Umbrella Fund

Sanlam Umbrella Fund Industry Update

Joint Forum update

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Insurance | Financial Planning | Retirement | Investments | Wealth

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Draft Taxation Laws Amendment Bill & Draft Tax Administration Laws Amendment Bills, 2017

The Draft Taxation Laws Amendment and Tax Administration Amendment Bills, of 2017, were published for comment on 19 July 2017. In the draft Bills the government announced a number of amendments relating to retirement funds. Most of these are in the nature of correcting or removing anomalies and we really must applaud the way in which National Treasury has responded to industry concerns in the last few years. We do however wish to take issue with the first proposed amendment.

1. Transferring retirement fund benefits after reaching normal retirement date

In 2014, government changed paragraph 4 of the Second Schedule of the Income Tax Act to the effect that retirement benefits, like withdrawal benefits, will only be taxed as such, once the member has elected payment. This was something of a watershed change and opened the door for occupational retirement funds such as the Sanlam Umbrella Fund to offer their members much more than active membership benefits. This amendment opened the door for phased retirement and a new generation of paid-up membership.

Our request to National Treasury has been to allow phased retirees to transfer to any other retirement fund – including a retirement annuity fund or a preservation fund. It would make sense for a member of a fund with a restrictive or costly benefit structure, to transfer to another fund with a more attractive or cost effective offering.

In the draft Bill, National Treasury only allowed phased retirement benefits to be transferred to a retirement annuity fund.

Observation:

The industry however appears to have convinced National Treasury, since the publication of the draft Bill, to allow transfers to preservation funds as well on condition that the once off withdrawal will not be allowed.

2. Tax exempt status of pre-March 1998 build-up in public sector funds

In an emancipation exercise in which certain public sector retirement fund members were allowed to transfer their benefits to private retirement funds, the Income Tax Act was amended to ensure that benefits (accumulated before March 1998) will remain tax-free on exit from the private sector retirement or preservation fund that they transferred to. If the benefits were transferred to a second fund the tax advantages were lost.

The Government now recognises that where employers (whose employees belong to a private sector fund to which their pre-March 1998 benefits were transferred), for purposes of improving economies of scale, merged or consolidated with other employers, thereby forming a different fund, the exemption applying to pre-March 1998 benefits will no longer apply and this results in unfair treatment.

In order to address this anomaly, changes will be made with effect 1 March 2018 to allow for the tax-free status of pre-March 1998 benefits to remain intact upon one additional transfer.

Observation:

It appears that the effective date refers to the date on which the member exits from the second fund. That would mean that it would benefit all those members who have already transferred to a second fund. They may, at the time of transferring to the second fund, have accepted that they have lost the tax concession but if they only exit the fund after 1 March 2018, their benefit will continue to qualify for the tax exemption.

3. Removing the 12-month limitation on joining newly established pension or provident fund

When an employer establishes a new pension or provident fund or joins an umbrella fund for the first time, existing employees have up to 12 months to make application to join that fund. An employee who fails to make application to join within the 12-month period is not permitted to join that fund at any later stage.

We pointed this aspect out to National Treasury two years ago and they agreed that the limit is restrictive and creates policy anomalies.

It is proposed that the current limit of 12 months be removed with effect from 1 March 2018 so that employees who were already in service of a particular employer are allowed to join that fund at any time, subject to the rules of the fund.

Observation:

This adjustment will only affect a small number of South Africans but it is important that this anomalous provision be removed. We prepared a member communication to assist employees in that position to consider the advantages of retirement fund membership.

4. Postponement of annuitisation requirement for provident funds to 1 March 2019

In terms of the T-Day legislation, compulsory annuitisation was introduced for provident fund members with effect 1 March 2016 (only in respect of contributions made after this date). In February 2016 however, Government postponed this requirement for two years. "The postponement was done in order to provide sufficient time for the Minister of Finance to consult with interested parties, including National Economic Development and Labour Council (NEDLAC), regarding the annuitisation requirements for provident funds after the publication of the comprehensive policy document on social security, and to report back to Parliament on the outcome of those consultations no later than 31 August 2017."

Because much has happened since and the discussions on the comprehensive paper on social security are still underway in NEDLAC, the provisions will be postponed for one year until 1 March 2019.

Observation:

We recognise that the situation is complex and problematic. We welcome the fact that the industry is provided with clarity well in advance.

5. Monthly tax deduction may not exceed one-twelfth of R350 000

In terms of the draft Tax Administration Laws Amendment Bill, paragraph 2 of the Fourth Schedule to the Income Tax Act, will be amended to provide that the monthly tax deduction allowed may not exceed one-twelfth of the R350 000 annual threshold, i.e. the tax deduction may not be more than R29 166 per month.

Observation:

The maximum tax deduction iro of retirement fund contributions of R350 000 has created a number of practical administrative problems. After consultation with the industry, the consensus was that it is best to allow only a proportional amount as a deduction every month.

The default regulations

1. The final version

The default regulations were gazetted on 25 August 2017 and (read with Notice 3 of 2017 issued by the Registrar of Pension Funds on 30 August 2017), will become effective in 18 months' time on 1 March 2019 in respect of existing funds. It will however apply with immediate effect to all new funds registered on or after 1 March 2018.

These regulations follow on the 2011 National Treasury paper, Charges in South African Retirement Funds. The first draft was published on 22 July 2015 and a second on 23 December 2016.

In essence, the default regulations require all pension and (most) provident funds to establish a default investment strategy, a default preservation strategy and an annuitisation strategy that would be appropriate for their members. The annuity strategy however only applies in respect of those provident funds and provident preservation funds where the rules provide for an annuity. The annuity strategy in addition also applies to pension preservation and retirement annuity funds.

These regulations have been received very well by the industry and many funds, especially the commercial umbrella funds, have already started to implement default options.

The regulations seek to ensure that retirement savings of South Africans are invested with clear retirement objectives in a prudent and cost-effective manner and that they enjoy the strategic advantage and the economies of scale that a group arrangement offers. It re-emphasises that boards of retirement funds have the responsibility to secure and protect the interests and investments of retirement fund members during and post the accumulation stage.

These regulations will place a much greater responsibility on retirement fund trustees and their advisors. Trustees of stand-alone funds may be required to gather additional member data and ensure (and be able to demonstrate to the Registrar) that the defaults are appropriate for the members who will be enrolled into them. This effectively means that trustees should ensure that the default investment portfolio, the in-fund preservation strategy and the annuitisation strategy they implement would provide members with the most appropriate pension in return for the contributions invested. The fund's default benefit structure now reminds of a group personal financial plan for the members invested in it.

The position in respect of umbrella funds is still in the process of development. The industry requested National Treasury to adjust the regulations to reflect the current reality in respect of Umbrella fund – and that is that each employer is allowed to select the most appropriate umbrella offering and or default investment strategy for its employees. What is envisaged is that the regulations will be amended to require each employer with the assistance of a FAIS accredited benefit consultant to ensure that the default investment portfolio/s are appropriate for the profile of its membership.

The default regulations also attempt to slow down the rate at which withdrawal benefits are taken in cash. It does so by making sure members have access to a counselling service before they make an election with regard to the manner in which their benefits must be paid, failing which, the member's benefits will remain in the fund as a paid-up benefit. This however introduces a retail element to occupational retirement funds.

The default regulations in addition aim to improve portability of pensions and introduce measures aimed at encouraging the consolidation of benefits in the new employer's fund.

What National Treasury has not attempted to do in these regulations is to align the characteristics of the alternatives available to a withdrawing member, such as preservation fund membership, paid-up membership, a member with transferred withdrawal benefits and ultimately also a phased retiree.

No significant changes introduced

The final version of the regulations did not introduce any significant new concepts and requirements that were not contained in the last draft version of the regulations.

2. Default investment portfolio

An appropriate default investment portfolio for the members

Pension and provident funds (in respect of any Defined Contribution (DC) component) will have to amend their rules to provide for one or more default investment portfolios (DIP) by 1 March 2019.

The board must ensure (and be able to demonstrate to the Registrar on request), that the default investment portfolio(s) are appropriate for the members who will be automatically enrolled into them. The design aspects of such a portfolio that must be focused on include its objective, underlying asset allocation, fees and charges and the expected risks and returns to which it exposes its members.

More than one default

The DIP may differ for members in different membership categories. In addition the composition of the portfolio for members in one membership category (e.g. those who are invested in a lifestage strategy) may differ from member to member based on the following factors: the age or likely retirement date of the member, the value of the retirement savings of the member in that fund and the actual or expected retirement funding contributions of the member.

Which investment portfolios will qualify?

Most existing regulation 28 compliant portfolios should qualify in principle. In the last draft of the regulations, National Treasury indicated that special requirements may be imposed in respect of guarantees and performance fees. These concerns have not been articulated in the regulations but the Media Statement mentions that performance fees will be allowed subject to a standard to be issued by the FSB.

The board must in addition ensure that:

- The fees and charges in respect of the default investment portfolio(s) are reasonable and competitive, taking account of the size, asset allocation and other characteristics of the fund;
- All fees and charges (whether borne directly or indirectly by the fund, implicit or explicit), are disclosed on a regular basis, not only to the trustees but are also appropriately disclosed to members, in a clear and understandable language, and in formats which may be prescribed;
- Both passive and active investment strategies are considered as part of the default investment portfolio;
- There are no loyalty bonuses or other complex fee structures;
- Members are not locked into the default investment portfolio if member investment choice is provided. The cost of transfers between portfolios must be reasonable;
- The default investment portfolio is reviewed on a regular basis to ensure compliance/appropriateness.

Much higher level of investigation and research

In order to comply a fund (and potentially a participating employer) will have to determine its membership profile and their retirement needs and requirements. Based on this information it will have to agree on an investment objective, the underlying asset allocation, the expected risks and returns and the fees and charges. The solution should be reviewed on a regular basis to ensure that it remains appropriate and cost effective for the members who will be automatically enrolled into them.

This requires a level of investigation and research that is higher than the selection procedure presently adopted by many funds. In selecting the defaults the board should not only ensure

compliance with its new statutory duties; it should also prepare to explain or, where appropriate, be able to defend, its default offering to disgruntled members who complain to the Pension Funds Adjudicator or the FSB. A failure to comply could have a number of implications, especially if members can prove that they suffered financial losses as a result of the failure.

3. Default preservation and portability

The rules of pension and provident funds will have to be amended by no later than 1 March 2019, to provide that members who terminate service before retirement become paid-up in the fund, until the fund is instructed by the member in writing to make payment of or transfer his/her benefit.

Withdrawing members: At present, around 80% of members take their withdrawal benefit in cash. In terms of the default regulations such a member must be given access to retirement benefits counselling before any withdrawal benefit is processed. In addition the benefits must remain paid-up in the fund (in the same portfolio unless the rules provide otherwise) until the member completes and signs the forms instructing the fund to pay out or transfer the benefits.

These regulations will require the fund and or the HR office to adjust their processes and procedures somewhat. The member should be invited to consider an explanation of his or her preservation options under the fund as well as their risks, costs and charges. Our interpretation is that this information can be provided in writing (or in such other medium that may qualify or be prescribed) but in addition the member should have access to a counsellor on request. Should the member decline the offer to receive counselling (preferably in writing), the process would be much the same as before. The signed form will however have to be kept on record for compliance purposes.

Paid-up members: Those members who would like to preserve their benefits (and practically anyone else that has not submitted written instructions to withdraw or transfer their benefits) will remain invested in the same portfolio in the fund (unless the rules provide otherwise) until such time as the member provides instructions.

Defined Benefit (DB) fund trustees should note that upon the member becoming paid-up, a defined benefit amount must be converted to a defined contribution component and have it preserved as such;

Paid-up members must be presented with a paid-up membership certificate within two (2) calendar months (of the fund becoming aware that the member has left the services of the participating employer).

Investment fees and charges in respect of the portion of the member's benefit invested in the default investment portfolio may not differ on the basis of a member's paid-up status. The administration fees for paid-up members must be fair, reasonable and commensurate with the cost of providing the administration service to members still in the service of the participating employer.

The fund rules should specify that in respect of paid-up members, no new contributions to the fund are permitted, no deductions may be made in respect of risk benefits, and members must be given access to retirement benefits counselling before any withdrawal benefit is paid to them or any transfer is made on their behalf to another retirement fund.

Transfers into the new employer's fund - Portability: The rules of the fund must allow for transfers into the fund from any other fund. The fund must within four (4) months of a member joining the fund, obtain a list of all paid-up membership certificates in respect of any retirement savings of that member; request whether the member wishes these benefits to be transferred into the fund; and if the member so elects, arrange the transfer of all such retirement savings into the fund without levying a charge on such amounts in respect of the transfer. This provision also applies to transfers from DB funds provided that such transfers comprise a defined contribution benefit component.

These new duties are placed on the fund. The fund however will not be able to process these requirements if they do not have the support of the employer and do not have access to the personal

contact details of all new members. Employers must therefore expect retirement funds to become much stricter on the provision of member data, especially tax numbers, cell numbers and e-mail addresses. It appears possible however for most of these requirements to be integrated and complied with when the member (new employee) goes through the onboarding procedures of the employer. In fact, the forms that will be prepared to help capture these requirements can in principle be forwarded to the new employee together with his or her appointment letter.

At present there is a difference in the status of a paid-up member and a member who transferred benefits to the new employer's fund. A paid-up member can withdraw the entire paid-up benefit at any time whilst the transferred benefits can only be withdrawn when there is a benefit event such as resignation. In addition to this aspect, the important considerations members and their advisors will be keen to compare are the costs and features of the old and new fund's "preservation options".

4. Annuity strategy

All pension, pension preservation and retirement annuity funds, as well as provident or provident preservation funds, where the rules enable a member to elect an annuity, must establish an annuity strategy by 1 March 2019.

The annuity/ annuities provided for in the annuity strategy must be appropriate and suitable for the specific classes of members who will be enrolled into them.

Boards must ensure (and be able to demonstrate to the Registrar on request), that in determining an annuity or annuities, the board has considered, as far as it can reasonably ascertain, the level of income that will be payable to retiring members, the investment, inflation and other risks inherent in the income received by retiring members, and the level of income protection granted to beneficiaries in the event of the death of a member enrolled into the proposed annuity.

The board must in addition ensure that:

- the asset class composition of the investments, their performance and changes in the incomes in respect of the annuity are communicated to members on a regular basis, in a clear and understandable language and in a format which may be prescribed
- the fees and charges in respect of the annuity or the assets held in respect thereof are reasonable and competitive, considering the benefits provided to members
- all fees and charges (whether borne directly or indirectly by the fund, implicit or explicit), are disclosed on a regular basis not only to the board but that in addition the relevant information is appropriately disclosed to members, in a clear and understandable language, and in formats which may be prescribed
- members are given access to retirement benefits counselling not less than three (3) months before their normal retirement age as defined in the rules of the fund
- the annuity strategy is reviewed at least annually to ensure that the annuity or annuities continue to comply with the regulations and are appropriate for members.

Living Annuities: Living annuities may be paid directly from the fund or through a fund owned policy or sourced from an external provider as part of the annuity strategy, provided that the investment choice is limited to four (4) investment portfolios (compliant with regulation 28 and 37) and that drawdown levels are compliant with a standard to be prescribed.

Where the living annuity is paid from the fund or through a fund owned policy, funds must monitor the sustainability of income drawn by retirees in these living annuities and make such members aware if their drawdown rates are deemed not to be sustainable.

A compelling way to comply with this requirement may be to model the annuity on an annuity tool, based on a set of standard assumptions.

In-fund pensions: An annuity payable by the fund in terms of the rules of the fund may be chosen as part of the annuity strategy.

Out of fund annuities: Annuities provided by a long-term insurer may be provided as part of the annuity strategy subject to such conditions that the Registrar may prescribe.

5. Exemptions

The Registrar may on written application by a fund or in general, exempt a fund, or categories, types or kinds of funds, from all or any of the provisions of these regulations, subject to conditions that the Registrar may impose. The regulations do not apply to funds in liquidation as contemplated in section 28 of the Act.

Observation:

The Sanlam Umbrella Fund has embraced default strategies and has incorporated all three of them into our benefit structure over the past few years. Many of our members have already adopted these strategies with very positive results.

We will never the less have to do review or processes and procedures, and rules to ensure compliance. These adjustments should not be significant but we will communicate and explain them in due course. We hope to offer participating employers and their members' access to fully compliant default benefits well before the deadline date of 1 March 2019.

The world of work is changing along with advances in technology and the changing needs and behaviours that flow from increased interconnectedness. We appreciate the need for retirement fund benefit structures adjust and adapt.

We are therefore developing strategies to ensure that our defaults will not only be compliant with the new default regulations but will enhance the value of your members' fund membership and give them even more assistance and support in achieving good retirement outcomes.

Unclaimed Retirement Benefit Search Engine

The Registrar of Pension Funds on 16 August 2017 advised that the Unclaimed Retirement Benefit Search Engine is available on the FSB website via the link:

http://www.fsb.co.za/Magic94Scripts/mgrqispi94.dll?APPNAME=Web&PRGNAME=UB_Partial_Search

According to an explanatory document, the search process will be as follows:

- An enquirer will be provided with a unique reference number for each enquiry logged through the FSB search engine. This reference number must be used for future correspondence or enquiries regarding the specific case with the FSB.
- The search engine will establish if there is a possible match on each of the search criteria provided.
- If a possible matching record(s) is identified, the enquirer will be provided with the name(s) and contact details of the administrator and/ or fund(s). A message will also be e-mailed to the administrator/ unclaimed benefits contact person informing them of the possible match and provide them with contact details as furnished by the enquirer.
- Once the enquirer has been provided with the contact detail, he/she will be required to contact the fund / administrator directly and then follow the normal claims process of a fund to lodge a valid claim.

- If there is no matching record(s), the enquirer will be notified that no match could be found on the unclaimed benefits search engine.

Observation:

The administrator of the Sanlam Umbrella Fund, SEB Core, will help update the FSB's unclaimed benefit database on a regular basis.

The Fund encourages members to make use of the search engine to identify benefits that may be payable to them. An enquiry regarding a possible unclaimed benefit can also be made to the FSB's following toll-free numbers: 0800 110 443 or 0800 202 087.