Legal Report July 2022

1. Amendments to regulation 28 of the Pension Funds Act

Draft amendments to regulation 28 of the Pension Funds Act were published for comment in February 2021 and October 2021. The final amendments have now been published in the Government Gazette.

The amendments are aimed mainly at making it easier for retirement funds to invest in infrastructure. Some of the more important amendments are as follows.

A definition of "crypto-asset" is introduced, and a fund is prohibited from investing in crypto-assets. It is in this regard stated in the media statement accompanying the amendments that "*the excessive volatility and unregulated nature of crypto assets require a prudent approach, as recent market volatility in such assets demonstrates*".

The definition of "hedge fund" is replaced by a new definition, and it is stipulated that a fund may invest in a hedge fund, subject to conditions that may be prescribed. The reason for this amendment is explained as follows in the media statement:

"*As part of aligning various regulatory approaches and achieving consistency, only investments in CISCA approved hedge funds will be permitted.*"

"Infrastructure" is defined as "*any asset that has or operates with a primary objective of developing, constructing and/or maintaining physical assets and technology structures and systems for the provision of utilities, services or facilities for the economy, businesses, or the public*". This includes both public and private infrastructure.

Infrastructure is not introduced as a new asset class, but is recognised within the existing asset classes specified in regulation 28. The aggregate exposure of a fund to infrastructure, excluding any debt instrument issued or guaranteed by the South African government, may not exceed 45% of the total assets of the fund.

The exclusion of the look-through principle in respect of the underlying assets of a hedge fund or private equity fund, does not apply in the case of infrastructure investments in a hedge fund or private equity fund.

A new Table 2 is inserted in regulation 28, which must be used for reporting the top 20 holdings in infrastructure investments.

The aggregate (in other words combined) exposure limit to the following is increased from 35 percent to 45 percent:

- certain debt instruments not listed on an exchange;
- preference and ordinary shares in companies, excluding shares in property companies, not listed on an exchange;
- immovable property, preference and ordinary shares in property companies, and linked units comprising shares linked to debentures in property companies, not listed on an exchange;
- hedge funds;
- private equity funds;
- any other asset not referred to in Table 1 of regulation 28.

The limit applicable to private equity funds is increased from 10% to 15%.

The aggregate (in other words combined) exposure limit to the following is increased from 15 percent to 20 percent:

- preference and ordinary shares in companies, excluding shares in property companies, not listed on an exchange;
- private equity funds.

The aggregate exposure by a fund per issuer or entity, in respect of all asset categories specified in Table 1, irrespective of the limits referred to in Column 1 of Table 1, must not exceed 25 percent of the aggregate fair value of the total assets of the fund, excluding any debt instruments issued by, and loans to, the government of the Republic and any debt or loan guaranteed by the Republic.

The maximum exposure by a fund in respect of housing loans to members is decreased from 95% to 65%. The new limit will apply in respect of loan guarantees entered into on or after 3 January 2023. The limit will not apply in respect of loan guarantees that have been entered into prior to 3 January 2023. According to the media statement, the lowering of the housing loan limit "*is meant to curb abuse of the housing loan scheme by fund members*". National Treasury, in the comments matrix with regard to the amendments, further say the following:

"*Lending options not a supported policy due to implications of reducing retirement provision. Policy intent to phase out housing loans - reduction to 65% as a start.*"

Regulation 28(8)(b) currently makes provision for certain assets, whereunder participatory interests in collective investment schemes and investment policies, to be excluded in applying the limits set out in regulation 28. These exclusions will from 3 January 2023 no longer apply. This means that the look-through principle will no longer be excluded in respect of the underlying assets of these investments. According to the media statement this is "*to enable the regulators to collect important statistics on underlying exposures, as part of understanding and monitoring linkages in the financial system and for proactive supervision*".

The amendments will come into effect on 3 January 2023. It is stated in the media statement that the Financial Sector Conduct Authority (FSCA) is in the process of finalising the standard on reporting requirements aligned to the revised regulation 28, and that it will be issued for public comment soon.

2. FSCA Regulation plan

The Financial Sector Conduct Authority (FSCA) on 30 June 2022 published its Regulation Plan for the next three years (2022 to 2025). The plan is intended to support the FSCA in managing how it carries out ongoing legislative review and development of the regulatory framework, in line with its strategic objectives, over the course of the next three years. For the employee benefits industry, inter alia the following is of note.

Guidance Notices will be used more frequently to inform outcomes- and principles-based requirements, thereby providing some level of consistent application of the legislated outcomes and principles.

Industry specific rules will still be provided for, but an overuse of rules will be limited as far as possible. Instead of providing for detailed rules, a greater reliance will be placed on outcomes, principles and guidance where possible.

Where possible, requirements will be streamlined and consolidated into a single conduct standard as far as possible so as to avoid multiple pieces of law, thereby creating a much simpler and easier to navigate legal landscape. This will also relieve undue regulatory burden.

Various regulatory framework developments within the retirement fund environment are in the last phase of finalisation in that the conduct standard has either been submitted to Parliament or is very close to being submitted to Parliament. These developments include the following:

- Conduct Standard – Payment of Pension Fund Contributions: This Conduct Standard has already been submitted to Parliament and is expected to be finalised soon. The FSCA is also working closely with National Treasury to ensure that the repeal of regulation 33 of the Pension Funds Act, which will be replaced by this conduct standard, coincides with the effective date of the Conduct Standard.

- Conduct Standard – Conditions for investment in derivative instruments: It is expected that a final version of this Conduct Standard will be submitted to National Treasury for onforwarding to Parliament during the third quarter of

2022. The final Conduct Standard will be made shortly after the Parliamentary period has elapsed.

- Conduct Standard – Conditions for living annuities in an annuity strategy: This Conduct Standard is undergoing final refinements and it is expected that it will be submitted to National Treasury for onforwarding to Parliament during the last quarter of 2022. The final Conduct Standard will be made shortly after the Parliamentary period has elapsed.

- Conduct Standard - Communication of Benefit Projections to Members of Pension Funds: This Conduct Standard is undergoing final refinements and it is expected that it will be submitted to National Treasury for onforwarding to Parliament during the last quarter of 2022. The final Conduct Standard will be made shortly after the Parliamentary period has elapsed.

Pension Funds Financial Statements and Regulatory Reporting Standard

The regulatory reporting requirements for retirement funds, including the formats for reporting, are outdated. The intention is to update the current requirements and incorporate the updated requirements into a Standard. Technical work on the reporting requirements is ongoing and the FSCA will publish the proposed reporting requirements for public comment in due course.

Joint Standard – Culture and Governance

Culture and governance remain a critical priority area for both the FSCA and the Prudential Authority (PA), and the two Authorities are currently in the process of developing a high-level Joint Standard relating to Culture and Governance which is envisaged to be published for public consultation during the course of 2023.

Joint Standard – Information Technology governance and risk management

The Joint Standard relating to Information Technology governance and risk management has progressed well. Following a robust public consultation process on the draft Joint Standard, the FSCA and the PA are busy with final refinements to the Joint Standard, and it is expected that the Joint Standard will be submitted to National Treasury for onforwarding to Parliament by the end of 2022 or beginning of 2023.

Joint Standard - Cyber security and cyber resilience requirements

The draft Joint Standard relating to cyber security and cyber resilience requirements was published for public comment in December 2021. Further refinement of the Joint Standard took place, and it is envisaged that a second version of the draft Joint Standard will be published for public consultation in due course.

Conduct Standard relating to Financial Consumer Education Initiatives

The FSCA is developing a draft Conduct Standard that will require all financial institutions to take reasonable steps to ensure appropriate standards of behaviour, put in place governance and oversight arrangements when developing financial education content, and to implement, monitor, evaluate and report on consumer financial education activities.

Conduct Standard regarding industry practices and treatment of lost accounts and unclaimed assets

The treatment of lost accounts and unclaimed assets within the financial sector remains a significant concern. In the retirement sector alone, unclaimed assets stood at R47.3 billion in 2021. To mitigate risks relating to lost accounts and unclaimed assets more effectively, the FSCA will be developing policy proposals surrounding the treatment of lost accounts and unclaimed assets, with the ultimate goal of proposing legislative interventions through a Conduct Standard. The policy work, that will inform legislative proposals, will take place during the course of 2022 and 2023 and may entail public consultation on Discussion, Position and/or Policy Papers. Formal draft legislative proposals are only expected to be published during the first quarter of 2024 and finalised during mid-2025.

Development of cross-sector licensing forms

In an attempt to ensure a consistent approach to licensing across the sector, and also in anticipation of the licensing framework to be given effect to under the COFI Bill, the FSCA will be developing cross-sector licensing forms. The cross-sector licensing forms are expected to be finalised during 2023.

Other aspects of note

The FSCA will, subject to resource availability, further consider the possibility of a Conduct Standard relating to Culture and Governance for retirement funds.

The FSCA in 2020 initiated a Harmonisation Project, which is aimed at the development of cross-sector conduct standards. It is stated in the Regulation Plan that drafting of the harmonisation frameworks is currently underway and that it is expected that drafting will continue throughout 2022, and that consultation on the frameworks should occur during 2023.

The Retail Distribution Review (RDR) proposals remain a priority for the FSCA and integrating these into the wider regulatory reform is considered imperative for alignment and regulatory efficiency.

The Joint Standard on outsourcing by insurers remains a priority for the FSCA and the PA, and the Authorities will continue to finalise this Joint Standard during the course of 2022.

The regulation of crypto assets remains a high priority for the FSCA, and the FSCA will continue to monitor the crypto environment and formulate policy responses as deemed appropriate.

3. Fees in respect of transfers between retirement annuity funds

The Financial Sector Conduct Authority (FSCA) has published a draft Guidance Notice on the application of section 14(7)(b) of the Pension Funds Act for public consultation. In terms of section 14(7)(b), the fees or commission payable in respect of financial services rendered after the transfer from one retirement annuity fund to another, may not exceed the maximum allowed in terms of the Long-term Insurance regulations, except if agreed to in writing by the transferring member on an annual basis.

No provision is however made in the Long-term Insurance regulations for a transferring member to agree to fees in excess of the maximum commission caps. Section 14(7)(b) of the Pension Funds Act is accordingly in conflict with the Long-term Insurance regulations in this regard. The purpose of the Guidance Notice is to set out how the FSCA will deal with this conflict.

The FSCA in the draft Guidance Notice say that section 14(7)(b) of the Pension Funds Act is primary legislation whereas the Long-term Insurance regulations are subordinate legislation, and that it is trite law that, in the case of a conflict between primary legislation and subordinate legislation, the primary legislation must prevail. The FSCA will therefore, after the transfer from one retirement annuity fund to another, allow the agreement of fees in excess of the maximum commission caps, despite the fact that this is not allowed in terms of the Long-term Insurance regulations.

The Guidance Notice further sets out the requirements that a fee agreement in terms of section 14(7)(b) of the Pension Funds Act must comply with.

Comments on the draft Guidance Notice can be provided to the FSCA until 2 August 2022.

4. Increase in the jurisdictional limit of the Ombud for Financial Services Providers (FAIS Ombud)

The jurisdictional limit of the Ombud for Financial Services Providers (FAIS Ombud) has been R800 000 since 2004. The Financial Sector Conduct Authority (FSCA) has published a draft amendment to the FAIS Ombud’s Rules on Proceedings, increasing the jurisdictional limit to R3 500 000. Comments on the proposed increase can be provided to the FSCA until 19 August 2022.

5. Changes to the tax directive process

The South African Revenue Service (SARS) has issued a letter in which it advises that it will be enhancing the tax directive process with regard to retirement fund benefits. The enhancement entails the validation of data captured on the tax directive application form against the information held by the Financial Sector Conduct Authority (FSCA).

The following data will be validated against the fund's information as registered with the FSCA:

- the registered fund name;
- participating employer name; and
- FSCA registration numbers (participating employer number included) should be captured as it is on the FSCA data base.

Data captured on the tax directive application must correspond with the registration data with the FSCA. Incorrect data or omitted data will result in the tax directive application being declined.

Funds are in the letter reminded that the registered information as per the FSCA can be found on the FSCA website, and they are encouraged to refer to this information prior to submitting the tax directive application.

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