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Letters to the editor may be submitted to Bessie Venter, PO Box 35655, Menlo Park, 0102 or to bessiev@fsb.co.za.

Guidance on applying for FAIS licences

ince the first publication of the Financial Advisory and Intermediary Services Act, 2002 (the Act), the public was put on notice that persons rendering financial services to clients contemplated in the Act, must apply for licences before the date mentioned in section 7(1) of the Act.

The FSB immediately took the steps necessary for establishing the registrar's office and other systems and structures, including the appointment of required staff. It also recognised representative bodies to help the registrar with the consideration of licence applications.

The Minister of Finance has now determined 30 September 2004 as this date.

Acquiring licensed status is important because the carrying on of unlicensed financial services business on or after 30 September, may lead to criminal prosecution for contravention of the prohibition contained therein.

For persons who foresee that they may in future, but after 30 September, commence business, the Act contains no restriction regarding dates for submission of applications.

Persons who have not yet submitted the required applications, must do so immediately.

Guidance notes for prospective applicants

Experience at the registrar's office shows that due to all the requirements with which applicants have to comply and the many discretions granted to the registrar in evaluating and considering applications, an average period of two months is necessary for completing applications. And this is only provided that applications are fully completed, containing all the required information and attachments.

In order to assist prospective applicants to be licenced on 30 September 2004, the following guidelines are offered regarding prospective future dates of submission, and of official completion of consideration of applications:

Date of submission of completed application	Prospective date of official finalisation of application
Before or on 31 March 2004	Before or on 31 May 2004
Between 1 April and 30 April 2004	Before or on 30 June 2004
Between 1 May and 31 May 2004	Before or on 31 July 2004
Between 1 June and 30 June 2004	Before or on 31 August 2004
Between 1 July and 31 July 2004	Before or on 29 September 2004.

It is important to note that 31 July is the last date for submission of applications to meet the deadline of 30 September. The registrar will use his best endeavours to complete considerations of applications within this timeframe.

Prospective applicants, most of whom may need years to acquire the necessary qualifications and experience, may choose their own application dates. They are however advised that the application date must be at least two months before the envisaged date of commencement of business. These applicants must also note that the guidance offered as regards the relevant dates assumes that applications are fully completed with all the required attachments.

Defective applications will inevitably cause long delays. Such applicants may not be licensed on 30 September 2004 and will have to cease carrying on their unlicensed business to avoid prosecution under the Act. The same result will ensue in the case of applications refused by the registrar due to the applicants not complying with the Act's requirements, whatever the date of submission may have been.

It is also important to note that in case of successful applications before 30 September 2004, the licensee needs to comply with the subordinate legislation in terms of the Act only from 30 September 2004. The licensee must also inform the registrar of any change between the date of issue of the licence and 30 September 2004 regarding information, qualifications and personal situation which may affect the legitimacy of the licence and may need reconsideration or amendment.

Applicable application documentation

Prospective licence applicants must comply with the following important documentation published under the Act in the *Government Gazette*:

- Determination of Fees payable to the Registrar of Financial Services Providers, 2003 (GN 536 in *Government Gazette* No. 24761 of 15 April 2003);
- Notice on Qualifications and Experience of Compliance Officers in respect of Financial Services Business, 2002 (BN 83 of 2003 in *Government Gazette* No. 25299 of 8 August 2003);
- Determination of Criteria and Guidelines for the Approval of Compliance Officers, 2002 (BN 84 of 2003 in *Government Gazette* No. 25299 of 8 August 2003);
- Determination of Fit and Proper Requirements for Financial Services Providers, 2003 (BN 91 of 2003 in *Government Gazette* No. 25446 of 10 September 2003);
- Exemption of Authorised Financial Services Providers as regards Representatives, No. 1 of 2003 (BN 95 of 2003 in *Government Gazette* No. 25514 of 30 September 2003);
- Exemption of certain Authorised Financial Services Providers from Requirements pertaining to Audited Financial Statements and Financial Soundness, No. 1 of 2003 (BN 96 of 2003 in *Government Gazette* No. 25514 of 30 September 2003);
- Exemption of Investment Managers from Fit and Proper Requirements, No. 1 of 2003 (BN 97 of 2003 in *Government Gazette* No. 25514 of 30 September 2003);
- Application by Financial Services Providers for Authorisation by the Financial Services Board (BN 98 of 2003 in *Government Gazette* No. 25523 of 3 October 2003);
- Determination of Procedure for Approval of Key Individuals, 2003 (BN 122 of 2003 in *Government Gazette* No. 25628 of 24 October 2003);
- Exemption of Authorised Financial Services Providers and Representatives conducting Short-term Deposit Business from certain Fit and Proper Requirements and the General code when rendering Financial Services relating to Money Market Funds, 2003 (BN 135 of 2003 in *Government Gazette* No. 25723 of 14 November 2003);
- Notice on the Form of Licences, 2004 (BN 9 of 2004 in *Government Gazette* No. 25942 of 23 January 2004).

Source:

Guidance Notes on Licence Application Procedures (the FAIS Act), 2004, published in Government Gazette No. 26135 of 11 March 2004

Forex brokers to register with FSB

The FSB has published a code of conduct to regulate dealings in foreign currency in terms of the Financial Advisory and Intermediary Services Act, 2002 (FAIS).

The FSB's FAIS manager of supervision, Wendy Hattingh, said the Minister of Finance gazetted regulations that paved the way for the registration of forex currency brokers.

They may now apply for the required licence in terms of the FAIS Act, either directly to the FSB or to the soon to be recognised Forex Investment Association.

The code of conduct will regulate the conduct of authorised financial services providers (FSPs) and their representatives involved in forex investment business.

'The code of conduct apply to FSPs involved in certain foreign currency denominated investment instruments relating to forex trading, more specifically currency spot trading. However, it does not include transactions in foreign exchange conducted under exchange control laws by authorised dealers and their bureaux de change, or commercial agencies,' Hattingh said.

Spot currency trading involves investing money on behalf of a client with a foreign clearing firm or foreign exchange service provider, and then trading on it after clearing such funds in terms of the relevant provisions of the exchange control laws.

FSPs dealing in foreign currency spot trading have never before been regulated. In terms of FAIS, however, all FSPs need to have a licence to render financial services by 30 September 2004.

It was deemed necessary to include this activity in pursuit of consumer protection after the relaxation of exchange control regulations. Because of the nature of this activity, a specific code of conduct for this type of intermediary was drafted. Hattingh said this was done after consultation with the Forex Investment Association and other role players.

FSPs who wish to be licensed by 30 September should note that applications must reach the FSB by 31 July. The application form and information regarding approved recognised bodies are available on the FSB website, www.fsb.co.za.

FAIS promotes true alignment of interests

By Anton Swanepoel, Director: Products and Training at PSG Konsult and author of Invest like a Pro and Retire like a Pro

The Financial Advisory and Intermediary Services Act, 2002 (FAIS) is very clear when it refers to its objective. The interests of the consumer must be served and one thing is for sure: If the interests and actions of financial advisors are not aligned with the interests of their clients, it will be impossible for investors, especially for people planning for their retirement, to achieve their long-term investment objectives.

The investor, advisor, administrator, multi-manager and asset manager make it possible for investors to achieve their investment goals.

These parties are interdependent. If any of them follow a selfish agenda, success will be impossible. The whole process of true alignment starts with the financial advisor. If he/she aims astray as a result of ignorance or serving own interests, the efforts of all the other parties become meaningless. But before we go into the issue of serving own interests, it is important to understand the current status of the relevant parties, with specific reference to individuals planning for retirement.

Current status of role players

Investor

Investors generally do not take enough responsibility for their own decisions. In many cases they expect financial advisors to be magicians. Many investors expect advisors to grow their capital at unprecedented levels, without investment risks. Because of their unrealistic expectations, such investors make life difficult for advisors. Ignorance is the main reason for these perceptions and that is why the focus on appropriate advice in terms of FAIS is so important. Desperation, greed and ignorance are human elements that can be managed through simple consumer education techniques.

FAIS emphasises consumer education. The fact that advisors are faced with the legal obligation to lead their clients into making well-informed decisions will help advisors to take more care in their planning process. However, investors will have to accept that the ultimate decision is still theirs and with it they will have to accept some responsibilities.

Advisor

Our industry has many competent advisors, which I am proud to name my colleagues, and some even my friends. The assurance I can give consumers is that there are many advisors with a true desire to serve their clients, regardless of the industry perception.

One thing that professionals in this environment have learnt over the last years is that we desperately need better and sustainable investment solutions for individuals with a need for wealth preservation.

Once again FAIS will help to distinguish between investors' wants and needs. One of the most important obligations of an advisor is to do a client needs analysis. If investors do not truly understand clients' needs they will never be able to make appropriate recommendations.

Advisors must also ensure that all other role players are aligned with the proposed investment strategy. They should become the clients of the other role players. But there is one serious prerequisite – advisors must know what they are doing!

Historically, I had to use investment models that were based on theories, written by academics that did not have the privilege of serving the needs of people who just could not afford to lose their capital or just could not afford negative returns. Hopefully FAIS will help more professional advisors and their clients to distinguish between investment objectives that are measured subjectively and objectives that can be measured according to objective benchmarks. The main reason for this statement is that the way you feel about your investments leads to herd behaviour, which would not pass the appropriate test. Furthermore, it exacerbates the issue of trying to hit a moving target continuously. On the other hand, investment objectives that are measured according to objective benchmarks, like inflation, tend to lead to rational investor behaviour, which is aligned with the new legislation's objectives.

Investors will also have to come to grips with the fact that although advisors are obliged to serve clients' interests, it does not mean that they have to work for free. Alignment of interests will be the key to successful investing – especially for those planning their retirement.

Administrator

Currently the administrator, like a Linked Investment Services Provider, is responsible for administration only. Investors tend to underestimate the importance of sound administration of investment schemes and that it costs money. It is important that advisors try to keep a sound balance between cheap administration fees and making sure that the administrator can continue with a sustainable business. This is also of importance for consumers as I have witnessed a number of administrators that cut their fees to such a point where they could no longer sustain their business. This resulted in admin-intensive take-overs, causing clients a lot of heartache and in some

cases, additional costs.

In many cases administrators were forced to request "kick-backs" from fund managers to maintain their businesses, which obviously cannot be tolerated under a FAIS environment. In other cases advisors were putting pressure on administrators to pay them additional commission above their advisory and management fees, which developed into a vicious circle. I am confident that this practise will be exposed under the new law as the "kick-back" system does not serve the interests of the consumer and as it is not disclosed to consumers in general, it also means that this practice will be non-compliant.

MSCI World Index, S&P 500, the JSE etc.

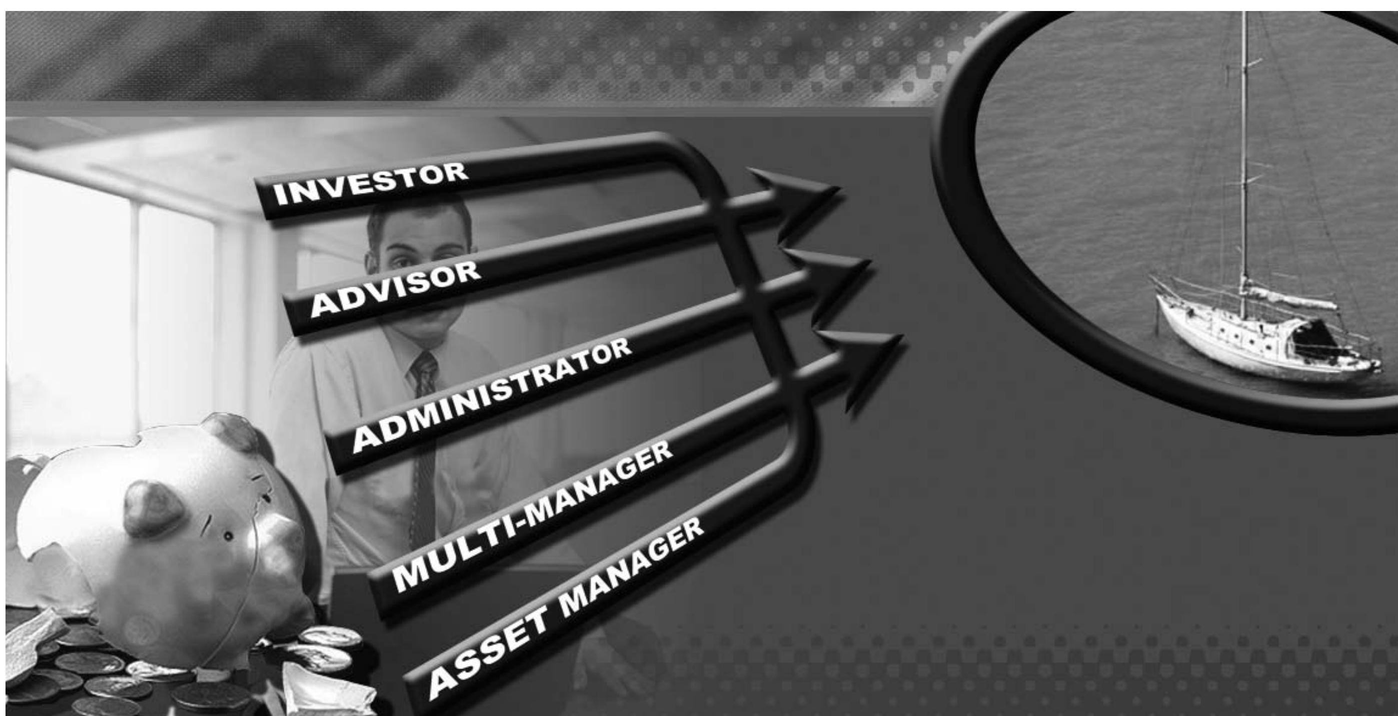
Financial advisors have been tasked to construct portfolios to meet investors' objectives, which are based on absolute return expectations.

Asset managers made ongoing suggestions to advisors pertaining to ideal asset classes and portfolios and then it was up to the financial advisor to make the changes. This allowed investment advisors to become quasi-asset managers – a job that the majority of advisors are not "fit and proper" to do.

Asset managers are in a much better position to manage investment portfolios according to absolute return benchmarks.

advisors.

- Salespeople are forced to become professional financial advisors.
- Investors have lost a lot of money over the years. Many "advisors" were blaming the markets, but perhaps one should also question some of the advice given and some of the investment tools. One of my favourite quotes is by Warren Buffet, who said: *"It is only when the tide goes out that you can see who has been swimming naked."* I think that this principle also applies to financial advisors - when the good tide of the markets turned, one could clearly see investment philosophies showing their true colours. Although painful, these lessons will stand us in good stead in



Multi-manager

The multi-manager can be friend or foe, depending on how they apply their services. In my view, they are friends if they do the following:

- Listen carefully to the needs of professional financial advisors who are trying to serve their clients – especially those who expressed the need for wealth (preservation).
- Make pro-active suggestions to improve current models, instead of persisting with their own asset allocation models as it defeats effectively the object of true multi-management.
- Charge fair, market-related fees.

Asset manager

Historically, asset managers have been measured based on investment portfolios with relative benchmarks, like the Nasdaq,

Hopefully asset managers will be measured differently in future. The time is long overdue for asset managers to manage assets and financial planners to do financial planning. I am also confident that FAIS will help us all to focus on our respective strengths and to stay out of each other's areas of expertise.

Hopefully fit and proper requirements of FAIS will take care of the confusion that existed and allow true professional advisors to take their rightful place in the circle of professions.

Need to revisit current position

An industry turned into a profession

- Historically, investment advisors were insurance salespeople that sold investment plans. It became clear that investment planning requires a lot of technical skills and as a result more highly trained people joined the industry as financial

future.

- The only way to protect the consumer was to turn the industry into a profession and there is one major difference between the selling game and a profession. A salesman sells on the upside, whereas a true professional knows what can go wrong and protects his/her clients against it.

Ethics, legislation and codes of conduct

- Many countries have implemented legislation to protect consumers against poor advice.
- As the industry turned into a profession, more attention was given to advisors' ethical behaviour. We will see the same happening in South Africa.
- The profession needed a code of conduct to guide advisors in their day-to-day practice.

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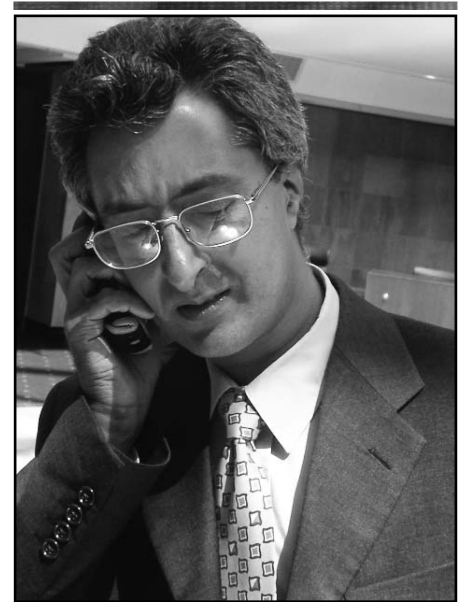
Members of Policy Board for Financial Services and Regulation appointed

The Minister of Finance has appointed the new members of the Policy Board for Financial Services and Regulation. "The Board is guided by the Policy Board for Financial Services and Regulation Act, 1993. Its objective is accordingly to advise the Minister on aspects of the financial system which are conducive to promoting financial stability", explains Dr Cyrus Rustomjee, chairperson of the Policy Board.

"We will soon identify and pursue a fairly detailed work programme which will fulfil the mandate given to the Board by the Act. This will include issues identified by the Minister."

When questioned about his views on a single regulatory structure, Rustomjee says that it is a complex question as South Africa benefits from a highly sophisticated financial system. "We are also beginning to demonstrate some capacity to differentiate ourselves, based on both institutional and policy-related features of our financial system, from a number of emerging market economies. These factors make consideration of the advantages and disadvantages of a single regulator approach a complex and detailed issue. The approach I would like to take would be to examine each of the issues associated with the concept before making an overall judgment."

The members appointed with effect from 1 January 2004 to 31 December 2005 are:
Dr Cyrus Rustomjee (chairperson), Mr Lesetja Kganyago (deputy chairperson), Mr Anthony Bolani, Dr Hans Falkena, Mr David Harpur, Ms Venette Klein, Mr Russel Loubser, Ms Pindi Mabena, Mr Christopher Malan, Ms Dawn Marole, Ms Carmen Maynard, Mr Donald Molema, Mr Modise Motloba, Mr Barry Scott, Mr Abel Sithole, Prof Elizabeth Stack, Mr Ronald Store, Ms Diane Terblanche, Mr Bob Tucker and Ms Wezi Ximiya. Appointed as *ex officio* members are: Prof PA Delport (Member of Standing Advisory Committee on Company Law), Mr Errol Kruger (Registrar of Banks), Mr Patrick Masobe (Registrar of Medical Schemes), Mr Jeff van Rooyen (Executive Officer of the FSB) and Dr Alistair Ruiters (Director-General of Trade and Industry).



We will soon identify and pursue a fairly detailed work programme, says Dr Cyrus Rustomjee, chairperson of the Policy Board.

SACCAWU-linked company slammed with R104m law suit

Tony Mostert, curator of the South Africa Commercial, Catering and Allied Workers Union (SACCAWU) National Provident Fund, is suing Cape Town company Merit Asset Managers (Pty) Ltd (Merit) for R140 million in the Cape Town High Court.

Mostert is suing for damages suffered due to the alleged misappropriation of fund money and breach of contractual obligations.

'Merit is the first of many parties in the SACCAWU case who will be taken to court regarding alleged misappropriation of funds and other irregularities,' Mostert warned.

The FSB placed the SACCAWU National Provident Fund under curatorship in September 2002 after an inspection uncovered a series of transgressions by the fund trustees.

Mostert's appointment as curator gave rise to a lengthy court battle as the former trustees of the fund tried to remove him from the post. His appointment was however endorsed by the High Court Transvaal Division. The trustees who opposed his appointment were ordered to pay punitive costs.

Since then, Mostert says, his investigations have given him reason to suspect gross irregularities, such as the possible wrongful payment of R100 million to Merit Asset Managers and the company's consequent misappropriation of the funds.

Mostert is suing Merit to recover the R100 million allegedly paid to it unlawfully by the fund trustees, plus interest and legal costs.

The curator has already recovered about R35 million of the R100 million entrusted to Merit.

Mostert's case involves the payment of funds by Merit to some companies, ostensibly as loans, which the company was not entitled to do. Seventy-one million rand was paid to Saccawu Investment Holdings (Pty) Ltd, of which Zulani Mtshotshisa and other union officials, were the directors.

An amount of R1,5 million was extended to PSC, a company of which Krisch Naidoo and Zulani Mtshotshisa were the sole directors. This company had no prospect of repaying the loan, and is insolvent.

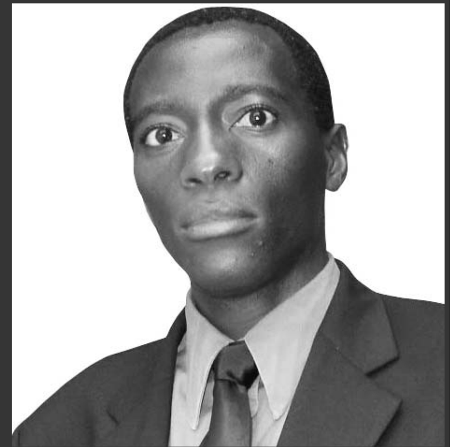
R100 000 was also paid to Da Gama Williams, a firm of attorneys. Investigations showed that a girlfriend of the former principal officer of the SACCAWU fund worked for the firm.

A court date has not yet been set.

Source:

FSB Media Release,

Vuyani Ngalwana new pension funds adjudicator



Former deputy director of the Asset Forfeiture Unit, Vuyani Ngalwana, has been appointed the new pension funds adjudicator.

Ngalwana replaces professor John Murphy who left for a position at the United Nations at the beginning of last year.

Thirty-six-year-old Ngalwana is not unfamiliar with the workings of the office of the adjudicator as he had presented a number of seminars on pensions law over the past four years - most recently on two occasions with Murphy.

He was the editor of Juta's *Pension Law Bulletin* for three years and the author of *Pension Dispute Resolution Procedure: An Easy Guide* (1999).

He has also adjudicated on numerous income tax matters and has given three judgments as chairperson of the Special Board for hearing Income Tax Appeals. He has also given extensive comments on the South African Law Commission discussion paper on division of pension benefits between spouses on divorce.

Ngalwana, who holds a master of laws (income tax) from the University of Cape Town, has been a member of the Cape Bar and a legal advisor to Southern Life's Employee Benefits Legal Advisory Services.

The new pension funds adjudicator is an avid reader - particularly law journals and reports. He has a passion for research and writing law articles. Some of his work which were published in various publications include: "Pension to provident transfers"; "The under-representation of blacks and women at the Bar"; "Pension Interest and Divorce Cases: What precisely is the Correct Position?"; "Do the Rules of a Pension Fund constitute a Trust Instrument or a Contract?"; "Death Benefit Apportionment: Trustees Beware"; and "Dispute Resolution Procedure in the Retirement Industry".

Ngalwana, while at Diocesan College (Bishops) in Cape Town, participated in cricket, chess and cross country. Nowadays he is into road running and playing golf. Besides his home language of isiXhosa, he is also fluent in English, Afrikaans and isiZulu.

Source:
FSB Media Release, 4 March 2003

Fedbond Collective Investment Scheme in Participation Bonds

he FSB informed the public that in terms of a court order granted in the Pretoria High Court on 3 February 2004, the entire collective investment scheme business of Fedbond Participation Mortgage Bond Managers (Pty) Ltd (Fedbond) and Fedbond Nominees (Pty) Ltd, was placed provisionally under the joint management and control of Mr Edwin Marcus Letty and Fedbond. Mr Letty is a former practising attorney and chief executive of a long-term insurance company.

The order was agreed to by the management of the scheme and the FSB as an interim measure.

Following an inspection of the scheme which revealed certain apparent non-compliance issues, the FSB deemed it appropriate to take this course of action in the interest of participants in the scheme and to mitigate any potential losses.

The monitor is required to undertake a full investigation into the overall financial soundness of the scheme and to report back to the court on 8 June 2004. Pending this report the scheme is precluded from accepting new investments or repaying capital to investors. Subject to the findings of the investigation it is anticipated that interest will continue to be paid to investors.

The FSB wishes to emphasise that the scheme has not been placed in liquidation, nor has the court made any conclusive determination of the merits of the application.

Source:
FSB Media Release,
3 February 2004

Help! There s a mistake on my bank account

he Banks Act, 1990 and the Code of Banking Practices oblige banks to promote fairness and justice. Mistakes and maladministration still occur, however, and these could result in financial damages, distress and inconvenience to the client. What can the client do when noticing wrong figures on a bank statement, for example?

Most people are probably unaware of the existence of the Ombudsman for Banking Services who is responsible for processing legal complaints against banks. This is a free service and banks must respect the final decisions of the Office. The Ombudsman is advocate Neville Melville. His office employs professional help desk and investigation staff that handle all the investigative work.

Who can use these services?

Individuals and small businesses with a turnover of R5 million or less and with a claim of R800 000 or less are allowed to use the services of the Ombudsman. Before a client files a complaint at the Ombudsman, the complaint procedures within the bank should be followed. If the bank does not solve the problem to the client's satisfaction, the client may fill in a standard form (available at the branch or supplied by the Ombudsman by e-mail, fax or post). The complainant has to use a complaint reference number supplied by the bank when applying for assistance from the Ombudsman. The particular problem is then explained as clearly and as detailed as possible on the form and all relevant documentation is attached.

Procedures

When a complaint falls within the Ombudsman's jurisdiction, it will give the bank the opportunity to resolve the matter within 15 working days. If the bank fails to resolve the matter to the complainant's satisfaction within the given time, the complaint is considered to be a dispute. The Ombudsman can, at this stage, make an initial assessment or, investigates the matter and comes to a decision. The Ombudsman may request further information as well as an explanation as to why the complaint has not been resolved satisfactorily. No hearing takes place.

This process may take up to four months. The final conclusion and recommendations are given in writing. At any time during this process the bank and the complainant may choose to come to an agreement.

Determinations made by the Ombudsman, based on the law and the Code of Banking Practice are binding on the bank. However, recommendations based on principles of fairness, good banking practices and the Code of Banking Practice are not binding on the bank. If a determination is made that is adverse to either party, that patry may apply to have the Ombudsman's decision reviewed by a retired judge. When complainants are not satisfied by the decisions made by the Ombudsman, they are not obliged to accept these decisions. A complainant may therefore seek legal advice when the matter has not been resolved satisfactorily. The complainant's acceptance, on the other hand, of the compensation suggested or determined by the adjudicator, serves as final resolution of the matter.

By Dr J H Minnaar-van Veijeren, Director: I-Value Risk Management (Pty) Ltd

All the necessary information about the Ombudsman for Banking Services (including hints for avoiding banking problems) can be found on its website www.obssa.co.za. An online form is also available on this site. The telephone numbers of the Ombudsman are 0860-800-900 (cost subsidised) and (011) 838-0035. Dr J H Minnaar-van Veijeren s telephone number is 012 452 3620.

New retirement fund initiative enhances regulatory function

By Pieter W. Buys, PhD, Senior Manager, IFI Advisory, PricewaterhouseCoopers Inc.

Alexander Forbes, Financial Reporting Solutions (Pty) Ltd (FRS) and PricewaterhouseCoopers developed and implemented the South African XBRL Retirement Fund Digital Supply Chain Initiative during the past 18 months. The initiative was necessary because of the pending changes in the legislation around retirement fund reporting.

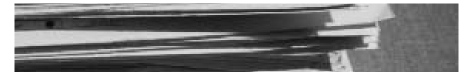
Initiative

In its regulatory role, the FSB receives and analyses financial reports from registered retirement funds. Its support of the initiative was part of an effort to eliminate any non-value adding activities. The FSB also wanted to be pro-active in its effort to comply with the regulations of the Electronic Communications and Transactions Act, 2002. At the time, the FSB received financial reports from around 3,300 private retirement funds, while pending legislation would have added 11,000 more underwritten funds to the pool. Because of the volume of these reports, it would have been difficult to cope with the additional workload. By using XBRL technology, the FSB could receive reports digitally, thereby reducing the need for manual intervention in the capturing of financial data.

Alexander Forbes handles a multitude of unique retirement funds, each with its own rules, trustees, auditors, and circumstances. The traditional accounting processes and reports preparation of the funds are manual, with different people performing the daily fund administration and preparation of accounting data. Consequently the accounting data and reports reflected the assortment of these different efforts.

To improve their financial statement preparation, Alexander Forbes had to consider how to move from a “Slow Close” scenario to a “Smart Close” scenario.

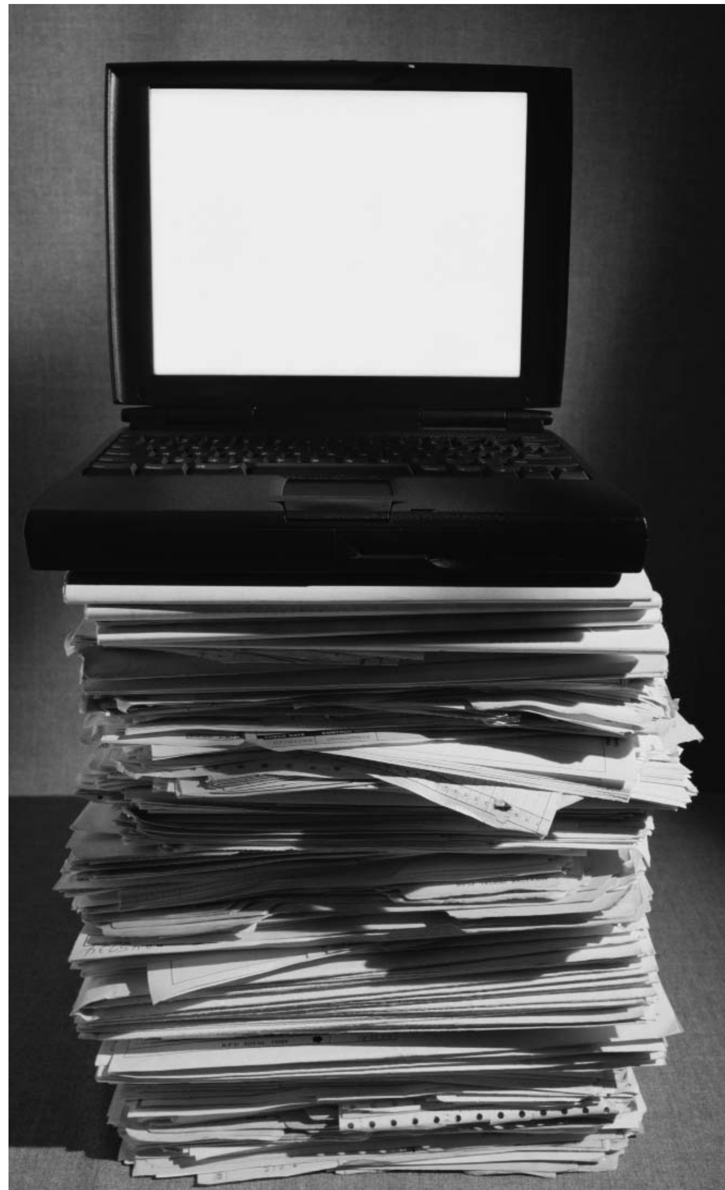
To enable the digital transmission of retirement fund reports, the initiative based its approach on the XBRL enabled technology of FRS. The major problem with the preparation of any kind of financial report is the time required to sort out the accounting data before it can be used in the preparation



of financial statements. The objective was to standardise the capturing of accounting data and the preparation of the financial reports.

Changing the process

The objective was to create a standardised accounting process, which will bring about Straight Through Reporting (or STR). STR is an optimal processing environment for internal and external information management reporting which replaces the inefficient processes with efficient ones, less reliant on human interaction.



It was essential to understand the reporting requirements from a legal perspective. Once there was an understanding of these requirements, a unique retirement fund taxonomy was developed. From this taxonomy it is then possible to generate XBRL compliant instance documents.

Due to the ground breaking nature of this initiative, there was some security and quality control concerns around the digital submission of the financial information. As part of the quality control effort the pension fund, the fund auditor and the fund trustee had to verify the reasonableness of these reports. The purpose of this verification was to ensure that the reports generated by the FRS tool are a true reflexion of the information within the ERP system. Once such ‘approval’ has been obtained, the instance document is down-

To p.20

Deregulation of commision: An opp

By AndrØ Swanepoel, Deputy Executive Officer: Insurance, FSB

outh Africa is one of a few countries in the world that still caps commission payments in the insurance industry.

Maximum commission regulation was introduced in 1977 as a result of unjustifiably high commission rates and the continued escalation of commissions due to a broker-driven market.

The FSB's philosophy is to remove the ceilings, but to retain the necessary full disclosure. Financial services providers should see this move to decap as entrusting them with more responsibility and to act professionally in providing advice and services.

Arguments for and against decapping

The following reasons exist for the decapping of commissions:

- Our economy is essentially a free market economy and the regulation of maximum commissions is an intervention that inhibits market forces to determine the appropriate levels according to advice or services rendered.
- Other financial services sectors, such as the collective investment schemes sector, have done away with it.
- Regulatory caps stifle innovation, competition and the ability of insurers and intermediaries to co-operate to provide effective services, especially in the technology-oriented market.
- In an environment where the maximum becomes the norm, no consideration is given to the quality of services.
- The Financial Advisory and Intermediary Services Act, 2002, (FAIS) will restrict the operation of unscrupulous intermediaries in the market.

Arguments against decapping include:

- The socio-economic status of the majority of South Africans and the lack of education regarding financial products and services and negotiating skills, call for responsible consumer protection.
- Decapping will lead to insurers competing for distribution channels to the detriment of the consumer.
- Insurers and intermediaries have more knowledge than consumers and are in a better negotiating position.
- Very few consumers have the ability to negotiate commission.

The Policy Board for Financial Services and Regulation thus advised the Minister of Finance that South Africa must follow the route to decap gradually, first starting with policies normally bought by the so-called sophisticated market in the short-term insurance industry and certain types of single premium and fund policies in the long-term industry. Policies that will be decapped later are the personal lines policies in the short-term industry and the individual life recurring premium policies in the life industry. The underlying principle is to decap but to make full disclosure to the customer regarding all the costs, the type and structure of those costs and the incidence thereof.

The current process

FAIS dovetails well with the move to decap commissions in the insurance industry.

The Minister of Finance has already given approval that the commissions on policies sold to commercial and corporate entities in the short-term industry be decapped, but only after the final date on which all intermediaries must be registered.

A consultation paper on the deregulation of commission payable on certain long-term insurance products was issued in December 2003. A proposal will shortly be finalised and submitted to the Minister of Finance for his approval.

The Sandler report

The Sandler Report, published in the United Kingdom in July 2002, recommended that cost of advice must be separated clearly from the cost of the product.

It also recommended that a clear distinction be made regarding the independence of advisers, product providers should make products available to independent advisers at a wholesale price, and consumers should know what they are paying for.

The above indicates that we are entering an era of professionalism regarding the delivery of advice and services which will place the cost and quality of these under the spotlight.

Core principles

Although the FSB needs to balance legislation between the protection of the consumer and allowing the industry to innovate and provide products to satisfy consumer needs, the FSB believes that decapping could open a wide range of possibilities in which intermediaries could show their professionalism. As South African consumers come from widely different backgrounds and educational levels, decapping must be done in stages and should run hand-in-hand with the FSB's consumer education project. Intermediaries will bear a big responsibility in this process.

The essential elements in a professional code include registration, a proper code of conduct, professional indemnity insurance and an effective disciplinary code. These elements are all present under FAIS. Intermediaries should therefore use this opportunity to show that they can be trusted. If they adhere to the principles embodied in the King II

portunity towards professionalism?

code of corporate governance, namely discipline, responsibility, accountability, fairness, transparency, independence and social responsibility, the more the regulator might be inclined to entrust intermediaries with more freedom.

Definitional issues

It will be necessary to redefine why and how intermediaries need to be paid, the level of remuneration depending on the amount of advice or services rendered, the timing of those payments, the necessary claw-backs, the responsibilities toward the customer between those inside and outside the FAIS net, the future accountability toward the customer and the legal relationship between the product provider, independent intermediary and the client.

In this process it will be important to change the consumer's attitude to realise that they must be prepared to pay for valuable advice.

The following issues could be debated:

- Should the meaning of acquisition cost (what the product provider pays to the intermediary for bringing in the business) be redefined? How should this be disclosed and is it negotiable with the customer?
- Shareholders could pay the acquisition cost from their funds. In this way supervisors will be able to ensure that costs do not get out of hand.
- Shouldn't we call acquisition cost "commission", and the portion that is negotiated with the customer the "fee"? Maybe all products should bear a small acquisition cost, or commission, negotiated between the provider and the intermediary and paid by shareholders, as well as the fee portion negotiated between adviser and client and directly debited against the client's policy.
- What services and/or advice will be rendered in future, how often and what would it cost?
- How can the intermediary ensure that the customer understands the effects of ongoing fees? Does the customer understand what a 0,5% or 1% fee based on the fund assets entail? Does the money to be paid bear any relationship to the value of the advice given or services rendered if one calculates that on an hourly basis?
- Does the customer understand that he/she is responsible for the ultimate decision?
- On what basis can the customer be compensated for bad advice or services rendered?
- What should the level of commission/ fees be compared with other industries?
- Should we rethink the level of commission or fees between the different types of products, e.g. risk cover, investment products, disability products, fund policies and assistance policies?
- How should the commission/fees payments be weighted over the term of the investment or policy, depending on product type?

We must move away from remunerating intermediaries by all sorts of different names like commission, fees, recurring charges, etc. and then hiding it in the disclosure document.

It seems that there is a lot of work to be done before sliding into an environment of no statutory ceilings. This is really an opportunity for intermediaries and providers to show their professionalism and re-assess the total commission and fees environment.

The ancillary question to the above issues is whether the industry needs guidance by the regulator on some of these. Although the FSB does not want to be prescriptive, an orderly transgression into the new order is important.

Up-front versus recurring commission

There is a worldwide move in the long-term industry towards paying recurring commission rather than up-front commission on policies with recurring premiums.

Much of the criticism against the long-term industry stems from the fact that the commission is paid up-front, based on the initial contractual term of the policy.

It is also common practice to pay commissions even before the first premium is paid, which is against the regulations.

While the lid regarding commission ceilings is removed slowly, it is now the right time for the long-term industry to show its professionalism and discuss:

- How to determine the level of remuneration for acquisition cost, advice and ongoing services rendered.
- Who should be responsible for the payment of these different types of remuneration?
- What the level of remuneration should be for different kinds of products.
- The incidence and the term over which the remuneration should be paid.

The question is whether it is professional to pay all the commission up-front? Up-front commission has the following disadvantages:

- There is an incentive for intermediaries to sell policies with longer terms than necessary to get more commission.
- If a policy does not run its full term (because of a lapse or surrender), too much commission would have been paid. This results in surrender values after short durations that do not provide good value for money. The insurance industry must get away from the argument that all policies are there for the longer haul and that the industry is therefore not concerned about bad values.
- There is an incentive for intermediaries to

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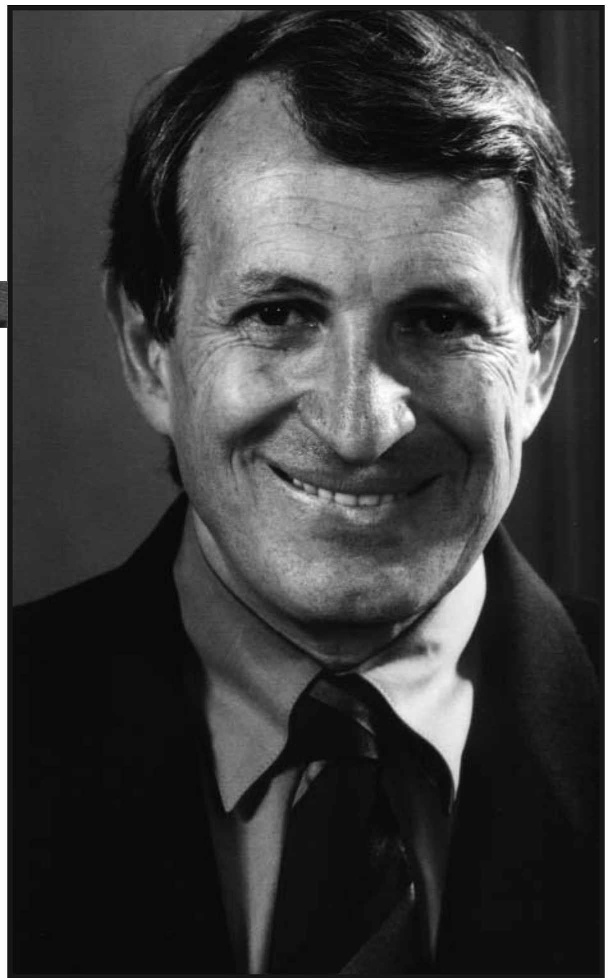
FSB appoints new chief actuary



By Astrid de Vos, Communications Department, FSB

> The position holds many challenges, especially as far as pension fund surplus is concerned. My first priority will be to address the issues regarding surplus legislation as well as the backlog that arose due to the prolonged absence of a chief actuary, says Mike Codron.

he FSB's search for a suitable candidate to fill the vacancy of the chief actuary was a lot like panning for gold with a tea strainer.

The post not only called for a seasoned actuary with a lot of industry experience, but also for someone with enough standing to manage industry perceptions, especially regarding pension fund surplus legislation.

Patience eventually brought rewards in the form of Mike Codron, who has more than 30 years' experience in the financial services industry, of which a great many were spent in the retirement industry.

'As chief actuary, Mike will form part of the executive team of the FSB, where we believe he will make a significant contribution to the implementation of our strategy and the overall effectiveness of the organisation,' says Jeff van Rooyen, executive officer of the FSB.

Mike believes the position holds many challenges, especially as far as pension fund surplus is concerned. 'My first priority will be to address the issues regarding surplus legislation as well as the backlog that arose due to the prolonged absence of a chief actuary,' he says.

Another priority during his term at the FSB would be to play a pivotal role, together with the FSB's deputy executive officer of pension funds, in trying to improve the relationship between business and labour.

'On the insurance side, some of the challenges include a revision in the way in which solvency is measured to incorporate company specific internal models (instead of a rules-based approach), as is being done in other parts of the world.'

'The new international accounting standards may have a significant effect on insurers. The FSB would like to stay as close as possible to GAAP, but there may be instances where the regulator should deviate. We therefore need to stay up-to-date with the developments to make proper decisions,' he says.

The actuarial department will continue with feedback to statutory actuaries of life insurers consisting of summary statistics of otherwise confidential information relating to the valuation bases used in determining the liabilities of long-term insurers.

After finishing school in Zimbabwe, Codron came to South Africa to study at the University of Cape Town, where he obtained a B.Sc. degree. In 1968, while still a student, he started his career at Shepley and Fitchett, a financial services organisation.

In 1973 he became a fellow of the Faculty of Actuaries in Edinburgh. Soon afterwards, he joined Ned-Equity (now Sage Life).

From 1981 to 1994 he worked for Fulford Brothers, where he gained invaluable experience in pension funds. He then joined Ginsburg Malan & Carsons where he became managing director of the Johannesburg company.

Mike joined Alexander Forbes in 1999 when the latter purchased Ginsburg Malan & Carsons. He was appointed as senior actuary and also chaired the Actuarial Professionalism Committee.

During his many years in the actuarial profession, Mike has held the following positions:

- President of the Actuarial Society of South Africa (ASSA)
- Chairman of the ASSA Professionalism Committee
- Currently a member of the Professionalism Committee of the International Actuarial Association (IAA)
- A board member of the Institute of Retirement Funds and chairman of its Investment Committee.

Mike says he is proud to be an actuary. 'I would like to put something back into the profession, and that is why I joined the FSB. I feel I can make a contribution to the exciting challenges ahead.'

Better protection for retirement savings

The FSB is seeking to apply 15 internationally accepted principles to protect retirement savings", said Wilma Mokupo, FSB's head of retirement funds at a retirement fund governance seminar in Sandton on 9 February 2004. Old Mutual Actuaries and Consultants hosted the seminar.

The FSB, as a member of the International Organisation of Pension Regulators and Supervisors (IOPRS), subscribes to 15 of this body's principles and intends to regulate governance in the retirement fund industry in accordance with these principles.

Mokupo says the principles were compiled by the IOPRS with the assistance of the Organisation for Economic Co-operation and Development. The 15 principles are:

1. Adequate regulatory framework

An adequate regulatory framework for private pensions should be enforced to ensure the protection of beneficiaries, the soundness of pension funds and the stability of the economy. This framework should be enforced in a flexible way (taking into account the complexity of schemes) and should not place an excessive burden on pension markets, institutions or employers.

2. Appropriate regulation of financial markets

Well-functioning capital markets and financial institutions are required for the investment of retirement savings to be productive and diversified. Advance-funded retirement schemes, which pay members a pension based on what they have saved, should go hand-in-hand with a strengthening of the financial market infrastructure and regulatory framework

3. Rights of beneficiaries

Non-discriminatory access should be granted to private pension schemes. Regulation should aim to avoid exclusions based on age, salary, gender, period of service, terms of employment, part-time employment and civil status. It should also promote the protection of vested rights and proper entitlement processes, taking account contributions from employees and employers. The transfer of retirement savings from one fund to another should be encouraged.

4. Adequacy of private schemes

Private funds should be properly assessed in terms of adequacy, including the risks of receiving an adequate pension.

5. Regulatory system and separation

Adequate legal, accounting, technical, financial and managerial criteria should apply to pension funds, but without an excessive administrative burden. The pension fund must be legally separated from the sponsor.

6. Funding

Private schemes should be fully funded and not dependant on one generation of younger members paying for the pensions of the previous generation.

7. Calculation techniques

Appropriate methods of valuing assets and liabilities, including actuarial techniques, must be set up and based on transparent and comparable standards. There should be an increased reliance on modern and effective risk management, while industry-wide risk management standards for pension funds should be promoted.

8. Supervisory structures

Effective supervision of pension funds must be set up and there should be a focus on legal compliance, financial control, actuarial examination and supervision of managers. Appropriate supervisory bodies should be established in order to conduct off- and on-site supervision.

9. Self-supervision

Self-regulation should be encouraged. The role of independent actuaries, custodian services and internal independent supervisory boards should be promoted within an appropriate regulatory framework.

10. Fair competition

Regulation should promote a level playing field between all the operators. Fair competition should benefit the consumers and allow for the development of adequate private pension markets.

11. Investment

Investments by pension funds should be adequately regulated. This includes the need to balance assets and liabilities and the consideration of principles related to diversification.

12. Insurance mechanisms

The need for insolvency insurance and/or other guarantee schemes must be considered to protect fund members.

13. Winding-up

Proper winding-up mechanisms should be put in place where an

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It's all about enabling people to make informed decisions

In a competitive world of increasing consumer demands and issues, the onus to educate and create a viable learning environment, rests with the initiators of products, goods and services. At the same time, the essence of being part of a vibrant economy is to propel to the highest limits, the qualities of understanding good policies and the procurement of a sustained educational programme .

Consumer education is all about enabling people to make informed choices," says Olivia Davids, newly appointed head of consumer education at the FSB. Talking to her soon reveals that this warm and friendly lady has a wealth of experience and knowledge to her credit. She is, as one would expect, passionate about educating consumers.

While she can wax lyrical about the abstract and philosophical concepts of her discipline (she is busy with her doctorate in consumer protection from a policy implementation perspective and is studying the impact of various policy models on the implementation of consumer protection initiatives), she is mostly concerned about the need for proper labelling of products and services, as well as the suffering of consumers who have fallen victim to fraudulent scams.

Davids, who served on the FSB's Consumer Education Review Committee and the Department of Trade and Industry's Consumer Affairs Committee, says there is huge ignorance about consumer rights and responsibilities, products and services at all levels of society. This includes adults, children and consumers in isolated communities.

'We also need to be mindful of persons with disabilities and must ensure that information is accessible to the visually and hearing impaired, and those who may not be able to frequent the venues where such information may be found. There are too many people who are falling prey to fraudsters. It is our task to forewarn consumers and arm them with the relevant information.

'We would also like to see South Africans looking into the future in terms of their children's education, preparing for retirement and participating in other financial investment projects which will ensure some sort of a nest egg.'

Biggest challenge

Davids sees her biggest challenge as putting in place a sound programme of consumer education that will be sustainable and bear fruit for all sectors of society.

She describes the department's long-term goals in terms of its vision and mission:

- To enable all South Africans to manage their financial matters soundly by taking informed decisions about their financial future and also to ensure that all service providers are committed to fair business practices; and
- To build a strong financial future for all South Africans.

'The department's current goals entail getting consumer education into the formal education system, creating and promoting public awareness of products and services regulated by the FSB, conducting intensive consumer education programmes, training and building capacity of identified partners, as well as developing and maintaining relations with providers of financial products and services, industry representative bodies and business.'

Davids sees the department as being well poised to contribute to the formulation of new legislation and policies that will be responsive to the changing consumer environment.

'The key to attaining these goals is a professional and competent staff that is committed to the FSB's quality assurance principles – and by staff I mean everyone at the FSB. Consumer education is a team effort in the broadest sense of the term.

'In working towards these goals, we will need to build and nurture sound networks in South Africa and abroad, to ensure that consultation forms the cornerstone of our activities and that communities are well briefed and sensitised to the importance of consumer education. We ask for co-operation from the media, business, non-government organisations, funders, community leaders, individuals and others as we embark on this huge, but very worthwhile challenge.'

According to Davids, specific activities to ensure that consumers are educated in the non-banking financial services industry would include participating in the processes aimed at developing curricula on financial education in schools. Similarly, work will also be done at tertiary education level to encourage the inclusion of consumer financial education in programmes of study. 'The important point to remember is that consumer education must be integrated into all subjects and not taught separately which would make it vulnerable to cuts when funds are low.

'Other activities would involve facilitating workshops in communities, preparing brochures in the appropriate languages for the respective target markets, and training members of the community on the specifics of consumer issues.

'We plan to engage in some media campaigns, and, very importantly, to work in partnership with other regulators and organisations involved with financial literacy training and awareness programmes. Our team is already involved in a number of these initiatives. We also look forward to launching our major consumer education project in the very near future.'

Future role

On how she sees the future role of the FSB with respect to consumer education, she says:

- 'I strongly subscribe to the view that the education and development of consumers contribute directly to the development of the State.
- I also believe that the FSB will have a role to play in facilitating consumer education for a long time to come.
- Changing products, services and legislation will necessitate that link between the FSB and the community.
- The role of the FSB is a facilitative one, in that we want the education programmes to be sustainable and self-sustaining and this can only be achieved when communities take ownership of programmes."

When not working, Davids reads old English novels – she's fascinated by social history and the interpretation of historical events and its consequences – takes long walks, cooks and enjoys a good movie. 'I also love to travel,' she adds.

Her life philosophy is to take things as they come and not to panic too much. This positive approach to her personal and professional life, coupled with her boundless enthusiasm and hands on approach to everything she does, is bound to give new impetus to consumer education at the FSB.

Retirement savings

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employer sponsoring a fund goes bankrupt. This should ensure that contributions owed to the fund by the employer are paid in the event of insolvency.

14. Disclosure and education
Appropriate disclosure to and education of members should be encouraged, especially where choice is offered. Beneficiaries should be educated about the pitfalls of misusing retirement.

15. Corporate Governance
The corporate governance role and capacity of pension funds should be considered. This includes: the role of guidelines (statutory and voluntary) for governance activities; the impact of shareholder activism by pension funds on corporate behaviour; and the governance of pension funds themselves and the role of trustees.

Court lifts First Central curatorship

The Pretoria High Court granted an application by the registrar of short-term insurance for the cancellation of the appointment of Gerrit Sandrock and Jay Pema as curators of the short-term insurance business of first Central Insurance Ltd.

First Central Insurance was placed under final curatorship on 3 April 2001 and during the course of the curatorship the curators filed seven reports to the Court on progress made, payments to policyholders and other creditors of the company, as well as the financial position of the company.

In papers before Court, the registrar stated that he was satisfied that the stage had been reached where the curatorship could be terminated as the vast majority of claims of policyholders and curators against First Central Insurance had been settled in terms of directions issued by the Court during the curatorship. The curatorship can therefore not be continued cost-effectively.

The management and control of the short-term insurance business of First Central Insurance will now revert to the board of its directors. However, the registrar's office still needs to approve a new board of directors for First Central Insurance and negotiations are in progress between the company and the registrar's office.

No new insurance activities will take place until the registrar has applied his mind to a few conditions precedent. All insurance business of the company not completed by the curators will be dealt with as the responsibility of the new board of directors.

Source:
FSB Media Release, 26 February 2003

Shareholder activism in the South African Reserve Bank: A blessing or a curse?

By Dr Johann de Jager,
Legal Services Department,
General Counsel,
South African Reserve Bank

The South African Reserve Bank (SARB) is constituted in terms of, and regulated by the South African Reserve Bank Act, 1989. The SARB is a juristic person with a share capital of two million rand, divided into two million ordinary shares of one rand each which have all been issued to shareholders in terms of section 24 of the SARB Act. These shareholders do not share in profits, but are paid, out of net profits of the SARB, a fixed dividend of ten per cent per year per share held. This position with regard to fixed earnings on their shareholding was ostensibly accepted by all shareholders, from the implementation of the SARB Act until before the meeting of SARB shareholders on 26 August 2003.

Shortly before that meeting, a shareholder gave notice of the intention (by means of what was termed a "special resolution") to amend section 24 of the SARB Act to allow for a change in the distribution of the SARB's net profits, from a fixed dividend of ten per cent per share annually, to a ten per cent annual share of the net profits of the institution. Arguments raised in support of the proposed "special resolution", which had profit-sharing for SARB shareholders in mind, were based on an analogy drawn between a public company incorporated for gain and the SARB.

Discussion

Since the system of private shareholding in the SARB was implemented not with a profit motive in mind, but with a corporate governance objective, the following submissions were offered to demonstrate the unique nature of the SARB, thereby indicating that ordinary corporate considerations did not apply to the issue.

Establishment

A company is formed by its promoters and its incorporation is secured by compliance with the requirements of the Companies Act, 1973, regarding the registration of the proposed company's memorandum and articles of association.

The Bank was established as the central bank of the Republic in 1921 by the Currency and Banking Act of 1920, a special Act of Parliament. It started trading on 30 June 1921, and currently functions in terms of the SARB Act.

Authority of shareholders: determination of business and powers

The constitution of a company is contained in its memorandum and articles of association. Since the memorandum of association provides the basis for the whole corporate structure, it is regarded as a company's founding document. The memorandum governs the relationship between the company and third parties and is mostly concerned with the external regulation of the company. It defines the capacity of the company and describes its main business. Members may, by means of a special resolution, order the internal affairs of their company in the way that suits them best, subject to prohibitions in the Companies Act or any other law.

As the SARB was established by means of its own Act, it is not subject to the Companies Act and qualifies as a statutory corporation. Consequently, the objectives and powers of the SARB are solely those which Parliament has laid down in the SARB Act. Any wider powers are not available to it. Beyond the objectives and powers of the SARB Act, it is legally incapable of doing anything, so that any act outside its powers is void in law. By this token, shareholders cannot order the affairs of the SARB either by deviating from the prescriptions of the SARB Act or by amending that Act.

Shareholders: rights and powers

The structure of the Companies Act is based on the traditional model of a company, which regards shareholders as "owners" who are entitled to its control. The general meeting of shareholders is regarded as the forum at which the members can exercise ultimate control over the company's affairs. Consequently, the Companies Act strives to affirm the status of the general meeting as the primary organ of a company by vesting it with powers for gaining and exercising control over the company. These powers include the power to dismiss and appoint directors, to exercise the powers vested by the articles of association in the board whenever the company lacks an effective board of directors and to ratify acts within the company's powers, but not within the powers of the directors. Shareholders may also, by means of a special resolution, voluntarily dissolve a company.

The primary objective of the SARB is to protect the value of South African currency in the interest of the country. Since price stability affects the society as a whole, it is evident that the SARB fulfils a public interest role. It is generally accepted that a high level of central bank independence, as well as a clear explicit mandate for the central bank to curb inflation, are necessary institutional measures to ensure the protection of the value of the currency. Accordingly, the SARB Act does not provide its shareholders with powers to exercise ultimate control over the SARB. Instead, it endeavours to achieve a balance of power and responsibility between Government and the pri-

vate sector by entrusting the management of the SARB to a board consisting of fourteen directors. Seven of these members are appointed by the President and seven by the shareholders. It may, however, be argued that management power is weighted in favour of Government since all the executive directors of the SARB form part of the directors appointed by the President. Moreover, the Governor, who is the chairperson of the board, also has a casting vote.

Neither Government nor the SARB's shareholders have explicit powers to remove directors, nor have they been granted clear authorisation to exercise the powers of the board in the event of it being unable to exercise its powers. The SARB's shareholders are also unable to dissolve the bank, since it can only be done by an Act of Parliament.

Companies: ultimate goal

The management of companies is placed in the hands of persons with special skills in order to manage the company with a view to making profit. Large-scale corporate capitalism is regarded as the most efficient and practically realisable system for creating wealth and this essential objective distinguishes companies from all other associations and institutions without a profit motive. The premise that shareholders are the "owners" of a company gives rise to the notion that maximisation of profit is to ensure shareholders' wealth. Shareholders' perceived "ownership" of a company is based on the supposition that shareholders take the risk by providing equity capital to the company for it to operate, grow and prosper.

SARB's management vests in its board of directors, of which the Governor and the three Deputy Governors are the executive members. Historically, the transition from a competitive, profit-maximising central bank to a non-competitive, non-profit-maximising central bank proved difficult to achieve. The trend therefore developed to set up central banks by means of legislation as non-profit maximising, non-competitive institutions. The SARB is a clear example of this.

Section 3 of the SARB Act determines that the primary objective of the institution is to protect the value of South Africa's currency, which is also entrenched in the Constitution of the Republic of South Africa, 1996. The Constitution also determines that the SARB, in pursuit of its main objective, should perform its functions independently, but with regular consultation with the Minister of Finance.

Shareholders: Limitations

Having regard to the relevant provisions of the SARB Act, it is clear that the legislature did not intend to place shareholders of the SARB on an equal footing with shareholders in an ordinary company with a profit motive. The SARB Act places restrictions on the right to hold or acquire shares in the SARB and restricts payment of net profits to shareholders to a dividend of ten per cent per annum on the paid-up share capital of the Bank. These provisions, however, do constitute a more favourable dispensation than in the case of a company without a profit motive incorporated under section 21 of the Companies Act. Section 21(2) of the Companies Act prohibits the payment of any dividend to members of such a company and prescribes that its income and property be applied solely towards the promotion of its main object.

Allocation of net profits: the SARB and the Federal Reserve System

In terms of section 24 of the SARB Act, one tenth of any surplus remaining in the SARB at the end of a financial year must be allocated to the reserve fund of the SARB and nine-tenths must be paid to Government. This provision is similar to relevant provisions pertaining to the Federal Reserve System of the United States. After paying its expenses and making the required provisions, the Federal Reserve System pays the rest of its earnings to the United States Treasury. Since the Federal Reserve System came into operation in 1914, about 95 per cent of its net earnings have been paid to the United States Treasury.

Effect of proposed special resolution

Owing to its nature, the SARB is subject to various risk exposures. The accumulation and maintenance of sufficient reserves are therefore absolutely essential. If one-tenth of the profits of the SARB had to be paid out to its shareholders, the institution would be deprived of a major source of income. It could result in the SARB having to rely on Government for purposes of funding. This would not only negatively affect the independence of the SARB, but would increase the financial burden on the public. Under such circumstances, it may be argued that the SARB was performing its functions unconstitutionally, since it was favouring its shareholders, while prejudicing the public (as taxpayers).

Furthermore, if shareholders in the Bank were to become entitled to profit-sharing dividends as envisaged in the special resolution, it could give rise to serious legal problems, such as pertaining to the duties of the SARB's directors, undue competition, insider trading and the suitability of the SARB to continue to act as a central bank.

The shareholders of the SARB are, however, unable to amend the provisions of the SARB Act by means of a special resolution. The legislative authority in respect of legislation in the national sphere of Government (such as the SARB Act) is vested in Parliament and the Minister of Finance is ultimately responsible for the process of ensuring any amendments to it. Should the special resolution of the nature in question be adopted, it would have no effect on the existing provisions or the implementation of the SARB Act, but could at best be brought to the Minister's attention for possible consideration.

Conclusion

Despite the opposition of the SARB's board and management to the proposed amendment, the majority of shareholders of the SARB still voted in favour of the proposed resolution. In reaction, the Governor of the SARB stated publicly that a proposed amendment of the nature suggested would constitute a major change in the public service obligations of the SARB and would, owing to the SARB's unique role in the economy, not be in the public interest. He confirmed that the resolution would nonetheless be submitted to the Minister of Finance for his consideration, although the board of the SARB would strongly recommend against its implementation.

The action of shareholders emphasised the unusual private-shareholding structure created and maintained by the SARB Act, viewed against the background of international best practice in respect of central banks. Central banks worldwide typically do not have private shareholders, but are usually owned by their respective Governments. The question arises whether the shareholder activism displayed by SARB shareholders, clearly indicative of an exchange of their public interest role of ensuring corporate governance in the central bank for the pursuance of a self-interest profit motive, signaled a need to end private shareholder participation in the governance of the

Highlights - tax relief for all

outh Africans who earn lower salaries are the main beneficiaries of the moderate tax relief announced in the budget, though all taxpayers will be compensated for the effects of inflation.

Tax brackets have been adjusted to provide some relief across the entire income spectrum.

The tax relief has been distributed so that 11% benefits people earning up to R60 000; 49% to those earning between R60 000 and R150 000; 30% to incomes between R150 000 to R250 000; and 10% for incomes of R250 000 and above.

Those earning between R32 500 and R70 000 a year will pay R400 less tax, those earning between R75 000 and R100 000 pay R680 less, R120 000 (R930 less), R150 000 (R1 430 less), R180 000 (R1 680 less) and those earning over R200 000, more than R2 000 less.

The primary rebate has been raised by R400 to R5 800 for all individuals, increasing the threshold below which people do not pay any income tax to R32 222 from R30000.

For people aged 65 and over, the threshold is raised to R50 000 from R47 222.

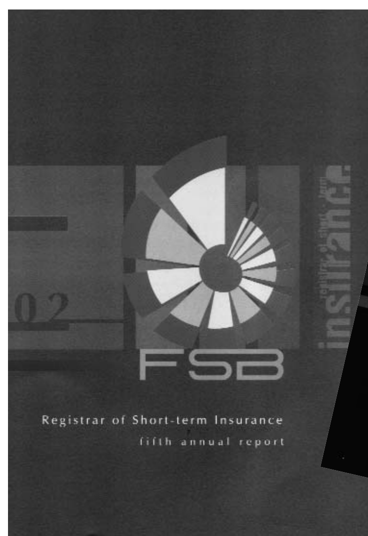
The secondary rebate is increased by R100 to R3 200 a year for people aged 65 years and over.

Source:
Personal Finance, 21 February 2004

Annual Reports of Registrars of Short-term and Long-term Insurance published

The fifth Annual Reports of the Registrar of Long-term Insurance and the Registrar of Short-term Insurance have been published. Copies cost R90 each and can be obtained from Johanna Tau at johannat@fsb.co.za or (012) 428 8148. These include tables containing detailed figures for each insurer.

Should you wish to access the electronic version, go to the FSB's website (www.fsb.co.za), click on publications / reports and then scroll down to the Annual Report of the Registrar of Short-term Insurance and the Annual Report of the Registrar of Long-term Insurance.



Deregulation of commission: An opportunity towards professionalism?

replace existing policies with new policies which generates up-front commission.

A lot of these problems will disappear if commission is paid on a recurring basis when premiums are paid. But such a sudden change would disrupt the market and intermediaries would take a serious knock in their income.

The FSB is not advocating that all remuneration of intermediaries should now be on the same level over the term of the policy. Based on the principle that the remuneration should be in accordance with the incidence of the efforts or the work done, a greater percentage of the commission could and should probably be paid over the shorter term and in the beginning of the policy term.

As would-be professionals under the new legislation, intermediaries must ask themselves what is fair and in the interests of the policyholder. Should the policyholder not have a choice to discuss all these aspects and decide whether he or she wants to pay the intermediary up-front or over another term?

Quality and sustainability versus quantity

The culture of commission payments was, and most probably still is, largely based on a philosophy that prefers quantity above quality and sustainability. However, many companies have changed their attitude and the claw-back regulations should also assist to focus the mind.

So, how can we change this for the better, and ensure that it is sustainable in the long term?

The FAIS legislation will assist to a large extent as financial services providers will need to be registered either through a recognised body or directly with the FSB.

The definitions of advice and intermediary services are very wide and few people would be able to escape the regulatory net.

The fit and proper requirements and compliance officer system will hopefully ensure that quality advice and services are rendered continuously.

The FSB also realises that no legislative system is infallible and that is why all must work together in cultivating a culture of compliance and quality of service.

The payment mechanism

It must be remembered that although commission on certain policies is decapped, other regulations regarding commission will still apply. For instance, commission can still only be paid to the intermediary in monetary form and the claw-back rules will still apply.

But because of the decapping, the debate about whether a payment is commission on those policies or a fee should now disappear. It will still be necessary to define which portion of the total remuneration is the commission and which part is the fee. The total charges must be disclosed to the client.

The short-term industry has already been operating for a long time on a basis where there is commission plus a fee.

The FSB has also noticed this trend in the life industry where intermediaries now have very good reasons why policyholders must also pay an additional fee. Nothing prohibits an individual to agree to an additional payment and there is also no prohibition if the insurer agrees to collect and pay this on behalf of the policyholder to the intermediary. The issue is that policyholders often do not know that fees, and even commission, are negotiable. The FSB trusts that the disclosure regime will focus on the services to be rendered and that the remuneration be a point of discussion.

The fees debate

The fees debate mainly revolves around the following:

According to the FSB's Directive 132, the legal nature of a policy is not such that it enables a life insurer, in a legal sense, to separately identify funds belonging to a particular policyholder. The funds held by the life insurer is legally the corporate property of the life insurer. It is therefore not available to a policyholder to mandate payments of such funds to any person as if they amount to funds held "in trust" by the insurer. Payment of a portion of a "capital account", "estate" or "reserve" to an intermediary, whether authorised by a policyholder or not, the FSB considers as a payment towards services rendered in maintaining a policy, i.e. for rendering services as an intermediary, and the payment must be included in calculating whether the maximum commission limit is being exceeded.

In the case of long-term policies it is important to remember -

- that as soon as the insurer accounts for the fee as part of the premium, that fee becomes part of the assets of the insurer and any payments by the insurer from those assets thereafter will be regarded as commission, and the claw-back regulation will be applicable to this amount;
- where the fee is in addition to the defined commission it can only be paid when the policy is outside the restricted term and then as a portion of a benefit payment in the form of a withdrawal or surrender; and
- where the insurer does not account for the fee as a premium, any arrangement regarding the payment of the fee can be made.

Where the insurer pays a fee in the form of a withdrawal or surrender, or as a portion of the benefit when that benefit is payable, the FSB would also like to see that the initial instruction regarding the fee is in writing, that the policyholder may at any time change the instruction, that the name of the intermediary is known and that the insurer keeps record of fees paid.

True professional

It is important that product providers and intermediaries respect the law. Hopefully the FSB will soon be able to declare to the Minister that intermediaries are toeing the line and that all products can be decapped. But most important, it is the behaviour of intermediaries that will determine the way forward regarding removal of the ceilings on other insurance products.

Furthermore, a true professional will rather operate on a fees basis where remuneration is linked to actual services rendered instead of commission for the mere introduction of business.

FAIS promotes true alignment of interests

From p.5

Offering professional financial and investment advice requires different skills

- Financial and investment advisors are experts who have to focus on general issues affecting investors. Subjects like individual tax and estate planning, general financial planning, and investment planning are specialist subjects. To keep up with all the changes require full time attention.
- What we have seemed to miss is that the fundamental difference between planning and asset management is that planning deals with timeless fundamentals, which can be controlled. On the other hand, asset managers, economists and actuaries tend to be experts in understanding the variable elements.

- Asset management requires specialist skills that are totally separated from that of giving holistic financial and investment advice. If financial advisors confuse the subjects it will lead to one of the areas, or both, being neglected.

I am confident that we will see a generation of financial advisors that will take up the challenge of enhancing their levels of advice and alignment of interests, thereby also enhancing the level of the industry's integrity.

New retirement fund initiative enhances regulatory function

From p. 9

loaded into the FSB's work-flow system, from where the relevant FSB staff members are notified of the submission via automatic e-mail.

Challenges

The greatest challenge has been the creation of the taxonomy and the identification of the data elements. For XBRL to be successful, all participants in the supply chain had to agree on the taxonomy. Once the taxonomy was finalised, the essential elements or data points that require tagging had to be identified. It is only after all the parties have agreed on the universe of data to be tagged and submitted, that the true power of XBRL can be realised.

Benefits

The initiative has resulted in several major benefits for Alexander Forbes.

On the receiving side of the supply chain, the FSB is able to receive the required information in a less stressful and timelier fashion. The FSB's willingness to make this platform available to users makes it the first regulatory agency in South Africa that is able to receive digital financial reports with minimal human intervention. Alexander Forbes is an administrator in South Africa that is able to generate XBRL based reports and submit them to the overseeing regulatory agency. Due to new internal efficiencies, Alexander Forbes is expecting savings of up to 30% in bookkeeping staff requirements for data capturing and report preparation. Staff can therefore be freed for use in other value adding areas of the business. XBRL digital financial reports are now generated, which shorten the entire financial process substantially, thereby achieving a high-level of straight through reporting. For example, the total time required to prepare and finalise a set of financial reports suitable for (digital) submission has been reduced from five days to a few minutes.

Alexander Forbes is also able to extract all sorts of management information using business intelligence tools that queries the digital data. For example, for the first time, Alexander Forbes is able to accurately determine the average audit fee for pension funds. This illustrates the potential ability to use XBRL enabled technology not only for external reporting and submission, but also for internal reporting and decision-making support.

Conclusion

The participants in this initiative have invested a great deal of time and effort into making this initiative a success, as well as some highlighting issues that will truly enable this (and future) e-government and e-business initiatives. Such issues include digital signatures, the use of business intelligence tools, data security and industry change management. It is believed that this South African initiative may prove to be one of the first of many successful digital supply chain success stories. In fact OPRA (the pension fund regulator in the United Kingdom) has already embarked on a similar digital supply chain initiative.