under the baobab tree

ISSUE 7 2015

FAISOmbud
Office of the Ombud for Financial Services Providers

INTRODUCTION

Welcome to what is now the 7th edition of our newsletter Under the Baobab and the first edition for 2015. The first quarter of 2015 came to an end with the conclusion of March, which normally presents the final opportunity for owners of retirement annuities to take advantage of the tax deductions not utilised during the tax year.

This year has already seen a number of significant developments in the financial planning environment, none more so than the introduction of tax free savings accounts as from 1 March 2015. This initiative by The National Treasury is to encourage individuals to save, and in so doing to increase the overall level of savings in the economy, and reduce individual financial vulnerability and reliance on debt. We have already seen a number of Financial Services Providers introduce a variety of tax free savings products into the market.

The 1st of March 2015 also saw a change to the way income protection policies will be taxed with premiums no longer tax-deductible in exchange for tax free benefit pay-outs. These taxation developments within the financial planning environment, are the focus of our first case study, which deals with the different ways in which retirement benefits are taxed upon resignation (withdrawal) or retirement from the fund, and the importance of ensuring that your financial planner provides you with the appropriate advice.

CASE STUDY 1:

UNDERSTANDING TAX IMPLICATIONS ON RESIGNATION

When you retire from a pension fund, you are allowed to take a lump sum up to a maximum of one-third of the retirement interest in that fund. The first R500 000 of this lump sum is tax free and any amounts in excess of this are taxed according to a sliding scale from 18% to a maximum of 36%. When you resign from your fund however you may access the full benefit as a lump sum however only the first R25 000 is free from tax and any amounts in excess of this will once again be taxed according to a sliding scale from 18% to a maximum of 36%.

THE CASE OF 'MR K'

The complainant, Mr K, resigned from his employer, during 2013; he had enquired from the respondent as to the implications involved in withdrawing funds from his pension benefit. Mr K had wanted to utilise a portion of this benefit to contribute towards the outstanding finance on his motor vehicle. The respondent subsequently advised Mr K that he was entitled to make a withdrawal to the maximum value of R300 000, which according to the respondent would be free from any tax.

In accordance with the advice provided, Mr K applied for the withdrawal of R300 000 from his pension benefit, only to be surprised when a sum of R249 500 was eventually paid into his bank account. After having approached the respondent for an explanation, it was discovered that the shortfall had been a result of tax levied against the lump sum by SARS for the amount in excess of R22 500, which was contrary to the advice provided by the respondent that the entire amount would be tax free.

The respondent took responsibility for the incorrect advice provided and offered to compensate Mr K in the amount of R13 500. Mr K was not happy with the offer and wanted to be reimbursed with the full amount deducted by SARS, and 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 acknowledged the shortcomings in their advice and once again reiterated its willingness to resolve the matter by paying the complainant a sum of R13 500 which represented the commission earned and administrative costs incurred when transferring the remaining funds to a preservation fund.

The respondent was of the view that any payment in lieu of the tax deducted from the lump sum would amount to undue enrichment. After careful consideration this Office could not ignore the fact that the complainant had, notwithstanding the shortfall, still utilised the proceeds received to reduce the outstanding amount owed on his vehicle.

We were satisfied therefore that the complainant required the funds for a specific purpose, and as taxation is a legislated obligation, the respondents offer was presented to the complainant as a fair and reasonable resolution of the complaint. The complainant then agreed to the settlement and the file was closed.

Lessons learnt

1. The tax implications differ on retiring from a retirement fund as opposed to withdrawing early from a retirement fund as a result of resignation, retrenchment etc.

2. The member of a retirement fund must ensure that tax implications are factored into any decision to apply for a lump sum commutation, to ensure that the amount required is net of any tax.

3. Tax is payable in terms of The Income Tax Act, so any relief sought from this Office in respect of the inappropriate advice may not result in the return of the amount paid to SARS.

CASE STUDY 2:

CREDIT LIFE INSURANCE: KNOW YOUR RIGHTS

Credit life Insurance is a policy that is provided to a consumer subsequent to a credit agreement, and may even be a condition of the credit transaction. These policies ensure that the consumer is able to meet the obligations of the credit agreement in the event of death, disability, and retrenchment. Unlike the more traditional life cover policies available in the market where acceptance and/ or premiums payable are dependent on a person's medical history and the results of medical tests conducted, credit life policies guarantee acceptance. This acceptance however, contains certain clauses that exclude cover for any claim attributable to a medical condition that was diagnosed or had existed prior to the inception of the policy: these policies also limit cover available in terms of the retrenchment benefit.

Facts

The complainant purchased furniture in terms of a credit agreement from the respondent, who was a registered Financial Services Provider. As a result of an unsuccessful knee replacement surgery the complainant was declared unfit to continue with his current line of work and had therefore submitted a claim in terms of the credit life policy provided for in the agreement.

Despite the fact that the complainant's policy made provision for cover in the event of disability, his claim had been rejected as a result of the complainant having been self-employed and that according to the respondent, self-employed individuals were excluded from applying for that specific policy as a result of the additional risk posed to the insurer.

The complainant, dissatisfied with the rejection of his claim, approached this Office for assistance.

Our intervention

This Office was of the view that the fact that the complainant was self-employed had been known to the respondent through his credit application; documentation was therefore required to confirm whether or not the complainant had been alerted to this exclusion clause when the policy was sold to him. No proof was forthcoming; it was therefore evident that this material term of the policy had not been disclosed to the complainant, as he would not have purchased this policy had he been aware that he would not qualify. The respondent subsequently agreed to honour the claim by settling the outstanding balance of the complainants claim totalling R79 765-00.

Lessons learnt

1. Whether or not a credit life policy is a condition of the credit application or not, there is still a duty on Financial Services Providers to render financial services in terms of the FAIS Act, which requires that the relevant disclosures be made with regards to the material terms of the contract.

2. Credit life policies are inexpensive products freely available upon application, however this means that they contain numerous exclusions with regards to medical history, employment etc., which only come to light when one submits a claim.

CASE STUDY 3:

IGNORING THE CLIENT'S INSTRUCTION

Mrs M had purchased a short term insurance policy from the respondent to provide cover for her motor vehicle. Premiums were to have been deducted from her bank account on a monthly basis. At the inception of the policy Mrs M had provided the respondent with details of the savings account where she had authorised the deduction of the premiums.

Mrs M subsequently required that these details be changed to that of her cheque account. According to Mrs M she had informed the respondent of the change in her bank account details immediately after having received confirmation from the bank that the new cheque account had been opened. The respondent however failed to change Mrs M's details on their system and as a result of this oversight Mrs M's account was not debited at the end of the month.

Mrs M had then contacted the respondent again requesting them to update her details and had also sent an e-mail to the respondent to confirm the discussion. Notwithstanding the latter the respondent once again failed to update her details and no premiums were

collected for a period of three months which eventually saw the policy cancelled by the product provider for non-payment of premiums.

Mrs M subsequently lodged a complaint with our office

Our intervention

The Office asked the respondent to answer the claims made by Mrs M that she had informed them of the change in bank details, and yet had failed to action the instruction as received. It was pointed out to the respondent that the complainant provided us with a copy of the e-mail in support her case.
The respondent answered by offering to reinstate the policy on the original terms and conditions. The complainant nevertheless had to pay the three arrear premiums. The complainant confirmed that the matter had been resolved to her satisfaction.

Lessons learnt

1. The General Code for Authorised Financial Services Providers and Representatives provides that the financial service must be conducted in accordance with the reasonable requests and or instructions of the client.

2. It is important that the complainant ensures that proof of such requests have been maintained and can be made available in the event of a complaint.

CASE STUDY 4:

PROCRASTINATION MAY BE A COSTLY HABIT

Most people learn about prescription the hard way, when it's too late to do something about it, or too late to seek any kind of recourse. So what is prescription? Prescription is the time limit in which a person may take legal action against a contract, debt or delictual claim which, in terms of South African Law, expires after 3 years.

This Office, in accordance with Section 27 (3) (a) of the Financial Advisory and Intermediary Services Act 37 of 2002 is also bound by the law of prescription.

It is very important to be mindful of prescription because once a matter prescribes there is no remedy or recourse available in terms of the law - take for instance the case of Mr H.

Facts

During August 2011, Mr H had been advised by the respondent to move 70 % of his investment into the Equities Environmental Alternatives (EEA) Life Settlement Fund. Later, due to concerns about the fund, Mr H decreased that exposure to 30%. During November 2011 the Financial Services Authority ('FSA') in the UK had labelled the Life Settlement Fund "toxic".

During December 2011 the EEA Life Settlement Fund was frozen and no further redemptions were permitted as a result of liquidity concerns experienced due to an extraordinary high number of clients requesting to exit the fund in view of the warning by the FSA. The result was that the complainant had in the end only received 3% of his money back from the fund.

Mr H had alleged throughout that the respondent had continuously assured him that the required due diligence exercises had been conducted, and that the risk of this specific investment had been downplayed. Mr H was also upset that issues with regards to liquidity had never been disclosed to him.

Our intervention

When interacting with the complainant during our preliminary investigation, Mr H confirmed that he first became aware of the problems associated with the investment on 28 November 2011. However, Mr H only lodged a complaint with this Office on 11 February 2015. As more than three years had elapsed between 28 November 2011, and the date when this complaint was received by this Office, the matter had prescribed, despite what had initially appeared to be a strong case of non-disclosure, and we could be of no further assistance.

Lessons Learnt

1. The decision to dismiss a matter in terms of prescription is based purely on the facts of each individual complaint.

2. This Office does not have the discretion to continue with a matter that has clearly prescribed.

3. The period of three years begins when one became aware or ought to have reasonably become aware of the problem.

A Word of Thanks

The newsletter committee would like to thank the following individuals for their contributions in having provided the stories behind the case studies discussed above. They are in no particular order Miss Sthando Kunene, Miss Nivedna Rajmohan, Miss Philile Kamanga, and Mrs Rita Mari van der Westhuizen.

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