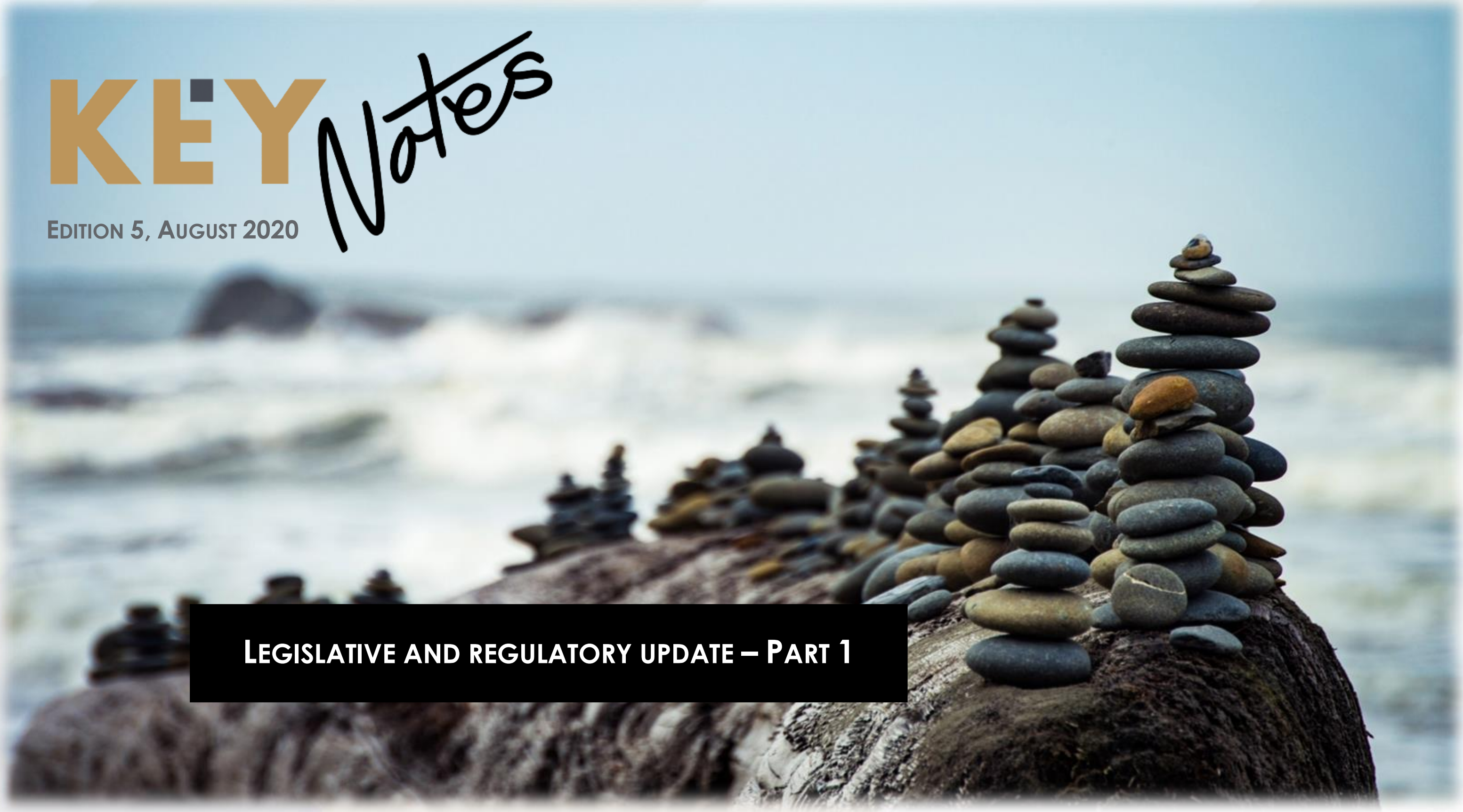

KEYNotes

EDITION 5, AUGUST 2020

LEGISLATIVE AND REGULATORY UPDATE – PART 1

2020 has, thus far, been nothing if not eventful.

In a world trying to find new ways to live and work in the midst of a pandemic, there has been a raft of new legislation, proposed legislation and communication affecting the operation of retirement funds in South Africa.

In fact, there has been so much communication from the regulator over the last few months that we could not do it justice in a single edition of KeyNotes. In order to provide you, our reader, with some respite, we have split what would be a very challenging read into two parts.

Clearly, with so much to cover, we have only provided a brief summary of each issue. Certain issues may be more relevant to some funds than others and significant additional detail may be required. Please contact your Keystone consultant should you wish to engage further on any of these issues.

Part 1 of our legislative and regulatory update deals with the following:

- The Draft Taxation Laws Amendment Bill, 2020;
- FSCA Conduct Standard 4 of 2020 (RF): Minimum skills and training requirements for board members of pension funds;
- Draft Conduct Standard: Requirements related to the payment of pension fund contributions;
- Draft Conduct Standard: Conditions for investment in derivative instruments for pension funds;
- Draft Conduct Standard: Communication of benefit projections to members of pension funds;
- Draft Conduct Standard: Conditions for living annuities in an annuity strategy; and
- Draft Conduct Standard: Conditions for smoothed bonus policies to form part of default investment portfolios.

Part 2 will follow shortly and will cover various Financial Sector Conduct Authority ("*FSCA*") communications and notices.

DRAFT TAXATION LAWS AMENDMENT BILL, 2020

National Treasury released the 2020 Draft Taxation Laws Amendment Bill ("*TLAB*") and the 2020 Draft Tax Administration Laws Amendment Bill ("*TALAB*") for public comment on 31 July 2020.

Whilst there are numerous proposed amendments affecting sections of the various tax acts, the main amendments affecting retirement funds are summarised below:

- **Compulsory annuitisation of provident fund benefits with effect from 1 March 2021:** The compulsory annuitisation of provident fund benefits was written into the Income Tax Act in 2015, but the enabling provisions have been delayed year after year. As it stands, provident fund retirees (allowing for some grandfathering concessions for existing provident fund members) will be required to annuitise 2/3rds of their benefit on retirement with effect from 1 March 2021. Various contextual amendments have been made to the Income Tax Act to formalise this. Importantly, this also means that transfers from pension funds to provident funds will be tax free and has (potentially) material implications for funds established as hybrid arrangements (where members have concurrent membership of a pension fund and a provident fund).

  It is likely that many industry stakeholders believed that the provident fund annuitisation provisions would be delayed again. If this is not the case (and there is no guarantee that the enabling legislation is not derailed between now and 1 March 2021), boards of both pension and provident funds and fund administrators should start preparing to implement the requisite changes to rules, administration systems, member communication, etc.

- **Clarifying deductions in respect of contributions to retirement funds:** A correction has been made to a definition in the Income Tax Act with regard to "own contributions" to retirement funds, back-dated to 1 March 2016.

  This is unlikely to have any impact on the operations of retirement funds.

- **Taxation of un-deducted contributions in a member's estate:** Whilst there is no actual change to the existing tax status, clarification has been made confirming that un-deducted contributions (retirement fund contributions which have not previously enjoyed tax relief) in a deceased member's estate will be taxable if the beneficiaries take the amount in cash, but tax-deductible if the amount is used to purchase an annuity.

  This is unlikely to affect many members as most regular contributions receive full relief in terms of the limit of 27.5% of gross income (subject to a maximum of R350 000) per year.

- **Commutation of living annuities owned by a trust:** The balance of a living annuity may, under the current regime, only be commuted for cash on the death of the annuitant or if the balance in the living annuity account is less than R125 000. The Draft TLAB provides that a living annuity owned by a trust, initially nominated as the owner of a living annuity upon the death of the original annuitant, may be commuted for cash if the trust is dissolved.

  This is unlikely to have any impact on the operations of retirement funds.

- **Withdrawal of benefits on leaving South Africa:** Currently retirement annuity and preservation fund members may withdraw their benefits from these funds on emigration or expiry of their work visa. In future, individuals will have to have ceased to be a tax resident for a minimum period of three consecutive years before they can withdraw such benefits.

  Although this is a highly emotive issue that has been widely reported upon in the press, it is will not have any impact on the operations of retirement funds. It will affect members who intend to emigrate and have benefits in a retirement annuity or a preservation fund.

FSCA Conduct Standard 4 of 2020 (RF): Minimum skills and training requirements for board members of pension funds

Status: Issued by the FSCA by notice in the Government Gazette on 10 July 2020
Compliance deadline: 10 January 2021 for existing board members and within 6 months of the date of appointment for new board members

The FSCA has, for a number of years, been considering how to ensure that board members have the relevant skills, knowledge and training to perform their fiduciary duties. This consideration has been balanced against the need to avoid making such requirements so onerous that they would preclude a large number of individuals from acting as board members.

In this regard, the FSCA issued Conduct Standard 4 on 10 July 2020. The Conduct Standard requires that all board members complete the FSCA Trustee Training Toolkit [1], without assistance and under the supervision of the principal officer or the chairperson of the board (unless there is a good reason not to do so under supervision), within 6 months of the later of the commencement date of the Conduct Standard or the person's appointment as a board member. If the completion of the Toolkit is not done under supervision, the board member will need to sign a declaration stating that they have completed the Toolkit without assistance.

Board members who have previously attained the certification of the Toolkit do not need to re-do this – they will, however, need to sign a declaration stating that they completed the Toolkit without assistance.

Our thoughts: *Existing board members must complete the Trustee Training Toolkit by 10 January 2021. Board members should agree whether or not supervision is required (or, in fact, possible under current circumstances) – if not, declarations that the Toolkit was completed without assistance will be required. Similar declarations will need to be made in respect of board members who completed the Toolkit prior to 10 July 2020.*

Draft Conduct Standard: Requirements related to the payment of pension fund contributions

Status: Issued by the FSCA in draft form (for public comment) on 29 May 2020
Compliance deadline: 90 days after publication in the Government Gazette

The Draft Standard requires that employers provide member contact information and certain other information (which may not currently be provided) on monthly contribution schedules submitted to funds' administrators. Some of this information may not be held centrally by the employer or may not be on standard reports extracted from employer payroll systems. Administrators are required to communicate the requirements to employers (at inception and regularly thereafter) and must match schedules received to those received in the previous month.

The Draft Standard imposes a number of additional onerous disclosure and reporting requirements on the principal officer / monitoring person and the board. These include the requirements that:

- The monitoring person submits a report to the board within a prescribed period following the date on which a contribution statement was due by an employer;
- Contraventions or non-compliance with the requirements of the standard must be brought to the attention of each affected member and the FSCA within prescribed periods; and
- If such contravention continues for a prescribed period, funds are required report such contravention to the South African Police Service.

The Draft Standard also clarifies the calculation of interest to be charged on late payments or unpaid amounts.

[1] This includes tutorials, case studies, formative (initial) assessments and the summative (final) assessment.

In the majority of cases, the new requirements will have no direct implications for members. The requirements should, however, improve communication to members and enable funds to trace members who exit without making a benefit decision. The requirements could, however, have material implications for boards, employers and administrators.

> ***Our thoughts:*** *Some of the data requirements contained in the Draft Standard may require systems development to be undertaken either by administrators or employers or both. We all know that such development takes a significant amount of time (and the timeframe for compliance from the date of publication is unlikely to be sufficient). It would, therefore, be prudent for boards to (i) consult with their administrator to determine whether there is a process in place to ensure compliance and (ii) sensitise employers to the potential process and data requirements well in advance of publication of the Standard.*

Although we understand that many industry stakeholders have submitted comments to the FSCA in relation to the Draft Standard, it is unlikely that material changes will be made prior to enactment (especially not in relation to the data requirements).

DRAFT CONDUCT STANDARD: CONDITIONS FOR INVESTMENT IN DERIVATIVE INSTRUMENTS FOR PENSION FUNDS

Status: Issued by the FSCA in draft form (for public comment) on 8 June 2020
Compliance deadline: 6 months after publication in the Government Gazette

Where funds invest in derivative instruments, such investment must meet a number of prescribed restrictions, including their use, the amount that may be held, their valuation, acceptable counterparties, etc.

> ***Our thoughts:*** *Once published, Boards should consult with their investment consultant and / or investment managers to ensure that investment mandates are aligned to the requirements of the Standard and that use of derivatives by investment managers does not contravene such requirements.*

DRAFT CONDUCT STANDARD: COMMUNICATION OF BENEFIT PROJECTIONS TO MEMBERS OF PENSION FUNDS

Status: Issued by the FSCA in draft form (for public comment) on 8 June 2020
Compliance deadline: 6 months after publication in the Government Gazette

> The initial version of this Draft Standard was issued in March 2018. This updated draft takes account of comments received from stakeholders in the initial round of comments. It is, however, not materially different from the previous version and many of the material concerns which we had with the previous draft remain in the current draft.

The purpose of the Draft Standard is to compel funds to provide benefit projections to members [2] on entry to the fund, annually thereafter and on withdrawal from the fund.

The benefit projections must contain certain prescribed information and the assumptions used in the benefit projections must be within prescribed limits. We believe that the provision of benefit projections to members is critical to empower such members to take responsibility for their financial wellbeing, i.e. they may assist members in making better contribution level decisions, investment decisions and may encourage preservation on exit.

[2] This has been defined quite widely and includes in-service defined benefit and defined contribution members, paid-up members and in-fund living annuitants

As such, we believe that the principles underlying the Draft Standard are sound and that standardisation of assumptions is desirable (it allows the comparison of benefit projections if a member has benefits in more than one fund). Our main concern with the Draft Standard (which was also the case with the previous version) is that certain of the assumptions are, in our view, conservative rather than realistic and will, in most cases, not align to targeted fund portfolio returns. This means that the message to members may become confusing.

Our thoughts: *Many funds provide an annual projection statement to in-service DC members. Fewer funds currently provide projections on entry and on exit of members or to paid-up and living annuity categories. Although some of the assumptions may change prior to publication of the Standard, it is unlikely that the requirements to provide projections to different member categories and on different life events will change. As such, boards could start to consider how benefit projections will be performed and delivered to members following publication of the Standard.*

DRAFT CONDUCT STANDARD: CONDITIONS FOR LIVING ANNUITIES IN AN ANNUITY STRATEGY

Status: Issued by the FSCA in draft form (for public comment) on 8 June 2020
Compliance deadline: 6 months after publication in the Government Gazette

The purpose of the Draft Standard is to prescribe the requirements which must be met in order for a board to include a living annuity as part of its annuity strategy in terms of Regulation 39 to the Pension Funds Act, 1956 ("*the Act*"). Such requirements include:

- General conditions, such as suitability and appropriateness;
- The requirement to measure and provide information to living annuitants on the sustainability of their selected draw-down rate;
- Monitoring and communication requirements;
- The requirement to recommend that living annuitants draw-down at a specified rate dependant on their age; and
- The requirement to limit the draw-down rates to age-relate maxima.

The initial version of this Draft Standard was issued in November 2018. This updated draft takes account of comments received from stakeholders in the initial round of comments. A number of material changes have been implemented, specifically in relation to maximum allowable draw-down rates.

The prescribed "recommended maximum" and "maximum" draw-down rates per age-band, as reflected in the Draft Standard, are set in the table below:

Age	Recommended maximum draw-down	Maximum draw-down
55	4.0%	6.5%
60	4.5%	7.0%
65	5.0%	8.0%
70	5.0%	8.0%
75	5.5%	8.5%
80	6.0%	9.5%
85	7.0%	11.5%

Our thoughts: We do not believe that comments submitted by industry stakeholders will result in material changes to the Draft Standard. As such, boards which have selected a living annuity as part of their annuity strategy could start considering the requirements of the Draft Standard and how compliance will be achieved following its publication.

Our main concern with the above is that maximum draw-down rates may be viewed as too restrictive and will drive members from well-managed, cost-effective living annuities to those outside of Regulation 39 compliant annuity strategies (which are often more costly). This is a very bad outcome and can only be resolved by the regulator levelling the playing field between Regulation 39 compliant and non-compliant living annuities (which is exceedingly unlikely to happen, at least in the short-term).

Draft Conduct Standard: Conditions for smoothed bonus policies to form part of default investment portfolios

Status: Tabled in parliament on 24 June 2020
Compliance deadline: 9 months after publication in the Government Gazette

Funds which intend to have a smoothed bonus portfolio in their default investment portfolio (as defined in Regulation 37 to the Act), must ensure that the smoothed bonus portfolio meets various prescribed requirements, as set out in the Conduct Standard.

***Our thoughts:** Boards which have selected a smoothed bonus product as part of their default investment strategy must obtain certification from the investment manager that such product complies with the requirements of the Standard (or, alternatively, will be made fully compliant within nine months of the publication of the Standard.*

If you have any questions or would like more information on how the above may affect your retirement fund, please contact your Keystone consultant directly.

Please note

KeyNotes is a Keystone publication and provides general information of relevance to the Boards of retirement funds. It is not intended to be used as a substitute for specific professional advice (including, but not limited to, legal or tax advice). Each retirement fund's specific circumstances may be different and this publication does not take such specific circumstances into account – as such, it may not be relevant (or appropriate) in all circumstances. It should, therefore, not be used to form the basis of any decision, without specific advice relating to that decision. Keystone accepts no responsibility or liability to any party for any consequences arising from reliance placed on this publication, or on the opinions expressed herein. KeyNotes is prepared for our clients. It may not be reproduced or distributed to any other party without our prior written consent.