Sanlam

Legal Report

February 2024

1. Amendments to the Pension Funds Act

The Pension Funds Amendment Bill, which proposes amendments to the Pension Funds Act ("the Act"), has been tabled in Parliament. Public hearings on the Bill are scheduled for 12 March 2024 and clause-by-clause deliberations by Parliament's Standing Committee on Finance are scheduled for 26 March 2024.

The proposed amendments are mainly aimed at making provision for the two pot system, but also deal with certain other aspects. Some of the more important amendments are as follows:

- A definition of "pension interest" is inserted in the Act, which will apply instead of the definition of "pension interest" in the Divorce Act. In terms of this definition a member of an occupational fund will not cease to have a pension interest when his service is terminated, and it will accordingly be possible to also make a pension interest allocation in the case of a paid-up member and a deferred retiree.

- Section 37D of the Act will be amended to make it possible for a non-member spouse to also receive a portion of the member's pension interest in the case of the dissolution of a marriage in terms of the tenets of a religion.

- Fund return on the non-member spouse's portion of the pension interest will no longer accrue from the date of the deduction of such portion from the member's benefit, but from the date of divorce.

- The maximum housing loan that may be granted to a member will be limited to a maximum of 65 percent of the member's benefit. This is to bring it in line with the recent amendments to regulation 28 of the Pension Funds Act, which limit housing loans granted by retirement funds to a maximum of 65 percent of the fund's total assets.

- Section 37D of the Act, with regard to damage caused to the employer by reason of theft, dishonesty, fraud or misconduct by the member, will be amended to stipulate that a deduction can also be made from the member's benefit in the case of a compensation order in terms of section 300 of the Criminal Procedure Act. This is to resolve the problem caused by decisions by the Financial Services Tribunal to the effect that a deduction can only be made in the case of a civil judgment, and not in the case of a compensation order as aforesaid.

- A fund will not be able to permit a member to take a savings withdrawal benefit where an employer housing loan or guarantee has been furnished, or where there is a judgment in favour of the employer that has not yet been satisfied, unless the remaining fund value will be sufficient to repay the loan or guarantee or satisfy the judgment. A savings withdrawal benefit as aforesaid is a withdrawal from the savings component that will be established in terms of the two pot system.

- A fund may, for a period of 12 months, refuse a member to take a savings withdrawal benefit where the employer has not yet obtained judgment against the member, and the withdrawal will result in there being insufficient remaining value to comply with the pending judgment.

- A retirement fund may not without the consent of the member's spouse grant a housing loan to a member, or allow a member to take a savings withdrawal benefit, if the fund received formal notification from the member or spouse that a divorce action has been instituted.

- A deduction from a member's benefit in respect of future maintenance must be made in monthly payments or annually in advance, where a fund is unable to make monthly payments.

- A retirement fund may not allow a member to take a savings withdrawal benefit where there is a maintenance order against the fund in place, unless the fund is satisfied that the remaining fund value will be sufficient to comply with the order.

2. Requirements for rule amendments in respect of the two pot system

The Financial Sector Conduct Authority (FSCA) has issued FSCA Communication 3 of 2024 (RF) ("the Communication"), in which they set out the FSCA's requirements for rule amendments in respect of the two pot system.

Amongst others, rule amendments will have to make provision for the following:

Seed capital

The rules of a fund will need to provide for a seed capital amount of 10% of the value of the member's share in the fund immediately before 1 September 2024, subject to a maximum of R30 000.

Savings Component

The rules will need to provide for a savings component, to be made up of one third of contributions from 1 September 2024 onwards, together with investment return thereon.

The rules need to allow for an amount equal to or more than R2 000 to be withdrawn from the savings component once in any tax year.

The rules must stipulate that any withdrawals from the savings component before retirement will be taxed in terms of the PAYE tables, and will be taxed in accordance with the retirement tax table if accessed in cash on retirement.

Retirement Component

The rules will need to provide for a retirement component that will consist of two thirds of contributions from 1 September 2024 onwards, together with investment return thereon.

The rules will further be required to stipulate that the funds in the retirement pot cannot be accessed by members for cash withdrawals, or upon resignation from employment, and cannot be claimed as a cash benefit. The rules will further need to stipulate that the amount in the retirement component must be used to provide an annuity subject to the de minimis amount and that the annuity will be taxed as and when it is paid to the pensioner.

Requirements for Defined Benefit Funds

The Communication clearly sets out what should be contained in the rules of defined benefit funds to make provision for the two pot system. Should the fund wish to adopt a different methodology than that set out in the Communication, this must be approved by the FSCA in advance, whereafter the methodology must be clearly set out in the rules.

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Transfers of components

The rules will need to contain requirements relating to transfers between the various components. In particular, the following needs to be provided for:

- Transfers from the savings component to the retirement component.
- A prohibition on transfers into the savings component, other than the seeding amount.
- Transfers of the savings component and retirement component across funds, subject thereto that the components must be transferred together.
- The transfer of the vested component subject to current rules.

Deductions in terms of section 37D of the Pension Funds Act

The rules will need to provide that deductions in terms of section 37D of the Pension Funds Act will be effected proportionately across the three components.

Member communication

Funds must communicate the implications of the two pot system to members in a manner which is simple, clear and comprehensive and such communication must be timely and on-going.

The communication should, inter alia, alert members to the impact that any withdrawal from the savings component will have on the value of the member's benefit. This can be done by way of illustration, using examples.

The FSCA may request a copy of the communication issued by the fund or administrator to members.

Submission of two pot rule amendments

All rule amendments in respect of the two pot system should be limited to the rule amendments as set out in the Communication. No other rule amendments are to form part of two pot rule amendment submissions.

3. Corrections to the two pot legislation

The Revenue Laws Amendment Bill, 2023 ("the Bill"), dealing with the introduction of the two pot system on early access to retirement savings, was tabled in Parliament in November 2023. The National Assembly passed the Bill on 20 February 2024, and the next step is now that it must be adopted by the National Council of Provinces. Once the National Council of Provinces has adopted the Bill, it must be signed by the President, whereafter it must be promulgated by publication in the Government Gazette.

After the Bill was tabled in Parliament, it however came to light that there are several errors in the Bill. In an attempt to address these errors, National Treasury has published the Draft Revenue Laws Second Amendment Bill, 2024 ("the Amendment Bill") for public comment. Apart from certain technical corrections, the Amendment Bill amends the two pot legislation in inter alia the following respects, which amendments will come into effect on the implementation date of the two pot system, being 1 September 2024:

- It will no longer be necessary to obtain a tax directive when transferring the seeding amount from the vested component to the savings component.
- It will no longer be necessary to obtain a tax directive in the case of intra-fund transfers, in other words transfers between components in the same fund.

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- In the case of a member with more than one contract in a fund (as may be the case with a retirement annuity fund), seeding will apply per contract.

- A member of a provident fund or provident preservation fund who was 55 years of age or older on 1 March 2021, and who wishes to participate in the two pot system, has 12 months from 1 September 2024 to make an election in this regard. If the member does elect to participate in the two pot system, the seeding amount must be calculated on the value of the member's vested component on the last day of the month in which the election was made.

- The Bill currently stipulates that, in the case of a transfer to another fund, all components must be transferred to the same transferee fund. This is amended to also stipulate that where amounts are transferred to more than one fund, a proportionate share of each component must be transferred to the same fund.

4. Draft Joint Standard on Outsourcing by Insurers

The Prudential Authority (PA) and the Financial Sector Conduct Authority (FSCA) have previously issued a draft Joint Standard on Outsourcing by Insurers for public comment. Slight amendments have been made to the previous draft of the Joint Standard, and a revised draft Joint Standard has been submitted to Parliament. The submission to Parliament is a requirement in terms of section 103(1) of the Financial Sector Regulation Act, which requires that, before issuing a regulatory instrument, it must be submitted to Parliament for a period of at least 30 days while Parliament is in session.

The Joint Standard, once issued, will replace Prudential Standard GOI 5, which currently regulates outsourcing by insurers. The rationale behind replacing Prudential Standard GOI 5 with a Joint Standard is as follows.

As Prudential Standard GOI 5 was issued by the PA, the outsourcing by insurers currently falls within the regulatory scope of the PA. This results in a gap from a conduct of business perspective as the PA is only responsible for the prudential supervision of insurers, with the conduct supervision of insurers falling under the FSCA.

There in view of the above is a need to expand the current outsourcing regulatory framework beyond Prudential Standard GOI 5, in order to provide an appropriate and comprehensive regulatory framework governing outsourcing by insurers from both a prudential and conduct perspective. The Joint Standard is therefore intended to harmonise the outsourcing requirements for the insurance sector, and enhance oversight by the PA and the FSCA.

According to the statement accompanying the draft Joint Standard, the Joint Standard is intended to address the following:

- set out minimum requirements for the outsourcing of material functions;

- set out the concept of “materiality” in the business of the insurer;

- set out the conditions that determine when an outsourcing arrangement requires prior regulatory notification;

- set out matters that an insurer must consider prior to an outsourcing decision and legal provisions that must be included in any outsourcing contract;

- set out requirements for the management and review of outsourcing arrangements;

- require insurers to have a board-approved policy and related procedures for assessing the risks involved with outsourcing; and

- repeal and replace Prudential Standard GOI 5.

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The requirements as set out in the draft Joint Standard are substantially similar to those currently contained in Prudential Standard GOI 5. There are however a few important changes, whereunder the following:

- An insurer must, in order to identify and manage all risks that may be introduced by an outsourcing arrangement, undertake an appropriate due diligence for every activity or function to be outsourced, prior to entering into an outsourcing arrangement.

- When terminating any material outsourcing arrangement, an insurer must assess the potential impact, consequences and risks of the proposed termination to policyholders and the insurer's business, and report thereon to its board of directors.

- The notice of termination of an outsourcing arrangement which is required to be submitted to the PA and the FSCA, must inter alia:

  - include proof that the insurer approved the termination;

  - explain whether there are any outstanding issues that could have a potential impact on the service to policyholders and how these issues will be managed to ensure policyholders are not adversely affected; and

  - highlight any outstanding fees and how such fees will be paid.

The following transitional provisions will apply:

- an insurer must comply with the Joint Standard within 6 months from the commencement date thereof, during which period it must continue to comply with Prudential Standard GOI 5;

- any outsourcing arrangement entered into prior to the commencement date must comply with the Joint Standard within 24 months from the commencement date or upon renewal or renegotiation of the outsourcing arrangement, whichever comes first.

5. Calculation of late payment interest by retirement funds

The Financial Sector Conduct Authority (FSCA) has during May 2023 issued FSCA Communication 15 of 2023 (RF), dealing with the calculation of late payment interest on retirement fund contributions.

In terms of section 13A(3)(a)(i) of the Pension Funds Act contributions to a retirement fund must be paid "*not later than seven days after the end of the month for which such a contribution is payable*".

Section 13A(7) of the Pension Funds Act stipulates that "*interest at the rate as prescribed shall be payable from the first day following the expiration of the period in respect of which such amounts were payable*".

FSCA Conduct Standard 1 of 2022 (RF) ("the Conduct Standard"), dealing with the requirements related to the payment of retirement fund contributions, came into effect on 19 February 2023. In terms of paragraph 5(1)(a) of the Conduct Standard "*compound interest on late payments or unpaid amounts must be calculated from the first day following the expiration of the period in respect of which such amounts were payable until the date of receipt by the fund*".

According to the FSCA the combined effect of the above provisions is as follows:

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"*The wording in paragraph 5(1)(a) of the Conduct Standard read with sections 13A(3)(a)(i) and 13A(7) of the PFA is clear and unambiguous. Section 13A(3)(a)(i) of the PFA requires that contributions must be paid not later than seven days after the end of the month for which such a contribution is payable. It follows, in terms of the wording of paragraph 5(1) of the Conduct Standard and section 13A(7) of the PFA, that LPI must be calculated from the day after the seventh day referred to in section 13A(3)(a)(i) of the PFA.*"

In accordance with the FSCA's opinion, as set out in the Communication, late payment interest must accordingly be calculated from the 8th day of the month following the month in respect of which the contributions were payable.

The matter has now been complicated by the fact that the Pension Funds Adjudicator's office has in OPFA Communication 1 of 2024 expressed the exact opposite opinion, and stated that late payment interest must be calculated from the first day following the month in respect of which the contributions are payable. Late payment interest in respect of the January contributions, for example, must accordingly be calculated from 1 February.

The fact that the FSCA and the Pension Funds Adjudicator have different views about this matter obviously places funds in a difficult position. It is not yet known whether the OPFA Communication has in any way caused the FSCA to review its position, or whether the FSCA will issue further guidance in this regard.

6. *In duplum* rule does not apply to interest on arrear contributions

The *in duplum* rule applies to interest on outstanding debt, and entails that the interest cannot be more than the capital amount of the outstanding debt. The Pension Funds Adjudicator ("the Adjudicator") has in the April 2023 issue of its Quarterly Digest advised that they are of the view that the *in duplum* rule also applies to late payment interest on retirement fund contributions.

Subsequent to the above, the High Court in the matter of *Municipal Workers Retirement Fund v Umzimkhulu Local Municipality and Others* however ruled that the *in duplum* rule does not apply to late payment interest on retirement fund contributions. This has caused the Adjudicator to review its previous stance, and the Adjudicator has in OPFA Communication 1 of 2024 stated the following:

"*The OPFA considers itself bound by the principle of stare decisis and accordingly aligns its position in accordance with the finding of the Court.*"

The Adjudicator's new stance is accordingly that the *in duplum* rule does not apply to late payment interest on retirement fund contributions.

7. 2024 National Budget

The Minister of Finance delivered his Budget Speech on 21 February 2024. The following proposals and information provided in either the Budget Speech or the Budget Review are of interest to the employee benefits industry:

Transfers between retirement annuity funds by members who are 55 years or older

In 2023, changes were made to the Income Tax Act to allow for tax-neutral involuntary transfers of members of pension funds or provident funds who have reached the normal retirement age as contained in the rules of the fund, but have not yet elected to retire.

It has come to Government's attention that the law allows tax-free transfers of an involuntary nature in the above circumstances, but excludes transfers of a retirement interest from one retirement annuity fund to another. It is proposed that the law be amended to allow involuntary transfers of a retirement interest between retirement annuity funds.

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Two pot retirement system

The two pot system will be implemented through amendments contained in the Revenue Laws Amendment Bill and the Pension Funds Amendment Bill. The two pot system will come into effect on 1 September 2024. It is stated in the Budget Review that National Treasury aims to finalise the legislative process rapidly in the next few months to ensure that the industry and regulators can prepare for implementation of the two pot system.

Auto enrolment

National Treasury is still in the process of considering policy proposals on how to expand the participation and coverage of all formal and informal workers in a retirement fund without excessively burdening their disposable income. These proposals build on National Treasury's December 2021 paper entitled *Encouraging South African Households to Save More for Retirement*. Policy research and engagement continues on the outstanding reforms with regard to auto-enrolment, mandatory enrolment and consolidation of retirement funds.

Unclaimed assets

At the end of 2022, the Financial Sector Conduct Authority (FSCA) published a discussion paper entitled *A Framework for Unclaimed Financial Assets in South Africa*, with recommendations to address high levels of unclaimed assets. The FSCA has considered stakeholder feedback on the discussion paper and will release a comprehensive response in early 2024. This feedback will inform the development of a framework for the identification, monitoring, management and reporting of unclaimed assets, including tracing of beneficial owners.

Interest limitation rules

Current law limits interest deductions when there is a relationship between a debtor and a creditor, and the corresponding interest income is not taxed fully. An unintended consequence of this rule may unfairly prejudice tax-exempt investors, such as pension funds, when they lend to a related party. Government will consider this matter further, with the possibility of including amendments in the 2024 Taxation Laws Amendment Bill.

8. Draft Prudential Standard on regulation 28 quarterly reporting requirements

The Financial Sector Conduct Authority (FSCA) has previously, for public comment, issued a draft Prudential Standard on the quarterly reporting requirements in terms of regulation 28 of the Pension Funds Act. Following the comments received, amendments have been made to the previous draft of the Prudential Standard, and a revised draft Prudential Standard has now been submitted to Parliament. The submission to Parliament is a requirement in terms of section 103(1) of the Financial Sector Regulation Act, which requires that, before issuing a regulatory instrument, it must be submitted to Parliament for a period of at least 30 days while Parliament is in session.

The purpose of the draft Prudential Standard is to align the regulation 28 quarterly reporting requirements with the amendments to regulation 28 which came into effect on 3 January 2023. It perpetuates the current approach of quarterly reporting on non-compliance with regulation 28 (so-called exception reporting). The FSCA is currently busy consulting on a so-called holistic reporting Prudential Standard, which will require both non-compliance reporting and reporting on assets held in compliance with regulation 28. Once the holistic reporting Prudential Standard is made final, it will repeal the exception reporting Prudential Standard, in other words the Prudential Standard that has now been submitted to Parliament. The exception reporting Prudential Standard will in other words only be in force as a temporary measure until such time as the holistic reporting Prudential Standard has been finalized.

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

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