

PERSONAL FINANCE

Investment penalty excesses uncovered

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Illustration: Colin Daniel

Life assurance company Momentum has, for a second time, been forced to recalculate the confiscatory penalties it has levied on investors' policies. But even after correcting its calculations and reducing the penalties, policyholders have still been hit hard.

This was revealed in a ruling issued by the Deputy Pension Funds Adjudicator (PFA), Muvhango Lukhaimane, this week.

Two weeks ago, after the intervention of Personal Finance following a determination by financial advice ombud Noluntu Bam, Momentum discovered it had made a R800 000 mistake on the penalties it levied on two brothers, Warrick and Gerald Port, who were initially penalised more than R1 million on investments of R1.2 million and R1.5 million.

This time, after a complaint to the PFA by M Esterhuyze of Pretoria, a member of the Momentum Retirement Annuity (RA) Fund, Momentum agreed to reduce a total penalty of R172 095 for four "causal events" by R38 386 to R133 709.

But Lukhaimane also checked Momentum's calculations with an independent actuary to assess the penalties applied to Esterhuyze's savings. The actuary found the reduced penalty of R133 709 to be "excessive", and it needed to be reduced by a further R10 390.

A causal event is any event that results in a policyholder or life assurance RA member reducing or stopping premiums or contributions, even through no fault of the policyholder.

In the case of the Port brothers, the massive R1-million penalty was levied by Momentum even though there was gross mis-selling by their financial adviser, Jacobus Geldenhuis, of Fugio Financial Services in Kempton Park, who collected upfront commissions on 10-year recurring premiums instead of following instructions to invest a single premium for five years, which would have earned him substantially less in commission.

Bam ordered that Geldenhuis compensate the Port brothers on the basis of the initial penalty, which she had referred to Momentum to check. It was only after Personal Finance approached Momentum for comment that the company found it had overcharged the brothers R800 000.

In the latest case, Esterhuyze was, in 2008, sold a Momentum RA with a 33-year term, maturing in 2041.

Esterhuyze agreed to a contribution of R6 600 a month escalating at 10 percent a year – which is well above the current inflation rate.

Personal Finance has calculated that, by the end of the term, Esterhuyze would be paying a premium of (a probably totally unaffordable) R153 286 a month.

If, however, he had been advised to increase his contributions at a more realistic percentage, closer to inflation of, say, five percent a year, his premiums would have escalated to R33 021 a month – about 4.5 times less than at the 10-percent rate.

On February 11, 2010, Esterhuyze switched the underlying investment portfolio. He was penalised R412, which was deducted from his accumulated value of R164 813.

According to Lukhaimane, by May 2011, Esterhuyze's contributions had grown to R12 402, and he then reduced his monthly contribution to R6 000. Momentum deducted R56 086 from his accumulated value of R361 845 as a penalty for this "causal event".

In April 2012, Esterhuyze made the RA paid up, making no further contributions. Momentum hit him with a further penalty of R58 773.

On June 13, he decided to transfer the RA to Discovery, which resulted in Momentum levying yet another penalty, of R56 824. This left him with R291 171.

In its response to the adjudicator, Momentum says the reason for the penalties is to recover the commission paid to the financial adviser and the interest on the commission, which was paid upfront but calculated on future premiums.

The ruling states that an assurer must have rules, approved by its statutory actuary, that outline how it will value your policy if a causal event occurs. In addition, penalties must comply with the limits set in the 2006 Statement of Intent (see "Double-dipping' a concern for FSB", right), laid down in the regulations under the Long Term Insurance Act.

In dealing with the complaint to the adjudicator, Momentum agreed to the reduction of the penalties. Lukhaimane ordered that she be provided with proof that the R38 386, together with interest on that amount plus R10 390, had been transferred to the Discovery RA.

Freek Kruger, of Momentum Retail Insurance, told Personal Finance that Momentum does correctly apply the regulations relating to the deduction of costs in respect of causal events.

He says Momentum was not forced to reduce the costs charged due to an incorrect application of the legislation.

“Momentum was receptive to considering alternative methods of arriving at cost deductions applicable to causal events due to the current legislative gap (lacunae) in applying the intent of the regulations. It is for this reason alone that Momentum agreed to the proposal from the Pension Funds Adjudicator to adjust the cost in this case,” Kruger says.

Another penalty reduced

Personal Finance is also aware of an RA policyholder who obtained from an assurer a reduction of more than half of his penalty for cancelling the policy early. One of the conditions of the settlement was that he did not disclose the details of his case to the media.

The assurer initially told the RA member it would impose a penalty of about R47 000 on his R267 700 policy. This was despite the fact that the member had had the policy for 27 years of the 33-year term.

This week, the life assurer agreed to reduce the penalty to about R18 000.

The member agreed to pay the administration and asset management fees he would have paid on the policy had he kept it to maturity, but got the assurer to waive the alleged losses incurred historically on administration and asset management fees.

In its dealings with the member, the assurer explained to him that it had calculated the alleged losses incurred on these expenses over the past 27 years in today's rands, and it would ordinarily write off these costs when such a policy reached maturity.

'Double-dipping' a concern

Life assurance companies have continued to apply multiple penalties on the same endowment policy or retirement annuity (RA) despite the Financial Services Board (FSB) warning last year that the practice is unacceptable and contrary to an agreement reached between the industry and Trevor Manuel, then Minister of Finance, in 2005.

In 2005, Manuel, in effect, levied a R3-billion admission-of-guilt fine on life companies by ordering them to pay back penalties levied on investors' policies, and he got the industry to agree to limits that could be imposed on future penalties.

The agreement was that, on RA products sold before January 1, 2009, the penalties would be limited to 30 percent, and on RAs sold after January 1, 2009, the penalties would be limited to 15 percent. The agreement also limited penalties on life assurance endowment policies sold before January 1, 2009, to 40 percent and on those sold after that date to 20 percent.

Before Manuel's intervention, confiscatory penalties of up to 100 percent of your accumulated savings were levied by the life assurance companies.

In terms of the Statement of Intent signed by Manuel and the life industry, upfront commissions to advisers were reduced to a maximum of 50 percent of the total contributions paid, and the intention of the FSB is to further reduce upfront commissions to zero.

Even with the agreement between the life industry and National Treasury in place, Old Mutual last year attempted to duck the agreement by levying penalties more than once on a policy, applying them whenever what is termed a “causal event” occurs – for example, when a policyholder defaults on contributions and then again when the policyholder transfers to another product provider before maturity date.

The FSB has warned the life industry that it cannot “double-dip” in this way on penalties.

After complaints about Old Mutual double-dipping on penalties, Jonathan Dixon, the FSB’s deputy executive in charge of insurance, said that charging penalties more than once was not in the spirit of the Statement of Intent.

Personal Finance received another complaint this week about Old Mutual double-dipping on penalties. In the complaint, a client of financial adviser Devan King of Durban initially made an Old Mutual RA with a value of less than R200 000 paid up. The client was hit with a penalty of R21 902. More recently, the RA member wanted to transfer the RA to another provider. The proposed penalty was R22 166 on a residual accumulated value of R174 547, making a total penalty of R44 069.

Adrian Burke, general manager at Old Mutual, says: “The discussions and debates around multiple causal events have not questioned whether it is acceptable or appropriate to implement benefit reductions where there is more than one causal event.

“The debate has been around the quantum of the total benefit reduction across all causal events combined – the concern being that the total benefit reduction should not exceed the limits agreed to in the Statement of Intent agreement.”

Burke says that, according to the regulations, a maximum of 30 percent as a reduction can be made for causal events on the policy. He says a combined charge of just over 20 percent has been levied on this customer’s account based on the following calculation:

The fund value quoted at the time of the request for information for a transfer to Discovery was R174 547 plus R21 902 (the penalty) plus R22 166 (the first penalty). The total benefit reduction (R44 069) was therefore just over 20 percent of the value before any benefit reduction (R174 547 + R44 069 = R218 616) and therefore well within the allowed limits, Burke says.

He says Old Mutual is committed to the “fair treatment of customers and is looking to apply the spirit of the law, rather than the letter of the law”.

Quite how the life assurance companies calculate the penalties is a mystery.

In April, Personal Finance revealed that, on virtually identical policies involving investments of the same amount from one investor, Old Mutual and Sanlam calculated totally different potential penalties.

* The Sanlam product was worth R474 752. The penalty was calculated as R14 974, or 3.1 percent of the investment value.

* The Old Mutual product was worth R483 736. The penalty was R54 786, or 11.33 percent of the investment value.

Where you can go to complain

If, after altering your contributions to a life assurance retirement annuity (RA), you feel you have been overcharged, you can take your complaint to the Pension Funds Adjudicator. If you feel the same after altering a premium on a life assurance endowment policy, you can go to the Ombudsman for Long-term Insurance.

You could also complain to the Ombud for Financial Services Providers if your adviser put you into a life assurance RA or endowment policy without telling you that:

* There will be potential penalties if you reduce your premiums/ contributions, or make the policy/RA paid up (you leave the money invested but make no further contributions), or cash in an endowment policy before maturity, or retire before the maturity date (but after the age of 55) of an RA.

* The penalties will apply even if the events that caused the change are through no fault of your own – for example, being retrenched and not being able to afford the premiums; or working for an employer without an occupational retirement fund and then working for an employer where membership of an occupation fund is compulsory and your RA contributions become unaffordable; or being injured in an accident and medical costs mean you have to cut back elsewhere on expenses.

* There are investment products, including RA products provided by asset managers, that are unit trust-based and are fully flexible, allowing you to increase, decrease or stop paying penalties at any stage without penalties.

* The penalties are a consequence of your lowering your premiums after being advised to sign up for an excessive annual escalation in your premiums/contributions, possibly well above the inflation rate, that can rapidly result in payments becoming unaffordable.