FAISOmbud
Office of the Ombud for Financial Services Providers

under the baobab tree
Issue 13 2017

INTRODUCTION

This, the 13th issue of Under the Baobab Tree, the newsletter of the Office of the FAIS Ombud, sees the end of the third quarter of 2016. As we turn our attention towards the end of 2016, we have an opportunity to look back at some of the complaints that this newsletter has highlighted during the preceding year. Our first case study for instance focuses on the proliferation of endowments policies as investments, and whilst there is a place for endowment policies within the financial planning environment, it must be appreciated that it remains a life assurance policy, and may not be suited to all potential investors. We also have a case study that focuses on short term insurance, which is an area of financial services that continues to fall fowl of the provisions of the FAIS Act and its corresponding General Code of Conduct for Authorised financial services Providers and Representatives (the Code). Short Term insurance is a vital component of any balanced financial plan and as a mechanism to preserve wealth. However, the decision with regards to the purchase of short term insurance policies and the recommendations made by Financial Services Providers (FSP) continues to be based primarily on the premium payable regardless of the implications thereof. We also focus on aspects of retrenchment and retirement planning, which are two aspects that one does not often appreciate until you are actually faced with the prospect of retrenchment or until you find that you have failed to make sufficient provision for your retirement. The value of both these financial products cannot be underestimated, however where one is unable to make an informed decision with regards to these types of products, the consequences can be devastating and in some cases, such as retirement, remain with one for the rest of one's life.

In addition, this Office would like to focus on an aspect of the financial services landscape that has grown exponentially in the last few years, which is that of cash back benefits on life assurance policies. This is discussed towards the end of the Newsletter and while no case studies have been included given the nature of these policies and the restrictions we face as an Office when assessing and investigating these complaints, the value in understanding the importance of this aspect of the financial services landscape is apparent in our discussion thereof below.

CASE STUDY 1

An endowment policy is a life insurance contract designed to pay a lump sum after a specific term, the minimum term being 5 years. This minimum 5 year term is also referred to as a restriction period during which the investor has two access points to the funds namely; one loan and one surrender, a full withdrawal from the endowment policy during this time will however be met with significant penalties. Endowment policies are as a result not always the most appropriate option for those individuals with limited resources and who may require access to their funds at any time.

THE CASE OF "MS M"

Facts

The Complainant had approached the Respondent during October 2015 for advice on how to invest the proceeds received from the Road Accident Fund. These funds represented the Complainants entire portfolio and he had required that these funds provide him with a monthly income. The Complainant accepted the Respondent's recommendation which he believed was a straight forward investment. Following the investment, the Complainant attempted to access the funds but was subsequently informed that his funds had been placed in an endowment policy and that should he persist with his withdrawal request he would incur penalties.

Our Intervention

The Complainant claimed that he had not been informed that penalties would apply in the event of the proceeds being accessed prior to maturity. In its response to the initial correspondence from this Office the Respondent claimed that all the relevant disclosures had been made to the Complainant and that he was therefore aware of the implications of withdrawing from the policy prior to maturity. This Office responded that when one considered the personal circumstances of the Complainant it was evident that an endowment policy would not have been an appropriate recommendation, and the Respondent was asked to review its decision with regards to the resolution of the complaint. The Respondent conceded that the policy may not have been an appropriate investment vehicle for the Complainant and refunded all the penalties levied against the policy to the satisfaction of the Complainant.

Lessons learnt

1. Endowment policies are provided for a specific term, the minimum term being 5 years, and during this time the client is restricted with regards to accessing the proceeds. These policies are as a result inappropriate for those who may require access to the funds in the event of an emergency.
2. It is therefore of vital importance that a FSP obtain all relevant and material information to ensure that any recommendation made with regards to placing ones funds into an endowment is as a result of I being appropriate to the needs and circumstances of the prospective client.
3. There is no such thing as a single need, so ensure that the FSP considers your entire situation and always ask the FSP to motivate why a specific recommendation is appropriate to you.

CASE STUDY 2

Short-term Insurance is a way of creating financial security against the repercussions of unforeseen events such as a motor vehicle accident, the theft of a motor vehicle or the damage to property etc. Short-term Insurance transfers the risk from the client to the insurer, by pooling the contributions, or premiums, of insured individuals, with the purpose of placing the insured in the same position as before the unforeseen event. With regards to motor vehicle insurance there are three categories of cover provided, Comprehensive, Third Party Fire and Theft, Third Party Only. As the name suggests comprehensive cover provides the greatest level of cover, however there are several aspects to be taken into account with regards to additional extras fitted to the vehicle as well as any outstanding finance charges that may require additional cover. Simply insuring ones motor vehicle comprehensively may not ensure that your vehicle is comprehensively covered.

THE CASE OF "MR L"

Facts

In the matter of "W", the complainant had purchased a vehicle which was subject to a finance agreement. The vehicle was comprehensively insured through insurer "A". Following a significant increase in premium a few months after the inception of the policy, the complainant requested the respondent to seek alternative insurance. Complainant's portfolio was subsequently moved to insurer "B" who also provided comprehensive cover however at a more affordable premium, which included a premium is respect of top-up cover, which was in respect of the outstanding amount owing to the bank. The new policy also included a "new for old" clause which stipulated that should complainant suffer a total loss in the first year of cover, the vehicle would be replaced with a new vehicle.

Complainant was subsequently involved in an accident and the vehicle was damaged beyond repair. The claim was duly submitted and complainant was presented with an agreement of loss, which included the noted retail value of the motor vehicle as well as an additional 10% in respect of the top-up cover. The amount stipulated in the agreement of loss however was lower than the outstanding amount owed to the finance house. The complainant was convinced that the respondent had insured his vehicle for the incorrect retail value, and had approached this Office for assistance.

Our Intervention

Upon receipt of the complaint, the matter was referred to respondent in accordance with the rules on proceedings of this Office. Respondent was requested to provide this Office with documentation showing compliance with the Code. Following an in depth investigation, it was established that whilst respondent had correctly identified the retail value, it had failed to ensure that the additional extras that had been fitted to the vehicle, and which did not come standard with the

vehicle, had not been specified on the policy. It was clear that the respondent had failed collect all relevant and available information regarding the specifics of the vehicle, and as a result had been unable to ensure that the recommendation made had been appropriate to his needs. After this was raised with the respondent, it agreed to settle the matter for an amount equal to the value of the optional extras that had not been provided for.

Lessons learnt

4. Comprehensive cover will ensure that your motor vehicle is covered in respect of accidental damage sustained to the vehicle, the theft of the motor vehicle, and for damages sustained to a third party where you are at fault. It must however be appreciated that your vehicle is only insured for the retail value at the time of the loss.
5. In the event that there are any outstanding finance charges that are in excess of the prevailing retail value then you would need to purchase additional cover in the form of some sort of top-up cover to ensure that one is not left owing the finance house in the event of the vehicle being stolen or written off.
6. Any additional extras that did not come standard with the motor vehicle must be specifically noted on the policy and an additional premium paid in respect thereof, as these items are not included in the vehicles retail value.

CASE STUDY 3

In an uncertain economic climate, retrenchment is a reality for many South Africans. Retrenchment cover as the term is casually referred to, comes both in the form of retrenchment insurance and as a benefit. When we refer to rretrenchment insurance, we refer to a policy that covers the insured's salary in the event that he or she is retrenched, in which case the insurance company will pay out a portion of the insured's salary for a limited time, usually six months. With regards to retrenchment insurance as a benefit, it is noted that many insurance companies offer retrenchment insurance as a benefit on other insurance policies, such as car insurance. When retrenchment cover is a benefit and not a standalone policy, it does not cover the insured's salary, but rather covers the insured's premiums for that cover. That is, if your car insurance includes retrenchment cover the cover will pay for the car insurance premiums for a period, usually six months. This type of cover is also prevalent in credit life policies, where in the event that one is retrenched the policy will ensure that the premium towards the outstanding loan continues to be paid for a period of 6 months. It is important to note that the purpose of retrenchment cover is to provide one enough time to find another job, and not to entirely replace one's income and neither does it absolve one from the commitment to settle one's outstanding debt once the 6 month period has expired.

THE CASE OF "MR S"

Facts

The complainant, together with his wife, applied for a home loan with the bank, the respondent in this matter. Soon after the loan was approved, the complainant was approached by a financial advisor of the respondent and recommended that the complainant apply for a comprehensive life insurance policy, which included credit and retrenchment benefits. Approximately two years later, complainant's wife was retrenched and they duly submitted a claim in respect of the retrenchment benefit. However, the claim was rejected on the basis that complainant did not have retrenchment cover in place, but rather disability cover.

our Intervention

Upon receipt of the complaint, the matter was referred to the respondent in terms of the rules on proceedings of the Office, to provide this Office with documentation showing compliance with the provisions of the Code. An investigation into the matter revealed that although the respondent had identified the need for retrenchment cover, it had never uploaded the information onto the system. Despite this the respondent still maintained that the claim would have been rejected, and had subsequently referred to an alleged non-disclosure by the complainant of a pre-existing back condition. As a result a settlement offer was made taking into account the premiums that the complainant would have paid had the correct cover been incepted, however the offer fell short of the benefit that complainant would have been entitled to. This Office addressed correspondence to respondent advising that it was of the view that the manner in which the financial advice was rendered failed to adequately provide for the needs of the complainant where after the respondent made a settlement offer in favour complainant, equalling the amount that would have been paid, had the cover been in place.

Lessons learnt

7. It is important to understand not only the terms and conditions applicable to retrenchment cover, but what type of retrenchment cover you have.
8. Important to understand that retrenchment cover does not replace one's salary or indeed negate the need to meet one's obligation in terms of credit agreements. Retrenchment policies provide temporary relief for a limited period of time whilst one seeks alternative employment.

CASE STUDY 4

A contract for difference (CFD) is an agreement between a buyer and seller to exchange the difference in price between of an underlying instrument over a period of time. In effect CFDs allow investors to position themselves in relation to the rise and fall of securities on the stock exchange without the need for ownership of such securities. CFDs are leveraged investments that require an investor to deposit cash as a margin rather than the payment of the full value of the underlying position. As a result

of this and the gearing employed by this investment, CFDs are not suitable to everyone, and should be carefully considered to ensure that any such recommendation made by a financial services provider is done so after having considered all relevant and available information to ensure that it is appropriate with regards to the needs and circumstances of the client.

THE CASE OF "MR F"

Facts

Complainant resigned from his employment at the age of 49 where he had been employed as a handyman. He subsequently received his pension pay-out and had invested a portion of those funds into a money market account. Upon advice from the respondent, complainant had then invested an amount of R100 000 in a CFD trading account through Nedbank. Complainant's instruction to the respondent had been that he wanted to receive high interest on his investment, but did not want to risk his capital. Approximately a year after the investment, the complainant received a statement regarding the investment, showing that the value of his investment had depreciated to less than R10 000, this was contrary to complainant's instruction that he required a safe investment, and following failed discussions with the respondent, the complainant approached this Office for assistance.

Our Intervention

Upon receipt of the complaint, the matter was referred to complainant in terms of the rules on proceedings of the Office, where the respondent was requested to provide the Office with documentation showing compliance with the provisions of the Code. The documentation subsequently provided to this Office fell short of the standard as required by section 9 of the Code, and it was apparent that the product recommended had not been appropriate to both the needs and risk profile of the complainant. Furthermore it was argued that the complainant could not have comprehended the complexity of the 40 page document provided for his signature. Following negotiations, the respondent agreed to refund complainant's capital, subject to any amounts owing, which was accepted by the complainant in full and final settlement of the complaint.

Lessons learnt

9. When a Financial Services Provider renders a financial service, representations made and information provided to a client must be appropriate, taking into account not only all relevant and available information, but also the factually established or reasonably assumed level of knowledge of the client.
10. Whilst CFDs have the potential to provide very attractive returns, this is as a result of the gearing employed, which means that even though one can receive lucrative returns, it is just as easy to lose one's entire capital in one trade.
11. CFDs are not appropriate to all investors and if you have any doubts you need to ensure that you obtain professional advice in this regard.

CASE STUDY 5

A provident fund is a fund in which an employer and the employee make a contribution while an employee is in employment with the organization. Unlike a pension fund where only one third of the benefit at retirement can be commuted to a lump sum, with the remaining two thirds being utilized to purchase an annuity, the entire benefit of a provident fund can be accessed as a lump sum upon retirement. Prior to retirement there are options available to the employee in the event that he or she withdraws from the fund that could see the funds either transferred to an approved retirement fund, provident preservation fund or retirement annuity, all of which allow one to preserve the prevailing benefits from the effects of taxation. There is however the option of accessing the entire benefit subjects to taxation, and utilizing the funds to either reduce debt or invest in alternative investment vehicles. Whatever the decision, any recommendation made by a financial services provider must be appropriate to the needs and circumstances of the client, and one must ensure that sufficient information is provided to allow the client to make an informed decision.

THE CASE OF 'MR M'

Facts

When Mr 'M' resigned from his employer he stipulated that the benefits of his provident fund must be paid out in cash as his new employer did not provide any pre-retirement saving s vehicle and so he was unable to transfer the funds. Mr 'M' then sought the advice of the respondent's representative, where he had clearly outlined to the respondent his desire to invest the funds in an investment where the funds could be invested, with the option to access the funds at any time in the event of an emergency. Unbeknown to the complainant the representative had provided him with a Retirement Annuity (RA) which meant that the complainant would be unable to access the funds until he turned 55, and even then he would only be able to access a third of the benefit in cash.

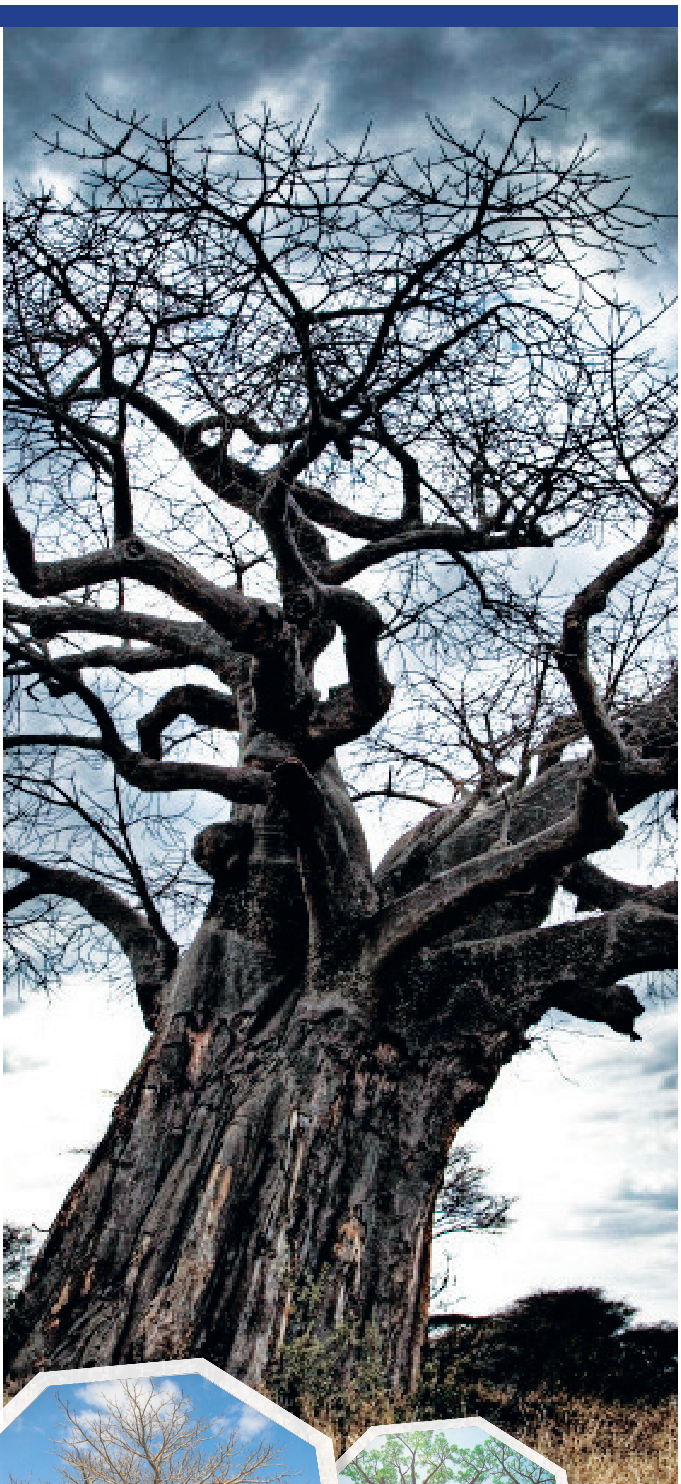
Our Intervention

Complainant requested this Office to investigate the conduct of the respondent's representative claiming that she misrepresented the product ultimately provided. Complainant also required access to his funds. Upon receipt of the complaint, the matter was referred to respondent in terms of the rules and proceedings of the Office. Respondent was requested to provide the Office with documentation showing compliance with the provisions of the Code. Upon investigation it was determined that the complainant had a number of liabilities and that the proceeds of the provident fund could have assisted him in reducing this burden. It was also evident that the respondent's representative had not obtained all relevant and available information from the complainant and as a result the product ultimately provided was not appropriate to the needs of the complainant as the time the advice was provided. After this was highlighted to the respondent, the respondent was successful in getting the retirement annuity cancelled from inception and the complainant was placed in the position he would have been had the product not been provided.

Lessons learnt

12. Whilst the complaint above was capable of being resolved, more often than not any decision taken with regards to the proceeds of a provident fund or any retirement benefit can be permanent and have significant implications for the client.

13. Upon withdrawing from a provident fund one has the option of taking the entire benefit as a cash lump sum, net of tax. By transferring the benefits of the provident fund to a retirement annuity one can avoid the effects of taxation but the funds are then inaccessible until one reaches the age of 55.



Cash Back Benefits

The emergence and proliferation of cash back benefits on life assurance policies, where clients are promised either a percentage of, or all of the premiums paid back at the end of a specific claim free period, are cause for concern. These life assurance policies which include benefits such as life cover, disability, dread disease and all other ancillary benefits are powerful financial instruments that provide peace of mind to either those left behind, or to the life assured in the event of a life changing event such as death, disability or the contraction of a dreaded disease.

The premise behind these assurance benefits is to ensure that the life assured and or the beneficiaries of the life assured are able to maintain their standard of living during those times of uncertainty. The determination of one's standard of living and the benefits required to ensure that this specific objective materialises is achieved through the collection of all relevant and available information in order to facilitate an analysis that will allow a financial services provider to produce a recommendation that is appropriate to the needs of the prospective client. The implementation of which will ensure the achievement of the desired objective.

The concern is that the lure of a cash back payment after a specified period often obscures any limitations and restrictions inherent in the benefits provided by the policy. These limitations include ancillary benefits such as disability and severe illness that are included as accelerated benefits on the policy which reduce any life cover benefits in the event of a claim, extended waiting periods and benefits that are dependent on the severity of one's diagnosis, as well as exclusions for pre-existing medical conditions. The concern therefore with the cash back offer from life assurance companies is that this benefit is promoted above all other benefits provided by the policy as the primary reason why one should apply for a particular product. This has essentially reduced the selection of a life assurance policy to which provider offers the most attractive refund after a claim free period, as opposed to which solution offers the client the best opportunity of achieving the objectives of a particular financial analysis.

FAISOmbud
Office of the Ombud for Financial Services Providers

under the baobab tree

OFFICE OF THE OMBUD FOR FINANCIAL SERVICES PROVIDERS

TEL 012 470 9080 / 012 762 5000
EMAIL info@faisombud.co.za
WEBSITE www.faisombud.co.za
Sussex Office Park, c/o Lynnwood Road and Sussex Avenue, Lynnwood, 0081

Anyone who has a complaint about the service delivery of this office must kindly email their complaint to hestie@faisombud.co.za