

Retirement Fund Update

2 of 2019

S I M E K A

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PRACTICALITIES WHEN WITHHOLDING BENEFITS

There are limited instances in which the benefits payable to a member of a retirement fund may be withheld by the fund. Section 37A of the Pension Funds Act provides that a member of a retirement fund's benefit or right to such benefit may not be reduced, transferred or ceded or be pledged or hypothecated or be liable to be attached, except in circumstances set out in section 37D. Section 37D in turn provides for the deduction from a member's benefit of any amount due to the member's employer in respect of compensation as a result of damage caused to the employer by reason of theft, dishonesty, fraud or misconduct.

It is important to note that there is a difference between the stage of withholding a benefit and the stage of deduction from a benefit. The former is the area within which a board of trustees is able to exercise its discretion subject to the fund's rules and certain other conditions. The board needs to be familiar with the provisions of the rules to enable them to decide whether withholding is justified. The rules of a fund could stipulate for example that a benefit may only be withheld for a prescribed period of time.

The decision whether or not to deduct from a member's pension benefit is purely based on legal and factual considerations and the exercise of discretion does not come into play.

The Pension Funds Adjudicator has dealt with several cases regarding the withholding of benefits by retirement funds. The following should be noted:

- A fund may be ordered to pay a member's benefit to him/her based on a withdrawal form signed by the member only.
- Where no contributions are received for a member, the administrator of a fund must within two months from the date on which the last contributions were received, request more information to ascertain whether the member has left service and became a paid-up member or whether a withdrawal form is being withheld.

- If it transpires that a withdrawal form is being withheld, the fund and/or the administrator should make all possible endeavours to compel the employer to submit the withdrawal form. If the employer fails to submit the form, the fund should put the employer to terms, and if necessary institute proceedings against the employer requesting an interdict requiring the employer to complete the withdrawal form to enable the fund to effect payment.
- Even though a member will by default become a paid-up member if no completed withdrawal claim form is received, the fund and/or administrator will still have a duty to request the withdrawal form from the employer to establish the exit event in respect of the member, or whether the member is still an active member.
- If the withholding of a benefit is requested by the employer, the employer should provide the fund with the amount that it believes it has a reasonable chance of obtaining from the member via a valid written admission of liability or court proceedings. If the member's benefit amounts to more than the amount in question, the balance must be paid to the member by the fund should the member elect to receive the benefit. Although not addressed by the Adjudicator, the tax consequences should be considered, since the total withdrawal benefit will accrue for tax purposes once the member elects to receive the benefit and the total tax must be deducted from the portion that is paid to the member.
- The Adjudicator may order the fund to pay the benefit or the portion exceeding the employer claim together with interest, if it was held unlawfully or if the fund did not fulfil its duties in requesting the employer to provide it with a completed withdrawal form. This ordered interest rate can exceed the actual investment returns earned by the fund.

TAX ON RETRENCHMENTS

With effect from 1 March 2011 any lump sum received by or accrued to an employee, whether it is a severance benefit received from the employer or a lump sum retrenchment benefit accrued from a retirement fund, are taxed according to the special tax rates table applicable to retirements with the first R500 000 taxed at 0%.

It is important to note that the tax is cumulative over a person's lifetime, meaning the person will only once get R500 000 taxed at 0%. For example, the receipt of a severance benefit before a retirement lump sum benefit, will reduce or use the R500 000 tax-free portion due to the working of the cumulative system. The tax on severance benefits from the employer

and retirement and resignation lump sum benefits from a retirement fund is calculated in the sequence of accrual. Should a severance benefit and a retirement lump sum benefit be received on the same date, the taxable amounts of the two lump sums will be added, and only the first R500 000 of the combined amount will be taxed at 0%.

Severance benefit payable by the employer

Previously employer severance payments qualified for a R30 000 tax exemption, but this exemption has been replaced with the inclusion of the severance payment in the retirement tax table.

A severance benefit is (loosely) defined as an employer-provided severance package for reasons of retrenchment, age, sickness, accident, injury, or mental incapacity. If a person has reached the age of 55, any benefit that he/she receives from the employer as a result of termination of his/her service, will be regarded as a "severance benefit" and will therefore also be subject to the special tax rates applicable to retirements.

Any amount that is paid/payable due to services rendered may not be included in the severance benefit amount. Leave pay and notice pay therefore do not form part of a severance benefit and will not be taxed according to the special tax rates table applicable to retirements.

Benefit payable by a retirement fund

In terms of the Second Schedule of the Income Tax Act, a retirement fund member will be regarded as being retrenched if:

- the person's employment is terminated due to her/his employer ceasing to or intending to cease to carry on business; or
- the person became redundant in consequence of her/his employer having effected a general reduction in personnel or a reduction in personnel of a particular class,

unless the person was at any time a director of the employer or such person at any time held more than 5% of the issued share capital or members' interest in the employer.

SARS do not differentiate between voluntary and involuntary retrenchments

If the particular position is no longer available and the retrenchment was part of an exercise to reduce personnel, it will be regarded as a retrenchment whether the person volunteered to be retrenched or whether he/she was forced to take a retrenchment package. The first step of a general retrenchment exercise is usually to allow employees to voluntarily apply for a retrenchment package before the forced retrenchments take place. The benefit becoming payable by a retirement fund in both the voluntary and involuntary retrenchment scenario will be taxed similarly to retirement lump sum benefits.

A "voluntary retrenchment" payment will only be taxed as a withdrawal/resignation benefit if a person volunteered out of his/her own to be retrenched and it was thus not part of a general exercise by the employer to reduce personnel (therefore the person actually resigned).

Voluntary / involuntary - Similarly taxed to retirement lump sum benefits unless not part of general retrenchment exercise.

GENERAL

DRAFT INTERPRETATION NOTE - APPORTIONMENT OF SURPLUS AND MINIMUM BENEFIT REQUIREMENTS

SARS issued a draft interpretation note which explains and clarifies the tax treatment of past and future actuarial surplus allocations or distributions made by funds to members, former members, existing pensioners and employers.

Comments on the draft note can be submitted to SARS by no later than 31 May 2019.

1 PFA INFORMATION CIRCULAR

No. 1 OF 2019

Cancellation of registration of retirement funds

The FSCA published the information circular on 4 March 2019, in which they state their intention to issue a guidance note setting out revised requirements for the cancellation of a retirement fund. In respect of applications already submitted, the information circular states that administrators and external auditors are required to confirm that all systems, platforms and accounts have been checked and that no remaining assets are due to those funds.

Further, where a fund or administrator becomes aware that the cancellation of registration of a fund was made in error as the fund still has members, assets or liabilities, the fund or administrator must immediately inform the FSCA, disclose all relevant information and full particularity of the error and provide an explanation for why the error occurred; and make application to a competent Court with jurisdiction in order for the cancellation of the registration of the fund to be reviewed and set aside.

2 PFA INFORMATION CIRCULAR

No. 2 OF 2019

Application for exemption from the default regulations or extension to comply with the default regulations

Funds were required to comply and be fully aligned with the requirements set out in the default regulations by 1 March 2019.

The FSCA continues to receive applications for exemption or extensions from the default regulations after 1 March 2019.

On 19 March 2019 the FSCA issued the information circular, requesting all funds to submit their exemption or extension applications by no later than close of business (16h30) on Monday 25 March 2019. Appropriate penalties will be considered after this period.

DUTY TO UPDATE MEMBERS' PERSONAL AND CONTACT DETAILS

The board of trustees of a retirement fund has a legal obligation to ensure that it has sufficient and updated personal and contact details in respect of all its members. This will assist the fund to contact a member when a benefit becomes due and payable and to ensure that members receive the required communication from the fund (e.g. benefit statements and the board's annual report).

The duty to update members' contact details has become even more important with the introduction of the requirement that a retirement fund must obtain tax directives in respect of all in-service members transferring to another fund in terms of section 14 of the Pension Funds Act. The board must ensure that the fund has the following updated information in respect of each of member to enable the fund to apply for tax directives:

- Name(s) and surname
- Date of birth
- ID number
- Physical address
- Postal address
- Income tax number

All funds are therefore urged to review the member information they possess to ascertain if it is current. Where necessary, the fund must take steps to obtain its members' latest personal and contact details and to update and maintain its member records accordingly.

Paid-up members and deferred retirement members

In terms of the default regulations, once a member has left the service of the employer, he/she becomes a paid-up member upon exit and if the rules of the fund allows, a deferred retirement member upon retirement. From that point the retirement fund will correspond directly with the member and the employer will no longer be involved.

This stresses the importance of employers providing retirement funds with correct contact details for members upon termination of service to enable funds to continue providing members with the necessary communication regarding their paid-up or deferred benefits in the fund.

PLA CONFERENCE 2019

The Pension Lawyers Association's annual conference was held in Johannesburg during March 2019. Changes to the retirement fund arena of a far reaching and transformative nature were placed in the spotlight. A theme that could be recognised throughout the conference was that boards of trustees need to be familiar with all aspects pertaining to the retirement funds they serve and not blindly rely on the advice of their service providers and other retirement experts.

Some of the noteworthy remarks made by speakers were:

Revocation of decisions in terms of section 95 of the Financial Sector Regulation Act by Adv Chris Loxton

Adv Loxton presented on the state of litigation in the retirement industry and discussed the revocation of decisions in terms of section 95 of the Financial Sector Regulation Act ("FSRA").

A financial regulator such as the Financial Sector Conduct Authority ("FSCA") or Prudential Authority ("PA") may revoke a decision that it made if:

1. the decision was made as a result of fraud or illegality;
2. the information on which the decision was based was inaccurate or incomplete and the regulator would not have made that decision if it had had the accurate and complete information; or
3. the decision is invalid for any reason.

A revoked decision will have the effect of placing the aggrieved party in the position as though the decision was never taken.

For example, the FSCA can register a rule amendment and should it be of the opinion that the rule amendment was registered based on fraud and/or illegality, or on inaccurate and/or incomplete information or that the decision was invalid, it can revoke that registered rule amendment.



NAHEEM ESSOP

presented on behalf of the FSCA

- The Conduct of Financial Institution Bill subjects financial institutions to the BBBEE Act and the Financial Sector Code for Broad-Based Black Economic in an effort to create an inclusive and transformed financial sector, which is a strategic priority for the FSCA. The FSCA reminded the retirement funds industry that regulation 28(2)(c)(iii) of the Pension Funds Act provides that funds must consider the need for transformation, and reiterated that consideration is not good enough and that funds will need to provide reasons as to why they have not transformed. Funds should also consider appointing section 26(2) trustees who are in line with BBBEE. The FSCA will be pro-active and pre-emptive in assisting the Pension Funds Adjudicator where they discover trends that can include systematic failures in funds.
- The FSCA will be undertaking “mystery-shopping” to see how providers are treating their customers, which is in line with the Treating Customers Fairly initiative and section 57 of the FSRA.
- The FSRA contains an intensive and intrusive guiding principle and allows for the FSCA to look into how trustees go about making decisions on behalf of their funds. This allows them to interrogate and/or challenge strategic decisions and ask intensive questions. These can include questions such as why a specific service provider has been appointed and why their contracts are extended even though their fees are excessive.
- The FSCA expressed a concern regarding excessive charges by attorneys to provide legal advice to funds. Funds are challenged to negotiate better fees with service providers and not simply accept what they are being charged.
- The FSCA will tighten the enforcement around Directive 8 regarding gifts and gratuities.

DEFAULT REGULATIONS UPDATE BY GRAHAM DAMANT FROM BOWMANS

- Funds and administrators must make enquiries to the employer if no contributions were received in respect of a member to ascertain whether the member has left service to enable the fund to issue paid-up certificates within the prescribed two months.
- The FSCA approved rule amendments that allow for payment of paid-up death benefits into the estate of a paid-up member as well as in terms of section 37C of the Pension Funds Act. The FSCA remarked that their current view is that it must be paid in terms of section 37C and that section 95 of FSRA enables them to revoke those amendments that were registered which allowed for payment into the estate. Although Guidance Note 8 is just a guide, the intention is that all funds must pay paid-up death benefits in terms of section 37C.
- Conduct standards on drawdown rates from living annuities has not been finalised. Funds are only exempt from regulation 39(3) insofar as the drawdown levels are concerned and not from monitoring the sustainability of the income. In the meantime, the limitations in the Income Tax Act will be applicable. The FSCA will issue another draft conduct standard before the final conduct standard is issued.

PENSION FUNDS ADJUDICATOR'S UPDATE

The Pension Funds Adjudicator's (“the Adjudicator”) update centred around the issue of equity in determinations.

- Section 30D of the Pension Funds Act provides that the Adjudicator must, where appropriate, apply principles of equity.
- Equity is about reaching a fair outcome and is not a clear-cut principle and even the courts are grappling with it.
- Before the Adjudicator issues an equity determination she will provide the fund with an opportunity to provide additional information and will alert the fund that she will be taking equity into account.
- She will also start providing guidance in respect of death benefits and will not simply determine that the fund must reconsider their decision.
- Levies are likely to increase as the office of the Adjudicator and the FAIS Ombudsman will share resources. Complaints have doubled and yet they have not increased their staff complement. Recruiting will be necessary to assist with the increase in complaints.
- Where a matter has prescribed, she may refer it to the FSCA for its consideration and simply responding that a matter has prescribed will no longer be good enough.
- There is a concern regarding the status of the FSCA tribunal's decision as the tribunal only has the power to review, but not to set aside the Adjudicator's decision as her decisions have the status of a civil judgment. The Adjudicator has requested a declaratory order from the court where complainants will be forced to approach the FSCA tribunal prior to approaching the High Court.

ADV PIETER VAN DER BERG: **Equity jurisdiction and principles of equity**

The FSRA introduced the requirement that ombudsmen in the financial sector apply the principle of equity, where appropriate. Adv van der Berg made the following remarks regarding this requirement:

- the purpose of legislation is to give certainty;
- stakeholders in retirements funds may approach the Adjudicator and the High Court (and now the FSCA tribunal) if there is uncertainty;
- the Adjudicator is a creature of statute and must therefore apply the law and it cannot be appropriate to deviate from the law;
- it is for example not desirable to have two different outcomes in a particular set of circumstances;
- he quoted from Schorer in 1767 where "Discretion as a substitute for legal law is to be feared (more) than dogs and snakes".

ARABELLA BENNET, LEIGH SEDICE AND JOHAN LOUBSER **discussed governance challenges with the signing of investment contracts**

The speakers suggested that boards of trustees that sign investment contracts should work through an appropriate checklist before entering into an investment contract. To illustrate the difficulty a list of defaults on or changes in terms of contracts in the recent past were shown which included bond contracts of Steinhoff, Eqstra, Umgeni Water, Consolidated Infrastructure Group, PPC. There were also some corporate restructuring where bondholders had no recourse/rights to challenge the restructuring at well-known names like Imperial and Bidvest.

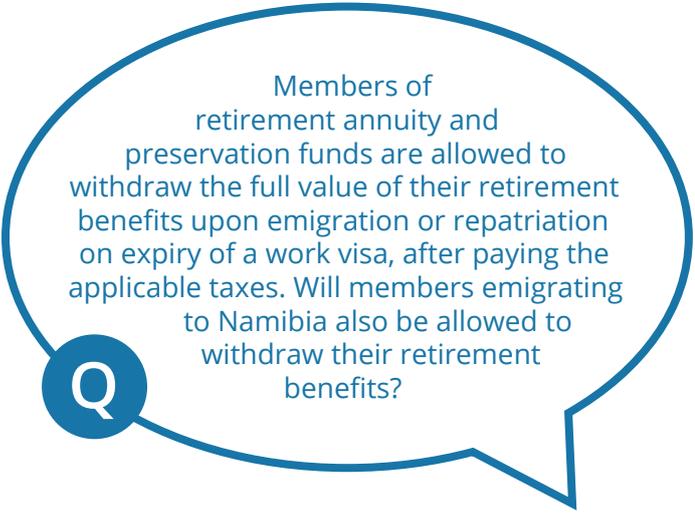
Aspects that need to be considered includes:

- downside protection;
- opaque fee structures;
- the actual investments as opposed to the structure wherein the investments were housed;
- understanding who the counter parties and co-investors are;
- the specifics of investment mandates and exit clauses.

ZUNAID AND ZAIN LUNDELL **discussed class actions and lessons from the Steinhoff debacle**

The complexity of multi-jurisdiction claims, the funding of litigation and use of special purpose vehicles vs direct litigation was discussed. Important principles and differences in principles in the different countries of how directors must take decisions were highlighted. The speakers did not rule out claims against boards of trustees, fund officers and advisers.

Q & A



Members of retirement annuity and preservation funds are allowed to withdraw the full value of their retirement benefits upon emigration or repatriation on expiry of a work visa, after paying the applicable taxes. Will members emigrating to Namibia also be allowed to withdraw their retirement benefits?

A An emigrant is defined in the SARB Guidelines as follows:

Emigrant means a South African resident who is leaving or has left South Africa to take up permanent residence or has been granted permanent residence in any country outside the Common Monetary Areas (CMA).

Members emigrating to a country inside the CMA which include Namibia, Lesotho and Swaziland will therefore not be able to access their retirement annuity or preservation fund benefits as a result of emigration.