SIMEKA

member of Sanlam group

Retirement Matters

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Draft Conduct Standard on Financial Education Initiatives

On 31 March 2023, the FSCA issued the Draft Conduct Standard on Financial Education Initiatives for comments by 15 May 2023, to set requirements for financial institutions when providing consumer education initiatives.

The Draft Conduct Standard defines Financial Education as *"the process by which financial customers improve their understanding of financial products, concepts and risks and, through information, instruction and/or objective advice, develop the skills and confidence to become more aware of financial risks and opportunities, to make informed choices, to know where to go for help, and to take other effective actions to improve their financial well-being"*.

Financial education initiative in turn is defined as *"any financial education programme, or other activity promoting financial education or literacy"*.

According to the accompanying Communication 11 of 2023, financial education initiatives can influence consumers' financial decisions and financial wellbeing and it plays a significant role in advancing financial sector transformation and financial inclusion.

Once it is final, the Conduct Standard will apply to all financial institutions. Retirement funds will therefore need to ensure that, when embarking on financial education initiatives, they comply with the Conduct Standard. Comments were submitted to the FSCA seeking clarity on whether retirement benefits counselling and member communication would be covered by the Conduct Standard and therefore fall within the definition of financial education initiatives.

The Draft Conduct Standard sets out various requirements with which financial education initiatives must comply. The requirements include the following:

- A financial institution must have appropriate governance arrangements in place to oversee the design and implementation of financial education initiatives. There must be systems, processes, policies, and controls in place to ensure appropriate reporting to the FSCA on financial education initiatives, pre and post implementation.
- A financial institution may use any delivery platform for a financial education initiative, provided the delivery platform is appropriate for the type of financial education initiative and the identified target groups, to ensure appropriate and effective reach.
- A financial institution providing virtual financial education initiatives must ensure that the virtual platform is appropriate for this purpose to ensure that the financial education initiative is effective. A financial institution should consider contingency plans for unforeseen circumstances.
- The outcomes of financial education initiatives must be measurable to demonstrate effectiveness and measure impact.
- A financial institution must monitor and evaluate each financial education initiative to assess its effectiveness, identify areas for improvement, and collect data which can be used to promote programme success, encourage positive customer behaviour, influence desired behavioural changes, and contribute to long-term skills development.
- A financial institution may not use a financial education initiative or the learning content thereof for the marketing of a financial product or financial service.
- A financial institution must report information relating to the provision of financial education initiatives to the FSCA. The manner of reporting is not set out in the Draft Conduct Standard, and it is merely stated that the FSCA may determine the medium, form, manner, content, and intervals for reporting by notice on its website.

The final Conduct Standard will come into effect 9 months after the date of publication thereof.

Transformation

- **Employment Equity Act**

The Employment Equity Amendment Act of 2022 (the Act) was signed into law on 12 April 2023 and draft regulations were published under the Act in May 2023 for public comment. It sets out five-year employment equity targets for several specified economic sectors, including the financial and insurance sectors.

The Act applies to all employees and employers who operate in South Africa, except for the South African National Defence Force, National Intelligence Agency, and South African Secret Services. The Act does not apply to retirement funds unless it has people in its employ and therefore operates as an employer.

- **FSCA Strategy for Promoting Financial Sector Transformation**

In terms of the strategy, published on 30 March 2023, the FSCA will be empowered through the Conduct of Financial Institutions (CoFI) Act to set direct requirements for financial institutions relating to transformation, and to supervise compliance with these requirements.

The FSCA recognises that a proportionate approach to transformation is required. The Financial Sector Code already applies a level of proportionality as requirements differ depending on the size of the financial institution and the nature of their business (banking, insurance, asset management, etc). Similarly, the FSCA will apply a proportionate approach to transformation requirements.

The FSCA will provide further guidance on how transformation will be implemented through instruments such as conduct standards and guidance notes. To monitor and track the efforts of the FSCA in relation to transformation, an annual implementation plan will be developed, setting out the activities to be undertaken by different FSCA departments in each financial year, aligned to the transformation strategy. The implementation plan will be updated annually to ensure it remains relevant and can suitably cater for changes in the sector and in the legislative landscape.

- **Financial Sector Transformation Council (FSTC) scorecard**

The Financial Sector Code in terms of the Broad-Based Black Economic Empowerment (B-BBEE) Act, states in Schedule 2 that many aspects of South Africa's B-BBEE dispensation are not relevant to retirement funds. However, funds have a critical role to play in the transformation of the financial sector itself in its appointment of service providers. Retirement funds are therefore encouraged to measure themselves annually against certain aspects of the B-BBEE scorecard in the amended Financial Sector Code. This will also aid in the development of more accurate and transparent barometers on the advancement of transformation imperatives of the financial sector.

Retirement funds are classified as mandated investors in B-BBEE legislation. Boards of management however have little or no influence on membership demographics. For this reason, it is recommended that retirement funds are not scored on the ownership aspect of B-BBEE, but to report annually on the proportion of fund liabilities attributable to black members (disclosure is therefore recommended, although funds will not be measured on it). As a result of the critical role that retirement funds play in the economy, it is recommended that funds annually disclose details related to training spend on board members and principal officers.

Boards of management of retirement funds are encouraged to focus on representation, meaning that the composition of the board should correspond with the membership demographics of the fund.

FSCA deregistration report

The FSCA published a report on the deregistration of inactive funds on 29 March 2023.

The Cancellations Project formed the subject matter of litigation from 2015 to 2018, with various allegations of irregularities and corruption on the part of the retirement funds industry and FSCA (then FSB) officials. All the courts, including the Constitutional Court, ruled in favour of the FSCA. The most recent court application lodged by the Open Secrets and Unpaid Benefits Campaign against the FSCA in 2021, was withdrawn in September 2022.

Given the enormity of the Cancellations Project, mistakes were inevitable but not systemic, and where they were uncovered, they were rectified. The FSCA took steps to enhance its cancellation processes. This is reflected in the internal Special Ad Hoc Project, enhanced internal processes, various Guidance Notices and Circulars, and the requirement to submit Factual Findings Reports as part of the application to terminate a fund.

As part of its supervisory functions and duties, the FSCA continues to engage with administrators, funds, and civil society organisations like Open Secrets. Going forward it will also publish the list of deregistered or reinstated retirement funds and participating employers on its website for transparency.

PWC retirement funds survey

PWC published its Sustainability of Retirement Funds document (Retirement Funds Survey – 7th edition) in April 2023. The findings of the survey are based on responses received from 60 funds, of which 27 were stand-alone funds and 33 were made up of specialised funds (umbrella, preservation, and retirement annuity funds).

Interesting points from the survey:

- On average 4 board of management **meetings** are held per year and those meetings run for an average of 6 hours per meeting.
- According to the survey conducted in 2020, 47% of the participants reported that some or all members of the board were **compensated**. In 2023, this figure increased to 74%.
- Among the survey respondents, an active investment strategy is favoured over a passive investment strategy, with 85% of the participants indicating that the active strategy best describes their fund's investment strategy.
- 92% of participants indicated that their fund's latest investment strategy had taken into account the environmental, social, and corporate governance **(ESG) principles**.
- 11% of the participants indicated that their fund and/or service provider has had a **cybersecurity** threat and/or attack during the most recent financial year of the fund whilst 11% did not know. 66% of the participants indicated that the fund's fidelity cover includes cyber security/data protection, while 36% indicated that the cover is uncapped and 30% indicated that the cover is capped. Where the cover is capped, the cap amount ranged from R100,000 to a maximum of R5 million.

Conditions for investment by retirement funds in derivative instruments

The FSCA on 11 May 2023 issued the final Conduct Standard 1 of 2023 and Communication 14 of 2023 on the conditions for investment by retirement funds in derivative instruments. To balance the benefit with the possible risks associated with investing in derivative instruments, the FSCA now prescribes conditions for retirement funds when investing in derivative instruments as part of its investment strategy.

The Conduct Standard sets out overarching principles for the use of derivative instruments by funds, as well as conditions relating to:

(a) permissible use of derivative instruments;
(b) net derivative positions that should always be covered by appropriate reference assets;
(c) valuation of derivative instruments;
(d) determining the allowable counterparties for purposes of derivative instruments;
(e) providing guidance on the calculation of exposure to derivative instruments;
(f) setting out the allowable netting provisions for derivative instruments;
(g) determining the conditions in respect of collateral; and
(h) prescribing the conditions for reporting.

The Conduct Standard will come into effect twelve months after the publication thereof, therefore on 11 May 2024.

Q&A

Q: Can a member exit from their occupational retirement fund while still in service?

A: No, a member can only exit upon an event as described in the rules of the fund, e.g. resignation, retirement, dismissal, retrenchment or death.

The Income Tax Act in the definition of pension fund and provident fund prevents exit while still in service by stating that *"membership of the fund throughout the period of employment shall be a condition of the employment by the employer of all persons of the class or classes specified therein who enter employment with that employer on or after the date upon which the fund comes into operation; or the employer becomes a participant in that fund"*. Neither the fund nor the employer has a discretion to allow the payment of a benefit to a member who has not actually left service.