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STOP!
YOU ARE NOT COMPLIANT!

Harnessing administrative law in encouraging compliance

By Gerhard van Deventer,
Executive Director, Directorate
of Market Abuse, FSB



Having the enforcement shotgun behind the door is important for every regulator, even in industries where non-compliance is the exception.

The FSB uses criminal prosecutions¹ and registrar's penalties² in its enforcement armoury. However, additional and more effective enforcement became necessary.

Background

In 1999, on the advice of the King Commission,³ the FSB was given the responsibility to combat insider trading in South Africa. With this came the



opportunity to experiment with a new enforcement tool in the form of a statutory civil action⁴ to disgorge profits and claim penalties from offenders. This process proved to be very successful and penalties in excess of R50 million⁵ were recovered.

In February 2005, the Capital Markets Enforcement Committee was established as an administrative body to adjudicate on all forms of market abuse.⁶ The FSB decided to extend the jurisdiction of this Committee to all the industries it regulates.⁷ On 1 November 2008, the FSB Enforcement Committee was established by an amendment to the FI Act, 2002.⁸

Jurisdiction of the Committee

If the Registrar or the Directorate of Market Abuse⁹ determines that any law administered by the FSB has not been

complied with, he may refer the case to the Committee. This includes non-compliance with subordinate legislation like regulations and codes of conduct. However, cases in which the Registrar has the authority to impose penalties cannot be referred to the Committee.

Process

Referral to the Committee is initiated by the Registrar filing a notice setting out the details and nature of the alleged contravention, and the recommended administrative sanction.¹⁰ The Registrar must file an affidavit setting out the facts and documents supporting his case.

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Compliance *continued from p 3*

The respondent(s) has 30 days to deliver an answering affidavit.¹¹ This affidavit must state which allegations the respondent admits or denies, as well as the respondent's version of the facts.¹² Pleadings are closed by the filing of the replying affidavit of the Registrar.¹³

Within 30 days of close of pleadings, the Committee must determine a hearing¹⁴ and appoint a panel of at least three of its members to consider the case.¹⁵

The panel must consist of an attorney or advocate of more than ten years standing, or a judge to act as chairperson,¹⁶ and additional members.

At the hearing all parties get the opportunity to argue their case. Parties may address the panel on whether a law has been contravened and what the appropriate administrative sanction should be.

The matter is decided on the papers before the panel, taking into account arguments by the parties. However, in exceptional cases, if a matter cannot be properly decided on the papers, the panel may order any person to appear before the panel to give evidence or furnish additional documents.¹⁷

Committee determinations

The Committee may impose an unlimited penalty on respondents.¹⁸ The penalty must be sufficient to deter the respondent from repeating the contravention. It must convince the industry that the game is not worth the candle and be far greater than any benefit derived from the unlawful conduct.

The Committee will also take into account other factors such as the nature, duration, seriousness and extent of the contravention, any loss or damage suffered, the effect of the unlawful conduct on the industry, previous contraventions, previous penalties and the degree of co-operation by the respondent.¹⁹

The Committee may award a compen-

sation order in cases where there is a link between the unlawful conduct and calculable damages suffered by another party.

The Committee may make cost orders extending beyond the traditional order for legal costs. Cost orders may include the investigation and preparation costs of the FSB. The Committee may also order the respondent to pay the remuneration costs of panel members.²⁰ Enforcement increases the cost of regulation. Where possible, the increased costs should be borne by the offenders.

Enforcing Committee orders

A determination by the Committee has legal force as if it was made by the High Court. The FSB enforces these orders in cases of non-payment, by lodging a certified copy of the order with the High Court. Civil execution steps are then available to the FSB.

Appeal against a Committee decision

A determination may be taken on appeal to the High Court.

The appellant does not need to apply for leave to appeal. The launching of appeal proceedings does not suspend the execution of a determination of a panel, but the appellant may apply to the chairperson of the Committee for such

suspension.

Double jeopardy

Committee proceedings do not affect any person's right to seek legal redress in other appropriate forums. A respondent may therefore be penalised by the Committee and sued by a victim in the civil courts.

Similarly, Committee proceedings do not limit the possibility of criminal prosecution or disciplinary proceedings. This does not offend against the principle of double jeopardy, but a latter tribunal must take into account any administrative sanction imposed by the Committee.

The establishment of an Enforcement Committee has been a major step forward for FSB enforcement. If the process is used with vigour and discretion it will have a substantial effect. The purpose of the administrative penalties is to encourage compliance with the law. In fairness towards compliant industry professionals, offenders' penalties should be substantial.

The purpose of these penalties is not to fund the FSB's operations. Penalties are paid into a trust fund and used for the funding of special consumer education or enforcement projects.

References

¹The FSB hands over cases to the prosecuting authorities from time to time. The decision to prosecute is the prerogative of the Directorate of Public Prosecutions.

²The registrar imposes penalties for late submissions of returns, etc.

³The first King Commission that published their report in October 1997.

⁴This civil action was set out in the now repealed Insider Trading Act, 1998, and provided for the FSB to issue civil summons for profits made or losses avoided as a result of transactions that offended against the insider trading prohibition, and a maximum penalty of three times such amount.

⁵In terms of the Insider Trading Act, 1998, these funds were distributed to persons that could have been prejudiced by the unlawful conduct of the defendant.

⁶Insider trading, price manipulation and false or

misleading reports relating to listed companies.

⁷Through the now repealed sections 97 to 105 of the Securities Services Act, 2004.

⁸Financial Institutions (Protection of Funds) Act, 2001 - by the insertion of sections 6B to 6I.

⁹The DMA has the authority to decide on the referral of market abuse cases.

¹⁰See section 6B(1) of the FI Act, 2002.

¹¹See section 6B(2) of the FI Act, 2002.

¹²See section 6B(3) of the FI Act, 2002.

¹³See section 6B(4) of the FI Act, 2002.

¹⁴See section 6C(1) of the FI Act, 2002. The parties must be given at least 30 days notice to prepare.

¹⁵See section 10A(2)(a)(iii) of the FSB Act (Financial Services Board Act, 1990).

¹⁶See section 10A(1)(a)(ii) and (iii), read with 10A(2)(b) of the FSB Act, 1990.

¹⁷See section 6C(3) of the FI Act, 2002.

¹⁸See section 6D(2)(a) of the FI Act, 2002.

¹⁹See section 6D(3) of the FI Act, 2002.

²⁰See section 6D(5) of the FI Act, 2002.

Spotlight on FAIS processes

By Charene Nortier and Wendy Hattingh, FAIS Department, FSB

The Financial Advisory and Intermediary Services Act (FAIS Act), 2002, governs financial services providers (FSPs). This means that any business that provides either advice or renders an intermediary service regarding financial products, falls within the ambit of the FAIS Act.

The FSB's FAIS Department is responsible for the regulation of FSPs and consists of three departments with the following functions:

- Registration is responsible for new licence applications, profile changes (any change to the application submitted), updating the central representative register, approval of mandates and application forms for discretionary and administrative FSPs, lapsing of licences, queries relating to the status of an FSPs licence and liaison with the FSB's Finance Department regarding the collection of levies.
- Supervision oversees the implementation of a risk-based approach to supervision of FSPs, the analysis of financial statements and compliance reports, on-site visits to FSPs and compliance officers and liaison with industry relating to changes in subordinate legislation.
- Enforcement deals with complaints against FSPs that cannot be referred to the FAIS Ombud, investigations into the affairs of FSPs and regulatory action (suspension and withdrawal of licences or debarment of persons), updating



debarments on the central representative register and the reinstatement of representatives on the register.

The FAIS Act requires FSPs to submit financial statements and compliance reports annually to the FSB. The purpose of the compliance report is to give feedback in terms of compliance with the requirements of the FAIS Act. The purpose of the financial statements is to enable the FSB to determine if the FSP complies with the solvency requirements of the Determination of Fit and Proper Requirements, which were put in place to protect the interest of consumers.

Promulgated

The FAIS Act was promulgated on 30 September 2004, and the first sets of annual reports were required in 2005. FSPs that were authorised in 2004 were required to submit at least eight reports to date; four sets of compliance reports and four sets of financial statements.

During 2005 and 2006 the FAIS Department focused on processing applications for authorisation, as the number of applications received far exceeded the expectations. The initially



small division and high volumes of applications forced the Registrar to focus on the most critical areas first. This meant that the supervisory activities, including the acknowledgement and analysis of annual reports, received less attention. From 2006 the FAIS Division expanded and was in a better position to focus on supervisory activities.

As part of the attempt to work through all the backlogs regarding the receipt of, acknowledgement and analysis of annual reports, the FAIS Department adopted a holistic approach - we tried to establish what we have received from the date of an FSP's authorisation to the date of analysis, and then to address all outstanding documents and other queries. This approach has been more successful than the year-by-year or case-by-case approach followed in the past.

A disturbing phenomenon has been that many FSPs have submitted reports,

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but then failed to respond when asked for either the correct documentation, or answers to queries.

Common problems are for instance reports with the wrong reporting date (submitting a report before the end of the reporting year), reports not signed by the key individual or compliance officer, or FSPs that completed wrong reports. Such reports cannot be accepted until the errors are rectified.

Common problems with the submission of financial statements include the submission of financial statements drawn up by the key individual, when the requirement is that it should have been drawn up by an accounting officer (in the case of a close corporation) or an auditor (in the case of a company). Many FSPs collect premiums, which require that an auditor must complete a report in terms of the FAIS Act.

As part of the ongoing effort to inform FSPs, the FAIS Supervision Department has published six newsletters to date (all available on the FSB's website www.fsb.co.za). Three of the newsletters deal with the submission requirements regarding compliance reports and financial statements. The newsletters explain regulatory requirements in plain English.

Despite the newsletters, numerous e-mails and phone calls, many FSPs did not respond positively or at all. During the last quarter of 2008 the FAIS Supervision Department started sending out letters, indicating the intent to penalise FSPs for non-submission of reports and non-response to queries regarding incorrect reports. FSPs responded which enabled us to resolve outstanding issues. Where an FSP responded with explanations and missing reports, the penalties were either completely waived or significantly reduced. This exercise continued in 2009, with FSPs receiving such letters during February and March 2009. Every response is dealt with individually, and each response is dealt with on its own

merits. Many FSPs have indicated that they were not aware of their obligations in terms of the FAIS Act, where we do our best to inform them of their responsibilities.

Although the dismay this exercise has created in the industry is regretted, the positive aspect is that numerous FSPs have engaged in active dialogue with the Registrar for the first time since the authorisation of their licence applications. We hope that this ongoing dialogue will enable FSPs to adhere to their licensing conditions and that they will continue to submit their annual reports in future.

It is worth noting the following reporting dates for 2009:

In the past, Section 19 of the FAIS Act required that all FSPs submit their financial statements to the Registrar not later than six months after the end of their financial year-end. With the publication of the Financial Services Laws General Laws Amendment Act, 2008, the submission dates for financial statements in terms of the FAIS Act have changed. This means that FSPs now have four months to submit their annual financial statements to the Registrar.

The change in the period for the submission of financial statements comes into effect on 1 May 2009 which means that:

- FSPs with a financial year-end on or before 30 April 2009 still has six months to submit their financial statements for 2009;
- FSPs with a financial year-end on or after 1 May 2009 has four months to

submit their 2009 financial statements; and

- All FSPs will need to submit their 2010 financial statements to the Registrar within four months from their financial year-end.

Some examples are:

Financial year-end and financial to be submitted by no later than:
28 Feb 2009 by 31 August 2009
31 March 2009 by 30 September 2009
31 May 2009 by 30 September 2009
30 June 2009 by 31 October 2009
31 December 2009 by 31 April 2010
28 February 2010 by 30 June 2010
31 March 2010 by 31 July 2010.

FSPs who are required to submit audited financial statements must inform their auditors about the new dates to ensure that the prescribed financial statements are submitted on time.

Regarding compliance reports, the following is important:

The 2009 compliance reports will be published during April 2009. No extension is granted for the submission of compliance reports.

The financial year-end of the FSP does not influence the reporting date as was the case with the previous reporting dates.

Where an FSP is authorised for more than one category, only one report needs to be submitted. For example, an FSP that is licenced for Categories I and II, only needs to submit the Category II report. (It is required to submit the report for the "highest" category of licence granted.)

See table below.

Type of FSP	Reporting Date	Submission Date
Category I with Compliance Officer	31 May 2009	15 August 2009
Category II, IIA and Forex FSPs	31 August 2009	31 October 2009
Category III	31 August 2009	31 October 2009
Category IV (new)	31 August 2009	31 October 2009
Foreign FSP (new report)	31 August 2009	31 October 2009
Category I without Compliance Officer	31 December 2009	28 February 2010

Profile

FSB must maintain a fine balance

“Being a regulator, without dampening financial innovation is a major challenge facing the FSB. Since time immemorial, innovative ideas have found their way into the financial services sector, in the process unlocking capital and contributing to much needed activity in the economy. The FSB should be seen as harnessing appropriate innovation. It should not be seen as unnecessarily impeding the functioning and evolution of the sector.”



So says newly appointed Deputy Executive Officer of Investment Institutions at the FSB, Bert Chanetsa, who joined the Board on 1 February this year.

Scoring six sixes in one over on the cricket field as a youngster is not his only claim to fame. Extensive experience of more than 20 years as a legal and financial advisor for many organisations, including banks in London, Chicago, Boston, Sydney, Toronto, Harare and Johannesburg makes this qualified attorney well-equipped to head the FSB's Investments Institutions division.

“I have a passion for financial dynamics, especially where they interface with the law,” he says. He has always been interested in market abuse and insider trading and has been the Law Society's nominee on the Directorate of Market Abuse (DMA) for five years. He is thus no newcomer to the FSB.

In 1998 the Minister of Finance, Trevor Manuel, appointed him on the Standing Advisory Committee on Company Law.

He also wrote a financial column for *Business Report* for two and a half years. The column focused on corporate and financial issues.

Of the three sub-divisions of the FSB's Investments Institutions division, namely Capital Markets, Collective Investment Schemes and the Directorate of Market Abuse, he believes that Collective Investment Schemes will feature more prominently in the future.

Specialised knowledge

“Investor access to Collective Investment Schemes was slow in the past as more specialised financial knowledge was required for participation. Financial literacy has been spreading, with the result that Collective Investment Schemes are more visible as more people are now accessing them. The FSB has to look after the interests of investors across the board, from the financially informed to those who have

just become banked. The investing public is generally receptive to “good ideas” which have a positive effect on the bottom line and enhance value. Naturally, good ideas find their way into the Collective Investment Scheme space as with any other vibrant discipline. It is our task to oversee existing and emerging products as well as the channels through which they are distributed, without impinging on liquidity and access to capital,” Chanetsa says. He also believes that hedge funds will be a major issue in future, one that the FSB will have to watch closely.

He and his daughter Sylvia, aged nearly 5 live in Johannesburg. Reading, working out and listening to jazz are other passions that he has. He is also an ardent sports fan who loves cricket and rugby, sports he participated in when he was younger. The Lions is his favourite rugby team and yes, he was at Ellis Park a couple of weeks ago when the Lions beat the Brumbies.



FSPs should warn clients of financial risks

Excerpt from *Silke on Finance Law News*, January 2009

According to the FAIS General Code of Conduct, financial services providers (FSPs) must identify financial products appropriate to a client's risk profile before giving advice. But as the words "risk profile" are not defined in the FAIS Act, 2002, or Code of Conduct, they should be given a broader interpretation.

Paragraph 8 (1) (c) of Part V11 of the Code of Conduct, headed "Furnishing of advice" reads:

"A provider other than a direct marketer, must, prior to providing a client with advice -
(c) identify the financial product or products that will be appropriate to the client's risk profile and financial needs, subject to the limitations imposed on the provider under the Act or any contractual arrangement."

Should an FSP enter into a "contractual arrangement" as defined, not to address a client's risk profile and only specific financial needs, there will be no need to consider the client's "risk profile", unless pertinent to the advice dispensed.

However, the words "risk profile" are not defined in the FAIS Act or the General Code of Conduct and are often misconstrued as applying only to investments. "Risk profile" must be given a broad interpretation and does not only refer to investment products. Category 1 FSPs specialising in multiple categories of long- and short-term insurance, unit trusts, medical aid, retails pensions, etc. should take heed of the legislature's very wide reference to "identify the financial product that will be appropriate to the client's risk profile and financial needs".

Depending on an FSP's licence conditions it is well-advised, where appropriate, to alert clients of the numerous risks and potential financial needs before giving any advice and to document such facts. This should be clearly documented and signed by both the FSP and the client. This will protect

an FSP should events occur which a client has not planned for. The types of risks that clients could be exposed to, include:

Personal financial risks

- The risk of not beating inflation over the long term
- The risk of not allocating money for short-, medium- and long-term needs
- The risk of not having an emergency fund
- The risk of not planning for retirement
- All the risks a client will be exposed to relating to short-term insurance, e.g. averaging and under-insurance
- The risk of not leaving sufficient liquid cash in one's estate to care for family and final expenses on death
- The risk of becoming disabled and not having sufficient assurance
- The risk of not having proper medical cover
- The risk of not having a valid will when providing advice on estate planning
- The risk of failing to make provision for children's education

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In future, it's up to YOU
to produce the evidence!

Exclusion clauses: Who has the burden of proof?

By Judge Brian Galgut, Ombudsman for Long-term Insurance.

Policies often contain exclusion clauses, which are provisions that excuse the insurer from liability in described circumstances. One of the most common such clauses deals with pre-existing health conditions, where the insurer will not be liable for a claim arising from a condition that existed before the inception of the policy.

In complaints to our office, pre-existing condition exclusion clauses are the most common basis on which insurers deny liability. Such clauses are used in all policies where there is no underwriting (where the insurer assesses risk by asking medical and other questions).

When such a claim is lodged, insurers often mistakenly place the burden of producing evidence about the insured's medical history on the claimant. The claimant's only legal obligation is, however, to provide evidence that substantiates the claim, nothing more. If an insurer then wishes to rely on the pre-existing condition exclusion clause, the insurer must prove the pre-existence of the medical condition. It is only if the information the insurer seeks is something known to the claimant alone that the law would require the claimant to produce it.



The following case illustrates our approach. The deceased had owned a dread disease policy that contained the following pre-existing exclusion clause:

"No claim for any benefit will be payable under this policy if the claim is related ... directly or indirectly to a physical defect, medical condition or injury which manifested symptoms to the claimant before the commencement of this policy and which would have caused a reasonable and prudent person to seek medical advice and/or treatment."

- The claimant, who had been married to the deceased, was a nominated beneficiary under the policy.
- The life assured died in hospital from a stroke, a condition covered in the policy.
- The claimant submitted the claim documentation to the insurer, for which she had gone to a great deal of trouble and inconvenience.
- These included the notification of death form and the certificate of the medical attendant, both indicating that the

deceased had been admitted to hospital and died later that day from a stroke.

- The claimant was further put to considerable delays and inconvenience in obtaining a response to her claim.

After some months the insurer eventually wrote to the complainant requesting a post mortem report and clinical evidence showing that the deceased had died from a stroke. The complainant responded that no post mortem had been conducted, but the insurer persisted that it needed confirmation that the insured had suffered a stroke. By reference to the pre-existing exclusion clause it also required the complainant to furnish a report by the deceased's medical attendant to prove that the insured had not suffered from any illness before inception of the policy that later contributed to his stroke.

After the complaint was lodged with

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How to access financial institutions risk and adequacy

By Dr Franso van Zyl, Chief Counsel Legislation, FSB

Today there is more supervisory emphasis on assessing financial institutions' risks and the adequacy of their controls.

Regulators should ensure that:

- internal incentives are compatible with the objectives of regulation;
 - management has mechanisms to detect weaknesses in systems and controls before damage is done.
- There are procedures, processes and structures to reinforce internal risk control mechanisms. These include internal auditors, audit committees, reporting procedures, and those responsible for compliance, risk analysis

and management systems.

To effectively assess a financial institution's systems and controls, regulators must understand the systems, be familiar with management and have adequate sanctions. Regulators may also develop codes, standards and statements of best practice to reinforce compliance with regulatory standards.

It has become costly and difficult to effectively monitor the activities of large, global institutions. The activities of such institutions have outgrown the national accounting, legal and supervisory regimes on which systemic stability depends. Globalisation, conglomerates and derivatives make detailed supervision difficult. For instance, a single trader operating in a far-flung location can virtually shift a financial

institution's risk exposure overnight.

Regulators are trying to improve the coordination of their activities by concluding Memorandums of Understanding (MOUs).

Regulators also wrestle with the complexities of how best to devise capital standards for interest rate and trading activity risk.

A system of applying risk-weightings to capital adequacy has become complex. It is also difficult to apply such a system to different financial institutions with different risk profiles.

The Basle Supervisors Committee has proposed a new approach to determine the appropriate amount of regulatory capital based on the bank's own internal risk management systems. This approach gives banks an incentive to improve their risk management

systems. The smaller the bank's value at risk, the smaller its regulatory capital requirement. A disadvantage is that different banks may arrive at different capital requirements for the same portfolio. The feasibility of this approach depends on the ability of regulators to evaluate banks' risk management models.

Regulation should become more of a co-operative arrangement between major financial institutions and their regulators.

Ideally institutions should set limits and capital requirements within a prudential framework based on their assessment of risk of loss. They should monitor compliance against these internally set limits, with appropriate penalties, probably in terms of stiffer capital requirements, set to address situations where internal limits are not met.

In monitoring institutions' control frameworks, regulators should have a checklist against which to measure institutions. Basle, as well as the International Organisation of Securities Commission (IOSCO) already outlined risk management guidelines for derivatives.

The then Coopers & Lybrand (now PricewaterhouseCoopers) and a review panel also developed principles for risk management, called Generally Accepted Risk Principles (GARP). GARP sets out 89 principles through which banks and securities firms can manage their risks and regulators can benchmark risk management practices.

The use of models

It should be noted that institutions currently develop and use risk assessment models to help measure and control risks in their operating activities. Provided that regulators approve parameters, the setting of parameters for risk assessment models could be left to institutions. From a regulatory perspective, institutions could continue to set parameters for their risk assessment models but these

parameters should be reviewed and approved by the appropriate regulator.

Monitoring operational controls framework

Where regulators outline basic principles of control and of capital adequacy and liquidity, the onus is on management to demonstrate that procedures and controls are in place. Non-compliance should lead to some form of censure. This approach is in line with the "precommitment" approach proposed by US regulators in 1995. In this way the regulatory framework would be more flexible, as institutions can use their own operating procedures and processes to demonstrate regulatory compliance. It is also more robust, as one can measure the adequacy of controls and capital more objectively against prescribed benchmarks.

Guidance provided by regulators on management standards

While it is risky to be too prescriptive, regulators have a role in encouraging appropriate management standards, which should be based on sound management practices. But supervisors must also explain how to put their thinking into practice. In doing so, regulators must make it clear that management is still responsible for deciding how to run the business." (Consultative Paper 109, page 9).

To promote sound management and ensure compliance with regulatory standards, management and regulators should be clear about the way management responsibilities and incentives flow through the hierarchies of a financial institution. Those with ultimate management responsibility must be accountable to the regulator in the event of management failure. What is required is an approach that will not only focus the thinking of directors, but which will also help regulators to monitor and assess management structures, intervene in a crisis, and discipline

individuals.

The role of regulators in promoting sound management will therefore be to ensure that:

- financial institutions have clear "statements" regarding management structures, the way in which they ensure that their systems and controls are adequate and effective, and the individual responsibilities of their directors;
- individuals are aware of, and understand their responsibilities.

The Financial Services Authority (FSA) of the UK has proposed the following draft guidance by a regulator on management responsibility in a Consultative Paper 109 Annex A, pages 2 to 3, which is worth considering:

Governance

In a regulated firm, the structure and procedures for taking important decisions should give weight to the need to achieve proper standards of investor protection, including sound risk management.

Objectives and risk profile

A regulated firm should ensure that its senior managers are clearly aware of the firm's objectives, including its strategy on the nature and degree of risk to which it is prepared to be exposed.

Staffing arrangements

A regulated firm should ensure that the quality of its staff, and its arrangements relating to staff enable it to achieve high standards of investor protection.

Clarity and acceptance of responsibility

A regulated firm should ensure that its senior managers are clearly aware of, and accept the nature and extent of their responsibilities (including the firm's arrangements for holding them

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Risk continued from p 11

accountable, and the extent of limitations on their delegated authority)

Understanding business risks

A regulated firm should ensure that its senior managers get sufficient, clear and timely information to enable them to understand the business areas for which they are responsible and to take sound decisions about all risks which may arise.

Accountability

In a regulated firm, the managers with responsibility for service delivery should be accountable for the quality and timeliness of their performance.

Systems and controls

To reinforce high standards of investor protection, a regulated firm should install and keep effective internal systems and controls with which effective operation and sound financial management can be reinforced and supervised.

Impediments to control and compliance

A regulated firm should design, build and use operating arrangements to ensure that it cannot corrupt the integrity of the firm, or its systems and controls.

Delegation

A regulated firm should ensure that, where a manager delegates any part of his or her responsibility, he or she must be aware of anything that poses a material risk to its discharge.

Rectification

Where there is a breakdown in systems and controls, or material damage to any customers, a regulated firm should take immediate steps, in consultation with the regulator, to rectify the shortcoming and provide full redress.

Responsibility of individuals

A regulated firm should expect a manager to comply with this guidance. In so far as the firm's regulator has jurisdiction over the individual, the regulator is entitled to the same expectation."

Statement by regulated institutions on management structure and systems

The FSA has also suggested a statement by a regulated institution regarding its management structure and systems. "The degree of detail into which the description of the responsibilities and controls in the statement goes will need to strike a balance. The proposals are aimed at ensuring not only that responsibility is recognised, but also that it is not shirked. The statement needs not go into detail as it can become outdated. The statement should give the supervisor a useful and meaningful picture of how responsibility is divided at the most senior levels. The statement of management structure and systems should pose a minimum burden on the running of the institution. "Institutions should already have a clear picture of how the overall management system works, and who is responsible for what. The cost of setting this out in a statement and updating the document would be small. If this leads to the supervisor having greater confidence in financial systems, it may bring about a reduction in the regulatory burden in the long run. Where firms find it difficult to draw up a clear statement of their management systems and responsibilities, it could indicate a problem".

One would expect:

- the guidance on management standards to extend existing good management practice across the industry as a whole; and
- the statement of management structure, systems and responsibilities to help the regulator select the appropriate level of regulatory activity.

The above may result in a reduction in losses suffered by retail and wholesale investors, and a decline in the overall level of systemic risk. Moreover, the riskiness of financial institutions will be reduced. This will help to justify the validity of investors' existing assumptions about the institutions through which they enter into transactions." (Consultative Paper 109, page 12).

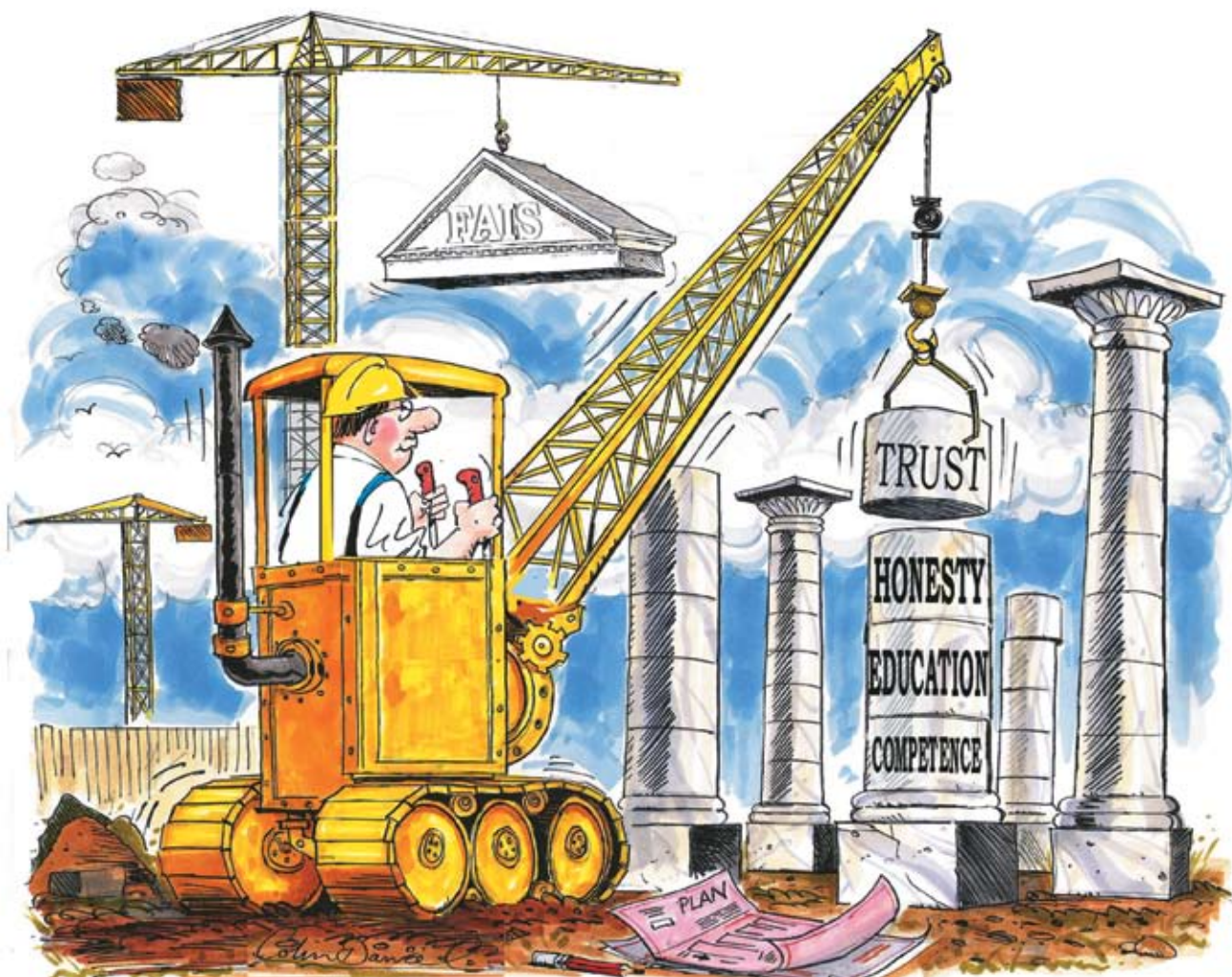
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our office, we informed the insurer that if it wished to rely on the pre-existing exclusion clause it would have to get the necessary medical evidence. The insurer could not expect the claimant to look for evidence on which the insurer wished to rely to decline the claim. We also pointed out that the medical form and death certificate indicated that the deceased had suffered a stroke. As no post mortem had been conducted, it was futile to require a copy of such a report. The complainant had not lived with her husband in the city where he worked. She lived in a rural

area and had no knowledge of his possible visits to a doctor. Even so she managed to get the name of his doctor and informed the insurer. We indicated that it was up to the insurer to request a medical history from the doctor.

The insurer contacted the doctor who disclosed that although the insured had consulted him, he had only done so after the inception date of the policy.

As there was no evidence of a pre-existing condition, the insurer paid the claim. We also suggested the insurer to pay compensation for the complainant's inconvenience and distress as a result of the poor service. This was also done.



FAIS: A manual containing sound business principles

By Anton Swanepoel, Counsellor on FAIS

Generally legislation is never popular with those being regulated, because it is perceived as being autocratic and one-sided. To make matters worse, people naturally tend to resist change.

The purpose of this article is to show that if financial services providers want to establish good businesses, they would gladly comply with the requirements of the The Financial Advisory and Intermediary Services Act (FAIS Act),

2002, and General Code of Conduct. Hopefully the principles in this article from the world's greatest business authors and the richest man in the world, Warren Buffett, would be convincing enough to change some of the paradigms pertaining to FAIS compliance.

Honesty and integrity

Warren Buffett told his son, Howard, that it takes 20 years to build a reputation and five minutes to ruin it.¹ Therefore "Never lie under any circumstances." When Warren Buffett acted as chairman for Solomon Incorporated he wrote a letter

to shareholders stating: "We are going to do first-class business in a first-class way. I want every employee to be his own compliance officer.² As chairman, I will consider myself the firm's chief compliance officer, and I have asked all 9 000 of Solomon's employees to assist me in that effort. I have also urged them to be guided by a test that goes beyond rules."³

Buffett looks for three qualities when hiring people: Integrity, intelligence and energy. But the most important is integrity, because without that,

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intelligence and energy can kill you.⁴

If we think about honesty and integrity as a cornerstone of any long-term sustainable business, perhaps the requirements in the Act⁵ and General Code of Conduct⁶ should only be an after-thought.

Education

Like all good students Warren Buffett uses his training as a foundation. In time, he staked the bricks far higher than his best teachers.⁷ Buffett's partner, Charlie Munger, often attributed much of Buffett's success to the fact that he was a learning machine.⁸ Buffett was quoted in the Omaha World-Herald when he told students that *"risk comes from not knowing what you are doing."*⁹ Education is our stepping stone towards competence. It builds trust and enables you to lead in a highly competitive industry. Nelson Mandela also said: *"If you don't have education, you can never lead."*

If we think about what a good education can do for any business, perhaps providers should welcome the FAIS fit and proper requirements.

Business infra-structure and systems

Would you trust a medical doctor, attorney or dentist who works from the boot of his car?

Only a presentable business can turn clients into promoters. Without a professional business infra-structure and business system, building a presentable business is impossible. The best practices in the country all have presentable offices, professional staff, a client relationship management system (CRM), computer software programmes and a professional advice and intermediary services process. If you think about how business efficiencies contribute to the bottom line in any business, perhaps providers would think differently about their obligations in the FAIS Act¹⁰ and General Code of

Conduct.¹¹

Business relationships and business transactions are founded on trust.¹²

Bob Burg says in *The 100 Greatest Sales Tips of all Time: Internalise the golden rule that says, "All things being equal, people will do business with, and refer business to, those people they know, like and trust."*

The trust equation will help us understand the underlying factors that instill trust. Based on my own experience as a financial advisor and intermediary of approximately two decades in the trust business, I would argue that trustworthiness in our industry is a function of five elements:

$$T = \frac{C(1) + C(2) + C(3) + PI}{S}$$

Where:

T = Trustworthiness

C(1) = Character

C(2) = Competence

C(3) = Communication

PI = Professional intimacy

S = Self-interest

Trustworthiness

Trustworthiness means that you can be relied on to be good, honest and sincere – that¹³ you can be trusted.¹⁴

Character

Honesty and integrity come first, before you can be referred to as being trusted. The General Code of Conduct helps providers to build trust.

Competence

Knowledge and skill lay the foundation for credibility and reliability.¹⁵ The General Code of Conduct helps providers to enhance trust between advisors and clients.

Communication

The ability to demonstrate character and competence is an essential building block in establishing trust. However, if

these two cornerstones of trust are not communicated¹⁶ to clients in a way that makes them respond positively, you will probably be remembered as a very good and competent person – and nothing more. If you cannot communicate what you stand for, but only your expert knowledge in a caring, simple and understandable manner, chances are that you will not do the business. We have to communicate relevant material information in such a way that the client understands it,¹⁷ trusts it and accepts it. Written communication goes a long way to establish high trust between providers and their clients. The General Code of Conduct promotes adequate record-keeping.¹⁸

Professional intimacy

Due to the personal nature of being a financial advisor, establishing and maintaining a close (intimate) professional relationship with clients are essential.

The ability to demonstrate care, understanding, empathy and kindness will make it easy to be likeable. Doing business with people we like is the best kind of business. Simply put – if I like a person it is easier to trust him or her. *If you cannot smile, do not open a shop. Old Chinese proverb*

Self-interest

Self-interest occurs when someone considers only his or her own interests. This implies a self-centered attitude, which is defined as thinking only about yourself and not the needs of others.¹⁹ If clients can see that providers act in their best interest and they disclose their interests, high trust will exist. Once again, the General Code of Conduct promotes high trust between providers and their clients.²⁰

Every transaction is based on an agreement between the parties

The law of contract is important in the modern world, because it is inseparable

Banking complaints on a meltdown

"In spite of the global economic meltdown, the South African banking fraternity has their finger on the pulse during these troubled economic times when handling your banking complaints," said Advocate Clive Pillay, Ombudsman for Banking Services (OBS), at the release of the Ombudsman's annual report in April.

"This is evidenced by a decrease of 34% in cases received by the OBS in 2008. The total number of files decreased due to the success of the referral project initiated in June 2008. By referring bank customers to the banks' dedicated dispute resolution departments first, many simpler complaints were resolved by the banks without the intervention of the OBS,"

Pillay said.

"The current challenging economic climate has not stopped banks from innovating and covering new markets. This innovation can spur criminal activity as demonstrated by some of the more complex cases being handled by the OBS.

"In 2008 fraud accounted for 8% of the OBS number of files closed. Seven cases proceeded to the OBS final recommendation stage in 2008. All of these were against one particular bank and involved internet banking fraud related complaints.

"As the banking public becomes more vigilant, our role in encouraging more caution will become more important as a growing number of unbanked consumers are brought into the formal financial

fold," said Pillay.

There has been an increase in the amount awarded as compensation to customers compared to 2007. The reason for this is the increase in mortgage bond related claims, which involve higher amounts. A total of 857 files were closed regarding mortgage finance related complaints, with 63% of these complaints awarded in favour of the bank and 37% in favour of complainants.

Banking consumers can rest assured that the OBS is committed to ensuring a quick and efficient dispute resolution service to all banked customers," Pillay says.

Source: Media release, Ombudsman for Banking Services, 6 April 2009.

from every form of economic activity.²¹ Warren Buffett started his entire investment business with an agreement with his investors.²² The FAIS Act²³ and General Code of Conduct²⁴ are also very explicit about the importance of the contractual relationship between providers and their clients.²⁵ I still maintain that this is one of the primary weaknesses in our advice record-keeping and compliance standards. Most advisors do not conclude written advice agreements with their clients and compliance officers generally don't care. Without contracts any risk management plan in an advisory and intermediary business is built on a weak foundation. The FAIS Act and the General Code of Conduct cannot be blamed for this oversight.

Good record-keeping

In 1975 the Securities and Exchange Commission (SEC) launched an investigation of a transaction by Berkshire Hathaway. Buffett had to fight to save his reputation and had to open his files. His files represented

a comprehensive collection of documents.²⁶ At the end all the evidence helped to restore Buffett's reputation.

If the most respected businessman in the world can be investigated, chances are good that any provider may have to face a complaint at some point. The same documentation that should keep

clients happy should also satisfy the Office of the FAIS Ombud.

However, if the provider's record-keeping is adequate as required in the Act and the General Code of Conduct, chances are slim that the client will lodge a formal complaint.²⁷

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⁴Mary Buffett and David Clark, The TAO of Warren Buffett: Simon & Schuster 2006, p 58

⁵See section 8 of the FAIS Act, 2002

⁶See par 2 of the General Code of Conduct

⁷Janet Lowe, Warren Buffett Speaks: John Wiley & Sons, Inc p 116

⁸Alice Schroeder: The Snowball, Warren Buffett: Bloomsbury Publishing Plc, p 632

⁹Jim Rasmussen, "Buffett Talks Strategy with Students" Omaha World-Herald, January 2, 1994, p 17S, as quoted in Warren Buffett Speaks by Janet Lowe: John Wiley & Sons, Inc p 140

¹⁰See section 8 of the FAIS Act, 2002

¹¹See par 11 of the General Code of Conduct

¹²L Pockell & A Avila: The 100 Greatest Sales Tips of All Time: Warner Business Books 2006, p 34

¹³Oxford Advanced Learner's Dictionary, p 1586

¹⁴See par 2 of the General Code of Conduct

¹⁵See par 2 of the General Code of Conduct

¹⁶See par 3 of the General Code of Conduct

¹⁷See par 8(2) of the General Code of Conduct

¹⁸See par 9 of the General Code of Conduct

¹⁹See Oxford Advanced Learner's Dictionary, p. 1325.

²⁰See par 2 of the General Code of Conduct

²¹RH Christie, The Law of Contract: LexisNexus Butterworths 2001, p 1

²²Alice Schroeder: The Snowball, Warren Buffett: Bloomsbury Publishing Plc, p 202

²³Section 20(3)(a) of the FAIS Act, 2002

²⁴See par 3(1)(d) of the General Code of Conduct

²⁵Franso van Zyl: The FAIS Manual: JUTA 2004, p 1-71 and 72

²⁶Alice Schroeder: The Snowball, Warren Buffett: Bloomsbury Publishing Plc, p 409

²⁷See section 16(2) of the FAIS Act, 2002, and par 9 of the General Code of Conduct

Economic outlook

Does South Africa need an emergency interest rate

By Flip Meyer*

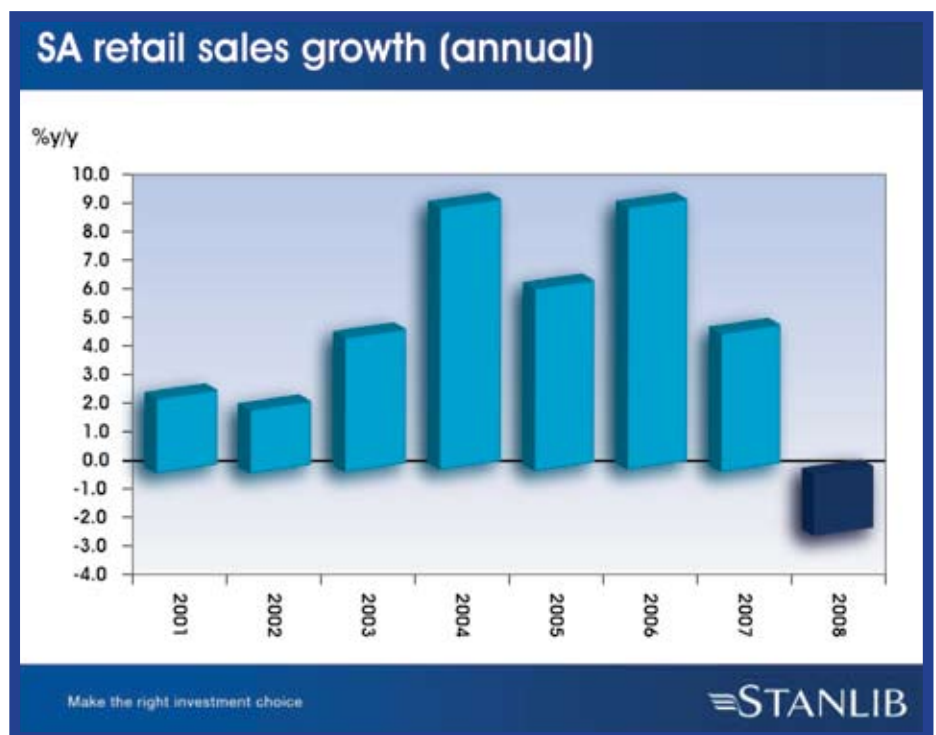
The poor economic growth of the South African economy is a sign that consumers and business is feeling the pinch. An emergency rescue act is suggested by some. Pessimists say South Africa needs more cuts in interest rates to at least pull this country out of an economic mess.

The course of the South African economy in 2009 will be determined largely by global trends. However, a few questions pertaining to South African conditions will come to the fore in 2009.

Economists are predicting a slowdown in the 2009 economic growth well below 2%, compared with more than 5% in 2007 and good economic growth up until the last quarter of 2008. This will be the first recession in South Africa for the past 17 years.

Cut rates

Recently there have been debates about the need of the South African Reserve Bank to cut rates and that inflation targeting should be set aside. However, this seems like an over reaction and the normal downward trend in inflation should take care of interest rate cuts. An example of the sluggish economy is



the crisis in the motor industry.

The motor industry is the most volatile manufacturing sector in South Africa, measured over any significant time. Hence the recent declines are not totally unexpected when one considers that in both 2004 and 2005 passenger car sales increased by more than 20% (in volume terms). In 2008 passenger car sales were down 23,3% compared with 2007, and are currently projected to decline by around 10% for 2009 as a whole; improving in the second half of the year.

Unfortunately the manufacturing data have been extremely volatile from month to month during 2008/2009. This is partly due to the disruptions caused by the electricity outages and strikes

in various industries. However, the overall trend is clear, and that points to a very significant drop in manufacturing activity.

A sharp drop-off in residential housing activity, a recession in many aspects of consumer spending (especially motor vehicle sales), sluggish world demand and hence a massive decline in South African exports and a glut of inventories, have and will continue to have a negative effect on South Africa's manufacturing activity.

Fortunately, the public sector's infrastructural programme remains sound. This should have a positive effect on some of the manufacturing industries.

The latest manufacturing data certainly support the most recent cuts in domestic interest rates, and together with the slump in general economic activity and slowing inflation, justify further rate cuts in 2009.

Unfortunately, this slump is also probably going to be accompanied by further job losses as companies try to bring their cost base more in-line with the lower output level.

Kevin Lings an economist at Stanlib expects CPI inflation to still move back into the target range during the second quarter of 2009. This combined with the weakness in the economy and slowing credit demand should allow the Reserve Bank to continue to cut interest rates. There would obviously now be some doubt about the chances of an interim interest rate meeting.

Moderate inflation

Johan Rossouw, head of economic research and strategy of Vuvani Securities, says he expects a moderation in inflation below the upper limit of the target inflation rate. The inflation targets set for the Reserve Bank are between 3 and 6%.

Rossouw forecasts further interest rate relief in the second half of 2009.

Jacques Laubscher, group economist of Sanlam, says there is no justification for abandoning or drastically changing South Africa's inflation-targeting regime. What can at most be considered is the possibility of widening the target range from 3% - 6% to 3% - 7% to allow even more flexibility in dealing with sharp movements in inflation that have their origin in volatility in important exogenous determinants of inflation such as the exchange rate, food prices and fuel prices.

Such a change should be implemented when inflation is well inside the target band and not when it is close to or above the upper end of the range to avoid accusations of opportunism

and maintain credibility. Perhaps the criticism will in any event, die down as inflation declines, reaching the centre of the targeting range by mid-2009, and the repo rate and interest rates of banks along with it, says Laubscher.

Lings says on a trend basis, credit demand is showing very clear signs of slowing.

The prior increases in interest rates, the introduction of the National Credit Act, 2005, a slump in disposable income growth, a slowdown in housing price growth, increased job losses and worsening consumer confidence have all had a measurable impact on overall demand for credit as well as on consumer and housing activity.

The drop in credit demand combined with the general weakness in the economy, rising unemployment and a softening in inflation should allow the Reserve Bank to continue to cut interest rates.

**Meyer is a freelance journalist. His web site address is www.flipmeyer.com*

Risks continued from p 8

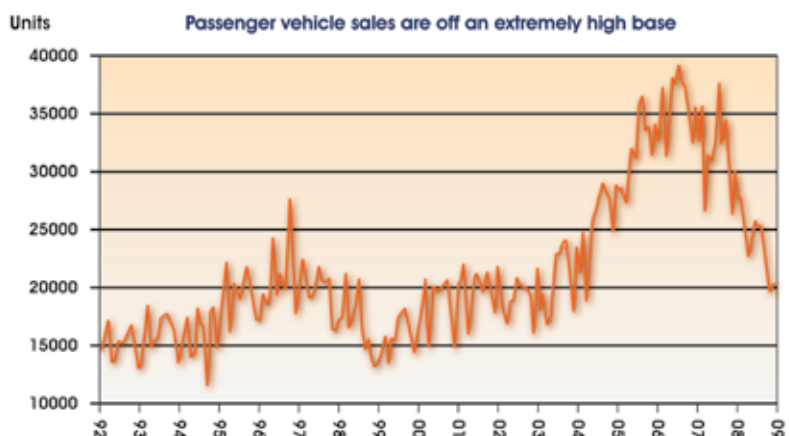
Business financial risks

- The risk of not having a succession plan in a business
- The risk of the sustainability of a business being dependent on a key person
- The risk of death while working and not unlocking the value of one's share in the business for one's family's well-being
- The risk of not having a buy-and-sell agreement in place with one's business partners.

Should FSPs not have the time or inclination to provide such warnings, they should get a signed letter from the client stating exactly for what purpose he/she is consulting with the client so that it forms the contractual basis of the advice dispensed.

**Send your queries and comments to Adv Ken Silke at ken@financelaw.co.za*

SA passenger vehicle sales



Make the right investment choice

STANLIB

New national strategy to promote consumer education



Olivia Davids, head: Consumer Education, FSB

A new national strategy, which aims to address consumer financial education (CFE) from a different perspective, is on the cards. “Although the strategy is in draft format and is still being discussed, it promises to have a great effect on CFE”, says Olivia Davids, head of the FSB’s Consumer Education Department.

“Due to changes in the regulatory environment, a fresh approach to CFE was necessary. These include the introduction of the National Credit Act, 2005, the Consumer Protection Bill, 2008, recent amendments to FSB legislation and a restructuring of the economy,” says Davids.

“We believe that it is a national imperative to have a financially literate population. South African consumers find themselves in ever changing complex financial services markets and are faced with a multitude of choices.

“Without a national framework, many initiatives by various bodies, organisations and government departments were until now short-term, varied in quality and the effectiveness of such initiatives not appropriately measured. This resulted in many short-term initiatives that led to a fragmented approach to consumer education.

“To address these challenges, the FSB embarked on a consultative process to develop a national framework and implementation strategy for CFE. This included a discussion forum to comment on the existing strategy and plan ahead. It also included drafting a discussion document for a revised strategy, facilitating a focus group discussion, circulating a draft framework for comment and developing an implementation strategy from the framework,” Davids explains.

Central to the new strategy is the establishment of a Consumer Financial Education Central Coordinating Committee (CCC) for consumer education. Davids says the committee plans its first meeting later this year. The FSB will be responsible for the secretariat of the committee and the membership will be drawn from the following:

- Industry bodies and associations
- Regulators
- Government departments
- Consumer representatives
- Ombud offices

Other stakeholders will also be invited according to expertise required.

“The idea is to centralise and coordinate the various roleplayers’ consumer education projects and programmes, thus ensuring that CFE makes a more significant contribution to financial literacy in South Africa,” Davids says. The committee will also establish guidelines for coordinating consumer education regarding:

- implementing financial consumer education programmes;
- educating consumers on what products and services are available and which may be most applicable to their circumstances;
- ensuring that consumers are cautious when buying financial products and that they know their rights; and
- making consumers aware of their rights, responsibilities and recourse options when buying financial products.

The committee will also develop partnerships through memoranda of understanding.

Sub-committees

It is envisaged that sub-committees will be constituted to deal with issues such as identifying projects, monitoring the implementation of projects, establishing a research agenda, liaise with stakeholders, review existing consumer education materials as well as recommend new materials for development.

Funding

The expectation is that the consumer financial education activities of the members of the CCC will be funded by the member institutions themselves. However, additional funding may be accessed through the following:

The Financial Services Consumer Education Foundation

The FSB established the Foundation in 2004 as a trust vehicle for receiving and disbursing donations for deserving consumer education projects.

The FSB Discretionary Fund (DF)

The DF is made up of the repository account of the FSB into which levies as a result of minor non-compliance issues such as the late filing of reports are deposited.

Enforcement Committee of the FSB

Offenders pay fines levied against contraventions of legislation. After necessary costs have been deducted including reparation to aggrieved parties, remaining funds will be deposited in the DF for use by the FSB for CFE as

described above.

Donations

Organisations are to be encouraged to apply to various local funds and donor agencies for funding for CFE projects. International donors also have priority areas that they fund for certain periods of time and organisations will be encouraged to apply for this funding.

The FSB will assist with providing information about funding programmes through its website. Other sources of funding to be explored will include:

- *Financial obligations for CFE under legislated agreements*

Should the Financial Sector Charter be gazetted or any other legislation promulgated which requires a financial allocation to CFE, such funds could be used for CCC approved projects.

- *Stakeholder funding*

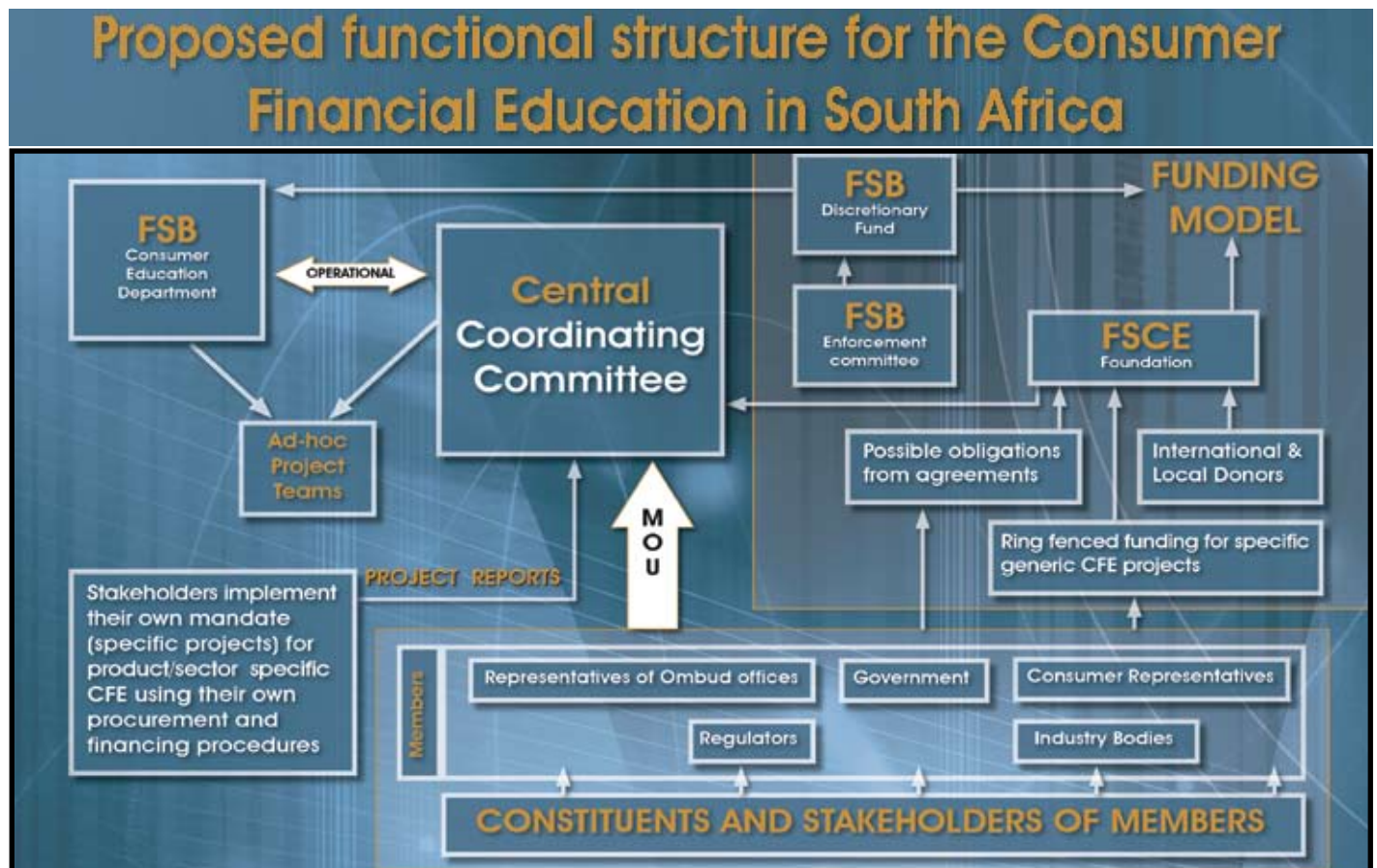
Some stakeholders may wish to channel funds for consumer education projects

through the foundation, while others may want to settle their invoices directly with service providers.

“All roleplayers involved in the strategy will continue with their projects as in the past. We believe, however, that the repetition of messages will have greater impact on the consumer,” Davids says.

She stresses that the idea is not to trespass on any of the participating bodies’ mandates. “Each will continue within its own culture and mandate but we hope all will join forces and work within the priorities of the CCC.

“We believe that the financial education of consumers should be part of the social development conscience of all financial institutions and bodies in South Africa. Budgets for these should not be seen as a luxury but a standard item on the budget agenda,” Davids says.



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