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Retirement Fund Update Quarter 2 of 2016

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Financial Services Board: New Acts, Regulations and practice notes

1. PF Notice 1/2016: Appointment of valuator

In this Notice the Registrar of Pension Funds lays down the requirements for the appointment of a valuator. The information to be submitted to the Registrar in respect of the appointment of a valuator (within 30 days of the appointment), is contained in Annexures A and B to the Notice. A valuator whose appointment has been terminated or who has resigned must, within 21 days, submit a written report in the format of Annexure C to the Notice, setting out the reasons for such termination or resignation.

The Notice requires that a fund must appoint another valuator within 90 days from the date of termination of the appointment of its previous valuator. A fund that, as at 10 February 2016 (the date when the Notice was published), is not valuation exempt and who does not have an appointed valuator must appoint a valuator within 90 days of publication of the Notice.

An actuary that wants to be appointed as a valuator must submit an affidavit to the Registrar in the format set out in Annexure D to the Notice. The Notice requires that a valuator maintains suitable professional indemnity insurance with regard to the fund for which he/she is appointed.

Observation: *The FSB issued draft notices in this regard over a period of time that allowed all interested parties to discuss and help refine the requirements. One of the more significant developments is the requirement for valuers to secure professional indemnity insurance. In the past smaller operations were allowed to merely limit their liability to a multiple of their fees.*

2. FSB Annual Report 2014/15

The report was published on the FSB website after a press release on 11 February 2016.

The following statistic is a sign of the times and shows the rate of fund consolidation and the shift to umbrella funds. During the period under review only 13 new standalone funds were registered compared to 3 884 new participation employers joining umbrella funds.

216 on-site visits to funds and administrators were done. This list of supervisory issues identified include

- “Funds failed to timeously renew their fidelity guarantee and professional indemnity policy
- ‘Rebuilding’ member data due to maladministration by previous administrator of the fund
- Remunerating the principal officer and members of the boards of funds for services despite fund rules not providing for this
- Section 7B exemption expired without a request for extension submitted
- Administration system of an administrator could not calculate late payment interest



- Abuse by trustees of remuneration per meeting attended
- Failure to timeously submit annual financial statements and valuation reports
- Term of office of the employer-appointed board members not defined in the rules
- Delegation documents to committees of the board not signed
- Delays in issuing benefit statements

Observation: *The Simeka risk assurance approach is risk based and designed to identify these types of risks early. The FSB's surveillance unit also follows a risk based approach in identifying funds for compliance monitoring and visits. The FSB attach significant value to the discussion of risks that the fund faces with the auditor and in the audit committee.*

SARS: New Acts, Regulations and practice notes

3. Revenue Laws Amendment Act, 2016

The Revenue Laws Amendment Bill 2016 introduced to Parliament on 24 February 2016 gives effect to the decision by the government to postpone the annuitisation requirement for provident fund members for two years to allow for further consultation with key stakeholders. However, the harmonisation of the tax deductibility of contributions to retirement funds will still apply from 1 March 2016 for all types of retirement funds, including provident funds.

In the final Bill a clause was added to the effect that the Minister of Finance must deliberate with interested parties in respect of the implementation of the annuitisation requirement for provident fund members and table a report in the National Assembly by not later than 31 August 2017 in respect of the results of such deliberations. The Bill was signed into law on 17 May 2016, with retrospective effect from 1 March 2016.

4. Binding General Ruling (BGR) number 31: Interest on late payment of benefits

This BGR, issued on 4 March 2016, clarifies when an amount constitutes interest, as opposed to forming part of the lump sum retirement fund benefit. BGR 31 replaces General Note 32.

In terms of the ruling an amount that is calculated after receipt of the claim form until the date that the fund is obliged to pay the benefit in terms of the rules of the fund, is regarded to be part of the lump sum benefit.

Any additional amount that may become payable in circumstances where the fund fails to meet this obligation and is at fault for delaying the payment of the benefit constitutes interest that is not part of the lump sum benefit. The fund must issue an IT3 (b) certificate to the member in respect of such interest and send a copy to SARS. It seems that SARS is of the view that interest (not forming part of the lump



sum benefit) will be payable only where the benefit is not paid within a reasonable period and the delay was caused by the fund.

Comment: *Funds and administrators must ensure that, to the extent that it is within their control, benefits that have accrued be paid without delay.*

5. Interpretation Note number 89: Maintenance orders and the tax-on-tax principle

The Note, issued by SARS on 1 March 2016, provides guidance and clarity on the treatment of maintenance orders and the tax-on-tax principles relating to maintenance orders that retirement funds pay while a member is still a contributing member and has not left the retirement fund. The Note replaces General Note 37.

As background the Note states that section 37D of the Pension Funds Act allows a maintenance order to be deducted from a member's minimum individual reserve, and the Income Tax Act was amended to provide that any maintenance order amount deducted from a member's minimum individual reserve is deemed to be normal income (in terms of section 7(11) of the Income Tax Act) in the hands of the member.

A maintenance order paid by a retirement fund out of the member's minimum individual reserve is deemed to have accrued to the member on the day the amount is deducted from the member's minimum individual reserve in the fund. The additional amount paid out of the member's minimum individual reserve to cover the employees' tax payable on the maintenance order results in the accrual of an additional deemed amount in the hands of the member. The tax-on-tax formula can be used to determine the additional tax payable as a result of the tax-on-tax effect.

Comment: *It should be noted that some experts believe that despite the provisions of the Pension Funds Act, it will not be permissible to deduct maintenance from an active member's minimum individual reserve, unless the Pension Funds Act is amended. Their argument is that the legislature in section 37D could not have contemplated anything other than a maintenance order that is enforceable against a fund. In terms of the Maintenance Act an order can (in respect of a lump sum) be obtained against a fund only if the lump sum constitutes a debt, which is not applicable in respect of an active member since the benefit has not yet accrued to him/ her. In fact, if he/she should die before termination of service, an amount (benefit) will be payable not to his estate but to his/her dependants and/or nominees.*



Other developments

6. Draft King IV report

On 15 March 2016 the Institute of Directors in Southern Africa (IoDSA) and the King Committee released a draft version of the latest King Report, King IV, for public comment. IoDSA stated that a number of developments in corporate governance made a new version necessary. Prof King said: “King IV breaks new ground by offering an integrated approach to corporate governance encompassing the economic, social and environmental spheres as well. It also impacts on sectors other than listed or large companies such as state-owned enterprises, local government, non-profits, SMEs and retirement funds, among others. Quality and effective corporate behaviour offers a way out of many of our current economic and sustainable development challenges.”

Draft King IV is structured as a report that includes a Code, with additional, separate supplements for various sectors and categories of organisations i.e. SME’s, NPO’s, public sector organisations and entities, municipalities and retirement funds. These sector supplements will be released at later dates. The Code contains both principles and recommended practices. It is envisaged that the Code principles and intended outcomes will be applicable to all organisations irrespective of their form of incorporation, with the practices to be applied on a ‘proportionality’ basis depending on the nature and size of the organization.

The Draft King IV builds on King III but consideration will also be given to developments that include e.g. the following areas: Executive and directors’ remuneration, integrated reporting, responsible investing and linkage with the Code for Responsible Investing in South Africa (CRISA), the evolving role of social and ethics committees, mandated audit firm rotation and tendering, information security and protection, strategic risks and dependencies, group governance, board diversity and combined assurance.

King IV is outcomes orientated. It places accountability on the governing body (e.g. the board of a retirement fund) to attain organisational outcomes of an ethical culture, sustainable performance that creates value, adequate and effective control and sound stakeholder relationships, through the discharge of its responsibilities relating to strategic direction, approval of policy, effective oversight and disclosure.

As a result of this approach, King IV has only 17 principles (compared to the 75 principles of King III). These are that the governing body (e.g. board of a retirement fund) of the organisation (e.g. fund) should:

1. *Set the tone and lead ethically and effectively.*
2. *Ensure that the organisation’s ethics are managed effectively.*
3. *Ensure that the organisation is a responsible corporate citizen.*



4. *Lead the value creation process by appreciating that strategy, risk and opportunity, performance and sustainable development are inseparable elements.*
5. *Ensure that reports and other disclosures enable stakeholders to make an informed assessment of the performance of the organisation and its ability to create value in a sustainable manner.*
6. *Serve as the focal point and custodian of corporate governance in the organization.*
7. *Ensure that in its composition it comprises a balance of the skills, experience, diversity, independence and knowledge needed to discharge its role and responsibilities.*
8. *Consider creating additional governing structures to assist with the balancing of power and the effective discharge of responsibilities, but without abdicating accountability.*
9. *Ensure that the appointment of, and delegation to, competent executive management contributes to an effective arrangement by which authority and responsibilities are exercised.*
10. *Ensure that the performance evaluation of the governing body, its structures, its chair and members, the CEO and the company secretary or corporate governance professional result in continued improved performance and effectiveness.*
11. *Govern risk and opportunity in a way that supports the organisation in defining core purpose and to set and achieve strategic objectives.*
12. *Govern technology and information in a way that supports the organisation in defining core purpose and to set and achieve strategic objectives.*
13. *Govern compliance with laws and ensure consideration of adherence to non-binding rules, codes and standards.*
14. *Ensure that the organisation remunerates fairly, responsibly and transparently so as to promote the creation of value in a sustainable manner.*
15. *Ensure that assurance results in an adequate and effective control environment and integrity of reports for better decision-making.*
16. *Ensure as part of its decision-making in the best interests of the organisation, that a stakeholder-inclusive approach is adopted, which takes into account and balances their legitimate needs, interests and expectations.*
17. *If it is the governing body of an institutional investor, ensure that the organisation responsibly exercises its rights, obligations, legitimate and reasonable needs, interests and expectations, as holder of beneficial interest in the securities of a company.*



For all of the above principles, Draft King IV provides recommended practices. Draft King IV requires an 'Apply and Explain' approach, as opposed to King III which is 'Apply OR Explain'. This means that application of the principles is assumed, and that an explanation is disclosed on the practices that have been implemented and the progress made towards governance outcomes. The intention is to help organisations move beyond a compliance mind-set to describing how implemented practices advance progress towards giving effect to each principle, the application of which is assumed due to it being basic to good governance. The overriding message of King IV is that good corporate governance practices help any organisation improve its ability to sustain itself and the social and environmental context in which it operates.

The King IV draft document was open for public comment and can be downloaded at: <http://bit.ly/KingIVdraft>.

Whilst Draft King IV is not law, the governance outcomes achieved and the practices adopted and implemented, will likely become the criteria by which the required standard of care and appropriate standards of conduct of any governing body and its members are measured. Due to the consultative process to be followed it is envisaged that the final King IV will be released on 1 November 2016 and probably become effective from middle 2017.

Draft sector supplement for retirement funds

During April 2016 the draft sector supplement for retirement funds was released for comment. The outcomes discussed include the following:

Ethical culture: The Board must lead ethically and effectively. It must ensure that the fund is a responsible corporate citizen, which includes that sustainable long-term performance of fund's assets must be considered, including factors of environmental, social and governance character.

Performance and reporting: The Board must lead the value creation process (high investment returns without irresponsible risk-taking). It must ensure that reports enable stakeholders to make an informed assessment of fund's performance.

Governing structures and delegation: Adequate and effective control of the fund is required. E.g. trustees must act with independence of mind irrespective of who elected/appointed them. Large funds could benefit from independent trustees.

Governance functional areas: (a) Adequate and effective control: The Board must govern risk and opportunity in a way that supports the fund.

(b) Stakeholder relationships: The Board must establish stakeholder relationships that result in the governance outcome of trust, good reputation and legitimacy. Under this heading reference is also made



to the application of responsible investing as contemplated in CRISA (Code for responsible investing in South Africa), as a matter of sound governance.

Observation: *In summary therefore – the proposed King IV and the sector supplement referred to above are more focused and will have specific application on retirement funds. It is outcomes orientated. It will place accountability on the board of trustees to attain the desired organisational outcomes. It only has 17 principles compared to 75 but it requires an ‘Apply AND Explain’ approach, as opposed to King III which is ‘Apply OR Explain’. This means that application of the principles is assumed, and that an explanation is disclosed on the practices that have been implemented and the progress made towards governance outcomes. When it becomes effective in mid-2017 it will not be law but it may well become the standard against which all trustees will be assessed.*

7. Retirement Reform

In the 2016 budget speech, the Minister of Finance said that despite the postponement of annuitisation for provident funds, government remains committed to its retirement reform objectives as announced in the 2014 Budget update on retirement reforms paper, released on 14 March 2014. The National Treasury intends to publish the final default regulations later this year, after considering comments received from the public.

Key elements of the reforms include:

- Mandation or auto-enrolment
- Improving fund disclosures
- Getting defaults right
- Consolidating the number of funds
- Simplifying retirement savings products and enabling portability between providers
- Ensuring effective intermediation

Observation: *With the exception of auto-enrollment there has been activity on all these matters. We expect the next draft of the default regulations in June 2016. Progress has also been made in ASISA on the requirements for the Effective Annual Cost (EAC) measurement. Fund consolidation is happening as a result of cost, efficiency, risk and many other market forces.*

8. Comprehensive social security reform paper

In his budget speech the minister of finance said Government has made significant progress in bringing about a fairer and more effective retirement system over the last 20 years. Government is committed to the release of the comprehensive social security reform paper later this year, led by the Ministers of Social Development and Finance.



9. Developments we are monitoring

9.1. Paper on pre-retirement preservation

Government intends to publish this paper during this year and to engage with unions on how best to take into account concerns related to retrenchment and unemployment.

9.2. POPI

Parliament has shortlisted candidates for the position of Information Regulator in terms of the Protection of Personal Information Act (POPI). This suggests that the Information Regulator should probably be established in 2016, and that POPI may commence later this year or early next year.

9.3. The Financial Sector Regulation Bill

The Bill follows the so-called “Twin Peaks” approach to financial regulation, i.e. it will establish two separate regulators:

- the Prudential Authority (“PA”) within the South African Reserve Bank to oversee the safety and soundness of financial institutions; and
- the Financial Sector Conduct Authority (“FSCA”), responsible for matters relating to market conduct, and aimed at ensuring that financial customers are treated fairly by financial institutions. The FSCA will replace the FSB.

However the power of the PA to lay down prudential standards for certain financial institutions, including retirement funds, with respect to the safety and soundness of those financial institutions and otherwise to achieve the objectives of the PA, is also to be exercised by the FSCA.

It is envisaged that the Twin Peaks system will be implemented in two stages. The first stage will establish the regulators and a uniform system and standards. In the second stage, the focus will be to streamline the current activity-based legislation (separate for banking, insurance, credit, pensions, etc.) into consolidated legislation.

9.4. Insurance Bill

The objective of the Bill is to promote the maintenance of a fair, safe and stable insurance market for the benefit and protection of policyholders by establishing a legal framework for insurers and insurance groups that—

- facilitates the monitoring and preserving of the safety and soundness of insurers;
- enhances the protection of policyholders and potential policyholders;



- increases access to insurance for all South Africans; and
- contributes to the stability of the financial system in general.

The Bill is drafted as framework legislation. It is enabling or empowering, which means that it contains the fundamental policy or underlying principles of legislation that are unlikely to change over time. It provides for the basic issues and powers necessary to regulate insurers, and delegates the power to make secondary legislation and authority to implement and enforce the Bill to the Prudential Authority.

9.5. Unclaimed retirement fund benefits search

The relevant FSB website is currently under construction, but once finalised any person who believes that he/she may be entitled to an unclaimed benefit will be able to do a search on the website by furnishing the following:

- Full name of the pension or provident fund
- Proof that he/she did contribute to the above fund
- Contact details
- Copy of ID

No personal information of any individual will be published on the FSB website. Should it transpire that an individual may possibly be entitled to a benefit, the FSB will provide him/her with the contact details of the fund or its administrator.

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