Legal Report November 2019

Newsletter of Sanlam Corporate: Legal

1. Extension of period for compliance by certain funds with regulation 38 of the regulations under the Pension Funds Act

The Minister of Finance on 25 August 2017 issued the so-called default regulations, which make provision for certain defaults/strategies in cases where members of a retirement fund do not make an election. These regulations (regulations 37- 40) form part of the regulations issued in terms of the Pension Funds Act.

The regulations came into effect on 1 September 2017. The Registrar of Pension Funds however on 30 August 2017 exempted all funds registered before 1 March 2018 from the regulations until 1 March 2019.

Regulation 38 requires that all members of an occupational retirement fund who leave service before retirement must be made paid-up members until such time as they instruct the fund to pay their benefits or transfer the benefits to another fund.

The Financial Sector Conduct Authority (FSCA) on 12 November 2019 in terms of FSRA Compliance Extension Notice 2 of 2019 (PFA) extended the period for compliance with regulation 38 to 29 February 2020 in respect of funds that have submitted applications for amendments to their rules in order to comply with regulation 38.

In FSCA Communication 5 of 2019 (PFA), which was issued together with the extension notice, the FSCA explained the reasons for the extension as follows:

"*Whilst considering the above applications (for rule amendments in order to comply with regulation 38), it came to the attention of the FSCA that industry stakeholders interpret and apply section 37C of the Act inconsistently, and that ambiguities and uncertainty exist regarding how 37C should be interpreted and applied. In order to provide clarity, certainty and to ensure consistent interpretation and application of section 37C of the Act, the FSCA* *is in the process of issuing an Interpretation Ruling, in terms of section 142 of the FSR Act, on the interpretation and application of section 37C.*

The Interpretation Ruling, once final, might necessitate further amendments to a fund's rules, specifically where a fund's interpretation of section 37C is not consistent with the Interpretation Ruling. In addition, the interpretation of section 37C also has an impact on how a fund's rules are worded or structured when ensuring compliance with regulation 38.

Because of the interconnectedness between the interpretation and application of section 37C and regulation 38, the FSCA deemed it prudent to await the finalisation of the Interpretation Ruling before approving the amendments that have been submitted by funds referred to above (amendments that were aimed at ensuring compliance with regulation 38).

This delay in approving these rule amendments, however, is resulting in funds being in contravention of regulation 38 even though they have already taken steps to ensure compliance with regulation 38.

In light of the above, the FSCA has taken a decision to, in terms of section 279(1) of the FSR Act, extend the period of compliance with regulation 38 until 29 February 2020. This extension is only granted to funds that have already submitted applications for an amendment to their rules in order to comply with regulation 38 and are awaiting a decision from the Authority pertaining to same."

2. Draft Interpretation Ruling on the application of section 37C of the Pension Funds Act

The Financial Sector Conduct Authority (FSCA) on 12 November 2019 issued a draft interpretation ruling on the application of section 37C of the Pension Funds Act. Section 37C deals with death benefits payable by a retirement fund on the death of a member, and stipulates that such benefit does not fall into the estate of the member, but must be paid to the member's dependants and/or nominees in such proportions as the trustees of the fund deem equitable.

The FSCA on 12 December 2018 issued PFA Guidance Notice No. 8 of 2018, in paragraph 4.6(e) of which the following is stated:

"*Section 37C of the Act is applicable to a paid-up member's benefit, in the same manner that it would apply to any other death benefit payable by a fund.*"

The above is contrary to Information Circular PF No 2 of 2010 issued by the Financial Services Board (FSB) on 8 March 2010, in which the following is stated:

"*The provisions of section 37C are only applicable to lump sum benefits which become payable by the fund in terms of its rules as a result of the death of a member. When a member exits the fund as a result of resignation, dismissal, retrenchment or retirement the relevant withdrawal or retirement benefit accrues in terms of the rules of a fund. Should the member die after the date of accrual of the withdrawal or retirement benefit, but before the benefit can be paid or before the member could make an election for the benefit to be transferred to another fund, the legal nature of the benefit does not change and the provisions of section 37C of the Act is therefore not applicable.*"

The FSCA in the draft interpretation ruling proposes that Information Circular PF No 2 of 2010 be withdrawn, and states that section 37C of the Pension Funds Act applies to any benefit paid upon the death of a member, including paid-up benefits and retirement benefits that became payable before the member's death. It is further stated that *"a fund must, if its rules are not consistent with this Interpretation Ruling, amend its rules within 6 months after the publication of this Interpretation Ruling to ensure consistency with this Interpretation Ruling".*

Sanlam Corporate: Legal does not agree with the opinion expressed in the draft interpretation ruling to the effect that section 37C applies to paid-up members and postponed retirees. A postponed retiree is a member who has retired, but has postponed the payment of his/her retirement benefit.

The reasons for our above view are as follows. Section 37C applies to *"any benefit … payable … upon the death of a member"*. The benefit of a paid-up member or postponed retiree becomes payable when he/she withdraws from service or retires. When a paid-up member or postponed retiree dies, one is accordingly not dealing with a benefit that became <u>payable</u> upon the death of the member as contemplated in section 37C. The benefit had namely already become payable upon the member's withdrawal from service or retirement, with the result that section 37C is not applicable.

Sanlam Corporate: Legal is aware that certain funds have, in the belief that this will result in section 37C being applicable on the death of a paid-up member or postponed retiree, amended their rules to stipulate that a member only becomes entitled to a benefit once he/she exercises an election regarding the manner in which the benefit must be paid. It should be noted that this view has not yet been tested in a court of law. It is as such uncertain whether a court would agree that a rule amendment as aforesaid has the effect that section 37C is applicable on the death of a paid-up member or postponed retiree.

It is stated in the draft interpretation ruling that the purpose thereof is "to provide clarity, consistency and certainty on the interpretation and application of section 37C of the Act". Sanlam Corporate: Legal is of the opinion that an interpretation ruling would not provide such certainty. The only effect of an interpretation ruling would namely be that the FSCA must in terms of section 142(3) of the Financial Sector Regulation Act interpret section 37C in accordance with the interpretation ruling. The interpretation ruling would not be binding on third parties, and more specifically on the executor of a deceased member's estate. If a fund pays the benefit in respect of a deceased paid-up member or postponed retiree in terms of section 37C, and the executor of the member's estate subsequently claims that the benefit should have been paid to the estate, it would therefore be no defence to say that the fund acted in terms of an FSCA interpretation ruling. In our view the appropriate remedy for any uncertainty that may exist regarding the applicability of section 37C would be a legislative amendment.

The draft interpretation ruling is open for comment until 13 December 2019. Sanlam will provide comments via industry bodies.

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