Commentary on the General Financial Services Laws Amendment Bill, 2008

Section 1(g) - Unclaimed benefits

We frequently encounter the situation where benefits cannot be transferred to a member due to administrative reasons such as the member not being registered for tax or their tax affairs not being in order. We further find that the members take no action to correct this situation. The definition of unclaimed benefit would appear to allow a clean method of retaining the member within the Fund until such time as the matter is resolved, we would also suggest that the option would be to allow an automatic transfer of such members to a preservation fund. Currently such a system cannot be implemented as SARS require a tax directive for such a transfer, at the same time refusing to issue such a directive because the member's tax affairs are not in order. Such directives are always NIL directives as the money remains within a registered pension fund and cannot be withdrawn until the member corrects his tax affairs. From an administrative point of view we understand that SARS are using the tax directive mechanism to track the transfer of money. We believe that SARS's aims could be fulfilled without the requirement that a tax directive be issued by a requirement of notification rather than a directive.

Section 4 – Principal Officer

We support the "fit and proper" requirements for a principal officer and the requirement that a report be submitted to the regulator on his termination, detailing the perceived reasons for the termination. Equally we support the extension to the valuator and auditor of these requirements. We would further propose that both such requirements should be extended not only to the above parties but also to all directors, office holders and employees of financial services companies. It should be remembered that it is the employees who are very often dealing directly with cash or in a position to commit fraud or theft by manipulation of the systems and processes.

Section 8 – Fees on transfer

We do not agree with the use of the fees or commissions under the Long Term Insurance Act being used as the criteria for fees on transfer. Insurers use a much criticized fee structure which provides a larger up front commission than is paid in many other sectors of the financial services industry. The section encourages other service providers to move their remuneration structure toward larger up front fees, instead of spreading the cost across the life of the product. Further, the inability to pay a fee on transfer will act as positive disincentive for proper advice to given in respect of transfers. The maintenance of the status quo will not necessarily be to the advantage of the consumer and acts as a practical deterrent to the portability of products. It is not clear what personal payment comprises and the scope thereof. We suggest that another basis for regulating fees on transfer be sought.

Consideration should also be given to the issue of transfers being made without advice. In our view very few people will pay directly for advice. The result is that transfers could be made without the benefit of advice from a financial advisor because of the prohibition on remuneration. While we agree that fees on transfer should be regulated, the adoption of the Long Term Insurance Act as the baseline strikes us as being inequitable to the rest of the financial services industry. Alternatives such as pre-disclosure (including pre-disclosure prior to the initial entry into the product) and time limited transfers (e.g. no more than one transfer in 5 years) could go a long way to providing both remuneration for those advising on transfers while limiting the cost effect of transfers on consumers.

Section 14 – Divorce

Where a non-member spouse's tax affairs are not in order the fund will not be able to make payment to the spouse. Further, certain funds, specifically those that are Shari'ah compliant, will not pay interest to the member (who indeed does not want to receive interest). It is thus proposed that the use of the word interest be substituted for fund return.

Under current legislation the tax on the non-members spouses interest is payable by the member spouse and further, is only payable on retirement of the member from the Fund. It is suggested that this should be amended so that, for divorces taking place after the 13 September 2007, the tax on the non-member spouse should be deducted from his or her share rather than the member spouse being liable for the tax and having a right of recovery, a right which is contrary to the clean break principle. The current right of recovery outside the ambit of the Act means that divorced couples are likely to engage in further acrimonious actions. It would also be appropriate for that tax to be paid on withdrawal and not at a later stage. It is suggested that the Income Tax Act be amended to provide for this.

Section 28 – Appeal

We note that there is no provision for further appeal to the conventional courts. In effect the Bill provides for a parallel legal structure to those of the courts. While we understand the necessity for swifter resolution of certain matters in respect of financial services we are concerned with the exclusivity of the structure and its divorce from the conventional court structure. There should at least be a right of appeal from decisions of the Appeal Board to a conventional court.

Section 46 – Dealing with FSP's

We understand that this Section prohibits an FSP from dealing with any person who is not registered in terms of FAIS. If this is indeed correct then we are unsure as to the impact of this Section as an FSP will generally not deal with another FSP, in our experience. We understand that more logically the Section should prohibit an FSP from dealing with an entity or person who is not licenced under a relevant law other than FAIS. In fact, we are of the belief that amendments to other acts such as Collective Investment Schemes Control Act, the Long Term Insurance Act, etc should be passed to prohibit the payment of commission by an entity registered under those Acts to any person who renders

financial services which fall within the ambit of FAIS but who is not authorised to render those services. In our experience, service providers are likely to react to a withholding of their fee payments whereas they are unlikely to react to requests or demands from product suppliers that they register. Placing the onus upon the product suppliers will go a long way to ensuring that every person who renders financial advice is authorised.

Section 47 – Fit and Proper

We support the extension of fit and proper requirements to all office holders in a FSP. In fact, we believe that the requirement should extend to all employees of an FSP. The financial services industry handles and invests a large proportion of the wealth of the people of South Africa. With this in mind it is important to ensure that all staff employed by such companies are fit to be handling other people's money. It is the employees who are very often dealing directly with the assets of the public and are thus in a position to commit fraud or theft by manipulation of the systems and processes. All financial services companies build checks into systems to ensure that this does not occur and a requirement for the fit and proper requirements to be extended to all employees would provide an extra check on employees.

We also note that the remedy is suspension of the licence of the FSP. We would propose that the first remedy would be a limited time for the FSP to remove such person from their position and possibly involvement in the business with the remedy of suspension of a licence to be used only where such person is not removed or remains involved in the business.

General Comments

Living Annuities

It was noted that in the Taxation Laws Amendment Bill (TLAB) of 2008 provision was made for entities such as CIS and Banks to provide living annuities to the general public. Such provisions were later withdrawn from the TLAB following

comments by certain industry participants. Among the comments was one which noted that the TLAB did not appear to be the correct legislative instrument to authorise providers of living annuities. Whether this is a correct assumption is entirely debatable but if so, we submit that the General Financial Services Law Amendment Bill is more than the appropriate place to authorise such providers.

Another comment was that it would be better to retain the provision of living annuities within the ambit of the Long Term Insurance Act. We find this comment to be entirely without basis. A clear distinction must be made between guaranteed annuities (which, due to their inherent nature, should be provided by Long Term Insurers) and living annuities which, due to their inherent nature, can be provided effectively and efficiently by entities such as Collective Investment Schemes.

We have also noted that submissions on the question of provision of living annuities tended to support, in principle, the provision of annuities by entities other than Long Term Insurers but expressed concern over more technical aspects of that change e.g. that all annuity providers should be regulated by the Long Term Insurance Act, a fallacy that we address below. The submissions indicated that the changes should only be implemented at a later stage, contingent upon reform in the pension fund sector. However, we submit that the provision of annuities is not purely or even wholly a matter relevant to the pension funds sector and an attempt to regulate the matter from the Pension Funds Act will encounter enormous difficulties as it will affect other Acts such as the Long Term Insurance Act, Collective Investment Schemes Control Act, Income Tax Act and any other Act regulating any other entity allowed to provide living annuities. From this point of view the appropriate places to provide for this change are indeed Acts such as the General Financial Services Laws Amendment Bill and the Income Tax Act. Further, we point out that little advantage is gained by waiting several years for the pension fund reform process to be completed. It would surely be better to allow the provision of annuities by

entities other than long term insurers immediately and make amendments to provide for the issues noted on practical application of those changes during the process of pension fund reform. It is the consumer who suffers most for the delay in implementing this reform.

It is essential to remember that a living annuity is one in which the annuitant does not enjoy cross-subsidisation with other annuitants and is, within specified limits, able to determine the amount of their withdrawal annually. Further, the success of the annuity is reliant upon the investment performance of the annuitant's funds, not upon the "deep pockets" of a Long Term Insurer. In other words, the underpinning tenets of Long Term Insurance are wholly irrelevant to the principles of a living annuity. A guaranteed annuity is a contract in which the annuitant is guaranteed a series of payments, regardless of the underlying performance of the general pool assets managed by the entity providing the annuity. In a living annuity the annuitant's income is dependant upon the investment return on his own segregated assets and not those of a general pool of investors and annuitants. That the Long Term Insurance industry is the almost exclusive provider of living annuities is a result of historical factors and a lag in legislative adjustment to take account of new financial products.

An analysis of living annuities and Collective Investment Schemes shows that the provision of living annuities is ideally suited to Collective Investment Schemes and their organisational paradigms and system, with an ability to manage investments and make payments to clients. The Collective Investment industry is a well run and regulated industry. It is noteworthy that the Association of Collective Investments has consistently supported the drive for Collective Investment Schemes to be able to provide living annuities, to the advantage of consumers via increased competition and lower costs.

Cognisance should also be taken of the sectors of the population to whom insurance based products are anathema. A clear example is the Muslim

population which is obliged for religious reasons to avoid insurance and interest based products. However, the current monopoly by Long Term Insurers on annuities in general and living annuities in particular means that Muslims are, upon retirement, obliged to invest their life savings in contravention of deeply held beliefs.

In summary, we propose that the General Financial Services Laws Amendment Bill should be amended to allow other regulated entities to provide living annuities. The provisions originally incorporated in the TLAB were, in our view, more than adequate to provide the framework for the provision of living annuities and the Financial Services Board has more than adequate powers to provide specific guidelines where required to supplement the framework.