

Life industry in a corner

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By Bruce Cameron

The life assurance industry is on short notice from the Financial Services Board (FSB) that it must, with immediate effect, drastically revise the way it treats policyholders. The industry also faces having to pay back millions of rands in undisclosed charges to policyholders.

Jonathan Dixon, FSB deputy chief executive in charge of insurance, warned life assurance companies this week, in the wake of renewed controversy over the penalties levied by assurers on policyholders, that the industry should already be applying the new principles-based Treating Customers Fairly (TCF) regulatory regime.

And a determination this week by Deputy Pension Funds Adjudicator Muvhango Lukhaimane may clear the way for all life assurance investment policyholders – both retirement annuity (RA) fund members and endowment policyholders – to reclaim the interest that has been “secretly” charged to them as part of the now-threatened way in which financial advisers are paid upfront commissions.

This week, Lukhaimane ordered the Momentum Group and the Momentum Retirement Annuity Fund to repay the undisclosed interest on an effective “secret” loan that the fund made to a member to cover the commission that was paid upfront to her adviser.

The determination is the latest of a number involving Momentum. Both Lukhaimane and financial advice ombud Noluntu Bam have issued determinations involving financial advisers and Momentum over the past month in the wake of complaints about the controversial penalties – including their multiple application – levied by life assurers when you reduce or stop paying premiums or contributions.

Dixon says the TCF regime is already in place, and the financial services industry should already be applying the principles of TCF when selling you products.

He says this includes life assurance companies being able to demonstrate that “measures are in place to ensure appropriate advice to customers and that customers are sold products that meet their reasonable expectations”.

Dixon says the FSB is concerned that the remuneration and commission structures of the life industry’s contractual savings products may pose a systemic risk of poor outcomes for customers.

He says these risks to you are already being tackled in a number of ways as part of the implementation of the TCF regime. This includes:

- * A retail distribution review. Already under way, this is considering a shift from life assurers paying upfront commissions to intermediaries for life assurance investment products to a system of fixed fees for advice, negotiated between the intermediary and his or her client;
- * An ongoing review of other functions outsourced to financial advisers and related parties that may pose a conflict of interest arising from the duty your adviser owes you, thereby undermining the objectivity of the advice;

* The development of clear, standardised product disclosure requirements; and

* Ongoing engagement with assurers in which they are expected to demonstrate how the TCF principles have been embedded in their culture and operations.

Dixon says the FSB is preparing an “information letter” that will be sent out to the life assurance industry. The letter will provide further guidance on how the TCF principles should be applied in the case of penalties being levied more than once when a policyholder or RA member reduces or stops paying premiums or contributions on more than one occasion.

Dixon says there is still some “groundwork” to be done before the letter can be finalised and distributed to the life companies.

Dixon rejects an argument by Momentum that it is waiting for clarification of the calculation methodology associated with multiple-penalty causal events.

Mark van der Watt, chief executive of Momentum Retail, told Personal Finance this week that Momentum and the rest of the industry are actively seeking clarity from the FSB.

He says: “While this matter is being clarified, Momentum’s systems recognise each event as a new event in the application of the legislation. Unfortunately, Momentum is not in a position to make a unilateral decision on the interpretation of the unknown future legislation and change its systems accordingly. The cost of changing systems now according to our interpretation and then again when regulation is finalised would be prohibitive.”

Van der Watt says Momentum is committed to applying legislation correctly, and the necessary adjustments will be implemented as soon as possible after clarity has been provided.

Responding to this comment, Dixon says that “it is nonsense to say that fair treatment cannot be applied on the grounds that the legislation is not clear”.

He says the spirit and intent of the Statement of Intent signed by the industry in 2005 and the subsequent regulations on allowable penalties “has always been clear”.

“The FSB’s expectations with respect to the fair treatment of customers in the event of multiple causal event charges was communicated to the life industry as far back as 2010.

“When determining the manner in which causal event charges are to be calculated, the insurer must take into account the potential cumulative effect on a policy’s investment value of charges that may be deducted in respect of multiple causal events that may occur over the lifetime of the policy.

“On the occurrence of a second or subsequent causal event on a policy, the causal event charge for that second or subsequent event must therefore be determined, taking into account the cumulative effect of that charge and all prior causal event charges on the policy’s investment value,” Dixon says.

Ruling on commission interest may have industry worried

Life assurance companies may have to pay retirement annuity (RA) members and even endowment (investment) policyholders thousands if the latest determination by Deputy Pension Funds Adjudicator Muvhango Lukhaimane goes unchallenged.

Lukhaimane has ordered Momentum and its Momentum Retirement Annuity Fund to repay undisclosed interest, and interest on the interest, it charged an RA member, enabling it to pay an upfront commission to an adviser on contributions made for 28 years into the future.

The determination opens the way for all life assurance RA members – and, potentially, life assurance endowment (investment) policyholders – to reclaim undisclosed interest they have been charged on similar structures used to finance upfront commission payments.

Personal Finance revealed more than 10 years ago that life assurance companies set up “secret” loan accounts when you are sold a life assurance RA or endowment policy, and interest is charged on the secret account.

The “loan” is to cover expenses that include the upfront commissions paid to financial advisers on life products.

If you reduce or stop paying your premiums or contributions, the life assurance company then calculates the penalties it will confiscate from your savings based on the outstanding “loan” and the maximums permitted by law.

As revealed in the recent determinations by both Lukhaimane and financial advice ombud Noluntu Bam over the past month, this money is confiscated by the life company whether the policyholder is at fault or not.

This includes the deduction of a penalty even if fraud was involved on the part of its representative selling you the policy.

Life assurance companies have since January 2009 paid 50 percent of commissions to its product sales people in the first year of the investment contract and the balance over the term of the endowment policy or RA. Prior to January 2009 the full commission amount could be paid in the first two years.

Against this, collective investment schemes (unit trust funds and exchange traded funds) pay commissions only as and when you pay your contributions on an RA or premiums on an ordinary investment. You are allowed to alter your payments without any penalties being levied.

In the latest determination, Lukhaimane says Ms A Simich was sold a Momentum RA product in June 2001 with an initial premium of R1 060 a month. This entitled the independent adviser or Momentum agent (whom Lukhaimane did not name) to a commission of R10 875 in the first year of the policy and R3 180 in the second year.

In July 2011, when Simich reduced her contributions, she asked that the adviser be removed from her policy. At the time, the balance on her commission “loan” account was R40 838, which included interest on the R10 875 paid to the broker.

Simich told Lukhaimane that she was shocked when she was told this, because she was never informed of interest charged on the commission when she took the policy.

Simich said that, had she been informed, she would have asked that the commission be paid to the broker over the term of the policy and not upfront.

Simich further submitted that:

- * She was not informed of the second commission payment of R3 180;
- * Momentum had made an error in the administration of her commission account when the premium was reduced in July 2011; and
- * She did not believe that she was receiving the best service.

In responding to Lukhaimane, Momentum says Simich was informed in her policy document (issued after she had signed an application) that commission would be paid upfront and would be recouped on a monthly basis to pay the initial commission.

Momentum told Lukhaimane that when the RA contract was issued to Simich, legislation did not require the full disclosure of all the costs that would be incurred.

Lukhaimane says: "Although it was not indicated that the commission paid upfront would carry a financing charge of 12 percent at that time, it was indicated that the commission would be recouped from the investment account on a monthly basis."

Momentum claims that "it is reasonable to expect that the [company's] shareholders, who finance the payment of upfront commission, be compensated for the use of their capital."

Lukhaimane, however, disagrees.

She says that in terms of the Pensions Funds Act, the Constitution and previous legal precedent, there was a duty on Momentum and the trustees of its RA fund to disclose relevant information to members.

This disclosure, she says, is important for the purposes of accountability and the provision of access to information as required by the statutes and a previous court judgment.

Lukhaimane says: "Nowhere in the first respondent's rules or the policy does it provide for interest to be added on the commission quoted to the complainant. Any costs to be deducted from a member's investment must be provided for in the rules and/or explicitly disclosed in the policy document."

She says the fact that the commission would have to be recouped on a monthly basis was communicated to Simich "does not remove the fact that she was charged hidden costs.

"This tribunal has decided on several occasions that a fund cannot charge its members hidden costs. All costs to be charged to members must be explicitly disclosed in the rules and policy documents."

This position was confirmed in an appeal against a previous Pension Funds Adjudicator decision in 2005 involving Sanlam's Central Retirement Annuity.

Lukhaimane said that although the determination was set aside by the court, it was because the court could not find on the evidence before it that there was no reasonable basis for the reduced benefit.

We're committed to fair play – Momentum

Financial services company Momentum claims it has a long history of treating customers fairly, saying it created a Fair Practices Board when the industry was still contemplating the principles of Treating Customers Fairly (TCF).

Mark van der Watt, chief executive of Momentum Retail, made this statement following a number of determinations by the financial advice ombud Noluntu Bam and Deputy Pension Funds Adjudicator Muvhango Lukhaimane concerning the penalties applied by life assurance companies when retirement annuity (RA) fund members and endowment (investment) policyholders alter their contracted contributions or premiums.

But Jonathan Dixon, Financial Services Board (FSB) deputy executive in charge of insurance, says the FSB will be engaging with Momentum and is reviewing how the company is applying the principles of the TCF regulatory regime.

Over the past month, Momentum has been the subject of three determinations by Bam and Lukhaimane.

Van der Watt says Momentum, following its discovery that it had made an R800 000 error in calculating penalties on the investment policies of two brothers, reviewed all contracts with similar commission structures to ensure the correct values were applied.

He says the error made due to the non-standard commission claw-back period selected on the contracts for the brothers was due to specific changes that were made on these particular contracts shortly after the inception date. No other contracts were affected.

Referring to Momentum's Fair Practices Board, Van der Watt says it has made several decisions in the past that support the TCF principles.

He says Momentum has been an active participant in various FSB-led initiatives on TCF; it is geared to implementing the principles in the way it does business; and it was one of the first companies to launch new-generation products with competitive and understandable cost structures.

Momentum recognises that it is "the custodian of our clients' financial wellbeing and our purpose is to help them achieve this", Van der Watt says.

He undertook to work with clients and the FSB to ensure that fair resolutions are achieved urgently on penalties and other matters related to treating customers fairly.