LEARNER GUIDE

Unit Standard Title:	**Describe issues of compliance or non- activity that could result in civil or criminal liability in terms of business law**
Unit Standard No:	**120127**
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NQF Level:	**4**

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Introduction: Module summary

1. How liabilities could arise within an organisation

- Five principle Acts that impact on a specific organisation are identified and the intention of each Act is summarised in a table.
- The concept of *directors' and officers'* liability is explained with three examples.
- The concept of *errors and omissions* is explained with examples.
- Potential liabilities in respect of three activity and three non-activity compliance issues are identified and an indication is given of whether each is related to civil or criminal liability.
- Potential liabilities in respect of three activity and three non-activity compliance issues are identified and an indication is given of whether each is related to directors and officers or errors and omissions.

2. How liabilities are linked to corporate governance

- The basic principles of good corporate governance are explained with reference to legal, ethical and civil compliance.
- Three areas of liability that arise out of legal compliance are identified and an indication is given of the consequences of non-compliance or non-activity.
- Three areas of liability that arise out ethical compliance are identified and an indication is given of the consequences of non-compliance or non-activity.
- Three areas of liability that arise out of civil compliance are identified and an indication is given of the consequences of non-compliance or non-activity.
- The link between civil and criminal liability is explained in terms of non-compliance or non-activity with business law.

3. The risks associated with non-compliance or non-activity.

- Risks associated with ethical non-compliance are explained with examples.
- Risks associated with civil non-compliance are explained with examples.
- Risks associated with legal non-compliance are explained with examples.
- Possible consequences for ethical, civil and legal non-compliance and non-activity are compared in a table.

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- The ethical, civil and legal risks in a specific organisation are quantified in terms of the potential consequences.

4. Evidence of compliance or non-compliance in an organisation.

- Evidence of compliance or non-compliance is identified in the documents of a specific organisation.
- Compliance to an organisation's systems is checked on site and any deficiencies are indicated in a report.
- The implications of instances of non-compliance for insurance claims is explained and three examples are given of circumstances when a claim may possibly be repudiated

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Module 1

How liabilities could arise within an organisation

Outcomes for module 1

Learners will be able to:

- Identify five principle Acts that impact on a specific organisation and summarise the intention of each Act in a table.
- Explain the concept of *directors' and officers'* liability with three examples.
- Explain the concept of *errors and omissions* with examples.
- Identify potential liabilities in respect of three activity and three non-activity compliance issues and give an indication of whether each is related to civil or criminal liability.
- Identify potential liabilities in respect of three activity and three non-activity compliance issues and give an indication of whether each is related to directors and officers or errors and omissions.

Background

Since 1994, the SA Government has been extremely conscientiousness with passing legislation covering all areas of life and work.

A recent estimate of laws affecting an SME either directly or indirectly totalled over 100.

The pressure on a company to be compliant with legislation is therefore enormous and mounting as more legislation is passed through the parliamentary process. This is particularly true for the financial services industry.

As the amount of legislation increases, the onus on companies to be responsible for compliance is increasing as well as their risk of being liable.

1. Orientation of Relevant Legal Terminology

Definitions of "liable" and "liability"

According to the Collins English Dictionary, the definition of "liable" and "liability" are as follows:

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Liable =

1. legally obliged or responsible, answerable
2. (also) susceptible or exposed

Liability =

1. the state of being liable
2. (also) financial obligation

Liability:

In legal terms

In legal terms, the word liability refers to **fault.** The person who is at fault is liable to another because of his or her actions or failure to act.

One example is in the case of a crime. The liability of the offending party may include providing restitution for damage to property or paying medical bills in the case of physical injury.

Another example of liability in the legal realm is an automobile accident. The person who caused the accident, through action or omission, is liable to the injured party. Liability insurance exists for just such a purpose. It covers the expenses of the injured party, including damage to the vehicle or other property as well as a certain amount of medical expenses, and may reimburse the injured party for attorney's fees if civil action is required.

Liability:

In accounting terms

In accounting terms, liability describes an **obligation**. It refers to money owed to complete a transaction, debt that has yet to be paid, or products or services that have been paid for but have not yet been rendered.

There are two general classifications to sum up these types of liability: **long term and short term**. Long-term describes debt paid out over more than one year, while short-term liability refers to debt paid within a year or less.

Some other examples of liability include money that is **yet to be paid** out, such as benefits from a life insurance policy or a settlement, either one of which represents a

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liability for the insurance provider. An employee's pension, as well as any other savings or retirement fund, is also considered a liability for a company.

For the consumer, liabilities may include a home mortgage, second mortgage, line of credit, lien of any kind or car payment. Of course, for the entity to which these monies are owed, each item generally represents an asset.

Liability:

Overall

Overall, liability simply describes some form of obligation or responsibility. It represents an outstanding debt, products or services that have yet to be provided, or acknowledgment of responsibility and payment provided for damage caused through actions or negligence.

Civil liability

Civil law means the law of a state relating to private and civilian affairs.
If one has civil liability, one is therefore liable in terms of civil law, and if found guilty, normally will be ordered to pay compensation.

Criminal liability

Criminal law means the body of law dealing with the constitution of offences and the punishment of offenders.

If one has criminal liability, one is therefore liable in terms of criminal law and if found guilty, will face punishment e.g. fines, imprisonment and a whole host of other punishments.

Delict

A delict is an act (or omission) which in a wrongful and culpable way causes loss to another - responsibility toward society at large. This is where potential losses are most difficult to estimate.

You may have heard of the Thalidomide disaster. In the 1960's a drug meant to relieve morning-sickness in pregnancy resulted in babies being born deformed. It is

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thought that a similar disaster under today's conditions could result in awards as high as R5bn. (This is an example of Products Liability).

A boiler explosion might cause tremendous physical damage, and interrupt production, but the liability claims for physical injury and damage to third party property can be even bigger.

An organisation can suffer loss even without legal liability being established:

- The cost of investigation, and documenting their defence;
- Legal fees;
- Out of court settlements, where it is considered more cost effective to settle with the claimant, than risk everything on the outcome of an expensive court action.

Where disputes actually go to court, legal costs are much greater, as are the actual awards handed down.

Activity compliance

As the term implies, activity compliance is when an organisation actively changes or implements measures to ensure compliance with the relevant legislation.

Non-activity compliance

Non-activity compliance can be one of the following:

- The company chooses not to take any steps to comply with a specific piece or section of legislation
- The company does not know about the legislation with which it is required to be compliant

In the second point above, the liability for the company is not reduced in any way i.e. ignorance of the law is no excuse.

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2. List of relevant legislation

- General
- Retirement
- Insurance
- Investment
- Property
- Medical
- Estate planning
- Tax
- Business
- HR
- Operational Compliance

The following is a list of legislation affecting different areas of financial services companies:

General Acts

- Constitution of the Republic of South Africa No. 108 of 1996
- Inspection of Financial Institutions Act No. 80 of 1998
- Currency and Exchanges Act No. 9 of 1933
- Banks Act No. 94 of 1990
- Reserve Bank Act No. 90 of 1989
- Insolvency Act No. 24 of 1936
- Financial Services Ombudschemes Act No. 37 of 2OO4

Retirement

- Pensions Fund Act No. 24 of 1956
- Tax on Retirement Funds Act No. 38 of 1996

Insurance

- Long-term Insurance Act No. 52 of 1998
- Short-term Insurance Act No. 53 of 1998

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Investment

- Collective Investment Schemes Control Act No. 45 of 2002
- Custody and Administration of Securities Act No. 85 of 1992
- Financial Markets Control Act No. 55 of 1989
- Securities Services Act No. 36 of 2004

Property

- Property Time-Sharing Control Act No. 75 of 1983
- Immovable Property (Removal or Modification of Restrictions) Act No.94 of 1965.

Medical

- Medical Schemes Act No. 131 of 1998
- Medical Schemes Act No. 55 of 2001
- Medical Schemes Act No. 62 of 2002
- The Pharmacy Amendment Act 88 of 1997
- Medicines and Related Substances Control Act No. 101 of 1965
- Medicines and Related Substances Control Amendment Act No. 90 of 1997
- Pharmacy Act No. 53 of 1974
- Pharmacy Amendment Act No. 88 of 1997
- Medical Dental and Supplementary Health Service Professions Amendment Act No. 89 of 1997
- National Health Act of 2005

Estate planning

- Trust Property Control Act No. 57 of 1988
- Wills Act No.7 of 1953
- Intestate Succession Act No. 81 of 1987
- Matrimonial Property Act No. 88 of 1984
- Guardianship Act No. 1 92 of 1993
- Administration of Estates Act No. 66 of 1965
- Maintenance of Surviving Spouses Act No. 27 of 1990
- Estate Duty Act No.45 of 1955

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Tax

- Marketable Securities Tax Act No. 32 of 1948
- Transfer Duty Act No.4O of 1949
- Income Tax Act No.5 8 of 1962
- Stamp Duties Act No. 77 of 1968
- Value-added Tax Act No. 89 of 1991

Business

- Companies Act No. 61 of 1973
- Close Corporations Act No. 69 of 1984
- Electronic Communications and Transactions Act No. 25 of 2002
- The Promotion of Access to Information Act No 2 of 2000

Human resources

- Skills Development Act No. 97 of 1998
- Skills Development Levies Act No. 9 of1999
- Employment Equity Act No.55 of 1998
- Protected Disclosures Act No. 26 of 2000
- Basic Conditions of Employment Act No. 75 of 1997
- Labour Relations Act No. 66 of 1995
- The Occupational Health and Safety Act No 85 of 1993

Compliance

- Policyholder Protection Rules- Section 62 of the Long-term Insurance Act No. 52 of 1998
- Policyholder Protection Rules – Section 55 of the Short-term Insurance Act No.53 of 1998
- Financial Intelligence Centre Act No. 38 of 2001
- Prevention of Organised Crime Act No. 121 of 1998
- Promotion of Access to Information Act No.2 of 2000
- Financial Advisory and Intermediary Services Act No. 37 of 2002
- Protection of Constitutional Democracy against Terrorist and Related Activities Act No. 33 of 2004.

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King Report III

No discussion about legislation and corporate governance would be complete without reference to the *King Report on Corporate Governance for South Africa* which was released in September 2009.

Simply put the King Report III, an extremely comprehensive document, reports on how corporate governance is being handled in South African companies and gives guidelines as to how the Companies Act could be interpreted and implemented for best practice.

3. Director's and Officer's liability

Introduction

A director or officer's liability may arise from various duties under common law or statute.

We will first look at directors and their position in a company and then investigate their relationship with common law and statute law.

The director and officer of the company

Non-executive directors

A director is defined in the Companies Act as follows:

Director *includes any person occupying the position of director or alternate director of a company by whatever name he may be designated".*

A director includes a non-executive director and all the principles discussed in regard to a director apply equally to both executive and non-executive directors.

The company is an artificial legal entity and can only function through human agency in the form of the company's board of directors. This human agency has been described in the case law as the "directing mind and will" of the company.

Delictual and statutory liabilities

Thus, a company, through the board of directors, may incur **delictual** (see below) or **contractual liabilities** as well as **statutory liabilities**. The directors incur no civil

liability for the wrongful conduct of the company merely because they are directors, unless they themselves have perpetrated or have wrongfully failed to prevent such conduct.

Directors or officers may be **personally liable** to third parties, i.e. shareholders or creditors, for injury or damage caused by their own wrongdoing.

Directors – fiduciary responsibility

A director stands in a fiduciary relationship to the company, and owes his or her fiduciary duties to the company and not to individual members, creditors, subsidiaries or employees.

Fiduciary duties also attach to officers of the company who are not directors, but the nature and extent of these will depend on the particular position of the officer in relation to the company.

Director's contracts

Finally, directors' positions between themselves and the company may be governed contractually. In the absence of such a formal contract their appointment gives rise to an implied contract that their position will be governed by the articles of the company.

Under common law

Duties and obligations of directors and officers exist under common law.

The core duties and obligations of the director derive from the common law duty to show good faith to the company. The duties rest on the director individually and not on the board of directors, i.e. he or she is required to comply with the duties personally and failure to do so attracts personal liability.

A director's common law duties include the following:

- The duty to act with requisite care and skill.
- The duty to act within their powers.

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- The duty to retain their independence and to exercise their powers for the benefit of the company.
- The duty to avoid conflicts, especially in regard to the director's own personal interests.

Breach of the director's common law duties could entail personal liability of the director to the company for loss caused to the company as a result of the breach and may include an obligation to restore to the company the property lost or to account to it for profits.

In addition, a breach of such duties could result in a common law claim by a member or shareholder known as the member's derivative action. This action may be brought by a member against a director or shareholder who controls the majority of the board and who has caused the company to suffer losses as a result of conduct which is either fraudulent or ultra vires (beyond his/her powers).

This right of action is recognised in order to prevent recalcitrant directors, through their control of the board, blocking a member's attempt to see to it that the company's rights against the directors are enforced.

Statutory duties and provisions

A number of sections in the Companies Act deal with the duties and obligations of directors and could impose liability: (See table below)

The potential exposure of a director in terms of this section is extensive as a court, in the exercise of its discretion, can determine that any or all of the debts of the company are payable by the director personally without regard to the issue of causation.

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Table to show the sections in the Companies Act imposing liability on Directors and Officers

Section	Topic	Brief description
247	**Indemnity**: Indemnity and relief of and offences by directors	The directors are, as it were, on their own should they attract liability to the company for negligence, default, and breach of duty or breach of trust. In regard to insurance, the company may effect its own insurance covering its own losses caused by such actions by an individual director but the company may not release or indemnify the director, even if it has effected its own insurance. Obviously an insurer would then be entitled to proceed with a subrogated action against the individual director.
248	**Relief:** Relief of directors and others by court in certain cases	This section enables total or potential relief from liability to be granted where a director can show that he or she acted honestly and reasonably albeit negligently or in breach of duty or breach of trust. The relief may be granted on such terms as the court deems fit. The section does not however override the provisions of S424 to which we refer below
266	**Derivative Actions**: Initiation of proceedings on behalf of company by a member	This section supplements the shareholder's common law derivative action to which reference is made above. It makes provision for a shareholder, aggrieved by the inaction of the board of directors of the company, to initiate proceedings on behalf of the company to compel a director or officer to make good damages or loss to the company. A member may only initiate proceedings on behalf of the company if he or she has served a written notice on the company calling on it to institute such proceedings within

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		one month from date of service of the notice, and the company thereafter fails to do so.
417	**Enquiry into Company's Affairs:** Summoning and examination of persons as to affairs of company	This section is extremely wide and could expose directors or officers of a company to extensive examination and interrogation regarding the affairs of the company and the conduct of the company's business. The constitutionality of the provisions of Section 417 has been upheld by the Constitutional Court (see *Bernstein v Bester NO* 1996 (2) SA 751 (CC)), with the exception of the provision in Section 417(2)(b) that "any answer given to any such question may thereafter be used in evidence against him". This latter provision has been held to be constitutionally invalid in relation only to criminal proceedings against the person concerned except where the relevant charges relate to the giving of perjured evidence or a failure to answer lawful questions fully and satisfactorily (see *Ferreira v Levin NO* 1996 (1) SA 984 (CC)). It is often in the course of Section 417 enquiries that liability in terms of Section 424 is exposed.
424	**Liability for Fraudulent Conduct:** Liability of directors and others for fraudulent conduct of business	Section 424 establishes a punitive remedy in which a director can be held personally liable for all of the liabilities of the company without proof of any causal link between his or her conduct and those liabilities. The potential exposure of a director in terms of this section is extensive as a court, in the exercise of its discretion, can determine that any or all of the debts of the company are payable by the director personally without regard to the issue of causation.

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Other statutory obligations

Several statutes impose obligations on directors and officers of financial institutions.

These obligations are imposed in addition to the general duties of good faith, skill and care imposed on all directors and officers.

Although by no means exhaustive, the following is an indication of the extent to which such directors and officers are obliged to comply with particular statutory obligations. Failure to comply with these acts is a criminal offence and may also give rise to civil liability.
(See table below)

Table to show liability on Directors and Officers from other statutory obligations:

No	Statute	Brief description
1	The Trust Property Control Act No 57 of 1988	The Act regulates the operation of trusts and the functions, duties and obligations of trustees who are appointed to all trusts to administer property subject to the trusts. The Act further provides that the trust instrument which creates the trust and appoints the trustees, may exempt the trustee from providing security to the Master of the Supreme Court for the due and faithful performance of his duties by the trustee.
2	The Financial Institutions (Investment in Funds) Act No 39 of 1984	The Act defines *"financial institutions"* to include insurance companies, pension fund organisations, mutual building societies, unit trust schemes, trust companies, Participation Bond Schemes and the like. It regulates, in principle, how financial institutions shall control *"any funds of the institution or any trust property held by or on behalf of the institution for any beneficiary or principal"*. The Act further provides for the control

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		and regulation of financial institutions by the Financial Services Board, a statutory control body and for incidental matters. The duties imposed on directors, officials, employees and/or agents of financial institutions, again operate separately from and in addition to the ordinary duties of good faith and skill and care imposed on directors and officers of companies.
3	The Income Tax Act No 58 of 1962	The Act which regulates the income tax regime in the Republic provides for the appointment of a *"public officer"* on behalf of every corporate tax payer and imposes a multitude of mostly administrative duties on the person appointed as public officer
4	The Pension Funds Act No 24 of 1956	The Act regulates the establishment and the management and administration of pension funds and prescribes basic procedural aspects and also prohibits certain activities. In terms of the Act every pension fund shall have a *"principal officer"* who ultimately carries the responsibility for ensuring that every pension fund complies with all of the provisions of the Act.
5	The Banks Act No 94 of 1990	The Act regulates the activities of all banks and deposit taking institutions and, amongst others, prescribes and prohibits certain business practices and methods of conduct. In terms of the Act every bank shall have a *"chief executive officer"* who carries ultimate responsibility for ensuring that the bank complies with all of the provisions of the Act.
6	The Insurance Acts	The Short-term Insurance Act 1998 and the Long-term Insurance Act 1998 came into force on 1 January 1999. Directors and officers of insurers who are not fit and proper to hold office may be removed by the Registrars. A primary obligation is placed on directors and officers to see to it that the insurance company is maintained in

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		a financially sound condition. A board of directors must be assisted by an audit committee of at least three members, of whom two shall be directors, to evaluate control systems, accounting practices, information systems and auditing processes, to facilitate communication between the board of directors and the managing executive, auditor and internal audit staff and to recommend the introduction of measures which the committee believes may enhance the credibility and objectivity of financial statements. The returns to be filed by insurers contain questions which are clearly aimed at introducing some of the principles of the King Report into the management of insurance companies. A failure to carry out diligently the responsibilities under any of the above legislation could attract personal liability.
7	Inspection of Financial Institutions Act No. 80 of 1998	The Act empowers the Financial Services Board to in-spect the affairs of any financial institution or unregistered entities conducting the business of financial institutions in order to identify and deal with any irregularities. The legislation applies to: • Financial institutions • Any person, partnership, company or trust which is not registered or approved as a financial institution who the Registrar has reason to believe is carrying on the business of a financial institution • Registered medical schemes • Associated institutions including - o any person, partnership, company or trust in which, or in the business of which, a financial institution or unregistered person, has or had

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	Inspection of Financial Institutions Act No. 80 of 1998 (continued)	a direct or indirect interest; o any person, partnership, company or trust which has or had a direct or indirect interest in a financial institution or unregistered person, or in the business of a financial institution or unregistered person; o a participating employer in a pension fund organisation; o any person, partnership, company or trust that controls, manages or administers the affairs or part of the affairs of a financial institution or an unregistered person The legislation provides for: • Inspection of the affairs of financial institutions or unregistered entities conducting the business of financial institutions • Appointment of inspectors • The recovery of the cost of inspections from transgressing unregistered entities • Registrar's discretion to communicate information gained during or from an investigation to affected persons, financial institutions or unregistered entity • Registrars powers of examination relating to institutions and other persons Right to legal professional privilege • Inspector's observance of secrecy • Offences and penalties

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Miscellaneous statutory obligations

There are many other statutes imposing duties on directors and officers and these include:

- the Minerals Act 50 of 1991, the Occupational Health and Safety Act 85 of 1993 which imposes extensive duties and responsibilities on the “chief executive officer”,
- the environmental statutes including:
  - the National Water Act 36 of 1998,
  - the Environment Conservation Act 73 of 1989 and
  - the National Environmental Management Act 107 of 1998.

In terms of the last mentioned Act a director is defined to mean a member of the board, executive committee or other managing body of a body corporate and, in the case of a close corporation, a member of that close corporation, or in the case of a partnership a member of that partnership.

The Act imposes liability on any director of a firm who at the time when the firm commits an offence under any of the environmental laws listed in the schedule to the Act (which are most of the existing environmental laws), if the offence in question results from the failure of the director to take all reasonable steps that were necessary under the circumstances to prevent the commission of the offence. The penalty on conviction is the penalty specified in the applicable environmental law listed in the schedule to the Act.

Directors should consider the relevant statutes relating to their own particular fields of activity.

Criminal law

There are many and varied potential liabilities, both in the common law and in statute which could render a director criminally liable. We refer specifically to Section 332(5) of the Criminal Procedure Act which provides as follows:-

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"When an offence has been committed, whether by the performance of any act or by the failure to perform any act, for which any corporate body is or was liable to prosecution, any person who was, at the time of the commission of the offence, a director or servant of the corporate body shall be deemed to be guilty of the said offence, unless it is proved that he did not take part in the commission of the offence and that he could not have prevented it, and shall be liable to prosecution therefor, either jointly with the corporate body or apart therefrom, and shall on conviction be personally liable to punishment therefor."

Director's and officer's liability insurance

Section 247 of the Companies Act prevents a company from exempting or indemnifying directors from their legal liability to the company for negligence, default, breach of duty or breach of trust.

The company may however take out insurance as indemnification against any liability of directors towards the company and may indemnify such directors against costs incurred in defending any related proceedings provided they are successful in such defence.

4. Errors and omissions

Introduction

In the information age, organisations increasingly depend on technological systems and efficiencies to protect and leverage information. In this business environment, it is critical to protect against technological systems' errors or omissions that can create widespread damage or disruption to information assets and severely harm balance sheets.

In the evolving service-based USA economy, information assets now account for more than 70 percent of the market capitalisation of Fortune 500 organisations. As the value of these assets continues to grow, so does the need to remove or reduce the potential liability against errors and omissions.

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E&OE

One method often used by companies is to include **E&OE** on company documentation sent to clients.

E&OE is an initialism standing for "**Errors and Omissions Excepted"**. The phase is used in an attempt to reduce legal liability for incorrect or incomplete information supplied in a normally contractually related document such as a price list, quotation or specification.

It is often applied as a disclaimer in situations in which the information to which it is applied is relatively fast moving. In legal terms, it seeks to make a statement that information cannot be relied upon, or may have changed by the time of use.

E&OE is most commonly used in the United Kingdom, and is less well used in other English speaking countries.

In other words: Errors and Omissions Excepted, or E&OE, is the catch all "if we make a blinding error, then you knew that it wouldn't be covered by those terms and conditions". It is usually used to cover a company if they advertise, say, a R3000 TV at R300, just because somebody in the printing company carelessly puts a decimal point in the wrong place.

It is doubtful however that the use of this initialism would override statutory rights.

Errors and omissions (E&O) insurance

Another way to reduce liability to E&O is to take out insurance cover.

Errors and omissions (E&O) is the insurance that covers a company, or an individual, in the event that a client holds the company or the individual responsible for a service provided, or had failed to provide, that did not have the expected or promised results.

For doctors, dentists, chiropractors, etc., it is often called "malpractice insurance". For lawyers, accountants, architects or engineers, it may be called "professional liability". Whatever one calls it, it offers cover for errors (or omissions) that have been made or that the client perceives have been made.

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Most E&O policies cover judgments, settlements and defence costs. Even if the allegations are found to be groundless, large amounts of money may be needed to defend the lawsuit. They can bankrupt a smaller company or individual and have a lasting effect on the bottom line of larger companies.

In short, E&O coverage provides protection in the event that an error or omission has caused a financial loss for a client.

Who needs E&O insurance?

The best-known professionals who need E&O insurance are doctors, lawyers, accountants, architects, engineers, etc. However, less thought about individuals range from advertising agencies to commercial printers, Web hosting companies to wedding planners. If anyone is in the business of providing a service to a client for a fee, one has an E&O exposure. One needs to consider what will happen if the service is not done correctly or on time, and it costs a client money or harms their reputation.

The need for E&O insurance coverage

Why does a company need coverage?

To put it very simply, everyone makes mistakes. Even with the best employees and the best risk management practices in place, mistakes will be made. As we all know, no one is perfect.

If a freight forwarder sends a shipment to South America instead of South Asia, and it is a time sensitive shipment and their client loses a sale and, therefore, huge amounts of money, who will pay the loss?

If a wedding planner reserves the reception hall, the band, the caterers, etc., for May 22 instead of May 29 and everyone shows up except the wedding party and guests, who pays? And imagine the emotional distress caused to the bride if this were to happen.

There is also the less tangible loss of reputation for both the professional and his client. What will the cost be to the business that now has equipment in South

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America instead of South Asia? Will they lose future contracts with their current client as well as future clients?

By not purchasing E&O, a company can be taking a serious financial risk. These types of losses are not covered under a general liability policy. And, as stated earlier, even if one is not at fault, litigation is both time consuming and expensive.

Coverage offered by E&O insurance

There are no standard policy wordings for E&O coverage. Each policy must be read carefully to make sure that the coverage being offered fits the exposures of the company. An attorney, a doctor and a computer programmer all have exposures; however, the same policy would not work for all. There is no "one size fits all" E&O policy.

Most E&O policies are written on a "claims made" or "claims made and reported" form. This means that any claims must be made or, in some cases, made and reported, within the policy period. These policies have a retroactive date that becomes very important. Claims that arise out of acts committed prior to the retroactive date will not be covered. The farther back the retroactive date, the more coverage provided.

Some policies also include the defence expenses within the limit of liability. Some will exclude punitive damages. The wording of these policies can vary greatly, and each policy must be read carefully to make sure the coverage fits the exposure.

Cost of E&O insurance

The cost of E&O insurance may vary greatly depending on the class of business, location, claims experience (both of the individual insured and of the industry they are in) and from insurance company to insurance company. An insurance company that is very competitive on insurance agents or real estate agents, may not be competitive, or may not even offer coverage on business consultants, even if the consultant works with real estate or insurance agents.

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Underwriting E&O insurance

An insurance company underwriter may ask for copies of contracts, a description of quality control procedures, documentation procedures, training procedures, etc., or they may want nothing more than a completed application.

The underwriter will not only look at a company's experience to see if it has had claims, but they will also try to determine the reason a company hasn't had claims. Is it luck or is the company doing something that prevents the claim in the first place? And if the company has had claims, what steps have been taken to ensure that the same errors will not continue to occur?

Here are some practical steps a company can take to mitigate claims:

- Always have a written contract that spells out what will be done, what will not be done and what the fees will be.
- Communicate throughout the job and keep the expectations realistic.
- Have quality control procedures in place and use internal and external audits to check them.

The more comfortable a company can make the underwriter with the company's operation, the more likely they are to give the insured a competitive price on the policy and to provide the coverage needed.

Potential risks facing a company

The following table below shows some of the risks that face a company.

Table to show potential risks facing a company and the possible consequences:

Risk type	Examples	Possible consequences
Personnel risks	• Accident • A key person leaves • An entrepreneur is overburdened	• Loss of work input • The company loses important expertise • Ability to work is reduced
Business risks	• Demand for a product decreases • Disruption in a customer's payments • Production capacity doesn't correspond to a customer's needs	• The company's finances can't take it • Anticipated income doesn't arrive • The customer changes supplier
Property risks	• A fire in a production facility or shop • Water leakage spoils the company's stocks • A machine breaks down	• Sizeable damage, business operations are interrupted for several months • Production and deliveries are disturbed • Production is interrupted
Information risks	• A computer's hard disk breaks down • The customer register is sold without permission • The company's information is accidentally leaked	• Order data is lost • The company's reputation suffers. A competitor steals the customers • The company's competitiveness suffers
Operational liability risks	• An employee makes a mistake with a product or service • An agreed delivery is delayed	• Liability for damages to a third party • The company has to pay a contract penalty
Product liability risks	• A product causes damage • A faulty product has to be withdrawn from the market	• The company has to pay compensation • Financial loss, the company's reputation suffers
Interruption risks	• A power cut interrupts production • A delivery from a subcontractor is delayed • A load of raw material is stopped at the neighbouring country's customs	• The company's operations are interrupted • Production is interrupted • Capital is tied up, production is interrupted
Transport risks	• A product is broken during transport • A transport vehicle is stolen	• Financial loss • Deliveries are disturbed
Environmental risks	• An oil container breaks • Packaging proves to be unsuitable for recycling	• The company's reputation suffers and the company becomes liable for damages • Sales to an important export country are interrupted

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Module 2

How liabilities are linked to corporate governance

Outcomes for module 2:

Learners will be able to:

- Explain the basic principles of good corporate governance with reference to legal, ethical and civil compliance.
- Identify three areas of liability that arise out of legal compliance and give an indication of the consequences of non-compliance or non-activity.
- Identify three areas of liability that arise out ethical compliance and give an indication of the consequences of non-compliance or non-activity.
- Identify three areas of liability that arise out of civil compliance and give an indication of the consequences of non-compliance or non-activity.
- Explain the link between civil and criminal liability in terms of non-compliance or non-activity with business law.

Introduction

"*Corporate governance is concerned with holding the balance between economic and social goals and between individual and communal goals…the aim is to align as nearly as possible the interests of individuals, corporations and society.*"
~ Sir Adrian Cadbury Corporate Governance Overview, 1999 World Bank Report

1. Principles of good corporate governance

Directors:

- **The board**

Every listed company should be headed by an effective board of directors which should lead and control the company.

- **Chairman and Chief Executive Officer**

There are two key tasks at the top of every public company − the running of the board and executive responsibility for the running of the company's business. There

should be a clear division of responsibilities at the head of the company which will ensure a balance of power and authority, such that no one individual has unfettered powers of decision.

A decision to combine the posts of chairman and chief executive officer in one person should be publicly justified. Whether the posts are held by different people or by the same person, there should be a strong and independent non-executive element on the board.

The board:

- **Board balance**

The board should include a balance of executive and non-executive directors such that no individual or small group of individuals can dominate the board's decision taking.

- **Supply of information**

The board should be supplied in a timely manner with information in a form and of a quality appropriate to enable it to discharge its duties.

- **Delegation of duties**

There should be a formal procedure for certain functions of the board to be delegated, describing the extent of such delegation.

Appointments to the board

There should be a formal and transparent procedure for the appointment of new directors to the board.

Procedures for appointments to the board should be formal and transparent, and a matter for the board as a whole, although in practice nominating will usually emanate from the chairman or chief executive officer.

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Remuneration

- **The level and make-up of remuneration**

Levels of remuneration should be sufficient to attract and retain the directors needed to run the company successfully, but companies should avoid paying more than is necessary for this purpose.

- **Procedure for determination**

Companies should establish a formal and transparent procedure for developing policy on executive remuneration and for fixing the remuneration packages of individual directors. No director should be involved in deciding his or her own remuneration.

Accountability and Audit

- **Financial reporting**

The board should present a balanced and understandable assessment of the company's position and prospects.

- **Internal control**

The board should maintain a sound system of internal control to safeguard shareholders' investment and for maintaining the appropriate relationship with the company's auditors.

- **Audit committee and auditors**

The board should establish formal and transparent arrangements for considering how they should apply the financial reporting and internal control principles and for maintaining an appropriate relationship with the company's auditors.

Relations with shareholders

- **Dialogue with institutional shareholders**

Companies should be ready, where practicable, to enter into a dialogue with institutional shareholders based on the mutual understanding of objectives.

- **Shareholder voting**

Institutional shareholders have responsibility to make considered use of their votes. When evaluating a company's governance arrangements, particularly those relating to board structure and composition, institutional shareholders should give due weight to all relevant factors drawn to their attention and to eliminate unnecessary variations

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in criteria which each applies to the corporate governance arrangements and performance of the companies in which they invest.

- **Restricted periods**

Every listed company should practice the imposition of a restricted period in dealings in its securities by directors, officers and other selected employees preceding the announcement of its financial results or in any other period considered sensitive.

The seven characteristics of good corporate governance

It would be useful, at this point, to illustrate what can be regarded as constituting the seven characteristics of good corporate governance:

Discipline

Corporate discipline is a commitment by a company's senior management to adhere to behaviour that is universally recognised and accepted to be correct and proper. This encompasses a company's awareness of, and commitment to, the underlying principles of good governance, particularly at senior management level.

Transparency

Transparency is the ease with which an outsider is able to make meaningful analysis of a company's actions, its economic fundamentals and the non-financial aspects pertinent to that business. This is a measure of how good management is at making necessary information available in a candid, accurate and timely manner – not only the audit data but also general reports and press releases. It reflects whether or not investors obtain a true picture of what is happening inside the company.

Independence

Independence is the extent to which mechanisms have been put in place to minimise or avoid potential conflicts of interest that may exist, such as dominance by a strong chief executive or large shareowner. These mechanisms range from the composition of the board, to appointments to committees of the board, and external parties such as the auditors. The decisions made, and internal processes established, should be objective and not allow for undue influences.

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Accountability

Individuals or groups in a company, who make decisions and take actions on specific issues, need to be accountable for their decisions and actions. Mechanisms must exist and be effective to allow for accountability. These provide investors with the means to query and assess the actions of the board and its committees.

Responsibility

With regard to management, responsibility pertains to behaviour that allows for corrective action and for penalising mismanagement. Responsible management would, when necessary, put in place what it would take to set the company on the right path. While the board is accountable to the company, it must act responsively to and with responsibility towards all stakeholders of the company.

Fairness

The systems that exist within the company must be balanced in taking into account all those that have an interest in the company and its future. The rights of various groups have to be acknowledged and respected. For example, minority shareowner interests must receive equal consideration to those of the dominant shareowner(s).

Social responsibility

A well-managed company will be aware of, and respond to, social issues, placing a high priority on ethical standards. A good corporate citizen is increasingly seen as one that is non-discriminatory, non-exploitative, and responsible with regard to environmental and human rights issues. A company is likely to experience indirect economic benefits such as improved productivity and corporate reputation by taking those factors into consideration.

Legal compliance

In terms of legal compliance, refer to the previous module of this guide for full details of legal liability to the Companies Act.

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Ethical compliance – background

- **The South African Constitution** signed into law on 10 December 1996 lays the foundations for a democratic and open society in which government is based on the will of the people and all people in the country are equally protected by law. The Constitution is the overriding dominant legislation in South Africa which the state and all people must respect, protect, promote and fulfil.

Chapter 2 of the Constitution enshrines the rights of all people in the country and affirms the democratic values of human dignity, equality and freedom in the form of a Bill of Rights.

These rights can be classified into**:**

Property rights – rights as a juristic person
(able to contract)

Personality rights – rights as an individual

When interpreting any legislation and when developing the common law or customary law, every court, tribunal or forum must promote the spirit, purport and object of the Bill of Rights.

This important legislation lays the foundation for **ethics** (i.e. **moral principles, treatment of moral questions)** in South Africa.

Business ethics
Yet a recent National Association of Corporate Directors (NACD) survey of 280 corporate CEOs and directors found that "only one of three directors felt that they were highly effective in ensuring compliance".

The King III report makes recommendations for more stringent corporate governance and duties of directors of all companies in South Africa and this includes important recommendations on business ethics. An extract from the report:

- "Each company should demonstrate its commitment to its code of ethics by:
    - creating systems and procedures to introduce, monitor and enforce its ethical code;
    - assigning high-level individuals to oversee compliance with the ethical code;
    - assessing the integrity of new appointees in the selection and promotion procedures;
    - exercising due care in delegating discretionary authority;
    - communicating with, and training, all employees regarding enterprise values, standards and compliance procedures;
    - providing, monitoring and auditing safe systems for reporting of unethical or risky behaviour;
    - enforcing appropriate discipline with consistency; and
    - responding to offences and preventing re-occurrence."

Benefits of a business ethics programme

An effective program can:

• establish a code of conduct that reduces risk of criminal behaviour

• detect wrongdoing, foster quick investigations, minimise consequences

• demonstrate company's ethical/legal philosophy during an investigation

• reduce fines if company is found guilty of wrongdoing

• enhance company reputation and stature

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Module 3

The risks associated with non-compliance or non-activity

Outcomes for module 3:

Learners will be able to:

- Explain risks associated with ethical non-compliance with examples.
- Explain risks associated with civil non-compliance with examples.
- Explain risks associated with legal non-compliance with examples.
- Compare possible consequences for ethical, civil and legal non-compliance and non-activity in a table.
- Quantify the ethical, civil and legal risks in a specific organisation in terms of the potential consequences.

Introduction

As has already been said, the burden of compliance has been increasing exponentially throughout all business sectors.

This is especially true in the financial services sector where the all-embracing nature of the legislation such as FAIS and FICA make the risks of non-compliance very onerous and the penalties severe. In this module, we will concentrate on the risks of non-compliance in the financial services sector.

Effect of legislation

Although many have hailed the legislation as being long overdue, it is not surprising that the additional work and cost involved in compliance led to many people leaving the financial services industry overseas when similar legislation was introduced. A similar picture is beginning to emerge in South Africa where at least one company has informally reported that they have lost over 20% of their representative broker force who have left the industry.

But for those left in the industry who are committed to their careers and serving their clients, their choice is twofold – simply: to comply or not to comply.

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The risk of non-compliance - penalties

Some practitioners have asked the question "What if we just don't comply?"

The first part of the answer to that question is as predictable as the question itself. FAIS and the accompanying regulations provide both civil and criminal penalties for violations of the requirements established by the statute.

The regulations establish civil penalties of up to a maximum of R1 000 000.00 per person per year for all violations of specific provisions.

At the introduction of FAIS, many in the industry were seeking some means of quantifying the potential maximum civil penalties for non-compliance so that they could weigh up the risks of not complying. One method of quantifying the potential penalties took the view that the specific standards established in the regulations constitute the provisions. Under that interpretation, the security regulations could give rise to as much as R500 000.00 in civil penalties per year for total non-compliance.

The exposure to criminal penalties can be even more severe for a non-complying entity. FAIS provides criminal penalties of up to 10 year imprisonment for knowing non-compliance in a manner that violates specific provisions of FAIS.
For the same actions performed under "false pretences", the penalties can be five years imprisonment.

Penalties and fines imposed under FAIS do not limit possible penalties and fines permitted under other state programs, and also would be independent of penalties and fines imposed by related state laws.

Actions by the Ombud in previous annual report

Of course there cannot be any certainty in such calculations until enforcement is undertaken, but the cases handled by the FAIS Ombud in his latest annual report, give the following picture:

- Enquiries and non-justifiable complaints - 1836
- Resolved files - 310

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- Pending files - 356
- Referred to other forums - 1301
- Total files received - 3806

Finally, the amount of money put back in the hands of the consumer was approximately **R6.5m.**

Non-penalty costs

While the potential civil and criminal penalties outlined above are significant in themselves, there are other costs associated with a course of non-compliance or delayed compliance that could potentially dwarf those penalties.

As we have described, the FAIS regulations cut across the entire spectrum of the core business activities of most financial services entities. The breadth and depth of the regulations create an extraordinary range of possible sources of non-compliance and enhance the potential for costly consequences in the event of noncompliance.

While the sources of such non-compliance costs are too numerous to list here, the examples discussed below illustrate how quickly these other costs might accumulate and surpass the penalties provided in the regulations.

As discussed below, such costs include:

- potential loss of business opportunities;
- reduced value of business products;
- damage to public reputation;
- increasing incompatibility of information systems with industry standards;
- reduced investor interest;
- liability for improper disclosure of individually identifiable confidential information;
- loss of accreditation.

Non-compliance - loss of business opportunities

One of the intentions of the FAIS regulations is to bring a substantial measure of uniformity to information transactions between entities in the financial industry, both in terms of data structure and standards for information protection.

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Effect on transactional behaviour

As such, they directly impact and often prescribe transactional behaviour concerning the business relationships of entities. It is not surprising, therefore, that decisions regarding compliance with the regulations must take into account the impact such decisions will have on current and long-term relationships with business associates and customers. A policy of noncompliance or even delayed compliance with the FAIS regulations may well have significant negative impacts on those relationships.

Effect on business relationships

The Compliance Regulations specifically require that entities ensure that business associates comply with the regulations by including specific provisions in their business associate contracts e.g. mandates with product providers and FSP's.

A unilateral decision not to comply by one entity will require it to either forgo contracts with other financial entities (a strategy that could effectively put it out of business) or to agree to contract provisions that it has no intention of meeting. Even if a company was willing to implement this questionable strategy, it is likely that many business associates will require their contracting associates to demonstrate their capacity to meet the regulations, an assurance that the noncompliant entity would be ill-equipped to provide.

Non-compliance – unattractive business associates

Given the significant expenses that complying entities will incur in order to become compliant and their potential liability for improperly handled information, there is a strong likelihood that complying entities will avoid contracting with others who cannot themselves demonstrate a capacity to comply. Further, non-complying entities are likely to find it increasingly difficult for their information and transaction systems to interact with those systems of complying entities. As such, non-complying entities are increasingly becoming very unattractive business associates.

Effect on EB and medical schemes – loss of clients

For non-complying employee benefit groups and medical schemes in particular, the risk of losing customers is significant. Because employers who offer traditional

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employee and health benefits to their employees are themselves at risk under the regulations (if they are managing their own schemes), it is certain that a demonstrated capacity to comply with the regulations will become an important element in the deliberations of employers, employer groups, and benefits consultants in choosing employee benefits, medical schemes, etc.
An EB scheme or **medical scheme** without such a demonstrated capacity will be at a distinct marketing disadvantage in relation to its complying competitors.

This capacity also will play a role in proving an insurer‘s ability to develop, provide and successfully administer new products, such as defined contribution plans, and provide creative yet secure customer service solutions, such as on-line eligibility verification and subscriber information changes.

Effect of non-compliance on public reputation
Public awareness that a company is not in compliance with FAIS could seriously damage the organisation‘s public reputation.

Public polling indicates that many consumers have significant concerns about the misuse of confidential individual lifestyle and health information. If the general public or business community perceives that a financial entity is either callous or simply behind the times in failing to provide the greatest possible protection against such information risks, the entity will suffer a significant disadvantage in competing for the public‘s business and retaining the confidence of its clients and/or shareholders.

It is very difficult to quantify the potential for loss of business in actual rand estimates. The potential loss will vary widely with such factors as the size of the entity, its market power, the extent of its non-compliance and the awareness of that non-compliance by its customers and the community at large.

What can be said is that, in a competitive environment, non-compliance is likely to have a significant negative impact on business relationships and potentially on revenues.

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Operational costs

While loss of business opportunities represents a significant consequence of non-compliance, the gradual loss of operational competency is just as significant.

Non-complying entities will become increasingly isolated from the transactional standards and performance benchmarks of their industry. Whether or not the FAIS regulations are the most appropriate or efficient means by which to promote evolution of the financial industry can certainly be debated, but it cannot be ignored that the regulations will establish the framework within which that evolution will take place.

Any entity that chooses to remain outside that framework, or simply postpones its acceptance of the new legislated environment, will create for itself transactional and operational difficulties that are likely to compound over time.

Information systems

Some of these difficulties will arise directly in the **information systems** of the non-complying entity. As the volume of information required by the new legislation increases, and newer, faster systems within the industry are developed to implement the new standards, the burden on the obsolete systems of a non-complying entity will multiply. At some point, the old, non-compliant systems will become increasingly difficult and expensive to maintain and eventually will fail. If such systems are unable to compete in terms of processing time, the company will likely incur at least some degree of contractual or regulatory costs associated with failure to bill or pay in a timely manner.

As the FAIS compliance regulations gain momentum, the costs of maintaining or ultimately replacing outdated systems also will increase because the most qualified personnel and/or vendors will have been already engaged by entities that chose early compliance.

The marketplace for such information technology personnel is already tight as the expertise is not just confined to IT expertise, but financial sector expertise also. The pressure that FAIS compliance efforts will place on that marketplace will only

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intensify in the future.

Financial and capitalisation costs

A decision to delay planning for the resources needed for compliance may create significant financial difficulties for entities with limited financial resources or reserves.

With experience and by all accounts, the cost of compliance has a significant budgetary impact. For many entities, the cost of compliance will include significant changes in physical arrangements e.g. scanning and filing systems, as well as systems security and transaction related modifications. Such changes often require lead times that simply will not be available to entities that choose non-compliance or wait too long to implement the compliance process.

Moreover, many entities will need to amortize the cost of the compliance effort over the longest possible period of time. In order to do so, compliance planning should have long been in being. Those who choose to do nothing for any substantial period may find that the cost of compliance is not financially feasible within a single budget cycle.

In an industry where a great deal of consolidation is taking place and investor interest is frequently an important consideration, it is worth noting that non--compliance may be a consequential negative factor in an entity‘s valuation.

Precisely because compliance with the regulations is likely to be a costly and technologically difficult undertaking, and because the price of non-compliance is hard to quantify, investors are likely to perceive greater value in an organisation with a solid implementation plan and the certainty of an implemented and proven compliance system, and this perception will be reflected in a higher share price.

Third party liability

Entities that wish to adopt a policy of noncompliance or even limited compliance with the FAIS regulations may well become liable to parties other than the government.

The FAIS regulations require companies to contract with their business associates to

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ensure adherence by those business associates to the compliance provisions.

Failure by a company to actually implement the FAIS requirements will almost certainly lead to breaches of such contract provisions and subject the non-complying party to damage claims from its business associates.

Whether legally required to comply with the regulations or not, business associates that exchange financial information and transactions electronically will want to do business only with other entities that can provide similar computer security and compliance assurances.

With the advent of the Internet and the possibility of electronic connections with so many other institutions through open public lines, security has become crucial.

Recent court cases overseas have supported the notion of "downstream liability" that makes one party legally and financially liable for a vulnerability in its network when that vulnerability enables a hacker to gain access to another party's network and cause damage or disrupt access.

Protection of confidential information

In an increasing number of jurisdictions overseas, claims for damages arising out of a breach of a compliance right are being recognised under contract law.

In such jurisdictions, the failure to meet the compliance provisions is likely to be considered as strong evidence against, for example, a health industry defendant.

The degree of vulnerability of an organisation to compliance and security breaches will vary based on its size, business relationships and processes, and the complexity of its information system infrastructure.

Some organisations already have sophisticated systems designed to protect against such breaches. Nevertheless, even the most sophisticated systems are certain to retain some degree of vulnerability.

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For example, every one of the respondents to a recent international computer security survey discovered some unauthorised entry into their information systems when they used an intrusion detection device to look for such entries.

Even in the most technologically savvy organizations, information is still at risk. As computers and computing storage devices become smaller and smaller, significant amounts of data can fit on a CDROM or DVD, which can fit easily in someone‘s pocket and be spirited off the premises undetected.

In 1996 in Florida, USA, a health department employee obtained a computerised list of HIV-positive people, copied the list onto a disk, and mailed it to a local newspaper (fortunately, the newspaper did not print the list). While even unstinting compliance with the regulations will probably not protect against all such breaches of security, having a well-documented programme to achieve full compliance may well limit an organisation‘s exposure to civil penalties and civil liability.

Loss of accreditation or license

The financial industry may be the most accredited and licensed industry in our society. Whether an entity is an insurer or a provider or an ancillary service provider, it is almost certainly reviewed regularly by at least one licensing or accrediting body.

Withdrawal or suspension of one's FAIS licence is a significant risk in the case of non-compliance.

Staff actions

The danger of a whistleblower action in connection with noncompliance with the FAIS regulations seems particularly acute, simply because of the number of people in an organisation who would be aware of the regulations and could identify specific instances of non-compliance.

Summary

Each company in the financial services sector has to make a decision about how compliant and non-compliant they wish to be in the face of the raft of legislation which has descended on the sector in recent years.

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It should be clear from the above that the risks of non-compliance need to be weighed very carefully and it is highly recommended that companies consider a risk management process in order to assist decision making.

A risk management process is a method by which risks to the company (e.g. to the scope, deliverables, timescales or resources) are formally identified, quantified and managed. The process entails completing a number of actions to reduce the likelihood of occurrence and the severity of impact of each risk.

A risk management process is used to ensure that every risk is formally:

- identified
- quantified
- monitored
- avoided, transferred or mitigated.

One of the important points is that a clearly thought out risk management statement and process ensures that the company is pro-active in its risk management functions and not just managing crises if and when they arise. In a legislated environment, this could prove too little too late.

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Module 4

Evidence of compliance or non-compliance in an organisation.

Outcomes for module 4:

Learners will be able to:

- Identify evidence of compliance or non-compliance in the documents of a specific organisation.
- Check compliance to an organisation's systems on site and indicate any deficiencies in a report.
- Explain the implications of instances of non-compliance for insurance claims and give three examples of circumstances when a claim may possibly be repudiated

Introduction

In making their decision about compliance or non-compliance, a company in the financial sector needs to remember that, under FAIS, it has to be monitored by a compliance officer in the event that it has more than one key individual and one representative.

Specific monitoring duties are required, i.e.

- the compliance officer must carry out a compliance monitoring process and report to the management of the company at least once every three months
- The compliance officer must complete an annual report and submit to the FSB
- The company's auditors must submit a FAIS accounting report on an annual basis along with the financial statements.

The monitoring report

A compliance monitoring report will differ for each entity according to their operational requirements.

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Many smaller entities are basing their monitoring process on the annual FAIS report to the FSB in order to ensure conformity across the various reporting processes.

Please see Annexure A for an example of a FAIS Monitoring Report.

The annual report

The compliance year starts on 1 June and ends on 31 May of each year. The compliance officer must submit the annual report to the FSB by 15 August of each year or face penalties.

Implications of non-compliance for insurance claims and give three examples of circumstances when a claim may possibly be repudiated

A contract of insurance is a contract of good faith – bona fides. This requires the prospective insured to disclose any material information which will impact on the acceptance or otherwise of a proposal for insurance. Material information is that which establishes the level of risk that the insurer/underwriter may be exposed or not exposed to.

The disclosure of any material information can lead to the insurer taking any of the decisions below, namely:

1) accept the risk as is for a premium
2) refuse outright to accept the risk
3) accept the risk subject to a higher premium, and/or impose an additional or higher excess or impose a waiting period.

If the material information pertaining to the risk is not disclosed, it may prejudice the Insurer/Underwriter in terms of quoting a lower premium.

If at the claim stage the underwriter becomes aware that the risk is greater than what was anticipated, the claim can be reputed, because the Insurer /underwriter had relied on the *bona fides* of the proposer.

Examples:

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- If the proposer does not disclose that the alarm is not in working condition and the premises are burgled, the claim can be repudiated if he had disclosed that the premises are alarmed.

- If the tracking device on a vehicle is not activated and it is stolen and the Insurer was not informed that the tracking device is fitted but not activated.

- If you do not disclose that you live across the road from an informal settlement.

- If you do not disclose that your previous insurer had given 30 days to cancel the policy.

Another area of compliance is with regards to the policy terms and conditions. If the terms require one to notify the Insurer or the broker within 30 days of the event, this condition must be adhered to. The reason for this is that, if the services of a loss adjustor are required, the evidence will still be fresh and the chances of prejudice to the parties will be minimized.

In most cases it depends on the relationship the client has established with the broker or the Insurer. So even if the claim is reported a few days after the 30 day period has lapsed, the claim may still be entertained.

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