

Legal Report January 2022

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Newsletter of Sanlam Corporate: Legal

1. Taxation Laws Amendment Act, 2021

The Taxation Laws Amendment Act, 2021 (“the Amendment Act”) was published in the Government Gazette on 19 January 2022. The amendments affecting retirement funds are as set out below.

Allowing retiring members to choose a combination of annuities

A retiring member is allowed to choose a combination of annuities (including a combination of methods of paying the annuity) or a combination of types of annuities. A member can in other words choose a combination of an in-fund annuity, an annuity purchased from an insurer in the name of the fund and an annuity purchased from an insurer in the name of the member. This is also confirmed in Binding General Ruling 58, which was issued by the South African Revenue Service on 4 November 2021.

There is no limitation on the number of annuities that may be chosen. Where more than one annuity is chosen, the amount utilised to purchase or provide each annuity must however exceed R165 000.

Transfers by preservation fund members who are 55 years or older

In terms of paragraph 2(1)(c) of the Second Schedule to the Income Tax Act any amount transferred for the benefit of a member on or after normal retirement age forms part of the member’s gross income. Paragraph 6A of the Second Schedule makes provision for a deduction in respect of such a transfer, but only in the event of a transfer from a pension or provident fund to a preservation fund or a retirement annuity fund. Paragraph 6A is amended, with effect from 1 March 2022, to also make provision for a tax-free transfer from a preservation fund to another preservation fund or retirement annuity fund.

Clarifying the calculation of the fringe benefit in relation to employer contributions to a retirement fund that provides self-insured risk benefits

Self-insured risk benefits under a retirement fund are classified as a defined contribution component for fringe benefit purposes. This will ensure that retirement funds that provide both defined contribution component retirement benefits and self-insured risk benefits can account for the fringe benefit in respect of employer contributions based on the actual contribution. As a result, the value of the risk premiums under self-insured risk benefits are determined based on the cost to the employer (i.e., the actual contribution made by the employer).

Paragraph 2B of the Fourth Schedule to the Income Tax Act

Paragraph 2B, which comes into operation on 1 March 2022, before the amendments introduced by the Amendment Act stipulated that if a taxpayer receives remuneration from more than one source (including a pension from a retirement fund or insurer), the tax rebates applicable to the taxpayer are not to be taken into account by the retirement fund or insurer when calculating the taxes to be withheld on the pension. Paragraph 2B is amended so that the tax rebates should still

be taken into account in the aforesaid circumstances. The retirement fund or insurer paying the pension should instead apply the fixed tax rate as directed by the South African Revenue Service (SARS) in determining the tax to be withheld. SARS has sent a letter to all stakeholders, in which they set out how paragraph 2B will be implemented.

2. Early access to retirement savings

The Minister of Finance and National Treasury during 2021 on several occasions indicated that discussions are underway on allowing early access to retirement savings. National Treasury on 14 December 2021 published a discussion paper in this regard entitled *Encouraging South African households to save more for retirement*. The main proposals contained in the discussion paper are as follows.

In terms of a so-called two pot system, which is expected to be implemented in 2023, retirement contributions will be restructured into two pots. The one pot can be accessed at any time, whereas the other pot will not be accessible before retirement and must therefore be preserved until retirement. One third of all future contributions will go into the accessible pot (“the access pot”), and the other two thirds will go into a pot that must be preserved until retirement (“the retirement pot”).

The extent of vested rights on retirement savings accumulated on the implementation date of the two-pot system is still under consideration. It is stated in the discussion paper that comments and options would be welcomed on how vested rights can be protected.

The amount in the access pot will be available at any time, but can only be withdrawn once a year, depending on a fund’s ability to effect withdrawals and subject to a minimum value of, for example, R2 000. If the member made a partial withdrawal, a second withdrawal will however be allowed within the year for any amount remaining in the access pot.

The withdrawing member will have to incur the cost of a withdrawal so that non-withdrawing members do not subsidise the cost of those withdrawing. A member may also be required to undergo retirement benefit counselling or financial awareness before a withdrawal is undertaken. A withdrawal from a retirement fund reduces the member’s retirement savings, and a withdrawing member should be encouraged to increase his/her future retirement contributions to replace what is being withdrawn.

Preservation funds will also be required to implement the two-pot system. Transfers into preservation funds will mirror the structure of the transferor fund. This will enable members to continue to withdraw from the access pot upon transfer to a preservation fund.

Retirement annuity funds will also be included in the two-pot system.

Defined benefit funds, including the Government Employees Pension Fund (GEPF), will likewise be included in the two-pot system. This means that these funds would need to calculate a value for the one third contribution to the access pot at the time the member asks for access, and then sell assets from their wider portfolios to meet that obligation.

One of the questions posed in the discussion paper is whether members should be given immediate access to 10 percent (up to R25 000) of their retirement savings, in other words despite the fact that they have not yet built up an access pot. There are several risks if this were to be allowed, and it is stated in the discussion paper that Government will proceed with caution in this regard.

Due to various reasons the current tax treatment for contributions to, and withdrawals from, the access pot is unlikely to be appropriate. National Treasury will investigate potential alternatives, which could include the following:

- Adding withdrawals from the access pot to the member's taxable income in the year of withdrawal;
- Removing the tax deduction in respect of contributions to the access pot but making the withdrawal tax-free. In effect, this would create a tax-free savings account within a retirement fund.
- Moving to a flat deduction percentage for contributions. Members could, for example, receive a 30 percent deduction on their contributions, which is unrelated to income. Tax on withdrawals could either be at the same flat rate or could be added to the member's taxable income for that year.
- Keeping the current tax regime unchanged.

3. Auto Enrolment

National Treasury on 14 December 2021 published a discussion paper entitled *Encouraging South African households to save more for retirement*, which is discussed in more detail in point 2 of this report. In an annexure to the discussion paper National Treasury deals with its intention of introducing automatic enrolment into retirement funds (auto enrolment). It is in this regard stated that Government will propose legislation to compel all employers to deduct contributions to an occupational fund, or another approved fund, for all their employees. Employers would not be required to establish new funds, but would enrol their employees into existing funds, which would have to bid for the provision of retirement services or products.

4. Governance of umbrella funds

National Treasury on 14 December 2021 published a discussion paper entitled *Governance of umbrella funds*, which seeks to improve governance in retirement funds in general, but particularly in commercial umbrella funds. The main proposals contained in the discussion paper are as follows.

The role of employer representative committees, also known as joint forums, management committees or advisory bodies, should be formalised and standardised, and they should have the following functions in addition to those delegated by the umbrella fund's board of trustees:

- Conduct ongoing assessment of value for money for members as shall be prescribed. Value for money measurement criteria and tools should be established and a conduct standard be published in terms of which funds that are unable to demonstrate that they comply with specified value for money standards, will be required to procure the transfer of their assets and liabilities to other funds that do comply with these standards and then close.
- Assist the umbrella fund with updates/information to member data, ensure that contributions are paid over to the fund, process death benefits, provide updates to members and recommend amendments to benefit structures.

The Financial Sector Conduct Authority (FSCA) is already in the process of including measures to improve the governance of funds exempted from the requirement that fund members must elect at least 50% of the members of the board of trustees. This follows an announcement by the FSCA to make compliance with applicable principles and practices described in the King IV Report on Corporate Governance compulsory for funds subject to regulation and supervision in terms of the Pension Funds Act.

The FSCA has also issued Guidance Notice 4 of 2018, in which it has set out the conditions under which it is likely to exempt umbrella funds from the obligation to give their members the right to elect at least 50% of the members of the board. These conditions include the following:

- That, unless the rules of the fund provide for indirect elections of board members by means of the election by members of at least 50% of the members of local area committees, which committees may then elect the members of regional committees, which may then elect members of the board, at least 50% of the members of the board must be independent;
- The quorum for board meetings must be no fewer than four board members, which must include independent trustees, and no decision will be valid unless supported by at least 50% of those board members present at the meeting, of which at least half must be independent board members;
- The board must adopt a stakeholder-inclusive approach that balances the needs, interests and expectations of material stakeholders in the best interest of the fund over time, which must be combined with a timeous, regular and relevant communication strategy for the fund and its members.

In addition to the above-mentioned measures, the discussion paper also proposes the following with regard to the board of trustees of an umbrella fund:

- Board members, including independent ones, should not belong to more than three boards, including company boards, in any year;
- Independent board members should not be contracted as consultants or service providers to the fund of which they are trustees.

National Treasury supports a so-called auction system, which must be conducted under the auspices of the FSCA, to enable stand-alone funds to select and appoint default consolidation or auto enrolment funds when they need it. This would entail that umbrella funds are required to bid for the right to be a default consolidation or auto enrolment fund. Bids would cover administration costs and internal investment costs and must be lower than the minimum fee currently available in the market.

Also subject to a bid process should be the provision of services to an umbrella fund. This means that it should be prohibited for any commercial umbrella fund making the use of a sponsor's service providers compulsory. Therefore, there should be an open tender system put in place for any service, which would include the sponsor as a tenderer.

To strengthen competitive pressure and improve transparency of charges and costs, National Treasury is considering a disclosure-based initiative that would require funds to provide information on their cost structures. Standardised provision of information on charges is also proposed to enable comparison between funds and to promote effective competition.

Template rules for umbrella funds, written in plain language, should be published by the FSCA and required to be adopted by each umbrella fund on a 'comply or explain' basis.

No 'lock-in' provisions should be allowed in the umbrella fund's rules or in agreements with service providers. Providers of products and services should compete for the business of providing such products and services to an umbrella fund on an 'arm's length' basis rather than being able to rely on their 'captured client' to buy them.

The rules of the fund should not include any provisions which constitute an impediment to the termination of the appointment of the sponsor, or a party related to it, as a provider of services to the fund.

The rules should be capable of being amended without the consent of the sponsor unless the amendment is likely to have the effect of exposing the sponsor to financial risk or burden that would not be imposed on another entity of a similar nature if it was to replace the sponsor as sponsor on the effective date of the amendment.

More detailed reporting and disclosure standards applicable to retirement funds in various categories could be useful in promoting transparency, accountability and comparability.

5. Cybersecurity and Cyber Resilience Requirements

The Financial Sector Conduct Authority (FSCA) and the Prudential Authority (PA) on 15 December 2021 published a draft Joint Standard on Cybersecurity and Cyber Resilience Requirements (“the Standard”) for consultation. The Standard sets out the minimum standards for sound practices and processes of cybersecurity and cyber resilience for specified financial institutions, which include insurers and retirement funds. The Standard seeks to ensure that these financial institutions implement processes, and have tools and technology, which will prepare them for cyber-attacks, as well as enable them to respond to, and recover from, such attacks.

The Standard is open for comments until 15 February 2022.

6. Financial Sector Levies

National Treasury on 15 December 2021 published the *Draft Financial Sector and Deposit Insurance Levies Bill* (“the Levies Bill”) and the *Draft Financial Sector and Deposit Insurance Levies (Administration) and Deposit Insurance Premiums Bill* for comment.

National Treasury in February 2021 published the Financial Sector Levies Bill for comment. The Levies Bill is a revised version of the aforesaid bill, taking into account the comments received.

The Draft Financial Sector and Deposit Insurance Levies (Administration) and Deposit Insurance Premiums Bill provides for the collection and administration of levies imposed in terms of the Levies Bill. It also provides for deposit insurance premiums payable by banks.

Under the funding model that will be established by the Levies Bill, the operations and functioning of the Prudential Authority (PA), the Financial Sector Conduct Authority (FSCA), the Financial Services Tribunal, the Ombud Council, the Pension Funds Adjudicator and the Office of the Ombud for Financial Services Providers will be funded by levies imposed in terms of the Levies Bill, as well as through fees charged in relation to specific functions or services performed by the aforesaid bodies. The levies payable by life insurers, retirement funds, retirement fund administrators and financial services providers are set out in the Schedules to the Levies Bill.

Comments on the Levies Bill must be provided to National Treasury by Monday, 7 February 2022.

7. FSCA Information Request for information related to profiles of licensed financial institutions

The Financial Sector Conduct Authority (FSCA) during October 2021 issued FSCA Information Request 2 of 2021, in which certain information is requested from all licensed financial institutions, including retirement funds and insurers. In terms of the information request the requested information had to be provided by 15 December 2021. The FSCA on 14 December 2021 extended the due date for the provision of the information until 31 January 2022.

8. Update on development of the cross-sectoral Conduct of Business Return

The Financial Sector Conduct Authority (FSCA) is in the process of developing a cross-sectoral Conduct of Business Return (Omni-CBR). The FSCA previously indicated that an initial version of the Omni-CBR was planned for industry consultation by the end of 2021. The FSCA however on 22 December 2021 issued

FSCA Communication 22 of 2021 (General), in which it says that *“to ensure alignment with several key internal and external developments, and to facilitate a more meaningful engagement process, a decision has been taken to delay the publication of the draft Omni-CBR until early 2022”*.

The reasons for the development of the Omni-CBR are explained as follows in the Communication:

“To achieve its objectives, the FSCA is required to monitor the extent to which the financial system is delivering fair outcomes to financial customers, with a focus on the fairness and appropriateness of financial products and financial services and the extent to which they meet the needs and reasonable expectations of financial customers.

As outlined in the FSCA’s inaugural Regulatory Strategy (2018-2021) published in 2018, in order to monitor whether the financial system is delivering fair outcomes to customers, the FSCA needs access to meaningful, reliable, measurable and comparable information on key conduct indicators across financial institutions. To give effect to this the FSCA embarked on a multidisciplinary project to facilitate a process for detailed and consistent conduct of business reporting by financial institutions in future.”

It is stated in the Communication that the FSCA intends undertaking a robust consultative process during 2022 on the content and implementation of the Omni-CBR.

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