was started by the FSB in 2000. Insurers are required to keep the FSB informed about the resignations and appointments of administrators. This makes it easier to spot illegal operators and to respond to claims against registered entities. Inspections are carried out by the FSB when it becomes aware of the activities of an unregistered operator. If necessary, the FSB issues public warnings in the media regarding illegal operations.

However, Oppie Opperman, FSB's Head of Market Conduct, says the FSB is frustrated by the appalling rate of successful prosecutions against illegal operators. He says the structure of the funeral assurance business sector lends itself to exploitation and that prosecution of such cases was difficult. At the end of October there were 83 unattended cases with either the Public Prosecutors or the South African Police Service.

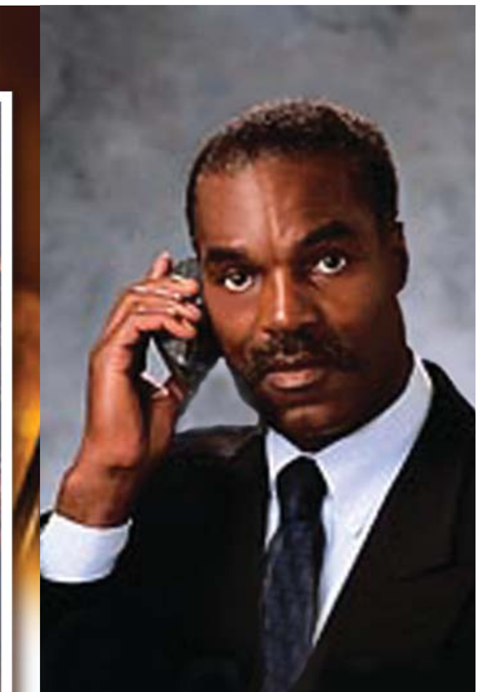
There are at least 38 registered funeral assurance companies in South Africa. Many of these accept business from assurance administrators, who in turn take business from brokers, funeral parlours, agents, societies and stokvels. Often premiums are handed down the chain of intermediaries without reaching the real insurer.

However, he vowed that the FSB would undertake further actions to strengthen the supervisory framework and create an orderly industry. He is cautious about too stringent supervisory and compliance measures, saying it could put off legitimate entrepreneurs who are willing to serve this section of the market.

During a recent FSB board meeting, the following added actions were on the table for discussion:

- Group scheme administrators may in future be required to register with the FSB as in the case of pension fund administrators. In terms of the FAIS Bill, administrators will be compelled to register in any way.
- The Consumer Education Programme of the FSB will be used to keep the public informed about its rights in the funeral assistance business.
- More on-site visits must be generated to ensure that insurers are managing their businesses with proper resources and that contractual agreements with administrators are in order. Insurers will be expected to make sure that administrators are fit and proper to conduct the business it sets out to do. Action will be taken against the directors of insurers who fail to do so.
- The problem of proper law enforcement must be addressed. Successful criminal prosecution is imperative, and so is publication thereof. The FSB will start by encouraging a good relationship between the FSB and law enforcement agencies and making a construed effort to prosecute culprits.
- The absence of structured arrangements for informed public discussions on unscrupulous operators. There is a need to secure community involvement to forge effective partnerships between the general public and the relevant statutory agencies.

While service providers may regard stricter controls in the industry as burdensome, the past has convincingly showed the industry that it needs urgent, but improved regulation. It is the purpose of the FSB to see that regulation of the industry offers prime protection to vulnerable consumers without posing obstacles to intermediaries. However, if regulations are made less stringent, it could open up more opportunities for insolvency and reckless management. A practical balance needs to be sought to give proper protection to consumers.



Consumer education in the long-term insurance industry

By Yvonne Themba, Deputy Director: Life Offices Association

South Africans are going through a rights-conscious phase, which is to be expected of the creators of a young democracy. Hence it is no wonder that financial consumer education is of high priority to companies, government, regulators, consumers and various interest groups and stakeholders.

The need to ensure that consumers are sufficiently informed and educated about issues pertaining to financial matters in the long-term insurance industry is one of the main objectives of the Life Offices Association (LOA). The reason is simple. For as long as the inherent positive value of long-term insurance, and saving, is not perceived by consumers to be paramount to their future financial well-being, financial education for existing and prospective consumers remains crucial to the industry.

At the heart of the problem lies the issue of lapsed policies. Although the latest figures indicate a slight decrease in lapsed policies compared to last year, the LOA believes that the rate of occurrence is still unacceptably high and of concern to the industry. Many consumers still readily elect to forfeit their insurance policies at the first signs of financial hardship.

To this end, the LOA and its members have collectively educated, and continue to educate current and prospective clients. Current initiatives in place are numerous and include the LOA's consumer education campaign. Its objective is to make available information and advice to consumers in an effort to ensure consumers make prudent insurance decisions.

Besides, many individual member companies now dovetail their educational initiatives with their internal growth strategies. There are also various INSETA (Insurance Sector Education and Training Authority) initiatives that seek to ensure, amongst other things, that the industry makes a meaningful contribution to the education of South Africans. Furthermore, the government employee education campaign is designed to ensure that civil servants are sufficiently informed regarding the management of their insurance portfolios in line with the regulations.

All these activities are focused on the consumer. The costs associated with these activities are astronomical. It is the long-term insurance industry that is shouldering the cost implications of financial education, as well as compliance, to ensure consumer protection. The benefits will necessarily be felt in the medium to long term. Why then does the idiom 'You can lead the horse to the trough, but cannot force it to drink', come to mind?

To close the gap, the facilitative role of the FSB should therefore be to continue to identify the areas in consumer education that should be addressed by the relevant financial services sector. FSB-funded initiatives could be implemented to actively boost awareness of the consumer protection regulatory framework in place, such as the Policy Protection Rules and later, the Financial Advisory and Intermediary Services Bill, 2001. Such initiatives should be well received by consumers, as they would be perceived to emanate from an independent, trustworthy source.

Most people would not disagree that the more enlightened, questioning and financially astute the consumer, the less likely he is to make bad financial decisions. More importantly, the more likely the consumer will be to abide by decisions in arbitration cases, as he would have near perfect information on hand. Only then will the benefits of consumer education and consumer protection be realised by all stakeholders.

FSB presents in-house legal and finance training

The FSB's Legal Department, in conjunction with the Law Society of South Africa, is presenting a course for FSB staff.

"The approach to the presentation of the course is practical, with the emphasis on the FSB work situation," says Louis Wessels, Head of the Legal Department and course co-ordinator. The course gives vocational guidance on aspects such as legal practice, legislation and finance.

"The aim is to equip staff to do better, not only in their own jobs, but also in other FSB-related activities. The course will benefit the employer and employee. Certain course modules such as wills, estates and trusts, personal budgeting and income tax will also benefit employees in their private lives," explains Wessels. The syllabus has two objectives, namely personal skills training and employee development. The 17 modules are spread equally between these objectives, although employee development will receive more attention. Subjects related to personal skills are presented on an average level.

Course modules include the following:

- Ethics in the workplace
- Communication skills
- Personal budgeting and financial planning
- Wills, estates and trusts
- Principles of SA income tax law
- Interpretation of financial statements
- The legal relationship between the employee and employer
- Constitutional and administrative law
- Access to information and confidentiality
- Interpreting statutes
- Drafting of legislation
- Drafting of court documents
- Commercial court cases
- Criminal law
- Insurance law
- Pension law
- Financial markets

Employees undertake to commit themselves to acceptable levels of attendance, proper preparation and active participation. Learners are expected to pass some form of assessment before getting a certificate.

Enrolment for the course far exceeded the Legal Department's expectations. Feedback from the 84 students who enrolled for the various subjects was extremely positive.

FSB approves first unit trust firm

The Financial Services Board has given approval for the first South African unit trust firm, GinsGlobal Index Funds, to sell a comprehensive range of offshore index funds in the country. Index funds are passively managed funds and a hugely popular form of investment world-wide. This type of fund does not need a portfolio manager. Managing it requires tracking the index.

GinsGlobal is a purely index-based unit trust operator. The company has teamed up with international fund manager, State Street Global Advisors.

Source: Business Day, 5 December 2001.