Retirement Fund Update

1 of 2019

In this Edition

The Conduct of Financial Institutions Bill

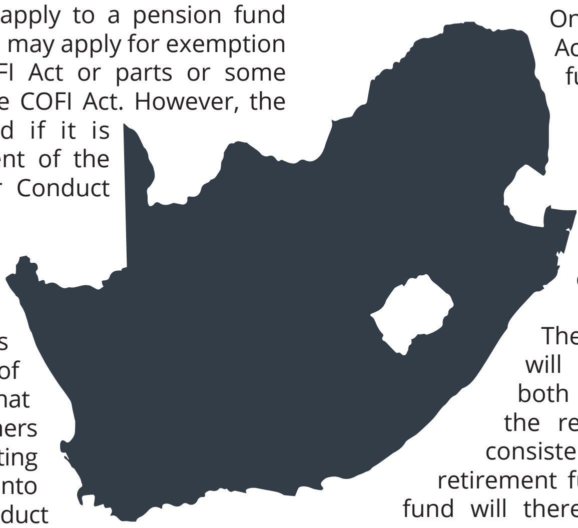
The Conduct of Financial Institutions Bill (the Bill) has been released for public comment by 1 April 2019.

Application

Once it is enacted, the Conduct of Financial Institutions Act (COFI Act) will apply to all financial product providers, financial service providers, holding companies of financial conglomerates and to persons licensed or required to be licensed in terms of a financial sector law, all known as financial institutions. A pension fund organisation is a financial product provider and thus a financial institution and therefore the COFI Act will apply to a pension fund organisation. Financial institutions may apply for exemption from the application of the COFI Act or parts or some provisions or requirements of the COFI Act. However, the exemption will not be granted if it is likely to prevent the achievement of the objective of the Financial Sector Conduct Authority (FSCA).

Aim of the COFI Act

The Bill outlines what customers and industry players can expect of financial institutions. It requires that financial institutions treat customers fairly by incorporating the Treating Customers Fairly (TCF) principles into the way financial institutions conduct business with their clients.



The Bill seeks to establish a consolidated, comprehensive and consistent regulatory framework for the conduct of financial institutions.

The Bill moves away from a rules-based approach (tick-box approach) to a principle-based approach, meaning that more reliance will be on high-level, broadly stated principles and rules and not on detailed prescriptive rules. Rules will however still be prescribed through conduct standards.

Licensing of financial institutions

A financial institution may not provide, as a business or part of a business, a financial product or a financial service unless licensed. The Bill introduces an activity-based licensing framework, which means that a financial institution will be licensed based on what they do and not what they are. The license must stipulate the activities that the financial institution is authorised to perform. This implies that should a licensee want to add or remove any of the activities which it is authorised to perform, it will require a change to its primary license.

Once the Bill has been enacted the COFI Act will apply to all retirement funds and a fund which at the date when this section comes into effect is registered in terms of the Pension Funds Act (PFA) will need to be licensed in terms of the COFI Act. The rules of a fund will have to be amended to align it with the COFI Act within 18 months from the date of commencement of the COFI Act.

The Bill proposes that retirement funds will be required to be licensed under both the PFA and COFI Act and subject to the requirements in both Acts to ensure consistency of treatment of members of retirement funds. The registration of a retirement fund will therefore continue in terms of the PFA. However, retirement fund benefit administrators and other service providers currently regulated under the PFA, will in future be licensed and authorised under the COFI Act only.

Members and employer elected board members of retirement funds are not required to be licensed under the COFI Act, but independent and professional board members will be required to be licensed and will be subject to fit and proper requirements as part of their wider regulatory obligations. Member elected board members should ensure continual skills development through training, even though they will not be licensed.

The FSCA may prescribe conduct standards regulating and imposing requirements on board members and sponsors of retirement funds.

Transformation under the COFI Act

The Bill is explicitly supportive of transformation and it provides that a financial institution must ensure that it has a transformation policy and a plan in place of how it intends to meet its commitments as set out in the policy.

Such transformation policy and plan should satisfy the requirements of the BBBEE Act and the Financial Sector Charter.

Retirement funds will be required to report to the FSCA on how it is achieving its transformation policy.

The Bill also aims to better support transformation of the financial sector by supporting participation of black business in the provision of financial products and services and strengthen the participation of vulnerable consumers. In providing for a transformative approach the COFI Act will allow the FSCA to exempt institutions from parts thereof for developmental, financial inclusion and transformation objectives.

Governance under the COFI Act

Financial institutions are expected to adopt, document, implement and monitor the effectiveness of a governance policy.

The governance policy must be approved by and subject to the oversight of governing bodies, in the case of retirement funds, the board of management. The policy must also set out how the financial institution will comply with the governance policy and set out the roles and responsibilities of the board of management, remuneration, communication with the FSCA and the compliance procedure amongst other things. This policy must be reviewed from time to time to ensure that it is valid and kept up to date.

Remuneration and compensation

Remuneration and compensation between financial institutions and persons providing services and activities should be fair and in the interest of financial customers and financial institutions should avoid conflicts of interest in this respect.

The remuneration must be reasonably commensurate with the activity or service performed and must not result in any activity or service being remunerated twice.

Offences and penalties

A person or financial institution that is required to be licensed under the COFI Act and is not licensed, commits an offence and is liable for a fine not exceeding R15 000 000 or imprisonment not exceeding 10 years or both a fine and imprisonment.

The COFI Act and other laws

Financial sector regulators and the South African Reserve Bank must enter into memoranda of understanding as set out in the Financial Sector Regulation Act to address any inconsistencies that might arise relating to the conduct of financial institutions as a result of financial sector laws.

Conclusion

The overall intention of the COFI Act is to ensure a consolidated, consistent and comprehensive regulatory framework in the financial services industry and to ensure that financial customers have the relevant protection. The regulator's influence on fund leadership through fit and proper requirements are increased. Retirement funds will have to produce and implement a transformation policy/charter and it seems as if the requirements of for instance the Financial Sector Code will become applicable on all retirement funds.

5 Guidance Note 5 of 2018
– Responding to FSCA queries

Guidance Note 5, issued by the FSCA on 19 October 2018, deals with the following cases:

- queries raised by the FSCA or where they requested additional information for the registration of a new fund and/or the registration of a participating employer in the umbrella fund;
- where a fund has submitted a proposed rule amendment and the fund has failed to provide the requested information; and
- responding to the FSCA's query within the prescribed time.

The Pension Funds Act prescribes the following response time periods:

Query	Days allowed
Provide the FSCA with additional information or respond to queries where an administrator has applied for the registration of a new fund or for the participation of an employer in an umbrella fund.	60 days
Provide the FSCA with additional information or to respond to queries where a fund has submitted a proposed rule amendment.	180 days

The FSCA reiterated in the guidance note that from 1 October 2018 it will strictly enforce these allowances and applications will lapse if the responses are not received within the days allowed.

The FSCA will send notifications to the relevant funds of its intention to lapse the application and if the fund does not provide the relevant information, it will be required to submit a new application and will need to pay the prescribed fees again and no refunds will be made.

6 Guidance Note 6 of 2018
- Recovery of arrear contributions by an attorney

Guidance Note 6, issued by the FSCA on 19 October 2018, deals with the recovery of arrear contributions by an attorney on behalf of a fund.

A fund may instruct an attorney to collect arrear contributions on its behalf from a defaulting employer. The recovery process usually results in the defaulting employer paying the arrear contributions into the attorney's trust account.

When instructing an attorney to recover arrear contributions on behalf of a fund, the fund should ensure that they enter into an agreement with the attorney. The agreement must at least provide:

1. That any amount recovered by the attorney in respect of arrear contributions must be paid into the fund's bank account within 7 days of receiving such amount;

   and

2. The defaulting employer must provide the relevant contribution statement together with the outstanding contributions to the fund.

Guidance Note 7 of 2018
7 - Amendments to ensure compliance with the default regulations

Guidance Note 7, issued by the FSCA on 7 December 2018, provides guidance to funds on the process and timelines for applications for amendments to rules submitted to the FSCA to ensure compliance with Regulations 37 to 39 (the "default regulations"), from which all retirement funds were exempted up to 1 March 2019 to enable a transitioning period.

To allow the FSCA to prioritise and assist in the timeous consideration of applications for amendments, funds are advised that only applications received by 31 January 2019 will be treated as urgent and the FSCA will attempt to consider and register such rules before 1 March 2019.

8 Guidance Note 8 of 2018
– Guidance on the default regulations

Guidance Note 8, issued by the FSCA on 12 December 2018, provides guidance to funds on the application of the default regulations.

> Regulation 37 deals with the implementation of default investment portfolios.

> Regulations 38 deals with preservation and portability (becoming a "paid-up member").

> Regulation 39 deals with the establishment of an annuity strategy.

The following table summarises the application of the regulations:

Regulation	Pension Fund	Provident Fund	Retirement Annuity Fund	Pension Preservation Fund	Provident Preservation Fund
37	✓	✓	✗	✗	✗
38	✓	✓	✗	✗	✗
39	✓	✗ unless the rules enable member to purchase an annuity	✓	✓	✗ unless the rules enable member to purchase an annuity

Beneficiary funds and funds in voluntary liquidation need not comply with the regulations.
Regulations 37 and 38 only applies to funds to which members belong as a condition of employment.

Default investment portfolios

> A participating employer in a fund may choose the default investment portfolio applicable to its employees who are fund members, but the board of management of the fund remains responsible to decide from which portfolios may be chosen.

> Where a fund only invests in one investment portfolio, it will be considered to be the default investment portfolio and must comply with regulation 37.

> An existing default investment portfolio that does not comply with the regulations will no longer qualify as the default investment portfolio(s) from 1 March 2019. Funds must move members to the new portfolio(s) that complies and communicate as such with members.

> Members should receive communication once a year, which should include the following with regard to the default investment portfolio:

- Asset composition
- Performance of the default investment portfolio compared to appropriate benchmarks
- Top 10 holdings by value and fund returns for the current year and at least the past two financial years.

Paid-up membership certificates

All paid-up members must be presented with a membership certificate. A template was included in the guidance note.

Retirement benefits counselling

> The FSCA confirmed that counselling may be in person or in writing.

> The person providing counselling need not be a FAIS accredited financial adviser, but the board must be certain that the person is duly qualified and experienced and can manage conflicts of interest.

> Counselling does not include advice, even on tax matters, and members must be informed as such. If advice is also provided, the person providing it must be a registered financial adviser or tax practitioner.

> A fund must keep a record of counselling.

> Retirement benefits counselling should be provided no longer than 6 months prior to a member's retirement and the board should make every effort to ensure that the information provided is still relevant and appropriate at retirement age.

> When members are given access to retirement benefit counselling, a disclosure and explanation must be provided in clear and understandable language, including fees, risks, costs and charges of:

- The available investment portfolios (not necessary for retirees)
- The terms of the fund's annuity strategy
- The terms and process by which the fund handles paid-up benefits (not necessary for retirees)
- Any other options available to members.

Converting paid-up benefits from defined benefit to defined contribution

Funds with defined benefit membership have been exempted from this provision and therefore may convert paid-up benefits to a defined contribution basis but are not compelled to do so.

Paid-up members

> Boards must apply their minds to reasonably determine if administration fees and charges for paid-up members are fair and reasonable compared to the administration of active members. Administration fees for paid-up members should be less than that of active members due to the absence of contributions and reconciliations.

> Deduction of administration fees are not a reduction of benefits, but boards must implement an administration regime that will not erode their benefits over time, especially where members with small benefits are concerned.

> Investment fees must be the same for in-service and paid-up members.

> A member may request to transfer a benefit from another fund where he or she is a paid-up member at any stage of membership and no charges for the transfer may be levied, excluding the FSCA's fees, if any.

> According to this guidance note, section 37C of the Pension Funds Act applies in the case of death of a paid-up member. However, according to section 37C, the benefit is not a death benefit and the result is that section 37C is not applicable. Section 37C will still have to be amended to provide that it will be applicable even after a member's service was terminated.

> The FSCA will establish a database of paid-up certificates, which funds must timeously and accurately update.

Annuity strategies

> Investment choice for living annuities are limited to four portfolios, therefore it may even be one portfolio.

Exemptions

> Funds must apply for the correct exemption – either regulation 37, 38 or 39.

> Applications must be made online on the recommended form.

> The FSCA may request supporting documentation or the fund may submit documentation as listed in the guidance note.

> The FSCA will not grant exemption unless they are convinced that it is in the best interest of members and does not prejudice the objectives of the default regulations.

The Protection of Personal Information Act

The Protection of Personal Information Act 4 of 2013 (POPIA) is South Africa's data protection law and was signed into law on 19 November 2013 and only certain sections of the Act are currently in use. These sections relate to the establishment of the Information Regulator.

The purpose of the POPIA is to promote the protection of personal information processed by public and private entities. The aim is to give effect to the constitutional right to privacy as contained in the Bill of Rights.

> The POPIA commencement date will not be before the Information Regulator is fully operational. The POPIA also allows for a twelve-month transition period for compliance with the Act once it becomes effective. The Act applies to any natural or juristic person who processes personal information including large corporate entities and government. It sets some conditions for those entities to lawfully process the personal information of date subjects (the person to whom the information relates).

The Act involves three parties (natural or juristic):

1. **The data subject** -
   The person to whom the information relates.
2. **The responsible party** -
   The person who determines why and how to process. In the context of retirement funds this will be the relevant fund.
3. **The operator** -
   A person who processes personal information on behalf of the responsible party. This will be the fund administrator.

Section 60 of the POPIA makes reference to a code of conduct applicable to a sector. A code of conduct can either be instigated at the Information Regulator's own initiative or by a body which represents an industry. In this regard the IRFA has prepared and submitted a draft code of conduct suitable for the retirement funds industry.

The aim of the code of conduct is as follows:

> Prior authorisation will not be required to process personal information, where such processing is in line with applicable legislation (such as the Pension Funds Act) and the fund rules; and

> Explicit consent of the members and beneficiaries will not be required to process their personal information, where such processing is in line with applicable legislation (such as the Pension Funds Act) and the fund rules.

The Final POPIA Regulations were published in the Government Gazette on 14 December 2018. The Regulations will commence on a date to be determined by the Regulator by proclamation in the Government Gazette.

The POPIA Regulations do not provide practical guidance on how to comply, but are mainly administrative in nature and regulates a number of administrative and procedural steps and obligations that POPIA imposes. These include the following:

a. How a data subject can object to the processing of their personal information;

b. How a data subject can request for correction or deletion of personal information or destruction or deletion of record of their personal information;

c. Responsibilities of Information Officers;

d. How to apply for the Regulator to issue a code of conduct;

e. How to request a data subject's consent for direct marketing;

f. How to submit a complaint to the Regulator;

g. Requirements when the Regulator decides to act as conciliator during an investigation;

h. Pre-investigating proceedings of the Regulator if the Regulator intends to investigate you;

i. How the Regulator will settle complaints;

j. How the Regulator will conduct assessments; and

k. How the parties will be informed of developments regarding an investigation.

Policyholder Protection Rules (PPR)

The Policyholder Protection Rules under the Long-term Insurance Act (PPR) aim to deliver better customer outcomes across the financial sector and improve market conduct in the insurance sector. It further aims to ensure that the long term insurance industry treats its customers fairly, and that incentives are aligned to ensure that less complex, good-value products are provided to consumers.

Amendments to PPR were published on 15 December 2017. The amendments to PPR took effect from 1 January 2018 with transitional provisions provided for certain sections. This means that not all rules had to be complied with by 1 January 2018. The scope and application of the amended PPR's has been extended to group risk insurance schemes.

The FSCA further issued a notice regarding the extension of the period for compliance with certain rules of the PPR on 6 December 2018.

The important amendments to the PPR insofar as it deals with group schemes and other employee benefits and the effective dates thereof are as follows:

PPR	Provisions	Effective date
Requirements for the fair treatment of policyholders	An insurer must have appropriate policies and procedures in place to achieve the fair treatment of policyholders (including members of a retirement fund or individual employees' part of a group scheme). The responsibility lies with the insurer and the insurer must have arrangements or agreements in place to support these provisions.	15 December 2018
General disclosure requirements	An insurer must make every effort to communicate directly with the member or employee and make certain disclosures wherever it is reasonably practical for the insurer. However, where this direct access is not reasonably practical the insurer may place reliance on the policyholder (retirement fund, or employer) or intermediary to communicate to the member or employee. In this instance the insurer must have policies and procedures in place to identify information that is required to be communicated, facilitate and support the policyholder and monitor compliance by the policyholder.	15 December 2018
Data management	An insurer must, as a minimum, have access to the names, identity numbers and contact details of all its policyholders (including members of a retirement fund or individual employees' part of a group scheme). Information is subject to POPIA, therefore the insurer must have an effective data management framework in place and may not use the data for any other purpose.	15 December 2019

PPR	Provisions	Effective date
Claims Management	On receipt of a claim, the insurer must liaise directly with the claimant unless the claimant has consented that communication may take place via the retirement fund or the employer.	15 June 2019
Complaints Management	A beneficiary of a benefit under a group scheme has the right to lodge a complaint directly with the insurer and does not have to direct his/her complaint to the scheme or retirement fund.	15 June 2019
Termination of policies	When a group scheme policy is replaced and the replacement policy is not equally or more favourable, all members or employees must consent to the replacement.	15 December 2019

The communication of insurers directly with members where for instance an employer or retirement fund is the policy holder will be challenging for boards of management in terms of these rules. Contracts with life insurers will therefore have to be revisited in this regard.

Draft conduct standard for living annuities in a default annuity strategy

Regulation 39 of the Pension Funds Act, one of the "default regulations", requires boards of management to establish an annuity strategy for all pension funds and pension preservation funds, as well as provident funds where the rules provide that members may elect an annuity upon retirement.

A retiring member's benefit will not automatically default into a particular annuity, but the member will have to select the board of management's preferred choice of annuity as set out in the fund's annuity strategy or choose any other annuity product made available by the fund.

Living annuities paid directly from the fund or through a fund-owned policy or sourced from an external provider may form part of the annuity strategy.

The FSCA issued a draft conduct standard for the criteria for living annuities in an annuity strategy on 7 November 2018 and invited comments before 14 January 2019. The final conduct standard will be legally binding, but this extension of the default regulations will only apply to living annuities that form part of the fund's annuity strategy and not to existing in-fund living annuities.

> According to the draft conduct standard, the annuity strategy of a fund must represent the fund's best proposal for the average member of that fund in order to assist those members who do not feel comfortable making their own decision at retirement.

Drawdown levels

The default regulations require that the drawdown levels from living annuities, where it is included as part of the annuity strategy to be compliant with a prescribed standard. The purpose of the conduct standard is therefore to prescribe the drawdown levels and will be applicable to in-fund and out-of-fund living annuities if it is made part of the fund's annuity strategy.

The proposed maximum drawdown rates have been determined in bands by age and gender setting out the limits to achieve sustainability by taking into account longevity and are as follows:

Age		
55	4.5%	4.0%
60	5.0%	4.5%
65	5.5%	5.0%
70	5.5%	5.0%
75	6.0%	5.5%
80	7.0%	6.0%
85	8.0%	7.0%

Sustainability

Sustainability refers to how long the income payable from a living annuity will last, and not whether it is sufficient to sustain a particular living standard.

The default regulations state that where a living annuity is paid from the fund or through a fund-owned policy, funds must monitor the sustainability of income drawn by retirees in these living annuities and make such members aware if their drawdown rates are deemed not to be sustainable. This draft conduct standard therefore provides guidance on the interpretation of sustainable income and the need to monitor and communicate income sustainability to pensioners receiving a living annuity that is part of a fund's annuity strategy.

The sustainability of income -

- must be regularly measured and monitored;
- must be clearly communicated to the pensioner at inception and thereafter on a regular basis;
- if the living annuity is to be paid by an insurer, the fund must ensure the insurer complies with the conduct standard may result in a monthly pension which is lower than the amount required as a living income.

Concerns regarding the draft conduct standard

- Where a living annuity is purchased from a long-term insurer, it would be impossible for funds to ensure that the long-term insurer issues relevant and appropriate communication to the pensioner.
- The drawdown rates are too conservative compared to those applicable to living annuities outside of a fund's annuity strategy. Boards of management will be hesitant to include living annuities in an annuity strategy and members will not opt in, even if it is part of the fund's strategy.
- In establishing the drawdown levels, the level of capital invested and personal circumstances are not considered.
- The suggested implementation date of 1 March 2019 will be unattainable seeing that further consultation is needed and implementation may be multifaceted.

The Taxation Laws Amendment Act and Tax Administration Laws Amendment Act

The Taxation Laws Amendment Act, 23 of 2018 and the Tax Administration Laws Amendment Act, 22 of 2018 were promulgated on 17 January 2019.

THE NOTEWORTHY CHANGES ARE AS FOLLOWS:

Transferring retirement fund benefits to a preservation fund after reaching normal retirement date

Members of retirement funds have the option to delay receipt of their retirement benefits to a date later than their actual retirement because retirement benefits only accrue for tax purposes when a member elects which portion of the retirement benefit he or she wishes to receive as a lump sum. Therefore, a member's retirement benefit may be deferred in his or her employer fund for as long as allowed in the fund rules.

Deferred members are allowed to transfer their benefits tax-free to a retirement annuity fund after their actual retirement, but before they elected to receive their retirement benefit. With effect from 1 March 2019 members will be allowed to also transfer their benefits tax-free to a preservation fund after their retirement date, but before they elect to receive their retirement benefit. The once-off withdrawal applicable to preservation funds will not apply to the amounts transferred from a pension or provident fund to a pension preservation or provident preservation fund made by the member of the fund after reaching normal retirement age but before the member made an election to retire.

Align tax treatment of preservation funds upon emigration

Upon formal emigration a person is able to withdraw the full value in his/her retirement annuity fund, after paying the applicable taxes. With effect from 1 March 2019 members of preservation funds will also be allowed to access and withdraw the full value of their retirement benefits upon emigration or repatriation on expiry of the work visas, after paying the applicable taxes. Such emigration must be recognised by the South African Reserve Bank for the purposes of exchange control.

Tax treatment of transfers of actuarial surplus between retirement funds

The Income Tax Act not only makes provision for contributions actually made by the employer or employee to retirement funds to be included as a fringe benefit but also include contributions made on behalf of the employer as a fringe benefit.

This means that transfers of actuarial surpluses between the employer surplus accounts in retirement funds of the same employer may be deemed to be a contribution by the fund for the benefit of employees, and regarded as a taxable benefit i n the employee's hands.

With retrospective effect from 1 March 2017 transfers of amounts from one employer surplus account to an employer surplus account in another retirement fund in which the same employer participates will not create a taxable fringe benefit in the employee's hands. Where an employer surplus account is used to increase pensions or improve members' benefits, those amounts will also not create a taxable fringe benefit.

Amended contribution certificates

Employer contributions must be taxed as fringe benefits and for this purpose defined benefit funds must provide a contribution certificate to the employer indicating the factor to calculate what value must be included as a fringe benefit. With effect from 1 March 2018 updated contribution certificates may be supplied to the employer within one month where an error occurred in calculating the fund member category factor or where an employee's fund member category changed during the year.

Annuitisation requirements for provident funds

The annuitisation requirements for provident fund members has once again been postponed until 1 March 2021.

Q

What is an unclaimed benefit?

A

Unclaimed benefits refer to any benefit not paid by the fund to a member, former member or beneficiary within 24 months of the date on which it became due and payable to such person in terms of the Fund's rules.

The following are specifically listed as unclaimed benefits in terms of the Pension Funds Act:

> A benefit payable as a pension which has not been paid within 24 months of the expiry of any guarantee period, or the date on which the instalment became unpaid.

> An amount due to an untraced former member in terms of a surplus allocation exercise within 24 months of the approval of a fund's surplus scheme.

> An unclaimed amount remaining in a fund to be deregistered or liquidated.

> A death benefit allocated and due to a beneficiary that has not been paid within 24 months from the date on which the fund became aware of the member's death or such longer period as may be reasonably justified by the fund in writing such as the date of signature of the resolution.

> A divorce allocation made to the former spouse of a member that remains unclaimed or unpaid for a period of 24 months from the date on which an election is made by the former spouse for cash or transfer to another fund or, if no election is made by the former spouse, the date on which the election period expires (i.e. 120 days after the former spouse has been requested to make an election).

Q

Will there still be unclaimed benefits resulting from a member leaving the service of the employer before retirement after 1 March 2019?

A

With effect from 1 March 2019, the benefits of members who leave the service of their employers, will automatically become paid-up. This means that is will not become unclaimed after 24 months and there will be a decline in the number of unclaimed benefits held in retirement funds and less transfers to unclaimed benefit funds will be performed.

The withdrawal benefit of a member who leaves the service of the employer on or before 28 February 2019, or such prior date if the fund implemented the default regulations before 1 March 2019 will not automatically become a paid-up benefit and may become an unclaimed benefit 24 months after the member's exit date.

If a member who leaves the service of the employer after 1 March 2019 and completes the necessary withdrawal form, thereby choosing to take his/her benefit from the fund, but does not take receipt of the benefit for any reason, the benefit may become unclaimed after 24 months. The benefit may then be transferred to an unclaimed benefits fund if provided for in the rules of the fund.