Sanlam

Legal Report January 2019

Insurance | Financial Planning | Retirement | Investments | Wealth

Newsletter of Sanlam Employee Benefits: Legal

1. Taxation Laws Amendment Act, 2018

The Taxation Laws Amendment Act was signed into law on 17 January 2019. The most important amendments affecting retirement funds are as follows:

- The annuitisation of retirement benefits under a provident fund and provident preservation fund has again been postponed - this time from 1 March 2019 to 1 March 2021. The Minister of Finance must in the meantime continue deliberations on this aspect with interested parties, including deliberations at the National Economic, Development and Labour Council (NEDLAC). The Minister must table a report in Parliament by 31 August 2020 on the results of these deliberations.

- A member of a pension fund or a provident fund may, with effect from 1 March 2019, transfer his/her retirement benefit to a preservation fund. The single allowable withdrawal applicable to preservation funds will however not apply to such a retirement benefit transferred to a preservation fund.

- A member of a retirement annuity fund who emigrates can terminate his/her membership of the fund by making a full withdrawal of his/her benefit. As from 1 March 2019, a member of a preservation fund will also be allowed to withdraw the full value of his/her post-tax benefit upon emigration. Such emigration must be recognised by the South African Reserve Bank for the purposes of exchange control.

- The Seventh Schedule to the Income Tax Act makes provision for any benefit provided to an employee by an associated institution of the employer (which includes a fund providing benefits for employees or former employees) to create a taxable benefit in the employee's hands if such benefit would have constituted a taxable benefit had it been granted directly by the employer. The Act has been amended, with effect from 1 March 2017, to the effect that a taxable fringe benefit in the member's hands will not arise on the transfer of surplus (from an employer surplus account) as contemplated in section 15E(1)(b), (d) and (e) of the Pension Funds Act. Section 15E provides that a participating employer may require the board to use actuarial surplus allocated to the employer surplus account for use by that employer for, among others, the following -

  "(b) payment of pensions, or an increase in pensions in course of payment, so as to compensate members for the loss of any subsidy from the employer of their medical costs after retirement;"

  "(d) improving the benefits payable to all members, or a category of members as defined in the rules, as determined by the employer;

(e) *transferring part, or all, of the employer surplus account … to the employer surplus account in another fund where the employer is a participating employer;".*

2. Recent developments related to Default Regulations

The Minister of Finance issued regulations 37-40 in terms of the Pension Funds Act (hereafter referred to as "Default Regulations") with effect from 1 September 2017. The Default Regulations prescribe conditions for default investment portfolios, default preservation and portability, and annuity strategies for funds. All funds must comply with the Default Regulations by 1 March 2019.

2.1 PFA Notice 2/2018: Conversion of DB amounts of paid-up members to DC amounts

Regulation 38(2)(c) of the Default Regulations requires pension and provident funds to amend their rules with respect to paid-up members to specify that "upon the member becoming paid-up, a defined benefit (DB) amount, must be converted to a defined contribution (DC) component and have it preserved as such."

Some DB funds provide for paid-up benefits to continue as a DB amount. A number of these funds have applied for an exemption from regulation 38 in this regard and the Financial Sector Conduct Authority (FSCA) on 5 December 2018 granted a general exemption to all DB funds.

2.2 PFA Guidance Notice 7/2018: Applications for rule amendments to ensure compliance with Default Regulations

In order for the FSCA to prioritise and assist in the timeous consideration of applications for amendments to rules to ensure compliance with the Default Regulations, the FSCA advised funds that applications received by 31 January 2019 will be treated as urgent and the FSCA will attempt to consider and register such rules before 1 March 2019.

Funds that have already submitted applications for amendments to rules in compliance with the provisions of the Default Regulations are requested to alert the FSCA of these applications to enable their escalation for urgent consideration.

Where funds intend to submit applications for amendments to rules consisting only of amendments in respect of Default Regulations, this must be reflected in the covering letter.

Where an application for registration of rule amendments does not consist only of amendments in respect of the Default Regulations or the FSCA raises queries which are not timeously responded to, such application will not be treated as urgent and may therefore not be registered timeously.

2.3 PFA Guidance Notice 8/2018: Guidance on the application of the Default Regulations

As a result of several enquiries on the application of the Default Regulations by retirement funds, the FSCA released a Guidance Notice. As provided in section 141(2) of the Financial Sector Regulation Act, "guidance notices are for information, and are not binding". The Guidance Notice should therefore not be regarded as a binding document, but as the FSCA's views on how the Default Regulations should be implemented.

The Guidance Notice contains two annexures i.e. -

- A template for a paid-up membership certificate; and
- The format for any application for exemption from any of the Default Regulations.

Among others, the FSCA expressed the following views in the Guidance Notice:

2.3.1 Default investment portfolios

- Provided the rules permit, funds may allow a participating employer in an umbrella fund to choose the default investment portfolio applicable to members employed by it. However, the ultimate decision regarding the available choices of investment portfolios and the appropriateness of the default investment portfolio lies with the board of the fund.

- If there is only one investment portfolio in which retirement funding contributions are invested, then that portfolio is considered as the default investment portfolio and must comply with the regulations.

- An existing default investment portfolio which does not comply with the Default Regulations will no longer qualify as the fund's default investment portfolio from 1 March 2019. Members invested in such a portfolio must before 1 March 2019 be transferred to a new default investment portfolio that complies with the Default Regulations.

- The asset composition, performance of the default investment portfolio(s) compared to appropriate benchmarks, top 10 holdings by value and fund returns for the current and at least two previous financial years should be communicated to members at least once every year.

2.3.2 Paid-up membership certificates

The paid-up membership certificate, which must be presented to a member in terms of regulation 38(1)(b)(ii), should as far as possible resemble the template attached to the Guidance Notice.

2.3.3 Retirement benefits counselling

- Retirement benefits counselling may be provided either in person or in a written format. In either event, a fund must retain a record of the retirement benefits counselling provided for to each member.

- The board must be satisfied that the person who provides the retirement benefits counselling is suitably qualified and experienced, and is able to properly manage any conflicts of interest.

- Retirement benefits counselling does not include advice, even on tax matters, and members should be expressly informed of this fact.

- It is recommended that access to retirement benefits counselling to retiring members should be provided no longer than 6 months before a member's retirement, so that the information is still relevant at retirement.

- Retirement benefits counselling provided to retiring members must comply with items (b) and (d) of the definition of retirement benefits counselling, i.e. retiring members must be provided with information with regard to the fund's annuity strategy and any other options available to them.

2.3.4 Paid-up members

- Administration fees for paid-up members should, in the normal course, be less than the administration fees for in-service members due to the absence of contributions to administer and schedules to consider every month.

- The deduction of administration fees for paid-up members does not constitute a reduction of a benefit as contemplated by section 37A of the Pension Funds Act, however trustees are required to implement a paid-up administration regime that avoids the benefits of paid-up members (especially those with small paid-up benefits) being eroded over time by fund expenses.

- A member may elect to transfer a paid-up benefit from another fund at any stage and no charges may be levied in respect of such transfer. This does not include section 14 fees payable to the FSCA.

- The FSCA intends establishing and maintaining a database of all paid-up membership certificates.

- *"Section 37C of the Act is applicable to a paid-up member's benefit, in the same manner that it would apply to any other death benefit payable by a fund."* [This statement is contentious and seems to be in conflict with Information Circular 2 of 2010, issued by the FSB, which indicates that section 37C of the Pension Funds Act is not applicable where a member became entitled to a withdrawal or retirement benefit and subsequently dies before payment or transfer of such withdrawal or retirement benefit. The Information Circular emphasizes that section 37C is only applicable to lump sum benefits which become payable by the fund in terms of its rules "*as a result of the death of a member".*]

2.3.5 Annuity strategies (regulation 39)

- Beneficiary funds do not have to comply with regulation 39.

- Provident funds and provident preservation funds are not expected to comply with regulation 39, unless the rules enable a member to elect an annuity.

- In respect of living annuities, the investment choice is limited to a maximum of four investment portfolios. It may be less than four and can even be a single portfolio.

2.3.6 Exemptions

- When a fund applies for an exemption from any of the provisions of the Default Regulations, the fund must specify whether the exemption is in terms of regulation 37(3), 38(3) or 39(6), and ensure that it applies for the correct exemption.

- Applications for exemption must be submitted via the FSCA's online system, using the form attached to the Guidance Notice.

- In order to substantiate the application for exemption, the FSCA may request supporting documents. Alternatively, funds may submit supporting documents with the initial application for exemption, such as:

    - For terminating funds - section 14 approval letter, board resolution, etc.

    - For asset values - extract from the financial statements, trial balance, etc.

    - For membership statistics - extract from the financial statements, membership reconciliation, etc.

    - Any other document that may be relevant to support the application.

2.4 Draft Conduct Standard on the criteria for smoothed bonus policies in default investment portfolios

The FSCA issued for comment a second draft of a proposed Conduct Standard containing conditions for smoothed bonus policies in order to be eligible as a default investment portfolio in terms of the Default Regulations.

The draft Standard requires that the policy must follow a formulaic approach to calculate and determine bonus declarations. The charge 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 proposed Standard is intended to take effect on 1 March 2019.

A fund will be able to apply for exemption from the proposed Standard for a specified period where it employed a smoothed bonus policy as its default strategy on the date when the Standard commences, if it would be prejudicial to members if the investment in the policy must be immediately terminated. Any exemption granted will only apply to assets invested in the policy on the effective date of the Standard.

Comments on the draft Standard may be submitted by 31 January 2019. Sanlam will provide comments via industry bodies.

3. Compensation for Occupational Injuries and Diseases Act: Increase of maximum amount

The Minister of Labour increased the maximum amount of earnings on which the assessment of an employer is calculated to R458 520 with effect from 1 March 2019.

4. Draft Conduct of Financial Institutions Bill

The draft Conduct of Financial Institutions (COFI) Bill, 2018 was published for comment on 11 December 2018 together with an explanatory policy paper that sets out the policy rationale for the COFI Bill.

The media statement issued by National Treasury on 11 December 2018 contains, among others, the following statements:

"The COFI Bill is the next phase of the legislative reforms aimed at strengthening the regulation of how the financial services industry treats its customers. The Bill follows the Financial Sector Regulation Act (FSRA) No 9 of 2017, which established two new authorities with dedicated mandates. The two new authorities are the Prudential Authority (PA) which manages prudential risk (financial health), and the Financial Sector Conduct Authority (FSCA) which manages the market conduct risk across all financial institutions. Both regulators became operational on 1 April 2018.

The FSR Act gives consumers and financial institutions an indication of what to expect of financial sector regulators, while the COFI Bill will outline what customers and industry players can expect of financial institutions.

The Bill aims to significantly streamline the legal framework for the regulation of the conduct of the financial institutions, and to give legislative effect to the market conduct policy approach, including implementation of the Treating Customers Fairly (TCF) principles. These principles currently have little legal backing."

"The Bill, which intends to replace the conduct requirements in existing financial sector laws, is designed to be:

- Principles-based: A principles-based approach seeks to set principles that specify the intention of regulation, rather than set rules for financial institutions.

- Outcomes-focused: Linked to the above, outcomes-focused supervision allows the regulator to test financial institutions on their delivery of the actual outcomes.

- Activity-based rather than institutionally driven: The same regulation will apply to similar activities, regardless of the institution performing the activity. This will create level playing fields amongst stakeholders.

- Risk-based and proportionate: the new framework will enable the regulator to monitor the financial sector, identify areas that pose greatest market conduct risks, and use proportionate regulatory capacity to address these risks. Proportionality will affect the regulator's supervisory approach.

"The Bill aims to establish a consolidated, comprehensive and consistent regulatory framework for the conduct of financial institutions that will:

- Protect financial customers;
- Promote the fair treatment of financial customers by financial institutions;
- Support fair and efficient financial markets;
- Promote innovation and the development of and investment in innovative technologies, processes and practices;
- Promote competition;
- Promote financial inclusion; and
- Promote transformation of the financial services sector."

Comments on the draft Bill may be submitted until 1 April 2019. Sanlam will provide comments via industry bodies.

5. Regulations in terms of Protection of Personal Information Act

The Regulations in terms of the Protection of Personal Information Act ("POPI") were published by the Information Regulator on 14 December 2018. These Regulations shall commence on a date to be determined by the Regulator by proclamation in the Government Gazette. Whilst some sections of POPI have already commenced (e.g. definitions, sections dealing with the establishment of the Regulator, and sections regarding the making of regulations), the commencement date for the rest of POPI has yet to be announced. It should be noted that in terms of POPI there is a grace period of one year after commencement, to conform to POPI.

The Regulations provide for various forms to be completed. For example, in terms of regulation 6 a responsible party who wishes to process personal information of a data subject for the purpose of direct marketing by electronic communication must submit a request for written consent to the data subject on Form 4. Form 4 requires the data subject to opt in to receiving direct marketing via electronic communication and allows the data subject to specify for which goods or services such consent is valid as well as stipulate which forms of electronic communication are acceptable to the data subject.

Section 55 of POPI sets out the duties and responsibilities of the Information Officer. Regulation 4 sets out various additional responsibilities of the Information Officer, for example to ensure that a compliance framework is developed and maintained.

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