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Retirement Fund Update

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An authorised financial services provider

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1 The Financial Services Board (FSB): Legislation and Circulars

1.1 Draft new Requirements for Annual Financial Statements

The FSB released a new draft set of annual financial statements for retirement funds, for comment by the end of July 2012. The more important changes include the following:

- Currently a separate set of statements is prescribed according to whether a fund is categorised as a large, small or audit exempt fund, and whether the fund is a privately administered or underwritten fund. In terms of the new draft, the format and wording of the statements of all funds will be the same except for the assurance report on Regulation 28 compliance and the auditor's report on factual findings. As regards the latter report, the format depends on whether the fund is large (ordinary), small and audit exempt, an umbrella fund, retirement annuity fund or preservation fund.
- The draft, especially the schedules relating to investments and Regulation 28 compliance, takes account of the changes to Regulation 28 that became effective in 2011.

1.2 Deputy Pension Funds Adjudicator (PFA)

The Minister of Finance appointed Ms Muvhango Lukhaimane as deputy Pension Funds Adjudicator in June 2012. She will be running the office of the PFA and may in future be appointed as the adjudicator. Ms Lukhaimane has a legal qualification and her previous work experience includes serving as a legal adviser at Sanlam Employee Benefits and as the Principal Officer of the Eskom Pension Fund.

1.3 Increased FSB Levies

Notice of the FSB levies for the 2012/2013 levy year was published on 5 June 2012. The levies pertaining to pension and provident funds, as well as preservation funds are as follows:

The lesser of:

- R1 138 plus R10,70 for every member or person receiving periodic payments (excluding members whose benefits remained unclaimed or beneficiaries in a beneficiary fund); or
- R2 072 000.

Plus: A levy for the Pension Funds Adjudicator of R3,95 per member or person receiving periodic payments is payable (excluding members whose benefits remained unclaimed).

The levy on fund administrators is R5 800 plus R450 per fund under administration and R0,55 per member or person receiving periodic payments (excluding members whose benefits remained unclaimed or beneficiaries in a beneficiary fund).

Observation: The participating employer levy of umbrella funds, which was R330, has been removed. This arrangement will be beneficial for umbrella funds with smaller participating employers.

1.4 Directive 157.A.i (LT): Guidance on What Constitutes a Guaranteed Policy

Directive 157Ai(LT) was issued by the Registrar of Long-term Insurance on 30 July 2012 and has been effective since 1 August 2012. It provides guidance on what constitutes a guarantee or partial guarantee of policy benefits under a long-term policy for purposes of Regulation 28(8)(b)(iii) under the Pension Funds Act. The statutory actuary of a long-term insurer must confirm that such non-linked policy guarantees (or partially guarantees) policy benefits, taking into account the requirements of the Directive.

1.5 Draft Conditions for Retirement Fund Administrators

The FSB published a new draft of the conditions for administrators in terms of section 13B of the Pension Funds Act, for comment by 6 September 2012. Some of the new requirements that are envisaged include the following:

- Benefit administrators must submit quarterly returns (currently annual) containing prescribed information;
- Investment administrators must be duly registered in terms of the FAIS Act as a Financial Services Provider (FSP). It must also be approved in terms of section 13B of the Pension Funds Act – such approval function is delegated to the Registrar of FAIS;
- Any name change of an administrator must first be approved by the Registrar;
- An extensive list of items must be addressed in the benefit administration agreement and service level agreement;
- The draft new Board Notice contains forms prescribing the notification (to the Registrar) of termination of an administration agreement and the subsequent report by the board to the Registrar;
- An administrator must maintain a minimum capital of R3 million as well as assets in liquid form equal to or greater than $\frac{13}{52}$ of annual expenditure. (The current requirement is $\frac{8}{52}$.) These assets must be held separately as a guarantee. Capital and liquid assets held in terms of any other legislation supervised by the FSB are however also taken into account;
- The Registrar must be notified before an administrator replaces its administration system and, once the migration to the new system has been completed, a certificate by an auditor must be submitted confirming that the new system complies with prescribed requirements.

Observation: *These measures will help prevent another governance failure by an administrator. They will however increase the cost of operation of administrators and will therefore put upward pressure on the operating costs of retirement funds.*

2 The Financial Services Board: Notices in Terms of Regulation 28

The Registrar of Pension Funds issued the following notices in terms of Regulation 28 under the Pension Funds Act:

2.1 Quarterly Non-compliance Reporting: Board Notice 3 – under review

The format for the quarterly reporting of non-compliance with any of the limits prescribed in Regulation 28 has been published on 31 May 2012 in Notice 3 of 2012. The Notice amends Notice 2 of 2012 in that the period within which a report must be submitted has been increased from 30 to 90 days after the end of a quarter. The first report, i.e. for the quarter ending 31 March 2012, must however be submitted simultaneously with the report for the second quarter, i.e. before or on 30 September 2012. The non-compliance report contains the following sections:

- | | |
|----------|-------------------------------|
| Part 1A: | Fund level breaches |
| Part 1B: | Insurer/entity level breaches |
| Part 1C: | Member level breaches |
| Part 2: | Declaration by fund board |

2.2 Request for Information: Implementation Costs of New Regulation 28

In an e-mail dated 31 July 2012, the Registrar of Pension Funds advised that he has received numerous representations regarding the implementation and costs related to Regulation 28. He requested role-players in the industry to provide him with the following information by 31 August 2012:

- Practical problems experienced in the implementation of Regulation 28;
- Practical problems experienced in the monitoring of compliance with Regulation 28;
- Detailed analysis and breakdown of different costs (end of the quarter ended 30 June 2012) relating to the implementation and monitoring of Regulation 28;
- Costs for developing systems to ensure proper implementation of Regulation 28 as well as reporting quarterly and for purposes of regulatory reporting on an annual basis; and
- Any other information deemed relevant for purposes of the survey.

2.3 Information Circular 1/2012

2.3.1 Information Circular

The FSB issued Information Circular 1/2012 on Friday, 7 September 2012, in an attempt to address anomalies and reduce the costs associated with the Regulation 28 reporting requirements. The Information Circular has the status of a statement of intention (The FSB is not able to amend a Regulation or Board Notice by merely issuing an information Circular). To give effect to the notice, changes may also have to be made to Board Notice 3 (BN 3) and where necessary other regulations and/or Board Notices.

In the circular the FSB announced the following important relaxations and undertakings:

- a. The deadline for the breach reports in respect of the first and second quarter was extended from 30 September to 31 October 2012.
- b. The breach report (envisaged in BN 3) will no longer be required to include any contraventions as a result of market movements in terms of Regulation 28(3)(j).
- c. Industry workshops will be held during September to help identify appropriate solutions which will be introduced by way of the amendment of the problematic regulations and Board Notices (in all likelihood with retrospective effect).

Observation: *We welcome this announcement and will work with the FSB to develop solutions.*

2.3.2 Current concerns

In terms of the current requirements of Regulation 28, underwritten funds should (on paper at least), have little need to or experience little difficulty in reporting breaches of Regulation 28. The asset manager (collective investment scheme (CIS)/insurer who issued a linked policy) is required to provide the fund with a certificate at the end of the fund's financial year, confirming that the assets held complied with Regulation 28, provided that the auditor of the insurer confirms the accuracy of the certificate at the financial year-end of the insurer. Two practical problems arose as a result:

- a. Auditors' interpretation of these requirements has generally been more conservative leading to qualifications to fund financials. There also appears to be a concern to certify compliance in respect of periods (fund and insurer's respective year-ends) that are not aligned.

An interpretation adopted by many was that failing such a Regulation 28 certificate by the asset manager, certified as correct by the auditor, the fund has no option but to request full details of the

investment portfolio so that they can assess compliance on a look-through basis. This is a time-consuming and expensive process. Another reason why Regulation 28 certificates could not be audited is because offshore asset managers are often not in a position to provide the required information.

At the FSB workshop in Sandton on 14 September, Wilma Makupa confirmed that an audited certificate is not required for purposes of Regulation 28 non-compliance reporting. She is of the view that 'timing' should not be a problem (certificates on the same date and for the same period), as long as the certificate has been issued in the last 12 months. Consideration is being given to move fund financial years to quarter ends. In addition, the interpretation and wording of the certificates are being agreed with the auditing profession and the message should filter down from Irba and Saica.

A related concern is where only e.g. one of a number of the fund's Regulation 28 compliant portfolios is in breach. Is it necessary for the fund to report on the entire asset base or can the fund only report on the delinquent portfolio concerned? At the workshop the FSB indicated that breach reporting in respect of only that portfolio is required. Where a portfolio is non-compliant because the property limit in that portfolio was breached for example, Wilma Makupa said that the FSB only wants details of the property part of that portfolio.

- b. Regulation 28(2)(a) requires that: "A fund must at all times comply with the limits as set out in this regulation". Based on a strict interpretation this means 'every second of every day'. In practice however, most service providers only report on a monthly basis. Whereas monitoring on a daily basis may be possible, the additional cost is significant.

In response to our enquiries, Alta Marais of the FSB advised that while the trustees are responsible for implementing systems and controls to ensure compliance to Regulation 28 and to monitor breaches, the Registrar does not expect the trustees to obtain daily reporting for monitoring compliance. The systems and controls implemented should indicate non-compliance.

With these issues resolved satisfactorily, most underwritten funds may have no need to report any breaches as they should be the exception rather than the norm - if all goes according to plan. We will have to wait for the final board notice to be sure that all the views expressed found their way into legislation.

2.3.3 Where breaches do occur the new position will be as follows:

- a. Breaches as a result of market movement (market movement breach) need not be reported to the FSB

In terms of the provisions of Regulation 28(3)(j) a market movement breach must be reported to the FSB without delay, no further investments may be made to exacerbate the position and the breach must be corrected within 12 months. Board Notice 2 however allows quarterly reporting and the FSB indicated that the position will be maintained.

At the aforesaid workshop the FSB confirmed that where the breach is as a result of market movement and no further investments are made and the position is corrected within the prescribed 12 month period, such breach need not be reported to the FSB.

Where a market movement breach occurs as envisaged in Regulation 28(3)(j), the asset manager should however still report the breach to the fund and satisfy the board that the breach will be corrected within the 12 month period and that no further transactions will be made to exacerbate the position. Any failure to correct the breach within 12 months must be reported to the FSB.

- b. Breaches as a result of a failure by the asset manager (BN 3 Breach)

Where an asset manager negligently or intentionally breached Regulation 28, the matter has to be reported to the fund and the fund will be required to prepare a breach report as set out in the to be revised BN 3 (a draft of the revised format is contained in Information Circular 1/2012). At the workshop, Wilma Makupa indicated that where there are breaches the FSB requires a roadmap to full compliance with the following elements, rectification, clear efforts to compliance, work in progress and specific time-frames that can be monitored. It is effectively a letter of comfort for the FSB.

Observation: *When this happens we expect the asset manager to provide the fund with full details of the portfolio and the breach to assist the fund to deal with all FSB concerns and requirements. The fund must be satisfied that the asset manager takes appropriate steps to rectify the position and may have to approach the Registrar for an exemption where necessary.*

2.3.4 Next steps for funds who only offer Regulation 28 compliant portfolios

Funds who only offer Regulation 28 compliant portfolios (CIS/linked) should:

- (a) Ensure that there is a contractual obligation on each asset manager to communicate any
 - BN 3 breaches to the fund when a breach is detected (preferably monthly, but at least quarterly) and it is clear that a Regulation 28(8)(b) certificate will not be issued at the end of the fund's financial year, and
 - Market movement breaches to the fund as and when they occur (at least quarterly)
- (b) Monitor the quarterly reports from the asset managers and where necessary help manage
 - a BN 3 breach report when one is reported,
 - a market movement breach when one is reported.

Observation: *This appears fairly straight forward and the reporting requirements for funds that only has Regulation 28 compliant portfolios will not be very onerous.*

2.3.5 Next steps for funds that have portfolios that are not Regulation 28 compliant

Funds who offer segregated portfolios and/or portfolios that are not Regulation 28 compliant should ensure that there is a contractual obligation on each asset manager to provide detailed information to enable the fund to assess and report any non-compliance. The fund will have to provide a full report to the FSB on all its non-compliant portfolios (on a quarterly basis) showing all non-compliant assets on a look through basis in terms of BN 3.

In response to our enquiries, the FSB indicated that Funds can delegate the reporting duties to an administrator or investment manager as long as such delegation is properly authorised. Where the fund offers a number of non-compliant Regulation 28 portfolios and delegation is possible at a reasonable price it appears desirable to do so.

2.4 Conditions for Securities Lending: Notice 2 of 2012

This notice prescribes the conditions for securities lending transactions by retirement funds. The previous notice on this subject (Notice 5 of 2011) has been withdrawn. One of the new provisions is that an authorised user, as contemplated in the Securities Services Act, may also be counterparty for purposes of a security lending transaction.

2.5 Securities Lending: Notice 4 of 2012

In terms of this notice the Registrar of Pension Funds extended the implementation date for funds to be compliant with the conditions for securities lending transactions until 31 December 2012.

2.6 Draft Notice on Investment in Hedge Funds

The draft notice contains conditions regarding aspects such as the structure of a hedge fund that a retirement fund may invest in, suitability of such an investment and ownership of assets of a hedge fund.

2.7 Draft Notice Regarding use of Derivative Instruments

The draft notice contains the conditions for the use of derivative instruments by retirement funds. A derivative instrument is a financial instrument that derives its value from the price or value of some other particular product. The draft notice, among other things, contains the principles that the board of a retirement fund must adhere to when derivative instruments are included in its investment portfolio.

3 Retirement Reform

We have not received any further papers from National Treasury after they released the one entitled 'Strengthening Retirement Savings' for comment on 14 May 2012. We have however gained further insights into the priorities and planning from Dr David McCarthy, retirement reform specialist at National Treasury, when he spoke at Sanlam's Benchmark Survey. We also met and discussed the results of the research we have done on the cost of retirement's funds.

Observation: *We get the impression that rolling out retirement reform measures (that are not linked to the NSSF) is a priority and that we should expect much greater pressure on the cost of retirement funds going forward. Of particular concern is the cost of annuities and preservation funds.*

4 South African Revenue Services: Legislation and Circulars

4.1 Draft Taxation Laws Amendment Bill, 2012

The draft bill was published for comment by end July 2012. The main aspects that will impact on the employee benefits industry include the following:

- Non-deductible contributions are taken into account when calculating tax on lump-sum retirement benefits. Similar relief is not provided when an annuity is purchased. The draft bill proposes that as from 1 March 2013 non-deductible contributions will firstly be applied to any lump-sum and the remainder, if any, will be applied to annuities. The proposal is only applicable in respect of annuities payable by pension funds, pension preservation funds and retirement annuity funds.

Observation: *In our view this measure should also apply in respect of annuities payable by a provident fund and provident preservation fund.*

- The definition of pension preservation fund will, with effect from 1 March 2012, be amended to allow a transfer from such fund not only to another pension fund or pension preservation fund, but also to a retirement annuity fund.

Observation: *In a letter to ASISA, dated 27 August 2012, SARS confirmed that from 1 March 2012 a transfer from a preservation fund to a retirement annuity fund will be tax-free but, until the Taxation*

Laws Amendment Bill, 2012 becomes legislation, there is a risk that the transferred amount will be regarded as the member's once-off withdrawal (if the legislation is not promulgated with retrospective effect).

- The definition of 'provident preservation fund' will, with effect from 1 March 2012, be amended to allow a transfer from such fund not only to another provident fund or provident preservation fund, but also to a pension fund, pension preservation fund or retirement annuity fund.

Observation: *This measure is more in the nature of a correction than a form of relaxation.*

- With effect from 1 March 2012 any amount that becomes payable by the Government Employees Pension Fund (GEPF) to a non-member spouse in terms of section 7(8) of the Divorce Act may be paid immediately and is taxable in the hands of the non-member. Both the member and non-member spouse will retain relief in respect of the part of the GEPF pension interest relating to pre-1998 years of service. Any section 7(8) divorce allocation that becomes payable on or after 1 March 2012 in respect of a divorce order issued before 13 September 2007 will be free of tax. Government's intention with the aforementioned amendments is that members of the GEPF and other public sector funds must be placed on equal footing with private sector funds in tax terms.

5 Compensation for Occupational Injuries and Diseases Act

In terms of a Government Notice, published on 8 June 2012, the maximum amount of earnings of an employee on which the assessment of an employer will be calculated has been increased to R292 032 per annum from 1 April 2012.

6 Protection of Personal Information Bill

We received the following communication from the Business Unity South Africa (BUSA) parliamentary Liaison Officer on 12 September 2012.

The Portfolio Committee on Justice and Constitutional Development last week finalised the Protection of Personal Information Bill (PoPI), and yesterday the National Assembly (NA) approved the bill. A copy of the bill as approved by the NA is attached. The bill will now be transmitted to the National Council of Provinces' (NCOP) Select Committee on Security and Constitutional Development for concurrence. The Select Committee may choose to hold public hearings on the bill - its intention to do so will become clearer once the committee determines its programme for passing the bill.

Implementation issues: Unless the NCOP opts to substantially interrogate the bill, it is looking increasingly likely that PoPI will be passed by Parliament by the end of the year. It will then come into operation on a date determined by the President. The bill makes provision for a one to three year implementation period. However, as the bill is premised on the establishment of an Information Regulator, the time taken to establish the regulator may further impact the bill's implementation – similar to the situation experienced with the coming into force of the Companies Act which was delayed pending the establishment of the Companies and Intellectual Property Commission.

Observation: *This act will introduce far reaching changes to the way we do retirement fund administration. The matter is under investigation and we will workshop the requirements with you in due course.*

With recognition to the major contribution and support by Anton Swanepoel of Sanlam Employee Benefits: Law Service.

The information and opinions provided herein are of a general nature and are not intended to address the circumstances of any particular member or fund. As the information and opinions are for information purposes only and do not constitute advice, no one should act upon such information or opinion without appropriate professional advice in respect of a particular situation.