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Retirement Fund Update

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Financial Services Board: New Acts, Regulations and practice notes

1. FSB Levies

The FSB levies for the period from 1 April 2016 to 31 March 2017 were announced in Board Notice 81 of 2016. Among others these include the following:

Levy on retirement funds

The levy on any registered retirement fund (including preservation funds but excluding retirement annuity funds) is the lesser of:

- R1 138, plus an additional amount of R13,20 per member of the fund and in respect of every other person who receives regular periodic payments from the fund (excluding a person whose benefit remained unclaimed or who is a beneficiary in a beneficiary fund); or
- R2 556 435.

Comment: *The Sanlam Umbrella Fund with 170 000 members will therefore pay a FSB levy in the order of R2 245 138 pa or R1.10 per member pm.*

Levy for Pension Funds Adjudicator (PFA)

The levy for any registered retirement fund is R4, 90 per member and any other person who receives regular periodic payments from such fund (excluding any person whose benefit in the fund remained unclaimed).

Comment: *The PFA levy for the Sanlam Umbrella Fund with 170 000 members is therefore R883 000 or R0.41 per member pm.*

Levy on fund administrators

R7 122 plus an additional amount of R555, 21 per registered fund that is under the administration of the administrator, as well as an amount of R0, 68 per member and in respect of every other person who receives regular periodic payments from the fund (excluding any person whose benefit in the fund remained unclaimed or a beneficiary in a beneficiary fund).

Comment*: Included in the administration fee of the Sanlam Umbrella fund (with more than 170 000 members) will therefore be an FSB levy of around R123 277 pa or R0.06 per member pm. That brings the total FSB levy in respect of the Sanlam Umbrella Fund to R3 201 415 pa or R1.57 per member pm.*

2. Withdrawal of Retirement Fund Practice Note RF 1/2004: Annuities paid in arrear

This Practice Note has been withdrawn by SARS due to changes to paragraph 4(1) of the Second Schedule to the Income Tax Act. The Practice Note prohibited a postponement of the accrual of a pension benefit upon retirement and a retired member had to become entitled to a pension no later than the end of the month following the month in which the member retired from employment.

Comment: *This is no more than a technical correction following the changes to para 4(1) of the Second Schedule to the Income Tax Act with effect from 1 March 2015 in terms of which a benefit accrues only when a member elects to retire from the fund.*

3. PF Notice 2/2016: Notice on Financial Soundness

The Notice (issued on 8 July 2016) contains the Registrar's criteria for financial soundness of retirement funds and the valuation basis in terms of which financial soundness must be determined, as well as the requirements for a scheme of arrangement that must be submitted to the Registrar by a fund that is in deficit or not financially sound.

Comment: *We discussed the draft notice in the Simeka Retirement Fund Update of the 1st quarter 2016. The final Notice does not contain material changes to the draft notice.*

4. The Financial Sector Regulation Bill

The Financial Sector Regulation Bill ("Bill"), follows the so-called "Twin Peaks" approach to financial regulation, i.e. it will establish two separate regulators:

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

The Bill was first published for public comment in December 2013 and a revised version published for comment in December 2014. The Bill was tabled in Parliament in October 2015 and the Standing Committee on Finance ("SCOF") subsequently held a series of public hearings and invited public submissions on the Bill. On 21 July 2016 National Treasury published its formal responses in relation to the comments submitted, as well as a further draft of the Bill, reflecting proposed drafting changes to cater for the comments submitted. The SCOF will make the final decision on any changes to be effected to the Bill before it is submitted to the National Assembly in Parliament.

5. Update: The cancellations of funds and the termination of participation of participating employers in umbrella funds

In February 2015 the Financial Services Board ("FSB") circulated two documents for comment:

- A draft PF Circular dealing with the commencement of participation, termination and recommencement of participation of participating employers in umbrella funds; and

- A draft Information Circular relating to the governance, winding up and cancellation of the registration of a shell fund or dormant fund without a board or liquidator.

Submissions in relation to the draft Circulars were made to the FSB (by the IRFA, amongst others), but to date no final Circulars have been issued. A Circular on deregistrations is however expected shortly.

The only current guidance in this regard is an email from the FSB in August 2016 (following correspondence between the FSB and role-players in the industry), the contents of which is set out below.

Cancellations of funds

All funds whose applications for cancellation have been lodged and/or are still to be lodged, must submit, in addition to the standard documents, affidavits deposed to by at least two of the following persons (at least one of whom must be a member of a profession):

- a former member of the board of the fund;
- the principal officer of the fund;
- a member of the board of the fund;
- the fund's valuator or the actuary who was the fund's valuator immediately before his or her appointment as such ended;
- the fund's auditor;
- a representative of the fund's sponsor or former sponsor;
- a representative of the fund's administrator or former administrator.

In the affidavits, the relevant person must declare that he/she has taken all steps reasonably required to identify and locate the assets and liabilities of the fund, if any, and has found that the fund has neither assets nor liabilities.

Termination of participation of participating employers in umbrella funds

To terminate the participation of a participating employer under an umbrella fund, the fund must submit to the Registrar:

- A trustee resolution in terms of section 12(2) of the Pension Funds Act;
- The attached annexure, completed in full; and
- The attached affidavit, completed in full.

Comment: *We discussed the requirements with the FSB recently and made a number of proposals to simplify the procedures. Indications are that a fresh set of streamlined requirements will be issued shortly.*

6. FSB warns the public against so-called tracing agent

On 16 August 2016 the FSB issued a press release warning the public against a particular individual who is allegedly charging claimants a fee for assisting them in claiming their benefits from a fund. She also allegedly informs claimants that she has direct access to the relevant fund's information, including their fund credit, and claims to work for the FSB.

Comment: *The warning confirms that whilst a person who believes that he/she is entitled to an unclaimed benefit or unclaimed surplus benefit may ask someone to assist him/her to claim it from the relevant fund, the only people who may charge for providing such assistance are authorised financial service providers and attorneys. Pension funds and provident funds may not charge a fee for assisting members to claim amounts due to them. The office of the Registrar of Pension Funds may also be approached since it assists (at no charge) members and beneficiaries to trace unclaimed benefits and unclaimed surplus benefits by liaising with the relevant funds and/or their administrators.*

Retirement reform

7. T-Day: Progress on compulsory annuitisation requirements at retirement

The Revenue Laws Amendment Act, 2016 postponed until 1 March 2018, the requirement that provident fund members must purchase an annuity at retirement if the benefit exceeds the de minimis threshold of R247 500.

Observation: *The two-year delay was intended to allow for further consultations at NEDLAC and with other stakeholders. More in particular the Minister of Finance is required to 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. We do not get the impression that the opposing groups have moved any closer together.*

Without the scrapping of the means test of the state old age grant (SOAG) many members who are required to annuitise may be prejudiced when the annuitisation provisions kick in. Government however simply does not have the money to fund the scrapping of the means test at the moment. The other matter in respect of which an announcement is awaited will be contained in the paper on social security reform. The big question is: Will the Government make retirement provision compulsory and establish a national state fund that all South Africans must belong to or will they introduce auto enrollment and put the fund out on tender as was done in the UK?

8. Comprehensive paper on social security and retirement reform

It was expected that the Social Security Reform Paper would be released by August 2016. However, according to media reports, National Treasury recently indicated that they are still working on finalising the paper. A new round of discussions will be held at Nedlac (National Economic Development and Labour Council), but discussions may also have to be held outside of Nedlac since some unions are no longer part of Nedlac.

***Observation**: The Department of Social Security is an important party to these discussions and is known to favour a national state fund with cross subsidised benefits. National Treasury stressed that the issues that had to be considered were complex and that they had to be careful not to rush the process. The proposals are part of long-term reform, and National Treasury wants to make sure that any reform measure does not have unintended consequences, which will be difficult to reverse. It is for this reason that the reforms are introduced gradually.*

9. The default regulations

National Treasury held discussions with various industry groups during the past few months and planned to publish an updated set of draft regulations for comment during the third quarter of 2016.

***Comment**: The purpose of the proposed regulations is to ensure that the benefit structure of the fund is appropriate for the needs of the members and will help ensure good retirement outcomes for them. Funds will be required to introduce default benefits in respect of the following scenarios, default investment portfolio, default in-fund preservation and default (mostly in-fund) annuity strategy. The solutions can be very attractive and very compelling and can be implemented even before the default regulations have been promulgated. We welcome these new requirements but appealed to National Treasury not to be to prescriptive and allow funds to experiment, explore and develop the most appropriate combinations in the next few years.*

SARS: New Acts, Regulations and practice notes

10. Draft Taxation Laws Amendment Bill (TLAB)

National Treasury and the South African Revenue Service (SARS) on 8 July 2016 published for public comment (by 8 August 2016) the 2016 Draft Taxation Administration Laws Amendment Bill (TALAB) and the 2016 Draft Taxation Laws Amendment Bill (TLAB). These bills give effect to most of the tax proposals announced in the 2016 Budget Speech and the 2016 Budget Review.

The Draft TLAB deals with the more substantive changes to the tax laws while the Draft TALAB deals with changes to the administrative provisions of tax legislation. The main provisions of the TLAB that would impact on the employee benefits industry are the following:

Retirement fund contribution deduction against passive income

From 1 March 2016 the tax treatment of contributions to retirement funds was amended to be harmonized across all retirement funds. Previously, deductions to retirement annuity funds were only allowed to be set off against “non-retirement funding income” (which included passive income such as interest or royalties, but excluded taxable capital gains), while deductions to pension funds could only be set off against “retirement funding income” (which represented income from employment and did not include passive income).

The harmonisation of the tax treatment of contributions in section 11(k) of the Income Tax Act allowed for a deduction against income from “carrying on a trade”, which had the unintended consequence of excluding passive income. This resulted in members of retirement annuity funds who were using the deduction against passive income no longer being able to deduct their contributions against passive income.

The Draft TLAB proposes that deductions for contributions to all retirement funds should be allowed to be set off against passive income. For the purpose of the section 11(k) deductions, the passive income does not include taxable capital gains.

Rollover of excess retirement fund contributions before 1 March 2016

Before 1 March 2016 retirement annuity contributions that were above the allowable deductible amounts were allowed to be rolled over to the following year to potentially be deducted in that year. Pension fund contributions that were above the limit were not allowed to be rolled over to the following year, but upon retirement these amounts could be taken tax free.

The 2016 changes do not cater for any excess contributions made before 1 March 2016 and previous contributions above the limit to retirement annuity funds can no longer be rolled over. Contributions above the limits to both retirement annuity funds and pension funds made before 1 March 2016 would then not be afforded the rollover treatment and could only be received tax free at retirement.

To continue with the current rollover treatment for retirement annuity funds and align the treatment for excess contributions to pension funds it is proposed that with effect from 1 March 2016 excess contributions to both of these funds before 1 March 2016 should be allowed to be rolled over and deducted in the following tax year. Excess provident fund contributions would not be allowed to be rolled over since there was no requirement for provident funds to purchase an annuity before 1 March 2016.

Disallowing the exemption for a lump sum, pension or annuity from a retirement fund that is located within the republic

The provisions of section 10(1)(gC) of the Income Tax Act allows a South African tax resident who is employed outside of the Republic to receive those retirement benefits (that they earned while outside the country) free from tax.

There is uncertainty regarding the interpretation of the current provisions of section 10(1)(gC). The consequence is that South African tax residents who work outside of the Republic can receive a tax deduction on contributions made to the South Africa retirement fund. However, upon receipt of the retirement benefits the amount that accrued while the South African tax resident was employed outside the Republic will be free from tax.

The Draft TLAB proposes that with effect from 1 March 2017 the exemption provided in section 10(1)(gC) will only apply to retirement benefits from foreign retirement funds.

Inclusion of emigration for exchange control purposes in respect of withdrawals from retirement funds

In 2015, changes were made in the Income Tax Act to allow individuals to withdraw a lump sum from their retirement annuity fund when they cease to be tax resident or when they leave South Africa at the end of their work visa.

It has come to Government’s attention that exclusion of the requirement that an individual must emigrate from the Republic and that emigration must be recognised by the South African Reserve Bank for purposes of exchange control creates a loophole for South African nationals or tax residents to be able to make an early withdrawal from their retirement annuity funds, without formally emigrating.

It is proposed that the definition of “retirement annuity fund” will be amended with effect from 1 March 2016 to include the requirement that an individual must emigrate from the Republic and that emigration must be recognised by the South African Reserve Bank for purposes of exchange control as one of the criteria to be met in order for individuals to be able to withdraw a lump sum from their retirement annuity fund.

11. Date of accrual when benefit is transferred to another fund

There was some confusion in the industry as to the date on which a lump sum benefit accrues for tax purposes in terms of a transfer in terms of section 14 of the Pension Funds Act from one fund to another. The industry was of the view that any one of the following three dates could possibly qualify as the accrual date:

- the effective date of the transfer;
- the date on which the transfer is approved by the Registrar, or
- the date on which the assets are actually transferred from the transferor fund to the transferee fund.

SARS was previously of the opinion that (b) above is the correct accrual date. However, following a submission by the IRFA, SARS has confirmed that based on paragraph 4 of the Second Schedule to the Income Tax, the accrual date of a section 14 transfer is the date on which the benefit is transferred to the transferee fund.

Comment: *The date of accrual would have been of particular importance in respect of pension to provident transfers, which would have been tax-free from 1 March 2016 – such transfers are however still taxable because the concession will only apply once compulsory annuitisation is implemented, which will not be before 1 March 2018.*

Other developments

12. Compensation for Occupational Injuries and Diseases Act, 1993

The maximum amount of earnings of an employee in respect of which his/her employer must pay contributions has been increased from R355 752 to R377 097 per annum with effect from 1 April 2016.

Observation*: This is a routine annual inflation adjustment of around 6%.*

13. Proposed reduction in the period for the submission of Quarterly Asset Allocation Reports

In a letter dated 27 May 2016 the SA Reserve Bank advised that they intend to reduce the period after each quarter within which the quarterly reports must be submitted from 3 months to 21 working days – this will apply with effect from 2017. The reason for the proposal is that the Financial Surveillance

Department of the Reserve Bank needs up-to-date information relating to cross-border transfers, including details on the foreign exposure status of institutional investors. Comments on the proposal were allowed by no later than 31 July 2016.

***Comment**: This duty to report has typically been delegated and outsourced to the administrators of funds over the past few years. Administrators indicated that they will not be able to submit the reports within the proposed reduced period because they do not receive the required information from asset managers soon enough to be able to do so.*

14. The discretion of the PFA to make an order for interest to be paid

The judgment of the Supreme Court of Appeal in National Tertiary Retirement Fund v Mokadi and Lukhaimaine NO [2016] ZASCO 91 (1 June 2016) concerned the discretion of the Pension Funds Adjudicator ("PFA") to order a fund to pay interest.

The judgment confirmed the following:

- Whether interest will accrue at all, the rate at which it accrues and the date from which it runs are matters that have been left to the discretion of the PFA by the legislature;
- Interest payable on amounts awarded by the PFA are governed by section 30N of the Pension Funds Act (which provides that "where a determination consists of an obligation to pay an amount of money, the debt shall bear interest as from the date and at the rate determined by the Adjudicator") and consequently such a debt is not subject to the Prescribed Rate of Interest Act;
- The result is that the PFA may (but is not obliged to) use the prescribed rate as determined in the Prescribed Rate of Interest Act when making a determination should she consider it to be appropriate in the circumstances;
- The PFA is also free to use a different interest rate (e.g. the average rate of inflation or the rate of fund return) where it would be more appropriate;
- The PFA may choose from a range of options which in her view is fair and appropriate in the circumstances (e.g. from date of determination to date of payment of debt; from date on which benefit should have been paid to the complainant);
- In terms of the common law, where payment of a debt is due and no interest has been agreed on between the parties, mora interest may be charged. In the context of a PFA determination this means that even where the rules of the fund do not provide for interest to be paid, the PFA has the discretion to order the fund to pay interest.

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