MINUTES OF MEETING BETWEEN GAA AND FIDELITY FUND

HELD AT CENTURION ON 27 NOVEMBER 2018 AT 10:00 AM TO 11:30AM

Present:

Representing the Fidelity Fund:

Motlatsi Molefe (Chief Executive Officer), Jerome Losper (Claims Executive), Andrew Stansfield (Fund Management Executive), Robert Burawundi (Investment Executive), Jan de Beer (Risk Management Executive).

Representing the AIIF

Sipho Mbelle (Managing Director) and Thomas Harban (General Manager).

Representing the GAA

Chantelle Gladwin-Wood (Co-Chairperson), Hilde Eksteen (Secretary).

Welcome

Mr. Molefe commenced the meeting and welcomed all attendees. He emphasised that the Fund welcomes our engagement and wishes to do so openly and transparently.

The meeting was called in order to address the GAA's correspondence, dated the 21st of November 2018, regarding certain queries arising from the implementation of the Legal practice Act (LPA).

Mrs. Gladwin-Wood briefly introduced the Gauteng Attorneys Association, as an all-inclusive, independent association which was inaugurated in August 2018 with its

main objective being to protect and promote the interests of all attorneys who are based in and around the Province of Gauteng, by acting similar to that of a Trade Union.

THE FOLLOWING QUESTIONS WERE RAISED BY THE GAUTENG ATTORNEYS ASSOCIATION AND ANSWERED BY THE FIDELITY FUND:

1. **Section 86(4) investments.**

a. It is understood by the legal practitioners that The Fidelity Fund takes 5% of the interest earned even though there is no protection provided to the clients in lieu of their contributions. The Fidelity Fund was therefore requested to consider removing this charge, because clients are paying for something without any benefit to themselves.

The Fidelity Fund made it clear that the above statement regarding our clients' cover is incorrect. They stated that the clients have always been and are still covered by the Fidelity Fund.

Before proceeding, it was re-iterated that all legal practitioners take cognisance of the fact that the previous Section 78(2 A) Trust Account has changed to a **Section 86(4) Investment Account** with the implementation of the LPA.

This account is normally used for the investment of trust monies of a specific client where there is an underlying legal transaction, and this also gives the largest exposure to the Fund. While the Fund was the only risk taker in the past, the clients had the benefit of investing monies into this account, whilst receiving full cover from the Fund as well as accruing interest thereon.

This gave rise to the reasoning behind the 5% contribution payable to the fund.

The 5% payable will be calculated and deducted from the interest accrued on the money deposited during the course of the calendar month or on

maturity. In laymen's terms our clients will contribute a minimum amount, which is calculated on the interest they accrued, in order to cover their section 86(4) investments against theft or misappropriation.

The claim must however still meet the requirements as set out in the Legal Practice Act.

b. Rule 55 and Temporary Transactions

Rule 55.3.2 states that Rule 55 shall not apply in cases where any investment is of temporary nature that is made in the course of and incidental to conveyancing and or other matters, including litigation, to which the investing client is a party.

A temporary investment in terms of Rule 55 can therefore qualify as an investment done by the legal practitioner on behalf of a client, without rendering any legal services. Furthermore the client will be entitled to the full amount of the interest accrued. The legal firm will be entitled to a reasonable fee, and will have to open a separate account in this regard.

If a legal practitioner provides services relating to investments and investment advice (loosely defined as an investment practice) he/she should comply with the FAIS Act, and must register with the FSCA as a financial services provider (FSP) and apply for the required license to operate an investment practice. The FSB (as the FSCA was known then) had issued an opinion to the LSSA in this regard. The provisions of Rule 55.12 will also apply in this regard.

Legal Practitioners also have to inform a client upfront that the client will not be protected by the Fidelity Fund in cases of Rule 55 investments.

It is also extremely important that Legal Practitioners take cognisance of the fact that the Fund cannot be held liable to refund the monies paid over to

the Fund in terms of the 5% contribution, where the Legal Practitioner incorrectly invested the money into a Section 86(4) Investment Account.

c. The "old" Section 78(2A) Investments.

The matter was dealt with in the discussion under paragraph 1(a) above.

The previous Section 78(2A) Trust Account has changed, with the implementation of the LPA, to a Section 86(4) Investment Account.

2. Interest "sweep" exemption

In terms of the LPA the 5% interest in terms of the section 86(4) account, owed to the Fidelity Fund will be deducted automatically (swept) from the investment/ bank account of Legal Practitioner while financial institutions are in the process of getting their mechanisms in place. Nonetheless, the Fidelity Fund passed a resolution to delay the implementation until the 1st of March 2019. This will ensure synchronization between the new tax year and the special levy contribution and will make it more practical for all stakeholders.

The Regulator, as well as the relevant auditing institutions such as SAICA and IRBA are being kept up to date on a regular basis and have full knowledge of the implementation of the LPA. They have to be aware of the fact that the 5% interest is not payable retrospectively from the implementation of the act.

The Regulator will therefore have to approve the audit in the event that a Legal Practitioner receives a qualified report from his/ her auditor and must state non-compliance with the LPA if the Legal Practitioner fail to pay the 5% contribution from date of commencement of the LPA.

3. Deceased Estates and Interest

A clear differentiation should be made between a Deceased Estate Account and a Short Term Investments which is regulated by Section 86(4) of the LPA.

Section 28 of the Administration of Estates Act 66 of 1965 states that an executor of an estate shall as soon as he/she has in hand moneys in the estate in excess of R 1 000.00, open a cheque account in the name of the estate with a bank in the Republic and shall deposit therein the money which he/ she has in hand and such other money as he/she may from time to time receive for the Estate.

A Legal Practitioner should therefore take cognisance of the fact that if he or she acts as an executor of an Estate Late and where he/she receives monies over and above the threshold mentioned in Section 28 of the Administration of Estates Act 66 of 1965 that a separate cheque account must be opened, and that these monies should not be placed in section 86(4) short term investment account. The Directive issued by the Chief Master purportedly authorising the administration of estate funds through the attorney's trust account is thus *ultra-vires* as it contradicts the provisions of the legislation.

The client is protected either way, whether the monies are invested in a separate Deceased Estate Account or invested in a Section 86(4) Account. However the same rules will apply in cases where the monies are invested in the Section 86(4) Account, and the 5% levy will still be payable.

From an administrative point of view it is also very important to understand that even though the Legal Practitioner runs and operates separate Estate Late Accounts, these accounts will still form part of the accounting records as a defined in the Act, and should be disclosed in your application your Fidelity Fund Certificate.

It is also critical to understand the roll of the AIIF and the bonds of security they provide. The terms and conditions under which the AIIF grants bonds of security to executors of deceased estates include the requirement that a separate estate late bank account be opened as prescribed in s28 of the Administration of Estates Act and that all estate funds be deposited into such account.

4. Premiums and Professional Indemnity Cover.

It is important for all Legal Practitioners to note that the Fidelity Fund is not under the obligation to provide Professional Insurance (PI) cover. The legislation gives the Fund a discretion (not an obligation) to provide the professional indemnity insurance vehicle for practitioners (it will be noted that s 77 of the Act uses the word 'may'.) The AIIF premium is currently paid by the Fund on behalf of practitioners.

5. We have already been advised of the reasoning behind the 5% interest clause in Section 86(4) of the LPA – which will no doubt create a significant and impacting additional source of income for the Attorneys Fidelity Fund. We were at the same time informed that the Attorneys Fidelity Fund will no longer be able to subsidise the annual premiums towards the Attorneys Insurance Indemnity Fund (AIIF) and that (if we recall correctly) practitioners will now have to foot that bill in its entirety.

   The questions that may need to be posed are the following:

   a. Where is the extra source of income going to be directed to?
   b. If they are no longer going to subsidise the AIIF premium, where is that saving going to be directed to?
   c. Have they considered what the impact of the extra burden (of having to pay the AIIF premium in toto) will be on new and existing practitioners, especially the single practitioners and smaller practices? We are already seeing the impact of practitioners being unable to even afford annual membership fees and audit fees. This extra burden will no doubt

impact on practitioners entering – and perhaps even remaining in – the profession.

d. Have they considered the impact what the interest clause will have on practitioners' clients? It may sway clients to seek other forms of securing their funds required for any transaction or litigation.

The claims received by the AIIF have grown excessively over the past couple of years, and therefore the risk of the Fidelity Fund increased at a phenomenal rate; for example in September 2018, (only three months into the AIIF's insurance year) the AIIF already bore the risk of paying out R55 million in claims, an increase compared to prior years.

The current outstanding liability for the outstanding AIIF claims is R524 million. The annual rate of claims growth is a cause of concern for the AIIF and the Fund. The AIIF's auditors have noted this and had requested that the Fund provide a letter of comfort committing itself to the future funding requirements of the AIIF. The AIIF premium is currently the largest single cost item on the Fund's balance sheet. The growth in AIIF claims can be curtailed if practitioners change their underlying behavior that leads to claims being brought against them.

The AIIF and the Fund have worked with experts from SA and other countries and the result of that project was that the AIIF is the most appropriate vehicle to provide the primary layer of professional indemnity insurance to the legal profession in this country, taking into account, amongst others, the size and structure of the profession and the legislative and regulatory environment. The outcomes of the exercise were also that the AIIF funding model.

It is against this background that the AIIF funding model has been re-assessed. The AIIF premium only covers the expected claim costs and the costs of administering the company. There is no allowance for a profit build in. In changing the funding model there is a sensitivity to avoid introducing another barrier of entry into the profession. For this reason, the proposal is

that new entrants to the profession be granted a two year exemption in respect of the payment of the contribution to the premium funding. The Fund will continue paying the premium, with the professions' making a contribution to a part thereof. The contribution from the profession will gradually increase over time.

The AIIF will gather risk related information on the profession over time and that data will be used for underwriting and risk related information so that risk profiles can be drawn. The risk profiles will in future be used to determine the premiums paid by individual practices, depending on their risk.

The Act establishes the legislative framework for the premium collection model. Section 77(5) authorises the board of the Fund to levy the premium, which must be paid when the application for a fidelity fund certificate is made (sections 74(1)(a)(i), 74(5) and Rule 51).

The Fund will always pay the premium to the AIIF. The LPA allows the Fund to collect a contribution in respect of the PI premium it paid to the AIIF, and the LPC have the responsibility to collect the premium and the payment of the contribution by the practitioner is required for receiving a fidelity fund certificate.

This will allow the Fund to ensure its own sustainability and that of the AIIF.
The time period in which the payment of contributions to the premium is phased in, appropriate underwriting models will be developed to define appropriate risk adjusted premiums for practitioners.

The 5 year transition period will also make it easier for Legal Practitioners to get used to making the contribution and will ease the transition for all parties. The AIIF is currently insuring all practitioners and it intends to keep it that way. It will therefore be compulsory for every Legal Practitioner to contribute towards the AIIF in order to be covered.