

# On the Move

## Regulatory and legislative feedback

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**momentum**

corporate



### **The new proposed two-pot retirement system**

The intention was for the second draft Tax Bill to be issued with the Minister of Finance's Medium Term Budget Policy Statement on 26 October 2022, but it didn't happen. The second draft Tax Bill was expected to detail the amended and additional proposals to the two-pot system from the comments received on the first draft Tax Bill. National Treasury verbally confirmed in November 2022 that the second draft Bill was being delayed due to three outstanding policy issues that had to be resolved. These are:

- the mechanism which will allow members to have immediate access to a certain portion of their retirement savings when the two-pot system is implemented.
- how the two-pot system must be applied in defined benefit funds.
- how the two-pot system must be applied in legacy retirement annuity funds. These are retirement annuity funds where the member has a guaranteed benefit at a determined age like a defined benefit fund. In most instances these guaranteed benefits were bought with a lump sum and the member is not making any contributions to the retirement annuity fund.

To date there has been no further progress on issuing the second draft Tax Bill and we will keep you informed on any progress.

### **Conditions for investment in derivative instruments for retirement funds**

Derivatives are financial instruments which derive their value/price from underlying assets. In South Africa, most derivatives traded can be divided into two classes of financial instruments, namely options and futures. The Financial Sector Conduct Authority (FSCA) recognises that although there is a place for the use of derivatives within funds' investment portfolios, there are several major risks inherent in these instruments, eg market transparency and liquidity risk. For this reason, derivative investments require closer monitoring, analysis and more intense supervision than most traditional investment products. To make sure this happens, the FSCA drafted a Conduct Standard which aims to set the overarching principles and parameters for the use of derivative instruments by funds. The FSCA has submitted the Draft Conduct Standard to Parliament for approval. Funds that have derivative instruments in their investment portfolios will have to comply with all the conditions within 12 months after the final

Conduct Standard is published. Any Conduct Standards issued by the FSCA is legislation and must be followed.

## **Requirements for the payment of contributions**

The FSCA issued a new Conduct Standard on 19 August 2022 on the requirements relating to the payment of pension fund contributions. The Conduct Standard will be effective from 19 February 2023 and will replace Regulation 33 of the Pension Funds Act. It sets out the new:

- Minimum information an employer has to provide to a fund for the payment of contributions.
- Notification and reporting obligations of the fund's trustees and monitoring person where there is non-compliance with section 13A by an employer.
- The interest rate payable by an employer on arrear contributions.

Momentum Corporate, the administrator of the FundsAtWork Umbrella Funds (the Funds) have already made the necessary system and process changes to comply with the new requirements. The Funds' current credit control procedure has also been aligned to the new Conduct Standard. The Funds have [communicated](#) the new requirements to all their participating employers so that they can adjust their payroll systems, if required, to comply with the new Conduct Standard.

The FSCA is looking at ways to address section 13A contraventions more proactively. One of these is to name and shame participating employers who default by publishing their names on the FSCA's website, as well as the funds who fail to report the non-compliance of these employers to members and the FSCA. The FSCA issued a communication on 9 June 2022, where they requested funds to alert all participating employers of the FSCA's proposed action. All participating employers were advised of the FSCA's proposed action in [June 2022](#), and the FSCA verbally advised industry bodies that they will start publishing the names of all non-compliant employers from early 2023.

## **Unclaimed assets**

The FSCA issued a discussion document on 21 September 2022 on the different types of unclaimed assets in the financial services industry, which included unclaimed retirement benefits. Comments on the discussion document were required by 30 November 2022. The FSCA indicated that they will start with industry discussions and engagement in early 2023 on the comments they received. Some of the noteworthy proposals made in the document are:

- A single central unclaimed assets fund will be established, and all retirement funds will be forced to transfer their unclaimed benefits to this central fund.
- Owners of unclaimed assets will have the right to reclaim the value of the assets at the point of transfer into the central fund, and any accrued interest between the date of transfer and the date of reclaim. There will be no expiry date for a claim and members and beneficiaries may claim their unclaimed asset at any time.
- For unclaimed benefits below a certain minimum prescribed limit, a fund will not be required to actively trace the members or their beneficiaries.

- Given the costs of tracing unclaimed benefit members and beneficiaries, an unclaimed benefit below a prescribed threshold will immediately be considered untraceable and go into the central unclaimed assets fund. It is proposed that the initial threshold amount is R1 000 for unclaimed benefits from a retirement fund that is older than 20 years, and R100 for all other unclaimed assets.
- An actuarially estimated unclaimed benefits pool that can meet the expected claims will be provided for in the central unclaimed assets fund. The remaining or surplus funds in the central unclaimed assets fund will be invested in initiatives that will have a positive impact, eg social, environmental, and developmental initiatives. Where the unclaimed benefits can generally be linked to specific geographic regions and communities in which the contributing retirement fund members lived and worked, the actuarially allocated amounts may be invested in those regions and communities through social impact funds. The social impact funds will be required to support infrastructure development, like schools and clinics within those regions and communities.
- Given the high number of unclaimed benefits in a few retirement funds, as the first phase, funds with a total of more than R500 million in unclaimed benefits, or funds with average unclaimed benefits per beneficiary exceeding R45 000 will be prioritised.

We provided extensive input to the discussion paper, and we will keep you informed on any progress.

### **Cybersecurity and cyber resilience requirements**

The draft Joint Standard on Cybersecurity and Cyber Resilience Requirements sets out the minimum standards for sound practices and processes of cybersecurity and cyber resilience for certain financial institutions like retirement funds. The first draft Standard issued in 2021 did not include administrators. After receiving comments that where a retirement fund uses a third-party administrator, the IT systems belong to the administrator, the scope of the Standard was broadened to also include administrators. The second draft Standard that was published in December 2022 includes administrators.

Although retirement funds are using their administrators' IT systems, some of the important requirements for funds are that:

- The trustees must ensure that roles and responsibilities for security are clearly defined in the service agreements with third-party service providers like its administrator.
- Funds must establish and maintain a cybersecurity strategy that is approved by the trustees. The trustees must review the fund's cybersecurity strategy regularly, but at least annually, to address changes in the cyber threat landscape, allocate resources, identify, and remediate gaps, and incorporate lessons learnt.
- The FSCA will as part of their supervisory programmes, review and assess the adequacy of funds' policies, processes, and practices related to cybersecurity and cyber resilience.
- Funds will have to notify the FSCA of cyber incidents or information security compromises.

A Joint Standard issued by the FSCA, and the Prudential Authority is legislation and must be followed.

## **Information technology risk management**

The first draft Joint Prudential Authority and FSCA Standard prescribing the requirements that a financial institution must comply with for information technology risk management, stated that it will not also be applicable to retirement funds. The FSCA has indicated that it was decided, because of the comments received on the draft Joint Standard on Cybersecurity and Cyber Resilience Requirements, that this Joint Standard will be amended so that its provisions and requirements also apply to retirement funds.

Amending the Joint Standard at this stage to include retirement funds, will constitute a significant change to it, and will require another round of public consultation. That will delay the finalisation of the Joint Standard and is something the FSCA wants to avoid. The FSCA indicated that only after the final Joint Standard is published, it will be amended to include retirement funds. The finalisation of this Joint Standard is high priority and the FSCA has provided its final input to the Prudential Authority for consideration. After that it will be submitted to parliament for approval.

## **Financial statements**

Board Notice 77/2014 sets out the prescribed financial statements that apply to the different categories of retirement funds. A draft Prudential Standard was published on 9 November 2022 which will, once finalised, replace the Board Notice in total. The draft Prudential Standard incorporates the Independent Regulatory Board for Auditors' (IRBA) two new revised illustrative auditor reports into the prescribed format for preparing financial statements. The FSCA is of the opinion that the financial statements of **all** funds must be audited, irrespective of size, to ensure that they can effectively oversee funds.

It is proposed in the draft Standard that the existing exemption granted to specific funds should be removed. These funds are generally funds with:

- assets of less than R6 million, exempting them from the requirements to appoint an auditor, and
- assets of less than R50 million exempting them from having their financial statements audited and reported on by an auditor.

Certain new information will also have to be provided in the Schedules to the financial statements, for example, trustee statistical information, like race and gender, and the deputy principal officer's expenses. The Standard will come into effect six months after the final Standard is published.

Because of the added audit expenses that this Standard will introduce, it could encourage funds, especially those with assets below R6m, to move to umbrella funds like the FundsAtWork Umbrella Funds.

## **Regulation 28 developments**

Regulation 28 was revised in July 2022 to provide for among others, these changes from 3 January 2023:

- Provision is made for infrastructure investments whether developed for the economy, a business (private sector), or the public sector.

- The inclusion of crypto assets in a fund's investment portfolio are prohibited.
- The limit of housing loans granted to members have been reduced from 95% to 65%. The new limit applies from 1 September 2023 for loan guarantees entered on or after this date. The FundsAtWork Umbrella Funds limit members' housing loan guarantees to 60% of the value of the member's retirement benefit that can be taken in cash when resigning or retiring.
- Funds may only invest in hedge funds structured as collective investment schemes (CIS).
- Previously, an overall aggregate exposure per entity of 25% for only South African cash instruments and debt instruments issued or guaranteed by a South African bank against its balance sheet was allowed. The overall aggregate exposure per entity of 25% will apply to **all** asset categories specified in Table 1 of the Regulation. It will exclude any debt instruments issued by, and loans to government and any debt or loan guaranteed by government. For that reason, it is very likely that most funds will exceed the 25% limit from 3 January 2023.
- All Regulation 28 compliant portfolios, which include Regulation 28 compliant CIS portfolios and life insurance policies (ie fund policies), as well as hedge funds and private equity funds which include infrastructure assets, will have to apply the look-through principle.

The FSCA issued a draft Prudential Standard on Regulation 28 quarterly reporting on 4 November 2022. The deadline for the 31 March 2023 quarterly report is 30 September 2023. For all subsequent quarters, the report must be submitted within 90 days after the end of the quarter. This allows approximately 9 months in 2023, for the necessary systems to be developed and alignment for compliance to the Standard. Some of the new proposals in the draft Standard are:

- The Regulation 28 changes which came into effect on 3 January 2023 require additional reporting requirements for infrastructure assets and other amendments to the asset spreading requirements. The Regulation 28 quarterly reports for funds must be updated in line with these amendments.
- All funds must report on compliance **and** non-compliance with Regulation 28 by submitting a quarterly report to the FSCA. Previously funds only had to report on non-compliances.
- A new trustee declaration/confirmation must be made confirming that the fund did/did not exceed the aggregate foreign exposure determined by the South African Reserve Bank (SARB).
- Matters related to environmental, social and governance (ESG) issues must now be reported on, for example:
  - Does the fund have an investment policy statement that includes ESG integration?
  - Does the fund have a specific policy that supports green/climate investment?
  - What is the amount of the fund's exposure to green, social or sustainability themed bonds?

- Does the fund's investment policy statement include details on how the fund intends to monitor, evaluate, and make strategic decisions about the ongoing ESG sustainability of the assets which it owns and intends to acquire?

### **Minimum skills and training requirements for trustees**

The Pension Funds Act requires that a trustee must not only reach certain levels of skills and training within 6 months after they are appointed as prescribed by the FSCA but must also maintain such skills and training throughout their term of office as a trustee.

The FSCA issued a Conduct Standard in 2019 where they prescribe the Trustee Toolkit they developed, as the minimum skills and training requirements for trustees. The FSCA is currently in the process of finalising phase 2 of the Trustee Toolkit, which intends to cover more topics and include more questions. The FSCA advised that the first 11 modules of the second phase will be rolled out in the latter part of 2023 and the next 11 modules in 2024.

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