



INTRODUCTION

The second quarter of 2015 sees the 8th edition of Under the Baobab the newsletter for the Office of the FAIS Ombud. Once again the quarter has seen significant developments within the legislative environment of the financial service sector, none more so than the coming into effect of Board Notice 92 of 2014. This notice came into effect on 1 May 2015 and provides a legal framework within which managers of collective investment schemes (commonly referred to as unit trusts) must advertise their products.

The Financial Services Board Notice 92 of 2014 also places specific obligations on advisers and product providers in respect of disclosures to clients specifically with regards to fees and charges. This enhanced disclosure is to be facilitated by the introduction a minimum disclosure document that is to replace the widely used fund fact sheets, which must contain the prescribed information in such a way that it is accessible to an investor. This notice has once again highlighted the importance of fees and charges being disclosed to prospective clients of not just collective investment schemes, but indeed any and all financial products.

These fees can range from commissions, administration fees, management fees etc., and they can have a significant effect on the performance of one's investment.

If we look at an example where one invests R10 000 for 25 years and we assume that the investment would grow at 6%pa with no fees, the investor will realise a maturity value of R46 500. If we introduce an annual advice fee of only 0.5%, this value decreases to R38100. If we were to increase that annual fee to 1% we see a further reduction to R 33900, and at 2% the investor is left with only R26500 over the same period.

This simple example, shows that even a small increase in annual charges, can seriously add up over the years as the annual charge you pay is set as a percentage of the money you've invested. As your money grows, the amount you pay increases. It is therefore important that consumers of financial services question their financial advisors as to not only the level of fees charged, but the impact that those fees will have on the performance of the proposed investment or policy, and where possible to negotiate a fee that is suitable to both parties.

CASE STUDY 1:

LIVING ANNUITIES – CAN YOU AFFORD THEM?

One of the options available at retirement is that of a living annuity. A living annuity is a special type of compulsory purchase annuity offered by insurers and retirement funds, where the income is not guaranteed but is dependent on the performance of the underlying investments. Therefore unlike the more traditional annuities it is the client who bears the investment risk. So whilst a living annuity allows the client to select an income between 2.5% and 17.5%, consideration must be given to whether or not the level of income chosen will coincide with the performance of the underlying portfolio. An income that exceeds the performance of the portfolio will begin to erode the original capital invested, which can have serious implications upon the retiree's standard of living.

THE CASE OF 'MR C'

Facts

The complainant, Mr C, had retired during September 2009; and had approached a representative of the respondent for advice with regards to the investment of his pension benefits. The complainant had accumulated an amount of R2 516 297 and had required an after tax income of R19 000.

In order to facilitate the complainant's income requirements, the respondent's representative had recommended an investment into a living annuity where the complainant would be allowed to draw down an income of R23956, which was a drawdown of 11.4%. The respondent's representative had not cautioned the complainant as to the risks involved in drawing such an income, and had in fact claimed that the investment could more than sustain such an income. As a result the income payments had exceeded the growth of the underlying portfolio, which had seen the funds placed in an income fund which at the time had an historical average performance of 7.5% before fees and charges. The result was that the complainant had sustained a loss of capital in the amount of R224 452.

Aggrieved by the recommendations made and the failure of the respondent's representative to have adequately managed his expectations with regards to the income he could receive, the complainant had approached this Office for assistance.

Our Intervention:

Upon receiving the complaint it was referred to the respondent in accordance with the rules on proceedings of this Office. In response, the respondent claimed that the complainant had requested the specific level of income, and that were one to consider the current value of the portfolio and the income payments received up to that point, then the complainant had not suffered any financial prejudice as this amount had been in excess of the original amount invested.

The respondent's response had failed to satisfy our concerns regarding the financial service provided, and the resultant financial prejudice suffered by the complainant, and so the matter was officially accepted for investigation in accordance with Section 27(4) of the Financial Advisory and Intermediary Services Act No.32 of 2002.

This Office argued that the respondent's representative would appear to have failed to provide the complainant with a reasonable explanation of the nature and material terms of the relevant contract and that he had failed to make full and frank disclosures that would have enabled the complainant to have made an informed decision.

The respondent's representative would furthermore appear to have failed to provide a recommendation that was appropriate to the complainant's circumstances and that the complainant had been allowed to labour under the false impression that he could draw an income of his choosing despite the fact that the underlying portfolio selected would not have been able to sustain such an income.

The Office was also of the view that despite the income payments received to date, the complainant had indeed suffered a loss in that he had now been seriously compromised with regards to his ability to adequately provide for himself going forward.

The respondent reverted back to this Office with an offer of R168045, which took into consideration the income that had been in excess of what would have been acceptable in the circumstances. This Offer was accepted by the complainant.

Lessons learnt

1. The purpose of an annuity is to provide an income for life at a time when one is no longer economically active.
2. It is therefore important to ensure that the level of income you are drawing from your living annuity is supported by the investment return of the underlying portfolio.
3. The importance of making adequate provision for retirement to ensure that you can continue to support your standard of living without having to take unnecessary risks to make up for a lack of capital.



CASE STUDY 2:

POST RETIREMENT PLANNING REQUIRES A HOLISTIC APPROACH

Another option available upon retirement is that of a guaranteed or traditional life annuity that secures you a pre-determined income for the rest of your life. Whilst this product does not provide much flexibility you can at the inception of the policy choose either a single life or joint life annuity, and whether or not to receive a level income, or an income that increases with inflation. The one major concern with traditional life annuities is that the policy dies with you, and so your heirs won't be able to inherit whatever is left on death. One can however consider purchasing a guaranteed term of say 10 years that will ensure that annuity payments continue to be paid to your beneficiaries should you pass away within this period. However once this period has been reached the policy will terminate. This means that careful considerations must be taken into account should you have any dependants that are financially dependent on you.

THE CASE OF 'MSD'

Facts

During November 2009 the complainant's, subsequently deceased, husband had approached a representative of the respondent for advice with regards to his pension benefits. The deceased had been advised to utilise the funds to purchase a single life annuity that would guarantee him an income for life.

Upon the passing of the deceased the policy had terminated and the complainant had received no further income payments despite the fact that she had no other source of income and had been entirely dependent on the deceased.

The complainant approached this Office requesting to be placed in a position she would have been had the deceased been correctly advised with regards to the products limited liquidity.

Our intervention

The respondent's response to this matter was that the deceased had made insufficient provision for retirement and that the funds had to be utilized in a manner that maximized the income payable. The respondent claimed that a joint life annuity would have resulted in a lower level of income which in itself would have been detrimental to the deceased. It was also argued that it was the deceased and not the complainant who had been a client of the respondent, and that it had no obligation towards the complainant.

After having failed to informally resolve the complaint, the matter was officially accepted for investigation and correspondence was directed to the respondent in accordance with Section 27(4) of the FAIS Act. This Office argued that the complainant had been entirely dependent on the deceased, and that any recommendation made to a client, especially during retirement, must take into account the clients circumstances as a whole. It was also noted that the documentation provided did not indicate that the deceased had been advised as to the material terms of the product and the risks involved, and that he had not even been informed of the option of purchasing a joint life annuity.

The deceased was therefore not afforded the opportunity to make an informed decision, and so a recommendation was made that the respondent look to resolve the matter with the complainant. The respondent ultimately made an offer of R44 614 in full and final settlement that had been accepted by the complainant.

Lessons Learnt

1. Whilst the ultimate aim of any annuity is to secure an income for life, careful consideration must be given to the effect that your death may have on the continued financial security of any persons that are financially dependent on you.
2. There must in such circumstances be a balance between the level of income required and the needs of those dependent on you financially.
3. Once again the importance of ensuring that adequate provision is made for retirement, cannot be overstated, as it will allow one to exercise all the required options.



CASE STUDY 3:

UNDER INSURANCE – COSTLY IN THE LONG RUN

The replacement value of goods is what it would cost you, at the time of a claim, to replace all your belongings with similar brand new ones. If you submit a claim, your insurer will calculate the replacement value you should have insured yourself for. If you insured your belongings for less than that, then you will be underinsured. Under insurance occurs therefore when there is a shortfall between the amount of cover selected and the actual replacement value of what is being insured, and you the insured must bear a rateable proportion of the loss. This rateable proportion, or the portion of the claim that you as the insured will be liable for, is determined through the application of the principle of average and the following calculation (Sum Insured / Value at Risk) x Amount of Loss will be used to reduce the settlement value of the claim ultimately paid to you.

THE CASE OF 'MR B'

Facts

The complainant, Mr C, and claimed that the respondent had been providing him with financial advice since 2000 and that he had been well acquainted with his personal circumstances. The complainant had applied for a short term insurance policy where he had insured a number of items, including the main residence that had been insured for a value of R500000.

During June 2012 the complainant's property had been destroyed, has a result of violent storms and after he had submitted a claim an assessor had been appointed by the insurer, who had valued the building at R 2 738 288. The complainant was subsequently informed by the insurer that he was under insured in terms of the building and that the insurer would be applying the principle of average to the claimed amount of R921 200. As a result of this the complainant's claimed had been reduced by an amount of R719 210 and he had been offered a settlement value of R201 989.

Our intervention

The complaint was directed to the respondent, who in accordance with the Rules on the Proceedings of this Office had been provided with the opportunity to resolve the matter with the complainant, or to provide this Office with its version of events in response to claims made in the original complaint. The respondent however failed to resolve the matter with the complainant, and had argued in its response to this Office that it was the complainant who had provided the valuation for the building and that it was not an expert with regards to property valuations, and could not have been expected to have corrected the value provided by the complainant.

The matter was officially accepted for investigation in accordance with Section 27(4) of the FAIS Act, and the argument was made that we did not expect the respondent to be an expert as to value of the insured item, however we did expect that the complainant was to have been informed as to the risks involved with underinsurance and that any and all values provided should not be what he valued them at but that they reflect the replacement value of the items.

The respondent responded to the above mentioned notice and made an offer of R400000 in full and final settlement that was accepted by the complainant.

Lesson learnt

1. Unless you have agreed upon a value with the insurer, always insure your items for their replacement value, that is what it would cost to replace them in the event of a total loss, and not for what you believe they are currently worth.

THE CASE OF 'MR D'

Facts

The complaint received from the complainant claimed that on 5 July 2012 he had received a pension fund statement reflecting the current value of his pension benefit, which had also confirmed that his funds had been invested in a Bond Fund. The complainant was relatively close to retirement and so after having discussed the matter with his personal financial advisor, the decision was made to switch all the funds to a defensive portfolio. The complainant had subsequently approached the respondent and had been advised that he could send the switch instruction via e-mail. On 5 July 2012 he sent the respondent an e-mail requesting that his pension proceeds be moved to a Defensive Fund.

During July 2013 the complainant discovered that his instruction had never been actioned by the respondent, and according to complainant he had sustained losses in the amount of R393 879.91. After approaching the respondent, he had been offered a settlement value of R136 141, after having been accused by the respondent of having committed arbitrage fraud and that he had utilised the situation to his advantage.

Our intervention

In response to our initial correspondence, the respondent had refused to improve upon its original offer and again reiterated its stance that the complainant had had sufficient opportunity to ascertain that the switch had not been actioned, and that he had ultimately used this error to his advantage.

In officially accepting the matter for investigation this Office had confirmed that the respondent had by its own admission confirmed that it had erred in not advising the complainant of the correct procedure to request a switch and that it was as a result of this omission that the switch had not been actioned.

This Office also argued that the complainant, was a lay person and not an expert in the field of financial planning, and that his conservative risk profile did not support the allegations made that he had utilised this situation to commit what the respondent termed arbitrage fraud. The respondent subsequently revised its offer to R250000 in full and final settlement of the complaint, an offer that was accepted by the complainant.

Lessons learnt

1. Ensure that you always determine the correct procedure for submitting a request to switch portfolios. Most product providers have specific switch request forms and the mere submission of an email may not suffice.
2. Always maintain a record of your interaction with the financial service provider which can be made available in the event of a complaint.
3. It is important that one does not simply assume that the request, once sent will automatically be actioned. Should you not receive confirmation within a reasonable period you must follow up with the provider as to the status of your request so as to limit any losses as a result of non-compliance.

A Word of Thanks

The newsletter committee would like to thank Miss Boitumelo Rantao and Miss Bongwekazi Balintulo for their continued contribution towards the success of the newsletter.



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Anyone who has a complaint about the service
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