Sanlam

Legal Report

January 2024

1. Implementation date of Two-Pot system

The Two-Pot system will mainly be brought about by amendments to the Income Tax Act. The proposed amendments in this regard are contained in the Revenue Laws Amendment Bill. When the Revenue Laws Amendment Bill was still in draft form, it stipulated that the Two-Pot system will become effective on 1 March 2024. Following comments received from various stakeholders to the effect that a 1 March 2024 implementation date would not be achievable, National Treasury amended the Bill so as to postpone the implementation date of the Two-Pot system from 1 March 2024 to 1 March 2025.

National Treasury indicated that the proposed postponement is due to the magnitude of the reform and the desire to ensure that when implemented the system operates as seamlessly as possible. They further stated that the postponement would also provide sufficient time for funds and trustees to consult fund members about rule amendments and to communicate clearly to members what the impact of the system will be on their future contributions.

Parliament's Standing Committee on Finance however on 21 November 2023 objected to the postponement of the implementation date to 1 March 2025 and decided that the implementation date should remain 1 March 2024. The Minister of Finance hereupon wrote a letter to the Standing Committee on Finance, in which he indicated that the implementation of the Two-Pot system can, in his view, for the following reasons not occur on 1 March 2024, but should be postponed to 1 September 2024:

- The Pension Funds Amendment Bill, dealing with the amendments that have to be made to the Pension Funds Act to make provision for the Two-Pot system, has not yet been tabled in Parliament. The effective date of the Revenue Laws Amendment Act cannot predate the effective date of the Pension Funds Amendment Act, and there is a concern that the legislative process in respect of the Pension Funds Amendment Act will not be finalised by 1 March 2024.

- Fund rule amendments can only be submitted to the Financial Sector Conduct Authority (FSCA) for registration after both the Revenue Laws Amendment Bill and the Pension Funds Amendment Bill have been enacted.

- In the case of the Government Employees Pension Fund (GEPF), fund rule amendments require consultation through the Public Sector Coordinating Bargaining Council. This is likely to extend beyond 1 March 2024.

- The South African Revenue Service (SARS) have indicated that they need at least six months after the promulgation of the Two-Pot legislation to put a tax directive system for savings withdrawal benefits in place. If the 1 March 2024 implementation date is retained, SARS would need to rely on a sub-optimal interim system, where they cannot guarantee quick turnaround times or the accuracy of the system.

- An implementation date of 1 March 2024 would require fund managers to urgently reallocate their portfolios to meet the potential liquidity demands from the expected withdrawal requests. This could result in negative market impacts.

- The Two-Pot system is a fundamental restructuring of the retirement system, and there should be a comprehensive communication and education campaign to inform members of the impact of the new regime on their retirement savings.

- SARS, the FSCA, the GEPF and the Government Pensions Administration Agency have indicated that a 1 September 2024 implementation date would be achievable, even though they would still be under pressure to get their systems and processes ready by that date.

The Standing Committee on Finance agreed that the Minister has provided sound reasons for the postponement of the implementation date to 1 September 2024, and accordingly agreed to the 1 September 2024 implementation date, as proposed by the Minister.

It is not yet known when the legislative process will be concluded.

2. Update on roll-out and implementation of cross-sectoral Conduct of Business Return (Omni-CBR)

The Financial Sector Conduct Authority (FSCA) has published an update on the current status of the roll-out and implementation of the cross-sectoral Conduct of Business Return (Omni-CBR). The Omni-CBR is intended to facilitate streamlined cross-sectoral statutory reporting, and sets out the types of conduct indicators to be reported on in future by various financial institutions, including insurers, financial services providers (FSPs), retirement funds and retirement fund administrators.

The FSCA has previously explained the reason for the development of the Omni-CBR as follows:

"*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.*"

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The FSCA in the update confirms the following:

- In light of the voluminous and critical feedback received through both the general consultation process and specific sector-wide and individual institutional engagements, the draft Omni-CBR template is currently undergoing a number of changes, including a significant streamlining of data points requested.
- Engagements are ongoing with the Prudential Authority to ensure alignment with, and mitigate potential duplication of, regulatory reporting requirements, where relevant.
- The FSCA is finalising a consultation survey to obtain deeper insights on the potential operational and systems impact of future Omni-CBR reporting. The survey is envisaged to run, to the extent reasonably possible, in parallel with the industry pilot of the revised reporting template.
- The implementation timelines as originally communicated are currently under review and will be extended.
- Follow-up industry engagements will continue until 1 April 2024 to clarify outstanding issues raised in respect of the current version of the draft Omni-CBR template.
- A revised, streamlined version of the draft Omni-CBR template will be published by 1 July 2024.
- An industry survey will be published by 1 July 2024 on the potential operational and systems impact of implementing the revised Omni-CBR requirements.
- The above timelines are subject to possible revision during 2024 in light of further refinement and harmonisation efforts that may be required following from the pending enactment of the Conduct of Financial Institutions Bill.
- The planned industry pilot will be launched in the second half of 2024 subsequent to, and based on, the outcomes of the survey referred to above.
- Further updates on progress relating to the activities described above will be provided by 1 July 2024.

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3. Draft Joint Standard on Cybersecurity and Cyber Resilience Requirements for financial institutions

The draft Joint Standard on Cybersecurity and Cyber Resilience Requirements for financial institutions was submitted to Parliament on 30 November 2023. The submission to Parliament is a requirement in terms of section 103(1) of the Financial Sector Regulation Act, which requires that, before a regulatory instrument can be issued, it must be submitted to Parliament for a period of at least 30 days while Parliament is in session.

The Joint Standard will apply to various financial institutions, whereunder insurers, retirement funds and retirement fund administrators. It sets out very detailed principles for cybersecurity and cyber resilience that financial institutions must comply with, including requirements that:

- promote the adoption of fundamental 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 regulated entities of material cyber incidents to the Prudential Authority (PA) and the Financial Sector Conduct Authority (FSCA).

The commencement date of the Joint Standard has not yet been determined. It is in this regard stated in the Standard that it will commence on a date to be determined by the PA and the FSCA through a notice published on their websites. The following is said in the consultation report accompanying the Standard:

"*The Joint Standard will be published and from the publication date a 12-month period will be given to financial institutions to implement the requirements of the Joint Standard.*"

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4. Taxation Laws Amendment Act, 2023

The Taxation Laws Amendment Act, 2023 was published in the Government Gazette on 22 December 2023. The amendments affecting retirement funds are as set out below.

Limiting the retirement funds contribution deduction when a member ceases to be a tax resident

In terms of section 11F(2) of the Income Tax Act ("the Act") the total allowable deduction in respect of contributions to a retirement fund may not in a year of assessment exceed R350 000. When a member ceases to be a South African tax resident, there are two years of assessment during a single 12-month tax period. The first year of assessment is from 1 March until the date on which the member ceases to be a South African tax resident. The second year of assessment is from the date on which the member is a non-South African tax resident until the end of February of the following year.

As a result of a member having two years of assessment in a 12-month tax period when he/she ceases to be a South African tax resident, such a member is able to make a tax-free contribution of up to R700 000 during a 12-month tax period. This is because the R350 000 maximum applies per year of assessment, and is not apportioned in instances where the year of assessment is less than 12 months. This is contrary to the policy rationale.

To address this anomaly, section 11F(2) of the Act is amended to stipulate that where a member's year of assessment is less than 12 months, the total retirement funds contribution deduction for years of assessment during the period of 12 months commencing in March and ending at the end of February of the immediately following calendar year, must not exceed R350 000.

The above amendment will come into operation on 1 March 2024 and apply in respect of years of assessment commencing on or after that date.

Clarifying the deductible employer contribution to a retirement fund

In terms of section 11F(4) of the Act, employer contributions to a retirement fund are taxable in the member's hands as a fringe benefit. Employer contributions are further deemed to have been contributed by the member, and the member accordingly has a deduction in respect of such contributions.

There is currently no requirement that the member only has a deduction in respect of employer contributions if the contributions have been included in the member's income. As a result, even if the employer contributions are not subject to fringe benefit tax because the member's remuneration qualifies for income tax exemption, the member may still be entitled to a deduction in terms of section 11F of the Act. If all the member's income is tax exempt, the employer contributions may further be carried forward to retirement or withdrawal and be allowed as a deduction against the member's lump sum or annuity, once again without the member having been taxed on such employer contributions.

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The above is contrary to the policy intent. The policy intent is for a deduction or tax credit to only be afforded to amounts included in the taxpayer's income. A deduction or tax credit should not be available for tax exempt amounts.

To address this anomaly, section 11F(4) of the Act is amended to stipulate that employer contributions are only deemed to have been contributed by the member to the extent that the contributions have been included in the member's income.

The above amendment will come into operation on 1 March 2024 and apply in respect of years of assessment commencing on or after that date.

Transfers of retirement fund members on or after normal retirement age

Paragraph (e) of the definition of "gross income" in the Act includes in the gross income of a person "a retirement fund lump sum benefit". "Retirement fund lump sum benefit" is defined as including "*an amount determined in terms of paragraph 2(1)(c) of the Second Schedule*".

Paragraph 2(1)(c) of the Second Schedule to the Act, referred to above, refers to "*any amount transferred for the benefit of that person on or after normal retirement age, as defined in the rules of the fund, but before retirement date, less any deductions permitted under the provisions of paragraph 6A*".

The combined effect of the above provisions is that any amount transferred for the benefit of a member on or after his/her normal retirement age forms part of his/her gross income unless it falls within the deductions provided for in terms of paragraph 6A of the Second Schedule. This is not limited to transfers in respect of members who have retired from employment, but includes transfers in respect of members who have not yet retired from employment, but who have reached normal retirement age.

Paragraph 6A, in respect of transfers on or after normal retirement age, currently only makes provision for a deduction in respect of a transfer from a pension fund and provident fund to a retirement annuity fund or preservation fund, and not to another pension fund or provident fund. The effect hereof is that when an active member who has reached the normal retirement age is transferred from a pension fund or provident fund to another pension fund or provident fund, the amount transferred is, based on the current wording of paragraphs 2(1)(c) and 6A, part of his/her gross income, and as such taxable.

To address the above issue, paragraph 6A is amended to include, in respect of transfers on or after normal retirement age, a tax deduction in respect of involuntary transfers from a pension fund or provident fund to another pension fund or provident fund. This will ensure a tax-free transfer of members of a pension fund or provident fund who have reached the normal retirement age and who are subject to an involuntary transfer.

The above amendment will come into operation on 1 March 2024 and apply in respect of years of assessment commencing on or after that date.

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5. Exemption of large retirement funds in respect of audit reports

The Financial Sector Conduct Authority (FSCA) has published an exemption notice in terms of which large retirement funds are exempted as follows (large funds are funds with total assets exceeding R50 million):

- For the preparation of financial statements in respect of a financial year that ends after 1 March 2018, a large fund is exempted from the requirement to complete Schedule D1, on the condition that such a fund completes the Independent Regulatory Board for Auditors (IRBA) approved illustrative "Auditor's report template: Audit of the Financial Statements of a Large Retirement Fund (Schedule D)", as may be amended by the IRBA from time to time;

- For the preparation of financial statements in respect of a financial year that ends between 1 March 2018 and 31 December 2022, a large fund is exempted from the requirement to complete Schedule IB1, on the condition that such fund completes the IRBA's illustrative "Assurance Report on Compliance with Regulation 28 of the Pension Funds Act" that was approved by the IRBA in March 2019; and

- For the preparation of financial statements in respect of a financial year that ends after 31 December 2022, a large fund is exempted from the requirement to complete Schedule IB1, on the condition that such fund completes the report attached to the exemption notice entitled "2023 Assurance Report on Compliance with Regulation 28 of the Pension Funds Act".

The background to the exemption is explained as follows in the Communication accompanying the exemption:

- Board Notice 77 of 2014 prescribes the format of the financial statements that must be completed by funds.

- On 5 March 2020 the FSCA published FSCA RF Notice 5 of 2020, in terms of which large funds were exempted from using certain prescribed auditor's report formats when preparing financial statements, on the condition that they use the illustrative auditors' reports approved by the IRBA.

- The amended regulation 28 includes additional reporting requirements in relation to infrastructure assets and amendments to the asset spreading requirements. The reporting requirements in Board Notice 77 do however not make provision for these new requirements.

- Board Notice 77 is currently in the process of being replaced with a Prudential Standard titled *Requirements related to Regulatory Reporting and Audited Financial Statements for Pension Funds* ("the Prudential Standard)". The Prudential Standard incorporates reporting aligned to the recent amendments to regulation 28.

- Until the Prudential Standard has been finalised, there will be misalignment between the amended regulation 28 and the reporting requirements prescribed in Board Notice 77. This is because, as already

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mentioned, Board Notice 77 does not make provision for infrastructure reporting, whilst regulation 28 does require such reporting.

- This misalignment creates a challenge from an auditor reporting perspective as auditors cannot provide assurance on compliance with regulation 28 if they did not audit whether a fund complies with the infrastructure reporting requirements. As such, there is a need for the regulation 28 audit report (Schedule IB1) to provide for an exception in respect of infrastructure reporting. The FSCA engaged the IRBA in this regard and the IRBA was not opposed to the FSCA providing for such an exception as an interim measure pending the finalisation of the Prudential Standard.

- In addition, there is a need to perpetuate the current exemption pertaining to the completion of Schedule D provided that a fund completes the IRBA Auditor's Report.

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

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