

# Legal Report August 2019

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*Newsletter of Sanlam Employee Benefits: Legal*

## 1. FSRA Conduct Standard 1 of 2019 (PFA): Transfers in terms of Section 14

On 5 August 2019 the Financial Sector Conduct Authority (FSCA) issued FSRA Conduct Standard 1 of 2019 (PFA) on Conditions for amalgamations and transfers in terms of section 14 of the Pension Funds Act (“Conduct Standard”).

This Conduct Standard replaces Directive PF No. 6, and sets out the process to facilitate transfers between a registered retirement fund and any other fund or person as per section 14 of the Pension Funds Act. It provides timelines and requirements for the lodging of an application for the approval of a transfer, and for the finalisation of the transfer following approval.

The overarching purpose of the Conduct Standard is to ensure that funds treat members affected by section 14 transfers fairly.

### What has changed?

#### Effective date

- Paragraph 20 (“Transitional arrangements”) of the Conduct Standard stipulates that all section 14(1) applications submitted on or after 31 January 2019 must comply with the new conditions and forms contained in the Conduct Standard (i.e. the Conduct Standard has retrospective effect). However, after the FSCA was made aware that the retrospective effective date is problematic, the FSCA on 28 August 2019 published FSRA Compliance Extension Notice 1 of 2019 (PFA), in terms of which the aforesaid date is extended to 31 January 2020.
- This means that section 14(1) applications submitted before 31 January 2020, and based on the conditions and forms contained in Directive PF No. 6, will still be considered by the FSCA.

#### Exemptions

- In terms of section VI of Directive PF No. 6 the Registrar exempted certain amalgamations and transfers from the provisions of section 14(1). No such exemption is given in the Conduct Standard, which means that the following transfers are no longer exempt from section 14(1):
  - o Transfers of unclaimed benefits to an unclaimed benefit fund;
  - o Transfers between unclaimed benefit funds;
  - o Transfers between retirement annuity funds;
  - o Transfers between preservation funds.

The above transfers are accordingly henceforth subject to section 14(1) unless the circumstances as set out in section 14(8) apply, i.e. both funds are valuation exempt, or both funds are beneficiary funds, or one fund is neither registered nor required to register in terms of the Pension Funds Act and the other fund is valuation exempt.

#### Actuarial surplus/reserve accounts

- The FSCA requires information about actuarial surplus and reserve accounts to determine if the proposed transfer is reasonable and equitable and meets the rights and reasonable benefit expectations of transferring members.
- The impact of any unapportioned actuarial surplus included or excluded from the transfer must be indicated in Form A.

#### Member communication

- As previously required by Directive PF No. 6, the transferor fund must provide affected members with adequate communication in order to enable them to make an informed choice about whether or not to object to the transfer, such as the transfer value (or reasonable estimate thereof) as at the effective date of transfer. In addition, the Conduct Standard requires the transferor fund to:
  - o Explain the risks as a result of the transfer;
  - o Explain how members' past service benefits will be impacted by the transfer, and whether there could be any prejudice upon transfer.
- Members must, at the very least, be provided with a comparison of the benefits and costs of both funds. This comparison is not required for unclaimed benefits transfers or voluntary transfers (e.g. transfers involving retirement annuity funds or preservation funds).
- Member objections must be included in the submission to the FSCA where the objection has not been resolved, together with the transferor fund's response and comments. Member communication is not required in respect of transfers of unclaimed benefits, and funds are not required to allow for objections from members with unclaimed benefits.

#### Transfer of assets and liabilities to comply with the Pension Funds Act

- Member transfer schedules must be forwarded to the transferee fund within 60 days of the date of the approval certificate issued by the FSCA in terms of section 14(1)(e).
- The transferee fund must reconcile the schedules with the amount actually received within 5 days of receiving the schedule.

#### Certifications (Form A)

- Certifications required in Form A are now more comprehensive. The boards of both the transferor and transferee funds and the valuator, where applicable, must express an opinion on *inter alia* whether the transfer is reasonable and equitable and will not render the fund unable to meet the requirements of the Pension Funds Act.
- No modifications to the forms are allowed unless highlighted and adequately motivated. Where a person has concerns about whether the rights and reasonable benefit expectations of members are satisfied (for instance a board member is concerned about the transfer values), these must be addressed to the FSCA in a separate letter.

#### Purchase of annuities in the name of pensioners

- Form C (which now has more requirements, e.g. summary of the pension increase policy and targeted pension increases) has to be used for groups of pensioners for whom annuities are to be purchased from an insurer or whose annuity policies are to be transferred to their names. Form C2 is to be used for a prospective transfer. (Form C, C1 and C2 were used previously for a prospective transfer and Form D for the purchase of an individual annuity policy.)
- The Board must certify that pensioners' reasonable benefit expectations are no worse in the purchased policy than what they would have been in the transferor fund, including consideration of expected future increases and contingent benefits.

#### Transfers to or from an entity not registered by the FSCA

- Form A or C must be used (previously A or B). In the case of a transfer to or from a foreign fund or entity, the following must be provided to the FSCA in support of the application for approval of the transfer:
  - o proof of the acknowledgment of the transfer by the South African Revenue Service (SARS);
  - o proof of registration of the foreign fund or entity in the foreign country;
  - o a letter confirming that the foreign fund or entity is in a sound financial condition;
  - o where the transfer has already been approved by the foreign regulator, confirmation of such approval.

#### Errors and adjustments to section 14(1) applications

- Where the board requests the FSCA to amend or withdraw an approval certificate, a letter signed by the principal officer or authorised board members must be submitted detailing that request.

#### Benefits payable in the period between the effective date and the final date of settlement

- In the event of benefits payable as a result of death, disability or any other form of withdrawal before the transfer is approved, the FSCA will consider as best practice that:
  - o The transferor fund pays the benefit payable in terms of its rules;
  - o The transferee fund pays the benefit payable in terms of its rules;
  - o Where there is a difference between the transfer benefit and the benefit paid to the member by the transferor fund, the balance of the transfer amount must also be paid to the member by the transferee fund following the transfer, together with fund return.

#### Transfers resulting in no members remaining

- Directive PF No. 6 stipulated that if a 'full transfer' (i.e. the approval of a transfer which results in the transferor fund having no remaining members) leaves the fund without a properly constituted board, the rules of the transferor fund must allow:
  - o for the extension of the board's term of office for at least 3 years from the effective date of the transfer; or

- where the board is no longer properly constituted, that the Registrar may appoint one or more independent persons to the board.
- In terms of the Conduct Standard, unintentionally leaving the transferor fund without a properly constituted board (e.g. in the case of a full transfer) must be avoided. Where the rules require that the board be comprised of fund members, the rules should be amended to state that the board does not have to be comprised of fund members and, if necessary, to extend the term of office of the existing board for a reasonable period.

#### Transfer from a trust to a beneficiary fund

- This is a transfer as contemplated in section 14(1), and the FSCA's approval is required. The trustees of the trust and the board of the beneficiary fund must ensure that communication with beneficiaries takes place in line with the communication requirements for a section 14(1) transfer. The trust deed and rules of the beneficiary fund must allow the transfer, and the trustees of the trust must complete the same certifications as required from a pension fund.

#### Transfers and tax directives

- Boards of funds and fund administrators must ensure compliance with the Income Tax Act, and ensure that members are not prejudiced, especially if the fund or administrator fails to comply with the Income Tax Act.

#### Transfers in terms of section 14(8)

The forms (H and J) which must be completed in the event of a transfer as contemplated in section 14(8) have been adjusted slightly, but importantly:

- The new form H requires 3 signatures from each fund (2 trustees and the principal officer) whereas the old form (in terms of PF Directive No. 6) required just one trustee and the principal officer to sign.
- The new form J requires the principal officer of each fund to sign whereas the old form (in terms of PF Directive No. 6) required completion by representatives of the funds.

Note that the extension granted in FSRA Compliance Extension Notice 1 of 2019 (PFA) is in respect of section 14(1) transfers - it does not apply in respect of section 14(8) transfers.

## **2. FSCA Communication 2 of 2019 (PFA): Exemption relating to hybrid annuities forming part of a fund's annuity strategy**

The FSCA on 1 August 2019 issued an exemption in respect of hybrid annuities that are offered by any retirement fund as part of its annuity strategy as required in terms of regulation 39 of the Pension Funds Act. A "hybrid annuity" is defined in the FSCA Communication as a *"living annuity ... which has a life annuity portfolio as one of its investment portfolios"*. A "life annuity portfolio" is, in turn, defined as *"a portfolio of life annuities that provides market values and is underwritten by an insurer licensed to conduct life insurance business under the Insurance Act, 2017 (Act 18 of 2017)"*.

Regulation 39 allows the inclusion of living annuities as part of a fund's annuity strategy, and requires that such a living annuity must, amongst others, comply with regulation 37. Regulation 37(2)(g) requires that members be allowed, at least once every 12 months, to transfer their retirement savings from their default investment portfolio into any other investment portfolio offered in terms of the fund's investment policy statement.

The FSCA Communication states that, since a life annuity has no viable surrender value, it would not be in the interest of members to be allowed to transfer out of the life annuity portfolio as required in regulation 37(2)(g). Consequently the FSCA advised that it would consider applications for exemption from regulation 37(2)(g) insofar as it relates to any hybrid annuity offered by a fund as part of its annuity strategy. Applications must be submitted in the format as set out in Annexure B to the Communication and the applicant (fund) will have to confirm that the following conditions will be met:

- The nature of the hybrid annuity will be clearly communicated to the member when he/she receives retirement benefits counselling;
- The retirement benefits counselling will be done in person, and the fund will retain a record of such counselling;
- The retirement benefits counselling will specifically draw attention to the fact that the member will not be in a position to transfer to another insurer in respect of the life annuity portfolio. If the member elects the hybrid annuity, then he/she must expressly indicate his/her acceptance of such restriction in writing; and
- The fund will permit a member who chooses the hybrid annuity the option to transfer it to another service provider that will accept the hybrid annuity, with the associated life annuity portfolio, at least once every 12 months.

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