ASSOCIATED COMPLIANCE

FOR A COMMON PURPOSE

August 2013 Edition

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From AC

Client Service Level Agreements

We have been recommending that these be implemented for some time now and it is pleasing to see clients starting to take the matter seriously as we see more enquires coming from clients on this subject. Some of the interest has been sparked by recent workshops by the FIA where a draft SLA has been provided to FIA members. This draft has been given to us for comment by a number of clients. Generally the document is well structured but we do have some comments that need to be taken into account before it is introduced:

- As with all generic documents it should not simply be used as is – it needs to be applied to your business processes to gain maximum benefit.
- It starts with a statement that the client has received a disclosure document. This suggests that this SLA is meant to be provided to a client at an initial meeting where the disclosure is provided. This may not be the case.
- The reference to sub categories under the personal lines section is a little brief in our view and should deal with all likely sections of cover available.
- It talks of a client "request" a needs analysis – we believe that as there is a legal obligation for you to provide one this term is not correct. You should be advising clients what you will be doing and deal with the consequences of a client declining this standard.
- The process followed, in terms of this SLA, is that you will get the client to sign the quote/advice agreement. In situations where there is no direct contact with a client this may present practical challenges.
- There is a disclaimer that attempts to absolve the broker of any responsibility in situations where the broker's recommendations are not accepted and this results in a loss to the client. We understand the intention but have our doubts as to how successful such a disclaimer would have. Only time will tell.
- The agreement does deal with the need to disclose additional services provided for which a broker will be charging a fee yet the document makes no provision for this.

- The document has the “advisor” signing the agreement rather than a nominated representative of the company. It may be that you don’t want your reps or advisor if you happen to use that term in your day to day dealings, signing the agreement and would rather have the owner/ KI signing.

- This is geared towards a short-term broker and will need adapting for long-term client or, better still, being able to be used for all categories.
- The agreement makes no provision for the responsibilities of the client. In our view such an agreement has to be a two sided affair and the importance of a client having some responsibilities in this business relationship cannot be missed. Such responsibilities would include:
  - Reading the documents provided and raising queries if there are areas not understood.
  - Advising the broker of changes to the clients risk profile e.g. new car, new address.

Whilst talking of the FIA they are still busy with their regional road shows. The remaining dates/venues are:

3rd September – Pretoria

10th September – Bloemfontein

12th September - Durban

17th September - Cape Town

18th September - George

3rd October - Polokwane

Amendment to the definition of Intermediary Services

The Insurance Laws Amendment Bill makes a proposed change to this definition in the FAIS Act.

For your ease of reference the proposed changes are as follows – the bold items in brackets are to be removed.

Amendment of section 1 of Act 37 of 2002, as amended by section 45 of Act 22 of 2008

1. Section 1 of Act 37 of 2002 is hereby amended—

(a) by the substitution in subsection (1) for the definition of "intermediary services" of the following definition:

" 'intermediary service' means, subject to subsection (3)(b), any act other than the furnishing of advice, performed by a person ***[for or on behalf of a client or product supplier]****—*

(a) the result of which is that a client may enter into, offers to enter into or enters into any transaction in respect of a financial product ***[with a product supplier]****; or*

(b) with a view to—

(i) buying, selling or otherwise dealing in (whether on a discretionary or non-discretionary basis), managing, administering, keeping in safe custody, maintaining or servicing a financial product ***[purchased by a client from a product supplier or in which the client has invested]****;*

(ii) collecting or accounting for premiums or other moneys payable by the client ***[to a product supplier]*** *in respect of a financial product; or*

(iii) receiving, submitting or processing the claims of a client ***[against a product supplier]*** *in respect of a financial product;"; and*

(b) by the deletion of subparagraph (ii) of subsection (3)(b).

The other related change is that the current exemption applicable to insurers that states they are not deemed to provide an intermediary service is also to be removed.

Apart from the wisdom of putting a FAIS change in an insurance law amendment bill there have been a number of enquires as to why the need for a change as there has been no apparent discussion with the industry on this. One enquiry submitted by Banks resulted in a response that it was due to certain abuses by FSPs on the current definition but not clear as to what those abuses are.

At face value this change would appear to create the possibility of a number of what appear to be unintended consequences, such as;

- The need for claims staff to be representatives, and
- The need for loss adjusters to be appointed as FSPs.

No need to panic as yet though as they do appear to unintended rather than planned changes. We will keep you posted.

The banks begin to respond to 'Twin Peaks' and 'TCF' Regulation

'Twin Peaks' will enable the Financial Services Board (FSB) to oversee market conduct in respect of all players in the financial services industry. This means that the National Credit Regulator (NCR), who has sometimes been accused of turning a blind eye to the NCA, will probably be replaced by the FSB (or whatever they decide to call themselves when the legislation finally goes through).

This means that agents who act for banks and who are employed by companies whose primary business activity is the retailing of an asset, will be under the same spotlight when arranging a credit facility as insurance practitioners are in terms of FAIS. In fact, just this month, the NCR published new 'Affordability Assessment Guidelines' which banks must comply with when assessing whether or not a loan should be granted. This will have a major impact on furniture dealers, motor dealers and any other dealer that offers credit facilities.

The NCR has also published draft amendments to the Credit Provider's Code of Conduct. Whilst this concentrates primarily on Reporting, Emolument Attachment Orders, Concessions and limitations to the terms of unsecured loans, there are two sections which will have an impact on the insurance sector.

Where a credit provider demands that credit life insurance be effected, the proposed amendments impose a number of disclosure conditions not previously required. Moreover the NCA wishes to restrict the premium to 0,4% applied to the capital sum assured and requires insurers to provide refunds to customers where policies are in place at rates higher than 0,4%.

What is more significant is the fact that banks have already begun implementing TCF principles. Wesbank this month sent a circular to motor dealers stating that if a dealer wishes to add a 'value added product' (VAP) to the capital sum when a client buys a car, the dealer must have had the product previously 'vetted' by Wesbank.

Section 102 of the NCA, inter alia, prohibits a bank from including in the capital sum any margin to the cost of petrol and registration when the dealer puts a vehicle 'on the road'. If there are charges that the dealer wishes to levy to the customer, these have to be paid by the customer outside of the credit agreement. At present, such additions to the capital sum are common practise, despite the prohibition, and it would appear that TCF is forcing the banks to be more vigilant.

Also Section 106 prohibits any amount to be added to any insurance premium, yet it is common practice for dealers to charge inspection and broker fees and which they add to the capital sum.

Presumably this practice will have to be curtailed because banks will be held accountable for any irresponsible addition to a capital sum.

It follows that Wesbank's requirement to review and approve all products can be expected, and indeed is necessary. No doubt other credit providers will soon be following Wesbank's lead.

Read more on the Twin Peaks model can be found at Insurance Gateway.

Could one of the greatest miss-selling scandals in the UK be repeated in South Africa?

Payment protection insurance (PPI), also known as credit insurance, credit protection insurance, or loan repayment insurance, is an insurance product that enables consumers to insure repayment of loans if the borrower dies, becomes ill or disabled, loses a job, or faces other circumstances that may prevent them from earning income to service the debt. PPI is widely sold by banks, motor dealers and other credit providers as an add-on to the loan or overdraft product.

Credit insurance can be purchased to insure all kinds of consumer loans including car loans, loans from finance companies, and home mortgage borrowing. Credit card agreements may include a form of PPI cover as standard. Policies are also available to cover specific categories of risk, e.g. credit life insurance, credit disability insurance, and credit accident insurance.

Although the policy is purchased by the consumer/borrower, the benefit paid in the event of a claim goes to the company that extended credit to the consumer.

PPI usually covers minimum loan (or overdraft) payments for a finite period (typically 12 months). After this point the borrower must find other means to repay the debt, though the period covered by insurance is typically long enough for most people to start working again and earn enough to service their debt.

PPI is different from other types of insurance such as home insurance, in that it can be quite difficult to determine if it is right for a person or not. Careful assessment of what would happen if a person became unemployed has to be considered, as payments in lieu of notice may render a claim ineligible despite the insured person being genuinely unemployed.

In all types of insurance some claims are accepted and some are rejected. However, in the case of PPI, the number of rejected claims is high compared to other types of insurance. A primary reason for this is that, as with many forms of general insurance, the insurance is not underwritten at the sales stage and is sold to customers without careful consideration as to whether it is right for their circumstances, and without careful attention to the policy eligibility conditions.

As PPI is designed to cover repayments on loans and credit cards, most loan and credit card companies sell the product at the same time as they sell the credit product. By May 2008, 20 million PPI policies existed in the UK with a further increase of 7 million policies a year being purchased thereafter.

Surveys show that 40% of policyholders claim to be unaware that they had a policy.

PPI was miss-sold and complaints about it mishandled on an industrial scale for well over a decade with this miss-selling being carried out by not only the banks, but also by intermediaries.

Several high-profile companies have now been fined by the Financial Services Authority for the widespread miss-selling of Payment Protection Insurance. Alliance and Leicester were fined £7m for their part in the miss-selling controversy, several others including Capital One, HFC and Egg were fined up to £1.1m.

In their 2009/2010 annual report, the Financial Ombudsman Service stated that 30% of new cases referred to payment protection insurance.

On 6 April 2011, the Competition Commission in the UK released their investigation order designed to prevent miss-selling in the future. Key rules in the order, designed to enable the customer to shop around and make an informed decision, include:

- provision of adequate information when selling payment protection and providing a personal quote;
- obligation to provide an annual review; and
- prohibition of selling payment protection at the same time the credit agreement is entered into.

In an article published in the CII's June/July 2013 issue of "The Journal" it was mentioned that the financial services industry in the UK is now paying the price of miss-selling PPI insurance to the tune of £14bn in compensation and related costs.

Could the same miss-selling be taking place here in SA? Let's hope not - the insurance industry is only now re-gaining its credibility.

How should fees and commissions be disclosed?

We have been getting a number of questions asked as to how this should be achieved. It is not always easy to have a standard due to differing IT systems used, assuming that such a system is used to generate quotes and records of advice.

Our view is as follows:

- commission should be shown as a percentage in disclosure document and/or policy schedule OR Rand equivalent if IT system allows for this,
- Broker fee should be shown as Rand per transaction in disclosure document and/or policy schedule and/or R of A PLUS separate invoice issued by broker to client if required,
- Binder/outsource fee should ideally be shown as Rand based in documentation (disclosure or Record of Advice or Policy schedule and/or script) and if not pos-

sible percentage in disclosure document or system driven R of A and/or script.

Debarment – a recent court case

All key individuals must read the articles in Insurance Gateway and Moonstone Monitor, referred to in our "Interesting articles we have read" feature, on the recent court case where an employee challenged their dismissal and debarment. We, as the compliance officer, will also have to ensure that the reasons for a debarment are valid and well implemented.

Whilst on the subject of debarment we were recently requested by a client to debar a representative. We felt it prudent to seek some input from the FSB given this recent court case.

We asked;

"The representative was involved in a hit-and-run accident where the third party is critically injured (probably fatal);

1. ***The representative denied this at first, then admitted it up to a point, then admitted it in full. See attached correspondence;***
2. ***The police have arrested her and she is currently out on bail, pending the case;***
3. ***She has confessed to illegally obtaining chronic medicine on the FSP's Medical Aid***

for a fellow employee, who did not belong to a Medical Aid; and

4. ***The representative has resigned so no disciplinary action can be taken at this time;***
5. ***The representative has been removed from the FSP's Register.***

As there are time limitations to debar the representative in terms of S14 of the Act and there are conflicting views as to whether there is sufficient evidence to do so, your guidance would be welcome."

The response:

"The approach makes it clear that there are two questions to be asked. The first is whether the wrongful or dishonest acts were done for the purposes of the financial product defined in the FAIS Act. This question requires a consideration of whether the representative was performing specified financial products as defined by the Act and is a purely factual question. There are no compelling facts in this matter to show that the representative was acting within the course and scope of employment for the purposes of a financial product as defined in the Act. Even though the representative's dishonesty acts have been done solely within the course and scope of employment for the purposes of a financial product as defined in the Act, there should nevertheless be a sufficiently close link between the representatives dishonesty acts and the interest of the financial industry and the purposes of the FAIS Act and the business of the FSP. The two charges are not 'sufficiently close' to give rise to debarment of the representative.

They went on to say:

"In addition to the above, I wish to point out that this Office is inundated with request for debarment of representatives under circumstances when they should have been debarred by the providers in this case. The legal structure of debarment section 14(1) is that the providers are required to debar representatives who are no longer competent or fit and proper to render financial services. That function is squarely placed with the provider because they are best positioned to act timely and have direct contact with the representatives."

So expect us to be more circumspect on all requests for debarment and we will expect you as the FSP to ensure that you deal with all such matters in timeously and in accordance with regulatory requirements.

FICA – reporting in terms the List established and maintained by the Committee pursuant to resolutions 1267 (1999) and 1989 (2011) with respect to individuals, groups, undertakings and other entities associated with Al-Qaida

We recently had reason to review the latest version of this list as it applies to South Africans for a client. The list had almost 100 locals on it, complete, in the main, with addresses and contact details.

For all clients who are Accountable Institutions, especially those with clients who are based in communities usually associated with such relationships, although it would be unwise to restrict your FICA due diligence to this sector alone.

The original extract from Al-Qaida and Taliban Sanction Committee - 1267 can be found here.

We recently attended the Compliance Institute annual conference in Johannesburg. There were a number of presentations that were of relevance to our client base, namely:

- Treating Customers Fairly,
- SAM, and
- Protection Of Personal Information.

Here is our commentary made on the TCF presentation to Compliance Officers by Leanne Jackson:

- Its role is to support the market conduct peak of the twin peaks framework.
- There will be a licensing process as well as statutory controls and reporting requirements. This, however, does not agree with later statements that there will most likely not be a "TCF Act". We assume the reference is to the use of the current applicable legislation and that further TCF related application requirements will be put in place in all spheres of the financial services industry.

- The intention is to allow the FSB to take regulatory action when necessary but to provide guidance more often. Part of this guidance would be to liaise with the various Ombuds to determine where shortfalls occur and relay this information back to the industry.
- Consultation will be undertaken – hopefully with the correct people and with sufficient time.
- In line with the regulations they are investigating function based delineations of the Regulators in each peak. In our opinion this will result in FSPs having two masters to answer to! Hopefully they manage to either completely separate the requirements or integrate them so well that there is no duplication.
- There is a review of the reinsurance market currently underway.
- Similarly inducements and loyalty schemes are under review. (Notice how the FSB has lumped these into the same category.)
- Key information documents will be part of the disclosure requirements. These documents will be stipulated by the Regulator and adherence will be part of the reporting requirements. They are looking to be highly proscriptive as there will be standardised terminology and an insurance advertising guideline.
- There is a review of product aggregation and comparison services currently underway.
- All forms of remuneration in the short and long-term arenas are under review (in case you didn't know); including third party cell captives.
- As we already know there are specific reviews on the "funnies": retail, motor and travel.
- Further focus will be placed on the Binder Regulations and Directive 159.
- Ongoing disclosure will be given more emphasis under the auspices of the FAIS Act and Regulations.
- Guidance on claims and complaints will be issued (we assume after discussion with the various Ombuds). This may have particular focus on excesses and exclusions (at least initially).
- Complaints returns may be requested or the register may require them to be categorised under TCF lines (i.e. the 6 pillars). Ombuds will have to apply TCF concepts when determining: as we see it that will make the FAIS Ombud's task easier and the other Ombuds' much harder.

- There is work underway to give the FSB autonomous powers to be able to more easily issue guidance. Our view is that this is not a great idea as it excessively reduces the necessary balances to prevent abuse.
- A positive note: The ‘broker’ has been given a potential lever with the insurer in that they could engage with the insurer to ensure that the products meet their clients’ needs.
- Lastly it was reiterated that this is not a compliance project, as seen in the FAIS/FICA environment. It will require more of our advice and input that will be necessary to assist the FSP. We will have more feedback after our meeting with the FSB on 10 September.

COVER July magazine has a summary of the SAUMA conference and one aspect of that was the TCF presentation done by Leanne Jackson of the FSB where she focused on how TCF will affect the UMA and how they should be preparing for its implementation.

And Insurance Gateway (July edition) has another take on TCF – ***“What Treating Customers Fairly is NOT.”*** Read more.

And Moonstone Monitor has yet another article that contains a link to a GAP analysis tool to assess where you are now.

As for the Protection of Personal Information Bill (POPI) it is clear that there will be work to be done with all clients to ensure they achieve compliance, although this is not a direct FAIS matter.

There was an interesting article on POPI that had a specific focus on the call centre industry in the August edition of COVER by Jana van Zyl of Dommisse Attorneys and Bruce von Maltitz of 1Stream.

Note that POPI was passed by Parliament this week so your changes need to get underway.

We do have copies of the presentations that were used in each of these three items if you would like a copy – just send a request to info@associatedcompliance.co.za

From the FSB

Amendment to Fit & Proper requirements

We reported last month on the expected formal postponement of the second level Regulatory Exams and earlier this month we saw the release by the FSB of an invitation to comment on proposed amendments to the Fit & Proper requirements. Amongst other things this may see the postponement being formalised. It will achieve this by simply dropping the requirement that the exams must be done within a fixed time frame. So they will still be needed but there will be no time limit. There is no indication as to when or how these exams will come back onto the radar.

The issue of on-going supervision for those affected by the lack of the second level exams is also addressed by potentially allowing supervision to fall away where the exam is the ONLY aspect of the Fit and Proper requirements that remains to be completed.

The other amendments of practical relevance are:

- Provision for the new category within the Fit & Proper structures to cater for Category V (professional clients). There would appear to be specific educational standards being created for this category. In fact the draft makes very little reference to Category V in the Fit & Proper tables, which we assume will be corrected in the final Gazetted version. At this stage it will be the same rules and exams as for Category I.
- Provision for new categories within Fit & Proper, namely B1a, B2a and Personal

lines A1. You will recall that within the first level Regulatory Exam framework exemptions were created for representatives that dealt exclusively with so called "more basic financial products." These are the formal categories to be created to cater for this exemption. It does not remove the need to complete the first level RE merely that there is a separate category to which the new RE exam, when released, will apply. This will also demand, for those of you who qualified for this exemption, to have these new categories linked to your licence profile as well as the profiles of the affected key individuals and representatives. We will obviously deal with this as and when required with the affected FSPs. We would expect there would be a period of time from when the category is launched to do this and this period will likely provide for such addition without the usual fee being charged.

There were also changes to definitions in:

- Administration of assistance business, and
- CPD

but these have no practical application for you that warrants a detailed explanation.

The above are all proposed amendments and the markets have until 6 September to provide feedback to the FSB, however we don't expect any significant changes to be made.

Category V

Within the released paperwork on the Fit and Proper changes was a note that this long awaited new category will be released by the end of the third quarter (i.e. the end of September). We are not aware at this stage as to what has changed from the original draft so we wait to comment further but we will start to flag those clients who may require this category during our upcoming monitoring visits. For those that need it the current licence will need to be amended as will the profiles of those key individuals and representatives involved with this category. As with the new categories referred to above we expect there will also be a period of time from when the category is launched and without the usual fee.

Recognition of Higher Certificate: Short term insurance SAQA ID 83526

This has now been formally approved an SP specific qualification, i.e. meets all requirements irrespective of when the person passes or was first appointed, for the following licence categories

- Short-term Personal Lines, and
- Short-term Commercial Lines,

and generic for the following:

- Long term A, B1, C, Retail Pension, Pension Fund Benefits, Health Service Benefits, Deposits (long and short term), Friendly Society Benefits and for a pure key individual and Category IV. The omission of long term Category B2 is a mystery.

Hippo case: The original penalty imposed has been reduced from R2M to R1,5M. Unclear as to what the factors are that led to this decision. All others aspects of the original decision remain as is.

Finstate fined R 40,000

The enforcement committee recently issued a fine against Finstate for allowing representatives to transact medical aid business without being registered with the Council for Medical Schemes. This was seen as a breach of both the Fit and Proper requirements of the Act and section 12 (c) of the Code of Conduct that demands ***"all applicable laws are complied with."***

From the FAIS Ombud

Thomson V Du Preez

The case was essentially about poor advice for their clients retirement planning. Such basic issues as selling an 8 year RA when the client was 5 years from retirement. The

FSP actually refused to provide a response to the complaint and the Ombud actually commented:

> ***"Given the evidence, I am not surprised by the respondent's refusal to file a response to the complaints. The respondent simply would not be able to defend her advice. Based on the total circumstances of this case, the likelihood"***

The broker was ordered to pay just short of R 200,000 plus interest as a result of the loss suffered. A full copy of the ruling is available upon request to info@associatedcompliance.co.za

Interesting things we have read

Directorship (Jul/Aug/Sep edition) – The magazine of the Institute of Directors.

An article of the Protection of Personal Information bill – one of many of late but this one has a focus on the responsibilities of the directors in the process of implementation and on-going maintenance of the regulatory requirements.

COVER Magazine August

The Changing environment of the UMA space by Stuart Sinclair of Leopard & Associates

Insurance Gateway – July edition;

Commission versus Fess – The Australian Experience with the local debate on fees gathering pace this is an interesting perspective. Read more here.

New Good Practice Guidelines take business continuity to the next level. Read more here.

Moonstone 22 and 25th July 2013: Debarment case – a must read for all Key Individuals. Read more & Read more... and Insurance Gateway. Read more.

Risks Wired 23/8/13

An article on the investigation into fees within the financial services sector. Read more here.

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