

Legal Report October 2020

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Newsletter of Sanlam Corporate: Legal

1. Conduct Standard 5 of 2020 (RF): Conditions for smoothed bonus policies as default investment portfolios

The Conduct Standard prescribes the conditions with which a smoothed bonus policy must comply in order to meet the definition of “default investment portfolio” as defined in the regulations in terms of the Pension Funds Act. The Conduct Standard was published on 9 October 2020 and funds concerned must comply therewith within 9 months of such publication date.

To be eligible as a default investment portfolio, a smoothed bonus policy must comply with the following criteria:

- A formulaic approach must be established to calculate and determine bonus declarations, both vested and non-vested. Among others, such approach must limit the smoothing period by spreading any excess bonus stabilization reserve over a period not exceeding 24 months (temporary deviations are allowed in exceptional circumstances, subject to prior notice to the FSCA), and must have a long-term funding level target not exceeding 105%;
- Any management actions that may be taken by the insurer to reduce the risk in the policy must be properly disclosed and documented;
- The charge relating to any guarantee provided in terms of the policy must be commensurate with the risk and be separately disclosed;
- The insurer will only be allowed to apply a market-value adjustment in pre- determined circumstances;
- No disinvestment penalties may be levied by the insurer.

The asset allocation in the smoothed bonus policy must remain within the strategic asset allocation that has been disclosed and must comply with the asset spreading limits set out in regulation 28 of the Pension Funds Act. Where a material change

in the strategic asset allocation is being considered, full disclosure must be made to all stakeholders, and the FSCA must be notified beforehand of the intended change and the reasons therefor.

An insurer that provides a smoothed bonus policy to a fund as part of a default investment portfolio must ensure that the fair treatment of the fund and its members are achieved in relation to the policy.

In the Statement supporting the Conduct Standard, the FSCA noted that:

- The limitations being imposed on the smoothed bonus portfolios will result in portfolios which smooth less and over shorter periods, which could lead to more volatile returns for members.
- Trustees will need to follow a more onerous process, should they opt to include a smoothed bonus policy in their default investment strategy. This will result in more effort, as well as more checks and balances being required.
- Insurers wishing to have their smoothed bonus policies included in funds' default investment portfolios will have less flexibility during the smoothing process. This may have an impact on the cost of any guarantees provided.

2. Draft Conduct Standard on conditions for securities lending for retirement funds

The FSCA published a draft Conduct Standard prescribing conditions for securities lending for pension funds, for comment by 30 November 2020. The FSCA stated that comments on the previous version (which was in the form of a draft Notice) have been taken into account and, among others, the draft Conduct Standard clarifies that the requirements will apply to all securities, irrespective of whether the securities are offshore or local.

Sanlam will provide comments via industry bodies.

3. Draft Conduct Standard prescribing conditions for investments in hedge funds

The FSCA published a draft Conduct Standard prescribing the conditions for retirement fund investments in hedge funds, for comment by 27 November 2020. Among others, the conditions include the following:

- A fund may only invest in a hedge fund if the hedge fund is administered by a registered manager authorised to administer a hedge fund as referred to in paragraph 2(2) of Board Notice 52 of 2015;

- a fund must ensure that when it invests in a hedge fund, the hedge fund manager contractually undertakes to disclose to the fund if the fund's exposure to embedded derivatives in the hedge fund exceeds one hundred percent of such derivatives; and
- where the board of a fund lacks the expertise to make investment choices, the board must, before it invests in a hedge fund, obtain expert advice as required in terms of section 7D(1)(e) of the Pension Funds Act to enable it to make the most suitable investment decisions for its fund in relation to investing in a hedge fund.

Sanlam will provide comments via industry bodies.

4. Delegation of Prudential Authority's powers to FSCA extended until 31 March 2024

In terms of section 292 of the Financial Sector Regulation Act the power of the Prudential Authority ("PA") to make prudential standards with respect to the safety and soundness of, among others, retirement funds (and otherwise to achieve the objectives of the PA) was delegated to the FSCA for a 3 year period which commenced on 1 April 2018. The Minister of Finance may, by notice in the Gazette, determine a shorter or longer period.

The Minister of Finance on 16 October 2020 determined (in a Government Gazette) that the period of delegation of the PA's powers to the FSCA with respect to, among others, retirement funds be extended until 31 March 2024.

5. Compilation and submission of manual in terms of Promotion of Access to Information Act, 2000

In terms of section 51 of the Promotion of Access to Information Act, 2000 ("PAIA"), all public and private bodies (including retirement funds) must prepare a PAIA manual, containing among others the following information:

- address and contact details of the head of the body;
- a notice regarding the categories of records of the body which are available without a person having to request access in terms of PAIA;
- a description of the records of the body which are available in accordance with any other legislation;

- sufficient detail to facilitate a request for access to records;
- a description of the subjects on which the body holds records and the categories of records held on each subject.

A copy of the manual must be submitted to the South African Human Rights Commission. A copy must also be available for inspection at the registered office of the body (e.g. retirement fund). The manual must be updated on a regular basis.

The date of commencement of section 51 was 15 February 2002, but the Minister of Justice and Constitutional Development has granted an exemption from the requirement of submission of the manual and has from time to time extended the exemption, the last of which was granted until 31 December 2020. Since there has not been a further extension yet, retirement funds should ensure that they comply with the requirements regarding the manual by no later than 31 December 2020.

6. Deduction from benefits to compensate employer for loss or damages suffered because of theft or fraud by member

According to media reports, the Pensions Fund Adjudicator recently ordered the GTC Umbrella Pension Fund to pay the withdrawal benefit of a member who was convicted of defrauding her employer and sentenced to seven years imprisonment. The member claimed her withdrawal benefit which became due when she left her employment before her jail sentence.

The fund withheld the withdrawal benefit since the employer requested that the complainant's benefit be paid to it because the loss suffered by the employer as a result of the member's dishonesty exceeded the value of the benefit. The complainant, who did not sign any acknowledgement of debt, lodged a complaint with the Adjudicator, who found there was no compensation order made by the criminal court entitling the employer to a deduction from the member's pension benefit. Therefore the Adjudicator ordered the fund to pay the benefit to the member.

Funds (and employers) must therefore be aware that section 37D(1)(b)(ii) of the Pension Funds Act allows a fund to deduct an amount of "*compensation (including any legal costs recoverable from the member in a matter contemplated in subparagraph (bb)) in respect of any damage caused to the employer by reason of any theft, dishonesty, fraud or misconduct by the member*" only if either -

- the member has in writing admitted liability to the employer; or
- judgment has been obtained against the member in any court

for an amount of compensation in respect of the damage caused to the employer by reason of any theft, dishonesty, fraud or misconduct by the member.

The judgment can be one made following a civil action or a criminal case. However, in the event of a criminal case, a mere conviction of theft or fraud is not sufficient - there must also be a compensatory order against the member (in favour of the employer) as contemplated in section 300 of the Criminal Procedure Act, 1977. In terms of section 300, a court that has convicted someone of an offence which has caused damage to or loss to another person, "*may, upon the application of the injured person or of the prosecutor acting on the instructions of the injured person, forthwith award the injured person compensation for such damage or loss*".

In *Records v Barlows Pension Fund [2000] 8 BPLR 920 (PFA)* ("Records") the Adjudicator stated:

"The magistrate's judgment being a criminal conviction for theft is based on the requirements of criminal law and criminal procedure, it does not amount to a judgment in respect of compensation for damage caused to the employer as required by section 37D. The words 'any Court' in section 37D refer primarily to the civil Courts rather than the criminal Courts as it is only the former which normally award damages for compensation. However, a magistrate in a criminal case, in exceptional circumstances regulated by the Criminal Procedure Act of 1977, can award compensation for damage or loss to injured persons (subject to certain conditions) and the effect of such an award is the same as a civil judgment."

In *Laing v Orion Money Purchase Provident Fund and Another [2012] 1 BPLR 52 (PFA)* the Adjudicator ruled as follows:

"As stated in Records, a criminal conviction without a compensatory order in terms of section 300 of the CPA does not amount to a "judgment" as envisaged in the Act. This is so because although extensive investigations into the merits of the accusations made against an employee may have been conducted and such merits having been examined, tried and accepted by the court, a conviction in this regard only finds that the employee concerned is guilty of the offence as charged. It does not proceed further to determine whether or not the employee concerned is liable to compensate his employer and if so, how much he is liable to pay to the employer. Only in instances where a compensatory order in terms of section 300 of the CPA was sought and granted by the court does the employee become liable to compensate the employer. In such an instance the pension fund has legal grounds upon which to effect the deduction. Where a compensatory order has not been granted by the court in a criminal case there is no determination of the employee's liability to the employer and therefore the fund has no power to effect the deduction sought, despite the conviction."

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