Legal Report September 2022

Newsletter of Sanlam Corporate: Legal

1. Changes to the tax directive process

The South African Revenue Service (SARS) during July 2022 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 enhancements were implemented on 16 September 2022.

In terms of the enhancements 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 in the above-mentioned letter are 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.

2. Second Code for Responsible Investing in South Africa

The Second Code for Responsible Investing in South Africa, 2022 ("CRISA 2") has been issued by the CRISA Committee, and is endorsed by the Association for Savings and Investment South Africa (ASISA), the Batseta Council of Retirement Funds for South Africa, the Financial Sector Conduct Authority (FSCA), the Government Employees Pension Fund (GEPF) and the Institute of Directors South Africa (IoDSA).

CRISA 2 builds on the first CRISA Code (2011) and contains five voluntary principles for stewardship and responsible investment as a key component of the South African governance framework.

CRISA 2 applies to asset owners, asset managers and service providers who wish to voluntarily align themselves with the principles therein contained. "Asset owner" is defined as follows:

"*An organisation that represent the holders of long-term retirement savings, insurance and other assets. Examples include retirement and pension funds, sovereign wealth funds, foundations, endowments, insurance and reinsurance companies and other financial institutions that manage deposits.*"

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CRISA 2 accordingly also applies to retirement funds.

The effective date for reporting publicly on the application of CRISA 2 is 1 February 2023.

The main objective of CRISA 2 is to reaffirm a framework of principles for stewardship and responsible investment as a key component of the South African governance framework. For purposes of CRISA, diligent and effective stewardship means managing investment arrangements and activities towards the creation of long-term value for the economy, the environment and society as part of the delivery of superior risk-adjusted returns to clients and beneficiaries.

The five principles laid down by CRISA 2 are as following:

- Investment arrangements and activities should reflect a systematic approach to integrating material environmental, social and governance (ESG) factors.

- Investment arrangements and activities should demonstrate the acceptance of ownership rights and responsibilities diligently, enabling effective stewardship. Active ownership is, with reference to a retirement fund, defined as the prudent fulfilment of responsibilities relating to the ownership of, or an interest in, an asset.

- Acceptance and implementation of the principles of CRISA 2 and other applicable codes and standards should be promoted through collaborative approaches and targeted capacity building throughout the investment industry.

- Sound governance structures and processes should be in place to enable investment arrangements and activities that reflect and promote responsible investment and diligent stewardship, including proactively managing conflicts of interest.

- Investment organisations should ensure disclosures are meaningful, timeous and accessible to enable stakeholders to make informed assessments of progress towards the achievement of positive outcomes.

3. Two-pot system

The 2022 Draft Revenue Laws Amendment Bill ("the Bill"), which introduces the so-called two-pot system, was published for public comment on 29 July 2022. (More details on the two-pot system are contained in Sanlam Corporate Legal's August 2022 Legal Report.) The commentary period has expired, and National Treasury has submitted their draft responses to comments received.

The following is of note:

The implementation date of the two-pot system will be postponed from 1 March 2023 to 1 March 2024. This is in response to submissions made by the retirement fund industry to the effect that the proposed implementation date of 1 March 2023 is not feasible given, amongst others, the system changes required to administer the two-pot system.

One of the comments received on the Bill is that the lack of immediate access to retirement savings will result in members resigning, in order to get access to savings. In response, National Treasury said that Government is open to allowing once-off seeding capital from the vested pot into the savings pot, to provide members with immediate access to a portion of their retirement savings. This is however subject thereto that immediate access should not have adverse implications on liquidity, and that the costs of such immediate withdrawals is not imposed on members choosing not to withdraw. The mechanism to enable this will require consultation with commentators.

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It is unclear how the two-pot system will apply to defined benefit funds. This is because a member's benefit in such a fund is determined based on a defined formula, without reference to contributions and investment performance. A consultative process will be undertaken with relevant defined benefit funds and stakeholders to consider how the two-pot system should apply to defined benefit funds.

The Bill will be amended to make it clear that members will be required to contribute a third of their contributions into the savings pot, and will in other words not be able to contribute less than a third into the savings pot.

The Bill currently stipulates that a member may not make more than one withdrawal from the savings pot in any 12-month period. It is however not clear how the 12-month period is to be calculated. National Treasury has confirmed that the 12-month period is intended to be a rolling 12-month period, and that the Bill will be amended to make this clear.

In terms of the Bill, the minimum withdrawal amount from the savings pot is R2 000. A member must accordingly have an amount of at least R2 000 in the savings pot before being allowed to make a withdrawal. It is however not clear whether the R2 000 is a gross or net amount. National Treasury has confirmed that the policy intent is for the R2 000 to be a gross amount. The Bill will be amended to make this clear.

The Bill will be amended to enable a member to withdraw the balance in the savings pot if such balance is less than R2 000 upon the member's exit from the fund.

The policy intent is for the commutation threshold of R165 000 to apply on a cumulative basis to amounts subject to annuitisation (i.e. the retirement pot and two thirds of the vested pot). The Bill will be amended to reflect this intention.

The policy intent is for participation in the two pots regime to be mandatory for all funds. Funds will in other words not have a choice whether or not to implement the two-pot system. The Bill will be amended to reflect this intention.

The policy intent is for provident fund members who were 55 years or older as at 1 March 2021 to be given a choice between one of the following:

- to continue contributing to their vested pot. In such cases 100% of the contributions will be allocated to the vested pot, provided that the member remains in the same fund that he/she was a member of pre-1 March 2021;

- to participate in the two-pot system, with one third of contributions allocated to the savings pot and two thirds to the retirement pot.

All T-day vested rights will remain. The vested pot under the two-pot system will accordingly consist of the T-day vested and non-vested pots as at the implementation date of the two-pot system.

Government acknowledges that changes will need to be made to section 37D of the Pension Funds Act to cater for the two-pot retirement system, and to ensure that section 37D deductions are catered for from the vested and retirement pots when membership of the fund is terminated, or when divorce order settlements become due and payable.

There was a request that so-called legacy retirement annuity products be exempted from participation in the two-pot system as participation would require a redesign of historically acquired insurance policies together with their respective terms and conditions. A consultative process shall be undertaken with the Financial Sector Conduct Authority (FSCA) and stakeholders to assess the merits of this request.

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Given that retrenchment is beyond the member's control, Government proposes that limited income-based withdrawals be permitted from the retirement pot in the case of retrenchment. These withdrawals will be subject to the following conditions:

- the vested and savings pots must have been fully utilised, and access to UIF benefits have been exhausted. The member will therefore be required to prove that he/she has no other alternative income source;

- access to the retirement pot will be provided for a limited period and as a form of annuity, with a maximum per year.

Arrear contributions that relate to a post-implementation period will be allocated to the respective savings and retirement pots. If the arrear contribution relates to a pre-implementation period, the current pre-implementation dispensation will apply. Contributions that became payable before the implementation date of the two-pot system, but which are paid after the implementation date, will in other words be allocated to the vested pot, and not to the savings and retirement pots.

The Bill currently stipulates that all contributions above the tax-deductible limit, being 27,5% of remuneration up to a maximum of R350 000 per annum, will fall into the retirement pot. This provision will be withdrawn as the administrative constraints in this regard are too onerous. Fund administrators do namely not have sufficient information to monitor the member's position relative to the limit, especially with regard to members who contribute to more than one fund.

Changes will, with regard to tax withholding by fund administrators in respect of withdrawals from the savings pot, be made in the Bill to allow for an administrative mechanism similar to the effective tax rates that are communicated by the South African Revenue Service (SARS) to administrators in the case of taxpayers who receive more than one pension income.

Government acknowledges that what is referred to as "pots" in the Bill are for all intents and purposes components within the respective funds, and will consider an adjustment to the names of the different pots to reflect their component nature. Additional definitions will also, where necessary, be incorporated into the Bill.

The definitions of "savings pot", "savings withdrawal benefit" and "retirement pot" will be clarified so as to ensure that the policy intent is correctly reflected in the legislation.

The next step is that National Treasury's responses, as highlighted above, will be considered by Parliament's Standing Committee on Finance, thereafter the amended Bill will be tabled in Parliament by the Minister of Finance. National Treasury has indicated that they are unable to confirm when the amendments to the Bill will be finalised as this is dependent on further consultation with the retirement fund industry and the required amendments to the Pension Funds Act.

4. Discussion paper on unclaimed assets

The Financial Sector Conduct Authority (FSCA) has published a discussion paper on unclaimed assets. The following recommendations regarding the treatment of unclaimed assets are made in the discussion paper:

Recommendation 1

It is stated in the discussion paper that unclaimed assets are not unique to the retirement fund industry. It is therefore proposed that the following financial products and instruments be subject to the proposed Unclaimed Assets Framework:

(a) Retirement fund benefits
(b) Bank deposits

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(c) Participatory interests in collective investment schemes
(d) Life and Non-Life Insurance policies
(e) Securities

Recommendation 2

It is recommended that the law prescribes what is meant by dormancy, lost accounts and unclaimed assets. In general, it is proposed that the definition of unclaimed asset, as far as possible, be aligned to the definition of an unclaimed benefit in the Pension Funds Act. In other words, an asset becomes unclaimed if the asset has not been paid by a financial institution to a beneficial owner or has not been claimed by a beneficial owner, within 24 months of the date on which it becomes legally due, payable or claimable.

It is further proposed that the FSCA develops a consistent approach towards the identification, monitoring and responding to cases of possible unclaimed assets, by financial institutions. The proposed approach is set out in detail in the discussion paper.

Recommendation 3

A Central Unclaimed Assets Fund (Central Fund) should be established to receive and manage unclaimed assets, and financial institutions should be compelled to transfer unclaimed assets, whether deriving from a retirement fund or another source, into the Central Fund.

The FSCA proposes to leverage from the work currently being conducted on the establishment of a central unclaimed retirement benefit fund by engaging National Treasury on a proposal to transfer the establishment of the central unclaimed retirement benefit fund from the Pension Funds Act to the Financial Sector Regulation Act, to rename it to the Central Unclaimed Assets Fund, and to enable the expansion of the scope of the fund to accommodate other assets. It is further proposed that as a first step, the fund should only accept unclaimed retirement benefits and once it is sufficiently operationalised it can, on an incremental basis, be expanded to receive other types of unclaimed assets.

Should complexities surrounding a Central Fund be considered insurmountable, an alternative approach is to require the transfer of unclaimed assets to the National Revenue Fund.

Recommendation 4

Beneficial owners should continue to be able to reclaim, in perpetuity, the value of the assets at the point of transfer into the Central Fund (or other fund as may be determined), as well as any accrued interest between the date of transfer and the date of reclaim.

Recommendation 5

It is proposed that assets be taxed on date of reclaim by the beneficial owner. It is further proposed that the beneficial owner must be treated in a tax-neutral manner. In other words, the beneficial owner must be put in a tax position as if the transfer to the Central Fund had not occurred.

Recommendation 6

All financial institutions should be required to keep records of dormant accounts, lost accounts, and unclaimed assets identified, including the number of accounts and beneficial owners, asset type, individual asset value, age of asset, where available age and race of the beneficial owner, how the institution has responded to tracing and verifying beneficial owners, and the effectiveness of such responses. These records should routinely be submitted in a prescribed format to the FSCA for monitoring purposes.

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Recommendation 7

A centralised data base should be established to assist in the tracing of persons in respect of all industry segments across the financial sector. This data base will initially only apply to retirement fund benefits. It is however proposed that it will, ultimately, be expanded to include beneficiaries of all unclaimed assets.

Recommendation 8

Given the costs involved in tracing financial customers, it is proposed that when an asset is confirmed by a financial institution as an unclaimed asset, an asset below a prescribed threshold be immediately considered "untraceable" and revert into the Central Fund. At this stage it is proposed that the threshold amount be prescribed by Conduct Standard and be set initially at R1000 for unclaimed assets older than 20 years deriving from a retirement fund, and R100 for all other assets.

Recommendation 9

Given the high concentration of unclaimed benefits in a few retirement funds, it is proposed that the FSCA more closely monitors the tracing of beneficiaries in these funds. Additional specialist resources may be required, like forensic investigators. In the first phase it is proposed that funds with more than R500 million total unclaimed assets, or funds with average unclaimed assets per beneficiary exceeding R45 000, be prioritised.

Recommendation 10

It is not possible at this stage to determine the extent to which there are concentrations of unclaimed assets sitting in other industry segments or entities. Should such concentrations however be detected, it is proposed that the FSCA considers further prioritisation approaches, guided by the experience of prioritising certain retirement funds.

Recommendation 11

It is proposed to actuarially estimate a sustainable unclaimed assets pool that can satisfy expected claims, and that the surplus funds be invested into initiatives that will have a positive systemic impact, e.g. social, environmental and developmental initiatives.

Recommendation 12

Financial customers should share responsibility with financial institutions for ensuring that their product and service providers have updated contact information. The FSCA proposes an ongoing awareness campaign, working together with financial institutions and relevant employers, to explain the importance of keeping personal details up to date, and the consequences of failing to do so.

Recommendation 13

There are various concerns with regard to tracing agents. It is therefore proposed that consideration be given how best to regulate the activities of tracing agents.

Comments on the discussion paper are due on 30 November 2022.

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

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