

FINANCIAL SERVICES BOARD



FINANCIAL ADVISORY AND INTERMEDIARY SERVICES ACT, 2002 (“FAIS ACT”)

FAIS CIRCULAR 11/2010

DATE: 13 December 2010

Circular on the requirement to obtain suitable guarantees, Professional Indemnity Cover and/or Fidelity Insurance as per the requirements of the Notice on Requirements for Professional Indemnity and Fidelity Insurance Cover for Providers, published in Board Notice 123 of 2009

1. Background

The Office of the Registrar of Financial Services Providers has received a number of queries regarding the requirements for Financial Services Providers (FSPs) to obtain Professional Indemnity Insurance and/or Fidelity Insurance Cover. Three types of guarantees or insurance cover are described in the Board Notice, namely suitable guarantees, Professional Indemnity Cover and Fidelity Insurance Cover. The Registrar has therefore deemed it appropriate to provide the following explanation for information purposes.

2. Suitable guarantees

A guaranty can be described as a promise by which one person assumes responsibility for paying another's debts or fulfilling another's responsibilities. Suitable guarantees refer to guarantees obtained through another entity, which is not provided in the form of insurance. Typically such guarantees are issued by a registered Bank.

In the case of a Bank, such guarantees can be issued after they have satisfied themselves that all the requirements have been met.

When suitable guarantees are issued by an entity such as a Bank, the following should be taken into consideration:

- (a) The guarantee should function as an alternative form of security and must provide the same measure of security as cash or money on deposit. The guarantee must thus be a substitute for money and must provide the beneficiary with a speedy and certain monetary remedy against the provider of the security. The guarantee must embody an abstract payment undertaking which becomes binding solely by virtue of the issue of the guarantee itself.
- (b) The so-called 'independently liability principle' must apply to this form of security. Although the issue of the guarantee arises from some underlying agreement or relationship between the beneficiary (client) and the principal (FSP) on the rendering of financial services, the guarantee must be separate from that contract or relationship and the rights and obligations created by the guarantee must be *independent* of those arising under any underlying agreement, contract or relationship. See *Loomcraft Fabrics CC v Nedbank Ltd and another* 1996 (1) SA 812 (A) at 814 for a discussion of the 'independent liability principle'.
- (c) The guarantee must be documentary in character, in the sense that the amount and the duration of the duty to pay, the conditions of payment, and termination of the obligation to make payment should depend solely on the document itself. The guarantor (issuing bank) must not be concerned with the investigation of external facts, such as the fact of the principal's (FSP's) default in performance of the underlying contract or the amount of the actual loss actually suffered by the beneficiary (client) as a result of that default. The undertaking of the guarantor (issuing bank) differs from that of a surety. The guarantee contains an unconditional undertaking to pay a specified amount to a named beneficiary on demand. A contract of suretyship, by contrast, involves 'an accessory contract by which a person (the surety) undertakes to the creditor of another (the principal debtor), primarily that the principal debtor, who remains bound, will perform his obligation to the creditor and, secondarily, that if and so far as the principal debtor fails to do so, the surety will perform it or, failing that, indemnify the creditor' (*Caney's The Law of Suretyship in South Africa* (2002) 5 ed by CF Forsyth and JT Pretorius at 27-8).

Although it is not the function of the Registrar of Financial Services Providers to prescribe the manner and format of suitable guarantees, a proposed template is attached to this circular. The template serves merely as a guideline as to the form and manner that such a guarantee can take.

3. Professional Indemnity (PI) Cover

PI cover protects a business against claims for loss or damage by a client or a third party if you have made mistakes or are found to have been negligent in some or all of the services that you provide for them. PI insurance will also cover legal costs. PI Cover thus provides cover when a claim is lodged against an FSP or its employees for restitution when a client has suffered losses or damages as a result of a professional action of the FSP or its employees.

- (a) Ensure you are properly covered.
- (b) Remember that PI cover is usually only valid whilst the policy is in place. Claims will only be covered if the policy is still active and in place. It is thus important to remember that if you plan to **cancel your policy** when you close your business or retire, you may need to arrange 'run-off' cover for a period of time afterwards.
- (c) Another aspect to remember is that if you plan to change insurers, you will either need to arrange run-off cover or get agreement from your new insurer to accept new claims for prior incidents.
- (d) Remember that you will need to check that the PI Cover you obtain also covers your employees.

4. Fidelity Insurance (FI) Cover

- (a) Fidelity Insurance provides cover in the event that an FSP incurred losses as a result of theft or other acts of dishonesty by its employees.
- (b) Fidelity insurance protects organisations from loss of money, securities, or inventory resulting from crime. Common Fidelity claims allege employee dishonesty, embezzlement, forgery, robbery, safe burglary, computer fraud, wire transfer fraud, counterfeiting, and other criminal acts.
- (c) Liabilities covered by crime insurance usually fall into two categories, although many policies combine both types of coverage:
 - i. **money and security coverage** pays for money and securities taken by burglary, robbery, theft, disappearance and destruction.
 - ii. **employee dishonesty coverage** pays for losses caused by most dishonest acts of your employees, such as embezzlement and theft

5. Can guarantees or PI/FI cover be obtained at a Group Level?

Where an FSP forms part of a group of companies, the guarantees or PI cover may be obtained at group level, provided that:

- (a) each FSP that is covered by the group policy is clearly identified in the guarantee/policy documentation, and
- (b) the value of the guarantee or amount of cover is sufficient to cover the amounts required for each individual FSP's situation, and

- (c) each FSP has a certified copy of the guarantee/ PI cover available for scrutiny by the Registrar should it be required.

6. What is meant by “maintain in force”?

- (a) There is a requirement that the “suitable guarantees”, PI cover or Fidelity Guarantees must be maintained in force.
- (b) This means that the FSP must ensure that they at all times have valid and active guarantees, PI cover and/or Fidelity Insurance Cover in place. Should an FSP decide to change their service or product supplier in this regard, they have to change over seamlessly, with no gap in cover.

An example is that FSP XYZ obtained PI cover to the value of R2 million with ABC product supplier. The cover was taken for 12 months, starting on 1 September 2010, ending on 31 August 2011. During 2011 they obtain a better product through DEF product supplier. They take out this PI cover from 1 October 2011, also for a 12 month period. The problem is that they had no PI cover from 1 September 2011 to 31 September 2011. This is not allowed.

7. How much cover is required?

It is important to take out cover that is sufficient to cover the risk your business face. The prescribed minimum is just that – the minimum you must have. You may require more cover than the minimum. Please discuss this carefully when taking out such cover, to ensure that you are adequately covered.

8. Who needs to take out this cover?

FSPs that do not receive premiums or hold assets on behalf of clients

Category	Choose one of the requirements below:	
	Suitable guarantees	PI Cover
I or IV	Minimum of R1 million	Minimum of R1 million
II and/or IIA	Minimum of R1 million	Minimum of R1 million

FSPs that receive premiums or hold assets on behalf of clients

Category	Choose one of the requirements below:	
	Suitable guarantees	PI Cover <u>and</u> Fidelity Insurance Cover. This can be a combined policy, but each type of cover must be at least:
I or IV	Minimum of R1 million	Minimum of R1 million
II, IIA, III	Minimum of R5 million	Minimum of R5 million each

9. Date of commencement

FSPs are required to have active and valid guarantees, PI Cover and/or fidelity Insurance cover, as it applies to them, in place by 21 September 2010. They must ensure that they maintain it thereafter.

REGISTRAR FINANCIAL SERVICES PROVIDERS

Example: Template that can be used when an entity issues a suitable guarantee in terms of the Notice on Requirements for Professional Indemnity and Fidelity Insurance Cover for Providers, published in Board Notice 123 of 2009

Suitable Guarantee

Bank's name and Address of Issuing Branch or Office:

At the request or on behalf of{insert name of FSP} we hereby undertake to pay {amount in words} upon receipt by us of the first written demand by the Chief Executive Officer of{name of beneficiary}.

Notwithstanding anything to the contrary in this guarantee, our obligation shall be construed as principal and not as accessory and shall not be delayed or discharged by the fact that a dispute exists between us, the beneficiary and/or any third party.

This guarantee shall be neither negotiable nor transferable.

We choose our *domicilium citandi et executandi* as indicated above and unconditionally submit to the jurisdiction and law of the South African Courts.

This guarantee shall expire at the close of banking hours on{expiry date}.

Signed at thisday of

..... {Full name & capacity of signatory}{signature}

As witnesses:

1.
2.