

Legal Report February 2018

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Newsletter of Sanlam Employee Benefits: Legal

1. Draft PF Notice: Communication of benefit projections to members of retirement funds

The Financial Services Board (FSB) published the above draft Notice for public comment. The draft Notice states that pension projections are an important tool in monitoring whether a retirement fund member is saving enough for retirement. Projections assist in managing the expectations of members of a retirement fund and influencing their behavior (contribution rate, period of saving, level of risk, etc.) by educating members about the realistic values of their future retirement benefits and the effect of retirement decisions taken.

The draft Notice requires that the annual benefit statements retirement funds send to their members must include a projection of the expected retirement benefit, which must be explained in a simple and clear manner.

This Notice will apply to every fund that is registered under the Pension Funds Act, excluding beneficiary funds and unclaimed benefit funds.

Frequency of projections

A projection statement should be provided to members when joining a fund, so that they can make a proper decision about contribution rates and investment choice, where relevant.

The annual benefit statement should provide clear and adequate information to current members in order to support them to make informed decisions about their retirement. Furthermore, providing the information will ensure a high level of transparency throughout the various phases of fund membership, starting from when a member joins the fund and continuing regularly during the pre-retirement period.

For living annuities, projection statements must continue on an annual basis after retirement, to allow the members to consider the sustainability of their income and draw down rates.

Communication

The communication to members must disclose that the aim of the projections is to offer guidance and that this is not a promise. Furthermore, a disclaimer should be included to indicate that the projections will differ from the final value of the benefits received.

The minimum key information that must be provided to each member of a retirement fund as part of the communication are the following:

- The member's projected benefit at retirement as a multiple of salary (cost-to-company and not of pensionable salary);
- The projected monthly pension in current day terms;
- The projected monthly pension in current day terms compared to the member's current monthly salary (cost to company), representing the replacement ratio;
- A note on the underlying risks and assumptions;
- The communication must also state to the member that his/her projected retirement benefit from the fund should be added to projected benefits expected from other sources, in order to consider the adequacy of the member's overall retirement provisions;
- For living annuities, the projections must reflect how long the capital will last, given the current draw down rate chosen by the pensioner. This could also be presented graphically.

Methodology

For a defined benefit fund, the projected benefit should be based on the benefit payable in terms of the rules of the fund, based on service to retirement and current pensionable salary.

For a defined contribution fund, the member's share of fund should be projected as follows:

- Applying the contribution rate defined in the rules (elected by the member, where relevant), after deductions for expected risk premiums and expenses;
- The real rate of return to be applied for the projections should be in accordance with certain assumptions provided in the draft Notice;
- The conversion of the share of fund to a pension at retirement should be based on a disclosed pension policy. The assumptions applied in converting the lump sum to a pension should be based on the rates being applied by the fund or the rates being quoted by insurers.

2. Information Circular PF No. 2 of 2018: Annual financial statements

The Circular invites comments on the following three proposals which the Registrar is considering:

2.1 Withdrawal of audit exemption and appointment of an auditor

Small funds are currently audit exempt. The Registrar intends to withdraw this exemption for all financial years commencing after 1 January 2019.

The Registrar states that the intended withdrawal of the audit exemption may lead to an increase in the costs of administering smaller funds. Smaller funds, therefore, should consider the viability of continuing as self-standing funds or alternatively consider transferring to an umbrella fund that will be suitable to meet the needs and requirements of the fund, employer and its members, and by ensuring that such umbrella fund offers good value.

2.2 Submission of annual financial statements

The current practice of certain funds submitting annual returns six to eighteen months after their financial year ends is not conducive to effective supervision. To effectively supervise retirement funds based on more current fund information and financial statements, the Registrar intends to propose that the Pension Funds Act be amended to reduce the period within which funds are required to submit their annual financial statements to the Registrar, from 6 months to 3 months.

2.3 Cash and accrual accounting and disclosure

The Regulatory Reporting Requirements for Retirement Funds as prescribed in Board Notice 14 of 2009 provide that the Registrar could, on application, allow a fund to continue using the non-accrual basis of accounting. However, it is the Registrar's view that funds have now been allowed sufficient time to change their accounting basis to accrual accounting and funds will, therefore, not be allowed to apply the non-accrual basis for financial years commencing on or after 1 January 2019.

3. Information Circular PF No. 3 of 2018: Increased foreign portfolio investment limits

On 21 February 2018, following the 2018 Budget announcement by the Minister of Finance, the South African Reserve Bank ("SARB") issued Exchange Control Circular No. 7/2018, indicating that the foreign investment limits have been revised upward.

Regulation 28(3)(i) in terms of the Pension Funds Act states that the aggregate exposure to foreign assets must not exceed the maximum allowable amount that a fund may invest in foreign assets as determined by the SARB, or such other amount as may be prescribed.

The Circular confirms that, based on the SARB's Exchange Control Circular No. 7/2018, retirement funds may now acquire foreign exposure up to the revised limit of 30% in respect of foreign portfolio investments, and an additional 10% in respect of foreign portfolio investments in Africa.

4. National Budget: 21 February 2018

Since Sanlam Employee Benefits published detailed information and comments on the recent National Budget, only some of the following main proposals which are relevant to the employee benefits industry are highlighted below:

4.1 Improving the treatment of retirement fund members

Government's retirement reform programme will continue in 2018. Progress on the annuitisation of provident funds and preservation has been slower than anticipated because of a delay in the release of the discussion paper on comprehensive social security reform. As a result, consultations in the National Economic Development and Labour Council (Nedlac) on annuitisation of provident funds and preservation are still in progress and expected to be completed by the end of the year. As soon as an initial agreement is concluded, a set of recommendations can be finalised.

Other issues to be referred to Nedlac include broadening coverage to low- income earners who fall outside the collective bargaining system or work for small employers and bringing all public retirement funds within the same regulatory framework as private funds.

Government has also directed the Financial Services Board (FSB) to proceed with the following reforms:

- Lowering costs and consolidating funds: A key driver of costs is the large number of very small and uneconomical retirement funds (there are currently 5 144 funds, of which 1 651 are active). The FSB will oversee a significant reduction in funds (preferably to less than 200).
- Modernising and improving the governance of all retirement funds to King IV standards: All retirement funds (including small funds) will soon have to submit audited financial statements annually and include a minimum number of independent trustees.
- Ensuring benefits are claimed. Working with government, the FSB will consult with Nedlac on more efficient measures to find beneficiaries, including centralising data and funds.
- Strengthening enforcement measures to deal with criminal and unethical practices: The FSB will publish directives in 2018 to improve disclosures by both retirement funds and administrators and to outlaw unethical practices.

4.2 Allowing transfers to pension and provident preservation funds after retirement

In 2017, amendments were made to allow the transfer of pension or provident fund amounts to a retirement annuity fund after the retirement of an employee. These amendments expanded the choice of a retiree who decided to postpone retirement. Pension preservation and provident preservation funds were excluded as the administration required to disallow once-off withdrawals from these funds was considered too onerous. Industry consultations indicated that the system changes will not be burdensome, thus it is proposed that transfers to pension preservation and provident preservation funds be catered for in the legislation.

Preservation funds will have to put controls into place to ensure that the once-off (pre-retirement) withdrawal option is not available for these members.

4.3 Increasing the prudential limit

To increase investment in diverse assets, the offshore limit for funds under management by institutional investors is increased. See paragraph 3 above for more details.

5. SARS Interpretation Note 99: Unclaimed benefits

This Note which was issued on 21 February 2018 explains the treatment of lump sum benefits classified as unclaimed benefits that accrued to members (both before and from 1 March 2009) for income tax purposes.

The outdated General Note 35 has been withdrawn.

Position before 1 March 2009

A lump sum benefit was deemed to have accrued to a member on the date that he or she became entitled to claim a lump sum benefit in terms of the registered rules of the fund. The rules of most funds confirmed that a member became unconditionally entitled to claim a lump sum benefit on the day of his or her resignation, dismissal, retrenchment or retirement from employment. The accrual of the amount was determined by the fact that the member became unconditionally entitled to the lump sum benefit and not whether the lump sum benefit was claimed.

In the case of a death benefit, the lump sum benefit was deemed for income tax purposes to accrue to the deceased member the day before his or her death.

Position on and after 1 March 2009

The legislation was amended with effect from 1 March 2009 to provide that lump sum benefits that become payable under the rules of the fund as a result of a member's resignation, dismissal or retrenchment from employment will only accrue to the member for tax purposes on the date that he or she elects to receive the lump sum benefit as a cash amount, or to transfer the lump sum benefit to another approved fund.

A lump sum benefit that accrued to a member as a result of his or her retirement before 1 March 2015 accrued to a member on his or her retirement from employment. The legislation was amended with effect from 1 March 2015 to provide that retirement benefits only accrue when an election is made by the member to receive the benefit.

The benefit payable by the fund as a result of the member's death accrues to the deceased member on his or her date of death.

6. King IV Practice Notes

Two practice notes were recently issued by the Institute of Directors of Southern Africa (IoDSA), which are also relevant for the boards of trustees of retirement funds.

6.1 Practice Note on board committees

King IV provides practical guidance for the governing body (hereafter referred to as "board") to create specific committees to assist with the discharge of the board's duties. This practice note explains the approach in King IV regarding board committees.

King IV does not prescribe which committees should be established and leaves it to the board to make a judgement decision in this regard, taking into account the needs and interests of the organisation. In delegating to committees the board should aim to achieve:

- Effective collaboration through cross-membership between committees;
- Ensuring complementary work is produced in instances of overlapping of jurisdiction between committees so as to avoid competing approaches;
- A balanced distribution of power of membership within the committees, to avoid dominating member/s and undue reliance on specific member/s.

6.2 Practice Note on declarations of interests

Practices 25 and 26 of the King IV Code Part 5 make recommendations concerning declarations of interests by a board member. The aim of this Practice Note is to provide clarity on the intentions behind Practices 25 and 26.

As fiduciaries, board members have a common law duty to avoid any conflict of interest and to act in the best interest of the entity at all times. This is in addition to any statutory duties. Conflicts of interest may arise where an individual's personal or family interests and/or loyalties conflict with those of the entity. As a general rule, no conflict between the personal interests of members of a board and the interests of the entity which they serve should be allowed. Where a potential conflict of interest cannot be avoided, this has to be managed in such a manner as to ensure that the interests of the entity are at all times protected. It is for this reason that the law in certain instances as well as best practice recommendations call for disclosure of interest in any matter on the agenda of the board or any of its committees.

It is recommended that each board member submits a general declaration of interests that could assist the entity in identifying potential conflicts. Boards are also encouraged to ensure that “declarations of interests” be included as a standard item on the agenda of every board meeting. This should be positioned on the agenda immediately after the standard formalities forming part of the opening of the meeting.

7. Council for Medical Schemes Circular 8 of 2018: Real time monitoring

The Council for Medical Schemes has published monthly real time monitoring submission deadlines for medical schemes during 2018. All medical schemes must submit the required information no later than four weeks after every month end. The following submission dates apply for 2018:

Month data	Submission date	Month data	Submission date
January	By 23 February 2018	July	By 24 August 2018
February	By 23 March 2018	August	By 28 September 2018
March	By 4 May 2018	September	By 26 October 2018
April	By 25 May 2018	October	By 23 November 2018
May	By 22 June 2018	November	By 4 January 2019
June	By 27 July 2018	December	By 25 January 2019

In terms of the Medical Schemes Act any medical scheme which fails to furnish the Registrar with the requisite information, is liable to a penalty of R1 400 for every day for which the failure continues.

Retirement funds or other clients requiring more information should not hesitate to contact their consultant.