



## Umbrella Fund

Sanlam Umbrella Fund Industry Update

**Joint Forum update**

July 2018

Insurance

Financial Planning

Retirement

Investments

Wealth



# Contents

|  |          |
|--|----------|
| <b>Contents</b> .....  | <b>2</b> |
| <b>1. Twin Peaks regulatory model effective 1 April 2018</b> .....                     | <b>3</b> |
| <b>2. Default Regulations: Additional guidelines and requirements</b> .....            | <b>4</b> |
| <b>3. Draft Guidance Note on exempting funds from member elections</b> .....           | <b>5</b> |
| 3.1 A new approach to exemptions iro member elections.....                             | 5        |
| 3.2 New exemption requirements for commercial funds .....                              | 5        |
| 3.3 Information to be provided by an umbrella fund .....                               | 7        |
| <b>4. Directive 8: Prohibition on the Acceptance of Gratifications</b> .....           | <b>8</b> |
| 4.1 What are the implications for trustees of standalone funds?.....                   | 8        |
| 4.2 What are the implications for umbrella funds and participating employers? .....    | 8        |
| 4.3 What is not affected .....   | 8        |
| <b>5. Proposed amendments to Policyholder Protection Rules</b> .....                   | <b>8</b> |
| <b>6. Draft Guide on the calculation of the tax payable on lump sum benefits</b> ..... | <b>9</b> |
| <b>7. ASISA Standard: Retirement Savings Cost Disclosure</b> .....                     | <b>9</b> |



# 1. Twin Peaks regulatory model effective 1 April 2018

On 29 March 2018 the National Treasury issued a media release advising that on 1 April 2018 South Africa's financial regulatory system will fundamentally change, as two new regulators come into operation:

- ⊙ the Prudential Authority (PA); and
- ⊙ the Financial Sector Conduct Authority (FSCA).

With this announcement, National Treasury launched the Twin Peaks model of financial sector regulation in South Africa. This was effected by the commencement of a number of sections of the Financial Sector Regulation Act, 2017.

## The Prudential Authority (PA):

Deputy Governor Kuben Naidoo has been appointed as the CEO of the Prudential Authority. Established within the South African Reserve Bank, the PA will supervise the safety and soundness of all financial institutions. These powers of the PA have however been delegated to the FSCA for a period of three years.

## The Financial Sector Conduct Authority (FSCA)

With effect from 1 April 2018, the FSB has been transformed into the Financial Sector Conduct Authority (FSCA). In addition to the FSB's powers under existing financial sector laws such as the Pension Funds Act (which will be phased out over three years), the FSCA also has powers to issue conduct standards for a wide range of financial sector activities, as well as enforcement powers.

## New leadership of the FSCA

As an interim measure, a transitional management committee will manage the FSCA until a commissioner is appointed. The committee will comprise of members of the former FSB executive committee, the chairperson, Mr Abel Sithole and a National Treasury appointee, Katherine Gibson.

Mr Sithole will care take as the FSCA commissioner until one is appointed.

## What has changed on 1 April 2018?

Gradual changes will take place in the course of the year. There will not be a big bang approach.

### From 1 April 2018 the following changed:

- ⊙ All communications, regulatory actions and decisions, are in the name of the FSCA with their email address, stationery, branding and logo.
- ⊙ The new website is [www.fsc.co.za](http://www.fsc.co.za) is operational.
- ⊙ The Financial Sector Tribunal will replace the FSB appeal board.

### Changes that will take place during the rest of the year, include:

- ⊙ New functional organisational design.
- ⊙ Up-skilling or recruiting new skills and expertise to address the expanded mandate, including enhanced analytical, technical and research capabilities.



- ⊙ The publication of the FSCA's first regulatory strategy by end September 2018.
- ⊙ Publication of various memoranda of understanding between the FSCA and other stakeholders.

**Observation:**

**The following changes were made to the Pension Funds Act as part of the roll out of Twin Peaks:**

- ⊙ **New definitions were introduced - Authority, Act, Standards, Register, Tribunal.**
- ⊙ **Definitions were deleted - FSB, Registrar.**
- ⊙ **A new section deals with the relationship between the Pension Funds Act and the Financial Sector Regulation Act.**
- ⊙ **The Adjudicator must take into account: principles of equity, contractual relationships & the Financial Sector Regulation Act.**

**Over time, the Pension Funds Act will be replaced with the Conduct of Financial Institutions (CoFI) Act. This Act will incorporate a number of aspects such as the principles of Treating Customers Fairly, the Retail Distribution Review, the Policyholder Protection Rules, the provisions of the FAIS Act and the new fit and proper requirements.**

**New terminology you should become familiar with:**

- ⊙ **FSB**                      **FSCA (also referred to as "Authority")**
- ⊙ **Regulator**                **Authority**
- ⊙ **Registrar**                **Commissioner**
- ⊙ **PF circulars**            **Regulatory Standards e.g. conduct standards**

## **2. Default Regulations: Additional guidelines and requirements**

From 1 March 2019 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 the profile of 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. The Sanlam Umbrella Fund is hard at work finalising its default offerings and will provide more detail at the Fund's Symposium in September.

The regulations make provision for additional requirements that can be prescribed by the FSCA. The only set of requirements we have received thus far is the draft notice on smoothed bonus policies.

### **Draft notice: proposed conditions for smoothed bonus policies**

The Registrar of Pension Funds issued for comment a Draft notice containing proposed conditions for smoothed bonus policies in order to be eligible as a default investment portfolio in terms of the Default Regulations issued in terms of the Pension Funds Act. These include requirements to the effect that the policy must follow a formulaic approach to calculate and determine bonus declarations. The cost of any guarantee provided in terms of the policy must be commensurate with the risk and there must be separate disclosure of guarantee charges and other costs relating to the policy. The notice will take effect on 1 April 2019.



#### **Observation:**

*We received confirmation from the service provider of the smoothed bonus investment portfolios on the fund's investment menu that, but for a few minor tweaks, they are confident they will comply.*

*This is the only "default regulation" guideline (albeit a draft) published by the FGSCA to date to our knowledge. This is problematic. Rolling out the default regulations is a complex matter and in the absence of the required guidelines, the boards of funds may tend to postpone making a final decision on products and services related to the regulations. We are concerned that the FSCA will find it very difficult to cope with all the rule amendments that will be submitted early in 2019.*

### **3. Draft Guidance Note on exempting funds from member elections**

#### **3.1 A new approach to exemptions iro member elections**

A draft Guidance Note was issued for comment by the FSCA (the "Authority") with regard to exemptions in terms of Section 7B of the Pension Funds Act.

Section 7A(1) of the Act requires that every fund must have a board consisting of at least four members, at least 50% of whom the members of the fund shall have the right to elect. In terms of Section 7B(1)(b), the Authority may on written application, and subject to such conditions as may be determined by the Authority, exempt the following types of funds from the requirement that the members of the fund have the right to elect members of the board:

- ⊙ *funds established for the benefit of employees of different employers, which are commonly known as umbrella funds;*
- ⊙ *retirement annuity funds;*
- ⊙ *beneficiary funds; and*
- ⊙ *pension and provident preservation funds as defined in section 1 of the Income Tax Act.*

#### **Observation**

*The Sanlam Umbrella Fund is one of the only commercial umbrella funds that makes provision for the election of 50% member representatives on the board of trustees. These individuals are industry professionals who are independent of the sponsor and are elected by the member representatives on the joint forums created by each of the 4 000 participating employers. Because these trustees are elected by the member representatives and not by the entire member ship of around 200 000 members, the FSCA still require the fund to apply for an exemption.*

*Bargaining council funds: Bargaining council, sectoral determination, trade union and municipal funds will however be exempted in future as long as they comply with their member representation provisions contained in their registered rules.*

#### **3.2 New exemption requirements for commercial funds**

These funds, conveniently referred to as commercial funds include, all umbrella type funds, retirement annuity funds, beneficiary funds and preservation funds will have to comply with the following new requirements:

- ⊙ Indefinite period exemption: The Authority will in future grant exemptions for an indefinite duration - not just for three years.



**Observation:**

***We welcome this proposal.***

- ⊙ Independent trustees: At least 50% of the members of the board of a fund must be independent board members. They must also be industry professionals.

**Observation:**

***For more than a decade, Sanlam Umbrella Fund members are represented on the board by at least 50% member representative trustees who are industry professionals and are independent of the sponsor***

- ⊙ Sub-committees of the Board: If the board utilises sub-committees, similar criteria apply to the composition of the members.

**Observation:**

***There are some practical aspects in this regard that we have taken up with the FSCA.***

- ⊙ Decisions can be taken by no fewer than 50% of the trustees: The rules of the fund must provide that no decision of the board will be binding on it unless that decision was supported by no fewer than:
  - 50% of the members of the board, of which no fewer than 70% are independent board members; and

**Observation:**

***This is a dramatic departure away from the balance of power principles of King IV. The implications of these provisions are best explained by an example. If a fund has six trustees, three sponsor nominated and three independents, it appears that the three independents can – without a majority vote – resolve to change the default portfolio to the one offered by the sponsor’s major competitor. In this example, each and every one of the independents must agree for a resolution to be valid. It effectively gives each one of them a veto right.***

***Such a measure will give almost unlimited power to the independent trustees. It is a dangerous and unworkable solution. We recommended that this measure be scrapped and aligned with the King IV principles.***

- if a decision is taken by round-robin resolution, it is ratified by the board at its next meeting.

**Observation:**

***The purpose of round-robin decisions are to take decisions that cannot wait for the next trustee meeting so that it can be implemented and acted on. There is no legal reason why such a decision has to be revisited and ratified at a formal trustee meeting.***

- ⊙ Local management boards or joint forums: Depending on the size of an umbrella fund, the Authority will consider it necessary that management committees at employer, sector or regional level be established, so that there is sufficient transparency and participation in the decision-making process of funds;



**Observation:**

*This appears to suggest that joint forums/local boards at employer level will become compulsory for each employer. We are not sure how the size of the umbrella fund should determine the need for a management committee. The FSCA probably meant “the size of the employer”. It is also not clear what is envisaged as regards participation by the management committee in the decision-making process of funds - this is the prerogative of the board of trustees.*

### **3.3 Information to be provided by an umbrella fund**

Upon receipt of an exemption, the fund must, within 30 (thirty) ordinary days of the appointment of an independent board member(s), furnish to the Authority in writing:

- ⊙ the full names, identity number and contact details of the board member;
- ⊙ the board member’s full employment history;
- ⊙ the name and contact details of an employee, official or other representative of that employer who would be willing to confirm in writing and, on request, under oath, the information given by the fund in relation to the board member;
- ⊙ Details of any other positions of trust occupied by the board member within a period of 10 years prior to the date with effect from which he or she was appointed to the board;
- ⊙ the name and contact details of an employee, official or other representative of the organisation who would be willing to confirm in writing and, on request, under oath, the information given by the fund in relation to the board member.

**Observation:**

*This is a complex new requirement that will be almost impossible to manage.*

If, after considering the information provided on the independent board member and any other relevant information, the Authority informs the fund that it is not satisfied that the independent board member is a fit and proper person to occupy a position of trust in relation to the fund, the sponsor must procure the immediate termination of the board member’s appointment.

The board must declare at each year-end its adherence to the principles of Good Governance, Code of Conduct and Code of Ethics issued as a guide to the boards by the Authority from time to time.

The Authority will take appropriate regulatory action in the event of any failure by the fund and its board to adhere to any of the provisions stipulated in the proposed Guidance Note.

**Observation:**

*It is not clear why this requirement is limited to umbrella funds.*



## 4. Directive 8: Prohibition on the Acceptance of Gratification

A Directive on the prohibition on the offering or acceptance of gratification was issued on 8 March 2018 and became effective on the same date. Guidance Notice no. 2 of 2018 was issued in July to provide practical guidance on the interpretation and implementation of Directive 8. We provide a very high level summary of the implications of Directive 8, read with the Guidance Notice.

### What are the implications for trustees of standalone funds?

No gratification may be accepted, agreed or offered to be accepted by a trustee, principal officer, deputy principal officer, fund employee, valuator, auditor, 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 in which any of the aforesaid persons or other officer or service provider to a fund serves.

In particular, this means that service providers of the fund may no longer provide or pay for any lunches, etc. or sponsor the attendance of sporting events, concerts, conferences, etc. or provide any other gratuities in respect of any one or more trustees - even if the value (per annum) is under R500 per trustee. The same applies to service providers who are soliciting for business.

Token gifts such as pens, diaries, desk calendars, calendars and so on may be provided and received but these gifts may not exceed the annual limit set by the board in terms of the fund's gift policy, which annual limit shall not be more than R500 per annum in aggregate from any one service provider.

### What are the implications for umbrella funds and participating employers?

The Directive does not specifically identify umbrella funds. The question as a result is, does the Directive apply to gratuities paid to employers by umbrella funds, their sponsors, service providers (or potential service providers) and intermediaries?

The view taken by the Sanlam Umbrella Fund is that the directive lays down a very clear framework within which gratuities may or may not be made (in order to prevent corruption as well as preventing the objective judgment of decision-makers being compromised) and taking into account the spirit of Directive 8, it would be difficult to argue that this framework should not also apply to gratuities offered or paid to employers that participate in umbrella funds.

### What is not affected?

The attendance of a symposium or seminar (which present topics relevant to retirement funds) facilitated by a service provider, to which their relevant retirement fund related client base (including any potential future client) is invited free of charge, such as the Sanlam Benchmark Symposium, remains permissible and in order. At an event such as this the consumption of refreshments and beverages (that are not exorbitant) will also remain permissible and in order.

## 5. Proposed amendments to Policyholder Protection Rules

Proposed amendments to the Policyholder Protection Rules made under the Long-term Insurance Act, 1998 proposes that the use of the term "funeral policy" be prohibited unless the policy benefits are intended to cover the costs associated with a funeral. This prohibition is meant to avoid regulatory arbitrage whereby insurers advertise life risk policies as funeral policies in order to circumvent compliance with the product standards that apply to funeral policies. It is expected that the proposed amendments to the PPRs will come into operation on 1 July 2018.





**Observation:**

*The licensing requirements for intermediaries marketing funeral products v group life insurance products are very different and so are the legal requirements. These products are designed for a specific application and they will not be effective in a mismatch situation.*

## **6. Draft Guide on the calculation of the tax payable on lump sum benefits**

A draft Guide on the calculation of the tax payable on lump sum benefits (Issue 3) is available on the SARS website. The document can be accessed by entering the words “Draft Guide on the calculation of the tax payable on lump sum benefits” in the “search” box on [www.sars.gov.za](http://www.sars.gov.za)

## **7. ASISA Standard: Retirement Savings Cost Disclosure**

The Association of Savings and Investment South Africa (ASISA) issued the Retirement Savings Cost Disclosure Standard (“the Standard”) that will be effective from 1 March 2019.

It will only apply to sponsors of commercial umbrella funds and unclaimed benefit funds. It will not apply to standalone funds operated by employers for their employees.

The Standard does not apply to retirement annuity funds, preservation funds, beneficiary funds, compulsory annuities and other retail products provided that they are included in the scope of the ASISA Retail Standard: Effective Annual Cost (EAC).

In terms of the Standard all costs relating to umbrella funds and unclaimed benefit funds must be presented in a standardised manner, enabling employers to compare like with like when considering quotations from different ASISA members. This will also make it easier for the Boards of Trustees of umbrella funds and unclaimed benefit funds to consider costs as part of their fiduciary duties.

ASISA members will be required to submit a compliance certificate to ASISA annually, certifying that the Retirement Savings Cost calculations and disclosures comply in all respects with the letter and spirit of the Standard. The certificate must be signed by the company’s CEO as well as either the auditor, statutory actuary, or chief compliance officer.

**Observation:**

*We welcome this new standard. It will assist employers and their intermediaries who consider participating in an umbrella fund, to compare the cost of each offering on a like for like basis. We still come across intermediaries who focus almost exclusively on the administration fees of such offerings, and ignores other much more significant costs and charges.*

*From 1 March 2019 the Standard Retirement Savings Cost Disclosure will be made available as part of the quotation process.*