FSB BULLETIN

p6

Greece: Too big to fail

p10

FAIS: Transactions must be accurately accounted

p18

Investment in life insurance

Investing pension assets for development:

If only money was the problem

FSB

CONTENTS

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

EDITOR
Dr Franso van Zyl

SUB-EDITOR
Bessie Venter

EDITORIAL COMMITTEE
Russel Michaels
Olivia Davids

COVER AND GRAPHICS
IE Communications
(012) 347 2882

CARTOONS
Colin Daniel, *Personal Finance*, Independent Newspapers

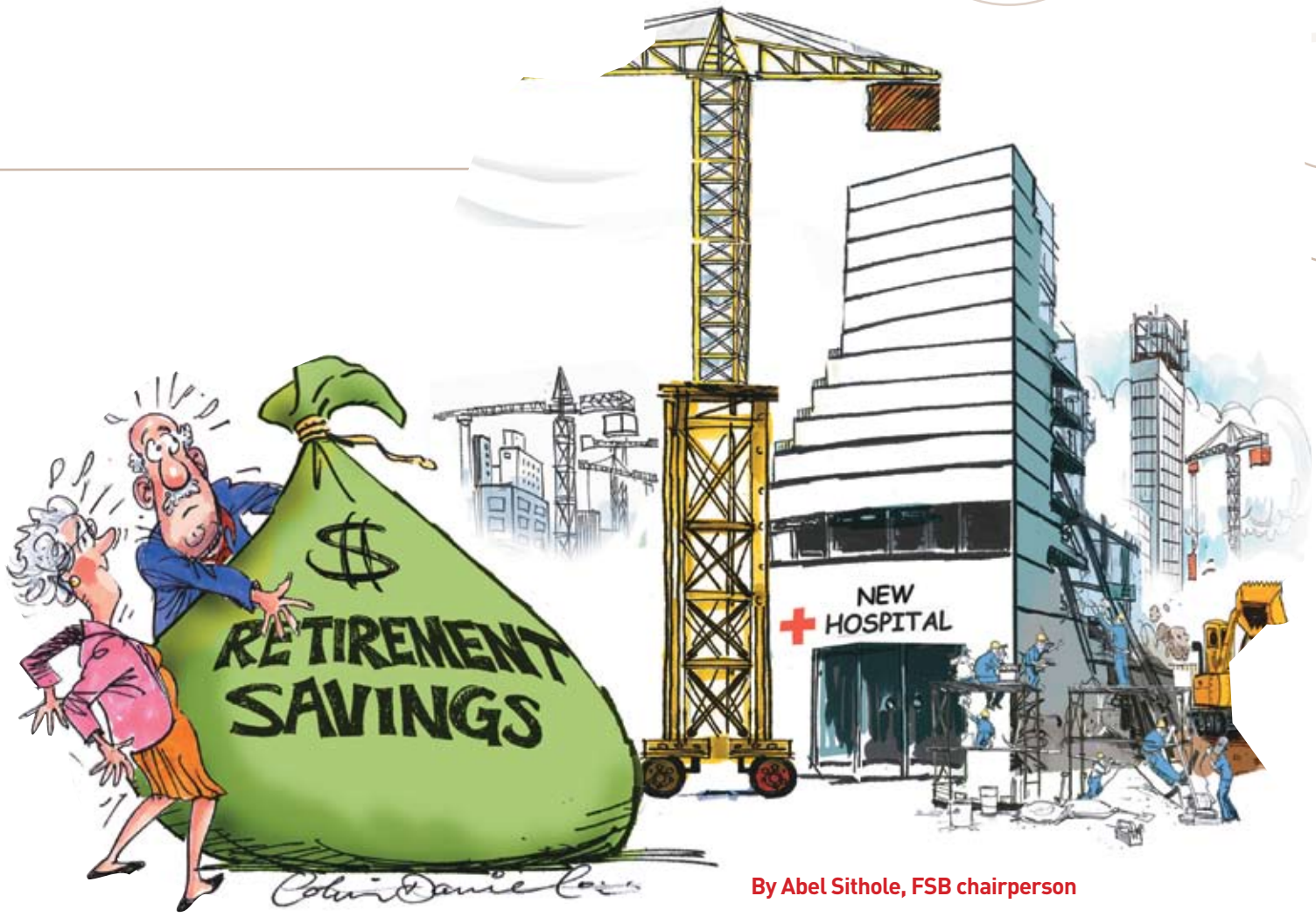
LAY-OUT
Greenpepper Communication Consultants (012) 332 1589

SUBSCRIPTIONS
All subscriptions enquiries should be directed to Pakama Miya at the contact details below.

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

POSTAL INFORMATION
PO Box 35655
Menlo Park
0102
Republic of South Africa
Tel: (012) 428 8155
Fax: (012) 346 6481
e-mail: pakamar@fsb.co.za

THE FSB BULLETIN
is available on the Internet:
www.fsb.co.za



By Abel Sithole, FSB chairperson

Investing pension assets for development: If only money was the problem

The Minister for Economic Development recently mooted the possibility of targeting a portion of pension fund assets for investment in developmental initiatives.

This is not the first time that this possibility has been considered. In 2003 a resolution was taken at the Growth Summit for five percent of investable pension fund assets to be invested in development projects.

Past experience with prescribed investments

South Africa has had experience with prescribing how pension fund assets should be invested. South Africa prescribed that 53% of pension fund assets be invested in South African government bonds until 1989. This was 75% for the public investment commissioners and 33% for long-term insurers. The jury is still out on whether this prescription served the best interests of pension funds and their beneficiaries or of the country and its citizens by financing expenditure of public interest projects. The black labour movement, which was in its infancy in the late eighties, argued strongly that some of these assets found their way into financing the apartheid military complex, which was instrumental in suppressing black people. However, prescription was dropped at the recommendations of the Jacob Committee Report of 1988 to free

Continued on p 4

Pension assets from p 3

the market in government bonds. The lifting of the requirement for prescribed investments was a well-informed and considered decision.

On the other hand, the industrialisation and employment creation drive of the apartheid regime in the 1950s, 60s and 70s spawned many enterprises that still play a major role in the South African economy to this day; the railways (Transnet, Prasa, Metrorail), harbours, Denel, Armscor, South African Airways (including SA Express, Airlink, ACSA) postal (SA Post Office and Post Bank) and telecommunication services (Telkom and Vodacom), Landbank, steel (ISCOR – now ArcelorMittal, Kumba, Sishen and Exxaro), the different agricultural boards (now defunct), national road network, water storage and transportation infrastructure, and synthetic fuel (Sasol, Natref) and even the now disbanded nuclear programme, etc. These enterprises did not only support the economy and provide jobs but also provided generous benefits such as training, subsidised housing and employee benefits (pensions, health, disability and death benefits). These projects together with job reservation were instrumental in ending white, especially Afrikaner unemployment and poverty. They provided a cadre of trained artisans and professionals for industry and the economy as a whole as well as entrepreneurs on whom the country still relies today. The question then is – didn't these and other similar initiatives make prescribed assets worthwhile even if the investment return was constrained?

Talk of any form of prescription in the investment of pension funds assets leads to unease on the part of members and pensioners and general polarisation on the merits of such a step. There are those who believe it can be a force for good and those who liken it to robbing the aged. To the former it is a small price to pay in contributing to the alleviation of the country's many deficits while to the latter it is a sure sign that we are on the slippery slope to expropriation.

Both these views have their merits and weaknesses. The industrialisation and job creation drive of the apartheid regime can be correctly criticised for being discriminatory and in some instances questions may be asked about the productivity and efficiency of the enterprises that were created. However, what is remarkable about this drive was its ability to mobilise capital for large scale projects whose legacy are enterprises that not only provided and continue to provide employment, but most needed goods and services. This does not imply that the correct developmental drive must mimic the industrialisation one. The current developmental drive must focus on projects appropriate to the times. Once such projects have been identified, it would be fair for government to expect all layers of society, including pension funds, to contribute.

Quantifying the amount to be raised by prescription

The total assets of all the different forms of pension funds in South Africa are currently estimated at R1.2 trillion. Five percent of R1.2 trillion is R60 billion. (Ten percent of R1.2 trillion is R120 billion.) Can pension funds afford this?

This is not as large an amount as is anecdotally assumed, especially if compared to the overall cost of the different charges associated with running a fund as well as the normal losses or gains due to market movement in asset values and the volatility of asset prices. One of the questions to ask is will R60 billion make a dent in the envisaged funding requirement for development or is it just a miniscule contribution? Put differently, is this the most effective and prudent way to raise the kind of funding that is necessary for this purpose? Can the country afford the uncertainty and displeasure that a possible prescription engenders, rightly or wrongly, in a section of the taxpayers who save through pension funds given the low savings rate and the government's stated desire to encourage saving?

The accumulated pension fund assets are a temptation for many vultures looking to make some easy money, either through some dubious investment schemes or exorbitant fees. The ease of access to these assets may detract government from making a well-informed and considered decision with major unintended consequences. The biggest risk is creating uncertainty about the security of long-term savings. The fear that government can use its legislative and taxation powers to expropriate pension assets or a portion thereof in whatever manner and for whichever purpose is not likely to encourage long-term retirement provision and saving.

How are these assets accumulated?

The availability and accessibility of amassed pension fund assets hide the fact that these are actually very small amounts set aside from workers' earnings over many decades. Lobbing of a percentage, however small, must take cognisance of the fact that it takes very long to accumulate these assets.

The 2009 Sanlam Survey of employee benefits shows that the average pension fund contribution rate is 11.3%, made up of 5.9% employee contributions and 9.9% employer contributions. The comparable figures for 2002 were 6.2% employee contributions and 10.6% employer contributions according to the 2008 Old Mutual Survey.

This is against what Salam considers to be a recommended total rate of 15%. In the days of defined benefit funds it was not unheard of for members to be contributing at a rate of 7.5% and employers at between 15% and 20%! There is therefore a steady declining trend in contribution to retirement provision, especially in the light of the

increasing cost of death and disability cover as well as management charges.

The mooted percentage of pension assets to be targeted for developmental initiatives is five percent. It can be approximated as equivalent to five percent of the accumulated average combined member/employer contribution plus returns less cost for the period of contribution to a fund and effectively a tax over this period. This tax would apply to all members or beneficiaries of pension funds, many of whom are ordinarily exempted from paying tax in their personal capacity as their income is below the tax threshold.

Effectively, a prescription to invest a percentage of pension assets in developmental initiatives would entail a tax on South African workers who are currently exempted from tax. This cannot be intended.

Where the assets are currently invested

The average South African pension fund invests its assets in approximately 65% equities, 20% fixed interest instruments, 10% foreign investments and 5% in property and other assets. About 15% of the fixed interest instrument investments are already largely in the bonds and loans of the government. state-owned enterprises and state associated entities.

Therefore the call for a percentage of pension assets to be marked for government's developmental initiatives is not due to a failure of pension funds to provide funding to government and its affiliates as they already are big providers of such funding. Pension funds participate in government issued bonds in a free market, out of their own free will, in line with sound investment principles that take into account the need for secure capital and income in particular and diversification in general in line with their liabilities. It follows that requiring pension funds to invest a targeted amount in developmental initiatives must entail not only prescription, but an acceptance of terms and conditions that are not market related.

Risks associated with having funds begging for takers

How will funding be allocated to the developmental initiatives and projects? It is not likely that there will be a shortage of projects that will parade as developmental initiatives because any pot of money, especially associated with pensions, is like a pot of honey.

The current experience is that schemers look for ways to fleece any beneficiary regardless of education, social standing and sophistication, of a pension fund who has a lump sum. There is no reason to assume that the easy availability of developmental assets derived from pension funds will not see its own schemers dressed to the nines with developmental plans and impressive presentations vying for a piece of the cake. Projects will change from being ordinary business to being developmental, to access these funds. This will not only lead to the quick depletion of the developmental funds but will lead to a contraction in funding for projects in general.

Is prescription the best and most effective way of raising R60 billion?

A special tax

Requiring pension funds to invest a targeted amount in developmental initiatives will entail broadening the tax base, as the assets of pensioners and pension fund members who ordinarily do not pay tax, will be allocated to bonds with terms and conditions that are not market related.

Would it not be much easier to levy a special once-off developmental tax for a period of time similar to the tax levied to facilitate the elections and democratic transition of 1994? This tax could be made appropriately progressive, targeting the relatively well-off and their assets. It would be easy to collect using tested SARS capability. Such tax would eliminate the scope for free riding that is likely to accompany a situation where the choice to invest in a development bond is left to individual funds; some will and some won't and they will not allocate similar percentages.

Raising the pension contribution level

Government could kill two birds with one stone, raise tax and increase saving by requiring that the level of the contribution to retirement funding increase to a higher average than currently.

This could be achieved by providing firm contribution guidance by setting a minimum contribution rate. Providing for a minimum contribution rate would have to be preceded by requiring compulsory provision to avoid a situation where employers opt not to make any pension provision. Government can sweeten the changes and encourage saving by raising the threshold for tax deductibility for members and employers. This would signal government's seriousness regarding saving, especially for retirement. This would also have the benefit that as saving rises, even without changing the current asset allocation, assets directed at bonds will increase, thus providing additional funding to government.

How pension funds invest their assets, especially the choice between equities

Continued on p 7

Too big to fail, too developed to falter!

By Elias Masilela, head of Sanlam's Policy Analysis

Reading an article in *Business Day* of 19 February 2010 entitled, "Merkel has stern words for Greece, Goldman", I had a multi-pronged reaction to Chancellor Angela Merkel's views. I agreed with her opposition to Europe extending financial assistance to Greece. I thought: Why salvage a member that played unfairly for a sustained period, deliberately breaking signed agreements?

The global developments we have observed over the past two years have effectively debunked the "too big to fail" notion. Merkel was also right to question the role of banks in the data scam in Greece.

However, I believe she came short of calling into question the failure of bodies such as the International Monetary Fund (IMF) and Europe's Eurostat, in identifying Greece's issues. Surely the protocols of these organisations are designed to prevent a major economy, over a sustained period, falsifying data and hiding a deficit more than three times what is condoned by the Maastricht Treaty? I would be surprised if these institutions were completely in the dark about this crisis of honesty and transparency in the developed world. This has effectively put the integrity of the euro under the spotlight as well as the entire regional institution.

Some technical understanding of how member country monitoring gets handled may be instructive at this point. For example, the IMF has a number of modes with which it monitors the performances of member economies. These will take into account the level of development and sophistication of an economy. This results in a two track approach to the monitoring of member countries.

On the one hand, developed economies are (or elect to be) placed on the high frequency track in terms of their data reporting to the IMF. This is purely because, allegedly that these economies have more timely, reliable and consistent economic and demographic data, with sound systems. Therefore, the majority report in terms of what is known as the Special Data Dissemination Standard (SDDS). On the other hand, developing economies are placed on a slower track called the General Data Disseminating Standards (GDDS). With this system, it is hoped that the IMF will keep close track of the states of health of its member countries, anticipate crises and pre-empt these before they hit as well as "... contribute to the pursuit of sound macroeconomic policies. The SDDS is also expected to contribute to the improved functioning of financial markets" (IMF). This system, yet again has not helped in anticipating problems, such as the one in Greece.

Way back in 1996, South Africa was one of the first developing countries to opt to be placed on the fast track. This was a conscious decision on South Africa's part to open itself up to scrutiny as well as put pressure on itself to compete with the best in the world. This decision originated in the need to improve investor perception towards the country very early in its reform programme. This has had positive and negative implications for the economy.

Currently, there are 67 countries on the SDDS platform. Among these are many emerging market economies, such as Argentina (1996), Brazil (2001), India (1996), Chile (1996) and Mexico (1996).

Another mode of monitoring economies is through country visits by high level technical teams of the IMF (and sometimes joint teams between the IMF and World Bank), classically known as Article IV Missions. These are like an independent external audit of an

economy.

These visits usually take place annually. However, an old IMF tradition has been to explicitly reduce the frequency of missions to developed economies, on the firm belief that these economies are stable, have transparent systems and are predictable. Bottom line... they are "too developed to fail, or too sophisticated to falter".

In South Africa's dark days, there was even a more contemptuous institutional stance, where South Africa was classified and treated under the European office – not the African office like all other African economies. In that regard, it would have been treated under the same veil, namely, too developed to fail. It is instructive to note that the health of the South African economy then was far less promising than that of post 1994 – the current period not excluded. It will be interesting to see the extent to which the IMF gets sucked into the Greek debacle, as it looks into the oversight mechanisms. For Europe, its own oversight mechanism must be under serious scrutiny.

However, the issues that Europe is grappling with today are not unique. Every economic bloc that functions like Europe is faced with these challenges from time to time. Our own, the Southern African Development Community (SADC), grapples with even more complex challenges.

If this is anything to go by, there is a lot that we still need to do under SADC's convergence framework to ensure the levels of transparency and accountability required for a successful regional bloc. Fortunately or unfortunately, there has been very little progress on the SADC convergence front, let alone the implementation of oversight mechanisms for one to be able to pass judgment. However, one may safely speculate that ours will be a much tougher task. Unlike the European example, SADC is faced with a much bigger challenge of member states that openly defy set and agreed convergence targets.

The political commitment for discipline seems rather remote. The moral obligation of member countries to lean on the diverging ones does not seem to be observed. A Merkel-type leadership is yet to emerge. Or, do we really need one?

This means, the likelihood of the long-term goal of an optimal currency area is still far fetched for us. The future of the common monetary area (CMA) remains long and intact.

Pension assets from p 5

and bonds, is partly driven by tax considerations. One way to encourage funds to increase their bond exposure would be to find ways to make investing in bonds equally attractive from a tax point of view.

Is the lack of capital the real cause of stunted development?

The focus on raising funds for development seems to be predicated on the assumption that one of the major contributors to the lack of appropriate development is the lack of capital. But is capital the most pressing challenge or is it a lack of investible opportunities or projects?

This question may seem like a mere distraction but it is the most crucial. Identifying the biggest contributor to the dearth of investment in initiatives that addresses some of the country's key challenges, especially the lack of jobs and contraction in the job market is crucial. It will ensure that the mental and physical energy, effort and drive applied to address the inhibitors have a chance to succeed. The efforts will at least be directed at solving the right problem. As mathematician Richard Hamming has said 'it is better to solve the right problem the wrong way than to solve the wrong problem the right way'.

The role of capital in all kinds of investment is generally acknowledged. However it is not the availability of capital that spurs fixed investment. Capital is put to use when entrepreneurs have come up with clever ideas for new products and or services, or for improving existing products and or services, and or expanding to new markets. This points to the fact that before focusing on raising capital, the focus must be on finding entrepreneurs with viable creative ideas, lacking the capital to realise them. This support should also apply to big companies that seek ways to be efficient and more productive.

Despite the often touted need to support small and medium enterprises, the role of big employers must not be underestimated. Big employers employ big numbers of employees. If a big employer loses thousands of jobs, it requires hundreds if not thousands of entrepreneurs to employ them in the place of the one.

Entrepreneurship, efficiency and productivity thrive in environments that foster individual freedom, creativity, ingenuity, independence, self-reliance and free enterprises which allow one to benefit from their risk taking, effort and perseverance.

While traits such as entrepreneurship, ingenuity, independence, sacrifice, courage and self-reliance cannot be taught, it is uncontested that education is a major contributor to people's inventiveness and innovativeness. Improving education across the board in the medium to long-term may be the most effective way to address the country's developmental challenges. It will increase the pool of inventive and innovative entrepreneurs. Entrepreneurs with value-adding inventions and innovations seem to always get the funding they need.

Lining up for the trophies: From left are André de Vaal (Commercial and Industrial Acceptances), Neville Koopowitz (Discovery), Carol Atkinson (Momentum), Anton Raath (Sanlam) and Hennie de Villiers (Sanlam).

South Africa's top insurance companies recognised

South African intermediaries gave recognition to top insurance companies at a function on 3 June 2010 in Johannesburg.

The 2010 Financial Intermediaries Association's (FIA) Industry Recognition Awards paid tribute to those insurance product providers who received favourable ratings in the FIA's annual intermediary satisfaction benchmark survey. The survey was conducted by Bluestream Research. The top contenders were, in most results, no surprise with Discovery, Momentum and Santam taking the top positions. Sanlam for the first time, won both the Investment Categories. CIA, backed by Compass, won the new UMA Category for Underwriters.

Seamus Casserly, president of the FIA, said the awards added value to the industry by providing benchmark best practice statistics for intermediary satisfaction. Furthermore, participating in the survey provides a platform for intermediaries to rank their interactions with insurance companies and in so doing, encourage healthy competition among providers.

Introduced in 1998 and a highlight on the financial services industry calendar, the awards see intermediaries and insurers acknowledging each other's roles as they meet the needs of individuals and companies throughout South Africa. These research results are highly valued by the industry and major players are keen to get the benchmark information. According to Pieter Aucamp from Bluestream Research, the results over the past five years have had a positive influence on competitive behaviour in the insurance industry. The fact that over 6 000 insurance contracts were rated this year, makes it one of the most comprehensive exercises on the benchmarking of intermediary satisfaction in the insurance industry. The stability and validity of the measurement have been proven over this time.

The benchmark could be regarded as a "true tool" to be used to measure, understand and improve business best-practice behaviour as well as to get more insight into the competitor landscape.

From left: Manie Booysen (FIA), David Harper (IISA), Sedick Isaacs (IIG), Seamus Casserly (FIA).

The availability of the research has provided criteria for performance measurement and it is obvious that the information is being used to improve business processes.

The results are obtained through FIA members' rating over 6 000 contracts of their product providers regarding the perceptions, views, expectations, awareness levels and opinion on:

- Product quality
- Service quality
- Relationship quality
- Overall satisfaction with their supporters

The 2010 award winners in the following categories are:

- Personal Lines - Santam
- Commercial – Santam
- Corporate – Santam
- Life/Risk – Discovery
- Investment (Investment Products Single Premium) – Sanlam
- Investment (Investment Products Recurring Premium) – Sanlam
- UMA – CIA (Commercial and Industrial Acceptances)
- Medical Aid – Discovery
- Employee Benefits - Momentum

FIA members act as intermediaries for more than 85% of all short-term insurance and the majority of financial planning business, healthcare planning as well as employee benefit business in South Africa. The association represents thousands of financial services intermediaries, of which many participated in the survey. Interested parties may contact the FIA to get copies of the report.

SOURCE: Media Release, Financial Intermediaries Association of Southern Africa (FIA), 4 June 2010

Guests attending the function:

1. **From left: Prof Chris Smit (UP), Linza van Aswegen (FIA), June Bezuidenhout and John Bezuidenhout (FIA).**
2. **From left: Carlo van Zyl (Tracker), Michael Clack (Renasa) and Udo Rypstra (TJH).**
3. **From left: Leon Marais (Auto & General), Lydia Nel (Glenrand MIB), Janet Dodds and Okkie Nel (Best Secure).**
4. **From left: Milenko Skoro (Chatis), Gary Jack (ACE), Lucy Kalify (front), Shani Plantema and Trent Lockstore, all from Collective Dynamics.**
5. **From left: Khethang Malefane (Discovery), Sharon Forman (Discovery) and Stephan Moloto (SHC Brokers).**

The purpose of the article is to highlight the significance of financial transactions and how advisors should deal with them in terms of the Financial Advisory and Intermediary Services Act, 2002 (FAIS Act).

Financial proposals and acceptance of those proposals form the basis of every provider/client relationship under the FAIS Act and of every advisory and intermediary services business. If there were no agreements between providers and clients, there would have been no transactions and without transactions, no financial advisory businesses. It is that simple.

Agreements

It is important to recognise that all services under the FAIS Act imply the existence of an agreement or contract through offer and acceptance between provider and client[1] and that this agreement or contract forms the foundation of any transaction under the FAIS Act.

This means that agreements or contracts are essential for the existence of providers and their accountability under the FAIS Act. If there are no agreements or contracts between financial services providers under FAIS, providers cannot do business and therefore cannot be held accountable. According to the author of *The Law of Contract*, HR Christie:

The law of contract is of fundamental importance in the modern world, because it is woven into and inseparable from every form of economic activity.

To fully understand the responsibilities and accountability of providers, it is important to understand the fundamentals of contracting and transactions as referred to in terms of the FAIS Act and the General Code of Conduct. Without this understanding by all the key stakeholders it will be impossible for the FSB to achieve its good objectives as recorded in the FAIS Act.

Service contracts and product contracts

The FAIS Act regulates two types of services, namely:

- Advisory services, which are product-related;[2] and
- Intermediary services, which are service related.[3]

It is important to distinguish between these services, because there is a specific requirement about the rendering of services in terms of the FAIS General Code of Conduct, namely:

When a provider renders a financial service-
The service (advisory or intermediary service)[4] must be rendered in accordance with the contractual relationship (offer and acceptance) and reasonable requests or instructions of the client, which must be executed as soon as reasonably possible and with due regard to the interests of the client which must be accorded appropriate priority over any interests of the provider.[5]

The easiest way to check whether there is an agreement is to look for an offer and acceptance of that offer. If a provider agrees to reasonable requests or instructions of the client, a contractual relationship is established. It does not matter who makes the offer or who accepts the offer.

In *Reid Bros (SA) Ltd v Fischer Bearings Co Ltd 1943 AD 232 241*, Watermeyer ACJ stated that *a binding contract is as a rule constituted by the acceptance of an offer.*[6] *In Dicks v SA Mutual Fire & General Insurance Co Ltd 1963 (4)*[7] *SA 501 (N)* it was stated: *"As*

FAIS: Transactions must be accurately accounted

By Anton Swanepoel, counsellor on FAIS

soon as the parties have agreed orally or in writing on its essential terms a contract *comes into existence."*

Offer

To highlight the significance of the contractual relationship (offer and acceptance) between providers and clients, the FAIS General Code of Conduct specifically refers to the contractual relationship, contract and transaction. The following paragraphs illustrate which phase in the client interaction process represents the key elements of the product offer:

A provider other than a direct marketer, must, before providing a client with advice-

(c) *identify the financial product or products that will be appropriate to the client's risk profile and financial needs, subject to the limitations imposed on the provider under the Act or any* contractual arrangement;[8]

Subject to the provisions of this Code, a provider other than a direct marketer, must-

(a) *provide a reasonable and appropriate general explanation of the nature and material terms of the relevant contract or transaction to a client, and generally make full and frank disclosure of any information that would reasonably be expected to enable the client to make an informed decision*;[9]

(b) *whenever reasonable and appropriate, provide to the client any material* contractual information *and any material illustrations, projections or forecasts in the possession of the provider*;[10]

On acceptance of this product offer a contract is established. According to HR Christie a contract may be defined as an agreement which is, or intends to be enforceable by law.[11]

Christie further argues that although there is a wealth of authority for regarding agreement by consent as the foundation of contract, a lawyer needs proof before committing himself to a conclusion that a particular state of affairs exist.

He will therefore need evidence of such agreement. Christie highlights Wessels where he stated that courts of law can only judge from external facts whether the minds of the parties have come together. In practice it is the manifestation of their wills and not the unexpressed will which is important.[12] The importance of proof of verbal or written agreements or contracts between financial services providers and their clients is highlighted in the FAIS[13] Act and more specifically in the General Code of Conduct:

A provider must have appropriate procedures and systems in place to-

(i) *record such verbal and written communications relating to a financial service (advisory and/or intermediary service)[14] rendered to a client as are contemplated in the Act, this Code or any other Code drafted in terms of section 15 of the Act;*[15]

A provider must, subject to and in addition to the duties imposed by section 18 of the Act and section 3(2) of this Code, maintain a record of the advice furnished to a client as contemplated in section 8, which record must reflect the basis on which the advice was given, and in particular-

(a) *a brief summary of the information and material on which the advice was based:*

Provided that such record of advice is only required to be maintained where, to the knowledge of the provider, a transaction *or* contract *in respect of a financial product is concluded by or on behalf of the client as a result of the advice furnished to the client in accordance with section 8.*[16]

A provider, other than a direct marketer, must provide a client with a copy of the record contemplated in 9(1) in writing.[17]

This requirement should come as no surprise as written offers and acceptance of such offers constitute a contract and it is normal practice for contracts to be given to both parties to keep as a record and proof of the agreement.

Continued on p 12

FAIS from p 10

The law of contract

The term *contractual relationship* is not defined in the FAIS Act and therefore its normal meaning will explain its relevance. *Contractual* means *connected with the conditions of a legal written agreement.*[18] *Relationship* means *the way two people behave towards each other or deal with each other.*[19] The term *contractual relationship* therefore means that the service must be rendered in accordance with *the way two people deal with each other that are connected with the conditions of a legal written agreement*. As the word *contract* is also used frequently in the General Code of Conduct, one should understand its meaning as defined in the dictionary. A contract is defined as *an official written agreement.*[20]

Although there are *advice* contracts and *services* contracts in the FAIS General Code of Conduct, I will focus on the contractual relationship between provider and client that exists from an *advice* point of view. To fully understand this contractual relationship one needs to come to grips with the following:

1. Advice under the FAIS Act refers specifically to *financial products.*[21]
2. The essence of the advice process is clearly defined.[22]
3. The way that providers must behave in their client interaction process is defined.[23]
4. Product disclosure requirements are specific and clear.[24]
5. The recording requirements of this process as well as the recording of the basis (foundation) of the advice are well defined.[25]

Unfortunately the requirements pertaining to the recording of contractual information is grossly misinterpreted by most providers and compliance officers. The General Code of Conduct specifically states: "*Transactions of a client must be accurately accounted for*".[26] From the aforementioned it is clear that *contracts* and the *contractual relationship* between providers and their clients and *transactions* are closely connected under the FAIS Act and the General Code of Conduct. If transactions are based on an offer and acceptance of financial products (contract), how can transactions be *accurately accounted for* if the record of advice is not a written agreement? The definitions make it clear that *contracts* and the *contractual relationships* between providers and their clients all refer to *written agreements*.

Sadly, the majority of financial services providers, compliance officers and the FSB all seem to be on a different page as far as the content and quality of the record of advice is concerned. These important fundamentals are also ignored in the framework of the regulatory 1 examinations. It could have brought an entire industry much closer together to achieve the objectives of the FAIS Act. Hopefully this could be rectified in the second level regulatory examinations. Unfortunately it seems that we will have to wait another couple of years before all the benefits of written agreements can truly serve clients and providers alike.

Filling new shoes

Jo-Ann Ferreira (left) was appointed head of the Regulatory Framework Department in the Insurance Division of the FSB. She is an advocate and is an expert in drafting legislation. She was previously employed by PriceWaterhouseCoopers, Ashira Consulting (Pty) Ltd and the National Treasury.

Clarinda Simpson is the FSB's new head of Finance. She is a chartered accountant and was employed by the Office of the Auditor-General as a senior audit manager before she joined the FSB.

References

[1]See Van Zyl: The FAIS Manual, p1-71
[2]See the definition of advice in terms of section 1(1) of the FAIS Act
[3]See the definition of intermediary services in terms of section 1(1) of the FAIS Act
[4]My insert
[5]See par 3(1)(d) of the General Code of Conduct
[6]See RH Christie, The Law of contract Fourth edition, p 31
[7]RH Christie, The Law of Contract Fourth Edition, p 24
[8]See par 8(1)(c) of the General Code of Conduct
[9]See par 7(1)(a) of the General Code of Conduct
[10]See par 7(1)(1)(b) of the General Code of Conduct
[11]See RH Christie, The Law of Contract Fourth Edition, p 2
[12]See RH Christie, The Law of Contract Fourth Edition, p 25
[13]See sections 16(2) and 18 of the FAIS Act
[14]My insert
[15]See par 3(2)(a)(i) of the General Code of Conduct
[16]See par 8(1)(a) of the General Code of Conduct
[17]See par 9(2) of the General Code of Conduct
[18]See The Oxford Advanced Learner's Dictionary, p 318 and the Oxford Business English Dictionary, p 117
[19]See The Oxford Advanced Learner's Dictionary, p 1229 and The Oxford Business English Dictionary, p 459
[20]See The Oxford Advanced Learner's Dictionary, p 317 and The Oxford Business English Dictionary, p 116
[21]See the definition of advice in terms of section 1(1) of the FAIS Act
[22]See paragraphs 4, 5, 8, 3, 7, 9, 11 and 20 of the General Code of Conduct
[23]See par 2 of the General Code of Conduct
[24]See par 7 of the General Code of Conduct
[25]See par 3(2)(a)(i) and par 9 of the General Code of Conduct
[26]See par 3(1)(e) of the General Code of Conduct

Six countries accepted the invitation to attend the FSB's consumer education familiarisation programme and thirteen delegates from the following regulatory authorities participated: They were from the Reserve Bank of Malawi, the Insurance Commission of Tanzania, the Namibia Financial Institutions Supervisory Authority, the Pension Fund and Insurance Regulatory Authority of Swaziland, the Pension and Insurance Commission of Zambia and the Securities and Exchange Commission of Ghana.

CISNA delegates benefit from FSB's consumer education experience

By Panama Mphanama, Consumer Education Department, FSB

The FSB's Consumer Education Department in the past regularly received requests from regulatory authorities in other countries to share its vast experience on consumer financial education.

This year the FSB invited delegates attending the bi-annual Committee of Insurance, Securities and Non-Banking Financial Authorities (CISNA) meeting to attend a consumer education familiarisation programme presented by the FSB. Six countries accepted the invitation and 13 delegates from various regulatory authorities participated in the programme.

The programme took place from 17 to 21 May 2010 in Pretoria.

The aim of the programme was to expose the participants to the consumer financial education strategy and activities of the FSB, consumer education programmes and legislation and initiatives of other regulators and industry and consumer bodies in South Africa. The programme also aimed to provide delegates with the necessary information to develop strategies according to their country's needs.

The programme dealt with a variety of topics as the participants were from different regulatory authorities. The main themes were:

- Consumer financial education strategies and programmes;
- Consumer protection;
- Regulatory frameworks; and
- The right to recourse and recourse mechanisms.
- Funding consumer education programmes

As a practical assignment delegates had to develop a framework for a consumer financial education strategy for their countries, using the information gathered during the presentations.

Delegates engaged in group discussions at the end of each day. These discussions were the building blocks for the development of the consumer financial education framework and strategy that they were required to present on the last day of the programme.

Proposal writing

The session on proposal writing hosted by the University of Pretoria, was of particular use to the groups in their deliberations as it assisted them in the important aspect of sourcing funds for specific programmes

Discussions dealt with the rationale for consumer financial education, the identification of target groups, the needs of consumers, ways to convey messages, the stakeholders that can assist in implementating the programmes and the educational programme content of a financial consumer education strategy.

Delegates were provided with evaluation forms. Judging by their feedback, the programme was of great value to them.

Economic crisis:

Worst to come?

By Andre Snyman, CEO of Consumer Assist

The year 2010 dawned with the cheerful prediction from the World Bank that it would take at least a decade for the world to pull out of the economic crisis.

This was on the back of many economists – who failed to predict the crisis in the first place – crowing that the worst was over towards the end of 2009. Now we know, the worst may be yet to come. The entire Eurozone is shaky.

Unemployment across the 16 countries that share the euro hits a record 10.1 percent rate in April, with almost 16 million people out of work, the European Union said. The unemployment rate for the common currency area is now running at the highest since the euro came into being in 1999, with almost 1.3 million more people out of work than 12 months earlier, according to seasonally adjusted Eurostat figures. Only Germany has seen a moderate easing in unemployment.

In South Africa with unemployment running at 40% or 28% depending on which StatsSA statistic you believe, a million more lost work last year and so far, 172 000 jobs have been shed, with more at risk after the last vuvuzela blows at the end of the 2010 World Cup.

Despite the criticism levied at Fifa, the demands it made of South Africa did much to push technological, communications and infrastructural growth – all necessary for economic progress. Good policing and South African citizens who heeded President Jacob Zuma's injunction to "behave" created an excellent global perception about the country. We need to maintain the good inherited from the World Cup and build on it to get over the debt obstacles and poverty that throw barriers to progress in our path.

Economic indicators have not been looking good. Borrowing by households and companies contracted for the seventh month in a row to May, reflecting heavily indebted households and a lack of confidence in South Africa's recovery. But despite logjams before the courts for debt review cases, it shows real benefits for consumers as this example shows. Jenna Marks (not her real name) applied for debt review in September 2008.

The amount outstanding on the certificate of balance (a summary of all her debt) in October 2008 was R219 724.93 to pay off a bank loan. The interest rate was 14% a year and the installment (just to cover the interest) was R2 827.20 a month.

Court

It took 17 months for the case to get to court – essentially to change the terms of the loan agreement as arranged by the debt counsellor. The court order was granted in March 2010. If Jenna had not gone under debt review the interest she would have owed from October 2008 to March 2010 would have been a staggering R52 741.13.

But once the court accepted the debt adviser's debt rearrangement proposal Jenna was relieved to see that she had saved more than R20 000 in interest! The interest owed now for this period was R32 658.98. Her monthly installment dropped from R2 827.20 to R1 040.68 and she will be debt free in 104 months. Debt review will also see around R1bn go back to creditors this year. In the absence of the debt review facility, creditors would have had to spend small fortunes pursuing monies owed to them, often fruitlessly.

And of course, there is another need for the economy to grow – rampant criminality by young people who can't find work. In May the Minister of Police, Nathi Mthethwa said, "One of the findings from our crime analysis over the past months, is that in South Africa about 70 percent of crime is mainly concentrated in three provinces: Gauteng, KwaZulu-Natal and Western Cape. Further analysis tells us that crime in South Africa is committed by the same offenders again and again. Sadly, the majority of offenders are young people and it cannot be business as usual when our prisons are filled by vulnerable young people."

We hear of tragic cases of talented young people who are unable to study because their parents cannot afford the fees; even schools are illegally harassing parents and blacklisting them if they cannot pay school fees.

And then there are those young people who have studied and have a degree but can't find jobs. In 2006 alone graduates without work numbered a million young people according to StatsSA. The figure must be far higher now.

There are some positive rays through the gloom. Standard Bank says the volume and value of mortgage loan applications are increasing, but the bank says those hardest hit by the economic crisis are in top earning categories. It is also reported that car sales are up by 35%.

Those who earned good salaries before the financial crash often over-extended their credit limits or suffered stock market crashes. The middle class has proved more resilient. We are selling consumer assist franchises at R120 000 each – with 50% loans from First National Bank. With job security questionable at many corporates more people are becoming entrepreneurial.

But consumers are wary of spending or making new investments with many

fearing job losses. The latest trade statistics issued in June showed that "imports decreased by R5.02 billion (9.83 percent) to R46.06 billion and exports decreased by R7.37 billion (14.29 percent) to R44.17 billion." Such drops suggest that manufacturing is contracting sharply and that always has a significant impact on job security.

Standard Bank also issued a statement in June saying: "Highly indebted consumers, the debt review process, and rigid unemployment will serve to cap household credit growth this year." At present 7 500 people are applying for debt review each month.

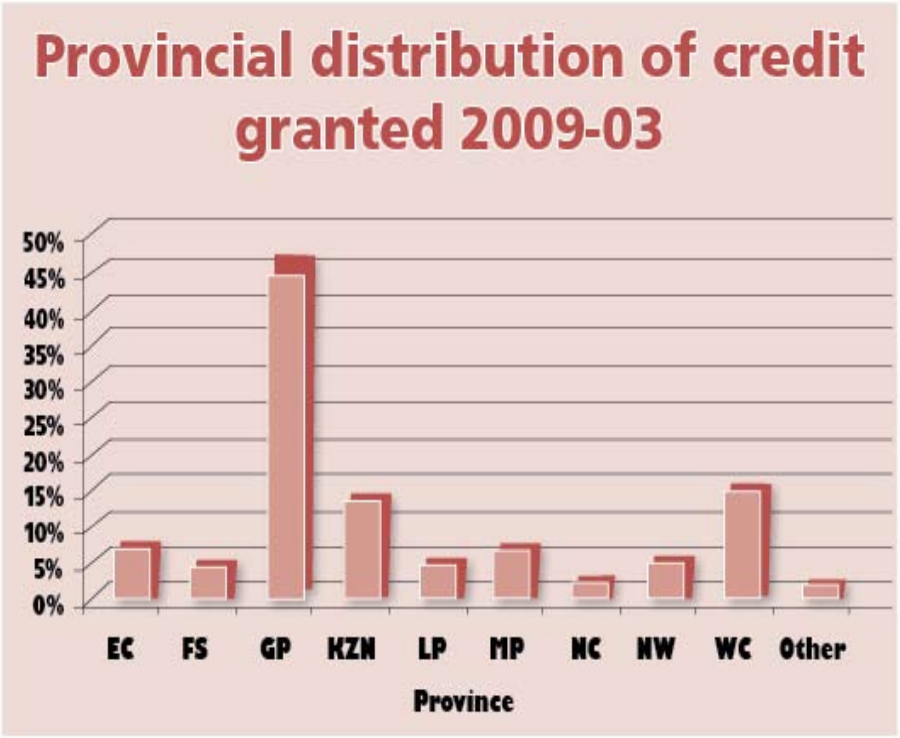
Standard Bank also noted that of 18 million consumers with credit, only 40,5% are up to date with payments, against 47,3% at the start of the economic downswing late in 2007. Household borrowing rose 3,6% this year to March, driven mainly by home loans. Household debt levels are still hovering at very high levels of about 80% of disposable income. Debt service costs are at 8,4% of that aggregate, despite substantial interest rate relief.

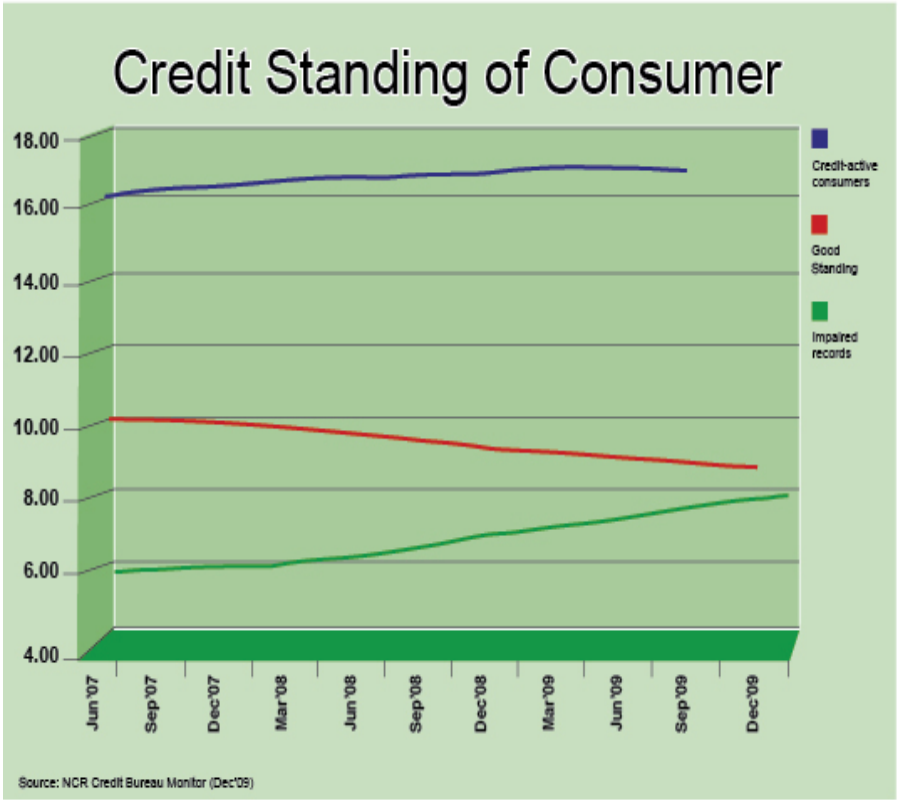
Credit

"There is no reason to expect a pickup in credit," said Annabel Bishop, an economist at Investec. "The economy is still weak and households and companies are still highly indebted."

Much more needs to be done to stimulate the economy and find programmes for young people to become involved in. Next year, according to figures of the Department of Health, there will be a shortage of 18 000 nurses, but we see no signs of large scale drives encourage young people to become nurses. The public and private sectors need to apply their minds to this because crime has a negative impact on economic growth and investment.

** Andre Snyman is CEO of Consumer Assist, the largest debt counselling company and franchise in South Africa. www.consumerassist.co.za*





Exclusion clauses

By Judge Brian Galgut, Ombudsman for Long-term Insurance

This article deals with exclusion clauses with a causation requirement, a difficult issue that is sometimes misunderstood.

Some exclusion clauses provide that the insurer will not be liable if the claim event arises directly or indirectly from the insured life's participation in a criminal act. As often as not, the issue in a given case is whether the fact that the life insured had been driving without a licence or under the influence of liquor can be said to be causally connected, directly or indirectly, to the claim event and in this regard the office's experience is that some insurers assume that, in the absence of any other evidence, the mere fact of driving without a licence or while under the influence of liquor, in itself creates a causal connection to the accident that follows.

This is in fact not so, as can be illustrated by the following case that came before the office recently.

CASE STUDY

The facts

The life insured had been the holder of a policy providing life cover. He did not hold a driver's licence but was killed while driving a motor vehicle, and the complainant, his widow, lodged a claim for the death benefit which the insurer declined to pay. The practical problem was that neither the complainant nor the insurer could produce any evidence about the accident, because no one had witnessed any aspect of it. The police accident report had been found to be impossible to obtain, and there was no other source from which any detail about the accident could be derived.

The issue

In denying liability the insurer relied on an exclusion clause in the policy that stipulated that it would not be liable if the claim event at issue, the death of the life insured,

"... arises directly or indirectly from ... participation in a criminal act...".

It is well established that it was the insurer that bore the onus of proving facts to support its reliance on the exclusion clause. The insurer readily accepted this, but contended that the fact that the deceased had not been licensed to drive, which was of course a criminal act, constituted evidence showing that the exclusion clause applied. It submitted that in the absence of any other evidence showing how the accident had happened, the fact that the deceased had not been licensed to drive was *prima facie* proof that his death had arisen from the criminal act of driving without a licence, and that if the complainant, faced with such *prima facie* evidence, failed to produce such other proof as she could in order to refute the *prima facie* evidence, the causal connection will have been proved.

The vital question was therefore whether the fact that the deceased had not been licensed to drive, which was of course evidence, was evidence relevant to how the accident had happened. If it did amount to such relevant evidence then, in order for her claim to succeed, it would be for the complainant to produce contradictory evidence to refute such *prima facie* evidence; and if on the other hand it did not amount to relevant evidence then it would be for the insurer to produce other evidence to justify its reliance on the exclusion clause. The answer to the vital question, in other words, would determine which of the complainant or the insurer would have to furnish evidence relevant to the accident in order to succeed.

Discussion

As framed, the exclusion clause required a causal link, albeit only indirectly, between the criminal act and the claim event, the deceased's death, and in the case concerned there were two possible

criminal acts at stake. The first was that the deceased had driven the motor vehicle without being licensed to do so, and the other that, when the accident happened that resulted in his death, he was allegedly driving negligently.

The insurer's contention was that when an unlicensed person drives a motor vehicle it is in every case foreseeable that he might be involved in an accident, and that he thereby creates a "greatly increased risk of having an accident". The contention is incorrect, however, because driving without a licence cannot on its own constitute negligence as such. It is only if one is not proficient at driving that it might be said to be negligent to take to the road as a driver, and in the instant case there was no evidence that the deceased was not proficient. On the contrary, it appeared that the deceased had been driving the vehicle for three years, for the first eighteen months under a learner's licence and thereafter without any licence at all.

The office was nevertheless prepared to assume, without finding, that the deceased had indeed not been proficient and that it was negligent of him to have taken to the road. The ultimate question was nevertheless whether it was that negligence that could be causally connected to the accident. In this regard the office was of the view that, without more, even evidence that he was not generally proficient did not prove, either *prima facie* or at all, that the fact that the deceased drove without a licence was causally connected to the deceased's death, and to illustrate this the Ombudsman wrote to the insurer, using the following scenarios as examples:

• Let us assume, as one possibility, that the deceased was involved in a collision with another vehicle, that the evidence establishes that the negligence of the other driver was entirely to blame for the collision, and that the deceased was not negligent in any way, either in relation to the collision or at all. It is obvious that in such a case there is no causal connection between the deceased's driving, with or without a licence, and the accident.

• Let us assume, as another possibility, that a collision occurs between two motor vehicles entering a traffic light controlled intersection at right angles to each other, and that the issue is which of the two motorists entered the intersection against the red light. Let us assume further that some witnesses testify that it was the vehicle driven by the unlicensed driver that did so, while others testify that it was the other driver. When a court, and therefore the office, evaluates the evidence in order to determine which of the versions should be accepted on the probabilities, the fact that one of the drivers was unlicensed is irrelevant, because the question is not what risks he undertook by driving the vehicle in the first place, but whether he was in fact negligent in relation to the collision itself.

• Let us assume, as a last possibility, that an unlicensed person drives around town for two hours, at all times driving perfectly proficiently, but is then negligent and thereby causes a collision. It will be his negligence at the end of the two hours, in other words his negligence in relation to the collision, that will causally have linked the collision to the criminal act. From this it will be appreciated that if the unlicensed driver was not negligent in relation to the collision, then no amount of negligent driving in the two hours that might have preceded the collision could have any bearing on the question of causality."

The above scenarios illustrate that in every case the unlicensed driver's negligent driving in relation to the accident itself is a *sine qua non* to causality, which simply means that without it, and no matter what else might have preceded the accident, there can be no question of a causal connection.

In the result the ultimate question, indeed the sole and only question is whether the deceased, whether licensed or unlicensed, had driven negligently in causing the accident, and the fact that he was unlicensed is therefore irrelevant. In this regard the insurer persisted in its contention that the fact that a driver is unlicensed is relevant evidence and as such would have to be thrown into the scale of probabilities in order to determine whether the driver was negligent in causing the accident. This is in fact not so, because the fact that he may have been unlicensed is not evidence of what actually occurred when the accident happened and is therefore irrelevant to the question.

One of the insurer's contentions was that, in order to discover whether a causal link exists, the forseeability test is applicable. While that may be so it would still not result in establishing causality. What is foreseeable if an unlicensed and unpractised driver takes to the road, is not simply that he may be involved in a collision, but that he may drive negligently and as a result be involved in a collision, which takes one back to the single and only question whether, in relation to the collision, the deceased was negligent in causing it.

Finally, the insurer relied on statistics that sought to show that a significant number of collisions involve motor vehicles being driven by people who do not hold valid licences. As stated above, however, the only issue is whether in the given case the life insured was in fact negligent in causing or contributing to the collision, and statistics do not constitute evidence either on that question or at all. On the contrary, statistics are figures that reflect what has happened in other cases, and while they may be accurate as far as they go they do not constitute evidence of what actually happened in any given case in which the question of whose negligence caused the collision is in issue.

Statistics therefore constitute evidence that is once again irrelevant, in the end in fact begging the very question at issue, which as stated above is whether in the instant case the deceased was driving negligently and if so whether such negligence contributed at all to the collision.

Continued on p 19

Investment in life insurance

Part 1

By Dr Franso van Zyl, chief counsel legislation (FSB)

In the event of one's death or disability, life insurance is one of the best ways to provide your beneficiaries or oneself with a substantial sum of money. It also serves the purpose of long-term saving. An advantage of life insurance is that one is forced to save one's money as one do not have easy access to these funds, as in the case of collective investment schemes for instance.

The life insurance industry has developed into one of the largest and most powerful industries in South Africa. Today, the large life insurers play an important role in the South African economy. Insurers traditionally use the following main asset classes:

- Bank notes and coins and deposits with banks.
- Cash investment in the money market (e.g. short-term investments such as negotiable certificates of deposits and government treasury bills. These investments normally have an investment term of up to 90 days).
- Bond market (effectively long-term loans to government and companies).
- Share market.
- Property.

While many new product variations have been developed over the years, the basic life insurance product has remained the same. For a certain premium one's life is assured for a certain sum of money.

Protection for the policyholder

In terms of the Long-term Insurance Act, 1998 (the Act), every company wishing to do insurance business in South Africa must first be registered with the Registrar of Long-term Insurance. Before a company can be registered, it must be able to meet certain legislative requirements.

During each year, each company at the end of each quarter must submit an unaudited statutory return and at the end of each financial year must submit an audited statutory return to the Registrar in which it reports the insurance business conducted in and outside the Republic during that period.

After studying the information in the returns, the Registrar must decide whether the company complies with the financial provisions in the Act or whether steps should be taken to safeguard its policyholders.

By virtue of the law, children may not be assured in such a manner that more than R10 000 is paid out if they die before the age of 6 years and R30 000 if they die between the ages of 6 years and 14 years. From the age of 18 onwards, a child can take out insurance on his or her own life without the permission of a parent or guardian.

The law protects policyholders and their dependants in the event of insolvency. A person is not allowed to influence another person to take out

insurance by providing any valuable consideration as an inducement. The person who knowingly and willingly receives such inducement is also guilty of an act punishable by law.

Then, too, the insurer may not practice or permit any differentiation between one policy and another as regards the scale of the calculated premiums or the bonuses granted, if the policies are the same type unless the statutory actuary is satisfied that the distinction is actuarially justified.

A policy is suspended until the insurer has received the first premium or until arrangements to its satisfaction have been made for the provision of the premium by debit order, stop order, credit card or other instrument approved by the Registrar.

The Act also prescribes requirements where premiums are in arrears. What needs to be stressed is that insurers fall under strict regulations and control measures, which aim to protect policyholders and their interests.

No person or institution may coerce anybody into taking additional insurance if he or she already has sufficient insurance. A condition that a person will be able to borrow money (or for instance be able to rent certain goods) if he or she is prepared to take out further insurance is therefore not permissible. If his or her existing insurance is insufficient to safeguard the debt incurred, the debtor must have a choice with whom he or she wishes to take out the policy.

Insurable interest can be described as the interest that a person has in property or a person who is to be assured. For example, I insure my house against fire because I have a pecuniary interest in it and will suffer damage if it burns down. Or I lent money to someone and may suffer a pecuniary loss if he or she dies. I have the right to assure my life for an amount equal to the damage I may suffer. Insurable interest is of great importance as an essential requirement of every insurance contract. If it does not exist when the policy is taken out, the insurer may raise the absence as a defense against a claim under the policy. There are three important principles that can be used as criteria (except on an own life or between spouses) in establishing whether a bona fide insurable interest exists:

- at the time a life policy is effected a financial interest which can be assessed,
- an expectation of suffering a loss, and
- an interest which exists at the time of application for the policy.

It needs to exist only at the time the insurance is taken out. A cessionary need not have an insurable interest in the assured life. A claim will be acknowledged after the insurable interest has lapsed, for example a debtor who has paid his debt.

How much life insurance does one need?

There is no hard and fast rule in this regard. If one is young and has no dependents, one does not really need any life insurance, except disability or accident cover.

However, if one is married or has children one needs insurance to support dependants in the event of death.

Secondly, calculate outstanding commitments should one die or become disabled and make sure that the sum assured will be enough to cover these commitments. In addition, one might want to assure one's children's education or a variety of other projects, e.g. the repayment of a bond. One may even consider it necessary to provide for a nest egg when one retires, with tax-free investment returns to some extent that beats inflation.

However, one should ensure that premiums are affordable to prevent policies being surrendered or made paid up.

Couples should consider joint life cover. There are three options:

- It pays out when the first of the two die.
- It pays out when the last partner dies.
- It pays out twice when both partners die.

Joint cover can be cheaper than two separate policies and is ideal for covering estate duty. It allows for a surviving partner to re-plan and provides a calamity plan if both parents die simultaneously. However, the disadvantages are that it is complicated at divorce and difficult to adjust if one's financial circumstances and plans change.

Another option is to consider premium waver cover. In most cases premium waiver is used to ensure that premiums will continue to be paid if one is disabled or die. This is important when the premium payer differs from the life insured.

To be continued

Cluases from p 17

Conclusion

For all of the above reasons the office made a provisional determination that the mere fact that the deceased had been driving without a licence did not in itself, in the absence of any other evidence, constitute *prima facie* proof that the driving without a licence was either a direct or indirect cause of the accident. The insurer accepted the provisional determination with some reluctance, but it asked for time to enable it to make further efforts to obtain the police accident report, which the office granted.

Our office will be discussing this topic in workshops later this year, both in Johannesburg and Cape Town.

There are also some cases on this issue on our website (www.ombud.co.za) under the topic Exceptions, Exclusions and Waiting Periods.

Source: OMBUZZ, e-newsletter of the Ombudsman for Long-term Insurance, May 2010

FSB Bulletin *second quarter 2010*