

**IN THE OFFICE OF THE OMBUD FOR FINANCIAL SERVICES PROVIDERS
PRETORIA**

Case Number: FOC 1093/09-10 GP (1)

In the matter between:-

PIETER BERNARDUS NIEMAN Complainant

and

JOHANNA SUSANNA PETRONELLA DU PREEZ Respondent

**DETERMINATION IN TERMS OF SECTION 28(1) OF THE FINANCIAL ADVISORY
AND INTERMEDIARY SERVICES ACT NO. 37 OF 2002 ('FAIS ACT')**

A. THE PARTIES

[1] The complainant Pieter Bernardus Nieman, a 69 year old pensioner of Honeydew.

[2] The respondent is Johanna Sussanna Petronella du Preez an authorised financial services provider (license number 2116) of 549 Farm Road, Sandalewood Park No. 16, Die Wilgers, 0184.

B. COMPLAINANT'S VERSION

[3] Upon retirement at the age of 65, complainant requested the respondent to set up a capital growth plan for five years. Following respondent's advice, an amount of R380 000 was invested in a Sanlam policy (no. 041694244X9) ('policy 1'), a voluntary annuity. The monthly income of R7 623 drawn from this policy was then used to fund another Sanlam policy (no. 041712836X0) (policy 2), a ten year endowment.

[4] Simultaneously a further recommendation was made to invest R375 000¹ in a PIC property syndication, the resultant income of R2 800 being utilised to fund a Sanlam ten year endowment² policy (no 041662761X1) ('policy 3'). Whilst this policy was taken out in the name of complainant, the PIC investment was made in Mrs Nieman's name allegedly for income tax purposes.

[5] During December 2007, the complainant's wife ("Christina") applied for a retrenchment package. Complainant and Christina approached the

¹ These were allegedly derived from the surrender of a Satrix 40 investment and older Momentum endowment policy.

² Whilst the PIC investment and the second policy did not form part of the complaint, it is of relevance to respondents defence and in addition illustrative of the type of product sold by respondent.

respondent to invest Christina's retirement benefit. During this time, a family member ("Amanda") who is also a financial advisor enquired from Christina whether she could assist her with financial planning.

[6] Amanda requested to look at both the complainant's and Christina's portfolios in order to get an overview of their financial position. At this point in time the complainant and Christina knew that the Sanlam policy 041694244X9 (policy 1) was a growth policy the returns of which were reinvested into an endowment policy (policy 2).

[7] Amanda pointed out to the complainant that policy 041694244X9 (policy 1) is in fact a voluntary annuity policy which will terminate after five years without any capital left.

[8] The complainant and Christina enquired from an independent broker about Amanda's understanding of the policy who told them exactly the same thing. That independent broker further enquired as to how they were going to fund the premiums of the endowment policy for the last five years of the ten year term.

[9] Christina contacted the respondent and asked her for an explanation. The respondent explained that should they not be able to pay the policy premiums after five years, the policy premium could be reduced or the policy could be made paid-up without any penalties. She further added, in the event they

wished to surrender the policy, they would be paid the full fund value at whatever time.

[10] The complainant contacted Sanlam to make enquires in respect of the policies. He was advised that the 041-policies' ('stratuspolisse') terms could not be changed and should premiums be reduced, penalties would be applied.

[11] On the 6th of February 2008, the complainant addressed a letter to Sanlam requesting that the annuity investment of R380 000 be switched to a capital growth plan. In the event that Sanlam could not do so, that the term of the endowment policy be reduced from ten to five years without penalties.

[12] On the 3rd of March 2008, the complainant received an e-mail from Mr. Riaan Jacobs, (Jacobs) of Sanlam in respect of an enquiry conducted into respondent's conduct. Attached thereto was respondent's response to the investigation. Effectively respondent provided an explanation that although policy 041694244X9 (policy 1) would cease after five years, the ten year policy (policy 2) it was funding could then be funded by the PIC investment in complainant's wife's name. However respondent fails to make mention of the fact that the PIC investment was already being utilised to fund the third ten year Sanlam policy.

[13] Effectively none of the complainant's or Christina's investments or investment income would be available in 2011 to fund the premium of R7 623. 78 when the income from the annuity comes to an end.

C. THE RELIEF SOUGHT

[14] The complainant claims the total amount of penalties payable should the term of the endowment policy be reduced to five years. He has since been informed by Sanlam that the penalty as computed by Sanlam as at March 2011 is R58 299.55. The penalties are based on the remaining term of the policy and therefore not static.

D. RESPONDENT'S RESPONSE

[15] On the 18th of November 2009, the respondent presented this Office with a convoluted response. What follows is a summarised translation.

[16] The respondent claims:-

16.1 Upon receiving the letter from the complainant during February 2008, she provided Sanlam with an explanation of how the planning was carried out, pointing out that this was all done in the presence of the complainant.

16.2 She stands by the advice given to the complainant and his wife and believes that it was the best option given their circumstances.

- 16.3 It was always her intention to generate as much capital growth at the lowest risk possible for the client. The investments as constructed, guarantee the capital as well as the income, with the potential for further growth. A tax free return is obtained from which a tax free income could be drawn.
- 16.4 The flexibility of the property investments provides different choices to the client as to how they want to deal with their funds at the end of the term.
- 16.5 The proposed planning could not be carried out because Amanda was as of January 2008 appointed to take care of affairs of the complainant and his wife and hence she (respondent) does not have access to their information.
- 16.6 Investments were cancelled and transferred, which resulted in respondent not being able to carry on with the agreed planning.
- [17] Respondent further provided with her response quotations and proposals which according to her were accepted and signed by complainant. Copies of the documents are attached hereto marked 'D' and 'E1'.

E. ISSUES

[18] The issues to be decided are:

- 18.1 Whether respondent acted in a manner which is not in compliance with the FAIS Act and/ or negligently;

18.2 Should it be found that the respondent's conduct was not in compliance with the FAIS Act and or negligent, whether it caused the complainant to suffer damage or financial prejudice; and

18.3 The amount of such damage or financial prejudice.

F. FINDINGS

Whether respondent acted in a manner which is not in compliance with the FAIS Act and or negligently?

G. THE INVESTMENTS

[19] As mentioned previously, the respondent provided the Office with documents in support of her submissions. These documents include *inter alia* a written proposal which the respondent avers were accepted by the complainant when the financial services were rendered as well as a document that could probably be best described as an action plan.

[20] Complainant however, maintains, he never had sight of the proposal or the action plan.

[21] According to the written proposal, the complainant contacted the respondent on 20th June 2006 after which a meeting was scheduled.

21.1 The record further provides, the complainant:

- “Seeks information about short to medium term investment options & retirement planning
- Requires conservative & low risk investment as well as contingency fund
- Seeks information on tax requirements
- Requires disclosure of fees applicable”

21.2 It was proposed that:

- “The amount of R380 000 be invested as Sanlam term investment
- The income of the property investment be re-invested as endowment in a guaranteed and tax free Sanlam multi managers portfolio over a 10-year period
- Income of Sanlam be reinvested on an endowment 10yrs”

21.3 “The origin of the funds to be invested is the complainant’s Eskom Pension Fund, i.e. the non compulsory one-third portion. The following investment proposals were made:

- i) “Sanlam term investment – 5yrs
- ii) Sanlam Endowment – 10yrs
- iii) PIC investments”

21.4 The proposal further sets out the ‘Pro’s & Con’s’ of the 3 proposed options as follows:

“Property investment

- Pro's – Income & capital growth
- No fixed term – estimated 5-years
- 5-year buy-back guarantee
- Con's – Income is fully taxed
- No written guarantee, but still low risk
- Money not available during investment period

Sanlam Term Investment

- Guaranteed growth and in combination with all other investments
- No risk
- Tax free plus a 3% guarantee and the possibility of better growth in the portfolio available to this product
- Medium to long term planning and diversification in different products as well as the time frames and options
- Still be open to better portfolio growth
- Safe against a market that is volatile in bad economic times

Endowment

- Pro's – Guaranteed market related product
- Tax free after 5-years
- Medium growth
- Con's – Funds only available after 5-years"

[22] The respondent's positioning of the PIC investment as a low risk investment, is a misrepresentation and also an infraction of Section 3(1)(a)(i) of the General Code of Conduct. The section provides:

'representations made and information provided to a client by the provider must be factually correct.'

[23] The PIC investment is in actual fact a high risk property syndication investment as it involves the purchase of shares in unlisted companies. On the respondent's own version, complainant requested capital growth at the lowest risk possible.

[24] Although the PIC investment is in the complainant's wife's name, the very act of advising the wife to invest in an investment with such high risk is on its own a violation of section 8 (1) (a) of the Code which provides:

'A provider other than a direct marketer, must, prior to providing a client with advice –

(a) Take reasonable steps to seek from the client appropriate and available information regarding the client's financial situation, financial product experience and objectives to enable the provider to provide the client with appropriate advice;'

[25] The written proposal, which the respondent avers was accepted by the complainant, describes the Sanlam annuity investment (income plan) as

“Guaranteed growth and in combination with all other investments” and “Tax free plus a 3% guarantee and the possibility of better growth in the portfolio available to this product.” These statements are false. The investment would cease after the five year period with no growth due to the complainant. Furthermore, the interest component of the income would also be subject to income tax in terms of section 10 (A) of the Income Tax Act 58 of 1962, as amended. Once again, respondent’s conduct violates section 3 (1) (a) of the Code including section 7 (1)(c)(xi).

[26] The respondent’s proposals that the Sanlam endowment investment is “Tax free after 5-years” and that the funds are only available after 5-years are misleading. Firstly, the investment term is ten years. Should the complainant cease paying premiums towards the investment, he would no doubt be subjected to hefty penalties. Secondly, although the proceeds of the policy are tax free, the policy is taxed in terms of the Four Fund Approach, which means that income tax is paid within the fund on behalf of the investor. In addition to income tax there is also a capital gains tax liability of 7.5% on any capital gain that the fund makes. The misleading information given to the complainant and the failure to disclose that the policy came with restrictions and penalties for early termination is a violation of sections 3(1)(a)(ii); and 7(1)(c)(x) of the Code.

Section 3 (1) (a) (ii) provides:

Representations and information provided to a client *‘must be provided in plain language, avoid uncertainty or confusion and not be misleading.’*

Section 7 (1) (c) (x) provides:

A provider other than a direct marketer must provide reasonable and appropriate general explanation of the nature and material terms of the relevant contract or transaction to a client, and generally make full and frank disclosure of any information that would reasonably be expected to enable the client to make an informed decision. In particular, a provider must disclose *'any restrictions on or penalties for early termination of or withdrawal from the product, or other effects, if any, of such termination or withdrawal.'*

H. PAYMENT OF ENDOWMENT PREMIUMS

[27] According to the complainant, after learning that there would be no capital left when the annuity installments cease, he requested that Sanlam change the investment to a capital retention type, alternatively reduce the investment term of the endowment to five years. The request was refused. Notification of the refusal was sent by e-mail by Jacobs. Jacobs' response further contained respondent's letter which she wrote to Sanlam in an attempt to explain how the premiums payable on the 10 year endowment policy were to be funded after the income payments ceased.

[28] According to the respondent, the income from the annuity was to fund the premiums on the endowment policy for 5 years. The PIC investment, which in respondent's view would have a capital value of between R550 000 to R600 000, would then continue to fund the endowment or partially fund the premium.

[29] What the respondent failed to mention in her letter addressed to Sanlam is the fact that the income from the PIC investment is currently being used to fund premiums on the third policy (041662761X0). The term of the latter policy is also ten years and the policy will mature approximately one month prior to the maturity date of the endowment funded by the annuity policy.

Even assuming that respondent was correct in her speculation that the PIC investment³ would appreciate to between R550 000 and R600 000 this could not remotely fund the premiums on policy 2 (041712836X0).

[30] According to the respondent, the complainant accepted and signed the quotations of the annuity policy and endowment. However, on the totality of the evidence before me, the likelihood that complainant signed the quotations knowing what he was purchasing are slim or non-existent. In fact the rational conclusion to make in these circumstances is that complainant did not understand that he was buying a voluntary annuity, the income installments of which were fixed for a term far less than the endowment policy he was committing himself to. Respondent's conduct in this regard violated the duty placed on providers to '*render financial services honestly, fairly, with due skill, care and diligence, and in the interests of clients and the integrity of the financial services industry.*'

[31] There can be no doubt that the respondent's advice to the complainant to invest in the five year income plan and to use the income thereof to fund a

³ An amount of R375 000 was originally invested in PIC.

policy which has a 10 year investment term was inappropriate. Apart from the commission earned on endowment policy, the respondent was, according to Sanlam, paid commission of R5 700 on the voluntary annuity and a further R39 643.65 on yet a further 10 year endowment. The advice in my view, was motivated by the commission.

[32] But for the respondent's conduct, the complainant would not have not have invested in such a ten year endowment. The complainant will simply not be able to afford the premium of R7 623.78 per month after the annuity installments cease. Consequently, the complainant will be forced to prematurely surrender the endowment policy, which will result in financial prejudice on his part.

I. CONCLUSION

[33] The issue at hand is not new, it's a frequent topic of debate within the industry and a source of much frustration for clients.

[34] It is difficult for anyone to anticipate the future, particularly ten years hence and frequently funds are no longer available to fund the policy. This results in clients being compelled to lapse them whilst incurring significant penalties. In most instances these extended policies are taken out for the benefit of the provider and their commission.

[35] It makes far more sense to limit the term to the minimum five years whereafter it becomes an open ended policy that the client can deal with as he chooses.

[36] In the present instance the complainant was a pensioner with a largely unpredictable future income stream. That respondent locked him into not one but two ten year policies is quite simply indefensible.

J. QUANTUM

[37] Based on the enquiries made by this Office, Sanlam offered to cancel the ten year endowment and to reissue the policy as a five year policy. This was done on condition that the respondent pay back the difference between the commission paid on the ten year endowment and that which would have been payable for a five year endowment. The respondent refused to resolve the matter in this fashion.

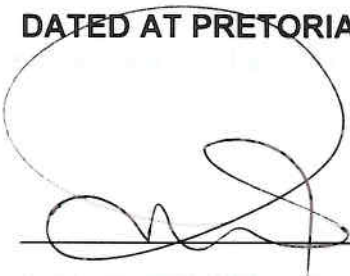
[38] The respondent leaves me with no alternative but to award damages equal to the penalties payable on cancelling the ten year endowment and exchanging it for an endowment with a five year term. Sanlam calculated the amount and informed this Office that the amount required is R58 299.55.

[39] Whilst as previously noted this amount may vary marginally according to the exact date of early termination such variation is unlikely to be material and as such I believe that said amount is fair and reasonable in the circumstances.

ORDER

1. The complaint is upheld.
2. The respondent is ordered to pay the complainant the amount of R58 299.55
3. Interest on the said amount at 15.5 % per cent per annum calculated from seven (7) days after the date of this order, to date of payment.
4. The Respondent is ordered to pay a case fee of R1 000, 00 to this Office within 30 days from date of this order.

DATED AT PRETORIA ON THIS THE 3rd MAY 2011.



NOLUNTU BAM

OMBUD FOR FINANCIAL SERVICES PROVIDERS