Sanlam

Legal Report June 2018

Insurance | Financial Planning | Retirement | Investments | Wealth

Newsletter of Sanlam Employee Benefits: Legal

1. Guidance Notice 2 of 2018: Guidance on Directive 8 (prohibition on the acceptance of gratification)

1.1 Background

Directive 8 was issued on 8 March 2018 to assist in combatting and preventing corruption and corrupt activities in the retirement fund industry. The Financial Sector Conduct Authority (FSCA) has received enquiries relating to the interpretation and implementation of Directive 8 and the purpose of the guidance notice is to provide practical guidance on the interpretation and implementation of Directive 8. The Guidance Notice does not replace Directive 8 and where there is any practical inconsistency between the Guidance Notice and Directive 8, preference must be given to the provisions of Directive 8.

It was especially paragraph 4 of Directive 8 that required clarification, for example whether training by service providers was permissible. Paragraph 4 of Directive 8 states:

"… that the following types of gratification are automatically not permitted to be accepted, agreed or offered to be accepted by a board member, principal officer, deputy principal officer, employee of a retirement fund, valuator, auditor, administrator, employee of an administrator or other officer or service provider to a fund, from any other person connected in whatsoever manner to a service provider of a fund, or from any potential future service providers, in which such principal officer, deputy principal officer, employee of a retirement fund, valuator, auditor, administrator, employee of an administrator or other officer or service provider to a fund or other officer serves:

a) any gratification which objectively viewed, creates a conflict of interest with their fiduciary duty towards the fund;

b) token gift/s that exceed/s the annual limit set by the board in terms of the fund's gift policy, which annual limit shall not be more than R500.00 per annum in aggregate from any one service provider;

c) any gratification relating to local or international due diligences including, but not limited to, subsistence, travel or accommodation;

d) any gratification relating to local or international entertainment or sporting events including, but not limited to, subsistence, travel or accommodation; and

e) conferencing costs or board of fund expenses."

1.2 Guidance on permissibility of training and business meals

Paragraphs 3.2 and 3.3 of Guidance Notice 2 of 2018 provide the following guidance on training and business meals provided by a service provider to a retirement fund officer (e.g. a trustee or principal officer):

*"**3.2 Training***

3.2.1 Directive 8 was not intended to stop training being provided by service providers or attendance at training sponsored by service providers. However, it intends to prevent corruption and corrupt activities being perpetrated under the guise of training.

3.2.2 In order to strike a balance by still supporting genuine training of board members while prohibiting corruption and corrupt activities, it is preferred that all costs for the training, travel and accommodation be paid for by that retirement fund. In instances where training is offered for free by a service provider to that retirement fund, the fund should at least bear the costs relating to the training (e.g. traveling and accommodation costs) but excluding those of the actual training.

3.2.3 Where a service provider intends to provide training or to present topics relevant to the retirement fund industry at no cost, which may also include refreshments and beverages, such an event must be open for registration to the general public or to a general category of persons.

3.2.4 The actual costs of such training, whether paid by the fund or offered for free by the service provider, must still be reasonably justifiable.

3.3 Business related meals and similar considerations

3.3.1 It is not impermissible under Directive 8 for a service provider to pay for business related meals provided that such meals are legitimately for the purpose of conducting the business of the fund. Such activities should however be kept to the minimum level necessary to maintain effective business relationships and should not be exorbitant.

3.3.2 Retirement fund officers are required to declare any business meals paid for by a service provider in the fund's gift register, which must include the value of such meals."

Paragraph 3.4 (on Entertainment) of the Guidance Notice states that retirement fund officers may not accept invitations to entertainment events paid for by service providers. This includes, but is not limited to, breakfasts, lunches, dinners, coffee, drinks, sporting events, hunting, jazz festivals and concerts. Retirement fund officers must apply their minds as to whether an invitation to an event is for a legitimate purpose or just for the purposes of providing entertainment.

Paragraph 3.5 (on Token gifts) of the Guidance Notice explains the term "token gifts" used in Directive 8. Paragraph 3.5 states that token gifts are gifts usually given (as a token of goodwill) at year-end which may include pens, diaries, desk calendars, calendars, mugs and other indulgences such as chocolates, biscuits or beverages. The annual limit from any one service provider is R500.00. According to the Guidance Notice the purpose of the limit is to prohibit a concession for goodwill to be converted into corruption and corrupt activities.

1.3 Sponsored Funds

Directive 8 permits sponsor appointed trustees to be remunerated by the sponsor of a retirement fund. The Guidance Notice confirms that where a section 26(2) trustee is appointed to a dormant fund or a shell fund and the section 13B administrator pays the expenses for the cancellation or liquidation of the retirement fund because the fund has either little or no assets of its own, this will not constitute a breach of Directive 8.

1.4 Gratification which objectively viewed creates a conflict of interest

The following points (other than with regard to section 26(2) trustees) are made in the Guidance Notice on gratifications and conflict of interest:

- As far as is reasonably possible, a retirement fund should bear its own expenses unless circumstances dictate otherwise and objectively viewed no conflict of interest is created.

- *"In an underwritten fund, the payment of board of fund expenses by the administrator does not objectively create a conflict of interest and would not be a breach of Directive 8. This does not mean that the board of such funds will not be expected to exercise their minds independently and fulfil their objects and duties as required in applicable legislation."*

- Where a retirement fund officer has an interest in a service provider to a retirement fund, and there are no circumstances that dictate that the retirement fund cannot reasonably appoint another service provider, this will constitute a breach of Directive 8. For example, the principal officer or trustee of a retirement fund may not also be a director or employee of the law firm appointed by the retirement fund for legal services. The reason is that this would create an avoidable conflict of interest.

1.5 Conclusion

The Guidance Notice emphasises that it does not intend to cover every aspect of Directive 8 and "*where there is uncertainty on whether a particular practice is compliant with the provisions of Directive 8 then such a practice should preferably be avoided."* According to the FSCA the Directive and Guidance Notice should be approached in the context of an outcomes and principles orientated regulatory framework.

2. Guidance Notice 2 of 2018: Quarterly updates of information on unclaimed benefits

Information Circular 4 of 2015 which was issued during 2015 requested funds to provide information relating to their unclaimed benefits. The data provided by funds has been captured on the Financial Sector Conduct Authority (FSCA) database which forms the basis for the Unclaimed Benefit Fund Search Engine provided for on the FSCA website.

In terms of the Guidance Notice retirement funds must submit updated unclaimed benefits data before or on 30 September 2018 and at least once every three months thereafter to ensure that the data remains valid and current. Similar to the previous request, funds are requested to provide updated details regarding unclaimed benefits electronically on the FSCA website.

Annexure A to the Guidance Notice provides information for the completion of the spreadsheet to be imported as well as guidance on how to update previously uploaded unclaimed benefit information on the FSCA's database.

The FSCA reiterated that in order to prevent fraud and to comply with the Protection of Personal Information Act, no personal information of any individuals will be disclosed on the FSCA website.

3. RDR Status Update June 2018

The FSCA recently released a document titled "RDR Status Update June 2018".

3.1 Background and purpose

The background and purpose of the Status Update is described as follows:

"The former Financial Services Board (FSB) published its Retail Distribution Review (RDR) in November 2014. The RDR proposed a number of regulatory reforms related to the distribution of financial products and the provision of financial advice. The RDR was informed by the FSB's Treating Customers Fairly (TCF) initiative, targeted at ensuring that the financial sector delivers clearly articulated fair outcomes for financial customers.

The RDR reforms were expressed as a set of 55 inter-related regulatory proposals, to be implemented through a multi-year regulatory reform process. Since the publication of the initial RDR proposals the FSB has published a number of RDR progress reports, updated proposals, and various specific regulatory measures through different regulatory instruments.

The Financial Sector Conduct Authority (FSCA) is continuing to roll out the RDR reforms, underpinned by its statutory mandate to promote the fair treatment of financial customers by financial institutions. Similarly to the FSB's approach, the FSCA will continue to implement the RDR proposals in a phased manner, aligning the development of regulatory instruments to broader legislative and regulatory developments giving effect to the Twin Peaks model of financial sector regulation. The RDR proposals will therefore be implemented using an appropriate combination of instruments under existing financial sector laws and standards under the Financial Sector Regulation Act (FSR Act) and the planned future Conduct of Financial Institutions Act (CoFI Act).

This document summarises the current implementation status of the 55 RDR regulatory proposals initially published in 2014 and planned RDR developments for the remainder of 2018."

The Status Update contains a table setting out the current status of all the proposals contained in the initial RDR document published by the FSB in November 2014.

3.2 Next steps for 2018

According to the Status Update the next steps for 2018 are as follows:

"***Before end June 2018:***

Publication of a discussion paper on RDR Proposals relating to Investment Management and Investment Advisers. The purpose of the paper will be to elicit stakeholder input on:

- □ *possible regulatory proposals to define the activity of "investment management";*
- □ *considering the extent to which investment management needs to be demarcated from other forms of discretionary investment mandates;*
- □ *clarifying the nature of the legal and business relationships between different types of entities in the investments sector; and*
- □ *resulting fee and remuneration implications.*

***Remainder of 2018**:*

- *Finalising the RDR related changes to the FAIS General Code of Conduct.*
- *Ongoing technical work on intermediary activity segmentation.*
- *Completion of the actuarial model for testing new life risk commission model impacts, and commencement of the testing process.*
- *Research into current tied adviser remuneration practices in the long-term insurance sector, to inform next steps on the proposal to strengthen the principle of Equivalence of Reward (RDR Proposal RR).*

- *Publication of a discussion paper on Adviser Categorisation. The paper will present updated proposals on:*

    - *practical aspects of the previously proposed two-tier adviser categorisation model;*
    - *possibly allowing product supplier agents to advise on products of another product provider in respect of different classes of financial products;*
    - *product supplier responsibility in relation to different categories of adviser;*
    - *use of referrals and leads to meet "gap filling" needs in tied advice models;*
    - *conditions for using the descriptors "independent" or "financial planning" to describe advice; and*
    - *implications for juristic representatives and group structures.*

- *Consumer testing of an RDR communication brochure and levels of consumer understanding of different terms used to describe different types of advisers.*
- *Publication of a discussion paper on an RDR Remuneration Dispensation for the Low Income Market (RDR Proposal TT). The paper will take into account the FSCA's broader financial inclusion and transformation priorities, including the proposed micro-insurance conduct standards being introduced through the LTIA and STIA PPRs."*

4. Joint Communication 1 of 2018 of FSCA and Prudential Authority (PA): Status of instruments issued under Long-term and Short-term Insurance Acts

Objective of the communication

The communication sets out the status of all instruments issued under the Long-term Insurance (LTI) and Short-term Insurance (STI) Acts, 1998, from the effective date of these Acts up to 1 July 2018.The instruments include Directives, Board Notices, Insurance Notices, Information Letters and Guidance Notes. The communication does not relate to Regulations and Policyholder Protection Rules made under these Acts, and Information Requests issued under these Acts.

Background

The LTI Act and STI Act, before 1 July 2018, provide for both the prudential and conduct of business legislative frameworks for insurers prior to effective date of the Insurance Act. Over the course of a number of years, various instruments were issued under the LTI Act and STI Act to facilitate the administration of the aforementioned Acts. These included Directives, Board Notices, Insurance Notices, Information Letters and Guidance Notes.

Position as from 1 July 2018

The Communication states that as from 1 July 2018, when the Insurance Act, 2017 commenced, this Act provides for the prudential legislative framework for insurers. The Insurance Act repeals all prudential requirements currently provided for in the LTI Act and STI Act. The remaining sections of the LTI Act and STI Act will provide the conduct of business legal framework for insurers pending the enactment and implementation of the envisaged Conduct of Financial Institutions Act.

As from 1 July 2018, the Financial Sector Conduct Authority is the responsible authority for the LTI Act and STI Act and the Prudential Authority is the responsible authority for the Insurance Act.

This means that not all the instruments issued under the LTI Act and STI Act will remain in force or be relevant post 1 July 2018. The Annexure to the Communication, therefore sets out which of the instruments remain in force, which are withdrawn / lapse on the effective date of the Insurance Act, and which are no longer relevant.

5. Communication 2 of 2018: Conversion of registrations under Long-term Insurance Act and Short-term Insurance Act to licenses under Insurance Act

The communication sets out the process the Prudential Authority (PA) will implement for the conversion of registrations under the Long-term Insurance Act (LTIA) and Short-term Insurance Act (STIA) to licences under the Insurance Act, 2017.

As from the effective date of the Insurance Act (1 July 2018), every previously registered insurer that was, immediately before the effective date, registered as a long-term insurer or a short-term insurer under the LTIA or STIA continues to exist as an insurer, as if it had been licensed under the Insurance Act. It may continue to conduct the insurance business for which it was so registered until its registration is converted to a licence under the Insurance Act. The PA must within two years after the effective date convert the registration of all previously registered insurers to a licence in accordance with the Insurance Act.

6. Medical Schemes Amendment Bill and National Health Insurance (NHI) Bill

On 21 June 2018 Health Minister Aaron Motsoaledi held a press conference on the Medical Schemes Amendment Bill and the National Health Insurance (NHI) Bill which have recently been released for public comment. Interested parties have three months to comment on the Bill

a. Medical Schemes Amendment Bill

The Bill seeks to amend the Medical Schemes Act in order to align with the National Health Insurance White Paper and the National Health Insurance Bill.

The Minister said that the first reason for the amendment bill is that the implementation of NHI is not going to be a once-off event but it will take place in a phased-in approach. He said that *"while this is happening the population of medical schemes beneficiaries need immediate relief from serious challenges experienced in the current medical scheme regime".*

The second reason for the amendment is to align the medical scheme environment to that which will exist under NHI so that there is a smooth, harmonious transition that does not unduly disrupt access to health care.

The Minister highlighted ten amendments envisaged by the Bill:

a) To abolish what has come to be known as co-payments. Co-payments means that the scheme pays a portion of the bill that a provider (hospital or private doctor) charges to a patient and the patient pays the balance.

b) To abolish the practice of using brokers within the medical scheme environment.

The Minister said: *"Almost two thirds of principal members of medical aid schemes pay monthly to a broker as part of their premium. Many of these members do not even know that they are paying this money which in 2018 is R90.00 per month. The total amount paid to brokers in 2017 was R2,2 billion.*

We want this money to be made available to pay for direct health expenses of members rather than serving brokers who are actually not needed in the healthcare system.

We are aware that most of the work supposedly done by brokers is actually done by the Council for Medical Schemes - the statutory body."

c) To abolish the practice of Prescribed Minimum Benefits (PMBs) and replace it with comprehensive service benefits.

d) To address the various unequal and even unfair benefit options which medical schemes are subjecting their members to. The amendment prevents any medical scheme from implementing any benefit option unless approved by the Registrar of the Council for Medical Schemes.

e) To declare the carrying on of the business of a medical scheme by a person not registered as a medical scheme to be a specific offence.

f) The creation of a central beneficiary and provider registry and the management thereof by the Registrar of the Council for Medical Schemes.

g) To introduce an income cross-subsidisation model. The Minister said:

"The essence of NHI which must start now even with the present medical aid schemes is that the rich must subsidise the poor, the young must subsidise the old and the healthy must subsidise the sick. The present contribution table charges the same rate for a lower income earner and a high income earner for the same benefits. This practice completely negates the principles of income cross-subsidisation."

h) To compel medical aid schemes to pass back savings if a member uses a designated service provider according to the rules of the scheme.

i) To effect amendments with regard to the cancellation of membership and waiting periods between joining a scheme and accessing benefits. This is because under NHI there will be no penalty related to late joining or age.

j) To make amendments relating to the governance of medical schemes. There will be minimum educational requirements and expertise in order to be a member of a Board of Trustees or a CEO of a Medical Aid Scheme.

b. <u>The National Health Insurance Bill</u>

The Minister said: "NHI is a health financing system that pools funds to provide access to quality health services for all South Africans based on their health needs and irrespective of their socio-economic status.

It will need a massive reorganisation of the current health system, both public and private."

The Minister said: "The objective of this Act is to establish a Fund that aims to achieve sustainable and affordable universal access to health care service by –

(a) Establishing and maintaining an efficient Fund through the consolidation of revenue so as to protect users against financial risk;

(b) Serving as the single public purchaser of health services in terms of the Act so as to ensure the equitable and fair distribution and use of health care services;

(c) Ensuring the sustainability of funding for health care services; and

(d) Providing for equity and efficiency in funding by actively purchasing health care services, medicines, health goods and health related products from certified, accredited and contracted service providers."

The Minister stated that "*in the massive reorganisation of the healthcare system"* twelve Acts have been identified as requiring amendment for the smooth running of the healthcare system and to impose quality. These include among others the National Health Act, 2003 and the Mental Health Act, 2002.

7. CMS Circular 25 of 2018: Demarcation exemption system

The Exemption Framework for providers of indemnity products that are conducting the business of a medical scheme and require exemption from certain provisions of the Medical Schemes Act was concluded and published on the CMS website during March 2017, by means of Circular 19 of 2017. The exemption is applicable for two years, with effect from 1 April 2017 to 31 March 2019, subject to certain conditions. The Exemption Framework is a transitional arrangement while the Department of Health leads the development of a Low Cost Benefit Option (LCBO) type of product to medical schemes. In terms of the Exemption Framework, entities providing products that fall within the ambit of the business of a medical scheme were given an opportunity to apply to be exempted from the provisions of the Medical Schemes Act.

In October 2017 the CMS met to consider all demarcation exemption applications submitted in terms of clause 7.2 (Stage 2) of the Exemption Framework. Entities that submitted exemption applications were individually notified of the decision of the CMS regarding exemption applications, as well as applicable exemption conditions on qualifying products that fall within the ambit of doing the business of a medical scheme.

In terms of Circular 25 of 2018, insurers and their respective financial service providers who were granted Stage 2 exemption were required to submit information via the CMS website relating to exemption conditions on the Demarcation Exemption System by 29 June 2018.

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