Legal Report January 2023

Newsletter of Sanlam Corporate: Legal

1. Draft Joint Standard on Cybersecurity and Cyber Resilience Requirements

The Prudential Authority (PA) and the Financial Sector Conduct Authority (FSCA) in December 2021 published a draft joint standard on cybersecurity and cyber resilience requirements for public comment. The comments that were received have been considered, and the PA and the FSCA have in December 2022 published a revised draft joint standard.

The joint standard will apply to various financial institutions, whereunder insurers, retirement funds and retirement fund administrators. It sets out detailed requirements and principles for sound practices and processes of cybersecurity and cyber resilience. The main aims of the standard are explained as follows in the Statement accompanying the standard:

"At a high level, the proposed Joint Standard seeks to:

- *ensure that financial institutions establish sound and robust processes for managing cyber risks;*
- *promote the adoption of cybersecurity fundamentals and hygiene practices to preserve confidentiality, integrity and availability of data and IT systems;*
- *ensure that financial institutions undertake systematic testing and assurance regarding the effectiveness of their security controls;*
- *ensure that financial institutions establish and maintain cyber resilience capability, to be adequately prepared to deal with cyber threats; and*
- *provide for notification by the regulated entities of material cyber incidents to the Authorities."*

An important change from the previous version of the joint standard is that it now also applies to retirement fund administrators. The reason for this is explained as follows in the Statement accompanying the standard:

"*During the consultation process, an argument was made for bringing into the scope of the proposed Joint Standard, pension fund administrators licensed in terms of the Pension Funds Act. This was in light of the governance and operational structures of pension funds. Where a pension fund uses a third-party administrator, the IT systems belong to the administrator. The exception would be for pension funds that do not outsource the administration of the funds and have developed internal capacity for this.*"

The revised draft joint standard is open for comments until 28 February 2023.

2. Draft conduct standard on conditions for investment by retirement funds in derivative instruments

Regulation 28(7) of the Pension Funds Act provides that retirement funds may invest in derivative instruments and empowers the Financial Sector Conduct Authority (FSCA) to prescribe conditions in respect of such investments. Pursuant hereto, the FSCA during June 2020 published, for public comment, a draft conduct standard on the conditions for investment by retirement funds in derivative instruments. The comments that were received have been considered, and a revised draft conduct standard was submitted to Parliament on 2 December 2022.

The purpose of the conduct standard is to balance the benefits of investing in derivative instruments with the possible risks thereof. The draft conduct standard sets out overarching principles for the use of derivative instruments by retirement funds. It also sets conditions relating to, inter alia, the following:

- permissible uses of derivative instruments;
- net derivative positions must at all times be covered by appropriate reference assets, which is defined as the assets from which the value of the derivative instrument is derived;
- valuation of derivative instruments;
- determining the allowable counterparties for purposes of derivative instruments;
- providing guidance on the calculation of exposure to derivative instruments;
- setting out the allowable netting provisions for derivative instruments;
- determining the conditions in respect of collateral; and
- prescribing the conditions for reporting in respect of investments in derivative instruments.

In terms of section 103(1) of the Financial Sector Regulation Act any regulatory instrument must, before it is issued, be submitted to Parliament for a period of at least 30 days while Parliament is in session. The final conduct standard will be issued on expiry of the 30 day period.

The conduct standard will come into operation 12 months after publication thereof.

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3. Taxation Laws Amendment Act, 2022

The Taxation Laws Amendment Act, 2022 ("the Amendment Act") was published in the Government Gazette on 5 January 2023. The amendments affecting retirement funds are as set out below.

Transfer of total interest in a retirement annuity fund

The current situation is that if a member of a retirement annuity fund wants to transfer to another retirement annuity fund, the member must transfer his/her total interest in the retirement annuity fund. If a member has more than one contract in the fund, he/she can accordingly not choose to only transfer one of his/her contracts. The definition of "retirement annuity fund" in the Income Tax Act is amended so as to allow retirement annuity fund members to transfer only one, or only some, of their contracts in the fund, subject to the following conditions:

- the value of each individual contract being transferred must exceed R371 250;
- where a member does not transfer his/her total interest in a retirement annuity fund to another retirement annuity fund, the value of the member's remaining interest, in other words after the transfer, must exceed R371 250.

The minimum of R371 250, referred to above, does not apply in the case of a full transfer from a retirement annuity fund, in other words where the entire benefit is transferred.

The above amendment will come into effect on 1 March 2023.

Protection of vested rights when transferring to a public sector fund

The so-called T-day amendments, which make provision for compulsory annuitisation, came into effect on 1 March 2021. The amendments make provision for the protection of vested rights, in other words benefits that are not subject to annuitisation. Vested rights may also be transferred into another retirement fund without forfeiting their vested rights protection.

It has come to Government's attention that the current provisions have the effect that vested rights would be forfeited if transfer is made into a public sector fund. To address this anomaly, the definitions of "pension fund" and "provident fund" in the Income Tax Act are amended to ensure that vested rights remain protected upon transfer to a public sector fund.

The above amendment will come into effect on 1 March 2023.

The applicability of T-day to public sector funds

It was stated in the Draft Explanatory Memorandum to the Draft Taxation Laws Amendment Bill that the T-day amendments (referred to under the previous heading) also apply to public sector pension funds that operate similarly to provident funds. Paragraph (eA) of the definition of "gross income" in the Income Tax Act did however not mention public sector funds that operate similarly to provident funds. As such, there was no clarity with regards to whether or not annuities received from a public sector pension fund that operates similarly to a provident fund should be included in paragraph (eA) of the definition of "gross income".

To provide clarity, paragraph (eA) of the definition of "gross income" is amended to include annuities from public sector funds that operate similarly to provident funds.

Although it was stated in the Draft Explanatory Memorandum that the T-day amendments also apply to public sector pension funds that operate similarly to provident funds, the South

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African Revenue Service (SARS) holds a contrary view. SARS is of the opinion that, in terms of the current provisions of the Income Tax Act, the T-day amendments do not apply to such funds. A National Treasury official during a workshop on 9 December 2022 said that the intention is that the T-day amendments should eventually apply to public sector funds, but that they are still grappling with the question how to amend the Income Tax Act accordingly. The applicability of T-day to public sector funds is in view of the aforegoing currently shrouded in uncertainty, and public sector funds would be well advised to obtain legal or tax advice in this regard.

The amendment is deemed to have come into effect on 1 March 2021.

Retirement of a provident fund member on grounds other than ill health

Paragraph 4(3) of the Second Schedule to the Income Tax Act currently stipulates that if a member of a provident fund who is younger than 55 retires for reasons other than ill health, any lump sum received shall be taxed as a withdrawal benefit rather than a retirement benefit. This does not apply to members of pension or retirement annuity funds. Paragraph 4(3) is repealed, with effect from 1 March 2023, so that there is no longer any distinction between provident funds and other retirement funds in this regard.

Tax-neutral transfers from a pension to a provident fund

Before 1 March 2021 transfers from a pension fund to a provident fund or provident preservation fund were taxable. From 1 March 2021, in accordance with paragraph 6(1)(a) of the Second Schedule to the Income Tax Act, such transfers are no longer taxable. Contrary to the intention, such transfers were however only tax-neutral in respect of contributions made to a pension fund <u>after</u> 1 March 2021. An amendment has been made so that such transfers will also be tax-neutral in respect of contributions to a pension fund <u>before</u> 1 March 2021.

Transfer of in-fund living annuities from one fund to another

In terms of the definition of "living annuity" in the Income Tax Act, as it read before the current amendments, it was not clear that an in-fund living annuity would still fall within the definition of "living annuity" if it is transferred to another fund. The definition of "living annuity" is amended to clarify that an in-fund living annuity cannot only be provided by the fund that the living annuitant was a member of on his/her retirement date. The in-fund living annuity can in other words be transferred to another fund.

Transfer to an unclaimed benefit fund of certain benefits contemplated in section 37C of the Pension Funds Act

Section 37C(1)(c) and section 37C(5) of the Pension Funds Act make provision for the transfer of death benefits to an unclaimed benefit fund in the circumstances therein set out. The definitions of "pension preservation fund" and "provident preservation fund" in the Income Tax Act did however not make provision for the receipt of benefits in the aforesaid circumstances. The definitions are amended, with the aim of enabling such transfers to an unclaimed benefit fund. The wording of the proposed amendments is however not ideal, and needs further refinement.

Transfer of benefits from pension preservation fund to provident preservation fund

The definition of "pension preservation fund" is amended to make it possible for a member to transfer from a pension preservation fund to a provident preservation fund. The definition does however still not make provision for a transfer from a pension preservation fund to a provident fund.

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4. FICA requirements in respect of the beneficiaries of life insurance policies

The Prudential Authority (PA) has, in terms of the Financial Intelligence Centre Act ("the FIC Act"), on 15 December 2022 issued a directive on customer due diligence (CDD) measures in respect of the beneficiaries of life insurance policies. The directive is effective from 19 December 2022.

The requirements imposed by the directive are briefly as follows:

- Life insurers must obtain particulars of the beneficiary of a life insurance policy as soon as the beneficiary is identified, designated or amended by the client.

- CDD measures in respect of the beneficiary of the policy at onboarding requires that, at a minimum, identification particulars should be obtained.
- A money laundering and terrorist financing risk assessment and commensurate CDD measures must be conducted on a beneficiary, in accordance with the FIC Act, before pay-out of the policy proceeds to the beneficiary.

- A life insurer must take reasonable measures to determine whether the beneficiary is a domestic prominent influential person or foreign public prominent official. Where higher risks are identified, life insurers should obtain approval from their senior management before the inception of the policy or during the course of the policy, as the case may be, to conduct enhanced scrutiny on the business relationship with the policyholder, and to consider making a suspicious transaction report to the FIC. (The terms "domestic prominent influential person" and "foreign public prominent official" have with effect from 31 December 2022 been replaced with the terms "domestic politically exposed person" and "foreign politically exposed person", and are defined in the FIC Act.)

- A life insurer must consider taking reasonable measures to determine whether the beneficiary is a person listed on a targeted financial sanctions list issued by the Security Council of the United Nations.

- Every life insurer is expected to determine if the existing information held in respect of the beneficiary of a life insurance policy is up to date and accurate.

- As part of an effective overall risk management process, a life insurer must ensure that there are trigger events which will prompt a review of the information held on the beneficiary of a life insurance policy.

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5. Enhancement of the online process for the submission of section 14 applications

The Financial Sector Conduct Authority (FSCA) has on 23 January 2023 published FSCA Communication 1 of 2023 (RF), on enhancements to the online process for the submission of section 14 applications. The changes to the online submission system will come into effect on 1 February 2023.

It is stated in the Communication that the new process will enable the FSCA to expeditiously consider submitted section 14 applications, resulting in faster turnaround times. The enhancements to the process are as follows:

- Additional fields will be provided, and will alert the applicant of any inaccuracies, helping to avoid delays in the approval of applications.

- To ensure that no relevant information is missing and that all necessary documents are provided for in the filed section 14 application, a checklist of all the required information and documents will be provided.
- The applicant will be able to indicate on submission of the section 14 application whether the transfer is a full or partial transfer, so that the minimum requirements can be confirmed upfront.

- The applicant will be able to capture multiple participating employers, so that the correct service fee is charged upfront and ensure that the certificate reflects the correct participating employer's name/s.

- Applicants will be able to select the correct transfer type so that they are aware of the relevant documents/information applicable to the transfer type.

- Applicants will be made aware of the turnaround times for accepted applications so that they can plan their follow-up activities.

- The applicant will be able to select single or multiple effective dates so that the correct service fee is charged upfront.

- When the applicant selects a transfer to an insurer or foreign fund, the transferee fund's fields will be disabled on the system and there will be no requirement to capture the transferee fund's details.

- The administrators linked to the transferor and transferee funds should be able to view and/or download a list of all section 14 applications and the audit trail/lifecycle of their status changes. This will give them the status of the application on demand and obviate e-mail queries to the FSCA on the status.

- The applicant will be able to ascertain the mandatory documents and other requirements, which will allow for the successful submission of an application.

- The following are mandatory documents and requirements for a section 14 application:

  (a) Cover Letter;

  (b) Prescribed transfer application forms;

  (c) Member Communication (if applicable);

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(d) Trustee Registers;

(e) In case of a full transfer, the submission of the transferor fund’s valuation reports must be up-to-date;

(f) The status of the funds must still be active;

(g) The status of the participating employer must be active.

- The applicant will complete a checklist that validates the basic requirements of a transfer type. Any unsuccessful validation will result in the submission being automatically rejected.

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

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