

Legal & Industry Updates

A. FSCA Guidance Notice 1 of 2019: Sustainability of Investments and Assets in the Context of a Retirement Fund's Investment Policy Statement

Regulation 28 of the Pension Funds Act [Regulation 28(2)(b) and Regulation 28(2)(c)(ix)] promotes responsible investing of fund assets. It also requires funds to have an investment policy statement ("IPS") which considers Environmental Social Governance ("ESG") aspects in funds' investment strategies. These requirements have been in place for many years, without concrete guidance from the authorities on their roll out.

The FSCA (then FSB) issued a draft directive in March 2018 on this matter. This draft directive was not finalised. The FSCA thereafter decided that a guidance notice was the more appropriate and flexible instrument in which to incorporate the content of this draft directive. The FSCA has therefore issued a final Guidance Notice on 14 June 2019, taking into account feedback received on the aforementioned draft directive. It is worthy to note at this point that FSCA guidance notices are not binding on retirement funds, as opposed to directives, which are binding.

This Guidance Notice sets out the sustainability considerations that funds' boards should be disclosing in their IPS. Specifically, a fund must consider any factor which may materially affect the sustainable long-term performance of the assets, including ESG factors. The Guidance Notice also covers fund reporting and disclosure to members.

The specific requirements of retirement funds as set out in this Guidance Notice are summarised below:

- ☐ **IPS contents.** A fund's IPS should cover:
 - When the IPS was approved and by whom
 - How often the IPS is reviewed
 - The extent to which ESG factors have been considered
 - How the fund will monitor and evaluate the ongoing sustainability of the assets it owns and which it is intending to acquire, including the extent to which ESG factors have been considered by the fund, and the potential impact on the assets of the fund
 - If a fund invests in assets that limit the application of ESG, active ownership or sustainability, the IPS should state why this limitation is in the best interest of the fund and its members. Alternatively, the IPS should set out the remedial action the fund has taken or intends taking to rectify the position or the reasons why no remedial action is being considered or taken.
- ☐ **Disclosure.** In the interest of transparency, accountability and fair treatment of members, funds are encouraged to:
 - Make a copy of the IPS or an abridged version of it available to members at no cost. If an abridged version is provided, it will be acceptable if it only reflects those assets relating to the specific category of members, but the sustainability considerations in relation to those assets should preferably be included

- Place the IPS on the fund's website (if the fund has one)
- Annually inform stakeholders of the contents of the IPS and changes to it.
- ❑ **Reporting.** Funds are encouraged to include feedback on the IPS and compliance with the Guidance Notice in their annual financial statements. That feedback should include:
 - Confirmation that members who asked for a copy of the IPS received it
 - Any significant changes in its IPS during the reporting period, specifically changes relating to sustainability considerations
 - Assets held in compliance with this Guidance Notice and the class of such asset as per schedule I of the financial statements
 - The value of the assets held in compliance with this Guidance Notice.

B. FSCA Notice Regarding the Publication of the Draft Conduct Standard: Minimum Skills and Training Requirements for Board Members of Pension Funds

Section 7A(3)(a) of the Pension Funds Act requires that fund board members must attain such levels of skills and training within six months after the board member's appointment, as may be prescribed by the FSCA. Section 7A(3)(b) further determines that board members must maintain their skills and training throughout their term of appointment.

The FSCA issued a draft Conduct Standard in May 2019, for comment. It proposes that the Trustee Toolkit as provided by the FSCA on the website: www.trusteetoolkit.co.za, be prescribed as the minimum skills and training requirement as envisaged in section 7A(3)(a) of the Act.

The most important points of this draft Conduct Standard are summarised below:

- ❑ The Conduct Standard will become effective from 1 January 2020
- ❑ Trustees appointed before 1 January 2020 must complete the Trustee Toolkit by 30 June 2020
- ❑ Trustees who successfully complete the Trustee Toolkit before 1 January 2020 are not required to complete the certification again
- ❑ Trustees must complete the Trustee Toolkit within 6 months of becoming a trustee. This is in addition to further skills and training from credible providers as deemed necessary by the board. (Clarity is being sought by the industry from the FSCA on the consequences for trustees who do not complete Trustee Toolkit within this 6-month period as well as clarity as to what constitutes a "credible provider" and who determines this)
- ❑ The Trustee Toolkit includes two types of assessment:
 - Completion of tutorials, case studies and formative (initial) assessment; and
 - Completion of a summative (final) assessment under the supervision of the principal officer or chairperson of the board to ensure that it is completed without assistance
- ❑ Trustees will be required to complete additional prescribed modules under the supervision of the principal officer or the chairperson of the board, as and when the Authority amends the Trustee Toolkit. Clarity has been sought from the Authorities on the timeframe that will apply for the completion of the additional modules.

C. Draft Taxation Laws Amendment Bill, 2019: Aligning the Effective Date of Tax Neutral Transfers Between Retirement Funds with the Effective Date of all Retirement Reforms

On 10 June 2019, National Treasury published an initial batch of the 2019 draft Taxation Laws Amendment Bill. In this, the effective date of tax neutral transfers between retirement funds is aligned with the effective date of retirement reforms.

The Taxation Laws Amendment Act, 2018 postponed the effective date for the annuitisation of provident funds from 1 March 2019 to 1 March 2021. In making changes to the effective dates, one change to paragraph 6(1)(a) of the Second Schedule to the Income Tax Act was left out. This makes provision for tax neutral transfers between retirement funds. The earlier effective date of 1 March 2019 for the tax neutral transfers from pension to provident or provident preservation funds creates a loophole, as the Authorities' intention was to align the effective date of the tax neutral transfers from pension to provident or provident preservation funds with the effective date of retirement reform amendments, which is 1 March 2021.

Once promulgated, the proposed amendment will be deemed to have come into operation on 1 March 2019.

D. Supreme Court of Appeal Ruling: Date on Which Funds Must Determine Whether Beneficiaries Were Dependent on Deceased Members

In the recent Supreme Court of Appeal case in *Fundsatwork Umbrella Pension Fund v Guarnieri and Others*, this court ruled on how funds identify dependants for the purpose of distributing death benefits. In the past, funds have generally assessed whether any potential beneficiaries were financially dependent on deceased members as at the date of such members' death. However, this case indicates that it is important to assess the circumstances of the deceased's beneficiaries in the period shortly before death benefit distributions are concluded.

A summary of this case and the Court's important findings are set out below:

- The trustees' investigation into the deceased's beneficiaries' financial dependency on the deceased, was based on the extent of their financial dependency at the date of the member's death
- The benefit was allocated to the deceased's wife, mother and two children
- The deceased's mother died four days before the trustees made their decision and her allocation would have been paid into her estate and distributed in accordance with her will to her surviving daughter
- The deceased member's wife lodged a complaint with the Pension Funds Adjudicator, requesting that her late mother-in-law's allocation be re-distributed to her and her two children. The Adjudicator instructed the Fund to re-investigate its distribution. The Fund reached the same decision
- The deceased's spouse and her children took the matter on appeal to the High Court. The High Court ordered that the amount allocated to the deceased's late mother be re-distributed to the deceased's spouse and children
- The Fund took that decision on appeal. The Supreme Court of Appeal reached the same conclusion as the High Court
- Furthermore, the Supreme Court of Appeal stated the following important points as part of its ruling:
 - The definition of 'dependant' in the Pension Funds Act uses past, current and future tenses in different scenarios, which the Court concluded was written carefully and deliberately
 - Looking at the language, purpose and practicality of section 37C of the Pension Funds Act, the Court stated that the time to determine dependency is when the death benefit distribution decision is made. **Any beneficiary must still be a beneficiary when the decision is made**
 - The court concluded that one cannot read into the definition of dependant the phrase "at the date of the death of the member"
 - The court took into account that 12 months, as set out in section 37C of the Pension Funds Act, could elapse between the date of death and the date of distribution. Much could happen in that period to change a potential dependant's situation, which must be taken into account by fund trustees, before finalising death benefit distributions.

This case implies that consultation with beneficiaries shortly before finalising death benefit distributions is of paramount importance, in order to ensure that the circumstances of such beneficiaries have not changed.