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Spotlight on FAIS

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‘Full client needs analysis’ a misnomer under FAIS

Problems have been identified regarding the use by financial services providers or their representatives of the expression “full client needs analysis” with reference to advice furnished to clients.

By Dr. Franso van Zyl, Chief Counsel Legislation (FSB)

This expression is often used as if it represents something expressly provided for in the Financial Advisory and Intermediary Services Act, 2002 (FAIS Act) or in the General Code of Conduct promulgated thereunder (Board Notice 80 of 8 August 2003), and as if it denotes a very important and wide-ranging activity to be conducted by the provider in the course of furnishing advice on FAIS financial products appropriate for a client. A consequential view attached to such usage is that such client has a “right” that such duty be so performed, which, in terms of section 21 of that General Code, cannot be waived. However, neither the expression “full needs analysis” nor the expression “needs analysis” appears in any provision of the FAIS Act or the General Code.

Suitability

As regards factors to be considered for purposes of rendering financial services, section 16 of the FAIS Act (which empowers the drafting of codes of conduct) only mentions in subsection (1)(c) “appropriate and available information”, to be sought from clients regarding their “financial situations, financial product experience and objectives…”.

The General Code, in Part VII, which (according to its heading) deals with “suitability” in connection with the furnishing of advice, then elaborates on these fundamental concepts with reference to differently worded factors, which can all be brought within the ambit of the meanings of the expressions appearing in section 16(1)(c) of the Act: *“the client’s financial situation, financial product experience and objectives”* (section 8(1)(a)), *“the client’s risk profile and financial needs”* (section 8(1)(c)), *“the client’s objectives, financial situation and particular needs”* (section 8(4)(a)(iii)), and *“any risk to the client”* and *“appropriate to the client’s needs, objectives and circumstances”* (section 8(4)(b)).

Of all the provisions which such factors are dealt with, the first two important provisions are those appearing in paragraphs (a) and (c) of section 8(1) of the General Code. Of these two, paragraph (c) literally seems intended to be the final provision to be implemented before reaching finality on advice in respect of a particular client.

It seems to provide that, at that stage, particular attention must be paid to the factors of “risk profile” and “financial needs”, with a clear proviso that limitations contained in the relevant “contractual arrangement” between the client and the provider must be heeded. As this arrangement will inevitably have to deal with the financial products or categories in which the client is particularly interested, these provisions clearly indicate that the provider must *from the start* focus exclusively thereon, and not on other financial products.

However, in the preceding paragraph (a) of section 8(1) the “objectives” of the client are also mentioned as a factor relevant to “appropriate” advice. If for example the provider’s advice regarding an appropriate financial product for the client

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Misnomer *from p 3*

represents an investment or purchase perfectly in harmony with the client's "risk profile" and "financial needs", but having no bearing on the client's previously ascertained "objectives", can it then be said that the relevant advice would be "appropriate"? If these provisions are read together, the answer must be no, in other words the initial intended advice would have to be reconsidered.

Such an intra-textual interpretation method, i.e. reading such sections together with the possible result that the one is limited by the other, has been expressly approved and applied by the FAIS Ombud in his determination of 29 September 2005 in the matter between *G and J le Vatte vs RS Spendley and Rosspen Financial Services CC* (pages 8 sqq), as being in accordance with our law on statutory interpretation.

In the result, the analysis required by section 8(1)(b) of the Code simply has to take into consideration information obtained on all relevant factors referred to above, which must all be read together for purposes of coming to a conclusion on what specific advice would finally be appropriate or suitable to the client, bearing in mind the financial products mentioned or referred to in the initial contractual arrangements with the client.

For purposes of these comments it is not necessary to elaborate and deal in detail with all those relevant factors, their interrelationship, and so on. What is of importance is to state that "needs" are clearly only one type of factor to be so considered. A particular distinguishing feature of the word "needs" is that it essentially has the dictionary meaning of something that is "lacking", or which must bring about a "relief" from some or other want, or which is "urgent" or "a necessity" (see *New Webster's Dictionary s.v. "need"*).

With respect to duties to be performed by the provider when dealing with a client seeking advice, the first important duty is set out in section 8(1)(a) which is to obtain the required information from the client for purposes of carrying out the other duties set out thereafter, in the course of which the above-mentioned various factors have to be taken into consideration. It must be noted again that the heading of section 8 is "suitability", which indicates the ultimate purport of the provisions of that section.

The first of these duties is set out in paragraph (b) of section 8(1), namely: "(A provider…..must….) (b) *conduct an analysis, for purposes of advice, based on the information obtained;…."*. The paragraph does not literally mention only a *"needs"* analysis, or set out the intended scope of the required *"analysis"* and its required details or elements. But the matters to be attended to in any such analysis become particularly apparent when one considers the various other duties and obligations set out in the succeeding paragraphs of subsection (1). Clearly, these provisions also do not support an inference that the "analysis" must only be focused on the determination of "needs" to be satisfied by the required advice.

For instance, the analysis must, for purposes of paragraph (d) of section 8(1), determine whether the client wishes to use the relevant financial product as a "replacement product". This may certainly be interpreted as being (literally) a "need" of the client to be satisfied. However, one can with equal justification conclude, in neutral terms, that such purpose merely represents an "objective" of the client referred to in section 8(1)(a).

In fact, if a generic description of the essence of an "analysis" contemplated in paragraph (b) of section 8(1) must be framed, the expression "client objectives analysis" or, more preferably, the expression "suitability analysis" would be much more appropriate, especially if that section is interpreted in the context of the other provisions of the section.

The problems referred to above in connection with the word "needs", are exacerbated by adding the word "full", which is not used in section 8(1)(b). The use of this additional word can be based only on an interpretation that an indication of an intention that the analysis required by that section must always be "full" is to be found in section 8(4)(a)(i). The General Code in this section deals with cases where want of sufficient information or other circumstances stated therein have prevented an analysis from being undertaken, or have caused only an incomplete analysis to have been undertaken. The wording used in the said subparagraph (i) attempts to describe this resultant situation by providing that the client must be informed that "(i) *a full analysis in respect of the client referred to in subsection (1)(b) could not be undertaken;..*". As the latter subsection does not specifically refer to a client, the wording *"referred to"* is susceptible to an interpretation that it can only refer to the "analysis" itself.

Legislative intention

The problematic interpretations dealt with in the above comments take one of two forms, namely that the inference can be made based on what is stated in section 8(4)(a)(i) that the legislative intention of the analysis required by section 8(1)(b) is-

(a) that such analysis (of the information supplied by the client) must always be "full" in the sense that it must deal with *all the factors* relevant to such an analysis and referred to above, and must be regarded as incomplete if information required therefore could, either partially or wholly, not be obtained from the client. In the result, the making of such an incomplete analysis would then be non-compliant with that section, and it is this eventual non-compliance that has to be communicated to the client. A necessary corollary of this interpretation as regards factors to be considered is that the required analysis cannot focus only on "needs", and must furthermore relate to those financial products or types or categories of products in which the client is interested and which are referred to in or appear from the information provided by the client to the adviser; or

(b) that such analysis must always be "full" also in respect of the client, in the sense that, the client being a person interested in investing in, or purchasing, one or more FAIS financial products, the analysis must also cover all investment or purchase possibilities as regards all other financial products. This interpretation can be strengthened if section 8(1)(b) is interpreted as dealing only with "needs", as a "need" to acquire one or two specific financial products may be of such a nature that it can only be properly satisfied by also considering investing in or purchasing of other additional or supplementing financial products not previously considered by the client, or the "need" can be of such nature that it can only be satisfied by investing in or purchasing totally different products not previously considered by the client.

The view is held that the type of interpretation referred to in paragraph (b) above has no rational or legally defensible basis with reference to the exact wording used in the sections of the General Code on which it is based, and the clear underlying legislative intention of that wording, especially if the wording is interpreted in the context of the other legal provisions referred to above, in which it appears. This *interpretation also in effect assumes that the FAIS Act envisages that a provider, whenever it has contracted with a client, has some or other public duty always to consider the totality of the particular client's position regarding financial and investment matters, in the context of virtually all FAIS financial products, even if that client clearly, based on the information fur-*

nishes to the broker, is interested in only one or more specific financial products.

The only reference in the Act or in the General Code to what may reasonably be regarded as such a type of "public responsibility" attaching to providers, is that set out in section 8(4)(b) of the Code (client elects not to follow the advice of the provider). But the additional powers granted by this section do not permit the adviser to influence or intimidate or force clients, either before or after conclusion of the required preliminary contractual relationship between the parties (section 3(1)(d) of the General Code), to submit in all cases to the wide type of analysis envisaged in paragraph (b) above, and then also eventually to pay fees in return for such services.

Also, in cases where a client is uncertain from the outset as to what financial product to invest in or purchase, the purpose of the required analysis cannot be for the provider to deal with most or all of the FAIS financial products, but can be only to focus on those specific products on which the client apparently seeks advice on the basis of all the information furnished by the latter.

In fact, in many recent determinations by the FAIS Ombud complaints have been upheld where, on the proven facts, the provider from the very beginning only intended to advise on specific financial products which, in the provider's own view, were suitable for the client, and actually paid scant attention to the views of the complainant (client), as is evident from the information supplied by the latter, on what financial product or products the latter intended to purchase or to invest in.

The interpretation referred to in paragraph (a) above, seems therefore to be more correct and in line with a much more defensible reading of the relevant sections of the General Code and the immediate context in which they appear.

A corollary to this preferable interpretation is that section 8(1)(b) of the General Code can not be said to vest any "right" in a client (within the meaning of section 21 of the General Code relating to waivers), to the all-embracing type of analysis referred to in paragraph (b) above, and that the client cannot refuse an offer by the adviser to undertake such a very wide-ranging analysis.

"Execution only" client

The question arises what the legal position would be where a client is a mere "execution only" client, that is, a client who has already made up his/her mind on what exact financial product to invest in or to purchase, who does not require or need any advice thereon, and only requires intermediary assistance for such investment or purchase.

Obviously such client only has to contact a FAIS licensee or representative who is authorised to render intermediary services, because if such a person is not also licensed or authorised to give FAIS advice, an analysis under section 8(1)(b) of the Code is not required. If the client under a misguided impression approaches a practitioner who can only render FAIS advisory services, such a practitioner surely has to inform the client that he cannot be of assistance, and no fees can be charged for imparting such information. Section 8(4)(b) of the General Code will then not apply, as that section clearly only deals with cases where the client has options not to follow the advice furnished. And if the intermediary eventually approached is also licensed to give FAIS advice, said intermediary should not make an offer to give advice where the client clearly intimates that he/she only desires intermediary services on the product he/she has already decided on. If the intermediary does not conform to this guideline, he/she runs the risk of causing potential catastrophic consequences to his/her professional career, if regard is given to recent FAIS Ombud determinations dealing with such situations.

Financial planning

Lastly, one has to look at the position where a client's affairs are the subject of an extensive "financial planning" exercise, in the course of which matters must be dealt with which are not covered by the FAIS Act. If it is required in the course of such planning exercise also to advise on suitable FAIS financial products for the client, it must be remembered that any investigation of such aspects can only be undertaken by the financial planner in the capacity as a FAIS provider or, if the financial planner is not such a provider, by another person who is such a provider, and then also always strictly within the limits set out in the General Code (see the definition of "advice" in section 1(1) of the FAIS Act).

In other words, during the course of such separate investigation, no norms, criteria, considerations, and so on, applying only within the profession of "financial planning" proper, and which are inconsistent with the FAIS Act, can be utilised or considered. Of course, the final results of such separate investigation, undertaken strictly in accordance with the FAIS Act and its General Code, can eventually become part and parcel of the ultimate "financial plan" to be devised for the client.

Possible amendments of the General Code

If unanimity within the FAIS profession cannot be achieved on the proper interpretation of section 8(1)(b) of the Code, it is suggested that consideration be given, in the interests of legal certainty, to the following possible amendments:

(a) the replacement of the current wording of paragraph (a) of section 8(1) of the General Code, with the following wording:

"(a) take reasonable steps to seek from the client appropriate and available information —

(i) with reference to the financial product or products, or category or categories thereof, on which the client seeks advice in terms of the client's contractual arrangements with the provider; and

(ii) regarding the client's financial situation and risk profile, financial product experience and objectives, to enable the provider to provide the client with suitable advice, and to comply with other obligations imposed on the provider in connection therewith in terms of this section or any other provision of this Code;"

(b) the replacement of the current wording of paragraph (b) of that section with the following wording:

"(b) conduct, on the basis of the information obtained and for purposes of the required advice, a suitability analysis in respect of the client and the relevant financial product or products, or category or categories thereof;";

(c) the replacement of the current wording of paragraph (c) of that section with the following wording:

"(c) identify, on the basis of the analysis conducted, the relevant financial product or products that will be suitable for the client, subject to any limitations (if any) imposed on the provider under the Act or this Code, or the contractual arrangements with the client;";

(d) the replacement of subparagraph (i) of subsection (4)(a) of that section with the following wording:

"(i) an analysis referred to in subsection (1)(b) in respect of the client and the relevant financial product or products could not be undertaken or, as the case may be, could only be partially completed;".

Board of Appeal to be reviewed

By Marinus Mans, Legal Adviser, FSB

The Board of Appeal of the FSB, established in terms of section 26(1) of the Financial Services Board Act, 1990 (FSB Act) is an independent and impartial specialist tribunal.

Any person aggrieved by a decision of the Executive Officer of the FSB can appeal against that decision to the Board of Appeal. The Executive Officer of the FSB consists of the collective of the different Registrars established by various statutory enactments contained in legislation dealing with the regulation of financial institutions (other than banks). It follows that an aggrieved person may in practice appeal against decisions made by the different Registrars.

The Board of Appeal consists of three persons (with an alternate each) appointed by the Minister of Finance. The chairperson must be a person with wide experience and expert knowledge in law, while the two other members must respectively be a person with wide experience and expert knowledge of financial services and financial institutions, and a person with wide experience and expert knowledge of the accountants' and auditors' profession.

FMCA and SECA Appeal Boards

Section 18 of the repealed Financial Markets Control Act, 1989 (FMCA) and section 21 of the repealed Stock Exchanges Control Act,1985 (SECA) established two Boards of Appeal that were similar to the FSB Board of Appeal. These Boards of Appeal heard appeals by any person aggrieved by certain decisions listed in the Acts of respectively the executive committee of a financial exchange and the governing body managing the affairs of a stock exchange.

With the coming into force of the Securities Services Act, 2004 (SSA) these two Boards of Appeal were amalgamated into the FSB Board of Appeal.

Increasing number of appeals

After the promulgation of the Financial Advisory and Intermediary Services Act, 2002 (FAIS Act) the Board of Appeal began to hear appeals dealing with the fitness and propriety of financial services providers. Because a financial services provider must cease to do business when his/her application for authorisation as a financial services provider is declined, appellants have increasingly started to

utilise their recourse in terms of section 26(2A) of the FSB Act, which states that an appellant may apply to the Board of Appeal for interim relief to suspend the decision of the Registrar pending the final decision of the Board of Appeal. The current provisions of section 26 oblige all members to attend a full hearing when an application for interim relief is heard. In the past the Board of Appeal only deviated from this practice where the Registrar did not oppose such application, by determining the application in a "round robin" manner. The structure is thus not designed to deal with these applications in a quick and streamlined manner.

In terms of the FAIS Act, determinations made by the FAIS Ombud may also be taken on appeal by any person aggrieved. Similarly, the Financial Services Ombud Schemes Act, 2004 (FSOS Act) makes provision for a similar type of appeal against the decisions of the Statutory Ombud. In terms of this Act certain decisions made by the FSOS Council may also be taken on appeal.

Financial services regulation in South Africa is entering into a new era of proactive enforcement. Decisions made by the enforcement committee established by the SSA may also be taken on appeal. Appeals and applications for interim relief to the Board of Appeal have increased and it is expected to continue to increase in the near future.

Types of Appeal

In the case of *Tikly and v Johannes* 1963 (2) SA 588 (T) it was established that an appeal can take the form of:
1) An appeal in the wide sense, which is a complete re-hearing and fresh determination on the merits of the matter with or without additional evidence or information;
2) an appeal in the ordinary strict sense, which is a re-hearing on the merits, restricted to the evidence or information on which the decision under appeal was given and in which the only determination is whether that decision was right or wrong; and
3) a review, which is a limited re-hearing with or without additional evidence or information to determine whether the arbiters had exercised their powers and discretion honestly and properly.

The FSB Board of Appeal is an appeal in the wide sense and may hear any evidence (oral or documentary). It is not restricted to a record on appeal and not concerned exclusively with the correctness of a decision. It has the powers to act as if it were the Registrar and must place itself in its position in order to reach a decision on appeal. It hears the matter afresh on information and evidence supplied by the parties in the hearing.

Though it has not yet heard appeals against decisions of the FAIS Ombud, the Statutory Ombud or the enforcement committee, established under the SSA, the Board of Appeal would also have to "step into the shoes" of all these very diverse regulatory bodies and would have to "change hats" when hearing the different appeals.

The question is whether this is a tenable situation. The regulatory bodies against whose decisions an aggrieved person may now appeal have diverse and different powers and their purposes are not the same.

A few problems with the current structure should be pointed out:
• A respondent aggrieved by a decision of the FAIS Ombud may appeal, but in terms of the Rules on Proceedings of the Office of the Ombud for Financial Services Providers, the Ombud may not be a party to the appeal and cannot assist or represent the complainant at the appeal hearing. The respondent will in most cases be either corporate institutions or financial services providers who can afford legal representation. As a general rule the complainant might not be able to do the same or might not reside close to Pretoria, where most appeals are heard. This might cause the complainant to either present his/her own case at the hearing or might decide not to attend the hearing at all. In the case of the former the complainant would not be able to match the case presented by the respondent's legal representatives and could be prejudiced, and in the case of the latter the Board of Appeal would have to make a decision based solely on the information and evidence presented to it by the respondent's legal representatives. This seems to be an inequitable situation to which an ordinary appeal of record might be the answer.
• The enforcement committee's decisions would deal with the imposition of administrative penalties or compensatory amounts where a person has contravened the SSA. The purpose and structure of the enforcement committee would not require an appeal in the wide sense but an appeal procedure that can act as a mechanism to ensure that the committee makes correct and fair decisions. This procedure should therefore be a more expeditious appeal of record.

Possible suggestions for a future Board of Appeal

The legislature may consider amending section 26 of the FSB Act to provide for:

• *The appointment of substantially more members*

Keeping in mind the extensive experience and outstanding qualifications of the current Board of Appeal, more members of that calibre can be appointed in order to avoid any possible backlogs.

• *A more cost-effective and streamlined procedure*

For instance, decisions regarding interim relief applications can be made by only the chairperson and on documentation alone.

• *Changing the type of appeal*

The particular type of appeal can be changed to an appeal in the ordinary strict sense whereby the Board of Appeal would concern itself merely with the documents available to the decision makers at the time the decision was made. The Board of Appeal would then determine only the correctness of the decision made and

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FAIS Ombud cure for financial ill

By Russel Michaels, Head: Communication and Liaison, FSB

The Chief Director: Financial Sector Policy, National Treasury, Jonathan Dixon, says the financial sector is still the host of many ills. Speaking at the Ombud for Financial Services Providers' (FAIS Ombud) 2005 annual report launch, he adds where a financial services consumer falls victim to these ills, the FAIS Ombud's Office aims to provide a cure through speedy, easily accessible and cost-effective dispute resolution.

'While an effective cure is of course one vital element of any consumer protection programme, FAIS Ombud, Charles Pillai, will agree that prevention is better than cure. The true measure of success is not how many cases the FAIS Ombud's office has effectively resolved, but rather how few financial services transactions cause a customer to walk through the doors of his office.

"In 1994, a financial sector existed that had developed within the context of an inward-looking policy environment, skewed investment opportunities and ownership by the few. Years of political and economic isolation meant that our regulatory structure had become progressively out of line with international standards.

"A highly concentrated financial sector meant that there was limited competition to bring down the costs to consumers or to spur innovation. A political dispensation that did not care for the majority of its people found its reflection in a financial sector that paid scant regard to the interests of the average consumer.

"From the perspective of the generally accepted objectives of financial regulation, while much had been achieved in building a large, sophisticated and stable financial sector, very little attention had been paid to the issues of consumer protection and access to finance.

Jonathan Dixon

"Lack of access to appropriate savings or transactional products, coupled with poor financial literacy, consumer education and consumer protection compounds the divide between the haves and the have-nots.

"Addressing this challenge required a collective effort.

"Part of the solution lies in putting in place an appropriate legislative framework and enabling environment. Recent market conduct legislation has included the Financial Advisory and Intermediary Services Act, 2002 (FAIS Act) - the enabling legislation for this office - the Financial Services Ombud Schemes Act, 2004 (FSOS Act) - which provides Pillai with the other hat that he wears, and aims to bring about comprehensive coverage and consistency in the dispute resolution arena; as well as proposed changes to the Pension Funds Act, 1956 to name but a few.

"But legislation can only go so far. Bringing about true change is also about the enforcement of such legislation and the spirit and integrity with which financial sector participants take the message of this legislation to heart.

"In terms of enforcement, I am informed that the process of licensing all

Board of Appeal *continued from p 7*

the

would not "step into its shoes" when an appeal is heard. As this would be an appeal mostly on record it will also be expedient and consumer friendly.

• *Ensure that the appeal continues to be a section 34 tribunal*

In terms of a judgment by the Supreme Court of Appeal and another by the Constitutional Court, the Board of Appeal was held to be an independent and impartial tribunal as contemplated in section 34 of the Constitution (*Financial Services Board v Pepkor Pension Fund*,1998 (4) All SA 129 (C) and *Nichol v Registrar of Pension Funds* (2005) 7 BPLR 559 (SCA)). A change in type of appeal would not affect its current status as a section 34 tribunal, provided that the amended section continues to make provision for a fair public hearing and independent and impartial members continue to be appointed.

• To ensure that the appeal procedures continue to comply with the provisions of the Promotion of Administrative Justice Act, 2000, and where deviations might occur with regard to the provisions and regulations as regards a public hearing procedure in terms of that Act, it must always pass the "fair but different" test laid down by section 4(1)(d) of that Act.

financial advisers and intermediaries is nearing completion and that the FAIS Office of the FSB will increasingly be switching their attention to monitoring, enforcement and disciplinary actions.

"But ultimately, we want to achieve a situation of far more effective and stringent self-regulation. The experience of the Financial Sector Charter is informative in this regard. In many ways the Charter is visionary.

"Firstly, it is a model of constructive industry co-operation on a national scale, not in the form of collusion, but rather in the sense of the sharing of intellectual capital to find solutions to present day challenges.

"Secondly, it breaks new ground in terms of an industry coming forward voluntarily to commit itself to doing things that it is not obliged to do in terms of the law. Legislation and regulations are key to setting the guidelines within which firms must operate - and within which we protect overall financial stability. However, there are times when an industry needs to look beyond what they are obliged to commit to in terms of the law.

"It comes down to a change in mindset. The relationship between business and government - or alternatively put, the job of aligning private sector interests with public interests - can be an adversarial one, characterised by animosity and negative legislation, or it can be one of constructive partnership.

"Ultimately, it comes down to a shared vision. Some things may not be in law, but often they are the right things to do - not only for moral reasons but also because they build the foundation on which we will all benefit in the future.

"It is morally and economically imperative for the sector itself to come forward with a proactive response to the problems of competition, disclosure and consumer protection in the financial sector. Not only because it is the right thing to do, but also because putting the customer at the heart of how financial sector companies go about their business - and maintaining the confidence of their customers - is the only way of ensuring long run growth and sustainability.

"That, if you like, is the wish list. Perhaps, Pillai, in the long run your Office will become obsolete? One can but hope. But in the interim, the work that you and your team perform is vital. Your team as a whole is to be commended for the energy with which they have tackled the task before them.

"For as long as there are ills in the financial system, we must strive to make sure that they are treated as quickly and painlessly as possible. While we have, through the FSOS Act, fixed what one might term the holes in the 'medical system', we must do more to ensure that financial services consumers are made more aware of this 'free health care'.

"Consumer education is, obviously, key. And through the Financial sector Charter process, we are striving to ensure a step change in the funds that the financial sector provides to meet this challenge through the FSB.

"Through the FSOS Act, we have also strived to ensure an effective 'back office' system where there is consistent application of standards and processes across Ombud's offices and a smooth system of referrals. The FSOS Council will aid this process tremendously.

"A challenge still remains is to ensure that we also tackle the 'front office'. While the FSOS Act did not envisage a super-Ombud's Office, it certainly recognised the increasing need for one centralised, widely known point of contract for all consumer complaints in the financial sector."

OBS surging ahead

The Ombudsman for Banking Services (OBS) has improved its levels of efficiency as well as its public awareness, according to the OBS's annual report for 2005.

In addition to facilitating the payment of R16.2 million by the banks to customers who submitted complaints, the OBS surpassed its service standard target turnaround time of an average of 70 days from date of opening to date of closure of the file, by recording an actual average of 63 days to closure.

The OBS came close to achieving its target of finalising all files within six months of opening, having finalised 97% of complaints received within that period. This was despite the departure of several key personnel, most of whom left to take up high-level positions in the banking industry.

These are significant achievements, given the OBS's reason for existence, namely to offer a fair, quick, informal and effective alternative to the courts, free of charge.

The OBS's concerted effort to market itself to all stakeholders paid great dividends. A Markinor survey revealed that 63% of bank customers interviewed had heard of the OBS. This was the highest level of awareness of any of the related organisations and represents a 43% increase over the previous year's result.

The increased level of awareness brought with it a corresponding increase in the number of complaints received. The office fielded 17 165 helpdesk enquiries and opened 4 092 new files, representing a 42% increase over the previous year.

The Ombudsman, Advocate Neville Melville, indicated that he had raised his concerns regarding long-standing causes of the joint top two complaints with the Banking Association "in the hope that the banks will take the appropriate action". Interaction with the banks in this regard is ongoing.

"The OBS looks forward to contributing to a South Africa 'alive with possibility'," he said.

Advocate Neville Melville

Source
OBS media release,
22 February 2006

Building rewarding relationships

with your client based on FAIS will diminish the incidence of complaints

The Ombud for Financial Services Providers (FAIS Ombud), Charles Pillai, has consistently maintained that the principle of building rewarding relationships between provider and client is one sure way to reduce the level of complaints.

By Francois Opperman,
Assistant Ombud for Financial Services Providers

This principle of building a rewarding relationship is encapsulated in the principle of *ubuntu*. This principle was first recognised by Justice Pius Langa (as he then was) in the celebrated case of *S v Makwanyane* 1995 (3) SA 391 (CC). Now the Chief Justice of South Africa, the learned Judge Langa, decried the lack of *ubuntu* that was prevalent in the community at the time and saw the introduction of the constitutional ethos as the embodiment of a new culture expressed in the provision of National Unity and Reconciliation contained in the interim Constitution (at para 223 and 225).

Expressed in its simplest terms the principle of *ubuntu* is expressed in the Zulu phrase, *Umuntu ngumuntu nagabantu*, which, from Zulu, translates literally as: "A person is a person because of other people." Extrapolating this principle to the context of the provider/client relationship, it simply means that there exists a symbiotic relationship between the two.

The real business of complaints handling started on 30 September 2004. In a period of just under 18 months, the financial services industry has seen twelve determinations from the FAIS Ombud. Coupled with this the FAIS Ombud has been instrumental in effecting just under 300 settlements between provider and client.

Pillai's view from the outset was that the principles that the Ombud's office establish in its determinations and settlements will ultimately provide the financial services industry with what can be considered best practice in the rendering of financial services.

This article is an attempt to demonstrate our experience in respect of certain trends and practices that have emerged from complaints handling and also to provide hints and tips for advisers to ensure that they are compliant with the Financial Advisory and Intermediary Services Act, 2002 (FAIS Act) and thereby reduce or eliminate the risk of complaints.

Number of complaints

Since April 2004, 3 393 complaints were registered with the FAIS Ombud's Office. Up to 31 March 2004, the FAIS Ombud accounted for 604 complaints. This number quadrupled from April 2005 to date, with 2 789 complaints and enquiries having been registered for the current reporting period. Of these 447 were FAIS related complaints. In total 287 of these complaints have been resolved in favour of complainants, effectively putting a little over R5 million back in the hands of consumers.

Type of complaints

The FAIS Ombud's Office is bound by the FAIS Act and the subordinate measures promulgated thereunder. Determinations are issued with a careful eye on compliance, particularly with the various Codes of Conduct. Through investigating complaints in terms of the FAIS Act and either settling or having such complaints determined, the following areas of concern were identified:

• Focus on commission

Some financial advisers focus solely on selling financial products that pay attractive commissions, rather than focusing on rendering a professional service that is in the interests of the client. This was evidenced, for example in a determination issued by this Office, where a complainant approached a bank to invest the proceeds of the sale of her house in a money market account linked to her cheque account.

When she attempted to complete a transfer the following day she discovered that no such money market account existed. It was discovered that the money was in fact invested in a medium-term investment. It was not invested with the bank at all! We found that the broker earned commission of R 6 840 for ten minutes of work in effecting a five-year investment for the complainant, contrary to her needs.

As this was clearly contrary to the mandate entrusted to the bank, the determination ruled that the complainant be refunded the amount of R26 067.07, including commission and loss on the investment. This is just one example; the Office has settled about ten similar matters.

We have found that there are often insidious ways in which the client is, without any regard to the circumstances, directed towards a commission paying financial product, whether a need for such product exists or not. In almost all these instances, the Ombud found that the financial service was rendered without any consideration for the needs and objectives of the client.

• Non-disclosure

The non-disclosure of fees, charges, commissions and key characteristics of the financial product being sold is a common occurrence. The FAIS Act requires full and appropriate disclosure of all costs, charges and commissions by the financial adviser before the conclusion of the transaction.

• Miss-selling to and misleading of consumers

This is another common problem. The Office recently ruled on a case where an adviser sold a product to the client simply because that particular product was accredited by the bank where the adviser was employed. The adviser dissuaded the client from purchasing the product she originally intended by convincing the client that the funds would not be guaranteed. This was found to be untrue.

Clients rely on what financial advisers tell them because of the skill and expertise they purport to have. The quest for commission generally breeds an environment for misrepresentation and miss-selling of financial products. This does not benefit the consumer and clearly impacts negatively on the integrity of the financial services industry.

Fine print and the tick-box approach to compliance

"Fine print" on documents is another practice that we found to be problematic. Clients simply sign documents without being informed about exactly what they are signing. Consumers find themselves bound by clauses such as the "Customer Declaration" where it is agreed that —
• certain disclosures were handed to client;
• the client agreed to the product/s being sold;
• a proper explanation of these products was given;
• all fees, costs and commissions were disclosed by the broker; and
• there was no need for a financial needs analysis.

This approach indicates that providers try to get around real compliance with the FAIS Act and the General Code of Conduct by paying "lip-service".

In our analysis of complaints these are the most prominent issues that seem to prejudice consumers financially. It is also interesting to note that many complaints come from consumers who are over the age of 60 – consumers who can be considered to be vulnerable.

Important underlying principles

The FAIS Act has a number of important objectives, which can be summarised as follows —
• to ensure consumer protection; and
• to uphold the integrity of the financial services industry.

Financial advisers should constantly have these objectives in mind when rendering financial services. It is important to note that there will be some close calls in the course of the adviser's practice, which may result in complaints. This is inevitable. The best way in which to gain the trust and confidence of clients is to make excellence a hallmark and build a rewarding relationship with clients.

What does the FAIS Ombud look for?

From an examination of the determination issued thus far, it is clear that the FAIS Ombud looks for evidence of the following:
• The contractual or other legal relationship between the parties;
• adherence to the provisions of the FAIS Act and its subordinate legislation; and
• the fairness or otherwise of the outcome.

In our effort to resolve complaints, we will constantly look at what the FAIS Act, in particular the General Code of Conduct and the law generally, have to say about a particular issue.

Investigations conducted by the Office reveal that the most common areas of non-compliance with the General Code of Conduct are as follows:

• Record-keeping in terms of section 3(2)(a) and section 9 of the Code

In a case determined recently, the provider failed to keep a copy of the handwritten transaction completed by its representative. The handwritten information was transferred to an electronic format and the handwritten copy was destroyed. Thus the authenticity of the contents of the handwritten document could not be established.

• Failure to comply with requests or instructions from clients in terms of section 3(1)(d) of the Code

In another case the complainant requested the broker to cancel an investment, which she wanted to re-invest with another company. A week later, the complainant enquired about this investment, only to discover that the original investment was still in place. She blamed the broker for the delay and claimed for interest that she lost on the subsequent investment.

• Section 3(1)(a)(iii) requiring specific duties

In a case involving direct marketing, the applicant for a loan was required to take credit life insurance. During the telephonic application process the call centre agent informed the applicant that previous illness and injuries were excluded in any subsequent claim. Without any further enquiry by the call centre agent relating to pre-existing conditions, the applicant telephonically accepted the policy. The applicant passed away and his wife lodged a claim with the insurer. The claim was rejected based on non-disclosure of information. Our investigation revealed that the

Continued on p 12

Relationships *continued from p 12*

deceased has passed only standard 6 and that he was living a simple life with no knowledge of insurance. The FAIS Ombud ruled that the agent should have elicited more information from the deceased in order to establish pre-existing conditions.

• *Section 7(1)(c)(iii)(aa) dealing with separate disclosures*

In a matter where this issued was raised, the complainant was under the impression that his money was invested with a bank. When the complainant enquired from the bank as to why he was not receiving any statements, he was informed that there was no investment with the bank. He made further enquiries and discovered that the money was invested with another company, in a high-risk investment vehicle and that huge commission was payable.

• *Section 8 dealing with furnishing of advice and suitability*

In a matter investigated by this Office the complainant wanted to invest funds in a savings vehicle to purchase a new property. She approached a broker for advice and he subsequently invested the money in an endowment policy for five years. The Office found that no needs or risk analyses were done. The broker failed to consider the complainant's financial situation, financial product experience or objectives. This Office ordered the respondent to cancel the investment and also pay interest on the balance of the investment.

• *Section 11 pertaining to risk management*

A recommendation was issued by this Office in an instance where the respondent failed to employ the resources, procedures and appropriate technological systems to eliminate risks that clients, product suppliers and other providers would suffer through theft, fraud, other dishonest acts, poor administration, negligence, professional misconduct or culpable omissions. In this case the broker within the banking hall of a large financial services provider sold an investment to the complainant. On enquiry from the bank the complainant found that no investment was made with the bank. The respondent was requested to investigate the complaint but could not find any record of the transaction that took place on their premises. This Office found that the broker wrote the business in her personal capacity, using the respondent's resources and thus there was no record of the transaction. The respondent was ordered to cancel the investment and to pay interest thereon.

The above is not an exhaustive list but merely an indication of what can go wrong when providers fail to comply with the provisions of the FAIS Act.

It also becomes increasingly important for financial advisers to continuously update their knowledge on what happens in the industry with regard to latest cases. Large financial institutions send out circulars pertaining to the most recent developments. It is critically important that advisers are conversant with the views expressed by courts in relation to matters involving the rendering of financial services. The FAIS Ombud publishes its determinations and settlements in order for members of the public and, most importantly, advisers to get a sense of the functions of this Office and the issues we adjudicate.

Legal principles

When writing a determination, this Office not only interprets the provisions of the FAIS Act, but also extrapolates the principles expounded in case law, academic writing and comparative jurisprudence. These provide the FAIS Ombud with direction on how to deal with particular issues.

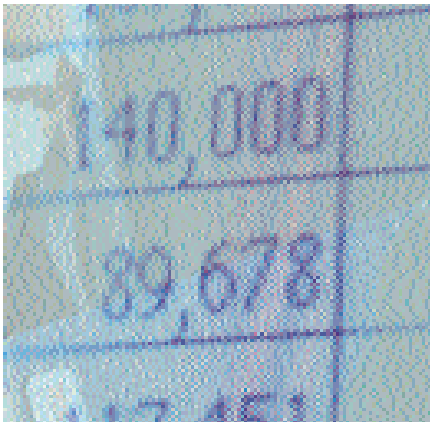
We also draw on principles set by the High Court and Supreme Court of Appeal. When rendering financial services a provider should always employ due care, skill and diligence. Various judgments pronounced on these as well as determinations issued by the FAIS Ombud. The General Code requires that the financial service should be rendered honestly, fairly, with due skill, care and diligence, and in the interests of clients and the integrity of the financial services industry.

By maintaining these standards, we are bound to see a shift in the required levels of rendering financial services.

Conclusion

The principles that the Office of the FAIS Ombud establishes in its determinations and settlements provide direction to the industry with regard to best practice. In this way, consumers will benefit financially through the delivery of financial services that are in their interest.

Now that the FAIS Ombud has set the tone through determinations and settlements, it is expected that the Office will contribute significantly to the transformation of the financial services sector in which consumer protection and the integrity of the financial services industry will be advanced significantly.



New insurance head wants to be part of 'bigger picture'

His move to the FSB enables him to be part of the "bigger picture" of the financial flow process in South Africa. "I like to be part of the restructuring of the insurance industry with its contentious policy issues, which are in the spotlight. The FSB is a good vantage point to do just this."

So says Patrick Ward, who has been the FSB's head of Insurance Registration and Policy since February this year.

He holds a CA and with his vast experience, obtained inter alia at Arthur Young, the predecessor of Ernst and Young where he did his articles, an American computer firm, Eskom and Rand Water, he is ready to face this challenge. Ward was also a consultant for three years, specialising in utilities, pension funds and treasury.

He believes that greater transparency in the insurance industry is the biggest challenge facing this sector. This is true especially for the long-term insurance industry, with matters such as surrender values and commission structures being in the spotlight. "The industry also needs more supervision to make sure that it complies with existing regulations," he says.

Ward argues that government has an important role to play. "If government does not take steps to preserve consumers' long-term savings such as their pension, consumers will become a burden to the state in their old age. Greater transparency is therefore also in the interest of the government," he says.

The phenomenon where policyholders become shareholders in the big insurance firms, thereby sharing in the profits has changed the nature of the big insurers as they are now driven by shareholders profit motives and not policyholder value driven. Ward believes this requires even more vigilance as shareholders are now in control and policyholders now need protection.

He also believes that the FSB has a huge role to play in educating the consumer. Yet, there should be a delicate balance between protecting the consumer and allowing financial services providers to do their business. "We must not over-regulate the industry. In South Africa, however, with its vast differences in educational levels among consumers, the duty of the regulator is even more critical to prevent financial abuse. We must level the playing field. There must be healthy competition, but no abuse," he says.

He is also excited about the future role of the FSB's Compliance Section, as this section can tackle and investigate problems before they mature. "I am sure we will see many positive results coming from the investigations of this section in future," he says.

Ward further sees the function of the Insurance Registration and Policy Department as ensuring that only registered insurance providers do business in South Africa. He feels strongly that the local market must be protected – too many insurance brokers attempt to by-pass this market with their eyes fixed on the international market. "We have to look after the interests of local companies and individuals," he says.

Having said that, Ward emphasises that keeping in touch with what is happening abroad is important. "I believe there are valuable lessons to be learned from, for instance, the Spitzer report, which exposed malpractices in the insurance industry in the United States. The FSB's Insurance Registration and Policy Department has close links with similar regulatory bodies in other countries and this is keeping us abreast with international developments."

Patrick Ward

As far as his department is concerned, Ward regards the "restocking" of the Registration and Policy Section as a priority. "Many of the experienced staff of this section was transferred to the Compliance Section. We have to find suitable financial and legal minds to fill this void to meet the challenges facing the industry," he says.

Born in a small mining town in Zambia, small-town life is close to his heart. Although he and his family live in Randburg, Johannesburg, a move to a small town close to Pretoria may be on the cards in future.

"I believe life is too short to put too much emphasis on worldly goods. There are many more important things," Ward says. He firmly believes in family and community values and says urbanisation is a threat to these. "There is much to be said for upholding these values," he said.

He is married to Hanli and he has four children, ranging from 15 months to 22 years. Having a baby in the house means that family time is mostly spent at home these days, but if Ward gets the chance he likes to be outdoors and a visit to a game reserve is always a special treat. "We love the outdoors and being in nature."

He is also a keen gardener and his motorcycles, a Yamaha Superbike and a BMW 1100 GS, make the world a better place, Ward says.

Agreement between the LOA and Minister of Finance:

Minimum standards for long-term insurance savings products

The announcement made last year by the Minister of Finance, Trevor Manuel, regarding minimum standards for early termination values of retirement annuities and endowment policies is a significant attempt to bring old policies in line with current socio-economic changes.

The standards were set to help policyholders who were forced by circumstances to exit their savings or investment policies early during the course of the past five years. Going forward, they provide peace of mind to consumers who may be forced to exit early due to significant changes in their circumstances.

Since the announcement various joint National Treasury and industry task groups have been working on finalising the underlying actuarial and regulatory details of the Statement of Intent. Finalisation of the minimum standards is only expected in the second half of the year.

The CEO of the Life Offices' Association (LOA), Gerhard Joubert, answers some questions on how the implementation of these standards will work.

What was the significance of the announcement made on 12 December?

The Statement of Intent that was signed was a document setting out certain principles on which further discussions will be based. It was the result of extensive and constructive discussions, which led to a much greater mutual understanding of the policy imperatives of National Treasury and the business imperatives of the long-term insurance industry. When these discussions started earlier this year, the parties agreed that it was of vital importance to enhance the savings culture of South Africans and that this goal would be best served by the industry giving the consumer a better deal on early termination values. In this context, the members of the LOA agreed to a set of standards to ensure that the early termination values of RAs and endowment policies would not be less than certain agreed minimum amounts.

We believe the agreement takes cooperation between the private sector and Government to a new level, and that it constitutes an equitable solution for all stakeholders. It provides policyholders with improved policy values while ensuring that the life industry remains profitable. It also motivates people to continue to be policyholders and encourages future savings. Above all, the minimum standards also provide policyholders with greater certainty that they will get a fair deal.

How will it work?

It is important to differentiate between the prospective and retrospective application of the minimum standards.

Retrospectively, all RAs that have been terminated early from 1 January 2001 (as well as endowments that have been made paid-up but are still on the books), will be enhanced to a level of a minimum value of 65% of the investment account. The process of increasing policy values will be automatic and the respective life office will inform policyholders of the relevant increases. Former policyholders of lapsed RAs will have to apply for the enhancement in policy values. Former policyholders of surrendered or lapsed endowments (i.e. business that is no longer on the books) are excluded from the agreement pertaining to minimum standards.

Gerhard Joubert

These minimum amounts are expressed as percentages of the investment accounts of policies. The percentages may vary, depending on retrospective or prospective application. The investment account of a policy represents accumulated premiums, plus investment returns, less charges (including charges in respect of taxation, risk cover, guarantees and expense recoveries).

Prospectively, RAs and endowments that are made paid-up after the implementation date will have minimum early termination values amounting to 70% of the investment account. Endowments that are surrendered and RAs where the funds are transferred away from the company will have minimum early termination values of 60% of the investment account.

The implementation date for the prospective application of the minimum values is linked to the date when the new commission regime (which will entail a move towards ongoing commission) becomes effective. This date was estimated at 1 October 2006, on the assumption that draft proposals would have been made available by National Treasury by the end of February 2006. Since these proposals have not been forthcoming by that deadline, the implementation dates will no doubt also have to move forward by a

month or two.

What is the difference between terminated, early surrender, paid-up and lapsed?

The termination of a policy is a general reference to a policy that stops for a number of possible reasons, for example because the policy lapsed or was surrendered. A policy termination could also mean that premium payments are stopped, or even reduced.

Early surrender is a specific type of early termination, and refers to the cancellation of a policy before its maturity date in return for payment of its surrender value.

Paid-up is another type of early termination. It refers to the situation where a policyholder ceases to pay premiums but the policy remains in force and continues to be credited with net investment returns.

A lapsed policy terminates because it has been in force for such a short period of time that it has not built up a policy value (after the deduction of unrecouped expenses).

How will someone know if their policy is one of those that will be enhanced?

RAs and endowment policies that have been made paid-up since 1 January 2001 and are still administered by the same life insurer will be credited with the amount required to meet the minimum early termination value.

Former policyholders of lapsed RAs will have to apply for the improvement in policy values. Former policyholders of surrendered endowments are excluded from the agreement pertaining to minimum standards.

When will these new increased values start reflecting on policies?

Now that the announcement has been made, the real work starts. There is a host of actuarial and regulatory details that still need to be finalised before the standards can be implemented.

LOA member companies that represent more than 80% of the market have already indicated that they support the principles set out in the minimum standards, but the boards of directors of all the individual companies still need to approve the agreement. Once board approval has been obtained, the internal controls and governance mechanisms of the individual companies will ensure compliance with the LOA agreed standards. In light of the practical implications, it is however unlikely that any payments will be made before the middle of 2006.

For any queries relating to the announcement, the public can log on to www.loa.co.za and look under press releases for all the documents that have been released so far. There is also a section with Frequently Asked Questions (FAQs).

In addition to the efforts that will be undertaken by member companies, the LOA will be launching a consumer education campaign during 2006 to explain the effect of the minimum standards on policyholders.

What effect will these standards have on the industry?

The implementation of minimum standards for policy holders is a significant step in the right direction for the industry.

We have now made a major commitment for the future, and this shows that we recognise that the needs of customers have changed and that we cannot, for example, hold the policyholder liable for all unrecovered commission should the policy be terminated early. This commitment should go a long way in ensuring that costs and risks are shared more equitably between the various parties, that is the product provider, client and intermediary.

The long-term insurance industry had a major shake-up at the end of 2005, and 2006 will not only be a year of implementation but will also be a year that is characterised by further major changes – not only will we see a new commission regime (which will determine the implementation date of the minimum standards), but there is no doubt that there will be developments as far as the review of retirement savings (and the possible introduction of the National Savings Fund) is concerned.

This industry has faced some tough challenges over the last year, and there is no doubt that we will be able to look back on a year knowing that we did the right thing by facing and addressing these challenges proactively and creatively.

Directorate of Market Abuse holds first meeting

The Directorate of Market Abuse (DMA), which considers cases of market abuse, held its first meeting at the FSB in February.

On 1 February 2005 the Insider Trading Act was incorporated into the Securities Services Act, 2004 (SSA). In terms of this Act a new directorate called the DMA (Directorate of Market Abuse) was created, which replaced the Insider Trading Directorate. Unlike its predecessor, which only dealt with insider trading, the DMA is responsible for investigating and taking enforcement action in all cases of financial market abuse.

Since 1 February 2005, the DMA has been investigating cases of insider trading, prohibited trading practices (market manipulation) and false, misleading or deceptive statements (false reporting), made in respect of listed securities.

The SSA created an additional enforcement option for the FSB in the form of the Financial Markets Enforcement Committee (Enforcement Committee). The Enforcement Committee has the authority to impose administrative penalties, cost orders and compensatory orders on offenders. It is believed that the creation of the Enforcement Committee will enhance the FSB's ability to enforce anti-market abuse legislation substantially.

The DMA can refer cases of insider trading to the Enforcement Committee or take civil legal action against an alleged offender. In such cases the civil court or the Enforcement Committee may order that the alleged offender pay the profit made, or the losses avoided, as a result of the offending transactions, to the FSB, and a penalty of up to three times such amount. These funds are distributed, after recovery of costs, to persons who could have been prejudiced by the offending transactions.

Market manipulation and false reporting cases can be referred to the Enforcement Committee that can impose a penalty and a cost order on the alleged offender.

In addition, market abuse transgressions are criminal offences in terms of the Act. The Director of Public Prosecutions may institute criminal action against any person. It is not the function of the DMA to institute criminal prosecutions but would provide all information necessary to assist the Director of Public Prosecutions.

Source: FSB media release,

International body rates SA's private pension system highly

South Africa has a well-developed private pension system that ranks highly when compared to the Organisation for Economic Co-operation and Development (OECD) countries in terms of institutional development.

By Russel Michaels, Head: Communication and Liaison, FSB

That is the opinion of Yosuke Kawakami, senior adviser in the financial outreach unit, at the OECD.

Speaking in Cape Town at the OECD's roundtable on private pensions in Africa, Kawakami said the African countries that also participated in the meeting, appear to have capable professionals and institutions necessary to further develop their private pensions system in their own countries.

"The OECD is ready to share its experiences and lessons acquired through its history and activities, so that South Africa and its neighbours may better proceed with their reform plans on such issues as risk-based supervision and pension fund governance," he said.

He noted that important challenges remained at the more general economic level, such as improving social inclusion and investment, which are essential to sustain growth. "We welcome the leadership taken by the South African authorities to reinforce regional solidarity and cooperation and thereby promote the region, as Africa has to compete with other emerging markets for global attention and foreign investment."

This is the first time that the OECD has been in Africa to talk about private pension funds. Other participants in the roundtable discussion included Dube Tshidi, Deputy Executive Officer for Pensions of the FSB, Baron Furstenburg, Director: Market Conduct, National Treasury; actuary Rob Rusconi, trade unionist, Jan Mhlangu, and representatives from Kenya, Namibia, Nigeria and Zambia.

Part of the OECD's mission is to assist countries develop an adequate regulatory and supervisory framework that protects the rights of members and beneficiaries and promotes the financial security of pension plans and funds. As a starting point in Africa, the OECD would like South Africa to apply for observer status in the OECD working party on pensions.

In reviewing retirement provision in South Africa, Jonathan Dixon, the Chief Director: Financial Sector Policy of National Treasury, says there is a need to carefully align tax incentives to complement regulatory reform.

"There is a discrepancy in the tax treatment of pension and provident funds. Furthermore, there is no compulsory preservation, and indications are that the leakage which arises from this severely affects an individual's ability to retire with an adequate pension benefit."

Dixon added that there were further retirement fund challenges, including:

- Encouraging a culture of saving for retirement;
- bridging the divide between those in informal or low-income employment who do not make provision and those in formal employment who do make provision;
- educating trustees and members; and
- keeping costs in check and ensuring fund members get "value for money".

Dixon said government has identified the need to bridge the divide between the first and second economy in terms of the Accelerated and Shared Growth Initiative aimed at increasing South Africa's average growth rate of 6% by 2010.

"Increasing the savings rate which currently stands at 13.5% of gross domestic product to 25% of GDP will go a long way to achieving that objective. Saving is key to development. To that extent, reform of the long-term contractual environment is critical to this challenge. The primary objective of reforming the retire-

ment fund industry is to ensure that all South Africans receive a decent income at retirement.

"South Africa's savings is influenced by its disparate past with the majority of the population reaching retirement without own provision. Poor financial literacy and consumer education compound the difference between the haves and the have-nots.

"The cost of retirement funds has received a great deal of attention as the cost of retirement savings in South Africa is high and variable.

Juan Yermo, Principal Administrator, Financial Affairs Division of the OECD, says South Africa's private pension regulation is broadly in line with the OECD "benchmark" (Core Principles and Guidelines), but there are some areas requiring specific attention.

These include —

• governance;
• overseas investment and statement of investment principles;
• minimum standards of vesting and portability;
• rules for distribution of surplus assets in case of plan termination; and
• member choice of investment, information disclosure, default options and financial education.

Fiona Stewart, Administrator, Financial Affairs Division of the OECD says internationally regulators are moving from a compliance-based approach to a risk-based approach to supervision following moves by the banking and insurance sectors.

Stewart says good pension fund governance is vital for the efficient functioning of private pension systems. "The governance structure should ensure an appropriate division of operation and oversight responsibilities, and the accountability and suitability of those with such responsibilities."

International Organisation of Pension Supervisors consultant and former FSB chief actuary, Jeremy Andrew, stressed that a significant feature of South Africa's private pension funds is that all funds must have a board of trustees, 50% of whom are member-elected.

Andrew added that there were several concerns, which might usefully be addressed through the pending legislative review. These include:

• Extension of coverage to low-income workers;
• leakage;
• increasing costs eroding proportion of contribution saved;
• HIV/Aids increasing death and disability premium rates;
• rising administration costs;
• taxation of investment build-up;
• disclosure;
• governance - with special attention given to the over-reliance on service providers conflicts of interest and the education of trustees;
• powers of the regulator; and
• investment regulations.

EXTRA CASH for former private pension fund members

By Russel Michaels, Head: Communication and Liaison, FSB

A staggering R970m could be available to former private pension fund members - provided they have kept their old paperwork.

The FSB issued an appeal to former pension fund members who never received all their benefits to contact its hotline (0800110443 or 0800 202087). A search facility is also available on the FSB website under "Unclaimed Retirement Fund Benefits Search".

The FSB has contacted all pension funds to develop a database, which include about 1 000 funds. It is estimated that about 135 000 people could be owed at least R970m.

FSB Deputy Officer for Retirement Funds, Dube Tshidi, said much of this money results from unclaimed benefits from individuals of disadvantaged backgrounds who may have fabricated address details in order to secure employment in the apartheid years.

"It's not always a case of pension funds not wanting to pay. It's that contact details are not correct," he said when asked why so much money has not been distributed to former pension fund members. The onus is on individuals, and their beneficiaries, to prove the claim rather than on pension funds and the FSB.

When contacting the FSB, have the following information ready: The exact name of the fund; copies of benefit statements or payslips; the name of the employer and the duration of employment; and details about why the benefit was not claimed. If you are not able to supply sufficient information, you will lose your money. Unfortunately there is no other alternative, said Tshidi, as the risk of fraudsters attempting to stake a claim on the cash is high.

A political decision will be made about the future of funds that cannot be claimed. They may be applied to the payment of social old age pension benefits.

Individuals who believe they qualify for unclaimed pension benefits will also be referred to a contact at the fund or the fund administrator, said Dube.

Balance needed to protect consumers

"Prudential safety and soundness, competition and consumer protection need to co-exist to effectively serve the various stakeholders' interests. Hence, implementing an effective consumer protection and education framework involves achieving abalance between providing adequate safety for consumers while promoting competition and financial innovation."

This was the message of Dr. Zeti Akhtar Aziz, Governor of Bank Negara Malaysia, in her keynote address at the Third International Forum on Financial Consumer protection and Education held in Malaysia last year. (See report on p 19.)

"In formulating policies to safeguard consumers' interests, adequate consideration needs to be given to ensure the appropriate level of consumer regulation without imposing excessive regulatory costs and burden on financial institutions and consumers, and thus avoid compromising the benefits that the policies are designed to achieve. In the process, ethics and integrity cannot be legislated," Dr. Akhtar Aziz said.

She suggested that regulators consider different approaches to prevent market abuses or misconduct and promote consumer confidence. "Of importance is to evolve an appropriate incentive structure for financial institutions so that they recognise that it is in their best interests to foster fair and equitable business practices as part of good governance, corporate social responsibility and brand building. Good business practices need to be instilled and embedded in all aspects of the operations and at all levels within the institutions. "

Dr. Akhtar Aziz said well-informed and financially astute consumers who are in a position to make better financial decisions would promote competition among financial providers. "Market efficiency would improve with the creation of new products and services that are more responsive to the needs of consumers. In relation to this, financial literacy has become a vital skill in this increasingly more complex financial world, characterised by increasingly sophisticated financial products and services and growing diversity in financial service providers and distribution channels."

"While the overarching objective of consumer education is to impart knowledge that will improve consumers' financial decisions, it cannot be assumed that equipping consumers with more information will automatically lead to improved financial behaviour."

Dr. Akhtar Aziz pointed out that research had shown that consumer decisions might not always be made based on sound advice and knowledge, "but are at times based on impulsive intuition."

Spotlight on consumer issues

Judging by the topical issues raised at the Third International Forum on Financial Consumer Protection and Education in Kuala Lumpur, Malaysia, that was held in December last year, consumer matters are high on the agenda of many countries.

Olivia Davids, head of the FSB's Consumer Education Department, attended the Forum with delegates from 29 countries. The Forum was hosted by Malaysia's central bank, Bank Malaysia.

According to Davids, the objectives of the Forum are to provide regulators from various countries with an opportunity to learn from each other about best practices on consumer protection and financial literacy initiatives as well as to discuss topical issues in these areas. "The Forum targets senior regulators who are involved in policy formulation or work directly in the areas of financial literacy consumer education and protection. Speakers from NGOs and consumer bodies are invited to share their views at this forum," Davids says.

Davids added that the following consumer related issues were identified by the Forum as areas for concern that could serve as follow-up topics for future Forum meetings:

- Effectiveness of delivery tools (consumer education)
- A comprehensive communication plan to extend consumer education
- Empirical goals with respect to the percentage of the market being reached
- Prudential guidelines
- Cross-border consumer protection
- Market conduct
- Ways in which regulators can apply more ethical practices in the industry
- The ability to carry out transactions internationally, given the fact that some products offered through the Internet are complex
- Cash rebates for the use of credit cards
- Seniors and investments, given that many senior citizens unknowingly invest in high-risk products
- Class action suits on behalf of consumers
- Cooling-off periods

Olivia Davids

- Data research
- Disclosure issues, continued discussion of the presentation by the Federal Reserve
- Effective measurement of community programmes

Balance *from previous page*

"The key challenge lies in determining how behavioural factors and factors such as socio-economic and cultural backgrounds, life events and skill levels influence rational decision-making.

"The wide variation in information needs that arises from differences in prior experience, language and cultural background, the current financial situation and competing demands for consumers' time all pose challenges to the development and delivery of relevant information to consumers.

"The most effective means of engaging consumers who have a low level of interest in financial planning needs to be determined," Dr. Akhtar Aziz said.

Pension assets exceed trillion rand

For the first time total assets held by all pension funds topped R1 trillion according to the latest annual report of the Registrar of Pension Funds.

The 46th annual report for the 2004 calendar year shows that total assets increased from R909 billion in 2003 to R1, 098 billion in 2004. At the same time total contributions increased by 19% (from R24.887m in 2003 to R29.625m in 2004) due to an increase of 22.1% in employer contributions and an increase of 13.9% in member contributions.

Income from investments increased by 33.6% (from R22.351m to R29.861m) during the two years, while the adjustment to fair value of investments changed from a deficit of R19.832m in 2003 to a surplus of R49.587m in 2004. As a result, income from investments, including the adjustment to fair value, increased by 350%.

The five-year investment pattern shows a swing from insurance policies to shares and collective investment schemes in securities (CIS). The value of investments in shares and collective investment shares increased from 36.3% in 2000 to 40.7% in 2004 and the value of investments in insurance policies decreased from 31.5% in 2000 to 31.4% in 2004.

The return on investment made by pension funds for the past five years averaged 12.5%, with a low of 0.7% in 2003 to a high of 21.5% in 2004:

% returns	2000	2001	2002	2003	2004
	15.2	16.4	8.7	0.7	21.5

The total contributions received increased by 12.4% from R64 851m in 2003 to R72 921m in 2004. Total contributions of Official, Transnet, Telkom and Post Office funds increased by 10.2%, while total contributions to self-administered, underwritten and bargaining council funds in the private sector increased by 13.3%. In the same period benefits paid increased by 18.3% from R73 318m to R86 703m.

During the period under review the Registrar of Pension Funds was busy with several supervisory matters like inspections, on-site visits and litigation.

Source:
FSB media release,

The record of advice serves as vital evidence

By Anton Swanepoel, Director of Crux Consulting

The FAIS Ombud plays a significant role in guiding the financial services industry and financial services providers should embrace every opportunity to learn from it.

Since the inception of the Financial Advisory and Intermediary Services Act, 2002 (FAIS Act) until the end of March 2006 the total number of complaints received by the Office of the FAIS Ombud amounts to 3 672. Therefore, apart from the Act *not* making provision for the Ombud's Office to offer legal advice to financial services providers one can easily understand why the FAIS Ombud is focusing on the job at hand rather than spending time on "training or guiding" the financial services industry on FAIS related matters.

In view of the aforementioned I do believe that when financial services providers get the rare opportunity to listen to a presentation by the FAIS Ombud, Charles Pillai, they should grab every opportunity to learn from the case studies discussed during such sessions. One such opportunity was the Retail Financial Services Africa Conference hosted by the Institute for International Research in Johannesburg in March 2006. During his address Pillai re-confirmed a number of vital principles that financial services providers just cannot afford to miss. In my view the most significant issues highlighted by him include the following:

Ways to reduce risk of complaints

- Make excellence your hallmark;
- Thoroughly know the FAIS Act and comply;
- Be committed to life-long learning;
- Build rewarding relationships with your

client through espousing the principles of *ubuntu*. (Also see article on p 10.)

What is the essence that the FAIS Ombud's Office look for when evaluating cases?

• The contractual or other legal relationship between the parties

This is consistent with the required application by the FAIS Ombud in terms of sections 20(3) of the Act and 3(1)(d) of the General Code of Conduct (among others);

• The provisions of the FAIS Act

In other words, did the financial services provider comply with the Act and its subordinate measures in general, but with specific reference to:
(a) Seeking relevant and available information in order to determine the financial needs and objective(s) of the client[1].
(b) Conducting an analysis[2].
It must be clear that the adviser applied his/her mind in the interest of the client.
(c) Identifying appropriate financial products that serve the interests of the client[2].
(d) Adequate disclosures of relevant and material information[4] in a manner that will enable clients to make well-informed decisions[5] and that will avoid misrepresentation.

Non-disclosure is one of the main reasons for non-compliance with the Act.
(e) Keeping adequate records[6].
Pillai said: "Cases are won or lost based on facts. If we have the right evidence, chances are slim for us to find against the financial services provider. Poor record-keeping is at the centre of our determinations".

What is equitable in all the circumstances?

Once again, this aspect is consistent with the required application in terms of section 20(3) of the Act.

It is what we learn from the message of the FAIS Ombud and how we implement the solutions based on the message that will determine our success or failure under FAIS. I believe that one of the most important messages that we should listen to very carefully is the fact that poor record-keeping is at the centre of the FAIS Ombud's determinations. The only conclusion I can come to is that, as an industry, our records of advice as prescribed in the Act[7] and the General Code of Conduct[8] currently offers little or no substance.

A provider must … maintain a **record** *(put in writing or other legible shape, represent in permanent form, report of proceedings before court[9] written account, of something that is kept so that it can be looked at and used in the future, keep account, to keep a permanent account of facts or events by writing them down, filming them, storing them in a computer)[10]* **of the advice** *(any recommendation, guidance or proposal of a financial nature regarding a financial product)[11]* furnished to a client, … which record must reflect the basis on which the advice was given,[12] **and in particular-**
(a) a **brief summary** *(a brief account,[13] short statement that gives only the main points of something, not the details)[14]* **of the information** *(what is told, items of knowledge[15] facts or details about something)[16] and material (important, essential,[17] things that are needed in order to do a particular activity[18]* **on which the advice was based**;
(b) the **financial products[19]** which were considered;
(c) **the financial product or products[20] recommended** *(advised, course of action, that thing should be done, [21] to advise a particular course of action)[22]* **with an explanation** of why the product or products selected, is or are likely to satisfy the client's identified needs and objectives

A critical analysis of the "Client Advice Record" or Advice Record

After analysing as many "Advice Records" generally used by financial services providers as I could find I simply have to place the following on record:
• Beware of depending on a mere tick-box template and a free-hand document that does not offer any substance;
• if there is one document that could offer you the biggest protection under FAIS, this is the one and for this reason you are advised not to take any short cuts here; and
• take the time and effort to implement the best solution here, not the easiest.

What should be contained in the summary of the information and material on which the advice was based?

In my view a record of advice cannot merely be an index of activities. It is supposed to serve as *prima facie* evidence of relevant and material[23] information disclosed to the client to enable him/her to make a well-informed decision. The following framework within the advisory and intermediary services process should be regarded as relevant and material and should therefore be included in the report or proposal:

1. The financial objective(s)[24]

2. The key features of the recommended financial product(s)[25]

This is nothing new. Financial services providers have been disclosing product features and benefits to clients forever. Many of these benefits are usually contained in the quotations provided by the product suppliers. Since the introduction of the FAIS act the following statutory disclosures have to be made with specific reference to product features:
• A reasonable and appropriate general explanation of the nature and material terms of the relevant contract or transaction to a client, and generally make full and frank disclosure of any information that would reasonably be expected to enable the client to make an informed decision[26];
• whenever reasonable and appropriate, provide to the client any material contractual information and any material illustrations, projections or forecasts in the possession of the provider[27];
• in particular, at the earliest reasonable opportunity, provide, where applicable, full and appropriate information of the following[28]:
(i) Name, class or type of financial product concerned;
(ii) nature and extent of benefits to be provided, including details of the manner in which such benefits are derived or calculated and the manner in which they will accrue or be paid;
(iii) where the financial product is marketed or positioned as an investment or as having an investment component-
(aa) concise details of the manner in which the value of the investment is determined, including concise details of any underlying assets or other financial instruments;
(bb) separate disclosure of any charges and fees to be levied against the product, including the amount and frequency thereof and, where the specific structure of the product entails other underlying financial products, in such a manner as to enable the client to determine the net investment amount ultimately invested for the benefit of the client; and
(cc) on request, information concerning the past investment performance of the

Continued on p 22

Record *from p 21*

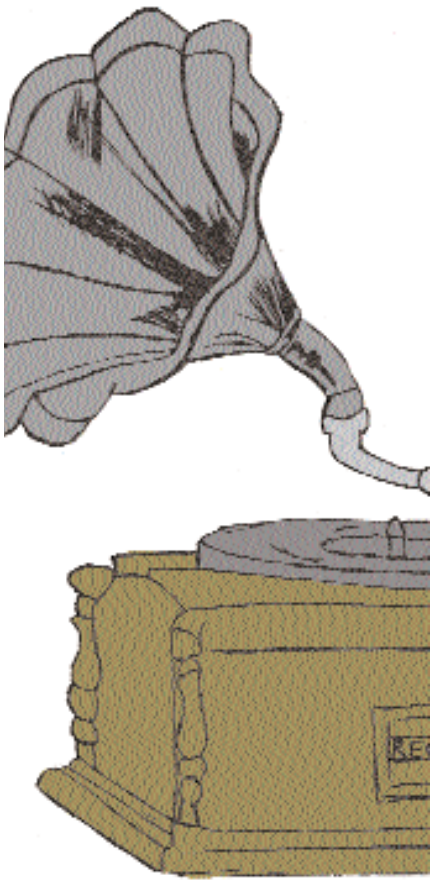
product over periods and at intervals which are reasonable with regard to the type of product involved including a warning that past performances are not necessarily indicative of future performances;

3. Terms and conditions

The following disclosures are non-negotiable in term of the FAIS Act and the General Code of Conduct:
• Concise details of any special terms or conditions, exclusions of liability, waiting periods, loadings, penalties, excesses,
• restrictions or circumstances in which benefits will not be provided[29];
• any guaranteed minimum benefits or other guarantees[30];
• to what extent the product is readily realisable or the funds concerned are accessible[31];
• any restrictions on or penalties for early termination of or withdrawal from the product, or other effects, if any, of such termination or withdrawal[32];
• material tax considerations[33];
• whether cooling off rights are offered and, if so, procedures for the exercise of such rights[34];
• any material investment or other risks associated with the product;[35] and
• in the case of an insurance product in respect of which provision is made for increase of premiums, the amount of the increased premium for the first five years and thereafter on a five year basis but not exceeding twenty years[36]; and
• the nature and extent of monetary obligations assumed by the client, directly or indirectly, in favour of the product supplier, including the manner of payment or discharge thereof, the frequency thereof, the consequences of non-compliance and, subject to subparagraph (xiv), any anticipated or contractual escalations, increases or additions[37];

4. Fees and commissions

The non-disclosure of fees, commissions and incentives have always been a topic of heated debate in our industry. The statutory disclosure requirements have levelled the playing field and this is one area where the FAIS Ombud has demonstrated that his office has zero tolerance[38]. The Act[39] and the General Code of Conduct clearly prescribe the following disclosures:
• The nature and extent of monetary obligations assumed by the client, directly or indirectly, in favour of the provider, including the manner of payment or discharge thereof, the frequency thereof, and the consequences of non-compliance[40]; and
• the nature, extent and frequency of any incentive, remuneration, consideration, commission, fee or brokerages ("valuable consideration"), which will or may become payable to the provider, directly or indirectly, by any product supplier or any person other than the client, or for which the provider may become eligible, as a result of rendering of the financial service, as well as the identity of the product supplier or other person providing or offering the valuable consideration, provided that where the maximum amount or rate of such valuable consideration is prescribed by any law, the provider may (subject to section 3(1)(a)(vii)) elect to disclose either the actual amount applicable or such prescribed maximum amount or rate.[41]



5. Intermediary service

Sometimes financial services providers make recommendations to clients with the intention of merely rendering an advisory service. In such cases it clearly would not be necessary for them to refer the offering of intermediary service when making a recommendation to a client. However, in most cases, when financial services providers present clients with recommendations it is done with the intention of also acting as the intermediary.

In the event that, in addition to an advisory service, an intermediary service it is recommend that the service value proposition is also included in the report to the client. This may not be necessary if the service offering in the disclosure notice or introduction letter to the client has been disclosed at the outset of the professional relationship. However, if it is clear that the client requires a specific service which differs from the normal service offering as disclosed to the client, the value proposition should be recorded in the report, recommendations or proposal[42].

References

[1]See section 8(1)(a) of the General Code of Conduct
[2]See section 8(1)(b) of the General Code of Conduct
[3]See section 8(1)(c) of the General Code of Conduct
[4]See sections 3 (1) (a) (iii) and 7 of the General Code of Conduct
[5]See section 8(2) of the General Code of Conduct
[6]See section 3 (2) (a) and 9 of the General Code of Conduct
[7]See section 16(2).
[8]See section 9.
[9]See The Pocket Oxford Dictionary, Oxford University Press, 1977: p. 687
[10]See Oxford Advanced Learner's Dictionary: p 1217
[11]See section 1(1) of the Act.
[12]See section 16(2)(b) of the Act and section 9(1) of the General Code of Conduct.
[13]See The Pocket Oxford Dictionary, Oxford University Press, 1977: p. 852.
[14]See Oxford Advanced Learner's Dictionary: p 1481
[15]See The Pocket Oxford Dictionary, Oxford University Press, 1977: p. 414.
[16]See Oxford Advanced Learner's Dictionary: p 765.
[17]See The Pocket Oxford Dictionary, Oxford University Press, 1977: p. 497.
[18]See Oxford Advanced Learner's Dictionary: p 908.
[19]See section 1(1) of the Act.
[20]See section 1(1) of the Act.
[21]See The Pocket Oxford Dictionary, Oxford University Press, 1977: p. 687.
[22]See Oxford Advanced Learner's Dictionary: p 1216.
[23]See section 16(2) of the Act.
[24]See section 8(1)(a) of the General Code of Conduct.
[25]See section 7(1)(a), (b), (c)(i),(ii) of the General Code of Conduct.
[26]See section 7(1)(a) of the General Code of Conduct.
[27]See section 7(1)(b) of the General Code of Conduct.
[28]See section 7(1)(c) of the General Code of Conduct.
[29]See section 7(1)(c)(vii) of the General Code of Conduct.
[30]See section 7(1)(c)(viii) of the General Code of Conduct.
[31]See section 7(1)(c)(ix) of the General Code of Conduct.
[32]See section 7(1)(c)(x) of the General Code of Conduct.
[33]See section 7(1)(c)(xi) of the General Code of Conduct.
[34]See section 7(1)(c)(xii) of the General Code of Conduct.
[35]See section 7(1)(c)(xiii) of the General Code of Conduct.
[36]See section 7(1)(c)(xiv) of the General Code of Conduct.
[37]See section 7(1)(c)(iv) of the General Code of Conduct.
[38]See section 7(1)(c)(iv)(v)(vi) of the General Code of Conduct.
[39]See the Spendley/Rosspen Financial Servives case and the Stephenson/Nedbank case.
[40]See section 16(2).
[41]See section 7(1)(c)(vi) of the General Code of Conduct.
[42]See section 7(1)(c)(ix) of the General Code of Conduct.

Call on pension administrators to come clean

The Registrar of Pension Funds issued a circular in April asking all persons and institutions (administrators) who have been granted approval in terms of section 13B of the Pension Funds Act,1956 to administer the investments of pension funds as defined in the Act.

Administrators are financial institutions in terms of the Financial Services Board Act, 1990 (FSB Act) and have to be supervised by the FSB. They are in particular subject to the provisions of the Pension Funds Act, 1956 and the Financial Institutions Act (Protection of Funds Act), 2001.

According to the circular, when dealing with pension fund monies under their control, administrators are required by law to —

- observe the utmost good faith;
- exercise proper care and diligence;
- refrain from gaining direct or indirect improper advantage for themselves to the prejudice of their principals (the pension funds concerned); and
- avoid conflicts of interest.

By way of example, the following practice would be unlawful:

An administrator consolidates or "bulks" credit balances of pension funds' bank accounts under its control and thereby procures a higher rate of interest from the bank. All interest yielded is not passed on proportionally to the pension funds entitled thereto and the additional interest derived from the consolidated amount, is for the benefit of the administrator. This "secret profit" is also not disclosed to the boards of management of the pension funds.

A further example: The administrator is part of a group of companies, which includes a bank. In this case there is no negotiation to increase possible interest rates payable to the funds being administered, but the group as a whole benefits.

There may be other permutations of this practice, the net result in each instance being an improper benefit or perquisite gained by the administrator at the expense of the funds under its management, and without full disclosure being made to the funds, the Registrar said.

As this practice may be widespread and as many pension funds may have been at the receiving end with concomitant losses to their members, the Registrar deems it advisable to investigate the matter thoroughly, if necessary by formal inspections into the affairs of administrators over the past years. A preferable alternative would be for administrators to volunteer information to the Registrar concerning practices of this nature conducted by them presently or in the past and to put forward proposals as to how redress will be made to the pension funds concerned.

All interest yielded is not passed on proportionally to the pension funds entitled thereto and the additional interest derived from the consolidated amount, goes for the benefit of the administrator.

According to the Registrar the purpose of the circular is to invite administrators to make full and frank disclosure to its office of —

- practices and methods, such as those mentioned above, but not necessarily confined thereto, whereby secret profits were made directly or indirectly by administrators or associated companies to the detriment of pension funds whose money they controlled;
- the pension funds involved;
- the amounts of which individual funds were deprived;
- how they proposed redress will be made to the funds.

Administrators of pension funds are requested to respond not later than 30 April 2006.

FSB steadily reduces fsp licence applications

FSB Deputy Executive Officer for Financial Advisory and Intermediary Services (FAIS) and Consumer Education, Gerry Anderson, says despite receiving several new applications for FAIS licensing, the steady reduction of the number of applications in process, is continuing.

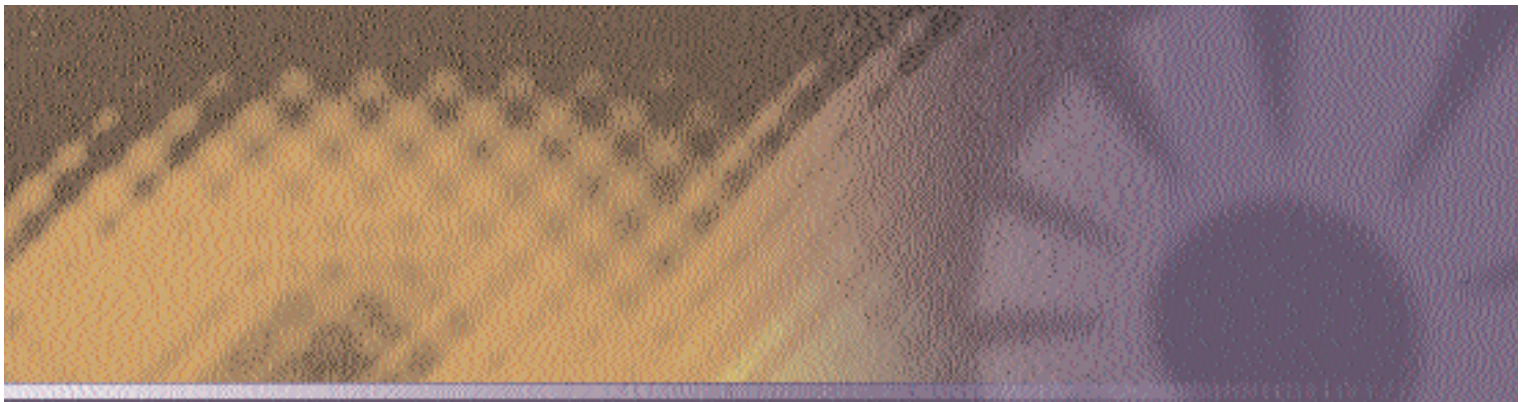
To date the FSB has finalised 13 260 applications for authorisation as financial services providers (FSPs).

In total, 662 of these applications have been declined.

Anderson says that the declining of the vast majority of the applications can be attributed to their being incomplete and not meeting the minimum requirements for approval.

Anderson says that FSPs whose applications had been unsuccessful are entitled to appeal to the FSB Appeal Board, an independent tribunal, if the applicant is dissatisfied with the decision by the registrar.

Source: FSB media release 7 April 2006



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