GO Benefits

Edition 44: January 2022

Industry Updates

A. FSCA's Three-year Regulatory Strategy Document

The Financial Sector Conduct Authority (FSCA) has released its Regulatory Strategy document which outlines its key priorities for the next three years, as is required by the Financial Sector Regulation Act (FSRA). The inaugural FSCA Regulatory Strategy was published in October 2018, covering the three-year period ending in September 2021. The FSCA's revised strategy is applicable from 14 December 2021 to 31 March 2025.

The strategic objectives and outcomes of the next three years are aligned with the FSCA's Strategic Plan (2020-2025) and Annual Performance Plans, based on the financial year starting at 1 April of each year. These are set out in the table below:

Update on the "Two-Pots System" to allow partial withdrawals from retirement savings before retirement

National Treasury released a discussion paper entitled "Encouraging South African households to save more for retirement" on 14 December 2021, discussing the "two-pot system", which will enable the restructuring of retirement contributions into two-pots.

There are no substantial conclusions in this paper and comment from industry on the ideas floated in this paper is sought by 31 January 2022. Government has stated in this paper that it is their intention to publish draft legislation on this proposal in line with the 2022 Budget process, which will take into account the comments received from industry.

	Strategic Objective	Intended Outcomes
1.	Improve industry practices to achieve fair outcomes for financial customers	❑ Good conduct and Treating Customers Fairly (TCF) principles embedded consistently across the financial sector ❑ Conduct risks mitigated
2.	Act against misconduct to support confidence and integrity in the financial sector	❑ Trust in the financial sector maintained
3.	Promote the development of an innovative, inclusive, and sustainable financial system	❑ Transformation in the financial sector supported ❑ Financial inclusion of low-income households and small businesses deepened ❑ Greater competition and contestability in the financial system enabled ❑ Sustainable finance and investment in the financial sector fostered
4.	Empower households and small businesses to be financially resilient	❑ Financial customers able to make better and more informed financial decisions
5.	Accelerate the transformation of the FSCA into a socially responsible, efficient, and responsive organisation	❑ Operational excellence embedded across all functions of the FSCA ❑ FSCA is recognised and trusted by financial institutions, financial customers, and other financial sector regulators in South Africa and internationally

B. National Treasury Discussion Paper: Governance of Umbrella Funds

National Treasury published a discussion paper on 14 December 2021 entitled 'Governance of umbrella funds', which seeks to improve governance in retirement funds, with a particular emphasis on commercial umbrella funds.
Comments from industry on this paper have been requested, with a deadline of 31 January 2022. A summary of this discussion paper is set out below.

National Treasury's Concerns with Umbrella Funds

- The board of commercial umbrella funds are not truly independent both because it has limitations in respect of the service providers used and because at least half the board includes trustees who are in the employment of the sponsor. National Treasury stated in their paper that is very difficult to expect an employee of the sponsor to act as a truly independent trustee if the consequence of such actions would be career limiting
- The sponsor establishes the fund on the basis that the services provided by the sponsor will be used exclusively by the commercial fund. National Treasury has stated in their paper that trustees of these commercial umbrella funds generally have no power to fire such service providers, the terms of engagement of which (including their charges) are not negotiated at arm's length because the board is not truly independent and is also not at liberty to choose a different service provider. National Treasury has stated further in this discussion paper that it seems there has recently been a shift from a one-stop-shop approach of in-house service providers
- Difficulties arise in umbrella funds where some employers are delinquent in paying their contributions. Administrators have recourse against the employer in these circumstances, but may be reluctant to take such action where retaining the employer's business is a conflicting commercial interest
- The structure of charges is not standardised across all retirement products, making it difficult to compare costs across various service providers.

National Treasury has stated in their discussion document that fees disclosures by both providers of financial products and services to their clients and by retirement funds to their members and participating employers is generally poor and is not required by law to be facilitated in a way that enables cost comparisons and competition

- Potential umbrella fund providers may face barriers to entry due to the high up-front costs in setting up commercial umbrella funds (leading to reduced commercial umbrella fund choice in the market)
- Participating employers may be discouraged from switching between commercial umbrella funds by barriers (eg, fund rules that prohibit an employer from exiting the fund or unwillingness to spend the time and effort on research in respect of other cost-effective umbrella fund providers, resulting in inertia and the failure to switch out of poorly performing funds).

Policy Options for South Africa

- National Treasury has retained their support for umbrella funds. However, they have stated that the effectiveness of the current commercial umbrella fund model appears to be compromised by the barriers discussed above
- Government is to come up with policy options to strengthen the governance of umbrella funds, in order to ensure that member interests are upheld, employers are made active purchasers of retirement funds and that the degree of competition in the market is increased.

Principles of Good Governance

The FSCA is looking to introduce the following:

- Board members, including independent ones, should not belong to more than three (3) boards in any year, including membership of company boards, so that they are not spread too thinly.

Comment: it is not clear as to whether or not principal officers are included in this proposed provision

- Independent board members should not be contracted as consultants / service providers to the same fund that they serve as trustees.

Structural Solutions

- National Treasury supports an auction system, similar to that used in Chile, to be conducted under the auspices of the FSCA to enable funds to select and appoint default 'consolidation' or auto-enrolment funds when they need them, that would include the sponsor as a tenderer in service provision. For example:
  - A central auction mechanism (via a dedicated portal) could be set up for trustees of small funds, which do not meet value for money or other criteria to continue in operation, to request bids from existing funds to take over their scheme
  - Only schemes meeting certain strict hurdle requirements would be allowed to bid for these closing funds - possibly on a 'blind', but certainly standardised, basis to allow for comparison
  - Criteria for awarding the winning bid could also be set by the Regulator. Alternatively, the Regulator could establish a regular auction (with set criteria) between umbrella funds bidding to become the default 'consolidation' fund for a set period
  - An auction system could also potentially be used to be the default provider under any auto-enrolment system.
- Further, it is proposed that independent governance committees be formalised and should have minimum standardised functions. The paper sets out suggestions for these government committees, as follows:
  - Conduct ongoing value for money of the umbrella fund as shall be prescribed
  - Assist the umbrella fund with updates to member data, ensure that contributions are paid over to the fund, process death benefits with the fund, provide updates to members on fund and recommend amendments to benefit structures
  - The transfer of funds based on value for money calculations should be at a low cost and no prohibitions to transfer funds will be permitted
  - Given the large fund membership of umbrella funds, the FSCA should supervise all types of umbrella funds more closely and regularly.

Greater Transparency to Influence the Level of Costs and Charges

- National Treasury has stated in this paper that introducing measures to improve transparency regarding costs could improve comparison among products and improve outcomes. As such, they are considering a disclosure-based initiative that would require umbrella funds to provide information on their cost structures
- Template rules for umbrella retirement funds in each category of retirement fund are to be written in plain language, published by the FSCA and required to be adopted by each umbrella fund on a 'comply or explain' basis by means of an on-line application mechanism in which fund specific details are entered on-line into the template rules
- No 'lock-in' provisions should be allowed in the rules or agreements with the umbrella funds' service providers
- Service and product providers should be required to compete for providing their products and services to commercial funds on an 'arm's length' basis, rather than being able to rely on their 'captured clients' to buy them. This should improve umbrella funds' prospects for providing 'fit for purpose' and 'value for money' benefits for their members and beneficiaries
- The rules of the fund must not include any provisions which are a barrier to the appointment terminations of the sponsor or a party related to it as a service provider to the fund
- The rules should be capable of being amended without the consent of the sponsor, unless the amendment may expose the sponsor to financial risk that would not be imposed on another entity of a similar nature if it was to replace it as sponsor on the effective date of the amendment
- More detailed reporting and disclosure standards applicable to retirement funds in various categories could be useful in promoting transparency, accountability, and comparability.

CONTACT US
GO Benefits:
info@gobenefits.co.za
FAIS licence number: 46820