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## Are financial institutions treating customers fairly?



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# Are financial institutions treating customers fairly?

By Marinus Mans, specialist analyst, FSB

The FSB established a task team in 2009 to grapple with this contentious but very important question. Marinus Mans, specialist analyst: Insurance Compliance of the FSB and member of the Treating Customers Fairly Task Team, explains.

Unfortunately, evidence suggests that financial institutions in South Africa are not always treating their customers fairly. A few examples of unfair treatment of customers include:

- High and layered fee structures on investment policies which make a positive return improbable;
- Restrictive wording on risk policies that shift the risk to the insured;
- Marketing material which makes misleading promises; and
- Commission structures that lead to policy churning.

This list is by no means complete.

It became apparent to the FSB that regulatory rules are not sufficient to address the problem, especially if these rules lead to financial institutions spending lots of time on finding regulatory loopholes. Bringing about acceptable outcomes for consumers will require a fundamental change in the behaviour of financial institutions. This change must put the fair treatment of customers at the heart of how the company does business. Treating Customers Fairly (TCF) is an outcomes-

focused regulatory approach aimed at bringing about behavioural change. The Financial Services Authority (FSA), the financial services regulator in the UK has been pursuing TCF regulation for the greater part of the previous decade. There is much to learn from their past successes and failures. The FSA's initial aim was to get firms to change their approach from one of narrowly complying with legislation

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### In the meantime, financial services institutions should consider the following question: Are you really treating your customers fairly?

and regulations in an attempt to satisfy regulators and avoid prosecution, to one that focuses on improved outcomes for consumers. This is a fundamental shift from a compliance-based to an outcomes-focused culture.

#### FSA's TCF approach

Financial institutions in the UK must consider TCF throughout the "product life cycle" – i.e. at each phase of service or of the product:

- New product design
- Promotion of service or product
- Advice
- Point of sale

- Information after point of sale
- Complaints and complaints handling

Over time the FSA also established the following desired outcomes:

- Consumers can be confident that they are dealing with financial institutions where the fair treatment of customers is central to corporate culture;
- Products and services marketed and sold in the retail market are designed to meet the needs of identified consumers;
- Advice is suitable and takes account of consumers' circumstances;
- Consumers are provided with clear information and are kept informed before, during and after sale;
- Consumers are provided with products that perform as financial institutions have led them to expect;
- Consumers do not face unreasonable post-sale barriers imposed by financial institutions to change product, switch provider, submit claims or complain.

As the effects of the global economic crisis were felt in the UK, questions arose as to the effectiveness of the FSA's "light touch" approach. It appeared that a principles-based approach on its own was not sufficient and that a combination of principles, rules and rigorous enforcement is necessary to deal with non-compliant financial institutions that are not willing to provide the desired outcomes.

There is lots of reading material with regard to TCF on the FSA's website (See <http://www.fsa.gov.uk/.../tcf/library/index.shtml>).

#### The FSB's TCF initiative

An FSB task team has been established to adapt the TCF framework for South African conditions. The TCF task team includes representatives from departments of the FSB that supervise financial institutions selling products to the retail market. These include representatives from Insurance, Financial Advisory and Intermediary Services (FAIS), Collective Investment Schemes (CIS) as well as Pensions

(with regard to retirement annuities in particular). The Consumer Education department is also involved because a significant part of TCF involves consumer education.

The FSB appointed a consultant to help the TCF task team with research and the drafting of a discussion paper. The discussion paper will not only deal with TCF principles but will also discuss specific examples of the type of conduct by financial institutions where customers are treated unfairly. These examples may not necessarily illustrate contraventions of acts, regulations, board notices and directives but "conduct unbecoming" that will, without naming and shaming, illustrate that financial institutions do not always treat their customers fairly.

In October 2009 the TCF Task Team held two workshops with National Treasury, fellow regulators, ombud offices and industry stakeholders to introduce the TCF concept and provide an opportunity for input in identifying examples of "conduct unbecoming". The attendees participated actively in the discussions and the task team received valuable input.

The discussion paper was published by the end of April 2010 (see [www.fsb.co.za](http://www.fsb.co.za)) and the TCF task team encourages all financial institutions operating in the retail financial services market to give input and make contributions. The FSB will hold a stakeholder workshop with the FSA in May.

It is still early days but the TCF task team has set out to achieve the establishment of a TCF framework that is an outcomes-focused regulatory tool that can be applied with traditional rule-based regulation; supported by proactive supervision, appropriate incentive structures and visible enforcement.

In the meantime, financial services institutions should consider the following question: Are you really treating your customers fairly?



# FSB develops Solvency Assessment and Management (SAM) project

By **Jonathan Dixon, deputy executive officer: Insurance, FSB**

**The FSB is developing a new solvency regime for the long-term and short-term insurance industries, to be in line with international standards.**

## Background

The basis of the SAM regime will be the principles of the Solvency II Directive, as adopted by the European Parliament. This will however be adapted to South Africa's specific circumstances. As an overarching principle, the recommendations arising from the SAM project should meet the requirements of a third country equivalence assessment under the Solvency II Directive.

The Solvency II Directive was adopted by the European Parliament on 22 April 2009 and endorsed by the Council of Ministers on 5 May 2009, thus concluding

the legislative process for adoption. The implementation date for EU countries is expected to be January 2013.

The FSB aims to promote the soundness of insurance companies through the effective application of international regulatory and supervisory standards. In line with this objective, the FSB aims to introduce a solvency regime along the principles set out in the new Solvency II Directive shortly after the date of Solvency II implementation in the EU.

## Solvency II is based on:

- Pillar I – Quantitative requirements, dealing with such issues as the valuation of assets and liabilities and the setting of capital requirements. This can be based on a standardised model prescribed by the supervisor or an insurer's own internal model approved by the supervisor.
- Pillar II – Qualitative requirements,

including standards and guidance on governance, internal controls, risk management and supervisory processes.

- Pillar III – Reporting and disclosure.

## SAM timelines

The proposed implementation date for the standardised and internal model approach for short-term insurers and long-term insurers is January 2014. The requirements of the SAM regime will become effective for all insurers from the date of implementation.

For short-term insurers, it is proposed that transitional quantitative requirements will be introduced from 2012 to address some of the more urgent concerns in terms of putting in place a more risk-sensitive approach to provisioning and capital requirements.

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# Roadshows to inform FSPs on regulatory examinations



**Hjalmar Bekker (Moonstone), Charlene Nortier (FSB), Jane Appasamy (INSETA) and Manie Booysen (FIA), speakers at the road shows.**

**The Financial Intermediaries Association (FIA) initiated road shows to provide financial services providers with detail on the impending regulatory examinations on levels 1 and 2. Joe Kotzé, national manager: Compliance of the FIA, explains.**

Workshops for financial services providers (FSPs) have already been presented in Johannesburg, Durban, Bloemfontein and Cape Town and 15 more will take place over the next two months. More than 1 100 intermediaries attended the workshops so far and feedback has generally been very

positive.

At the workshops representatives of the FSB gave background information on the fit and proper requirements, the purpose of the requirements and the need for the examinations. A speaker from the Insurance Sector Education and Training Authority (INSETA) provided an overview of INSETA's role, qualifications that are recognised by INSETA and what FSPs can expect in terms of training material. A representative from Moonstone Information Refinery, one of the four authorised examination bodies, gave comprehensive detail on the examinations and the role of the examination bodies.

Manie Booysen, CEO of the FIA, opened the workshops and stressed the importance of being associated with a representative body such as the FIA. "The road shows have so far served as an eye opener to many non-members on the valuable role that the FIA plays in representing the interests of intermediaries on all levels of the industry. This includes constant interaction with the government, regulators and other industry stakeholders," Booysen said.

## Countrywide

The workshops took place countrywide and proved to be very effective. Attendees said they found the discussions of great value in their preparation to complete successfully the examinations by the cut-off dates. The presenters emphasised that there would be no time for procrastination. Problems loom for those who thought that they can wait until the last moment to register for the examinations.

It is estimated that the four examination bodies would be handling up to 1 200 sittings of the examinations on levels 1 and 2 per day over the period ending 31 December 2013. They are, however, geared for these sittings all over the country.

## Feedback

Feedback from the presenters confirms the recognition and appreciation for the efforts of the FIA in educating and assisting their members in this important process. The FIA have been keeping members updated on all developments on the regulatory front and an abundance of information is forthcoming on the regulatory examinations.

There will be regular internal communication to members. The FIA website is being revamped and will carry all relevant information, documents and training material.

By Elias Masilela, head of Sanlam's Policy Analysis

**The national health insurance programme (NHI) will revolutionise the way South Africans view health care. But in order for NHI to be successful, it is important to have the commitment of numerous stakeholders. Here Elias Masilela, head of Policy Analysis at Sanlam discusses the need for better health care facilities before the NHI can be successfully implemented, as well as the important role played by government and private enterprises.**

While waiting for the convergence paper on social security and retirement reform from government, it seems, rightly or wrongly, policy focus has worryingly shifted to the proposed national health insurance (NHI) programme. The reason for worrying is multi-fold. Most importantly though, is that the NHI programme has been elevated above all other social and economic policy considerations, due to its political veil. It is not clear why this is the case or how prepared we are for such an entity, mainly because not much is known about the technical rigour it has been subjected to – particularly understanding the fiscal implications side by side with South Africa's burden of disease.

#### Competing policies

While it is not uncommon to have competing policies, it is rare to have competition among such significant policy matters. The biggest source of concern (particularly between participants in the long-term savings industry) is that this shift in focus may lead to a reduction in the importance and the impetus that had already been put behind the broader reform. This is important for the simple reason that the reform will be one of the most critical vehicles to the promotion of higher long-term savings in the country. In turn, this is crucial for the country's investment



## National health insurance and broader social security reform cannot be separated

and growth capacity, as well as the financial independence of households.

On the other hand, NHI will predominantly bring forth the inverse of this outcome, namely overall higher consumption expenditure. There is little doubt, therefore, why this policy refocus is resulting in a notable level of unease. Given the wide ripple effects it will have across the economy as well as the competition for dwindling resources, an integrated consideration of these two policy programmes is imperative.

This should in no way undermine the role of health insurance. Based on empirical evidence, it may be argued

that health is more important than retirement policies because if people are not healthy, there is no point in talking about retirement. While this may be true, it is not the case that health is the single most important imbalance in an economy.

It has to be considered together with other policy challenges. As given by this definition of social security, "...an institutional arrangement, driven by the State to secure the welfare of members of society through securing a certain amount of minimum income/standard of

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## Health insurance continued from p 7

living, during their productive years and in retirement. It is a system that prevents destitution in the case of members of society faced with incapacity and unemployment. It is a highly distributive institution that relies on the principle of solidarity among the income capable and the less income capable...” ... health should be seen and treated as a subset of social security. It should not be dealt with in isolation of the broader social security and retirement reform.

If we consider that health dominates one’s expenditure in retirement, this makes a stronger case for dealing with these matters as a package. We have illustrated in studies how expenditure patterns influence replacement ratio. The costs of health are significant in this regard.

In whichever direction we go and whichever policy we emphasise, each of these policies will compete for resources from the fiscus, as well as the taxpayer. That, to a large extent, may be the concern. It is not so much a concern that people do not appreciate the importance of health insurance. However, it has to be done within a broader context, ensuring sustainability.

To ensure that we achieve equity and optimality in our policy design as well

as implementation, it is imperative that these considerations are undertaken as a package. It is not difficult to imagine that these processes may share platforms and human resources for collecting contributions and distributing benefits. Furthermore, even on design, there are lots of considerations. One of these is the cross-subsidisation principle expected to drive social security and NHI. In this regard, it makes economic sense to deal with these together.

There have been a few reactions from the private sector to proposals of the NHI rollout.

One of the more interesting of reactions is one largely emerging from the health space, which predominantly sees the NHI as a new form of crowding out, likely to change the obtaining market balance. This is despite comfort provided by the drivers of the initiative. While their concerns may seem valid, given the power enjoyed by health service providers, it can be argued that any system seeking to include the lowly paid and unemployed masses, as well as providing them with wider choice - can only be good for the consumer.

The first alteration of the existing balance would be to diminish the obtaining pricing power of private service providers, which has resulted in low coverage. According to a recent general household survey, coverage sits at a meager 14% of the population, a 2% decrease from the 16% recorded in mid 2009. This low coverage can partly be explained by high costs of medical provisioning. In turn, a factor that underpins this can be seen as the absence of a credible alternative to private health delivery. One can conclude that the underlying problem is not insurance, but rather service provisioning, particularly by the public health sector. It has been argued that the under-resourcing of government institutions, in the form of skills and quality management, contributes significantly to the imbalance.

It is not insurance that people are in desperate need of, but medical services.

The reason that a lot of people do not have access to good medical services is because the public sector is not delivering sufficiently, which is what boosts the power in the private space. As such, medical costs are rendered unaffordable to most South Africans. Instead of medical insurance, this school of thought calls for the stiff regulation of prices. However, there is a huge debate about the sustainability of this solution. This is particularly so, if we believe in and want to encourage private enterprise in the sector.

The long-term structural solution is to have an alternative health service that is not solely dependent on the private sector, but one which includes the public and private sectors. Once a suitable healthcare delivery model has been identified or adopted, this will elicit an optimal pricing mechanism which can only bode well for the member or healthcare consumer, if not the public.

Currently if someone is faced with even a small ailment, they consult a private practitioner and pay a sizeable consultation fee just for a prescription - which one can also get from a public place at a reduced cost. However, many people simply do not have the time to wait in long queues to see a doctor so they opt to pay the private fees. According to data from Econex, only 6.6% of people covered by medical schemes ever visit a public health outlet.

If government could improve service delivery it could accord people easy and affordable access to quality care beyond the currently dominant private medical services. That is where we need to be focusing our resources. The NHI can come in to complement the underlying intervention. It cannot be a solution in its own right.

In conclusion, the NHI is a necessary but insufficient intervention for the problem that we are facing as a country. Secondly, it ought to be seen as part and parcel of the broader aim of dealing with welfare, and as such should form a part of a comprehensive social security plan for South Africa.



credit, signing contracts, who to contact for recourse and wariness of financial scams. In total, 5 050 students attended the week at the UCT and 1 025 at the UWC.

**Left: Sharing financial knowledge:** From left are Veronica Keyise (OCP), Lyndon Johnson (OCP), Gloria Morekhure (NCR), Elizabeth Lwanga-Nanziri (SASI) and Lyndwill Clarke (FSB).

**Photographs below: Elizabeth Lwanga-Nanziri (SASI) explaining the importance of budgeting to the students.**

# Students informed about financial matters

**The FSB joined the South African Savings Institute (SASI), the Western Cape Office of Consumer Protection (OCP) and the National Credit Regulator (NCR) in an exhibition at the orientation weeks of the University of Cape Town (UCT) and the University of the Western Cape in February.**

The purpose of the exhibition was to inform students about the regulatory functions of the FSB and the NCR, as well as introducing them to the OCP in the Western Cape. In addition, SASI encouraged students to spend their money wisely and emphasised the importance of saving.

## Guide for Youth

The FSB's Financial Guide for Youth was particularly popular among students. SASI provided students with a budget template, while the NCR and the OCP distributed pamphlets and spoke about





# Are Krugerrands a good investment?

By Dr Franso van Zyl, chief counsel legislation, FSB

**The Krugerrand was first minted and issued in 1967 as a way for investors to purchase South African gold. It has been produced every year since then, becoming one of the most popular gold coins in the world. The coins, minted in 22 carat gold, feature Paul Kruger, the president of the South African Republic from 1883 to 1902 on the front, and the Springbok gazelle on the back.**

Sources of Krugerrands in South Africa are commercial banks, coin dealers, gold-coin exchanges, some authorised users at the JSE and private individuals. Instead of working with a local coin dealer, one can use the services of a coin seller on the internet. Investors therefore no longer have to go from one coin dealer to the next to get Krugerrands. This means that more coins are accessible and the competitive pricing makes the coins more affordable than before. But either way, one has

to research the background of sellers to ensure that they are trustworthy. If possible, speak with the sellers in person and investigate their websites before you buy. Look up the seller's feedback scores and read comments from previous customers. Also check guarantees and refund options.

Krugerrands are supplied at a small premium because of their gold content. Prices are not fixed. Dealers determine their own buying and selling prices. Investors must therefore ensure that they get the best deal. As the Krugerrand is so well recognised, buying and selling are easy. As the gold price is quoted internationally in terms of troy ounces, one can easily determine the value of Krugerrands (containing one, a half, a quarter or a tenth ounce of gold). The one ounce Krugerrands are the most popular and can be found in large quantities.

The higher the premium, the higher the risk that the Krugerrand's value will have declined at the time of resale. Expectations of a rand devaluation

or political instability will raise the premium over gold content.

Many coin collectors like investing in uncirculated coins because they are considerably higher in value compared to Krugerrands that have been circulated. Proof versions of the coin are also popular.

A Krugerrand has legal tender status in South Africa, which allows it to be imported into many countries without import taxes, duty or VAT. As legal tender coins (meaning they can be used as a currency to pay for goods or services), they are not assayed or melted, this is different from many cast and minted bars.

## **Why do people invest in Krugerrands?**

Hard assets are one of those traditional inflation hedges. They include gold, diamonds, precious stones, works of art and antiques. Such items as diamonds and oriental carpets must generally rise sharply in price just to bring the resale value up to the same level as the retail

cost to the investor. The value of these investments depends on their rarity, features and qualities.

Krugerrands are gold and gold is a good investment as there is always a market for it. Since the beginning of civilisation, gold has been a premier way of storing wealth because of its currency value, adornment as jewellery, industrial value and investment status. Gold has often provided insurance against the unexpected, currency devaluations, severe market collapses, national crises and economic uncertainties.

Several South Africans invest in Krugerrands because:

- They fear political/financial instability. If there is concern about government seizing, squeezing or freezing wealth, there is nothing more comforting than gold.
- Fears about the stability of the currency.
- They want to hide their wealth from the Receiver of Revenue Service. They are attractive to those who do not want the Receiver of Revenue Service to know how rich they are getting, or who want to smuggle savings out of the country.
- Krugerrands have traditionally been seen as a way of investing in gold at a lower level of risk than via shares in mining companies. A Krugerrand cannot be destroyed or lose its value. Shares and other paper assets, even those constituting equity in gold mines, can provide a higher rate of return than gold, but they are not as strong in terms of financial security place.

However, there are now a number of listed instruments available that can expose investors to gold cost-effectively, e.g. ETFs, through the JSE's international market, its Commodity Derivatives Division, etc.

In the long-term, Krugerrands have been a mediocre investment, but not a bad one. Krugerrands and other rare gold coins should be kept as a medium to long-term investment, preferably for a minimum of five years. Krugerrands

are considered good "insurance policies" against urgent cash calls. It is better to be a seller of Krugerrands at market-related prices than to be a distressed seller of your property or shares, or surrendering your insurance policy.

Over the years, Krugerrands increased in value, often at 11% a year, a higher rate than the average home if rental income or value of occupation is ignored:

- Even if your capital is in cash and property, which are considered safe investments, coins will further diversify your portfolio. Diversification lowers risk. It is considered an effective "diversifier" because its performance tends to move independently of other investments and key economic indicators.
- Gold is a long-term hedge against inflation. In an uncertain world, there is nothing like the security that owning a bit of gold provides.
- The value of gold has remained remarkably stable.

However, one should remember that capital appreciation is vital with an asset such as a Krugerrand as it does not provide income. The value of these coins changes constantly due to the fluctuations in the gold price and the Rand/Dollar exchange rate. The capital appreciation is also subject to the costs of insurance and safe custody. Krugerrands carry no evidence of ownership and are susceptible to theft. One must make adequate arrangements for insurance and safe custody and charges throughout the period of ownership.

#### **Tax treatment of profits arising from sale of Krugerrands**

Unfortunately for investors, profits made from selling Krugerrands are subject to capital gains tax. The taxpayer is obliged to disclose any sale of gold coins in annual tax returns.

## Banks rewarded



**The Ombudsman for Banking Services (OBS) again last year rewarded banks and their employees for exceptional service when resolving complaints that reach the OBS office. The winners were announced at a function in Johannesburg. In the category for smaller banks, African Bank was the shining star, credited by the OBS with dealing the best with their customers complaints. From left are Sakhe Radebe, Sonette Botha, Roshika Samdhan-Pillay, Marilyn Budow, Alicia Adonis (all from African Bank), Ina Wilken (OBS board member), Phindile Jambane (African Bank), Adv John Myburgh SC (OBS board chairman), Magashree Ramsaroop and Thebeetsile Mothibi Sakhe Radebe (both from African Bank).**

By Anton Swanepoel, counsellor on FAIS

In this article the focus is on the suitability requirements for health service benefits provided by medical schemes as defined in section 1(1) of the Medical Schemes Act, 1998. Paragraph 8(1)(a), (b) and (c) of the General Code of Conduct states:

*A provider... must, prior to providing a client with advice-*

*(a) take reasonable steps to seek from the client appropriate and available information regarding the client's financial situation, financial product experience and objectives to enable the provider to provide the client with appropriate advice;*

*(b) conduct an analysis, for purposes of the advice, based on the information obtained;*

*(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...*

## Suitability

Paragraph 8's title of the General Code of Conduct is *suitability*. As this term is not defined in the Act or the Code, the word's normal meaning must be used. *Suitable* is defined as *right or appropriate for a particular purpose or occasion*.<sup>1</sup> In FAIS language one can translate it as *right or appropriate for the client's purpose, risk profile and financial needs*.

## The suitability test

How would one determine whether health service benefits provided by medical schemes will pass the suitability test as prescribed in the General Code of Conduct?

This is an important question, as it is one of the questions that the Ombud of

# The sustainability test: Medical schemes

Financial Services Providers will have to answer if a complaint serves before her. This article aims to put financial services providers in a position to ensure that they pass this test long before a client complains. If providers incorporate the fundamentals of suitability as highlighted in this article as part of their risk management plan, chances are slim that they will ever have to defend themselves before the FAIS Ombud. There are four key considerations when it comes to the suitability test. They are:

## 1. The client's needs and objectives

Financial needs have not been defined in the Financial Advisory and Intermediary Services Act (FAIS Act), 2002, and therefore the normal meaning of the words must be used. Financial means "connected with money and finance"<sup>2</sup> and *need* means "to require something because it is essential or very important, not just because you would like to have it".<sup>3</sup>

*Objective* is not defined in the FAIS Act and therefore we use the normal meaning of the word. *Objective* is defined as *something that you are trying to achieve*.<sup>4</sup> It would appear from paragraph 8(1)(a) and (c) of the General Code of Conduct that client's financial needs and objectives are closely related.

The only way providers can act in the interest of clients, as required in the General Code of Conduct, is to ensure that they understand the client's needs and objectives.<sup>5</sup> Offering client-based advice is not only a requirement in terms of the Code,<sup>6</sup> but also vital from a business point of view. If providers want to establish a trusted relationship with

their clients, understanding the needs of their clients is a key element in the trust building process.

## Example of needs:

The Jones family needs the following medical benefits:

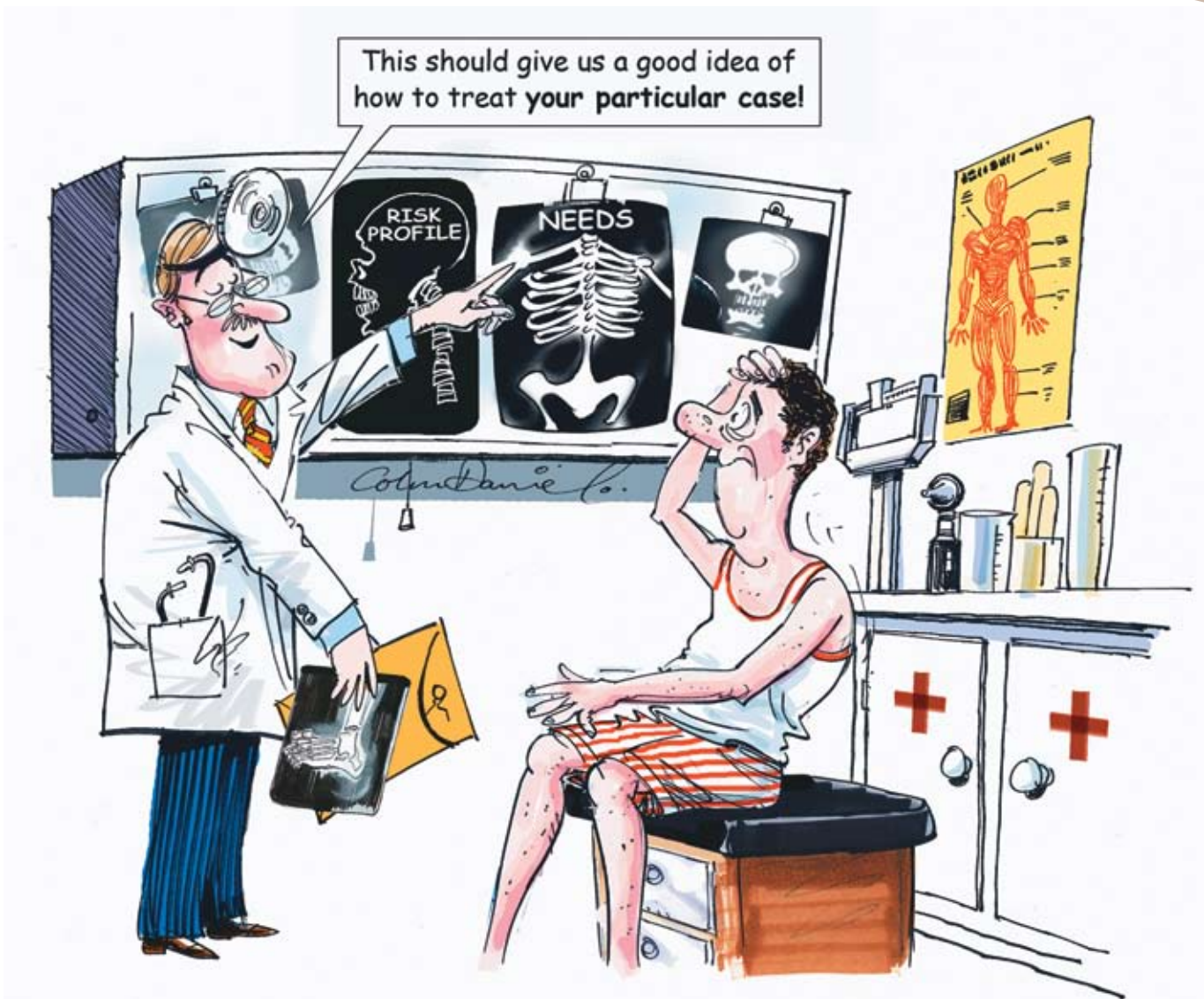
- Comprehensive hospitalisation benefits;
- Comprehensive surgery benefits;
- Comprehensive dental benefits; and
- A benefit that covers day-to-day medical expenses.

## 2. The client's risk profile

The term risk profile has not been defined in the Act and therefore we use the normal meaning of the words. *Risk* means *the possibility of something bad happening or a situation that could be dangerous*. To risk something is *to do something even though the result could be unpleasant*.<sup>7</sup> *Profile* is a description of something that gives useful or important information.<sup>8</sup> One can also define a person's profile as a *character sketch*.

*Important notice:* Risk profiling does not only apply to investments. It also applies to health service benefits.<sup>9</sup> A client who wants comprehensive surgery and hospitalisation benefits and therefore selects a comprehensive medical scheme has a different risk profile compared to a client who is willing to pay part of the expenses if such an event occurs.

The latter is willing to accept a higher degree of potential loss in the event of surgery and/or hospitalisation. To risk



something is to do something even though the result could be unpleasant. This type of client, who may not be able to afford not to be covered in such cases, may get desperate when expenses arise. The risk for the advisor is that the client may be tempted to blame him or her for not including comprehensive cover in the application. Therefore it is absolutely necessary that a client's risk profile should be established before the client's application is submitted to the medical scheme/product supplier.

**Example:**

Mr Jones decides not to include the comprehensive dental and day-to-day medical benefits after looking at the cost of cover. His decision affects his risk profile as he is now willing to risk the cost in the event of going to the doctor or dentist. The provider needs to record the decision and requires the client to verify it in writing.<sup>10</sup>

**3. The key features and benefits of the proposed financial product**

To establish whether the financial product would be appropriate for the client's purpose, risk profile and

financial needs, the most logical test would be to compare the client's needs, objectives and risk profile with the key features and benefits of the proposed financial product.

**Example:**

As stated earlier, Mr Jones required the following insurance benefits:

- Comprehensive hospitalisation benefits;
- Comprehensive surgery benefits;

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## Medical schemes continued from p 13

- Comprehensive dental benefits; and
- A benefit that covers day-to-day medical expenses.

However, he decided to accept the risk of paying his own expenses in the event of certain dental and day-to-day doctor's expenses. His final request only included:

- Comprehensive hospitalisation benefits;
- Comprehensive surgery benefits;
- Basic dental benefits.

In view of the client's needs and risk profile the financial proposal would meet the suitability requirement if the provider proposed health service benefits consisting of:

- Comprehensive hospitalisation benefits;
- Comprehensive surgery benefits;
- Basic dental benefits.

The provider in this case clearly considered the client's needs, objectives and risk profile.

However, the client's decision to change his initial requirement should be recorded clearly as a client request or instruction and signed by the client as confirmation.

If the provider then renders service in accordance with this client request or instruction, the final proposal will meet the suitability test. A signed document that confirms the client request or instruction would be vital because the provider would be at great risk if the client later alleges that the dental and day-to-day doctor expenses were also required. This would leave the provider with one more obligation in the advice process, with specific reference to the suitability test, namely:

#### 4. Disclosure of relevant material terms, conditions and exclusions

Paragraph 8(1)(c) of the General Code of Conduct provides:

*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...*

Product suppliers offer health service benefits subject to certain terms, conditions and exclusions. It is therefore important for providers to disclose these and other disclosures<sup>11</sup> as it would determine whether the product will pass the suitability test. Fees and commission could be considered as part of the policy's terms.

#### The value of a signed product material/brochure

Product suppliers that offer health service benefits or medical scheme products generally meet the requirements for disclosures of key features, benefits, terms, conditions and exclusions in their product material/brochure. Unfortunately some financial services providers still do not get the client to sign every page of the product material as evidence of acceptance of the financial product proposal. It is important to note that if the client signs every page, it offers evidence that the necessary features and terms, conditions and exclusions pertaining to the medical scheme have been disclosed to the client. More importantly it offers evidence that the client accepted the

proposal, *subject to the limitations imposed on the provider under the Act or any contractual arrangement...*

Three of the five vital elements necessary to pass the suitability test are contained in the quotation, namely:

- Key features and benefits of the long-term insurance policy
- Terms, conditions and exclusions
- The cost (including the advisor's remuneration)

The other two elements (needs/objectives and risk profile) should be covered in the financial service agreement<sup>12</sup> between the parties. The signed product material/brochure is an extension of the financial service agreement.

It is important to understand that while the client may need comprehensive dental and day-to-day medical benefits, the client's risk profile and ability to pay the premium on the full benefits, may have a limiting effect on the medical scheme benefits. If the client cannot afford the premium on a medical scheme that is suitable for needs, that will be a legitimate reason for applying for a scheme which offers less cover than necessary. Based on affordability, the benefits may be reduced and the advice will still meet the requirement of suitability. The key however is recording the circumstances and making sure that the client signs the necessary documentation to that effect.

#### References

<sup>1</sup> Oxford Advanced Learner's Dictionary, p 1480

<sup>2</sup> Oxford Advanced Learner's Dictionary, p 551

<sup>3</sup> Oxford Advanced Learner's Dictionary, p 979

<sup>4</sup> See Oxford Advanced Learner's Dictionary: p. 1005

<sup>5</sup> See paragraphs 2 and 8(1) (a) (c) of the General Code of Conduct

<sup>6</sup> See par 2 of the General Code of Conduct

<sup>7</sup> See Oxford Advanced Learner's Dictionary: p. 1264

<sup>8</sup> See Oxford Advanced Learner's Dictionary: p 1160

<sup>9</sup> See paragraph 8(1) (c) of the General Code of Conduct

<sup>10</sup> See paragraphs 3(1)(d), 8(1)(c) and 9 of the General Code of Conduct

<sup>11</sup> See paragraph 7 of the General Code of Conduct

<sup>12</sup> See section 20(3)(a) of the Act and paragraphs 3(1)(d) and 9 of the General Code of Conduct



# Governance: The way forward

**At the recent Institute of Directors Southern Africa (IoDSA) Business Update Conference, Sir Adrian Cadbury, who was responsible for the Cadbury Report on Governance in the UK, delivered the keynote address. He reviewed progress in corporate boardrooms and gave the audience his take on future directions. The article previously appeared under the title, Governance: Yesterday, today and tomorrow in *Directorship* (Jan/Feb/March 2010).**

Taken together, the three King Reports chart the progress of thinking on Corporate Governance over the years, giving valuable insight into the evolution of business and setting the course for its future development.

"South Africa stands alone in the development of thinking on the subject of corporate governance," said Sir Adrian Cadbury opening his address, referring to the three King Reports on Corporate Governance as remarkable and calling them a "compass that guides directors."

"The third King report looks outward at the impact of companies on communities," added Cadbury. "What we have here is a charter for corporate citizenship, which accurately describes the governance of tomorrow."

Advancing corporate governance Building on the previous reports, King III stresses the interdependence of companies and communities and advances governance thinking in the following key areas:

- Regarding the nature of reporting, King III emphasises the value of integrated sustainability reporting in giving a holistic picture of an organisation's performance and future prospects, economically, as well as in terms of non-financial social and environmental indicators.
- Reporting enables society to judge whether or not a company is living up to its obligations to all its stakeholders.

Where King II introduced the concept of sustainability and the importance of meeting present needs without compromising the future, the latest report "emphasises the vastly different business environment that would be the result of ignoring environmental that would be the result of ignoring environmental concerns such as climate change," said Cadbury.

There is clearly no choice but for sustainability to be a factor. Stakeholders should be informed of business decisions of all kinds, including, remuneration. "Pay packages should reward sustainable, profitable

progress and be dependent on performance, not aspiration."

In another notable addition to the report, Cadbury said King III's chapter on risk is the most comprehensive he has read.

Covering risk identification, planning, management and implementation the report warns boards to assess their appetite for risk vs. their desire for reward; something he says UK banks involved in the economic meltdown clearly ignored.

Equally, it emphasises the fact that boards' decisions depend on the quality of information they receive, something directors can have peace of mind about if they're confident that the company is already acting according to the King Code.

## **Encouraging dialogue between shareholders and directors**

According to Cadbury, the Code deals with principles and best practice recommendations according to an 'apply of explain' approach which is aimed at opening the way for discussions between the board and shareholders. "A decision to depart from the Code means that the board has given serious thought

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# SA's multibillion Rand money market goes electronic

By Tanya Knowles, head of marketing, Strate

**South Africa's multibillion Rand money market industry has officially started with the electronic issuing, trading and settlement of securities in place of the manual paper-based system, which has been in existence since the inception of the money market.**

As the largest issuer of money market securities, the South African Reserve Bank (SARB) has welcomed the implementation of a fully dematerialised money market. All SARB debentures and National Treasury Bills are now being processed in the new electronic format. Other major financial institutions have also fully embraced the dematerialised market.

Gail Edge, assistant general manager: Financial Systems Support at the SARB, explains that this system is long overdue in the market, bearing in mind the efficiencies and reduction in risks that can be achieved with dematerialising securities.

The new system is provided by Strate, South Africa's Central Securities Depository. Strate's, chief operating

officer, Anthony van Eden said, "the move of the country's money market from manual custody, clearing and settlement processes into a fully electronic environment has allowed enhanced straight-through-processing and risk mitigation for all issuers and investors in this informal over-the-counter financial market."

#### **The benefits of the electronic environment include:**

- Securities issued will no longer be in bearer form, nor will there be a requirement for certificate numbers;
- Delivery of securities against trades will not require splitting;
- No difference in the reporting of primary and secondary trades for settlement;
- Issuers will have electronic real-time records of all beneficial owners of their securities;
- Secure real-time settlement of trades, coupon and maturity payments;
- Final irrevocable delivery-versus-payment at beneficial owner level;
- Improved market liquidity;
- Enhanced straight-through processing
- Lower operating risk, reducing clerical errors and omissions;
- A significant reduction in the opportunities for fraud and theft; and
- A reduction in operating overheads associated with the paper environment.

#### **Industry initiative**

The project has been an industry initiative, partnered with Strate for a number of years. It is rewarding to see the electronic transacting of money-market securities, as this marks a significant milestone for the South African financial markets and its status internationally.

*For more information visit [www.strate.co.za](http://www.strate.co.za)*

## **Governance**

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to where the interest of the company lie, and shareholders should see it in this light."

#### **Board composition**

Given the vital role played by the board, King III recommends that shareholders, who are ultimately responsible for its composition, play an active part in selection its members. It is common practice for a chairman to nominate members, therefore limiting discussion and the easy acceptance of the new directors. However, as Cadbury recommends, "All board members should be a part of this process so that they share responsibility for their new colleagues, whose contribution they are then more likely to respect."

King III emphasises international best practice in terms of a division of roles between the chairman and chief executive officer, and stresses the importance of continual director development and performance evaluation. It also notes that where boards delegate functions to committees, the responsibility for the proper execution of these functions remains with them.

#### **Remuneration**

Regarding remuneration, Cadbury said King III's advice for considering pay policies throughout the organisation is the best guide he had seen. "Since everyone contributes towards a company's results, its pay structure needs to be seen as a whole if it is to meet the test of fairness. It matters that the fruits are distributed equitably, with sustainability principles in mind."

## **Sound ethics**

Throughout the King III Report, the importance of ethical standard is emphasised. "Values are the glue that holds the organisation together; the hallmark of a company that must come from the top down," said Cadbury. "Since ethical conduct forms the basis of trust in an organisation, it's vital that boards commit to such behaviour, setting the example for all to emulate."

#### **In summary**

In summary, King III represents a significant advance in the field of corporate governance, setting out the guidelines that organisations should follow on the road to becoming the good corporate governance, setting out the guidelines that organisations should follow on the road to becoming the good corporate citizens of tomorrow. However, it is crucial to note that acknowledgement of reciprocal responsibility is a prerequisite for companies to serve society's needs efficiently, ethically and in a sustainable manner.

"Today, ordinary people, through their investments, pensions and policies are effectively shareholders in the largest listed companies. They should therefore take an active interest in these companies' activities, and these organisation so that shareholders can put it to good use."

"Companies who act in accordance with King III will be acting as good corporate citizens. Society will benefit from their responsible actions and in turn owe it to these organisations to provide them with the appropriate legal, social and environmental framework to enable them to continue to prosper for the good of all," concluded Cadbury.



# Celebrating world consumer rights month

**The National Credit Regulator (NCR), as part of promoting public awareness and as part of celebrating World Consumer Rights Month, embarked on a series of activities including road shows, radio programmes, exhibitions and workshops in conjunction with other stakeholders.**

March 15 is celebrated internationally as World Consumer Rights Day and in South Africa March is dubbed the consumer rights month. The Consumer Protection Forum, which comprises the National Credit Regulator (NCR), nine provincial consumer affairs directorates, the Council for Medical Aid Schemes (CMS), Independent Communications Authority of South Africa (ICASA) and others jointly embarked on programmes aimed at educating South African consumers. The international theme

which has also been adopted in South Africa, is "Our money, our rights".

According to the NCR the international theme presents a valuable opportunity for various stakeholders to join forces and educate consumers on money related matters.

"Consumers who are empowered with information on how to handle their finances can easily deal with financial difficulties," says Peter Setou, Senior Manager: Education and Strategy at the NCR.

By September 2009, nearly 45% of South Africa's 18 million credit-active consumers had impaired records. Debt counselling applications also rose to more than 150 000. The tough economic conditions over the past year have severely affected many South Africans. While some were retrenched and lost their steady income, others were forced to take pay cuts as companies cut costs to stay afloat.

"Many people are faced with enormous financial pressures and most do not know how to handle their financial obligations under these circumstances.

Our education campaigns are geared at encouraging consumers to be more proactive and contact their credit providers should they foresee that they will not be able to fulfil their repayments. Conversely, we have appealed to credit providers to assist consumers to re-arrange their repayment to affordable levels," says Setou.

## **First step**

For consumers who can no longer afford their repayments, the first step is NOT to panic, but to contact all their credit providers and make arrangements based on their current income and affordability. Letters of demand or final notice should never be ignored. They should be attended to immediately.

Retrenched consumers must also inform their credit providers and establish if they have credit life insurance included in their credit agreements. This is cover payable in the event of a consumer's death, disability, terminal illness, unemployment, or other insurable risks that may prevent the consumer to meet his/her obligations under a credit agreement.

Consumers are also encouraged to be cautious with their retrenchment packages. Where the package is sufficient, consumers should list priority debts and determine how the package can be used in partly settle some debts or reduce them. Additionally, consumers

are advised to seek assistance from registered and licensed financial advisors or debt counsellors. Consumers should prioritise their housing loans, meaning they should never skip mortgage payments as they can lose their houses, advised Setou.

Credit providers must give consumers prior notice before they can approach a court for judgment to enforce debt repayments. They must also advise consumers of the available options such as:-

- Seeking help from a debt counsellor;
- Seeking help from an alternative

dispute resolution mechanism; or

- Bringing payments up-to-date.

During consumer month, consumers are encouraged to:

- Always act on a letter of demand. Contact credit providers and explain your situation. They would rather receive some payment than none at all.
- Seek help from a debt counsellor. If your credit providers are not willing to assist, approach a registered debt counsellor who will assist you to manage and restructure your debts.
- Never skip payments. Continue to make payments even when you are

under debt counselling. If you do not pay, you could lose your house or your car.

- Prioritise your home loan. Never skip your mortgage payment even if you are under debt counselling, pay as much as you can.
- Start saving today. Saving some money every month will assist you in future.
- Be alert all the time and exercise your rights.

**Source: Media release, National Credit Regulator, March 2010**

## Solvency assessment continued from p 5

It is also proposed that elements of Pillar II, dealing with guidelines in terms of governance, internal controls and risk management, will be developed for both industries for implementation in 2012.

The SAM regime will encompass supervision at the solo entity and insurance group level. This will necessitate interim changes to legislation by 2012, specifically to address issues such as defining the concept of insurance groups and the scope of insurance group supervision including reporting requirements.

These are challenging timelines. Successful achievement of the target dates will require a co-operative process and the active participation of experts from industry and other stakeholders.

The SAM Project will be managed according to the following project structure:

- Steering Committee – the highest body responsible for co-ordination and driving the implementation of the SAM regime. This Committee is chaired by the FSB. The chairperson of the Committee is Jonathan Dixon, deputy executive officer: Insurance and the vice chairperson is Marius du Toit,

Chief Actuary.

- Quantitative Requirements Sub-committee – tasked with making recommendations on quantitative requirements including capital models, technical provisions, valuation basis and the use of internal models. The sub-committee is chaired by the FSB. Hantie van Heerden, head: Actuarial Insurance is the chairperson with Tienie Hamman, specialist: actuarial as the vice chairperson.
- Risk Management and Governance Sub-committee – tasked with making recommendations on risk management and corporate governance standards and best practice. This sub-committee is chaired by Suzette Vogelsang, head: Insurance Prudential, with Lesedi Letwaba, head: Insurance Registration as the vice chairperson.
- Reporting and Disclosure Sub-committee – tasked with making recommendations on disclosure and reporting standards, and liaising with the relevant accounting standard setters to ensure optimal convergence between accounting standards and Pillar III disclosure requirements. This sub-committee is also chaired by Suzette Vogelsang, head: Insurance Prudential, with Johan Heyneke, specialist: Insurance Prudential as the vice chairperson.

The Task Groups under each sub-committee will be largely chaired by

industry representatives and will consist of nominated representatives from various stakeholders. All insurance companies and other stakeholders will be able to follow and provide input into the process through the nomination of a SAM Co-ordinator who will have access to a dedicated SAM website.

This is a major reform that will require not only considerable energy in the design of effective regulatory proposals that are appropriate to South African circumstances, but also concerted effort from the FSB and industry in terms of ensuring readiness for implementation in 2014.

This is a challenging task, but also an exciting one as it will ensure that the South African insurance sector stays at the forefront of international best practice in solvency assessment and management, for the benefit of policyholders and overall financial stability. It is a road that the FSB, industry and other stakeholders must walk together.

The journey has just begun, but the level of participation and energy shown to date by all stakeholders has been extremely heartening and bodes well for the successful achievement of a new milestone in the South African insurance sector.



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