

The legal protection of clients against insurance advisors in Lesotho and South Africa

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LIST OF ABBREVIATIONS

CBL	Central Bank of Lesotho
CBLA	Central Bank of Lesotho Act
CISNA	Committee of Insurance and Non-Banks Authorities
CPA	Consumer Protection Act
Code	General Code of Conduct for Authorised Financial Services Providers
FAIS Act	Financial Advisory and Intermediary Services Act
FSB	Financial Services Board
FSP	Financial Services Providers
IAIS	International Association of Insurance Supervisors
ISD	Insurance Supervisory Division
LTIA	Long-Term Insurance Act
Ombud	FAIS Ombudsman
PPR	Policyholder Protection Rules
STIA	Short-Term Insurance Act

Abstract

The protection of clients in their dealings with insurance advisors is very important. This is mainly because clients are not too knowledgeable about insurance products. This lack of knowledge makes vulnerable to exploitation by insurance advisors. It is the duty of the regulator of insurance to ensure adequate protection of clients in their dealings with insurance advisors. However, this may not be easily attainable in a jurisdiction like Lesotho where there is only one regulator for all financial institutions, the Central Bank of Lesotho. This more so because insurance is very complex as there are different persons and contracts involved. The client has to firstly deal with insurance advisors or intermediaries before an actual contract of insurance comes into existence. In Lesotho the insurance sector is regulated by the Insurance Act 18 of 1976. Although there are systems in place regarding the regulation of the insurance industry, they are not adequate nor guarantee effective protection of the clients. These measures are mainly focused on the relationship between the Commissioner and the insurance advisors and not the relationship between the insurance advisors and the clients. The ineffectiveness of the current regulatory framework in Lesotho was exposed by the MKM situation in 2007 which showed that clients in Lesotho are to a very large extent left unprotected against insurance advisors. Even the proposed *Insurance Bill* of 2013 which was meant to address problems not addressed by the Insurance Act, does not offer any assistance as it contains no provisions on the protection of clients.

The problem with the legal framework in Lesotho is that does not address the most important of protection of clients in their dealings with insurance advisors. This is also due to the fact that there is only one regulator for all financial institutions and this places a very burdensome duty on the Central Bank of Lesotho. In order to find solutions to this problem, a comparative study based on literature was done between Lesotho and South Africa. This is because South Africa on the other hand is more advance. The current legal framework in South Africa ensures the protection of clients in their dealings with insurance advisors. The non-banking institutions such as insurance advisors are regulated by the Financial Services Board. There are systems in place in South Africa regulating the conduct of insurance advisors towards clients. The *Financial Advisory and Intermediary Services Act* is one of the measures in place meant to ensure that those who render advice are fit and proper by requiring them, amongst others, to be in possession of relevant academic qualifications and operational ability to dispose of their duties in terms of the Act. This is different from the position in Lesotho where the only piece of legislation regulating the

insurance advisors is the Insurance Act. Furthermore, by virtue of section 2B of the *General Proclamation* of 1884, the common law of South Africa is applicable in Lesotho so it is important to examine the changes that South Africa has made to its common law on which Lesotho mostly relies.

The results show that the clients in Lesotho are to a very large extent left unprotected against insurance advisors as the current legal framework offers them no protection. The legal framework in South Africa on the other hand affords clients more protection. However, economic position of Lesotho it would not be ideal to take all measures applicable in South Africa and apply them to Lesotho as they are. Based on these findings recommendations made include that the Commissioner must engage in consumer education to ensure that clients know about their rights in dealings with insurance advisors. Another recommendation made is that the current legal framework be amended to include provisions relating to the protection of clients. It is also recommended that the Central Bank of Lesotho is well equipped to deal with matters relating to the protection of clients.

KEYWORDS: Clients, Insurance Advisors, Brokers, Agents, Intermediaries, Lesotho, South Africa, Advice, Regulation, FAIS Act, Insurance Act, Commissioner

Opsomming

Die beskerming van kliënte in hul omgang met versekerings adviseurs is baie belangrik. Dit is hoofsaaklik omdat kliënte nie genoeg kennis dra oor versekerings produkte nie. Hierdie gebrek aan kennis lei daartoe dat kliënte kwesbaar is vir uitbuiting deur versekerings adviseurs. Dit is die plig van die versekerings reguleerder om die voldoende beskerming van kliënte in hul omgang met versekerings adviseurs te verseker. Alhoewel dit egter dalk nie maklik bereikbaar mag wees in 'n jurisdiksie soos Lesotho, waar daar net een reguleerder vir alle finansiële instellings is nie, bekend as die Sentrale Bank van Lesotho. Selfs meer so omrede versekering baie kompleks is aangesien daar verskillende persone en kontrakte betrokke is. Die kliënt moet eers met versekering adviseurs of tussengangers onderhandel, voor 'n werklike kontrak van versekering tot stand kan kom. In Lesotho word die versekering sektor gereguleer deur die *Insurance Act 18 of 1976*. Alhoewel daar stelsels in plek is ten opsigte van die regulering van die versekerings bedryf, is hulle nie voldoende nie en waarborg hulle nie effektiewe beskerming van die kliënte nie. Hierdie maatreëls is hoofsaaklik gefokus op die verhouding tussen die Kommissaris en die versekering adviseurs en nie op die verhouding tussen die versekering adviseurs en die kliënte nie. Die ondoeltreffendheid van die huidige regulatoriese raamwerk in Lesotho was ontbloot deur die MKM situasie in 2007 wat getoon het dat kliënte in Lesotho tot 'n baie groot mate onbeskermd gelaat word teen versekering adviseurs. Selfs die voorgestelde *Insurance Bill of 2013*, wat bedoel is om probleme wat nie deur die versekerings wet aangespreek word nie aan te spreek, bied nie hulp nie aangesien dit geen bepalinge oor die beskerming van kliënte bevat nie.

Die probleem met die wetlike raamwerk in Lesotho, is dat dit nie die beskerming van kliënte in hul omgang met versekerings adviseurs aanspreek nie. Dit is ook as gevolg van die feit dat daar net een reguleerder vir alle finansiële instellings is en dit plaas 'n baie swaar las op die Sentrale Bank van Lesotho. Ten einde 'n oplossing vir hierdie probleem te vind, is hierdie vergelykende studie gedoen wat gebaseer is op die literatuur tussen Lesotho en Suid-Afrika. Dit is omdat Suid-Afrika aan die ander kant meer gevorderd is. Die huidige regsraamwerk in Suid-Afrika verseker die beskerming van kliënte in hul omgang met versekerings adviseurs. Die nie-bankinstellings soos versekerings adviseurs word gereguleer deur die Raad op Finansiële Dienste. Daar is stelsels in plek in Suid-Afrika wat die gedrag van die versekering adviseurs teenoor kliënte reguleer. Die *Financial Advisory and Intermediary Services Act 37 of 2002* is een van die maatreëls in plek om te verseker

dat diegene wat advies lewer geskik en gepas is deur te vereis dat hulle, onder andere, in besit moet wees van relevante akademiese kwalifikasies en operasionele vermoë om hul pligte in terme van die Wet uit te voer. Dit is anders as die posisie waarin Lesotho hul bevind, waar die enigste stuk wetgewing wat die versekering adviseurs reguleer die versekerings Wet is. Verder, uit hoofde van artikel 2B van die *General Proclamation of 1884*, is die gemene reg van Suid-Afrika ook van toepassing in Lesotho en daarom is dit belangrik om die veranderinge wat Suid-Afrika gemaak het ten opsigte van die gemene reg waarop Lesotho meestal staatmaak te ondersoek.

Die resultate toon dat kliënte in Lesotho tot 'n baie groot mate onbeskermd gelaat is teen versekering adviseurs aangesien die huidige regsraamwerk hulle geen beskerming bied nie. Die wetlike raamwerk in Suid-Afrika aan die ander kant bied kliënte meer beskerming. Alhoewel met die ekonomiese posisie van Lesotho sou dit nie ideaal wees om al die maatreëls van toepassing in Suid-Afrika te neem en toe te pas in Lesotho nie. Gebaseer op hierdie bevindinge is aanbevelings gemaak wat insluit dat die Kommissaris moet betrokke raak in verbruikersopvoeding om te verseker dat kliënte hul regte ken in hul omgang met die versekering adviseurs. Nog 'n aanbeveling is dat die huidige regsraamwerk gewysig moet word om sodoende bepalinge met betrekking tot die beskerming van kliënte in te sluit. Dit word ook aanbeveel dat die Sentrale Bank van Lesotho goed toegerus moet word om sodoende sake wat verband hou met die beskerming van die kliënte te kan hanteer.

SLEUTELWOORDE: Kliënte, Versekerings Adviseurs, Makelaars, Agente, Tussengangers, Lesotho, Suid-Afrika, Advies, Regulasie, FAIS Wet, Versekerings- Wet, Kommissaris

CHAPTER 1

1.1 Introduction

A contract of insurance may be defined as an agreement to compensate an insured for patrimonial or non-patrimonial loss as a result of the occurrence of an uncertain future event insured against.¹ An insurance contract is between the insurer and insured. However, before an insurance contract comes into existence, brokers or agents are usually involved, meaning there has to be involvement of third parties, also referred to as intermediaries.² It is important that the conduct of these third parties be regulated.³ This regulation can contribute to the protection of clients. This mini-dissertation specifically focuses on the protection of clients in their dealings with these parties in Lesotho and South Africa. In Lesotho, by virtue of section 6 of the *Central Bank of Lesotho Act* (CBLA)⁴ the Central Bank of Lesotho (CBL) is the regulator of all financial institutions in Lesotho, whether banking or non-banking institutions. In terms of Section 47 the CBLA, the CBL is also considered to be the Commissioner of all financial institutions. With this burden of regulating the entire financial industry the question therefore arises whether there is adequate protection of clients in their dealings with insurance advisors.

1.2 Problem statement

As mentioned in the introduction Lesotho has one regulator and supervisor of all financial institutions referred to as the Commissioner, situated within the CBL. These financial institutions include banks, insurance companies and other investment companies. This situation gives rise to a number of problems for the CBL as the Commissioner. Since no separate regulator and supervisor exists for the insurance industry, the CBL is faced with the challenge to, amongst all other financial institutions, also regulate and supervise the insurance industry. This not only causes problems for the Commissioner, but also creates problems for the clients.

The detrimental consequences of this situation became evident in the MKM saga which unfolded between 2007 and 2012. MKM was a business that initially started off as a cooperative society (trading as Star Lion) but ventured into investments

¹ Millard *Modern Insurance Law in South Africa* 55.

² Millard *Modern Insurance Law in South Africa* 55.

³ Millard *Modern Insurance Law in South Africa* 55.

⁴ 2 of 2000.

where many Basotho invested their funds. However, it emerged that MKM was bankrupt which resulted in many Basotho losing their investments. This led to the enactment of the new *Financial Institutions Act*⁵ (the FIA). Despite its enactment, the FIA does not have any guidelines related to the protection of clients in their dealings with insurance advisors. The only provision which might have some impact on the protection members of the public is section 9 of the FIA on the requirements of capital. In terms of these requirements a financial institution will not be registered as such unless it has a certain amount of capital available. The provision too does not expressly refer insurance companies or advisors. However, the definition of financial institution in section 2 of the Act could be said to include insurance companies and their advisors. The *Insurance Bill* of 2013 (the Bill) has also been passed but it too does not address the issue of protection of clients. It would thus appear as if insurance clients in Lesotho are largely left unprotected against unscrupulous insurance advisors.

In the absence of clear guidelines as to the conduct of advisors in the insurance sector, the possibility exists that financial advisors will not act in the best interest of a client and as a consequence, the client will potentially suffer damage. This position raises the need for legislative intervention that can provide protection to the insured and guidance to the industry especially with reference to the provision of advice to prospective insurance clients. It also raises the need to reconsider the position where the regulation and supervision of insurance advisors are moved from the central bank to a regulator specifically tasked with regulating the insurance sector. This mini-dissertation therefore submits that legislative measures are required in order to address the current shortcomings of the position in Lesotho. The focus of this mini-dissertation is on the protection of clients in their dealings with the insurance advisors.

In contrast to the position in Lesotho, in South Africa the financial services industry is regulated extensively by the Financial Services Board (FSB) and not by the Reserve Bank. Accordingly the FSB is responsible for oversight of the industry and generally the protection of clients in their dealings with financial (including insurance) advisors.

⁵ 3 of 2012.

In order to ensure that clients are protected against possible harmful conduct by advisors, the *Financial Advisory and Intermediary Services Act* 37 of 2002 (the FAIS Act) was enacted. The aim of this legislation is to ensure that clients are able to make informed decisions based on the advice furnished to them by their insurance advisors, thus protecting the clients. The FAIS Act is the primary piece of legislation which provides protection to clients within the insurance industry.

A further piece of legislation which provides protection to consumers in general, is the *Consumer Protection Act* 68 of 2008 (herein after referred to as the CPA). The aim of this Act is to regulate the contracting positions of individuals and corporations in an attempt to balance the playing fields and make the contracting process fairer. As a means of protection, the Act amongst others provides that in the event of ambiguity in the insurance contract, it must be interpreted in favour of the insured.

This mini-dissertation will examine the South African position regarding the protection afforded to clients in their dealings with insurance advisors in order to determine whether such position could be beneficial to the position in Lesotho, where no such protection is currently afforded.

1.3 Research Question

The primary research question to be investigated in this mini-dissertation is: What specific legal protection is available to clients in their dealings with insurance advisors in Lesotho and South Africa respectively? In order to answer this primary research question, the following secondary questions are asked

- a) What is the current legal position in Lesotho with reference to the protection of clients in their dealings with insurance advisors?
- b) What is the current legal position in South Africa with reference to the protection of clients in their dealings with insurance advisors?
- c) In comparison to the South African position how adequate is the protection afforded to clients in Lesotho and which legislative lessons can Lesotho take from South Africa?

The next chapters will answer the research question by reflecting specifically on the legal protection available in each jurisdiction, particular attention being on whether the protection in Lesotho is adequate when comparing the two jurisdictions. In the event it is found that indeed the protection in Lesotho is lacking, recommendations will be made on whether the South African legal position would be appropriate for Lesotho and how much of the South African law in this regard can be incorporated into Lesotho.

Chapter 2 will reflect on the protection afforded to clients in Lesotho through the Insurance Act. Chapter 3 will examine the protection which the South African position affords to clients and will specifically focus on the FAIS Act and the measures put in place in terms of the Act. Chapter 4 will compare the protection afforded in the two jurisdictions, particular attention being on whether the protection in Lesotho is adequate and whether there are any legislative lessons that Lesotho can take from South Africa. Chapter 5 will make the conclusion on the findings in chapter 4 and make recommendations where necessary.

CHAPTER 2

THE POSITION IN LESOTHO

This chapter is an exposition of the legal position of Lesotho in relation to protection of clients in their dealings with insurance advisors in answer to the research question.

2.1 *Legal Framework*

The conducting of insurance business and all ancillary activities related to insurance in Lesotho is governed by the Insurance Act⁶ (herein after referred to as the Act) and the (CBLA) as it outlines the powers of the Commissioner of insurance to some degree.⁷ The purpose of the Act as stated therein is to provide for the regulation and supervision of insurance business. The purpose of the CBLA is stated as, inter alia, to enable the Central Bank of Lesotho (herein after CBL) to ensure price stability so as to maintain a stable economy. The administration, control and all other related matters of the CBL are provided for in the CBLA. Section 47 of the CBLA further provides that the CBL shall also act as the Commissioner of all financial institutions, banking or non-banking institutions are all in terms of the section under the supervision and regulation of the CBL.

Lesotho currently has no legislation that regulates insurance advisors in their dealings with clients. This implies that where the Act contains no specific provision, the conduct of insurance advisors in their dealings with clients is governed by the common law.⁸ The legal framework related to regulation of insurance advisors primarily consists of the Act, and its regulations,⁹ the CBLA and the common law.¹⁰

⁶ 18 of 1976.

⁷ 2 of 2000.

⁸ By virtue of section 2 of the *General Proclamation 2B* of 1884, the common law of South Africa is the common law of Lesotho. The section virtually provides that where there is no statutory provision available on a certain issue, the law applicable in Lesotho, shall be law applicable in the Colony of the Cape of Good Hope, presently South Africa.

⁹ The regulations however do not have legal status. They are mere guidelines and means of providing clarity on the issues provided for in the Act.

¹⁰ The common law is taken into account on issues that have not been specifically provided for in the statutes. For example, the Act has no provision defining an insurance contract. In this regard in order to define an insurance contract, the common law is taken into consideration. For instance the case *British Oak Insurance Co. Ltd. v Atmore* 1939 TPD 9, 13 where the court held that an insurance contract is just like any other contract. As an insurance contract has been defined as a contract of utmost good faith, in order to determine what amounts to

There is also the Insurance Bill¹¹ which is still in the process of being enacted into law. The common law principles in this regard are discussed in the next section.

2.2 Common Law Principles

It should be noted that the sources on insurance law in Lesotho, particularly in relation to the research question, are extremely limited.¹² Reliance is on the common law principles as are applicable in South Africa by virtue of section 2 of The General Proclamation¹³ which provides that where there is no statute in relation to a particular issue, the law applicable for the time being is the law of the Colony of the Cape of Good Hope, which is the current South Africa, hence South African sources will be used every now and then where there is no source available in Lesotho literature on that particular aspect.

Under common law representation occurs where one person referred to as a representative acts as a middleman in the conclusion of any juristic act on behalf of another known as the principal.¹⁴ This is commonly known as agency. He must be authorised to act on behalf of the representative.¹⁵ Such authorisation may be contractual, ostensible, flow from employment or derived from common law or legislation.¹⁶

An agent often acts gratuitously.¹⁷ When carrying out his mandate he must however exercise reasonable care and skill. That is he must act as a reasonable person in the circumstances, would have acted. Failure to exercise reasonable skill and care renders the agent liable to the insured for such negligence.¹⁸ In the context of insurance the broker is an agent of the insured to obtain cover and also an agent of the insurer for the collection of premiums.¹⁹ Their relationship maybe based on

utmost good faith common law is relied upon. Even the conduct of insurance advisors is regulated by the common law.

¹¹ *Insurance Bill 2013.*

¹² The research question in this chapter is what is the specific legal protection that is afforded to clients in Lesotho?

¹³ 2B of 1884.

¹⁴ Reinecke, van Niekerk and Nienaber *SA Insurance Law* 507.

¹⁵ Reinecke, van Niekerk and Nienaber *SA Insurance Law* 508.

¹⁶ Reinecke, van Niekerk and Nienaber *SA Insurance Law* 508.

¹⁷ Davis *Gordon and Getz* 161.

¹⁸ Davis *Gordon and Getz* 161.

¹⁹ He is a middleman between the insurer and insured.

contract of mandate and such contract places a number of duties on the broker such as the duty of good faith and a duty of skill and care which would be exercised by a reasonable broker.²⁰

The duty of good faith gives the insurer the opportunity to avoid the contract if he finds the insured has misrepresented a certain material fact. This raises a problem more especially in an environment such as Lesotho where consumer education is still not adequate as a result of which the consumer is not able to appreciate the materiality of the disclosure he is supposed to make. As a result of the fact that the clients are often not sure of which facts is material, it is advisable that intermediaries and advisors should be able to help guide him through the whole process of obtaining insurance. The insured person may be from different classes of society and as such may not be able to appreciate the materiality of a certain fact, its legal and financial consequences. This mini-dissertation submits that in the event that this is the situation, the intermediary must be knowledgeable in the relevant field. Even the questionnaire he uses when gathering information from the client must be such that all material facts will be disclosed. It is further submitted that although utmost good faith is defined under common law, certain uncertainties persist.²¹ This is more so because from the definition, different classes of society are not taken into consideration. The intermediary must be knowledgeable in the field to enable him to guide the client as to which factors must be disclosed. Due to the fact that the current position is regulated by common law, which is in most cases outdated, a sound argument can be made out for the fact that the conduct of intermediaries and advisors with reference to the provision of advice to clients should be legislatively regulated.

²⁰ *Davis Gordon and Getz* 161. Davis state in relation to good faith, it should be noted that a contract of insurance is a contract of utmost good faith. This means that the insured must disclose to the insurer all material facts known to him, even if the broker or agent did not make an enquiry into those facts or he does not appreciate the materiality of that fact; see *Davis Gordon and Getz* 161.

²¹ The common law definition of utmost good faith as is applicable in insurance contracts is that the level of disclosure expected of the parties, is higher than that expected of parties to an ordinary commercial contract. The parties are expected to be more frank and forthcoming with information which may affect the contract. See Reinecke, van Niekerk and Nienaber *SA Insurance Law* 139. However this view was changed by the court in *Mutual and Federal Insurance Company v Oudtshoorn Municipality* 1985 1 SA 419 (A) where the court held that an insurance contract is just like any other commercial contract.

2.3 Regulation of Insurance Advisors

At this stage the important question to ask is how an insurance advisor is defined in the context of Lesotho and what is the kind of legal protection afforded to clients who deal with them? In terms of the Act insurance advisory business in Lesotho is broken down into insurance brokers and agents. The Act however, uses the word intermediary to define agents. In terms of the Act an insurance agent is a person who is authorised by an insurer for the purposes of soliciting risk and collecting premiums on its behalf.²² Such a person receives payment or agrees to receive it by way of commission or other remuneration from the insurance company.²³ An insurance broker is defined as a person who is an independent contractor.²⁴ While this describes insurance agents and brokers in terms of agency, the statute does not provide what exactly their business is and the manner in which they should conduct such business.²⁵

The Act in part 5 thereof deals with insurance intermediaries. The Act however does not offer a definition of insurance intermediaries. However, as stated above, the Act defines insurance intermediaries as being analogous to insurance agents and brokers. According to the Act, no person shall act as an insurance intermediary if he or she has not been granted a licence by the Commissioner. In the context of the Act, this means that no person shall act as an agent or broker if he has not been registered²⁶ or licensed accordingly.²⁷ Section 50 deals with licensing of insurance agents and section 53 deals with registration of brokers. The provisions of those sections are discussed in the following.

²² S1.

²³ S1.

²⁴ S1. This means, as stated in the section, a broker is not an agent of the company. However, he solicits or negotiates insurance on behalf of someone else thereby making him an agent of that person in return for a commission or compensation. He is not salaried like an agent who is an ordinary employee of the insurance company.

²⁵ In this regard, reliance is on the common law position in relation to the definition of an agency relationship and how the parties are to act towards one another and the duties they owe each other. For example, an agent must dispose of the mandate given to him by the principal in good faith and he owes fiduciary duties to the principal whereby he must not place himself in a position where his interests conflict with those of the principal or make secret profits to the prejudice of the principal.

²⁶ S50(1).

²⁷ S53(1).

2.3.1 Insurance Agents

To act as an agent, one must be in possession of a valid licence.²⁸ He must make an application which the Commissioner may grant after having considered if such a person does not suffer from any of the disqualifications mentioned in the section.²⁹ The Commissioner in issuing a licence 'may' demand that the applicant must be in possession of certain professional qualifications such as a certificate relating to the principles and practices of insurance.³⁰ From the above, it may be deduced that provision regarding academic qualifications is not mandatory since the Act uses the word 'may' and not a mandatory word such as 'shall' or 'must'.³¹ The requirement of a professional qualification is left to the discretion of the Commissioner. Furthermore, what is clear is that the Act does not state what those qualifications are. The provision of the Act is that the Commissioner may demand that the applicant be in possession of certain professional qualifications which are left to the discretion of the Commissioner.

The Regulations³² to the Act provide that over and above being a resident of Lesotho,³³ the applicant must have attained the age of 21.³⁴ With regard to academic qualifications, the applicant must have a COSC certificate or have attained a standard of education in English Language which in the opinion of the Commissioner is equivalent to a COSC certificate.³⁵ In addition, he may be required to have had a minimum of three months training in insurance business or have been

²⁸ What happens in this regard is that the insurance company gets licensed and it must submit to the Commissioner the register of its agent. However, this list as will be shown later on in this mini-dissertation is not accessible to the public and this may have certain implications on the protection afforded to the clients in their dealings with the advisors.

²⁹ S50(2).

³⁰ S50(3). The Act does not state specifically what the content of such qualifications may be. Reg. 12(d) does not shed any light either. It provides that an applicant must have gone through a three months course on the principles and practices of insurance. However, the insurance companies have resorted to requiring that to be registered as an agent under them, an applicant may have to possess certain academic qualifications such as a diploma in marketing but the emphasis in this regard is on whether the applicant can sell products. This raises concerns with the protection of the client because it seems the main focus is on selling as many insurance products to the public as possible.

³¹ Although in the case of *Letsika and others v NUL LC/73/05* it was argued that the word 'may' in a statute must be interpreted in the context within which it was used, it is submitted that if the legislature intended the provision to have a mandatory effect, then the legislature would have used a word which would have such effect, such as 'shall' or 'must'.

³² LN 71 of 1985. The Regulations are made by the Commissioner of insurance in terms of section 64 of the Act.

³³ Reg.12(1)(a).

³⁴ Reg.12(1)(b).

³⁵ Reg.12(1)(c). A COSC is an equivalent to the South African matric or standard 10.

previously, appointed as an agent.³⁶ It is submitted that this is not enough. The emphasis on the English Language education is a clear indication that the minimum academic requirement is that one is able to communicate in both English and Sesotho. It is further submitted that in order to ensure that matters relating to clients, especially their funds, are handled by proper persons, the Commissioner may require that an applicant must have a minimum of three credits at COSC level or an equivalent thereof, of which English Language must be one.³⁷

A licence issued in terms of the Act shall allow the holder to act as an insurance agent in the names provided therein.³⁸ The licence is renewable annually.³⁹ However, certain persons may not act or apply for licences to act as agents.⁴⁰ These are;

- a) Minors,⁴¹ that is persons below the ages of 21;
- b) Persons of unsound mind;⁴²
- c) A person who has been convicted of a criminal offence involving dishonesty;⁴³
- d) A person who has been found convicted of fraud or has knowingly participated in, or convicted of, any fraud against the insurer or insured, in the course of judicial proceedings relating to any policy of insurance or the winding up of an insurance company or in the course of an investigation of the affairs of an insurer;⁴⁴ and
- e) A person who has not been authorised to collect insurance premiums but has been doing so or by fraudulent representations has been procuring premiums of any insurance policy.⁴⁵

³⁶ Reg.12(1)(d). However, it is not clear in the Act what the scope of that course is.

³⁷ The practice had always been that agents would be required to have a COSC but the insurers have internalised their own minimum qualification. For example, Metropolitan requires that one must have a diploma in marketing and three years' work experience and it is internally taking its agent through an insurance qualification course. However, the biggest concern within the insurers when employing agents is whether one can sell products not his level of competency to deal with clients. This still raises problems for the clients because it appears that the main motive of insurance agents in Lesotho is to sell products.

³⁸ S50(4).

³⁹ S50(5).

⁴⁰ S50(6).

⁴¹ S50(6)(a).

⁴² S50(6)(b).

⁴³ S50(6)(c).

⁴⁴ S50(6)(d).

⁴⁵ S50(6)(e).

When the Commissioner determines that a person falls within any of the categories mentioned in the above section, he may at any time cancel the licence.⁴⁶ The Commissioner may also attach certain conditions to the licence granted to an agent of any insurance company.⁴⁷

The Act makes it mandatory for the insurer who employs agents to keep a register of such agents which must show their names and addresses.⁴⁸ However, the list is currently available to the Commissioner only. The public does not have access to it. This is problematic because a lay client would not know whether the agent they are dealing with is authorised or not, especially because the licences are renewed annually. They would not be able to tell whose licence has been renewed or not. A client, who finds that the agent who rendered him advice was not licensed, can resort to the common law principle of ostensible authority to establish the relationship between the agent and the insurer. In the case of *Northern Metropolitan Local Council v Company Unique Finance*⁴⁹ ostensible authority was defined as authority of the agent as it appears to others and often coincides with the actual authority. For example, where the agent was formerly registered as an agent of the insurer continues to act as such and the insurer does not remove from the public's point of view that such agent is no longer registered, the agent will be said to have ostensible authority to act on behalf of the insurer. The insurer will thus be stopped from claiming that the agent was not his agent. However, this may be problematic because the client is the one who will have to prove such ostensible authority.⁵⁰ Furthermore, it is an offence for a person who is not a holder of a valid licence to act as an agent or for an insurer to appoint a person whom he knows not to be a licensed agent.⁵¹

In the case of an agent who is unregistered the Act stipulates on conviction he should be liable to a fine of M50.00 and in the case of an insurer who appoints an

⁴⁶ S50(7).
⁴⁷ S50(8).
⁴⁸ S51.
⁴⁹ 2012 5 SA 323
⁵⁰ See *Northern Metropolitan Local Council v Company Unique Finance* 2012 5 SA 323.
⁵¹ S52.

unlicensed person, the fine shall be M150.00.⁵² It would be ideal if Lesotho could increase its penalties in alignment with the fees charged in some SADC countries. For example, Swaziland whose economy is the same size as that of Lesotho and are both pegged to the South African Rand. In Swaziland the penalties range between E5 000 and E40 000 and charging penalties of this magnitude would be ideal for Lesotho. It may also decrease the level of defaults when rendering advice to clients amongst the intermediaries and advisors. It is submitted in this regard that this penalties are very low and insurers can pay them easily. The Statute should rather provide that if one is found guilty of the same offence more than once, his licence must be revoked unconditionally. This will have the effect of protecting the clients against dealing with unlicensed persons.

2.3.2 *Insurance brokers*

As stated above, a broker is an independent contractor who carries on the business of soliciting or negotiating insurance for commission.⁵³ The Act mandates every insurance broker to be registered as such. According to section 53(1), no person shall carry on with the business of brokerage business, unless he or she has been registered as such under the provisions of the Act. Applications for registration of brokers are to be sent to the Commissioner. One has to complete the prescribed form and possess the prescribed qualifications.⁵⁴ However, the Act and the Regulations are both silent on the issue of what those qualifications are. The only viable provision in this regard is one which states that the Commissioner may demand that to be licensed as an insurance intermediary, an applicant must possess certain professional qualifications relating to the principles and practices of insurance.⁵⁵ Still, this is a problem because the provision states that the Commissioner 'may' demand that he possesses qualifications. This leaves the requirement of qualifications solely in the hands of the Commissioner to determine if

⁵² However, with time the Commissioner may make policies adjusting such amounts to address the modern day challenges. Since the common monetary market between Lesotho, Swaziland, Namibia and South Africa, the currencies of the three former countries are pegged to the South African Rand hence 1 Loti is equal to 1 Rand. Therefore M50.00 is equal to R50.00.

⁵³ For the purposes of this mini-dissertation the term broker shall be used to refer to all independent contractors.

⁵⁴ S53(2).

⁵⁵ S50(1). For a discussion on these qualifications, see Reg.12.

he would need to possess those qualifications and what those qualifications would be.

He must pay the Commissioner a prescribed fee upon which the Commissioner will grant a licence once he is satisfied that the applicant does not fall within the disqualification categories in section 50 (6).⁵⁶ However, if any of the grounds for disqualification in section 50(6) are found to exist, the Commissioner may cancel the registration.⁵⁷ The registration is renewable annually.⁵⁸

In this regard, the Regulations provide that an applicant applying for licensing shall be a person who fulfil the requirements set out in Regulation 12 relating to the licensing of agents, save for paragraph (d) thereof.⁵⁹ He must have a place of business in Lesotho open to the public.⁶⁰ He must also be represented by a person who shall satisfy the Commissioner that he has the relevant experience and competency to deal with all insurance matters.⁶¹ The applicant must also provide security for the performance of his duties and obligations and he must deposit an amount of M5 000 in trust with any registered bank in Lesotho.⁶² He must also, to the satisfaction of the Commissioner, maintain a professional indemnity policy in respect of his business.⁶³

The Regulations place an obligation on every licensee to display his licence in a conspicuous place at his place of business in Lesotho⁶⁴ and to carry it around with him when conducting business. However, despite all these measures, MKM still happened.⁶⁵ This is because from the provisions of the Act and the regulation there

⁵⁶ S53(2).

⁵⁷ S53(5).

⁵⁸ S53(4).

⁵⁹ Reg.14(a)(i).

⁶⁰ Reg.14(a)(ii).

⁶¹ Reg.14(b). Experience in this regard relates to the academic qualifications. Competency relates to the ability to be entrusted with public funds.

⁶² Reg.14(c). This security is the one that shall be used in the event the broker defaults in the performance of his mandate and the creditors must be paid out.

⁶³ Reg.14(d).

⁶⁴ Reg.17(1).

⁶⁵ Issues pertaining to MKM will be discussed later on in this mini-dissertation.

are still too many gaps that make room for products that may be prejudicial to the consumers.⁶⁶

However, it must be noted that the Act and the Regulations do not provide for regulation of advice as rendered to the clients by the brokers and agents even though this is very important to their business.⁶⁷ The Act and the Regulations only make provision for and regulate the relationship between the insurer and brokers and agents. They do not deal with the relationship between the client and the advisor. It is for this reason the Legislature saw it prudent to propose a new Bill as the current law is obviously outdated. To this end the statement of objects and reasons of the Bill provides that the current legal framework for supervision of insurance business contained in the Act is outdated and as such does not comply with most of the Core Principles of the International Association of Insurance Supervisors (IAIS). The statement further provides that the Bill is intended to repeal and replace the Act and provide for the

Consolidation, administration, supervision, regulation, control, protection and development of insurance business in Lesotho, thus ensuring that the insurance industry in Lesotho prudently meets the demands of the economy for risk management and stimulation of growth in the investment sector

It is therefore clear that the Bill is meant for the protection of the insurance business industry not the clients. Like the Act, the Bill focuses mainly on the supervision and regulation of the insurance industry and not market conduct regulation. The contents of the Bill will be discussed in more detail later on in this mini-dissertation. It is submitted in this regard that the law should provide for both prudential regulation and

⁶⁶ In this regard, the Eco-sure insurance product comes to mind. It is an insurance product offered via mobile phones. The rights of the clients in regard to this cover are not clearly defined as well as when one is covered. This may bring problems to the insured for example who commits suicide and his dependants are later on informed that suicides are not covered and they are left with the burden of burying their deceased who all along had cover for which he was paying premiums.

⁶⁷ Another important issue with regulation of the rendering of advice that the current law in Lesotho does not make provision for is the issue of waivers. It is submitted that it is a trend in Lesotho that the broker or agent assisting the client fill the proposal form, may convince the client to make certain waivers on the information that the client has to disclose. For example, where the insurer makes it a requirement for a client to disclose their weight, the broker or agent, especially brokers who are looking to gain more commission, may propose to the client that he says he is of a certain weight so that he may obtain cover and the broker, commission, more particularly because the insurer will not be able to prove that at the time of filling in the proposal form, the client was not of the required weight. It is submitted that this is wrong. This may bring problems to the client later on when the insurer shows that the client could not have been of that weight judging from their health record. A broker or agent in rendering advice to a client must at all times advance the interests of the clients.

market conduct regulation of the advisors in order to level the playing fields and to avoid similar incidents as that of MKM.

2.4 Insurance Supervisory Division

The Commissioner must ensure that insurance business is conducted on sound insurance policies and principles.⁶⁸ These are the international standards set for the conduct of insurance business. The Commissioner must therefore ensure that there is compliance with the provisions of the Act by registered insurers, agents and brokers.⁶⁹ The CBL therefore embarked on a review strategy in order to review the Act. A task team was formed. Its mandate was to formulate a plan for the development of a new policy and regulatory framework. To this end the CBL formulated a new insurance policy framework "with the aim of overhauling the regulation and supervision of the insurance industry".⁷⁰ The Insurance Supervisory Division (ISD) was then created.

The ISD performs the supervisory role of insurance companies, brokers and agents to ensure that there is observance of the provisions of the Act and the Regulations.⁷¹ The ISD had been tasked with the duties of renewing licences and registration of insurance businesses and it had adopted a risk-based approach to supervision. With this approach, emphasis is placed on the understanding and assessing of the adequacy of each financial institution's risk management system "which are in place to identify measures to control and monitor risk in an appropriate and timely manner".⁷²

⁶⁸ Anon Date Unknown http://www.centralbank.org.ls/publications/.../Chronology_25_years.pdf 33.

⁶⁹ Anon Date Unknown http://www.centralbank.org.ls/publications/.../Chronology_25_years.pdf 33.

⁷⁰ Anon Date Unknown http://www.centralbank.org.ls/publications/.../Chronology_25_years.pdf 33.

⁷¹ Anon Date Unknown http://www.centralbank.org.ls/publications/.../Chronology_25_years.pdf 34.

⁷² Anon Date Unknown http://www.centralbank.org.ls/publications/.../Chronology_25_years.pdf 34.

2.5 The Insurance Bill 2013

2.5.1 Objectives of the Bill

In 2010 the CBL acknowledged that the Act did not address the current developments in the insurance industry and the modern Insurance Core Principles.⁷³ As a result it had become difficult for the CBL to regulate and supervise the insurance industry in Lesotho hence the Insurance Bill was drafted.⁷⁴ The Bill by large contains the same principles as encapsulated in the Act. That is, the Bill is still mainly concerned about the prudential regulation of insurance business and not the regulation of agents and brokers for the benefit of the clients. There are however changes made in the Bill to address the modern day insurance industry structure. The objective of the Bill is to repeal and replace the Act in order to provide for the consolidation, administration, regulation, supervision, control, protection and development of insurance business in Lesotho to ensure that the industry meets the demands of the economy for risk management and stimulation of growth in the insurance sector.⁷⁵ The Bill further gives the Commissioner necessary tools and powers which will enable the Commissioner to effectively regulate and supervise the insurance sector. The provisions of the Bill are discussed in the next paragraphs.

2.5.2 Insurance Advisors in the Context of the Bill

The Bill uses intermediary to define the middleman in the contracts of insurance.⁷⁶

2.5.2.1 Insurance intermediary

The Bill incorporates a new term, insurance intermediary. In the Act, the term was just used while there was no definition provided thereof. An insurance intermediary is defined as an insurance broker and insurance agent as defined in the Act, with the

⁷³ CBL 2009 *Annual Report*.

⁷⁴ CBL 2009 *Annual Report* 29. These are principles set out by the IAIS to ensure effective supervision of the insurance sector. These Principles identify areas in which the insurance supervisor should have authority or control.

⁷⁵ The Bill which was proposed in response to the aftermath of the global financial crisis through its provisions confirms that indeed a need exists to enhance corporate governance structures in insurance business hence the Bill gives the Commissioner the powers to make necessary regulatory changes to achieve these improvements. The objective of the Bill is further to align the supervisory and regulatory role of the commissioner of insurance with international standards and practices as provided for by the Core Principles of International Association of Insurance Supervisors which provide the international community with standards against which the efficiency and effectiveness of insurance supervisory regimes are assessed.

⁷⁶ Clause 2 of the Bill defines an intermediary an insurance broker, agent, loss adjuster, loss assessor or risk consultant.

inclusion of insurance loss assessor or risk consultant registered in terms of the Act be added therein.⁷⁷

2.5.2.2 Insurance Agent

The Bill defines an insurance agent as a person who has been appointed and authorised by the insurer to solicit applications for insurance or negotiate insurance business on behalf of the insurer and to perform such other functions as may be assigned to him by the insurer. He is not a salaried employee of the insurer.⁷⁸ This is a slight change from the Act which defines an insurance agent as an individual who solicits insurance on behalf of the insurer for commission.⁷⁹ The Bill gives an insurance broker a wider definition. A broker in terms of the Bill is defined as a person who acts as an independent contractor or consultant. He is not an agent of the insurer. He earns a commission or is paid by way of other compensation.⁸⁰ His activities must include soliciting or negotiating insurance business on behalf of the insured or a prospective insured but not for himself.⁸¹ This includes the renewal or continuance of such business.⁸² His activities also include bringing together, either directly or through the agency of a third party with a view to the insurance of risks of persons seeking insurance and insurers and carries out work preparatory to the conclusion of insurance.⁸³

From the above, an insurance intermediary can be said, in the context of Lesotho, to be a person who solicits and negotiates insurance business on behalf of an insurer or insured as the case may be. It is therefore not clear as to where the advisory role of intermediaries fits in this context. Once one has been licensed as an insurer, the licence so issued must be prominently displayed to the public at each office of the insurer but there is no provision on whether an intermediary must also display this license. This is problematic because the register of the insurer's agents and brokers is not available to the public hence a client may be under the impression that he is

⁷⁷ Clause 2. The definitions of insurance agent and broker are still the same as in the Act.

⁷⁸ Clause 2.

⁷⁹ S1 of the Act.

⁸⁰ Clause 2.

⁸¹ Clause 2

⁸² Clause 2(a) of the definition of a broker.

⁸³ Clause 2(b) of the definition of a broker.

dealing with a licensed agent or broker only to find out later that this was not the case.

2.5.3 Powers of the Commissioner

Clause 3 of the Bill outlines the powers of the Commissioner. Those powers include the power to formulate and enforce the appropriate directives and codes of standards in the conduct of insurance business at all levels and for all categories of insurance, key players and service providers in the insurance industry of Lesotho.⁸⁴ It must be noted that the phrase "service providers" is used but there is no definition provided thereof, so conclusions as to who are service providers are left in speculation. Powers of the Commissioner further include the regulation and control, offering advice and guidance to insurers and insurance intermediaries on matters involving insurance underwriting and business claims in general.⁸⁵ The Commissioner is further empowered with offering protection, enlightenment and guidance to policy holders and the public in matters of insurance policies and their application or implication.

2.5.4 Licensing Requirements

According to clause 70 of the Bill, only licensed persons may carry on business as insurance intermediaries.⁸⁶ To be registered as a broker one must be a registered company⁸⁷ and such application must be accompanied by a letter of support from an insurer with whom the broker is contracted or will be contracted.⁸⁸ This means that individuals cannot conduct business as brokers under a sole proprietary business.

⁸⁴ Clause 5(2)(b).

⁸⁵ Clause 5(2)(c).

⁸⁶ Clause 70(1) provides that all persons who had validly been registered as intermediaries after three months of the coming into operation of the Act shall be deemed to have been validly registered under the Act. Clause 71(1) goes further to provide that all intermediaries who had been registered under the old Act and continue to be so validly registered, they will be deemed to have been so registered under the new Act. Clause 71(2) further provides an intermediary who had a valid licence under the old Act and accordingly renews it under the new Act, it shall be deemed that such licence was duly and validly renewed.

⁸⁷ Clause 73(1)(a)(i). However, there are certain implications involved with requiring that a broker must be a registered company. There are costs involved in the registration of companies, the process of registration of the company. Most importantly, acting under a company may remove the liability from the broker in his personal capacity because he may hide under the corporate veil. Although the corporate veil may be pierced, this mini-dissertation submits that, it is pointless to require that a broker acts as a company only to remove the corporate veil later on when this could all be avoided by requiring that broker continues to act as an individual in his personal capacity as in the Act.

⁸⁸ Clause 72(2).

The applicant must amongst others show that it has key employees tasked with the daily operations of the company who are resident in Lesotho⁸⁹ and that they comply with the qualification requirements prescribed by the regulations.⁹⁰ The key individual of the applicant must be a fit and proper person in terms of the Insolvency Proclamation.⁹¹ This means that he must be able to contract, control and contractually bind his estate without assistance. The Bill already suggests that a broker is a company therefore its key individuals must be fit and proper. The Bill further does not make its own determinations of fit and proper safe to say that he is fit and proper if he meets the requirements set out by the Insolvency Proclamation. It is submitted that this determination has no bearing on the way such a person conducts his business, behaviour towards clients, his level of knowledge or his ability to carry out the business and whether he has the operational ability or financial soundness to do so.

2.5.5 International Standards

As stated in the previous section, the Bill reflects the international standards set out by the IAIS. It is therefore important to discuss some of those standards as they have a bearing on the research question, that is, the legal protection of clients in Lesotho, in order to determine whether they offer adequate clarity on the issue. Lesotho as a member of the IAIS also adheres to the international insurance standards. However, it should be noted that these standards apply only to insurance companies not intermediaries.⁹²

Some of the international standards imposed by the IAIS include the supervisory standard on licensing.⁹³ The standards notes that regulation of insurance companies is meant to ensure that insurance companies are able to meet their obligations at any time and for the protection of policyholders.⁹⁴ It is noted therein that ongoing supervision as well as licensing requirements enhance confidence of the public in

⁸⁹ Clause 73(1)(a)(ii).

⁹⁰ Clause 73(1)(a)(v).

⁹¹ Clause 73(1)(b).

⁹² IAIS *Supervisory Standard* No.1 4.

⁹³ This standard is titled *Supervisory Standard* No.1. It was adopted on the 23rd September 1998.

⁹⁴ IAIS *Supervisory Standard* No.1 4.

the supervisory systems.⁹⁵ The licensing referred to in this standard is concerned with the capital adequacy, suitability of the managers and owners, adequate reinsurance.⁹⁶

The other supervisory standard of importance is the Supervisor Standard on Fit and Proper Requirements and Assessment for Insurers.⁹⁷ The standard imposes different requirements of fit and proper for both the owner and key individuals. However, as noted above, these standards are only concerned with supervision of insurance companies not intermediaries. The owner and the key individual are fit and proper if amongst others they demonstrate integrity in personal behaviour and business conduct,⁹⁸ sound financial judgement⁹⁹ and financial soundness in the context of the owner and sufficient knowledge, experience and academic qualifications. It is therefore clear that regulation and supervision of insurance advisors in Lesotho is still lacking even on an international basis.

2.5.6 Codes of Practice

The Bill makes provision for the enacting of Codes of Practice.¹⁰⁰ However, the Codes of Practice have not yet been drafted. Schedule 3 to the Bill provides for matters that may be contained in the Codes of Practice.

1. The Commissioner's interpretation of fit and proper;
2. Corporate governance including the appointment and functions of an audit committee and other committees;
3. The persons considered by the Commissioner to be key employees of the insurer or insurance intermediary;
4. The form and content of advertisements issued by insurers and insurance intermediaries;
5. The preparation of a business plan, including the matters to be contained in a business plan;

⁹⁵ IAIS *Supervisory Standard* No.1 4.

⁹⁶ IAIS *Supervisory Standard* No.1 4.

⁹⁷ This is the IAIS *Supervisory Standard* No.10 which was adopted in October 2005.

⁹⁸ IAIS *Supervisory Standard* No.10 2. Issues bearing on one's integrity, *inter alia*, would include criminal, financial and supervisory aspects.

⁹⁹ IAIS *Supervisory Standard* No.10 2. One must possess sufficient degree of balance, rationality and maturity necessary for conduct and decision making.

¹⁰⁰ Clause 190.

6. Persons who, even if qualified under the regulations for appointment as auditors or actuaries would not be approved by the CBL whether by reason of their relationship with the licensee concerned or for any other reason.

This mini-dissertation submits that if the Codes of Practice is a good start in the right direction. However, if they were to be drafted on the basis of this proposed content that would not be adequate for the protection of the clients. It is recommended in this regard that over and above the proposed content of the Codes of Practice, there should be a clause outlining how the intermediaries are to conduct themselves when giving advice to clients.

2.6 Enforcement

The discussions on the above sections make it clear that the legal protection afforded to clients in Lesotho is not adequate. It is therefore important to determine whether the enforcement measures applicable in Lesotho are able to assist in this regard.

2.6.1 Consumer Complaints Handling

The Commissioner through the ISD and Supervisory Policies and Regulation Division handles customer complaints.¹⁰¹ The aim of this is to protect the customers and to enlighten them about their policies. In most of the complaints handled in 2006, the Commissioner found that the customers did not understand their policies clearly.¹⁰² They only came to know of the risk against which they were covered when disputes arose. However in most of those cases, the insurance companies were willing to refund the premiums that had been paid by the customers. It was also discovered that the insurance companies had their own means of dealing with the insurance brokers and agents who did not disclose to customers all the relevant terms and conditions applicable to insurance policies. However, the Commissioner is of the view that the consumer education is the responsibility of the insurers.¹⁰³

¹⁰¹ CBL 2006 *Annual report* 21.

¹⁰² CBL 2006 *Annual Report* 21.

¹⁰³ CBL 2006 *Annual Report* 21. However, this research paper as will later be submitted is of the view that consumer education is the responsibility of the Commissioner as the caretaker of the insurance industry and tasked with the duty amongst others of levelling the play ground between the clients and the insurers, agents and brokers.

In 2007, the Commissioner received many complaints in relation to non-honouring of claims by ABC Insurance Brokers. ABC Insurance Brokers conducted itself like an insurance company.¹⁰⁴ It would dispute some claims and pay some. Some of the claims were repudiated on the premises that ABC Insurance Brokers did not accept the affidavits of chiefs and other legal entities such as the police and immigration offices yet insurance companies accepted such documents as legal documents. It was discovered that ABC Insurance Brokers paid claims on behalf of Metropolitan Life. Both companies were directed to stop such business dealings with immediate effect as this was considered to be an unethical way of doing insurance business. In 2007, the Commissioner received eleven complaints and nine of those complaints were resolved.¹⁰⁵ Another issue that has a bearing on the enforcement measures in place in Lesotho and the protection of clients is the MKM. The issues pertaining to MKM are discussed in the next section.

2.6.2 *MKM Burial Society t/a Star Lion Group*

Although MKM was not registered under the Act because initially it was registered as a society under the Cooperative Societies Act¹⁰⁶ and as such was not under the supervision of the Commissioner, it still shows that lack of enforcement is a problem in Lesotho. Many of the investments and funds of the Basotho were put at risk due to the fact that laws were not properly enforced in relation to MKM.

MKM Burial Society (herein after referred to as MKM) was licensed as a funeral undertaker by the Ministry of Trade.¹⁰⁷ In 2001 it came to the knowledge of the CBL that MKM was offering products that constituted "underwriting of insurance business" and this fell within the sphere of section 2 of the Act. Furthermore, MKM was not registered under any Act that governs societies. What this meant in effect, was that MKM was contravening the Act and all other laws that governed societies in Lesotho.¹⁰⁸ It was later found that MKM had drifted from its main mandate whereby

¹⁰⁴ CBL 2007 *Annual Report* 27.

¹⁰⁵ CBL 2007 *Annual Report* 28.

¹⁰⁶ 6 of 2000.

¹⁰⁷ Anon Date Unknown <http://www.lesothoembassyrome.com/embassy8d.htm>.

¹⁰⁸ Anon Date Unknown <http://www.lesothoembassyrome.com/embassy8d.htm>. The legal framework in Lesotho currently does not allow for conversion of societies into insurance companies. MKM however fulfilled the requirements for such conversion in that; it was funded with public contributions. Further in that the level of information asymmetry in its running was as high as that of an insurance company and as such called for prudential regulation. The

it was now carrying on what could be defined as financial and insurance product and was facing cash flow problems. By then many people had invested in MKM. When MKM was finally placed into liquidation many people had lost out on their investments

It is submitted in this regard that the moment it became apparent to the CBL that MKM was offering products similar to insurance products even though it was not under its supervision, it should have consulted with the relevant regulator in an attempt to either prohibit MKM from offering such products or subject MKM to its regulation. In this instance, the CBL delayed in taking action. The problems within MKM became apparent in the early 2000s but action to prohibit it from conducting business was taken around 2007. What this posed was a potential systemic risk as the problems within MKM escalated and unqualified persons whether on a domestic or international level continued to offer insurance products to the nation thereby exposing the public funds to harm. This showed that there is no adequate legal protection of clients in Lesotho. To avoid a similar incident it is submitted that the CBL in future when faced with similar MKM scenario, must take speedy action to place such institution under its regulation so that it can monitor its activities.

In the 2011 annual report it was reported that the CBL embarked on a strategy to improve the regulatory and supervisory framework in the insurance industry to align it with the international practices in insurance.¹⁰⁹ The CBL held meetings with the insurers which were intended to improve communication between the CBL and the insurers.¹¹⁰ It was believed that those meetings would help in decreasing regulatory and supervisory risks and "seek to improve the market conduct and practices in Lesotho".¹¹¹

The CBL continued to attend international meetings hosted by the International Association of Insurance Supervisors (IAIS) and regional meetings hosted by the

CBL as the regulator had a right to intervene in these circumstances especially where it was clear that the public funds may be placed at risk. In this instance, it would have to intervene in order to convert MKM into an insurance company so that it can be subjected to regulation by the CBL.

¹⁰⁹ CBL 2011 *Annual Report* 43.

¹¹⁰ CBL 2011 *Annual Report* 43.

¹¹¹ CBL 2011 *Annual Report* 43.

Committee of Insurance and Security and Non-Banks Authorities (CISNA).¹¹² These meetings are intended to

discuss international and regional regulatory issues with an effort to harmonizing the regulatory and supervisory frameworks in an effort to strengthen the financial stability and regulatory framework which complies with both international and regional standards.¹¹³

The Bill is a result of these meetings hence it is drafted in a manner that encompasses the principles and standards of the IAIS

2.6.3 *Enforcement Measures in the Bill*

The fines for non-compliance with the provisions of the Bill are still very low. One may be fined an amount of M5 000.¹¹⁴ This is the amount big entities such as insurers and insurance intermediaries can easily pay. According to clause 169, a person who makes or helps another to make a representation, statement, report or return which may be written or oral¹¹⁵ which statement may be false or misleading, commits an offence and is liable on conviction to an amount not exceeding M3 000.¹¹⁶ Such statement may be one that contains false statements which must be of material fact¹¹⁷ or omits to state a material fact required to be provided to the Commissioner or that is necessary in order to avoid the statement being misleading.¹¹⁸ Such statement must be required or permitted by the Act, Regulations, Code of Practice or Market Conduct Rules to be made or in case of a document, to be filed with the Commissioner.¹¹⁹

2.7 Conclusion

The whole of the insurance legal framework in Lesotho contains no provision giving the definition of advice and what will and will not constitute advice. There is no provision as to what will constitute the advisory business of the intermediaries. There is no provision dealing with situations of conflict of interest. There is further no

¹¹² CBL 2011 *Annual Report* 44.

¹¹³ CBL 2011 *Annual Report* 44.

¹¹⁴ Clause 167 provides that any person who contravenes the provisions of the Bill commits an offence and is liable on conviction to a fine not exceeding M5000.

¹¹⁵ Clause 169(a).

¹¹⁶ Clause 169.

¹¹⁷ Clause 169(b)(i).

¹¹⁸ Clause 169(b)(ii).

¹¹⁹ Clause 169(a).

provision on the cancellation of the contract by the insured on the basis of material misrepresentation by the insurer or insurance intermediary. The Bill too does not offer much assistance on the issue relating to regulation of the market conduct. It also deals with the financial regulation of the insurance industry as a whole. Protection of the clients is not specifically provided for.

One must note that the Bill is indeed a step towards aligning the regulation and supervision of the insurance sector with the international model of regulation. However, regulation and supervision of insurance intermediaries in Lesotho seems to be a subject that still needs to be worked on. The Act and the Bill do not deal with the market conduct regulation of intermediaries and advisors. They only deal with the relationship between the intermediary or advisors, and the insurer but not the advisors and intermediaries, and the clients. Both the Act and the Bill define certain terms that are applicable to insurance dealings but however fall fault of not stating how such persons as defined in the Act and the Bill should conduct their business for the benefit of the clients. Both the Act and the Bill do not state the rights of the clients in their dealings with the insurance advisor. There is further no extensive dissemination of information about insurance so that clients can know their rights and responsibilities. Although there is a complaints handling division, its jurisdiction is not clearly defined and its enforcement powers are not defined.

It should however, be noted that the CBL as the Commissioner of insurance is concerned with financial soundness of institutions it regulates, the so called prudential regulation and not the consumer protection aspects of regulation, market regulation. This is so more particularly based on the fact that one too many incidents have proved that there is a strong need for a law that protects consumers and urges strong enforcement. From the MKM incident it is still not clear whether there is any protection afforded to clients in the event the insurer or intermediary they had contracted with is not properly registered under the law. Again, the current legal framework as discussed above does not state the legal protection that is afforded to clients for example in the event the intermediary's licence is revoked or the broker surrenders the licence. Furthermore there is an issue with the current development in insurance products whereby a new product was introduced. This is a sort of cell phone insurance policy. The terms of this contract are not clearly defined and

explained to clients. There is also a problem with the fact that there is no law that provides for the regulation of mobile services in relation to insurance products.

The legal protection of clients in their dealings in Lesotho is not adequate it is therefore important to compare it with the legal position in other countries, particularly South Africa, because the legal systems are virtually the same and deduce from that comparison the improvements that are needed in Lesotho. The next chapter is the exposition of the legal protection of clients in South Africa.

CHAPTER 3

3.1 Introduction

In South Africa, the insurance industry is governed by the Long Term Insurance Act¹²⁰ (LTIA) and the Short Term Insurance Act (STIA).¹²¹ However, the Acts do not make provision for protection of insured persons in greater detail except for sections 59 and 53 respectively where reference is made to cancellation of contracts on the basis of misrepresentation and failure to furnish information. For a long time the trend had been that an insurance contract is one of utmost good faith and the insured had to provide all the information known to him even if the insurance advisor or intermediary did not ask him for such information.¹²² This prompted the need for greater protection of insured persons. This protection could be attained by way of legislation that affords them such protection and makes insurance contracts beneficial to both the insurer and the insured.

This chapter is an exposition of the South African law in regard to protection of clients in their dealings with insurance advisors. This way, it attempts to answer the research question as to the research question; what legal protection is available to clients in their dealings with insurance advisors hence a discussion of legislation that is aimed at the protection of consumers.

3.1.1 The Policyholder Protection Rules (PPR)

Before the enactment of the FAIS Act, the insurance industry was regulated by the insurance acts which had their own PPRs. These are consumer oriented rules which were promulgated in terms of sections 62 and 63 of the LTIA and the STIA,

¹²⁰ 52 of 1998.

¹²¹ 53 of 1998.

¹²² Reinecke, Van Niekerk and Nienaber *SA Insurance Law* 140; *Mutual and Federal Insurance Co Ltd v Oudtshoorn Municipality* 1985 1 SA 419 (A) 431I where the court rejected the notion of utmost good faith. The court pointed out that it was unable to find any Roman Dutch Law authority in support of the proposition that a contract of insurance was a contract *uberrima fidei*. The court held that the test to be applied was an objective one, that is whether a reasonable man in the position of the insured would have known that the fact was material and ought to be disclosed. However, in the recent case of *Jerrier v Outsurance Insurance Company* 4160/2010 the court in re-confirming that an insurance contract is a contract of good faith stated that the fact that the objective test is used does not mean that the contract is no longer that of good faith.

respectively.¹²³ They are meant to protect policyholders against arbitrary decisions taken by the insurance companies. They became effective on 1st July 2001. The purpose of these rules is to ensure that consumers are provided with sufficient information to enable them to make informed decisions when purchasing insurance products.¹²⁴ They also make provision for measures to ensure that the brokers conduct business fairly and with due care.¹²⁵

However, as stated by Hattingh and Millard¹²⁶ these rules deal mostly with the relationship between the intermediaries and insurer.¹²⁷ The PPRs must be read in conjunction with another Act because they do not contain any provisions on licensing of intermediaries and advisors.¹²⁸ It is therefore argued that they cannot be "implemented or interpreted without reference to the stipulations in the FAIS Act".¹²⁹ They deal mostly with instances where the intermediary or advisor is not regulated by the FAIS Act and its Codes. The PPRs are not conclusive in their regulation of the market conduct as regards client-intermediary or advisor relationship because they are concerned mainly with the relationship between the insurer and the intermediary.¹³⁰ A need existed to have a law that will address this aspect of advisory contracts and dealings so as to ensure that, for example, the insurance industry is the safe industry for clients which in the end will trigger economic activity.

3.1.2 *The New Era and Legal Framework*

In 1998 debates and talks were entered into whereby the government was of the view that a need existed in South Africa to have legislation that would protect the clients of financial products which included various insurance products. This led to the enactment of the FAIS Act. The aim of the FAIS Act as stated in its preamble is to protect clients in their dealings with financial advisors and intermediaries. The

¹²³ Hattingh and Millard *The FAIS Act explained* 22.

¹²⁴ Hattingh and Millard *The FAIS Act explained* 22.

¹²⁵ LTIA PPR 2 to this end states that the rules are meant to ensure that policies are entered into, executed and enforced in the interests of the parties and the public and in accordance with sound principles of insurance.

¹²⁶ Hattingh and Millard *The FAIS Act explained* 22.

¹²⁷ See in this regard Rule 5.1 which provides that an insurer may only contract with a licensed intermediary or broker.

¹²⁸ The FAIS Act provides for licensing requirement, lapse of the licence hence fact that an insurer cannot deal with an intermediary or advisor whose licence has expired as the licence becomes inoperative.

¹²⁹ Hattingh and Millard *The FAIS Act explained* 22.

¹³⁰ Hattingh and Millard *The FAIS Act explained* 22.

bulk of the Act addresses the question of protection of consumers of financial products.¹³¹ It instructs the Minister to create the General Code of Conduct for Authorised Financial Services Providers¹³² (herein after referred to as the Code) and also provides for the creation of the FAIS Ombudsman (herein after referred to as the Ombud), both of which are aimed at providing great protection to consumers.

It should however be noted that the FAIS Act is not the only Act that provides protection to insurance clients. Another law relevant for the protection of consumers is the Consumer Protection Act¹³³ (herein after referred to as the CPA). Although insurance products were not initially included in the scope of the CPA, they commenced to fall within its ambit in 2012.

Currently the insurance industry in South Africa is governed by the Insurance Acts, the FAIS Act and the CPA. The FAIS Act and the CPA are discussed in more detail in the following sections.¹³⁴

3.2 The Financial Advisory and Intermediary Services Act (FAIS Act)

3.2.1 Introduction

The preamble of the FIAS Act states that it is intended to "regulate the rendering of certain financial advisory and intermediary services to clients." It regulates the services rendered by non-banking institutions.¹³⁵ It is meant to "guide consumers in their daily dealings with their chosen product provider"¹³⁶ in order to ensure that the consumers make informed decisions when choosing the financial product of their

¹³¹ See for example the preamble of the Act which provides that the Act is meant to regulate the rendering of financial advisory and intermediary services to clients.

¹³² BN 80 of 2003 of 8 August 2003.

¹³³ 68 of 2008.

¹³⁴ The two insurance acts are not discussed in this paper because they are not very elaborative on the issue of advisory and intermediary services nor do they provide extensive consumer protection. The FAIS Act was specifically enacted to regulate the advisory and intermediary services. It therefore addresses issues that are not addressed in the insurance acts. e.g. advice is not defined in the Acts and it is corollary to advisory and intermediary services. The CPA on the other hand governs the relations between the suppliers and consumers. Insurance policies can be deemed to be products in the context of the CPA. The CPA further applies where an issue is not already governed by another statute. In this paper the CPA will be discussed insofar as the Insurance Acts and the FAIS Act are silent on the relevant issues.

¹³⁵ Anon Date Unknown <http://www.fsb.co.za/Pages/Home.aspx>. List of FSPs regulated by the FSB can be found on the FSB website.

¹³⁶ Anon Date Unknown <http://www.banking.org.za/index.php/consumer-centre/financial-advisory-and-intermediary-services-act>.

choice.¹³⁷ In terms of the FAIS Act, a person who renders financial service must observe all the requirements that are applicable to the conduct of business within the financial advisory and intermediary services industry.¹³⁸ An FSP has to be licensed with the Financial Services Board (herein after referred to as the FSB). The requirements regarding licensing will be discussed in the following paragraphs.

3.2.2 *Licensing requirements*

In terms of the FAIS Act, no person shall act as an intermediary or advisor unless he has been authorised to do so. If the FSP is an insurance company, such insurance company must be a registered FSP.¹³⁹ After the commencement of the FAIS Act only licensed FSPs may render financial services.¹⁴⁰ Any transactions concluded before the commencement of the Act by a client and a person who was not authorised at that time to act as an FSP are unenforceable as between the client and that person for lack of authorisation.¹⁴¹ The problem with this however, is that the section does not provide the remedies that are available to a client who genuinely could not have known that the person he was dealing with is not an authorised FSP. It only states that such transaction is not enforceable. The proposed remedy in this situation is that the FAIS Act should not affect transactions which were entered into before it came into force. That is to say, the transactions entered into before 2002 should be left to be enforceable as against the FSP and the client because declaring them unenforceable may be prejudicial especially to clients who could have not genuinely known that the FSP was not authorised to do so. In order to be issued with a licence, certain requirements must be met. These include the requirements of fit and proper and will be discussed in the following paragraphs.

¹³⁷ Anon Date Unknown <http://www.banking.org.za/index.php/consumer-centre/financial-advisory-and-intermediary-services-act>.

¹³⁸ Reinecke, Van Niekerk and Nienaber *SA insurance Law* 511.

¹³⁹ Reinecke, Van Niekerk and Nienaber *SA Insurance Law* 512.

¹⁴⁰ S7(1).

¹⁴¹ S7(2).

3.2.2.1 Fit and Proper Requirements

In order to render financial services, one must be registered with the FSB. In terms of section 8(1) of the FAIS Act a person applying for authorisation must at all times comply with the requirements of a fit and proper person.¹⁴²

From the above it is clear that to act as a FSP, a person must be authorised to do so. Such authorisation comes after an application has been lodged on behalf of the applicant with the Registrar of the FSB. This application must be lodged in terms of section 8. In terms of the section the applicant must show to the satisfaction of the Registrar that he complies with the requirements of fit and proper in respect of qualities of honesty and integrity,¹⁴³ competency and operational ability to fulfil the responsibilities imposed on him by the FAIS Act¹⁴⁴ and financial soundness.¹⁴⁵ It should be noted at this stage that the requirements of fit and proper differ for different FSPs, in particular the requirements relating to competency.¹⁴⁶

The next question is how these factors are determined. In terms of Determination of Fit and Proper Requirements for Financial Services Providers,¹⁴⁷ the requirements of fit and proper are more elaborated therein.

¹⁴² Over and above the fit and proper requirements in section 8, section 6A(2)(e) of the Act as inserted by section 180 of the *Financial Services Laws General Amendment Act 45 of 2013* adds that fit and proper requirements may also include continuous professional development. Continuous professional development in terms of section 1 as amended by the *Financial Services Laws General Amendment* means "a process of learning and development with the aim of enabling an FSP, key individuals, representatives or compliance officers to maintain the competency to comply with the Act."

¹⁴³ S8(1)(a).

¹⁴⁴ S8(1)(b).

¹⁴⁵ S8(1)(c)

¹⁴⁶ Section 3 BN 91 of 10 September 2003 provides for different requirements relating to compliance in relation to competency. For example for long-term insurance category A, one would need to have at least six months experience or must have completed a relevant SETA learnership. The minimum qualifications would be at least NQF Level 2 skills programme consisting of core unit standards registered by SAQA and quality assured by INSQA with a minimum of 12 credits as certified by INSETA or its approved agent or a grade 10, standard 8 or an equivalent NQF level 2 qualification. If the applicant is a key individual, he must within 2 years of appointment complete an appropriate level 2 skills programme which must consist of a minimum of 30 credits. While for short-term insurance in the category of personal lines, the applicant will need to have at least 1 year experience or must have completed a relevant SETA learnership. The minimum qualifications would be at least NQF level 4 skills programme, Grade 12, Standard 8 or an equivalent NQF level 3 programme. If the applicant is a key individual must within 2 years of appointment complete NQF level 4 skills programme with a minimum of 30 credits or a National Certificate at NQF Level 4.

¹⁴⁷ BN 91 of 10 September 2003.

3.2.2.1.1 Honesty and Integrity

Applicant must be a person of honesty and integrity. Where the applicant is a legal entity, its key individuals and representatives must be persons of honesty and integrity. The applicant and its applicant or key individual in the case of legal entity applicants must also be qualified to act as an FSP and must have relevant experience in the field.

In determining whether the applicant is honest and has integrity, the Registrar may refer to any or all information¹⁴⁸ in his possession or that has been brought to his attention.¹⁴⁹ The period used to determine one's honesty and integrity is that of five years. That is to say whether within a period of five years before the application was made, the applicant has been found guilty of any misconduct in relation to his honesty and integrity.¹⁵⁰ He must make a full disclosure of all information that has a bearing to his and key individuals' if the applicant is a legal entity honesty and integrity.¹⁵¹

3.2.2.1.2 Competency

The applicant must further show to the satisfaction of the Registrar that he is competent. That is to say that he must show that he has the necessary skills and academic qualifications.¹⁵² The *Determination of Fit and Proper Requirements for Financial Services Providers* thereof sets the minimum academic qualifications, experience and skills that he must at least possess to be regarded as competent. In

¹⁴⁸ Information in this regard could include the applicant's previous conduct in the same circumstances.

¹⁴⁹ S2(2).

¹⁵⁰ S2(3).

¹⁵¹ Van Zyl *FAIS Manual* 33. In the case of *Hamilton & Co (Pty) Ltd v Registrar of Financial Markets* the court, although the case dealt with the definition of honesty and character, the court had the following to say about the determination of honesty.

- a) The dictionary meaning of the words must be adopted;
- b) Such determination involves a moral judgment. In order to arrive at that judgment, it is necessary to consider the way that person conducts himself in both his private and business life and dealings;
- c) Honesty and fairness are qualities of a person and as such must be judged from that person's acts and motives. That is to say, the person's behaviour, mental and emotional situations accompanying that behaviour must be taken into account;
- d) These factors cannot always be estimated by one act or class of acts. All that is known about the person will form part of the evidence from which an inference of good or bad will be drawn.

¹⁵² S3.

terms of the *Financial Services Laws General Amendment Act (Amendment Act)*¹⁵³ over and above possessing the experience and qualifications, the applicant must also go through examinations which may be determined by the Registrar in order to test his knowledge so that he can be regarded as fit and proper.¹⁵⁴

3.2.2.1.3 Operational Ability

He must further show that he has the relevant operational ability to dispose of his duties and responsibilities in terms of the FAIS Act.¹⁵⁵

In order to be licensed as an FSP, the applicant must prove to the Registrar that he possesses the necessary characteristics, thereby making him a fit and proper person. He must show that he fulfils the requirements of fit and proper as set out in *Determination of Fit and Proper Requirements for Financial Services Providers*. The Registrar may request the applicant to furnish any other additional information which he deems necessary or request that such information be verified.¹⁵⁶ The Registrar may also impose conditions and restrictions on the licence.¹⁵⁷ Once the licence has been granted, the holder must display it at the offices, television advertisements and any other means of publication. For example, every advertisement of Outsurance must state that "Outsurance is an authorised financial service provider". After the lapsing of the licence as provided for in terms of section 11, the licensee will no longer be authorised to act as FSP.¹⁵⁸ Section 13 (a) provides that the licensee may not carry out, or continue to, act as an FSP for or a representative for or on behalf of another person who is not authorised as an FSP.

¹⁵³ 45 of 2013.

¹⁵⁴ S6(A)(b)(iii) of the Act as inserted by the Amendment Act.

¹⁵⁵ S4(1). He must show that he has a fixed business address, adequate access to communication facilities which must at the least include a full-time telephone or cellphone service, typing and photo-copying facilities or any other means of document duplication facilities. He must further show that he has adequate storage and filing systems in order to enable him to safe keep the records, business communications and correspondence. He must have an account with a registered bank within South Africa and if required by the Registrar he must show that he has a separate account for funds provided and paid by the client he must further show that he has appropriate money laundering control systems as are required by the *Financial Intelligence Centre Act*.

¹⁵⁶ S8(2)(a).

¹⁵⁷ S8(4)(b). For example the Registrar may require, as a condition of licensing, that if there are any changes in the personal circumstance of the key individual which may render him no longer fit and proper to offer financial services, such person may only render such services if he has been lodged an application which has been approved by the Registrar.

¹⁵⁸ For example where the licensee surrenders the licence.

As stated above, the licensing requirements ensure that only those who are licensed continue to render financial advice. This is more so because by being licensed it means that one meets the requirements of fit and proper hence one will be deemed competent to render advice to clients. Furthermore, the rendering of such advice can be easily regulated. The next question therefore is how such advice is regulated. This question is addressed in the next section.

3.2.3 Regulation of Advice

One of the main purposes of the Act is the regulation of advice¹⁵⁹ in order to enable clients to make informed decisions with regard to financial products. This is also to ensure that intermediaries and insurers conduct their business honestly and fairly with due diligence, skill and care.¹⁶⁰ Fairness in this context means that the person rendering the advice must be an open, impartial and honest person. With regard to honesty, a determination into his character so as to determine whether he rendered the advice honestly will have to be made. Van Zyl¹⁶¹ states that in determining that, it is important to know as much about the person rendering the advice as can possibly be known. All relevant factors must be put on the table to enable a decision on whether the advice was given honestly to be made. All factors relating to the character of the intermediary must be tabled. Due diligence, skill and care in this context means that the intermediary must not be negligent in rendering advice to the client and must act as a reasonable person would have.¹⁶² Such diligence, care and skill are those which are to be reasonably expected of a person who manages affairs of another.¹⁶³ An intermediary would have acted with due diligence, skill and care if

¹⁵⁹ Kloppers 2007 *Obiter* 133.

¹⁶⁰ Kloppers 2007 *Obiter* 133.

¹⁶¹ Van Zyl *FAIS Manual* 33.

¹⁶² The test used to determine this is the objective standard of a reasonable man. That is whether a reasonable man in the position of the wrongdoer would have acted in the manner with which the wrongdoer acted. If he would not have, then the wrongdoer is negligent. In the case professionals, the standard used is a little different. The inquiry is whether a reasonable man with the same skills and qualifications that the wrongdoer possesses would have acted the way that he did. If he would have acted differently, then the wrongdoer is negligent. If he would have done the same thing then the wrongdoer is not negligent. In the case of *Kruger v Coetzee* 1966 2 SA 430 (A), the court stated that negligence would arise if a reasonable man in the position of the defendant would have foreseen the reasonable possibility of his conduct causing injury or harm to another, and/or patrimonial loss to his property and would have taken steps to guard or prevent the possible occurrence of such and the defendant has failed to do so.

¹⁶³ S9(1) of the *Trust Property Control Act* 57 of 1998.

he acted as a reasonable person in the same circumstances with similar skills would have done.

The FAIS Act sets out to establish a properly regulated financial services profession due to the fact that it mandates that the advice given must be "done in an open and competent manner".¹⁶⁴ Accordingly section 1(1) of the FAIS Act defines advice as "any recommendation, guidance or proposal of a financial nature" given to a client or a group of clients by any means or medium. It is important to note that the advice must be aimed at a client making a financial decision in relation to the financial product, that is, a decision that may lead to certain financial consequences such a ownership or liability in relation to that financial product.¹⁶⁵

This position exists irrespective of whether the advice was rendered in the course of or is incidental to financial planning or results in the purchase, investment, transaction, variation or replacement taking place. It should be noted that in terms of section 1(3)(a) advice does not include factual advice given on procedure of entering into a transaction in respect of any financial product.¹⁶⁶ It does not include factual advice given in relation to the description of the financial product,¹⁶⁷ in answer to a routine administrative authority¹⁶⁸ or by display or distribution of promotional material. It further does not include an analysis or report of a financial product without express or implied recommendation, guidance or proposal that any particular transaction in respect of the product is appropriate to the particular investment objectives, financial situations or particular needs of a client.¹⁶⁹

¹⁶⁴ Anon Date Unknown <http://www.banking.org.za/index.php/consumer-centre/financial-advisory-and-intermediary-services-act>. The word "open" in this context means that the person rendering the advice must do so in a transparent manner. Hence the requirement of disclosure of all information and possibility of conflict of interest of on the part of the intermediary. "Competent" means that one must have the necessary competency to carry out the mandate, hence the requirement that the intermediary must comply at all times with the "fit and Proper Determination" and the requirement of relevant academic qualifications that an intermediary must at least possess. Since this research focus on the regulation of advice given to clients and one of the main objectives of the FAIS is to regulate the rendering of financial advisory services, it is important to define "advice".

¹⁶⁵ S1(1)(a)–(b).

¹⁶⁶ S1(3)(a)(i)(aa).

¹⁶⁷ S1(3)(a)(i)(bb).

¹⁶⁸ S1(3)(a)(i)(cc).

¹⁶⁹ S1(3)(a)(ii). In terms of s1(3)(a)(iii) advice does not include advice given by the board of management or member of the board of any pension fund, organisation or friendly society on the benefits to be enjoyed by the member of such or advice given by trustees of a medical scheme board.

3.2.3.1 Other Key Concepts

Since the purpose of the FAIS Act is to regulate dealings between a client and financial advisors and intermediaries, it is important to define other key concepts in order to determine the duties and liabilities of financial advisors and intermediaries in the event of non-compliance. Section 1(1) of the FAIS Act defines a client as a specific person or group of persons who are already subject to the financial service or may be subject to such service. A client may also be a successor in title of such person or the beneficiary of such service.

An intermediary service in terms of the same section is defined as an act of furnishing advice performed by one person on behalf of another.¹⁷⁰ Such an act must result in that the client entering into or offering to enter into any transaction in respect of a financial product with a supplier.¹⁷¹ As stated by Kloppers,¹⁷² advice given in respect of insurance policies would then render such policies capable of being financial products.

The FAIS Act excludes intermediary services performed by a product supplier who is authorised by another law to conduct a business as a financial institution and the rendering of must be regulated by another law, for example, the Banks Act.¹⁷³ According to Reinecke et al¹⁷⁴ intermediary services could include the introduction of new business to an insured person and the rendering of administrative services to a client.

3.2.3.2 Duties of the FSP

Having defined the key concepts such as intermediary services, it is therefore vital to outline the duties of the FSPs or any persons rendering financial services. Both the Act and the Code impose certain duties on the FSPs. Duties of the FSPs in terms of

¹⁷⁰ S1(1).

¹⁷¹ S1(1). In the alternative, the act must have been performed with a view to buying, selling or dealing in, maintaining or servicing a financial product purchased by a client from a product supplier or in which the client has invested. It also includes acts performed with a view to collecting or accounting for premiums or other moneys payable by the client to a product supplier in respect of the financial product or receiving, submitting or processing claims of a client against a product supplier.

¹⁷² Kloppers 2007 *Obiter* 134.

¹⁷³ S1(3)(b)(ii)(aa) and (bb).

¹⁷⁴ Reinecke, Van Niekerk and Nienaber *SA Insurance Law* 511; see also the case of *Tristar Investment v The Chemical Industries National Provident Fund* (455/12) [2013] ZASCA 59.

the Act include maintenance of records for a minimum period of five years and full and proper accounts.¹⁷⁵

3.2.3 *Conclusion*

The FAIS Act is a very important step in the protection of clients. It imposes compliance requirements that must be complied with by the intermediaries and advisors. It obliges them to be licensed in order to render financial services. This way it ensures that financial services are rendered by persons who are under supervision and regulation of the FSB. By requiring that FSPs must be fit and proper persons, it ensures that financial advice is rendered by persons who fall within the standards set by the FAIS Act. The FAIS Act imposes certain duties on the intermediaries and advisors which they must comply with. In relation to insurance, it means that the advisor must comply with these requirements when rendering advice to the client. The client must also know his or her responsibilities in relation to the whole process of rendering and receiving advice. Furthermore, the minds of the client and the advisor must at all times be ad idem hence the requirement on the provision of material information to the client so as to enable him or her to make a well informed decision. The advisor must therefore make sure that the client understands each step, term and procedure while rendering advice to the client. However, the Act does not provide the sufficient guidance in relation to the protection of clients hence the need for the Code. It lays the foundation on which the Code is build. The Code is discussed in great detail in the next section.

3.3 ***The General Code of Conduct (The Code)***¹⁷⁶

3.3.1 *Introduction*

The Code was published by the Registrar under Board Notice 80 of 2003 in terms of section 15(1)(a) of the Act. It was drafted by the Registrar after consultations with the Advisory Committee of the Financial Services Providers, the representative bodies of the financial services industry and the client and consumer bodies. Van

¹⁷⁵ See chapter 5 of the Act for the duties of the FSPs.

¹⁷⁶ There are different Codes of conduct for different FSPs as section 15(2)(a) provides that different Codes may be drafted such as the Short-term Deposit Code and the Pension Code, this research will only be confined to the provisions of the General Code unless the text states otherwise.

Zyl¹⁷⁷ states that the Code is "the main mechanism created by the Act to regulate the market conduct of the providers and representatives." The purpose of the Code is to ensure that clients are able to make knowledgeable decisions on financial services and to ensure that "their reasonable financial needs are met."¹⁷⁸ In terms of section 15(1) of the FAIS Act, the Code is binding on the Registrar and FSPs. The rights granted under the Code cannot be waived by the client. Furthermore, contravention with the provisions of the Code is sanctioned and the clients are afforded protection through the complaint resolution procedure through the office of the Ombud which is discussed below.

The other purpose of the FAIS Act is to ensure that those giving advice to clients provide them with adequate information about the financial product they use. To attain this, the FAIS Act authorises that there be a Code of Conduct whose content shall include the requirement of adequate disclosures of relevant material information, including disclosure of actual or potential own interests in relation to dealing with clients.¹⁷⁹ The important question in this regard would then be what constitutes information relevant and adequate enough in advising clients. According to section 8 (1) (a) of the Code, the FSP must retrieve from the client all information that will enable him or her to provide the client with appropriate advice. One of the greatest contributions of the new legislative framework is that a needs analysis needs to be done.

¹⁷⁷ Van Zyl *FAIS Manual* 24.

¹⁷⁸ Van Zyl *FAIS Manual* 24.

¹⁷⁹ S16(2)(a). The test for materiality is an objective one. That is whether a reasonable person in the position of the FSP, possessing similar qualifications, would have disclosed such information. A fact or information is material if on the strength of its disclosure or non-disclosure the client contracts to his or her prejudice. That is to say, but for the disclosure or non-disclosure the client would have decided differently or would have contracted but on different conditions, then such fact was material; see *Mutual & Federal Insurance Co Ltd v Oudtshoorn Municipality* and *Reinecke SA Insurance Law* 163. Materiality of a fact is a factual issue on which evidence must be led and the one who alleges such materiality must prove it. For example if the client is of the view that a certain issue such as the cost of obtaining the financial product is material, produce evidence to that effect and prove that but for that non-disclosure he would not have contracted or he would have contracted on different terms. However, some other facts are so obviously material that evidence need not be provided. For example, the financial status of the FSP or the insurance company for which the FSP underwrites is a material fact. This is to say that if the insurance company or the FSP is facing cash flow or liquidity problems then such fact must disclosed to the client so that he knows from the onset that he is about to contract with an insurance company that is on the blink of collapse; see *Reinecke, Van Niekerk and Nienaber SA Insurance Law* 163.

3.3.1.1 Responsibilities of the FSP

The FSP through its representative, in this context the insurance advisor, has a responsibility to act in a way that enables the consumer to make a well informed decision and "to provide appropriate and suitable solutions to the reasonable needs of the consumer."¹⁸⁰ Section 16 of the FAIS Act in this regard sets out the underlying guidelines to be taken into consideration when drafting the Code.¹⁸¹ In terms of the section, some of the listed responsibilities of the FSP as may be contained in the Code are

- a) to act at all times honestly and fairly in the interests of the client and the integrity of the financial services industry;
- b) the FSP must have adequate resources, procedures, skills and technology to provide professional service;
- c) the FSP must always seek information regarding the consumer's financial situation and financial product experience and objectives;
- d) the FSP must always treat clients fairly in the event of conflict of interest;
- e) The FSP must provide suitable and appropriate guarantees or professional indemnity or fidelity insurance with the mechanism to adjust guarantees or cover by the register.

This implies that the FSP must always further the interests of the client. The motive of earning a commission should at all times, come second to furtherance of the interests of the client. These duties as stipulated in the FAIS Act form the foundation for the underlying principles on the basis of which the Code was drafted.

3.3.2 *Underlying Principles of the Codes*

It is on these underlying principles as stated above that the Code was drafted. Some of the duties imposed on the FSPs by the Code are to act honestly, fairly, with due diligence, care and skill and act in the interests of the client in their dealings with clients,¹⁸² provide disclosure of information on product suppliers, FSPs and financial

¹⁸⁰ Anon Date Unknown <http://www.banking.org.za/index.php/consumer-centre/financial-advisory-and-intermediary-services-act>. The Codes set out the responsibilities of the FSP and must therefore be drafted in such a way that will ensure that the client be rendered the financial advice is able to make a well informed decision.

¹⁸¹ S16(1)(a)–(e) and s 6(2)(a)–(e).

¹⁸² Part II of the Codes.

services rendered¹⁸³ and make provision for internal handling of complaints by clients by the FSPs.¹⁸⁴ All this is to ensure fair treatment of clients and prudent regulation of the market conduct within the financial advisory and intermediary services industry.

3.3.3 *General Duties of the FSP*

The Code distinguishes between general and specific duties of FSPs. According to section 2 of the Code provides that as a general duty, when rendering financial services an FSP must always act fairly, honestly, with due diligence, care and skill. Failure act fairly, honestly and with due diligence, skill and care therefore amounts to failure to comply with the provision of the FAIS Act. The interests of the client must be at the core of the business of rendering of advice by the FSP. As stated above, the motive to earn a commission should come second to the interests of the client. The FSP must also preserve the integrity of the financial services industry at all times.

To this end, Swanepoel¹⁸⁵ states three "relevant, material elements" that are vital to disclose.

- a) the FSP must identify the client's objectives after obtaining the relevant information from the client;
- b) he must identify and explain the relevant investment benchmarks in order to keep the score and discuss the key features that will help make the objectives as clear as possible; and
- c) he must explain the key features and essential elements of the solution or product

Swanepoel¹⁸⁶ goes further to state that although the above mentioned are generally the accepted requirements in order to classify information communicated to the client as relevant and adequate, there are two more requirements, namely; the FSP's

¹⁸³ Part III, IV and VI of the Codes

¹⁸⁴ Part IX of the Codes.

¹⁸⁵ Swanepoel 2004 *FSB bulletin* 9.

¹⁸⁶ Swanepoel 2004 *FSB bulletin* 9.

service model must be explained to the client and he must be informed what the advice and service model will cost him or her.

The disclosure of the above mentioned factors would assist a client to make an informed decision. In the case of insurance, the advisor or intermediary would have to explain to the client who wants a life cover, whether such client qualifies after extracting from the client information such as medical history of that client. He will have to gather his objectives, explain the kind of life covers he can get, their costs etc. An instance of this is the case of *Stain v Old Mutual Life Assurance SA Ltd*¹⁸⁷ which was before the FAIS Ombud. This case is discussed later on in this paper.

3.3.4 *Specific Duties of the FSP*

The specific duties of the advisors and intermediaries are to be found in clause 3 of the Codes. These are duties that are imposed on them when dealing with each specific case and are elaborative on the general duties of care, skill, diligence, honesty and fairness.

3.3.4.1 Representations and Information must be factually correct

When rendering a financial service, the representations and information provided by the representative of the FSP must be factually correct¹⁸⁸ and provided in simple language to avoid any ambiguity and must not be misleading.¹⁸⁹ The information and representations made must be appropriate and adequate each specific case that the intermediary or advisor is faced with.¹⁹⁰ The representative of the FSP must also take into account the level of knowledge of the client in regard to the financial product.¹⁹¹ For example, in the case of insurance, the intermediary or advisor must provide adequate information about insurance policies available taking into account the level of knowledge of the client in that regard. This is to avoid the likelihood of misrepresentation or the client making a decision based on mistake or error in

¹⁸⁷ FOC/1664/05/WC.

¹⁸⁸ S3(1)(a)(i).

¹⁸⁹ S3(1)(a)(ii).

¹⁹⁰ For example an insurance advisor would have to provide clients with information that is appropriate and adequate in relation to the available policies and covers to which they qualify and the payable premiums.

¹⁹¹ S3(1)(a)(iii).

negotio. Both parties must be at par as to the advice being rendered and the goals of the client to be achieved.

3.3.4.2 Representations and Information must be provided timeously

The information and representation must be provided timeously so as to afford the client an opportunity to make an informed decision.¹⁹² If provided in orally, the information must, within a reasonable time, be confirmed in writing at the request of the client.¹⁹³ If it is provided in writing, it must be in clear and readable print size, spacing and format.¹⁹⁴ All monetary obligations payable by the client to the provider must be clearly stated. For example it must be state who will be responsible for the payment of the commission from the onset. Where such amounts cannot be ascertained, the basis for their calculation must be stated.¹⁹⁵ In the case of insurance, the premiums payable to the insurer or the advisor by the prospective insured must be clearly stated or the basis for their calculations. The information must be repeated to the client where there has been material change in the circumstances affecting the financial product.¹⁹⁶ Thus a client would need to know what his monthly premium is, how it is calculated and the commission to be received by his advisor.

3.3.4.3 Disclosure of Conflicts of Interest

According to the Code, the FSP must disclose actual or potential conflict of interest to the client.¹⁹⁷ This is because as stated above an advisor or intermediary is in a fiduciary duty as against the client and as such, law prohibits a person who is in a fiduciary position to be conflicted as this may hamper his judgement in the execution of the mandate. A non-cash incentive or any other indirect consideration payable by another any other person to the FSP may be viewed as conflict of interest and as

¹⁹² S3(1)(a)(iv). According to Swanepoel, a decision is well informed if the FSP model and the cost of the FSP model and advice are explained to the client. This is to say that if the client is able to ascertain from the initial stages of the negotiations with advisor or intermediary what he is contracting for and the terms of such contracting, then the client would be said to have made an informed decision. Further if the advisor has communicated the objective to the client, presented all the material features of the solution and the relevant and material information has been dealt with. The advisor must also take reasonable steps to ensure that the client understands the advice. (Swanepoel 2004 *FSB bulletin* 9).

¹⁹³ S3(1)(a)(v).

¹⁹⁴ S3(1)(a)(vi).

¹⁹⁵ S3(1)(a)(vii).

¹⁹⁶ Clause 3(1)(a)(viii).

¹⁹⁷ Clause 3(1)(b).

such must be disclosed to the client.¹⁹⁸ The interests of the client must be executed speedily¹⁹⁹ and all transactions of the client must be properly accounted for.²⁰⁰ The FSP must further not deal in the financial product for his own benefit, account or interest, especially where there is pending knowledge disclosure of which would affect the price of the financial product.²⁰¹

The communication between the FSP and the client must be recorded and kept for the prescribed five year period. They must be available for inspection.²⁰² As a contractual relationship exists between the FSP and the client, the FSP may not disclose any confidential information obtained from the client except where such disclosure is prescribed by law.²⁰³ By virtue of that contractual relationship, a fiduciary relationship thus exists between the FSP and the client and as a result the FSP must comply with the fiduciary duties imposed on him by law which include the duty not to disclose any confidential information.²⁰⁴ The main focus of the Code is the conduct of the FSPs and their representatives in their advisory dealings with the client.

3.3.5 *The Six Step Approach to Financial Planning*

In order to ensure that the spirit of the FAIS Act and the Code is upheld, the Financial Planning Institute for Southern Africa adopted the six step approach to financial planning.²⁰⁵ This six step approach denotes that the intermediary in rendering advice must comply with the following steps.

The first step is establishing and defining a professional relationship. This must be done in writing. The financial planner must at this stage inform the client about the

¹⁹⁸ Clause 3(1)(c).

¹⁹⁹ Clause 3(1)(d).

²⁰⁰ Clause 3(1)(e).

²⁰¹ Clause 3(1)(f).

²⁰² Clause 3(2).

²⁰³ Clause 3(3).

²⁰⁴ A person who is a fiduciary relationship with another has a duty to handle the affairs of another as he would handle his own.

²⁰⁵ Goodall *SA Financial Planning* 18. The six step approach to financial planning was established by the FPI and they are supported by Financial Planning Practice standards. They are meant to clearly state and establish the required levels of performance from the FSPs as envisaged by the FAIS Act and the Code.

financial plan and competencies that can be offered. Issues such as potential conflict of interest must be disclosed at this stage.²⁰⁶

The second step is the gathering of data and goals. The financial planner must identify the client's personal circumstances and financial objectives, needs and priorities.²⁰⁷ To do this the financial planner must collect factual data (qualitative documents and information) and information that may give an idea of the client's values and attitude towards financial products (quantitative information)²⁰⁸

The third step is analysing and evaluating the client's financial status. This involves the analysis and assessment of the client's financial status so as to understand his situation.²⁰⁹ This must be done in two stages.²¹⁰ Firstly there has to be an analysis of the information that was gathered in step two. Secondly there must be an analysis of the client's objectives. The planner must be able to say where such objectives can be achieved using the current plan or if there has to be a change in the plan.²¹¹

The fourth step is the development and presentation of financial planning recommendation and/or any alternations. The financial planner must ensure that the recommendations suggested fall within the ambit of the law.²¹² This means that the planner must ensure that the recommendations he gives are those he is licensed to give. At this stage, the planner must identify and evaluate financial planning strategies necessary to achieve the client's goals.²¹³ The planner must develop recommendations and present them to the client.²¹⁴

The fifth step is the implementation of the recommendations made in the previous step. The two parties must agree on how the recommendations will be implemented,

²⁰⁶ Goodall *SA Financial Planning* 19.

²⁰⁷ Goodall *SA Financial Planning* 20.

²⁰⁸ Goodall *SA Financial Planning* 20.

²⁰⁹ Goodall *SA Financial Planning* 24.

²¹⁰ Goodall *SA Financial Planning* 24.

²¹¹ Goodall *SA Financial Planning* 24.

²¹² Goodall *SA Financial Planning* 28.

²¹³ Goodall *SA Financial Planning* 28.

²¹⁴ Goodall *SA Financial Planning* 30. The planner must present the recommendations in such a way that the client is in a position to clearly understand the recommendations and ask questions and raise concerns which concerns must be addressed.

that is to say, the advisor and the client must agree on what the role of each of them will be in relation to the implementation of the recommendations.²¹⁵

The sixth step is the monitoring of the financial planning recommendation. This is where the client's situation is reviewed to ensure that the goals are being achieved. The review may be done periodically.

In terms of the FAIS Act, this six step approach would imply that the client indeed has to be part of the whole process of rendering advice to him commencement to completion of the whole process. Since the steps were created in the spirit of the Code, breach of this process would mean that the advisor or intermediary was negligent in advising the client. As a result the client may suffer damage and may institute an action against such advisor for negligence.

3.3.6 *Conclusion*

The question that one may ask is if there was a need to incorporate the FAIS Act within the insurance industry considering fact that the insurance acts already have the PPRs. As already stated, the PPRs only addressed the relationship between the insurer and the broker. A need therefore existed to statutorily regulate the relationship between the client and intermediaries and to regulate the market conduct of the intermediaries so as to protect the clients. The FAIS Act and the Code carry out this function perfectly. The shortcoming of the FAIS Act and the Code that must be noted is that they exclude the banking activities even though it is clear that there are some other activities within the banking sphere that may constitute advice as envisaged by the FAIS Act such as advice given to a client who wants to take a loan to purchase a house or a car. It is therefore submitted that this aspects of banking must be subjected to regulation by the FAIS Act and the Code.

The Code is not on its own enforceable. It is a guideline on the conduct of intermediaries and advisors. However, breach of the Code amounts to negligence under the Act and therefore enforceable. The FAIS Act has in place its own enforcement measures. These are discussed below.

²¹⁵ Goodall *SA Financial Planning* 31.

3.4 Enforcement

Part Four of the FAIS Act provides for enforcement mechanisms within the financial services industry.²¹⁶

3.4.1 Introduction

The ombudsman as established by section 20 became operational on the 1st October 2004.²¹⁷ It is described as

a forum to consider and dispose of complaints of consumers of financial products against their financial advisers in an independent and impartial procedurally fair, informal, economic and expeditious manner, taking into account not only the legal position but also considerations of equity.²¹⁸

Nienaber and Reinecke²¹⁹ state that before the establishment of the ombudsman, there was no other institution that consumers of financial products could turn to whenever they had complaints against financial advisers when they were given inappropriate and poor intermediary services.²²⁰ They further state that the ombudsman is aimed at protecting consumers against

Other forms of inadequate financial services, the miss-spelling of financial products and to ensure that in the process the FSP rendering the financial services would henceforth do so adequately and professionally.²²¹

In comparison to the court proceedings, the ombudsman proceedings result in shorter, faster and effective dispute resolution mechanism. The effect of not having an entity such as the ombudsman is that clients are taken advantage of and often rendered misleading advice.

In disposing of its duties and complaints of consumers, the ombudsman must at all times be impartial and independent.²²² The services of the ombudsman are free and accessible to all consumers²²³ hence the ombudsman is regarded as a

²¹⁶ S20(1) provides that there shall be established an office of the Ombudsman for the FAIS (herein after referred to as the ombudsman).

²¹⁷ Nienaber and Reinecke *Life Insurance in South Africa* 35.

²¹⁸ Nienaber and Reinecke *Life Insurance in South Africa* 35; see also section 20 (3).

²¹⁹ Nienaber and Reinecke *Life Insurance in South Africa* 35.

²²⁰ Although there were the Long term ombudsman and Short term ombudsman, these dealt specifically with matters only related to insurance.

²²¹ Nienaber and Reinecke *Life Insurance in South Africa* 35.

²²² S20(4).

²²³ Anon Date Unknown <http://www.faisombud.co.za>.

Complaint resolution mechanism... aimed at providing speedy and cost effective measures to save client having to follow the costly and time consuming route via the courts.²²⁴

However, according to section 40, the client is not precluded from following the normal court procedures in seeking redress. The court procedure is normally preferable where the complaint exceeds the required monetary ceiling.²²⁵ However, it would not be ideal for one to go through the court procedure as this has proven to be time consuming and very costly.²²⁶ It is submitted that the ombudsman is the best option more particularly because it has a higher monetary ceiling than the magistrates court which has a monetary ceiling of R100 000.²²⁷ Furthermore, the determinations of the ombudsman are binding as any other order of a court of law.²²⁸

3.4.2 *Complaint under the FAIS Act*

Since the ombudsman deals with complaints, it is vital to define a complaint as envisaged by the FAIS Act. Section 1 of the FAIS Act states that for a service rendered to be capable of being complained about, it must be rendered by the FSP or its representative after the commencement of the FAIS Act. The section introduces a two-step approach which must be complied with for a complaint to be brought before the office of the ombudsman. This denotes that one must allege that the FSP or representative of the FSP has contravened or failed to comply with the provisions of the FAIS Act and as a result he has suffered financial damages or prejudice or is likely to suffer prejudice or damages. The complainant may also allege that the FSP or representative has wilfully or negligently rendered him financial services which caused him prejudice or damages or is likely to cause him

²²⁴ Van Zyl *FAIS Manual* 41.

²²⁵ Van Zyl *FAIS Manual* 41. The stipulated monetary ceiling is R800 000 but if the respondent has agreed in writing that ceiling can be overlooked.

²²⁶ In terms of Rule 9(a) of the Rules of Proceedings of the Office of the Ombud for Financial Services Providers, a case fee of R1000 may be charged on the matter once it has been accepted for investigation. This amount is relatively low compared to the charges which may be incurred if the court procedure is followed.

²²⁷ Nienaber and Reinecke *Life Insurance in South Africa* 35.

²²⁸ To this end the FAIS ombudsman differs from the LTI ombudsman and the STI ombudsman in that these two ombudsmen form voluntary dispute resolution schemes and bind only the institutions that participate in them whereas the FAIS ombudsman is a statutory creature and its decisions are binding on participants and third parties.

such prejudice or damages.²²⁹ The complainant can also allege that the FSP or its representative has treated him unfairly.

The FSP or representative who has rendered the service may also be a person who has not been authorised as an FSP. In such a case if the ombudsman makes a finding in favour of the complaint, it may direct that the unauthorised representative and the FSP it represented be jointly and severally liable for any judgment made in favour of the complainant. This was the ruling of the ombudsman in the case of *Auberge Guest Lodge CC v Suzette Brickhill and Mathys Johannes Marias t/a Protea Makelaars*.²³⁰ In terms of section 7 of the FAIS, all persons who render financial services must be registered as authorised financial services providers. Brickhill, who was a representative of Marais, was not registered as such and Marais was aware of that fact. He however let her render financial services independently. Marais was also aware that Brickhill lacked necessary qualifications to render financial services. Marais was a registered FSP. Brickhill defrauded many clients. Marais in his response alleged that he was not aware that Brickhill was defrauding many clients. The ombudsman held that since Marais was aware that Brickhill was not an authorised FSP, yet continued to let her render financial services independently, they were both jointly and severally liable to pay to the complainant the R12 088.11 premiums that he had paid with the 5% interest per annum from the date the order was made till final payment is made.

The preceding paragraph brought into picture another aspect of agency as the intermediary or advisory is based on agency.²³¹ Agency often gives rise to the principle of vicarious liability. In terms of this principle, a principal is held responsible

²²⁹ This is to say that the FSP has intentionally or without having exercised the reasonable care required of him has acted in a way that has caused the client financial damage or is likely to result in such damage either to him or his property.

²³⁰ FAIS/05228/11-12/MP 3.

²³¹ In the case of insurance the intermediary or advisor will either be an agent of the client in which case he must procure insurance for the client or if he is an agent of the insurance company, he will have to find clients for the insurance company. The intermediary or advisor gets paid a commission for the work done. The duties that the Code places on them are similar to the common law duties placed on agents, for example that the agent must at all times keep the principal's information confidential at all times unless the law requires him to disclose it and that the agent must not make secret profits out of the transaction with the client.

for the delict of his agent.²³² The principal does not need to commit the act, or omission complaint of, in order to be held liable for it in delict.²³³ What is of importance is that the agent was mandated by the principal and was acting in the course and scope of that mandate. Hence in *Auberge Guest Lodge CC v Suzette Brickhill and Mathys Johannes Marias t/a Protea Makelaars*, Marais was held responsible for the actions of Brickhill.

3.4.3 *Jurisdiction of the ombudsman*

The Ombud has jurisdiction over matters involving the financial services that are regulated by the FAIS Act. There are certain conditions which have to be met before the Ombud have jurisdiction over a matter. One such condition is that the internal complaint resolution systems and procedures of the FSP must have been exhausted before a complaint is lodged with the office of the ombudsman.²³⁴ In order for the office of the ombudsman to have jurisdiction over a complaint it must be justiciable.²³⁵ According to section 27(3) of the FAIS Act, the ombudsman may decline to investigate the complaint if it is brought three years after the complainant came to know of its existence.²³⁶ This means that a complaint must be brought to the office of the ombudsman as soon as the client has become aware of it. The ombudsman may further decline to investigate the matter if proceedings have already been instituted by the complainant in another court.²³⁷ This was held by the ombudsman in the case of *Gary Le Vatte, Jeanette Le Vatte v Robert Steven Spendley and Rosspen Financial Services*²³⁸ where there had been some

²³² Burchell *Principles of Delict* 215.

²³³ Burchell *Principles of Delict* 215.

²³⁴ As part of compliance envisaged by the Act in section 16 thereof, the FSP must have in place internal complaint resolution systems and procedures in accordance with which the complaints must be resolved whenever they are received from clients.

²³⁵ Rule 4 of the Rules on Proceedings of the Office of the Ombud provides for determinations regarding justiciability. A complaint will be justiciable if it falls within the ambit of the FAIS Act and the Rules pertaining to definitions of advice and financial product as anticipated by the FAIS Act and act complaint of must have occurred at a time when the FAIS Act and the Rules were already in force. The person against whom the complaint is made must be subject to the provisions of the FAIS Act and such person must have failed to resolve the complaint satisfactorily within six weeks of receiving it.

²³⁶ S27(3)(a)(i) and (ii).

²³⁷ S27(3)(b).

²³⁸ FOC 600/05/EC. What this essentially means is that it must be the complainant who must have sought relief elsewhere before resorting to the Office of the Ombud, more particularly because the Office of the Ombud is regarded as the voice of the people, as the protector of the clients so if the client has sought and is in the process of being granted relief elsewhere, the Office of the Ombud process would be regarded as abuse of court procedure.

disagreements between the complainant and the respondents. The respondents instituted proceedings in court. When the matter was brought to the ombudsman, it was argued by the respondents that the matter may not be investigated by the ombudsman by virtue of section 27(3)(b) of the FAIS Act. The ombudsman held that in terms of the section it may not investigate a complaint if it is the complainant who has already instituted proceedings in any other court. Furthermore the ombudsman may decline to entertain a complaint where it is of the view that the matter may be rightly disposed of in a court of law. If a complaint is addressed to the Long-Term ombudsman when it clearly falls within the jurisdiction of the ombudsman, it must be re-directed to the office of the ombudsman immediately.²³⁹

The Act provides for the adoption of alternative dispute resolution in the proceedings at the ombudsman²⁴⁰ Regarding the legal force of a determination made by the ombudsman, it should be noted that such determination is binding on the parties like any other order made by an ordinary court of law.²⁴¹ Appeals from the decisions of the ombudsman lie with the Board of Appeal with leave of the ombudsman.²⁴² Leave of appeal will only be granted after taking into the complexity of the matter²⁴³ or if a reasonable likelihood exists that the Board of Appeal may reach a different decision.²⁴⁴ If the ombudsman refuses to grant leave to appeal, an appeal may be made with the permission of the Chairperson of the Board of Appeal.²⁴⁵

3.4.4 *Procedure for bringing complaints to the ombudsman*

The rules set out a procedure to be followed when bringing a complaint to the office of the ombudsman. Hattingh and Millard²⁴⁶ break down the rules into three stages of case management. The first stage is the initial stage. At this stage the case manager reads the case and ensures that the details of the parties are correct. This will also reveal the contact details of the compliance officer of the respondent.²⁴⁷

²³⁹ Nienaber and Reinecke *Life Insurance in South Africa* 35.

²⁴⁰ S27(5)(a)-(c).

²⁴¹ S28(5)(a).

²⁴² S28(5)(b).

²⁴³ S28(5)(b)(i)(aa).

²⁴⁴ S28(5)(b)(i)(bb).

²⁴⁵ S28(5)(b)(ii).

²⁴⁶ Hattingh and Millard *The FAIS Act Explained* 169.

²⁴⁷ Hattingh and Millard *The FAIS Act Explained* 169.

The second stage is the investigation stage.²⁴⁸ At this stage, an inquiry into the merits of the case is conducted. The question at this stage is whether there has been a contravention or non-compliance with the provisions of the Act or the Code which resulted in the complainant suffering loss or prejudice.²⁴⁹ The final stage is the adjudication stage.²⁵⁰ This is where the complaint is argued and maybe dismissed or additional information be requested by the ombudsman.²⁵¹ This paper however, submits that this route lengthens the complaints procedure and is redundant. What should instead happen is that at the stage the complaint is being brought to the office of the ombudsman for the first time and its justiciability is questioned, the complainant must be required to establish a prima facie case against the respondent.

The complaint must not exceed R800 000. In terms of section 27 (4) to be considered by the ombudsman the complaint must be written and be received by the other party.²⁵² The ombudsman must be satisfied that all the concerned parties have been notified and provided with necessary particulars to enable them to respond to the complaint.²⁵³ All the parties must be given an opportunity to respond to the complaint.²⁵⁴ This is in confirmation of the audi alteram partem rule.

3.4.5 Determinations

The ombudsman deals with issues that affect the FAIS and are listed therein.²⁵⁵ These range from violation of the Codes instances of appropriateness of the advice.²⁵⁶

²⁴⁸ Hattingh and Millard *The FAIS Act Explained* 169.

²⁴⁹ Hattingh and Millard *The FAIS Act Explained* 170.

²⁵⁰ Hattingh and Millard *The FAIS Act Explained* 170.

²⁵¹ Hattingh and Millard *The FAIS Act Explained* 169.

²⁵² S27(4)(a).

²⁵³ S27(4)(b).

²⁵⁴ S27(4)(c).

²⁵⁵ Nienaber and Reinecke *Life Insurance in South Africa* 36.

²⁵⁶ Most of the time when a complaint has been brought to the Office of the Ombud, it would be particularly because the FSP or its representative have been negligent in the exercise of the duties imposed on them either by the Act or the Code. *Steenkamp v Old Mutual Life Assurance Company SA* FOC/1345/05/FS. *Stain v Old Mutual Life Assurance* FOC/1664/05/WC

3.4.5.1 Violations of the Code

*Andrew Graham Studen v Nicolaas Leon Van der Walt t/a Investment and Insurance Broker*²⁵⁷ complainant had insured his house with Santam. The respondent was the FSP facilitating the policy. Santam later changed its requirements regarding security measures at the houses insured. Complainant alleged breach of section 2 of the Codes that the FSP must act fairly and honestly with due diligence, skill and care. It was also alleged that there was a breach of section 7 that whenever there is material change that affects the financial product (policy in this instance) the FSP must inform the client (insured). The ombudsman held that in order to properly discharge his duties the respondent is expected to fully understand the insurer's requirements before making recommendations to the public as envisaged by section 2. The Ombud found that the respondent as a result of lack of proper knowledge and understanding of the insurer's requirements was unable to put the complaint in a position to make a well informed decision and made an order against the respondent.

3.4.5.2 Appropriateness of the advice²⁵⁸

In *Stephenson v Nedbank*,²⁵⁹ the complainant had, acting on the advice furnished by Ms Rasool who was an employee of the respondent, agreed to transfer his investment of R1.2 million from the Nedbank Money Market Account to the Old Mutual Money Market Account. This was done under the impression that the investments were similar on all accounts except that the Old Mutual investment would yield higher return and the funds would be available after a period of 72 hours. The transaction was brokered by Mr. Maharaj, an employee of the respondent who was acting within the scope of his employment with the respondent as an authorised representative. The fees were, however, not disclosed to the complainant at any

²⁵⁷ FAIS/01995/11-12/WC 3.

²⁵⁸ Appropriateness in this instance means whether the advice rendered to the client is suitable for the financial needs, situation etc of the client. That is whether before rendering the advice, the advisor took the six step approach to determine the financial needs and situation of such a client. For example where a client wants to have an insurance policy such as life cover with the intention that after he dies while his children are still minor, the proceeds from the cover must then be used for their education, the advisor must be able to extract this from the client so as to give such client appropriate advice.

²⁵⁹ FOC/540/05/KZN. The case deals with investment but it is however important to show the effects of rendering inappropriate advice and what would amount to inappropriate advice. See also *Ramdass v Standard Bank* FOC/882/05/KZN (1).

stage during the negotiations and a needs analysis was not done as he had waived that right.

Later on when the complainant requested that he be provided with prove of investment, he was informed that provision of such documentation would only be possible if the funds were transferred back to the Nedbank account. This is when complainant became aware that the fees to the amount of R13 465.68 had been levied against his investment. After conversations with one Mr Hoyle who was also an employee of the respondent, it became clear that the Nedbank and Old Mutual accounts were significantly different.

The ombudsman held that the investment was materially misrepresented to the complainant and that the respondent had failed to comply with the Code of Conduct. The statements made by the respondent were not factually correct and constituted a false representation of the financial product being recommended. Mr. Maharaj should have known that there were material differences between the two products and either wilfully or negligently withheld them from the complainant in order to conclude the transaction and receive the commission. The respondent therefore did not act with the required skill, care and diligence expected of someone acting in a position of trust. The advice rendered to the complainant by the respondent was therefore not appropriate in the given circumstances. The respondent was ordered to repay the commission with interest.

3.4.6 Conclusion

The FAIS ombudsman is a welcome step in resolving complaints by client who suffer due to poor advice. It is a reflection of an ideal method of dispute resolution within industries such as the financial services industry more particularly because its procedures are detailed and cheaper than following the court procedure. What is also noteworthy about the FAIS ombudsman is the fact that its jurisdiction is well established and its decisions have a binding effect as any court of law. However, as stated, some of the procedures are redundant and as such lengthens the complaints process and must be dealt away with in the Act. However, the FAIS Act is not the only legislation affording protection to the clients. Another piece of legislation is the CPA and its contents are discussed below.

3.5 Consumer Protection Act

3.5.1 Introduction

Before the promulgation of the CPA, the sphere of consumer protection was unregulated and scattered with fragmented pieces of legislation.²⁶⁰ This resulted in lack of "basic consumer rights, an inadequate consumer voice and continuous exploitation of consumers".²⁶¹

Although promulgated in 2008, the CPA came into effect on the 31st March 2011.²⁶² Reinecke et al²⁶³ state that the insurance contracts, undertaking or assumption of risk were excluded from the application of the Act when it was initially promulgated because they were already regulated by other laws. The exclusion was

Subject to those sector laws being aligned with the consumer protection measures provided for in the Consumer Protection Act within a period of 18 months from the commencement of the Act, failing which the provisions of this Act will apply to insurance contracts.²⁶⁴

This exclusion however, did not provide a blanket exclusion of insurance contracts to the application of the CPA.²⁶⁵

Since the CPA became effective on the 31st March, it means that the 18 month period for the insurance businesses to align their conduct with the principles set out in the Act lapsed on the 30th September 2012 and consequently the CPA applies to the insurance contracts.²⁶⁶ It should be noted that the application of the CPA to insurance is only temporary while alignment of the laws is in progress.²⁶⁷ This means that whilst the laws are being aligned to reflect the principles of the CPA within the insurance industry, the CPA applies until such time when the alignment would have been completed.²⁶⁸

²⁶⁰ Anon Date Unknown <http://www.banking.org.za/index.php/consumer-centre/consumer-protection-act/>.

²⁶¹ Anon Date Unknown <http://www.banking.org.za/index.php/consumer-centre/consumer-protection-act/>.

²⁶² Reinecke, Van Niekerk and Nienaber *SA Insurance Law* 21.

²⁶³ Reinecke, Van Niekerk and Nienaber *SA Insurance Law* 21.

²⁶⁴ Reinecke, Van Niekerk and Nienaber *SA Insurance Law* 21.

²⁶⁵ Dinnie *The CPA* 6.

²⁶⁶ Reinecke, Van Niekerk and Nienaber *SA Insurance Law* 21.

²⁶⁷ Reinecke, Van Niekerk and Nienaber *SA Insurance Law* 21.

²⁶⁸ What was to happen while the exclusion was still operational was that where there was conflict between the insurance acts and the CPA, then the insurance industry would have to

The CPA is a legislation of general application. That is why even where the alignment of insurance laws are still awaiting alignment with the consumer protection measures within the CPA, the consumers of insurance products when not satisfied with the ordinary remedies and outcomes of the insurance law will have recourse to the CPA for other relief.²⁶⁹

The Act is described as a result of the intention of the Department of Trade Industry

To create and promote an economic environment that supports and strengthens a culture of consumer rights and responsibilities.²⁷⁰

The Act applies only to contracts entered into on or after 1st April 2011 with the exception of insurance contracts.

The aim of the Act

to promote a fair, accessible and sustainable marketplace for consumer products and services and for that purpose establish national norms and standards relating to consumer protection, to provide for improved standards of consumer information, to prohibit certain unfair marketing and business practices, to promote responsible consumer behaviour, provide a consistent legislative and enforcement framework relating to consumer transaction and agreements...

Put differently, the Act is meant to protect consumers from unfair market practices and ensure that consumers exercise sensible and reasonable behaviour when purchasing products.

3.5.2 *Purpose of the Act*

The purpose of the Act as stated in section 3(1) enunciates the same principles tabulated in regard to the protection of clients above save to say that the other purposes of the Act are to consolidate and replace the existing consumer protection laws.²⁷¹

The preamble of the Act states that it is aimed at protecting and promoting the economic interests of consumers to ensure accessible, transparent and efficient

decide what then should happen; either an alignment of the laws or amendment of the laws would have to be done.

²⁶⁹ Reinecke, Van Niekerk and Nienaber *SA Insurance Law* 21

²⁷⁰ Anon Date Unknown <http://www.banking.org.za/index.php/consumer-centre/consumer-protection-act>.

²⁷¹ S3(1).

redress for consumers who are subjected to abuse and exploitation in the market. The Act is also meant to give effect to internationally recognised consumer rights to promote an economic environment that supports and strengthens a culture of consumer rights and responsibility. It is further aimed at improving access to and the quality of information necessary to enable consumers to make well informed decisions. There should also be education programmes for consumers including education concerning the social and economic effects of consumer choices.

The underlying principles of the Act are that the information must be provided in plain language that is appropriate to the targeted group. It must be understandable to that group.²⁷²

3.5.3 *The CPA and Insurance Products*

In relation to insurance, the Act applies to insurance policies which may constitute products in terms of the Act.²⁷³ The Act covers product liability and product failure. In terms of the Act²⁷⁴ goods include anything marketed for human consumption and any tangible object including the medium on which it is written. The question is therefore whether insurance policies are goods in this respect so that they can be governed by the provisions of the Act. This research submits that they do, because of the fact that they are market for human consumption. Marketing is defined as promoting or supplying goods or services.²⁷⁵ To promote is to advertise, offer to supply goods or services for consideration, to represent a willingness to supply or engage in any conduct that may be construed as an inducement to engage in a transaction.²⁷⁶ Insurance policies fall within that category and therefore are goods within the context of the Act. However, the Act will apply to insurance products that are exempted from application of the two Insurance Acts and the FAIS Act.²⁷⁷

²⁷² Anon Date Unknown <http://www.banking.org.za/index.php/consumer-centre/consumer-protection-act/>.

²⁷³ Swannie *Webber Wentzel* ALN 3.

²⁷⁴ S2.

²⁷⁵ S2.

²⁷⁶ S2.

²⁷⁷ Bracher 11 July 2011
<http://www.mondaq.com/x/138290/insurance/Insurer+And+The+Consumer+Protection+Act>.

However, the Amendment Act²⁷⁸ exempts financial products that are regulated by the FSB Act from the application of the CPA.²⁷⁹ It provides that the CPA does not apply to any function, act, transaction, goods or services that are subject to the FSB Act.²⁸⁰ It is submitted insurance products and services are exempt from the CPA due to the fact that the insurance sector is subject to regulation by the FSB Act.

3.6 *Conclusion*

The South Africa insurance advisory industry is an ideal one with the rights of the insured or prospective insured clearly stipulated in legislation so as to avoid a situation where there is a disagreement about the basic rights of the consumers, their responsibilities and the duties of the insurance advisors. Where there is a specific legislation on these issues, there would be less confusion as to how far the consumer can go about exercising his or her rights. Furthermore, a clear legislation on the protection of consumers and conduct of the financial advisory market triggers a safe investment environment needed for growth of investment. This creates economic development as many people will buy insurance and sales on insurance too will increase. It is from this legal position of South Africa that Lesotho can take legislative lessons. This issue is addressed in the next chapter.

²⁷⁸ 45 of 2013

²⁷⁹ Anon 1 June 2014 http://www.jutalaw.co.za/newsletter/newsletter/consumer-law-review_01-jun-2014-2/.

²⁸⁰ This is in accordance to section 66 thereof which amends section 28(2) of the FSB Act.

CHAPTER 4

4.1 *Introduction*

This chapter attempts to answer the research question which is what specific legal protection available to clients in their dealings with insurance advisor both in Lesotho and South Africa. This will be done by comparing the Lesotho position with that of South Africa. Although the specific legal protection in each instance has been stated, the most important issues will be re-stated again in this chapter in an attempt to determine the legislative lessons that Lesotho can take from South Africa in this regard.²⁸¹

The preceding two chapters dealt with the exposition of the legal position in Lesotho and South Africa, in relation to regulation of insurance advisors and protection of clients in their dealings with insurance advisors.²⁸² A number of issues arose particularly in relation to the position in Lesotho.²⁸³ What became clear is that the insurance legal framework in Lesotho is outdated and does not address the modern day important issues pertaining to insurance. Another issue that arose in chapter 2 was that of MKM. It is clear from the chapter that MKM was a result of regulatory failure due to lack of proper and efficient regulation mechanisms of those rendering advice to clients. If legislation existed requiring certain standards in rendering advice, issues such as cash flow problems in MKM it would have arisen at the early stages and fewer clients might have invested in MKM.

Even though there are amendments proposed to address the issues not addressed in the Insurance Act of Lesotho, the Insurance Bill fails in this regard.²⁸⁴ It does not address the issues relating to regulation of advice given by the insurance advisors to clients, their remedies in the event they receive wrongful or negligent advice, their responsibilities and rights, how such rights are to be enforced by an entity with jurisdiction over such matters.

²⁸¹ Chapter 2 and chapter 3.

²⁸² Chapter 2 and chapter 3.

²⁸³ See chapter 2 in this regard. For example it became evident in that chapter that the enforcement measures in Lesotho are not adequate to ensure protection of the clients.

²⁸⁴ See chapter 2.

Chapter 3 dealt with the exposition of the legal position in South Africa. Issues that emerged in that chapter were that the South African legal framework in relation to regulation of intermediaries can be referred to as modern. Although there are insurance acts,²⁸⁵ the South African legislature went further to introduce a specific Act that deals with financial products and the conduct of the intermediaries – the FAIS Act. There is also the CPA which deals with protection of consumers within a wide spectrum. Insurance clients as discussed above fall within this category. Whilst the Insurance Acts deals with the conduct of insurance business, the FAIS Act deals with intermediaries and the procedures that they must follow in rendering advice to actual and potential clients. It also provides for the responsibilities of the clients in receiving the advice. In the following paragraphs a comparison will be drawn between a number of key issues related to the protection of clients when receiving advice from insurance intermediaries.

4.2. Regulation of Advisors in Lesotho and South Africa

This section analyses and compares the regulation of insurance advisors in both Lesotho and South Africa. This is in order to determine if there is anything that Lesotho can learn from South African and how much of it can be incorporated into Lesotho's legal system.

4.2.1 Licensing Requirements

4.2.1.1 Lesotho

According to section 50 of the Insurance Act, to act as an agent or broker, one must be in possession of a valid licence. Such licence may be granted after the Commissioner is satisfied that the applicant does not suffer from the disqualifications mention in the section.²⁸⁶ The section dealing with disqualifications and the licensing requirements makes no mention of the requirements of fit and proper save to say that for example the applicant must have been convicted of any criminal offence in which the charge was fraud. What is required is that one does not fall within any category of disqualified persons.

²⁸⁵ *Long-Term Insurance Act and Short-Term Insurance Act.*

²⁸⁶ E.g. the applicant must not be a minor, must not be insolvent or must not have convicted of an offence involving fraud.

With regard to academic qualifications, the Act and the Regulations use the word "may". The implication of this is that the issue of qualifications is left to the discretion of the Commissioner. That is to say, the Commissioner may determine which qualifications an insurance advisor may have to possess. Both the Act and the Regulations do not state what those qualifications that the applicants must possess are. Even the proposed Bill does not shed any light into this issue.

Furthermore, the Act and the Bill provide that it is an offence for an authorised person to act as an agent or to continue to act as an agent or for an insurer to appoint as an agent a person he knows has not been licensed to act as an agent or broker. The fines are stipulated therein. However, the remedies available to a client who received advice from such unlicensed person are not stipulated. This raises the issue as to what are the remedies available to an already insured person in the event of receiving advice from authorised persons or where the Commissioner finds that the advisor had not been conducting their business in a proper manner and they have to surrender their licence.

4.2.1.2 South Africa

In both Lesotho and South Africa, to act as an insurance intermediary or advisor, one must be authorised to do so. That is, one must be licensed and continue to be in possession of a valid licence as long as he or she continues to act as an insurance advisor or intermediary. Such authorisation comes after an application has been lodged with the relevant authority in each jurisdiction.²⁸⁷ However, there are major differences in relation to the licensing requirements in both jurisdictions.²⁸⁸ In South Africa an applicant must show to the satisfaction of the Registrar that he complies with the requirements of fit and proper in respect of the qualities of honesty and integrity, competency, financial soundness and operational ability to fulfil the responsibilities imposed on him by the FAIS Act.

The South African regulatory framework goes further to explain and elaborate on how the requirements of fit and proper are to be determined. This differs materially

²⁸⁷ In Lesotho applications must be lodged with the Commissioner of insurance. In South Africa they must be lodged with the Registrar of the FSB.

²⁸⁸ The licensing requirements in South Africa have already been discussed above in 4.2.1.1.

from the position in Lesotho. In Lesotho the determination of most requirements is left to the discretion of the Commissioner, in South Africa the determination of those requirements is clearly stated in the FAIS Act and the Code and is equally applicable to all applicants. This is unlike in Lesotho where the Commissioner may for example require that one applicant show that he possesses academic qualifications but not require the same from the next applicant. This could have an impact on issues related to transparency and legal certainty.

4.2.1.3 Determinations of fit and proper

- a) Honesty and integrity: the Registrar uses a five year period, that is, whether within five years preceding the application the applicant has been found guilty of misconduct in relation to honesty and integrity. This is similar to Lesotho, although the Act and the Bill do not state in precise terms that such a requirement is a requirement of honesty and integrity. The Commissioner uses the five year period too in order to determine the honesty and integrity of the applicant.
- b) Competency: In South Africa, this is defined in terms of academic qualifications. In this regard the Determinations of Fit and Proper²⁸⁹ state the required academic qualifications, skills and experience that one must at least possess in order to be regarded as competent. This differs materially from the position in Lesotho in that academic qualifications are not mandatory, save to say that one must have a pass in English Language at C.O.S.C level which is an equivalent of the South African matric and three months course on insurance. This is still not enough because anyone who has a pass in English Language at C.O.S.C level with no relevant experience and skills qualifies to be an intermediary or advisor, unless the Commissioner demands that the applicant shows that he possess certain qualification and possibly even experience.
- c) Operational ability: this is required in order to enable the applicant can show that he has relevant ability to perform his duties and responsibilities under the FAIS Act. For example he must show that he has adequate access to communication facilities, typing and photo-copying facilities or any other

²⁸⁹

BN 91 of 2003.

means of duplication and that he has a separate account for clients' funds. These requirements are not in place in Lesotho. Therefore, a risk of having unqualified persons with no facilities to carry on intermediary or advisory business and to attend to the affairs of others, being allowed to engage in intermediary or advisory business thereby putting the monies of the clients at risk exists.

- d) Financial soundness: the applicant in both instances must show that he is solvent in order to have a licence granted.

4.3 Regulation of Advice

4.3.1 Lesotho

In Lesotho there is no law stating how the intermediaries and advisors should conduct their business and the goals they should have in mind when rendering advice to the clients. Although reliance in this regard is on the common law, there are problems with this. A statute has more binding effect than the common law which is not clearly stated. In the presence of a law stating and defining the important terms in advisory and intermediary services, regulation and compliance with the law would be much easier because the participants in the sector have certainty about the level of conduct required from them.

The definition of advice is not provided for in Lesotho. In the absence of a proper definition of advice, the clients in Lesotho run the risk of receiving advice from wrong persons which advice may later on prove to be prejudicial to them. For example, clients may receive advice from a receptionist when in fact they should only be receiving advice from key individuals of the FSP.

Furthermore, had the definition of advice been given, the consequences of MKM could have averted if not completely avoided. As stated in chapter 2 above, as early as 2002 MKMN was not authorised to offer insurance or any insurance products and was already facing financial problems. If there was a law setting standards on the procedures of rendering advice like that reasonable care, skill and due diligence be exercised, it would have emerged at the earliest stages of rendering advice that MKM was already in financial problems. As many people as had invested in MKM would not have invested and those who would have invested would have done so with the

knowledge that their investments were at risk. MKM is a clear example that the six step approach applicable in South Africa is not practised in Lesotho. Otherwise all issues pertaining to MKM and its financial products would have emerged at the advisory stages.

4.3.2 *South Africa*

The South African legislature imposes certain standards on those rendering advice in order to enable clients to make informed decisions with regard to financial products.²⁹⁰ For example, the FAIS Act requires that the intermediary and advisors conduct their business honestly and fairly with due diligence, skill and care. There is a statutory definition of advice.²⁹¹ The FAIS Act imposes certain duties on those who render advice, for example an intermediary or advisor shall not be negligent when giving advice to the client. There is also the Code of conduct which also imposes certain duties on the intermediaries and advisors. Failure to comply with the provisions of the Code amounts to negligence as provided for in the Act.²⁹²

4.3.3 *Needs Analysis*

To ensure that advice is rendered in an appropriate manner and that adequate information is retrieved from the client in order to enable the intermediary or advisor to properly advise him, the South African Financial Planning Institute adopted the six step approach to financial planning. The advisors and intermediaries must comply with this approach. Failure to do so will amount to negligence as provided for in the FAIS Act. This is not applicable in the case of Lesotho. The result of this is that the clients are exposed to the risk of being given advice that fails to meet their financial needs. This may be problematic based on the fact that even the enforcement measures are not adequate such that a client may have recourse to such enforcement measures when he has been given inappropriate advice. A comparison on enforcement measures follows later on.

²⁹⁰ For what amounts to an informed decision, see chapter 3.

²⁹¹ See chapter 3 for a discussion of this definition.

²⁹² For a discussion on this issue see chapter 3.

4.3.4 Duties of the FSP

In South Africa there are certain duties imposed on the FSPs such as the duty to act honestly, fairly and with due diligence, skill and care.²⁹³ These duties are divided into categories, the general duties and specific duties. Although these duties are in the Code, the implication is that violation of any of the duties in the Code will amount to negligence in terms of the Act.²⁹⁴ In Lesotho, the governing legislation does not provide for the duties of the FSPs. The implication of this, is that to establish the duties that the advisor owed to the client, resort must be to the common law which as stated above, does not specifically state the specific duties of the advisors.²⁹⁵ It is recommended in this regard that a legislation must be enacted which shall in addition to providing for the procedures that must be adhered to when rendering advice, provide for the duties of the advisors when rendering advice.

4.4 Enforcement

4.4.1 Lesotho

The enforcement institutions in Lesotho are still the ordinary courts of law. Although a Consumer Complaint Handling Division exists within the CBL, it is flawed with short-comings. Firstly, although it adopts the alternative dispute resolution mechanisms, the decisions are not binding. Furthermore, the Consumer Complaints Handling Division is not clearly stated. It came into effect in 2006 but it has not handled more than 50 complaints to date.

The decisions of the Consumer Complaint Handling Division are not binding. The CBL annual reports show that some of the complaints were not resolved which meant that the clients had to resort to the courts of law which are already saturated with many cases. The implication of this is that the complaints of consumers, even the most uncomplicated consumer complaints will take long to proceed in court. Furthermore, the court route is very costly and not every client can afford it and may prejudice the interests of the client.

²⁹³ See section 3.3.3 and 3.3.4 for the discussion on the duties of the FSPs.

²⁹⁴ For example the duty of the FSP to disclose. Had this existed in Lesotho, the MKM situation may have been averted.

²⁹⁵ For a discussion on the common law principles see chapter 2 section 2.2.

There is also not adequate consumer education to consumers about their rights under the insurance contracts and in the dealings with intermediaries and advisors, more importantly about the Consumer Complaint Handling Division. There is no use of mass media or any media to educate clients about their rights and as to where they can complain and the procedures for lodging complaints. In one of the annual reports by the CBL, it was stated that it is the duty of the insurers to educate the consumers about their rights. This mini-dissertation however, submits that this is not what should happen. It should be the duty of the CBL as the Commissioner to supervise and regulate the insurance industry. This includes ensuring clients are educated about their rights; after all they are also role players in the sphere of insurance

4.4.2 South Africa

The jurisdiction of the ombudsman in South Africa is clearly stated.²⁹⁶ It has handled more than a thousand complaints. Its decisions are binding. This means that the complaints are resolved to their finality. There is adequate dissemination of information to consumers about their rights under the FAIS Act together with the Code and about the FAIS ombudsman. This information is disseminated and distributed by the FSB.²⁹⁷

4.5 Conclusion

In comparison to the South African legal position in relation to the protection of clients in their dealings with insurance advisors, the Lesotho legal position has many gaps and requires more work to be done. Although one may argue that based on the economic scale of Lesotho, the current model of regulation is adequate, it is submitted that this model is not adequate for the protection of clients against insurance advisors. It is recommended that even if another independent body like the FSB is not established as this may be costly to maintain, the CBL must have within it enough tools to enable it to regulate market conduct.

²⁹⁶ See chapter 3 section for the discussion on the ombudsman.

²⁹⁷ For example the FSB has a secured slot on Lesedi FM on Mondays where consumers are informed about their rights and responsibilities. The FSB personnel then answer the questions that the clients ask and address their concerns.

Indeed there are legislative lessons that Lesotho can take from South Africa in regard to the legal protection of clients in their dealings with insurance advisors in order to ensure that clients are adequately protected. For example, over and above the Bill, which will be enacted into law soon, there should be another legislation which provides for the regulation of intermediaries seeing that this aspect is not within the scope of the Act or the Bill and the powers of the Commissioner as conferred therein.

CHAPTER 5

5.1 *Conclusion*

In chapter 1 it was stated that the main research question to be answered in this mini dissertation is what is the specific legal protection of clients in Lesotho and South Africa in their dealings with insurance advisors. It was further stated that to answer this research question the following secondary research questions will be asked;

- a) What is the current legal position in Lesotho with reference to protection of clients in their dealings with insurance advisors; and
- b) What is the current legal protection in South Africa with reference to the protection of clients in their dealings with insurance advisors?
- c) In comparison to the South African position how adequate is the protection afforded to clients in Lesotho and which legislative lessons can Lesotho take from South Africa?

The aim of this mini dissertation was to compare the two jurisdictions and determine whether any lessons exist that Lesotho can learn from South Africa with regard to the protection of client against insurance advisors. This chapter focuses and concludes on the answers to the primary and secondary research questions as illustrated in the preceding chapters, particular attention being on whether the protection available in Lesotho is adequate.

Chapter 2 addressed the question of what is the legal protection available to clients in Lesotho. The aim of the chapter was to state Lesotho's legal position in this regard and whether a need exists for statutory reform. It was concluded that such protection was not adequate. This was based amongst others, on the fact that the legislation applicable in Lesotho applies only to the relationship between the Commissioner and intermediaries or insurers and not the conduct of such intermediaries towards clients. Furthermore it became evident that Lesotho's legislative framework currently provides virtually no protection to clients. This situation needed to be addressed as a matter of urgency in order to prevent another situation similar to the MKM saga. Chapter 3 addressed the question of the legal protection available to insurance clients in South Africa. The aim was to state the legal position in South Africa and then determine whether Lesotho can take any legislative lessons from South Africa. It was concluded in chapter 4 that indeed the protection in South Africa is much more extensive. This was based on the fact that in

South Africa there is regulation of the market conduct through legislation such as the FAIS Act and the associated Code. The chapter noted that a variety of protection is available to clients in South Africa. This protection includes the requirement that an FSP must be fit and proper to render financial services to clients. Given the nature of the protection available to clients in South Africa, chapter 4 concluded that a number of lessons exist which could strengthen the position in Lesotho.

The aim of chapter 4 was to compare the position in Lesotho with that of South Africa in order to determine whether Lesotho can take any legislative lessons from the South African position. From the discussion it emerged that some similarities exist. For instance, in both jurisdictions, an insurer acts through its agents and such agents must be registered while the insurer is licensed. Furthermore, brokers in both jurisdictions conduct business independently and should be licensed. However, to a large extent clients in Lesotho are at a distinct disadvantage especially with reference to their protection when dealing with financial advisors. For instance there is no regulation of advice in Lesotho, a needs analysis of clients is not done when rendering them advice and the licensing requirements of intermediaries only deal with the relationship between institutions and the Commissioner.

The legal protection afforded to clients in South Africa is more extensive. For instance, there is an extensive definition of advice and an obligation on those who render advice to do a needs analysis of clients and in order to enforce the rights of clients there is the FAIS Ombud. The decisions of the Ombud have the same force as the decisions of a civil court even though the question of enforcement of the orders made by the Ombud may arise. However, there has not been an instance where the Ombud has to enforce its orders. This shows the success of the Ombud.

Although the South African model seems more ideal, it may not be prudent for Lesotho to take everything as is applicable in South Africa and apply it. For example, based on the economic scale of Lesotho it may not be ideal to have the two regulatory bodies, that is an equivalent of the FSB and the CBL as this will require funds and resources to maintain and Lesotho is not in a financial position to do that. Compliance fees and penalties would have to increase so that this entity would be able to maintain itself. This may discourage people who are hoping to engage in insurance intermediary services. Based on the

aforementioned, a few recommendations can be made in order to strengthen the position in Lesotho.

5.2 Recommendations

5.2.1 The Insurance Bill 2013

It was stated in chapter 2 that the Bill has certain shortcomings, for example, like the Act, the Bill still focuses on the relationship between the Commissioner and the institutions with no reference to the relationship between the intermediaries and the clients. It is recommended in this regard that the content of the Bill must include provisions that address the relationship between the intermediaries and client. For instance, those who render insurances services to clients must do a needs analysis of clients.

5.2.2 FSB for Lesotho

As stated above in chapter 2 and 4, Lesotho is not in an economic position to have a body similar to the South African FSB as this may have the implication of increasing compliance fees. It is recommended in this regard that instead of having such body, legislation should rather be enacted. That legislation shall be one similar to the South African FAIS Act which provides for the regulation of advice. If this cannot be attained, the content of the Codes of Practice, as will be passed in terms of the Bill once it is enacted into law, shall be amended to include the procedures that the intermediaries must adhere to when rendering advice and their duties accordingly. If Lesotho elects to remain with the single regulator method of regulation it is recommended that such regulator must have within it the tools necessary for the regulation of the market. It is further recommended that a division within the CBL be established to oversee the enforcement of the legislation that will be enacted to address the relationship between the intermediaries and the clients.

5.2.3 Consumer Education

It is acknowledged that the Commissioner is aware of the fact that the current insurance regulatory framework in Lesotho is very outdated hence the Bill was passed. Consumer education as well as market conduct regulation is still a growing venture. Within the years it is believed that the market would be well educated about financial products, their rights and duties in relation to those products. The Commissioner must therefore educate the younger generation about financial products. As well stated, "an old dog cannot be taught new tricks" so it would be best to start educating the youth. It is recommended in this regard that the Commissioner must engage the media in this venture. In the recent years,

social media and networks have proven to be a very powerful tool for change especially in influencing the youth and it is believed that in years it could play a role in educating people about financial products. The Commissioner must also consider radio shows slots.

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