PERSONAL FINANCE

Big penalties ‘not in line with TCF’

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Legislation that compels retirement annuity (RA) providers to treat customers fairly needs to be finalised and enacted to stop huge penalties from being levied on members’ savings, the Pension Funds Adjudicator says.

The adjudicator, Muvhango Lukhaimane, makes this comment in a ruling in which she dismisses a complaint by a fund member, P Ramjith, who lost R48 300 (or 22 percent) of his savings of R219 000 after Liberty penalised him for terminating the contract prematurely.

Ramjith had been saving in the Liberty Lifestyle RA Fund for nine years, but his contract committed him to contribute for 38 years. When he applied to transfer his savings to another RA fund, Liberty imposed the penalty.

Ramjith complained to the adjudicator that the penalty was harsh, because, although the contract initially provided for a contribution of R150 a month, he had voluntarily increased his contribution to R5 808 a month.

Ramjith said if he had not done this, he would have been paying R326 a month when he terminated the contract, and therefore the penalty would have been much lower.

Lukhaimane’s ruling reveals this to be true, because, in its response to the complaint, Liberty provided a breakdown of the commissions on Ramjith’s contributions that were paid to his financial advisers.

In the first year of the policy, the commission was R1 350, and lower amounts were paid in the following three years. But when Ramjith voluntarily increased his contributions, large commissions were paid to the three financial advisers used by Ramjith.

One adviser received R19 350 over eight months in 2010 after Ramjith increased his contribution from R2 750 to R4 800 a month. Another R11 200 was paid to an adviser in 2011 and 2012, when Ramjith increased his contribution to R5 280 a month.

The total commission paid to Ramjith’s advisers was R67 184. After nine years, commission of R48 300 had yet to be recouped from the policy.

In her ruling, Lukhaimane found that the rules of the Liberty Lifestyle RA Fund provide for “causal event charges” when members apply to transfer their savings to another fund.

She also notes that, in a 2007 High Court case involving Old Mutual, the judge found that policies can provide for penalties without specifying how the penalties are calculated as long as they are calculated in accordance with accepted actuarial principles and practice.

Lukhaimane referred Ramjith's case to an independent actuary, who found that Liberty "was acting in accordance with generally accepted actuarial practice, the provisions of the [fund's] rules, the provisions of the policy documents, the provisions of the Long Term Insurance Act and the regulations".

She therefore dismissed the complaint, but not without noting that Ramjith's contract, like many RA contracts, failed to meet four of the six objectives of the principles of Treating Customers Fairly (TCF).

Lukhaimane says many RAs are not "designed to meet the needs of identified customer groups", and, either before or after they sign the contracts, members are not provided with clear information that they will face penalties if they stop or reduce contributions or switch to another provider.

Although the policy provided for a penalty, Ramjith claimed he was unaware of it.

Lukhaimane notes that the objectives of TCF also state that the advice you receive about financial products should be suitable, and you should not face unreasonable barriers when trying to change products or switch providers.

Leanne Jackson, the head of market conduct strategy at the Financial Services Board (FSB), said this week that although many aspects of TCF can be enforced through existing laws, more work needs to be done to ensure that some aspects of these existing laws better support TCF.

She says that bringing laws in line with the goals of TCF is an ongoing process, and the penalties that may be imposed on RAs and other investment products have already been reduced over the past few years.

However, Jackson says, the outcomes for consumers such as Ramjith are still poor and further work is required.

The FSB's retail distribution review (RDR), which is expected to recommend that no upfront commissions can be paid on investment products and instead to allow only fixed fees for financial advice, is likely to reduce or scrap penalties on policies sold after the recommendations are adopted, she says. However, you may still be liable for penalties on older policies. although the FSB is also looking at ways to mitigate these risks for existing policyholders.

The draft RDR is expected to be released next month.