



Imperfect FAIS compliance

p6

Savings dialogue

Death and disability provision should be factored



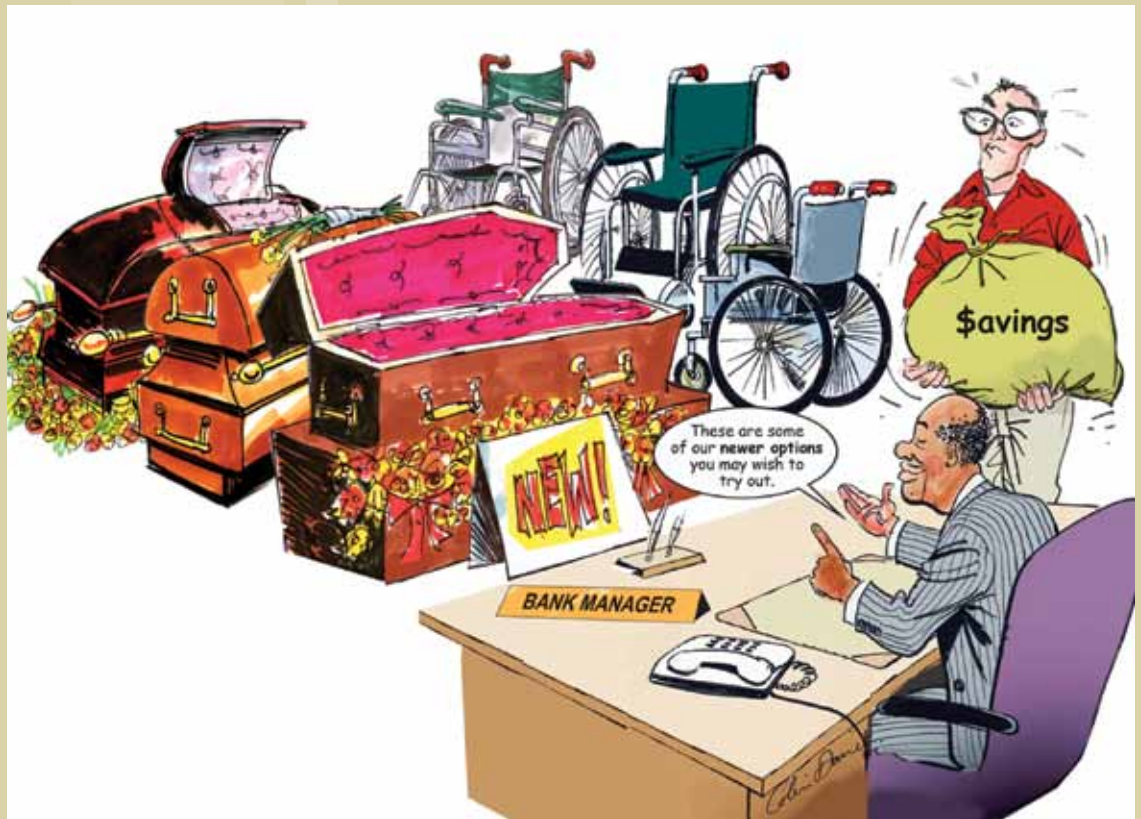
Bert Chanetsa appointed to ABA committee

p8



The SAM Capital Requirements Task Group gives feedback

p10



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

Dr Franso van Zyl
Olivia Davids

COVER AND GRAPHICS

Chillidesign
(012) 332 3833

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. Also see subscription form on p 19.

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) 422 2828
Fax: (012) 346 4861
e-mail: Pakama.Miya@fsb.co.za

THE FSB BULLETIN

is available on the Internet:
www.fsb.co.za

- 3** Death and disability benefits provision should be factored in the savings dialogue
By Abe Sithole, FSB chairperson
- 6** Imperfect FAIS compliance – cause and effect
By Charene Nortier, manager: FAIS Supervision, FSB
- 8** Bert Chanetsa appointed to ABA committee
- 9** FSB hosts IOSCO conference
By Norman Müller: head of Capital Markets, FSB
- 10** Feedback from the SAM Capital Requirements Task Group
By David Park, chairperson of the SAM Capital Requirements Task Group
- 12** Money does matter in KwaZulu-Natal
By Christi Naudé, KZN Financial Literacy Association co-ordinator
- 14** Surrender of life policies
By Dr Franso van Zyl, chief counsel legislation, FSB
- 16** Lining up for the FIA trophies
By Clive Franks, media and communications manager, FIA
- 17** South Africa's financial planning population seventh biggest in world
- 17** FSB to host international conferences
By Tsholofelo Dihutso, marketing and communications manager of the FPI
- 18** Record number of complaints for Ombudsman for Long-term Insurance



Death and disability benefits provision should be factored in the savings dialogue

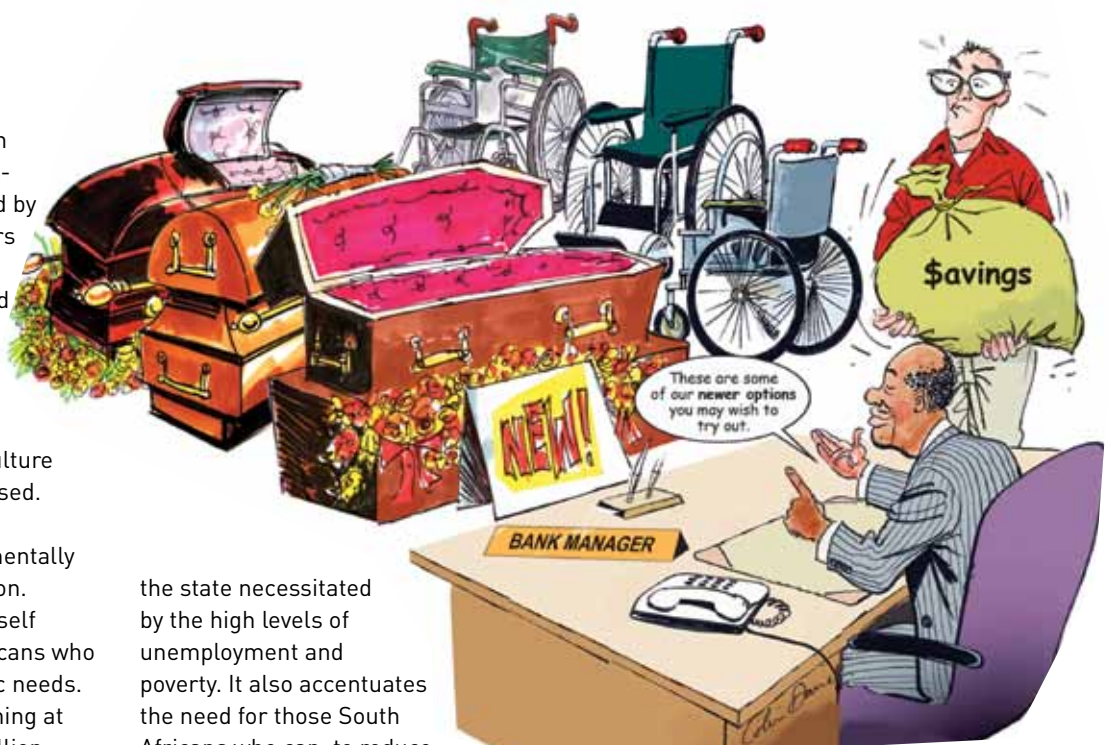
By Abe Sithole,
FSB chairperson

July is National Savings Month in South Africa. As in the past, well-founded concern were expressed by many analysts and commentators in different media about the low rate of savings in the country and South Africans will be reminded of the importance of saving for personal and national reasons.

These efforts to engender and improve the country's savings culture are lauded and should be increased. However, it is also important to remember that saving is fundamentally deferred or foregone consumption. Unfortunately, consumption is itself problematic for many South Africans who struggle to meet their daily basic needs. With official unemployment running at over 25 percent and about 15 million South Africans relying on grants to meet their basic needs, the poor comprise a significant proportion of the country's population. For these poor South Africans who cannot even scrounge a living, saving is out of the question. You cannot defer or forego consumption that you do not enjoy.

Poverty alleviation in South Africa

In his 2011 Budget Speech, the Minister of Finance, Pravin Gordhan, stated that of the close to 15 million South Africans who receive social grants, 38 percent are old age pensioners, 35 percent are children in poor households and 19 percent are disabled. This highlights the growing culture of dependency on



the state necessitated by the high levels of unemployment and poverty. It also accentuates the need for those South Africans who can, to reduce their reliance on the prospect of state provided benefits by saving and making provision for themselves. State provided benefits are a great lifeline for the poor and destitute but are unlikely to meet the needs of those who are accustomed to a higher standard of life.

Save, but provide for death and disability too

The large numbers of child and disability grant recipients point to a need to focus on providing for these benefits. Unfortunately, the focus on providing and saving for retirement often obscures this reality and need. As a result pensions, savings and investments dominate the broader dialogue on saving and have

become the key subjects people focus on.

South Africans are encouraged to save diligently for retirement expecting to build enough reserves to maintain their standard of life in retirement. Yet, not everybody will live to see their retirement years due to disability and death while working. There is thus a need to also focus on providing for dependents, especially children who are orphaned, and in the case of disability.

The plight of children, orphans in particular, is highlighted in the recent South African Child Gauge 2009/2010 produced by the Children's Institute at the University of Cape Town. This report shows that the number of children receiving the Child Support

Continued on p 4

Save, save, save!



Death and disability from p 3

Grant currently (2009) stands at 9 071 862, having increased from 5 913 719 in 2005. It also shows that there were approximately 3.95 million orphans in South Africa in 2008.

Pensions, savings and investments in general do cater for and are available to support dependants in the case of death and members in case of disability. Most retirement provision vehicles enable cheaper group death and disability cover due to the minimised risk of anti-selection. This is likely when these benefits are provided on an individual basis where individuals with impaired health would choose to get cover while those who are healthy don't.

However, even though retirement vehicles enable provision at old age, death and disability pose different challenges to those specific to retirement and therefore warrant separate and targeted provision, making use of the advantages that these vehicles provide. It is important to supplement these benefits if they are provided for at a group level or to get individual cover in the absence of group cover. The need to provide for death has given rise to the popularity of funeral cover, which has become for many South Africans the mainstay and in many cases the only death benefit cover.

The popularity of funeral cover is driven largely by its apparent affordability and the clearly specified and predetermined amount of benefit which makes it easy to understand. Unfortunately funeral cover has limitations in terms of the maximum cover that can be sold and bought, although many variations such as

enjoying the use of cars, purchase of tombstones, catering or income for a limited period, etc are currently in vogue.

The demand for funeral cover indicates that it is able to meet the immediate requirements of the costs of death associated with the funeral for many policyholders and their families. It is therefore a benefit whose accessibility and coverage must be increased. However, the hardship caused by death is not limited to funeral costs.

The effects of the loss of income become acute after the funeral as those left behind struggle to meet daily living expenses. This necessitates a death benefit that is both substantial and less restricted in application and use. This is the domain of life insurance.

Benefits for dependants after death

For life insurance to receive the same attention as a vehicle for death benefit provision, it needs to have similar characteristics as the current popular funeral cover—affordability and a clearly specified and predetermined amount. These characteristics are fortunately not unique to funeral cover.

Term life insurance is characterised by relatively affordable premiums, and a clearly specified and predetermined death benefit amount and a choice of the term or length of time that coverage is sought, compared to the more readily available whole and universal life cover.

For working age people below age 50 and in good health, the premiums for term life insurance should be very cheap and may compare well with those for funeral cover. Term life insurance

provides protection only in the event of death. For policyholders of life insurance, term life cover may not be attractive because the benefit is payable only if death occurs within the chosen term.

As such a policyholder of a term life insurance policy may pay premiums for five or thirty years and get no benefit even if death occurs a day after the term expires, while with a funeral policy a benefit is payable on death for as long as a premium is paid. Term life cover is therefore less popular than it should be. Insurers do not market such policies aggressively because they are less lucrative for sales staff due to low commission and minimal accumulated assets from which favourable fees and investment returns are earned.

This has given rise to the readily and more touted whole and universal life insurance policies, which provide for both life insurance and investment. Unfortunately, whole and universal life insurance policies are unaffordable to ordinary low income South Africans. At an average monthly salary of R1 600, an average earner cannot afford a policy that cost anything above R100, with premiums of R50 a month being realistically more affordable.

Furthermore, whole and universal life insurance policies have been shown not to necessarily be the best investment vehicles. However, they can still provide notable estate planning opportunities for the well-to-do. Wealthy people can use whole life in their estate planning by setting up an insurance trust that will pay their estate taxes from the proceeds of the policy.

The growing number of orphans call for people to take greater personal responsibility for their dependents and in particular orphans and widows and not to expect the state, which is already stretched to the limit regarding its social grants commitments, to provide anything beyond the basics. The current purchase of funeral cover must be accompanied by the purchase of life insurance cover.

Group cover, when it is available, must be used in the first instance as it is cheaper. However, the link of group life

to employment means that it cannot be taken with when an employee changes or loses employment and this necessitates the buying of individual life insurance at higher premiums. Lack of life cover can have devastating effects on widows and orphans depriving them of food, education, health care, shelter and other needs.

Income is your greatest asset — protect it

The provision of disability benefits is a more difficult proposition due to the difficulties of definition and diagnoses to determine whether a person qualifies for a benefit or not, how much and how long the benefit is payable.

Being disabled to do one thing does not necessarily result in being unable to do something else. However, being able to do something else does not necessarily mean that the disabled person will find gainful employment in another field at a comparable earnings level. These factors impact on the nature, size, extent and price of disability cover. The broader the definition of disability, or the bigger the size of the benefit and the more generous the payment terms in terms of when benefits start and end, the higher the price.

As is the case with death benefits, group cover, when it is available, must be used in the first instance as it is cheaper. However, the link of group disability cover to employment means that it cannot be taken with when an employee changes or loses employment and this necessitates the purchase of individual disability cover at higher premiums.

Nonetheless it is also an area that needs consideration over and above providing for retirement and death benefits. The extent of the need to provide for disability can be deduced from the number of current disability grant recipients.

The extent of disability in South Africa

According to the South African Social

Security Agency's (SASSA) statistics of 30 April 2011, 989 446 South Africans were recipients of the permanent disability grant, while an additional 210 985 were recipients of the temporary disability grant.

Although these are large numbers, they represent a small fraction of South Africans who are living with disabilities. It is estimated that about six percent (about three million people) of the total population of South Africa are people with disabilities. It is further estimated only one percent of people with disabilities are employed.

This shows that there are many South Africans who are not able to work and earn an income either due to a sickness or injury or birth deficiency or defect. Many disabled people are not employable and must be looked after by society. Many are within the ranks of the poor who are not able to get jobs and are therefore not able to earn an income.

There are, however, those who were employed and earned enough to look after themselves and their dependants but did not make the necessary provision. It is a sad fact that disability is the least provided for risk, although several income earners are likely to experience it at some stage in their working lives.

Thus, disability cover is probably the least purchased form of cover. Disability cover should be one of the most bought and provided for type of cover.

For those who are or were employed, disability could be in the form of incapacitating sickness, which may be temporary but still require periods of up to two years while a person recovers, or sickness or injury may be permanent resulting in a person not being able to work and earn an income for the rest of his life.

This inability to earn an income will affect individuals and their dependants, unlike death whose financial impact is borne largely by dependants. Without or with drastically reduced income, the sick or disabled often become indigent. The lack of income results in the inability to meet basic needs. It is often said

that a person's house or pension and related savings are their largest asset. In fact, the ability to earn an income is the greatest asset that a person has and needs to be enhanced and provided for and protected in the same way if not more than the way houses and their contents, vehicles and purchases are protected.

Without the ability to earn an income there cannot be saving of any kind — for retirement, for investment or to purchase goods or services. Only jobs can address this. The challenge is to make sure that those who currently earn an income protect this income against possible reduction or ending by disability by buying disability income cover.

Conclusion

The popularity of funeral cover can be extended to life insurance and disability benefits if these products can demonstrate the benefits of affordability and benefit transparency that funeral cover has without innovating or inventing new products.

It may just be a matter of going back to basics, communicating and selling the attributes of products that may have fallen out of favour due to lack of understanding by potential buyers and focus only, not unexpected, on the bottom line by providers.

The more those who can afford to are encouraged and enabled to provide for themselves, the more can be spent by government on people who genuinely need support.

This will help reduce high levels of poverty and inequality. Providers must revisit their product offering for death and disability cover.

There are basic products that can meet real needs and provide genuine value. Keep the benefit structure, pricing, terms and conditions simple to enable ordinary people to buy these very necessary products. As always a KISS offers better value.



Imperfect FAIS compliance – cause and effect

By Charene Nortier, manager: FAIS Supervision, FSB

The FSB’s FAIS Supervision Department started conducting onsite reviews at the offices of financial services providers (FSPs) in 2007. Since then more than 2 000 reviews have been conducted across the country.

Although there is an improvement in overall compliance, there are still some concerns. The major issues are discussed below.

Policies, procedures and risk management

Usually an onsite review is conducted by contacting the FSP to request certain documentation, either before, or for scrutiny during the visit. A noticeable result of this practice is that FSPs (and often their compliance officers) hurriedly develop the required documentation before the visit.

However, there appears to be a lack of understanding of the required processes and policies on the part of FSPs, or the staff of the FSPs do not have the necessary information to use in developing policies and procedures.

The importance to the FSB is whether

the FSP has applied his or her mind in developing policies and procedures that address a specific issue, and whether the FSP has ensured general understanding of and compliance with the content thereof. The FSB is not concerned with how a document looks. Of further importance is that the business and its management understand what needs to be done and the reason for doing it to ensure it is done consistently.

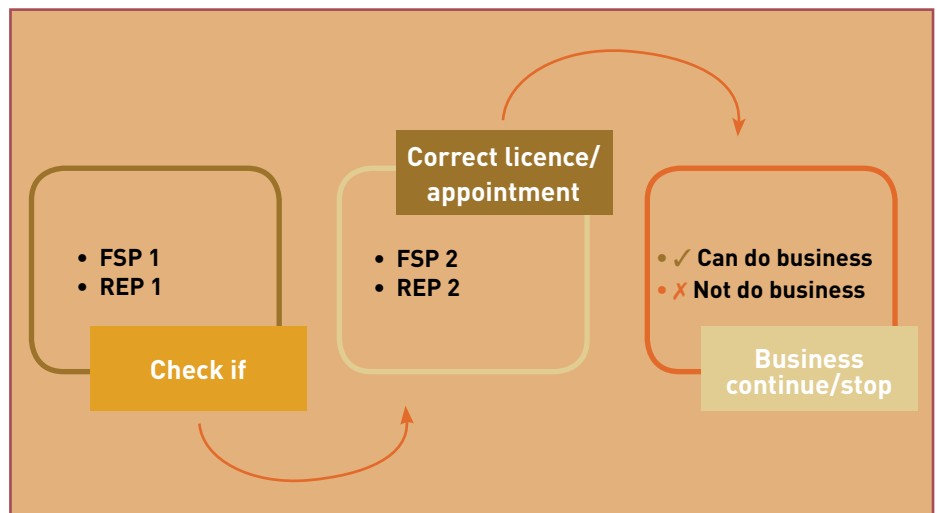
Doing business with other FSPs and representatives

(See graphic presentation below.)

Section 7(3) of the Financial Advisory

and Intermediary Services Act, 2002 (FAIS Act), requires that FSPs and their representatives only do business with a person rendering financial services if that person is licenced to do so and meets the relevant conditions, or is a representative that is properly appointed and meets the conditions.

FSPs tend to check at FSP level, but they don’t drill down to representative level. It is quite possible for the FSP to be correctly licenced, but that a specific representative within that FSP is not appointed for the relevant financial product category or subcategory. If the FSP accepts business from that representative in respect of a financial



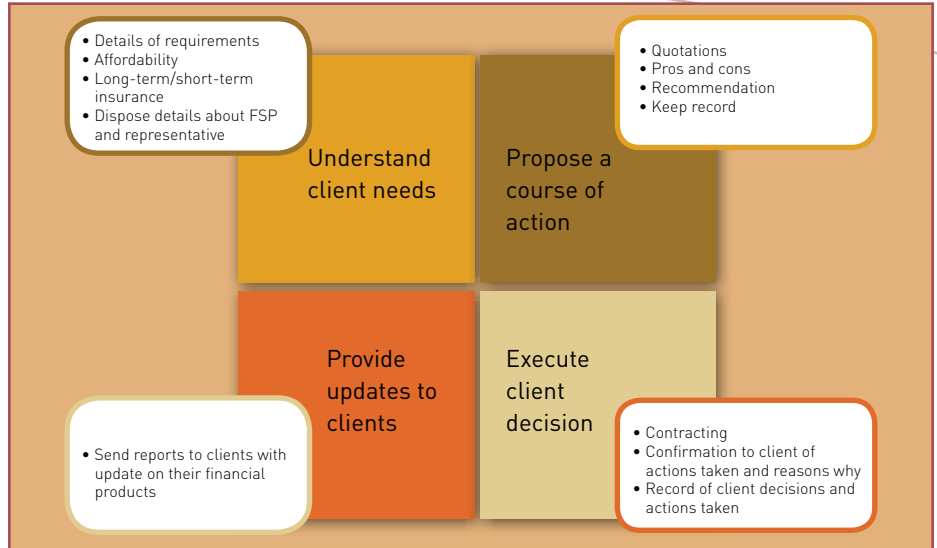
category or subcategory for which the representative is not authorised, it would be a contravention of section 7(3) of the FAIS Act. As a result the FSP could be referred to the Enforcement Committee of the FSB.

Key individuals

Although FSPs are not directly required to appoint more than one key individual, there is a compelling reason to consider appointing additional key individuals. An authorised FSP is not allowed to function if the key individual is unable to perform.

This means that if the key individual is unable to perform management and oversight duties due to illness, absence from work, death or resignation, the FSP must cease to perform the financial services until the Registrar has approved another key individual. The FSP must immediately notify the FSB if such an event occurs, and must stop functioning until the replacement key individual is approved. As this can be quite a lengthy process, it makes business sense to appoint more than one key individual, thereby ensuring business continuity.

It is also important to note that there is a specific obligation imposed on key individuals in terms of operational ability, to ensure that they are able to manage and oversee the rendering of financial services by the representatives



of the FSP. Of concern is the fact that there is a wide geographic dispersion of representatives in some companies or even just a large number of representatives and very few key individuals.

This would mean that the key individuals are unable to execute their operational management requirements and oversight regarding representatives.

Needs analysis, disclosures, feedback

The issue of needs analysis and disclosures to clients remains an area that requires clarification for FSPs and representatives. The diagram above illustrates the process that should be followed when doing a needs analysis,

making disclosures and providing feedback to clients.

FSPs and representatives often do not keep enough record of their disclosures and discussions with clients. The needs analysis should include issues such as suitability and affordability and should not include a financial needs analysis. Furthermore, the General Code of Conduct, 2003, requires the FSP to report to clients about products. FSPs should not rely on suppliers to provide clients with updates.

Submitting reports to the Registrar

FSPs are required to send two types

Continued on p 8



Bert Chanetsa appointed to ABA committee

Bert Chanetsa, deputy executive officer of Investment Institutions at the FSB, was appointed vice-chairperson of the International Securities and Capital Markets Committee of the American Bar Association Section of International Law. His term will run from 10 August 2011 to 9 August 2012.

Chanetsa, a South African attorney, has been a member of the American Bar Association since 1982, the same year he was admitted as an attorney-and-counselor in the State of Illinois, USA.

The American Bar Association (ABA) Section of International Law with more than 20 000 members in 90 countries is leading policy development in the international arena, the promotion of the rule of law, and the education of



Bert Chanetsa

international law practitioners. It focuses on the full range of international legal issues and is involved in a wide variety of substantive legal activities.

The Section has numerous task forces and has more than 60 regional and special interest committees within twelve divisions.

They are Africa/Eurasia, Americas/

Middle East, Business Regulation, Constituent, Corporate, Disputes, Finance, Industries, Legal Practice, Public International Law, International Treaties, and Tax, Estates and Individuals. They closely monitor and disseminate information on domestic and international policy developments with implications for law practice.

With more than 413 000 members, the ABA is the largest voluntary professional membership organisation in the world.

As national voice of the legal profession, the ABA works to improve the administration of justice, promotes programmes that assist lawyers and judges in their work, accredits law schools, provides continuing legal education, and works to build public understanding around the world of the importance of the rule of law.

**Source:
FSB Media Release,
26 May 2011**

FAIS compliance... from p 7

of reports to the FSB annually, namely compliance reports and financial statements. It is concerning to note that many FSPs don't do this. The simplest way is to access the online system and capture the reports via the FSB website (www.fsb.co.za).

The alternative is to send hard copies of the reports. It is the responsibility of the FSP to ensure that the documents are sent on time and that they are received by the FSB. FSPs not sure about which documents to send, can contact the FSB call centre for assistance at 0800 110 443 or 0800 202 087.

Appointing representatives

FSPs must ensure that representatives meet the Fit and Proper Requirements.

Representatives need to be adequately supervised. The reasons for services under supervision:

- It allows entry into the industry
- It allows and requires that FSPs develop the skills and competencies they would like to see in the people representing their interests.

Where a representative is found to act dishonestly or fraudulently, FSPs are required to take the necessary action, which includes debarment. FSPs should have processes in place to ensure that this can be done and is reported to the FSB.

Many FSPs do not have such processes in place. As this is an area that also involves labour laws and practices, it is critical that FSPs have HR processes and policies in place that explain the effect of such action, also in terms of labour laws and practices.

Conclusion

The above issues offer an overview of some of the problems regularly encountered by the FSB with respect to compliance.

You are encouraged to contact the FSB's FAIS Supervision Department for assistance on queries or specific concerns.

FSB hosts IOSCO conference

By Norman Müller: head of Capital Markets, FSB

The FSB successfully hosted the prestigious 36th annual conference of the International Organisation of Securities Commissions (IOSCO) at the Cape Town International Convention Centre from 17 to 21 April 2011. This is the first time that this event was hosted in South Africa and only the second time in Africa.

South Africa, through the FSB, has been a full member of IOSCO for the past 18 years and a signatory to the IOSCO Multilateral Memorandum of Understanding. During this period the FSB has relentlessly dedicated its resources to active participation in the activities and strategic decision-making structures of IOSCO. The FSB's membership of the most relevant and influential committees and task forces of IOSCO, including its Executive Committee (recently re-elected) and the Emerging Markets Subcommittee are testimony to the recognition and status it enjoys amongst its peers within IOSCO. The FSB, and certainly South Africa, take pride in their association with this highly acclaimed organisation.

IOSCO was established in 1983 and is now the world's most important international cooperative forum for securities regulatory agencies, boasting a membership of 181 and it is still

growing rapidly. The Organisation's members regulate more than 90% of the world's securities markets. IOSCO is the recognised standard setter in the area of securities and capital markets regulation and actively participates in the deliberations of the G20 and the Financial Stability Board.

Cooperation and transfer of expertise, in particular between developed and emerging markets, are at the heart of its mission. The member agencies, which include exchanges and market regulatory industry groups, have resolved through its structures to —

- cooperate to promote high standards of regulation in order to maintain just, efficient and sound markets;
- exchange information on their respective experiences in order to promote the development of domestic markets;
- unite their efforts to establish standards and an effective surveillance of international securities transactions; and
- provide mutual assistance to promote the integrity of the markets by a rigorous application of the standards and by effective enforcement against offences.

IOSCO members meet every year at the annual conference to discuss important issues related to world securities and futures markets. The conference was structured to provide closed meetings over the first three days and panel discussions and topical issues the last two days. The following topics were introduced by moderators and discussed

by a number of high profile panelists during the open panel discussions:

- The development of local debt markets: Challenges and interventions required
- The role of securities regulators with respect to systemic risk
- A new world order for corporate governance? Issues and recent international governance trends
- Consumer education: A national necessity or an unnecessary irritation.

South Africa's Deputy Minister of Finance, Nhlanhla Musa Nene, opened the conference and the Minister of Finance, Pravin Gordhan, addressed delegates at the gala dinner. The following keynote speakers made opening remarks and introduced the above topics:

- Prof Jeffrey Golden, visiting professor of the Law Department at the London School of Economics and Political Science – "Systemic risk and the future of financial regulation: The role of the courts."
- Roy Andersen, former executive president of the Johannesburg Stock Exchange – "Regulation: A business perspective."

More than 650 delegates from securities regulators and experts in the financial industry from around the world attended the conference.

The next IOSCO annual conference will be held in Beijing, People's Republic of China from 13 to 17 May 2012.

Greg Tanzer, Jane Diplock, Bert Chanetsa, Hans Hoogervorst, Dube Tshidi and the Deputy Minister of Finance, Nhlanhla Musa Nene at the conference.



The Minister of Finance, Pravin Gordhan (centre), was the guest speaker at the gala dinner. Here he is with FSB board members and delegates who attended the conference.



Feedback from the SAM Capital Requirements Task Group

By David Park, chairperson of the SAM Capital Requirements Task Group*

Solvency Assessment and Management (SAM) is a new risk-based regulatory requirement for insurance and reinsurance organisations operating in South Africa. The scheduled implementation date is 1 January 2014.

SAM deals with quantitative and qualitative aspects of statutory solvency and risk management and includes incentives for companies to better measure and manage their risk profile. One can achieve this through the use of a risk-based statutory capital requirement, combined with a market consistent balance sheet. The risk strategy, which companies set and the business decisions they make, will directly impact on their statutory solvency capital requirement (SCR).

In addition to the SCR, there will be a lower level of absolute minimum capital, called the Minimum Capital Requirement (MCR). Between the SCR and the MCR companies may be subject to regulatory intervention. SAM is expected to be largely based on Solvency II, the equivalent European insurance regulatory regime with a proposed commencement date of 1 January 2014.

Choice of models

Companies have several choices when calculating their SCR. The default choice is the Standard Formula – a pre-defined methodology covering the typical risks faced by companies. If the Standard Formula seems inappropriate for their business, companies have the option to –

- recalibrate certain assumptions in the Standard Formula (only for certain non-life underwriting risks and subject to regulatory approval); or
- develop a customised (or internal) capital model. This model needs to be approved by the FSB. It can either cover all their risks (a full internal model), or only material risks, with the less material risks covered using the Standard Formula (a partial internal model).

Although developing an internal model may result in capital savings and potential business benefits, these benefits need to be weighed up against the costs of developing and maintaining the model, as well as the onerous requirements for gaining approval for statutory capital purposes.

The FSB has the power to impose a capital add-on based on their assessment of the underlying risk governance framework. There is a trend in South Africa that



companies develop customised capital models for business benefits, without planning to have these models approved for statutory purposes by the implementation date. This appears to be driven by the realisation of the cost implications of having an internal model approved. We therefore expect a large portion of the market to initially use the Standard Formula approach for regulatory capital.

Standard Formula

The Standard Formula is a linear factor-based approach, which covers all of the main risks considered for purposes of statutory solvency. These include market risk, underwriting risk, counterparty default risk and operational risk. Reputational risk and strategic risk are excluded. Although companies are required to consider and report on these risks qualitatively, they are not required to hold solvency capital against these risks.

Within each of the main risks are a variety of sub-risks. For example, market risk comprises equity risk, interest rate risk, currency risk, etc. The Standard Formula specifies a methodology to calculate the capital requirement for each sub-risk. This will involve either stressing the entire



statutory balance sheet for a pre-defined scenario and calculating the change in surplus assets, or applying pre-defined factors to different risk measures. Simplifications may be available if the risk is not material.

Allowance is made for correlation between these different risks. Not all of the risks will occur simultaneously and the resulting SCR is therefore smaller than the sum of the capital requirements for each individual risk.

Calibration process

The Standard Formula SCR (and each individual risk underlying the SCR) is calibrated to a 1-in-200 year scenario (99.5% confidence interval) occurring in the next twelve months.

While the SAM Standard Formula SCR will be based on Solvency II, there is still some work to be done to ensure that the overall methodology is appropriate for the South African environment, and that the factors are correctly calibrated to our conditions. A task group has been established to determine the Standard Formula SCR and MCR methodologies.

This group is made up of stakeholders across the insurance industry.

The calibration process will be done

through a combination of direct industry input (through membership of the task group), collecting and analysing industry data, relying on investigations done as part of the development of Solvency II, and through a series of quantitative impact studies (QIS).

The QIS process will be used to test the effect and relevance of different methodologies and to get feedback from the industry on the proposed methodologies. It also presents an opportunity for companies to get an idea of the potential capital requirements under SAM, as well as the process and system changes to meet SAM's quantitative requirements.

As the Standard Formula is calibrated to the industry as a whole, there may be aspects that are not entirely appropriate for certain companies. A balance needs to be found between keeping the formula simple and relatively quick to calculate, as well as incorporating all the features of all the different companies.

Challenges for insurers

Based on our experience with local and international insurers, the main challenges for capital requirements under SAM include:

- Changing and updating processes, data sources and systems needed to calculate the quantitative aspects of SAM, including the SCR. Even if companies decide to use the Standard Formula SCR, there may still be significant changes required to their operating models. Identifying these changes early on in the process reduces the risk of undergoing a costly change exercise in a short space of time.

This process is usually combined with existing initiatives such as data clean-up projects and internal reporting rationalisation exercises in order to avoid duplication and to reduce costs. The first South African QIS (SA QIS1), due to be completed in September 2011 is seen as a good opportunity to identify the changes needed to implement the Standard Formula.

- Deciding whether to adopt the Standard Formula, partial internal model or full internal model as the basis for statutory capital. Choosing an internal model (whether partial or full) over the Standard Formula

may have cost implications in terms of changes to processes, data and systems, especially when considering the short timelines until full SAM implementation. These need to be considered against the potential benefits including possibly lower regulatory capital, improved understanding and managing of risks and better management information around risk.

- Some companies may need additional capital funding to meet the SCR requirements. Identifying this as soon as possible will mean that companies can start investigating different options to meet these requirements, and select the one that best suits their business model.

- The Standard Formula is calibrated to the entire industry, so it may not be appropriate to all insurance companies. This is particularly a risk for niche insurers. Companies need to monitor the developments in the calibration process and, where possible, provide input in order to ensure a more representative final calibration. QIS exercises are important to identify potential areas of concern, allowing companies to focus their participation in the SAM Task Groups to the areas of greatest importance.

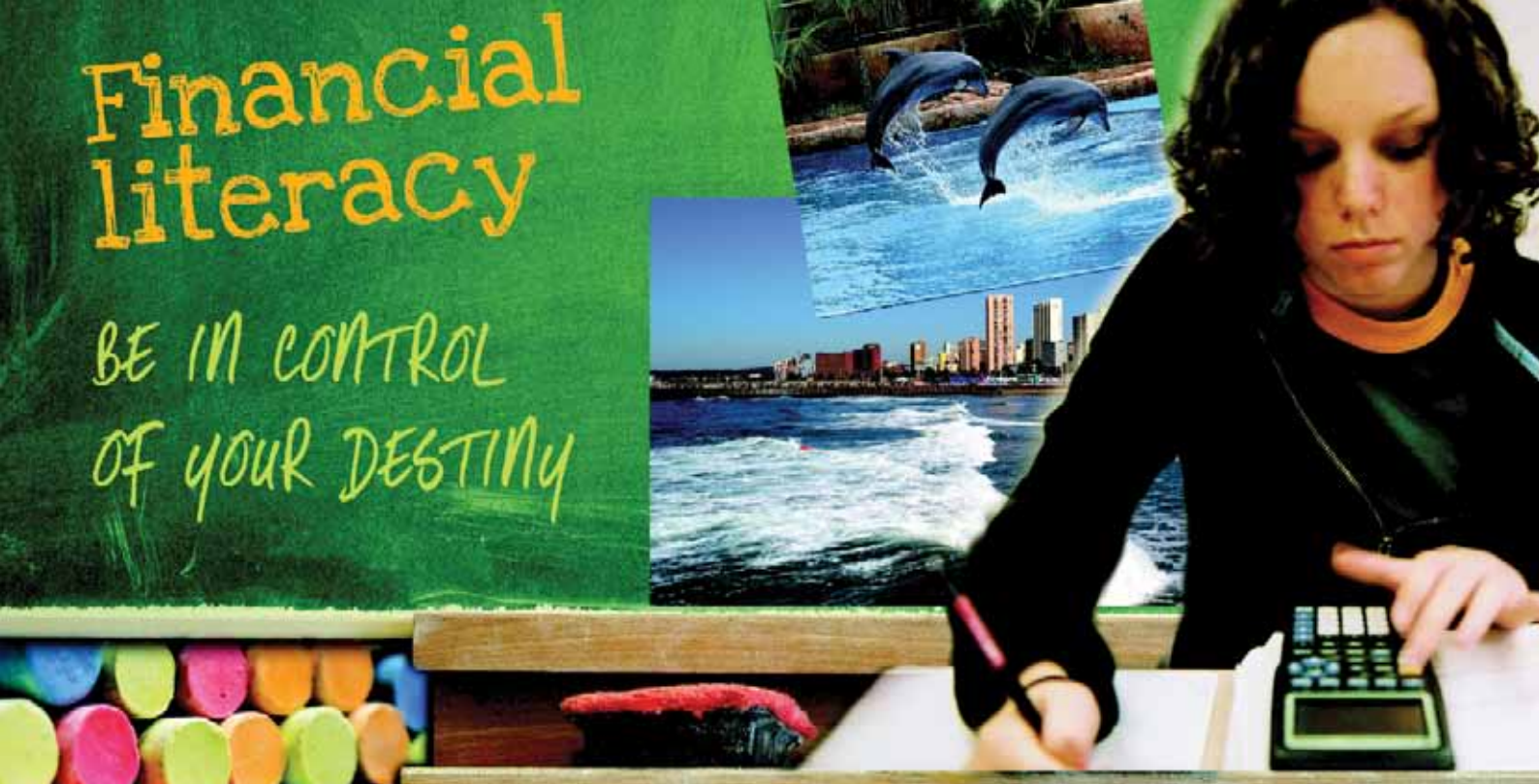
Conclusion

Although SAM is still in the process of being developed and finalised, the information coming from Solvency II gives a good indication of its likely direction. Development plans can be established with Solvency II compliance as a target, and then adjusted as clarity around the final SAM requirements emerge. The SAM QIS exercises are an important development tool that provide several benefits to participating companies. Firstly they will give an important indicator of the likely form of the balance sheet and Standard Formula capital requirements, and help identify areas where processes, systems and data may need to change under SAM. From a calibration point of view, the QIS exercises will help the Task Group identify specific areas to focus on, resulting in an appropriate industry-wide calibration.

**David Park is an actuary and a director at Deloitte.*

Financial literacy

BE IN CONTROL
OF YOUR DESTINY



Money does matter in KwaZulu-Natal

By Christi Naudé, KZN Financial Literacy Association co-ordinator

Money matters in KwaZulu-Natal and the way in which it is spent, matters even more. The newly established KwaZulu-Natal Financial Literacy Association is tasked with the responsibility of ensuring that the province becomes financially literate.

This initiative to help women, teachers, nurses, widows, children, young people, vulnerable groups and government employees to understand the world of money is the first of its kind in South Africa. We are setting the trend in a world where financial education issues are high on national agendas.

Need for financial literacy

Financial literacy and poverty

There is a positive relationship between illiteracy and unemployment rates, and therefore poverty levels.

Research has shown that people with low financial literacy are —

- more likely to have debt problems;
- less likely to participate in the stock market;

- less likely to choose mutual funds with lower fees;
- less likely to accumulate wealth and manage wealth effectively; and
- less likely to plan for retirement.

While the government and the private sector have initiated numerous programmes for the social and economic upliftment of people, these programmes cannot be successfully implemented if the population is financially illiterate.

Despite several financial literacy initiatives, KwaZulu-Natal and South Africa in general, remain by and large underserved by programmes offering financial education. Financial literacy in the province is based on several patterns:

- 3.8% of the adult population earns 39.4% of the total income;
- About 60% of households in KwaZulu-Natal earn less than R72 000 per year;
- 26% of the South African adult population is financially excluded;
- 72% of adults are not saving;
- More than 3.5 million people in KwaZulu-Natal receive income support grants from the government;
- The “unbanked” in South Africa put about R12bn “under mattresses” in 2009;
- A high debt to income ratio

- Substantial informal sector; and
- A high failure rate among small businesses.

Establishment of the association

As custodian of public funds, the KwaZulu-Natal Treasury, realises the effect of financial education on households, emerging entrepreneurs and young people. Finance MEC, Ina Cronjé, believes that sound financial management, whether on a personal or public level, makes the difference between opportunities missed and goals achieved.

“There is really not much of a difference between the provincial budget and a household budget. The golden principles underpinning all successful entities remain the same – whether you are big or small. However, if nobody tells you about them, what are your chances of success? Knowledge is after all a building block, and opinions, attitudes and behaviour emerge from what we know,” she explains.

“We can take a leaf from rapid growing economies like that of China, whose households are known to be the world’s best savers. It has to start with personal financial education,” she adds.

Therefore the MEC made it a priority to include financial education in outreach programmes. Since she assumed office as MEC for Finance in May 2009, the Provincial Treasury has organised a number of financial literacy information sharing opportunities. Events included visits to schools, as well

as mass community programmes for vulnerable women (widows, the disabled and pensioners) and impoverished communities.

However, as the demand for these programmes grew, it became clear that the Provincial Treasury was only scratching the surface of the need for basic financial education. A way had to be found to enhance the effect of interventions in order to reach more people and change attitudes and behaviour. This gave birth to the KwaZulu-Natal Financial Literacy Association. With this initiative the Office of the MEC would be taking a more active and leading role in financial education by providing leadership and support, and co-ordinating efforts with a network of partners.

On 10 December 2010 the Office of the MEC for Finance organised a *Briefing to Potential Partners* where the MEC shared the Provincial Treasury's vision of a financially literate province with potential partners. The potential partners, comprising financial institutions, accounting firms, academic institutions, regulatory bodies, business chambers, NGOs and sister government departments, requested a follow-up workshop.

The MEC's vision included the establishment of a provincial steering committee. At a workshop held on 25 January 2011, an advisory body, the KwaZulu-Natal Financial Literacy Association comprising all participants, was established to provide strategic direction and to coordinate operational and other implementation issues. To ensure that the work envisaged by the Association is executed, a steering committee, consisting of nine members, was elected on 18 February 2011.

Focus groups

It was decided to focus on five groups to enable members to develop programmes tailored to the needs of the specific groups. It will also allow members to put their effort, time and resources where

their passion lies. The five focus groups:

- In school youth
- Out of school youth
- Women and vulnerable groups
- SMMEs
- Government employees

All five target group sub committees (*In school youth, Out of school youth, Women and vulnerable groups, SMMEs and Government employees*) have launched their awareness campaigns in May and June 2011. The interest of partner organisations to join the Association as members is great.



The KZN Financial Literacy Association: From left are vice chairpersons Professor Krish Govender (UKZN), Olivia Davids (Financial Services Board) and chairperson Dr Peter Munns (South Coast Chamber of Commerce and Industry)

Three-year strategic plan

Every focus group will now submit a proposed three-year strategy to reach their respective target groups. These proposals will be scrutinised by the steering committee, who will then draft a three-year strategy for the entire province, comprising all five focus groups. Decisions will be taken on fundraising for new programmes and existing programmes.

Research, monitoring and evaluation

The Association has a Research, Monitoring and Evaluation Unit that is currently consolidating existing research, as well as developing a tool to evaluate the effect of each programme. The Unit will also establish a quality standard for programmes to ensure best practice.

Secretariat

All member organisations have their own project managers for their respective programmes. However, a coordinator, who also heads the secretariat, is based in the Office of the MEC. Four members of the secretariat assist her: the public relations and media manager, an administrative assistant (both based in the Office of the MEC), a treasurer, and a sponsorships and donations manager (both from partner organisations). MEC Cronjé, the champion of the association, states that "Working together in a co-ordinated way, government, business, the non-government and non-profit sectors will have a better effect than working in fragmented isolation, which often leads to some communities being over serviced, while others miss out."

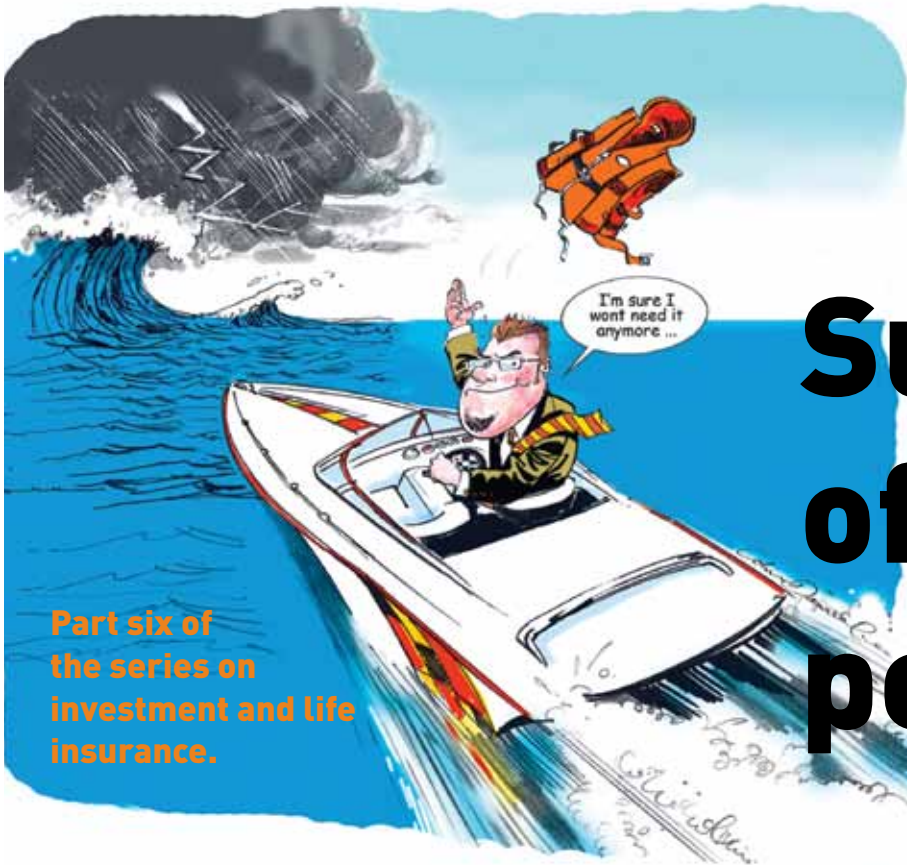
Working together will enable stakeholders to —

- follow best practice;
- use experts in the identified fields;
- get value for money;
- share the costs and have common messages;
- reach a wider audience;
- have greater success in changing attitudes and behaviour;
- contribute to economic growth and job creation; and
- have educated consumers who will take informed decisions.

Fifty entities have joined the Association to date as members. The members are from financial institutions, academic institutions, accounting firms, business chambers, NGOs, regulatory bodies and several government departments. We extend an invitation to other organisations to also join us.

Contact Christi Naudé for more information:

christi.naudel@kzntreasury.gov.za. Tel no: 033-8466985



Part six of the series on investment and life insurance.

Surrender of life policies

By Dr Franso van Zyl, chief counsel legislation, FSB

An intrinsic part of a life policy is the value that it builds up over time. This value can be accessed by way of a policy loan, a bank loan against the security of the policy, or surrender.

It is unfortunate that many people follow the last option because they lose the much greater value of life and/or health and disability protection.

Possible reasons for surrender:

- The policyholder's circumstances change and the policy is no longer necessary or affordable.
- The policyholder does not want the policy.
- The policyholder did not understand the policy and it was not suitable to the holder's needs.
- Acting on advice by unscrupulous intermediaries to cancel a policy by taking out a "better" option. Switching investments costs money and the policyholder may not gain while the intermediary gets commission.
- Insurers' pressure for sales performance exacerbates the conflict of interest of the intermediary and the client and aggravates the potential for early termination.

The main arguments for advising to

cancel a policy:

- Life insurance investments perform badly, especially if the policy is invested in a smoothed bonus-typed fund. This may not necessarily be the case as an insurance investment may or may not under-perform, depending on the ability of the financial institution managing your savings. This is even more the case where you and your adviser decide on the underlying investment and you are able to take control of the decisions.
- One can obtain life insurance against death or disability more cheaply. It is argued that remedy lies in cashing in the policy and taking new life cover.
- However, you may not be told:
 - The underlying costs of a new policy may be higher than those of the old one.
 - You will probably get a reduced investment value because of penalties for early withdrawals.
 - With a smoothed/stable bonus policy, you may lose guarantees on the capital as well as already vested bonuses.
 - The new investment may or may not perform better than the old one.
 - The risk insurance on your life may cost more or you may not obtain new cover due to being older or in bad health.
 - Risk insurance premiums against death or disability premiums may increase more rapidly in the future than it would have with the older policy.

There are currently codes and laws, which oblige insurers and intermediaries involved in replacing a policy to compare the features of both policies, especially investment options, and to show the costs so that a policyholder can understand the consequences of replacing the existing policy.

Surrender values in the first three years are relatively low as the first premiums are used to cover the high initial cost of the policy - including full commission, since the value of the policy will gradually increase.

It has been the practice to deduct the commission and the cost involved in issuing a policy up-front as the costs involved in drawing up a policy are incurred at the commencement of the policy terms.

This is probably aimed at deterring the early surrender of policies. If you are paying recurring premiums, it takes normally between 18 months and two years for the investment amount to exceed the cost.

When the investment value is greater than the outstanding amount, the policyholder will get some money back. However, some insurers may not only take back the outstanding amounts of the costs, but will withhold some additional money as a margin of profit.

The insurer can decide how much to give back as a surrender value. When a

policy is effected the applicant should request a written explanation with clear examples, which indicates the losses that will be suffered in case of early surrender.

Fortunately the practice of payment of commission up-front is something of the past as measures have been put in place at the initiative of the Registrar of Long-term Insurance and industry representative bodies.

Policyholders who are contemplating surrendering their policies should first consult the intermediary or insurer for alternative suggestions. Termination should be the very last option.

Your main objective should be to ensure that you do not have to lapse or surrender a policy. The policyholder may wish to consider the following options:

- **Make the policy paid-up:** The policyholder makes no further contributions, but leaves the accumulated capital invested. It remains static until he can continue his premiums. This means that a sum of money based on the amount paid up, is paid when the person dies, or on maturity in case of an endowment policy. This amount is obviously less than would be payable under the original policy. Since it ignores compound interest, it is also poor value for the policyholder.
- **Continuation of the policy:** If the holder wants the policy to continue, the insurer will usually agree that the holder needs not pay the required premiums. The premiums that would normally be paid are advanced as a debt against the policy's surrender value. If this goes on until there is no surrender value left, the policy will lapse. This means that the policyholder will lose all his money (premiums plus growth) once the outstanding costs exceed the money invested.

When the financial circumstances of the policyholder improve, the policyholder can either pay increased premiums until the full surrender value is realised or continue the agreed premium (or lower premium) and take a lower payment when the policy matures.

- **Negotiate an alteration:** If the

policyholder has a policy, which includes a risk and investment component, the holder negotiates with the insurer to reduce the investment portion of the premium while retaining the life cover portion. A second option may be to convert to another type of policy where life cover is retained while reducing the policy premium by no longer having an investment portion. A third option may be that where the policyholder has accumulated an investment portion, he uses this money to pay the premiums for the life cover.

- **"Selling" of a policy:** An option to consider is the possibility of "selling" a policy. This means that the policy is ceded to the buyer. The purchase price is the net surrender value as determined by the insurer. The seller is usually the life insured under the policy although since March 1993, no life cover is required under the contract. In case of a policy with life cover, the insured sum will go to the buyer when the seller dies.

Selling a policy

• Benefits for the seller

The benefit for the seller is that he or she may receive a premium of five to thirty percent above the surrender value.

Because most buyers and their advisers are aware of the benefits, they are usually happy to pay the premium. Care must be taken that the premium paid does not exceed the supposed cost-saving benefit.

• Benefits for the purchaser

Normally, a contribution to an investment policy would have to be made for five years or longer. By buying a "second hand" policy midway through this term or preferably an old ten-year investment policy, the full proceeds would be tax-free. Furthermore the buyer can continue to pay or escalate premiums, depending on the circumstances.

• Benefits for the intermediary

Based on the demand for a particular product, an intermediary would buy such a policy for purposes of on-selling it at a profit. Like shareholders or property dealers, any profits realised by such an intermediary are taxable as revenue. Alternatively and for a fee, the intermediary would introduce the seller to a willing buyer. This fee is taxable as revenue in the intermediary's hands.

• Insurable interest

Provided the seller applied for the policy for his own use, the buyer does not have to prove that he has an insurable interest in the life assured under the policy.

Tax implications

Any capital gained will be taxable in the hands of the buyer. There is almost a double tax on capital gains as the insurer is already paying the capital gains tax. The question is whether the proceeds received by the seller of the policy are taxable or not.

If a seller embarks on a scheme of profit-making by trading in policies, the proceeds would be considered revenue and thus taxable as gross income. The seller's intention at the time of investing in the policy must be ascertained. One factor indicating intention would be the length of time the seller held the investment policy (the longer it was held, the more likely he or she had a capital intention). Other factors include the method of financing the purchase or the nature of the asset.

At present there are no express legislative provisions in terms whereof the proceeds of an investment policy are always tax-free. This means general taxation principles would be relied on in order to reply to the above question. However, since the abolition of the Sixth Schedule and the acceptance of the

Continued on p 19



From left: Nick Kohler (Hollard), Hylton Kallner (Discovery Life), Dr Jonathan Broomberg (Discovery Health), Richard van Dijk (Sanlam), André de Waal (CIA), Ian Kirk (Santam), Alan Ehret (Stanlib) and Andrew Warren (Liberty)

Lining up for the FIA trophies

By Clive Franks, media and communications manager, FIA

The winners of the annual Financial Intermediaries Association of Southern Africa (FIA) Awards for 2011 were announced on Thursday 9 June 2011 at a gala ceremony held at the Sandton Convention Centre in Johannesburg.

According to Brian van Flymen, recently elected president of the FIA, the awards provide intermediaries with the opportunity to recognise the leading product suppliers in the financial services industry. "These

awards are an important tool with which the intermediary industry is able to recognise, and honour those providers in the industry who provide excellent service to clients via the intermediary channel."

Santam received top honours in two of the categories, winning short-term insurer of the year (commercial) and short-term insurer of the year (corporate) for the second consecutive time.

Short-term insurer of the year (personal lines) was awarded to Hollard, while Commercial and Industrial Acceptances (CIA) won the accolade of underwriting manager of the year.

Independent research company

Bluestream Research, was appointed to conduct a customer satisfaction survey among FIA's members with the three main criteria being assessments of product quality, service quality and relationship quality.

Van Flymen says the full results are given to all product providers to determine how well they scored against the winner as well as benchmarking themselves against the industry average in each category. "We hope that product providers use this information to assist them in recognising those areas in which they need to improve and those in which they need to improve and those in which they are performing well."

The 2011 FIA Award winners:

| 2011 AWARD CATEGORY | WINNER |
|--|------------------|
| Short-term Insurer of the Year – Personal Lines | HOLLARD |
| Short-term Insurer of the Year – Commercial Lines | SANTAM |
| Short-term Insurer of the Year – Corporate | SANTAM |
| Underwriting Manager of the Year | CIA |
| Long-term Insurer of the Year – Risk Product | LIBERTY |
| Investment Supplier of the Year - Retail Investments | STANLIB |
| Long-term Insurer of the Year – Recurring Savings | DISCOVERY LIFE |
| Employee Benefits Product Supplier of the Year | SANLAM |
| Health Care Product Supplier of the Year | DISCOVERY HEALTH |

FSB to host international conferences

The FSB will host the Organisation for Economic Co-operation and Development (OECD) and the International Organisation of Pension Supervisors (IOPS) Conferences in South Africa. Both conferences will take place at the Westin Hotel in Cape Town from 25 to 26 and 27 to 28 October 2011, respectively. This is the first time that these events will be held in South Africa.

South Africa's financial planning population seventh biggest in world

The need for competent financial planners is growing at a rate of six percent globally per year. This is based on the need for increased consumer protection, which comes as a result of the global financial crisis. In South Africa, the number of Certified Financial Planner® professionals (CFP® professionals) is more than 3 700, making it one of the largest financial planning hotspots in the world.

This was the message of financial planning professional, Karen Schaeffer, at the Financial Planning Institute's convention, held in Johannesburg earlier this year.

"The economic downturn was a wake-up call for consumers. Studies have shown that those who worked with a financial planner are more confident about their strategies, which is reflected in the growing numbers of CFP professionals around the world. At the end of 2010, there were nearly 134 000 certified financial planners worldwide. We are seeing tremendous growth, as high as 52 percent, in countries such

as China, Brazil, India and Indonesia. In terms of overall numbers, South Africa now has the seventh largest population of CFP professionals," Schaeffer said.

Schaeffer is a top international financial planner and chairperson of the Council of the international parent body, the Financial Planning Standards Board (FPSB). She was keynote speaker at this year's FPI convention and spoke about FPSB's efforts to establish financial planning as a distinct profession, similar to medicine and law.

Some of the global trends currently impacting the financial planning profession include the move towards a relationship-based approach between financial planners and their clients, with holistic service offerings, and regulatory change.

"As the global financial crisis highlighted the need for increased protection for consumers, regulators, including the FSB, are looking for ways to increase transparency, disclosure and improve the duty of care given to consumers. Regulators want greater consistency for best practices, which has opened dialogue about consumer

protection, governance, transparency, and professionalism around the world," she said.

Highlights at the convention was the first FPI Induction Ceremony for new members and the gala dinner where members active in promoting the financial planning profession were recognised and awarded.

The recipient of the Financial Planner of the Year award was Warren Ingram, executive director at Galileo Capital.

Wessel Oosthuizen who is currently the director of the University of the Free State's Centre for Financial Planning Law in the Faculty of Law, received the Chairman's Award for lifelong outstanding contributions to the financial planning profession.

Nico van Gijzen, managing director of Finlac, was awarded the first FPI Media Award. This award recognises an FPI member who is actively involved with, and has made significant contributions to the media in the year being assessed, to promote financial planning amongst consumers, the financial planning profession or the FPI and its marks.

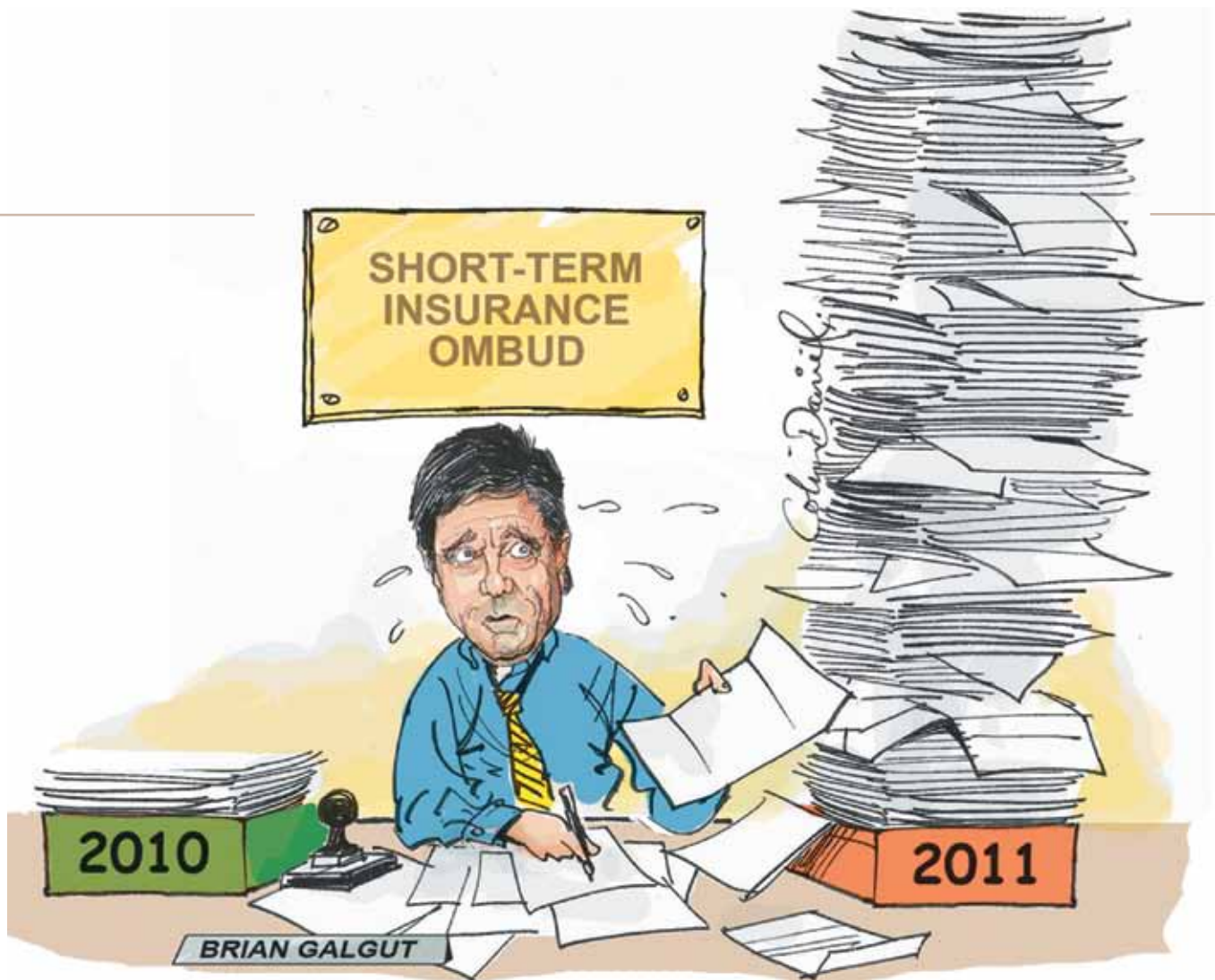
Source: FPI media release, 4 June 2011

The Financial Planner of the Year Award went to Warren Ingram (middle), with runners-up Jan-Carel Botha (left) and Shaun Latter (right)



The Chairman's Award for lifelong outstanding contributions to the financial planning profession was awarded to Wessel Oosthuizen (left). Right is FPI Chairperson, Gerhardt Meyer





Record number of complaints for Ombudsman for Long-term Insurance

The Ombudsman for Long-term Insurance, Judge Brian Galgut, says in the Ombud's 2010 annual report that was tabled earlier this year, that complaints received by the office totaled 9 236 last year, an increase of 2% from the previous year.

This is a new record for the office. There was an increase in all complaint categories. In total 2 204 complaints were referred to insurers to deal with,

as the complainant had not given the insurers concerned sufficient opportunity to deal with them in accordance with the insurers' complaints processes.

These complaints were sent as "mini" cases, or as transfers to internal arbitrators. In all, 4 115 complaints translated into full cases requiring full investigation by the office.

Most of the complaints received by the office (66%) are sent by fax. The greatest number of complainants (28%) live in Gauteng, with Kwa-Zulu Natal second at 21%.

The office finalised 4 124 cases in 2010. "We try to finalise at least as many full cases as we receive. In this way we keep the work in balance. We did, however, close fewer cases than in 2009, but the 2009 figures were inflated because we had finally closed 500 'cost cases' from previous years," Galgut says.

Cases about funeral policies continue to increase and this type of policy constituted 36% of cases finalised by the office.

"Our turn-around time were comparable to 2009, and 79% of cases

were closed within six months. We recovered R103 484 956 for complainants in the form of lump sum amounts.

"This does not include other forms of relief such as income benefits or resolutions not sounding in money e.g. reinstatements.

"We recovered some R21 million in one case the largest amount recovered in respect of one complaint by our office to date.

"We resolved 46,5% of cases, either wholly or partially in favour of complainants, which was higher than in previous years. This increase can be attributed mainly to the increase in

the W/P figure from 43% to 47% in cases where claims were declined. Because this category constitutes 53% of cases, this increase had a significant impact on the overall W/P figure. Furthermore the W/P figure for funeral policies went from 44% in 2009 to 49% in 2010. The high W/P figure would suggest that some insurers still decline claims too readily," Galgut says.

The office also experienced an increase in the complexity of cases. In total 15% of the cases that were closed were categorised as "complicated" as compared to 10% in previous years.

"As of 2011 we have in fact added

a further category of cases, the 'complicated plus' category. These are cases that take a lot of time and effort by adjudicating staff to resolve. The 'complicated' cases are charged at double the rate of a 'standard' case and the 'complicated plus' category will be charged at triple the 'standard' rate. The 'standard' charge rate for 2010 was R2 000 per case. This change in the charging structure is an attempt to spread the cost of the office more fairly amongst insurers," Galgut says.

Policies.. from p15

"trustee principle", it would seem inequitable that tax be levied a second time on the same policy, as this would lead to double taxation.

The onus of proof rests for purposes of the Income Tax Act, 1962, on the seller who must prove that he did not embark on a scheme of profit-making.

Furthermore, in terms of section 74 of the Income Tax Act the insurer may

be called upon to produce documents and evidence pertaining to a taxpayer concerning the transaction.

A further practical consequence is that the seller is required to disclose in his income tax return that he has ceded a policy.

Conclusion

There are certainly pecuniary benefits

for all parties concerned. Before the purchase or sale or before providing such advice, especially if inexperienced in this field, it is important to ascertain whether the insurer is able to effect the contemplated changes.

Furthermore, the various legal issues need to be carefully considered before all can truly benefit.



Want to receive the FSB Bulletin?

If you are not already subscribed to the FSB Bulletin or if your details have changed, please complete this form.

New subscriber

Change of detail

Subscriber name: Company:

Postal address:

E-mail address: Telephone no:

Fax no: Date:

Please fax this form to:

- The Editor, FSB Bulletin, Financial Services Board, PO Box 35655, Menlo Park 0102. Fax no: (012) 346 4861 **OR**
- E-mail your details to: Pakama.Miya@fsb.co.za **OR**
- Subscribe online at www.fsb.co.za

Enquiries:

For enquiries please phone (012) 422 2828



FSB Bulletin *second quarter 2011*

