

FSCA GUIDANCE NOTICE 2 OF 2020 (RF)

PENSION FUNDS ACT, 1956

FINANCIAL SECTOR REGULATION ACT, 2017

**GUIDANCE NOTICE ON THE APPLICATION OF SECTION 7C(2)(f) OF THE
PENSION FUNDS ACT, 1956 READ WITH SECTION 2 OF THE FINANCIAL
INSTITUTIONS (PROTECTION OF FUNDS) ACT, 2001**

1. PURPOSE OF THE GUIDANCE NOTICE

The purpose of this guidance notice, which is published by the Financial Sector Conduct Authority (“Authority”) in terms of section 141 of the Financial Sector Regulation Act, 2017 (No. 9 of 2017) (“the FSR Act”), is to provide guidance on the requirements in terms of the Pension Funds Act, 1956 (Act no. 24 of 1956) (“PFA”) and the Financial Institutions (Protection Of Funds) Act, 2001 (Act No. 28 of 2001) (“FI Act”) pertaining to the expectation of the boards of retirement funds when they consider releasing a proportion of the assets backing unpaid surplus liabilities.

2. BACKGROUND

2.1 On 2 November 2020 the Supreme Court of Appeal of South Africa (“the SCA”) declared Regulation 35(4) under the PFA invalid in the matters of *Hortors Pension Fund v Financial Sector Conduct Authority and Another, Southern Sun Group Retirement Fund v Registrar of Pension Funds and 3 Others* and *Vrystaatse Munisipale Pensioenfonds v Minister of Finance and 3 Others*. These appeals followed various cases in the Gauteng Division of the High Court where judgment (“judgment”) was in favour of the Authority, upholding the validity of Regulation 35(4) made in terms of section 36 of the PFA.

2.2 These cases and the SCA judgment, deal with the validity of Regulation 35(4) which provided that where boards of retirement funds are able to determine the surplus enhancement due to a former member but are unable to trace that former member, the board must place the corresponding enhancement into a contingency reserve account specific for that purpose and such money may not be released except when effecting payment to the identified former member or the Guardians Fund or some other fund established by law for receipt of those monies. The SCA held that Regulation 35(4) impinges on the board’s wide discretion by compelling the board to place the entire allocation in a contingency reserve account in perpetuity.

The Authority's position on the judgment

- 2.3 After careful consideration of the SCA judgment and following various discussions between the National Treasury and the Authority, a joint decision has been taken not to seek leave to appeal the SCA judgment.
- 2.4 The Authority's view has always been that retirement funds have an established obligation to former members to whom surplus has been allocated and the monies ought therefore not to be released from the contingency reserve accounts.
- 2.5 The SCA has held that, whilst it is accepted that the obligation to pay the former members remains, funds cannot be instructed to hold the assets for these obligations in a contingency reserve account in perpetuity. It is, however, the Authority's view that should part of the assets underlying these obligations be released, it must be done in a prudent manner that does not, *inter alia*, affect the future solvency of a fund.
- 2.6 The Authority has therefore decided to issue this guidance notice in terms of section 141 of the FSR Act to help the industry approach the SCA judgment with the necessary prudence to ensure that the interests of former members of funds who cannot readily be traced are protected, by setting out the Authorities' expectations on what would constitute ethical, prudent and responsible practices by a fund when they consider releasing a proportion of the assets backing unpaid surplus liabilities.

3. GUIDANCE ON THE APPLICATION OF SECTION 7C(2)(F) OF THE PFA READ WITH SECTION 2 OF THE FI ACT AND THE EXPECTATION FROM THE AUTHORITY IN THIS REGARD

- 3.1 The board's fiduciary duties enunciated under section 7C(2)(f) of the PFA provides as follows:

7C. Object of board

- (2) *In pursuing its object the board shall -*

.....

- (f) *have a fiduciary duty to members and beneficiaries in respect of accrued benefits or any amount accrued to provide a benefit, as well as a fiduciary duty to the fund, to ensure that the fund is financially sound and is responsibly managed and governed in accordance with the rules and this Act;*

- 3.2 In addition, board members are subject to the provisions of section 2 of the FI Act which, *inter alia*, requires them to observe the utmost good faith and exercise proper care and diligence with regard to the assets of their funds as follows:

2. Duties of persons dealing with funds of, and with trust property controlled by, financial institutions

A financial institution or nominee company, or director, member, partner, official, employee or agent of the financial institution or nominee company, who

invests, holds, keeps in safe custody, controls, administers or alienates any funds of the financial institution or any trust property-

- (a) *must, with regard to such funds, observe the utmost good faith and exercise proper care and diligence;*
- (b) *must, with regard to the trust property and the terms of the instrument or agreement by which the trust or agency in question has been created, observe the utmost good faith and exercise the care and diligence required of a trustee in the exercise or discharge of his or her powers and duties; and*
- (c) *may not alienate, invest, pledge, hypothecate or otherwise encumber or make use of the funds or trust property or furnish any guarantee in a manner calculated to gain directly or indirectly any improper advantage for any person to the prejudice of the financial institution or principal concerned.*

3.3 Accordingly, the board must always comply with its fiduciary duties and act in the best interest of members.

3.4 Given the judgment of the SCA, the Authority considers the following guidelines as necessary safeguards to ensure that boards act in a way that does not prejudice former members.

3.5 Should the fund consider releasing a proportion of the assets backing the unpaid surplus liabilities, the board would need to consider the risks to the fund and the practical implications.

3.6 In this regard, funds that apportioned surplus at their surplus apportionment date should consider the manner in which they intend on treating the assets underpinning these obligations going forward. In particular, funds must carefully consider the release of such assets for these obligations in a former member surplus apportionment account. In the judgement the SCA found that the Authority has a number of tools available to satisfy itself that funds have considered all relevant aspects properly.

3.7 It would be prudent for funds to only take decisions to release any assets having regard to the following:

- (a) The board should be able to illustrate the steps taken to identify and trace unclaimed former members within a reasonable period prior to the release of the assets. The Authority considers that reliance on historic and outdated tracing exercises may not be sufficient;
- (b) The Board should be able to motivate the assumptions used in determining the assets to be held in respect of the unpaid surplus allocations;
- (c) Given that the full obligation remains but that the assets held will be reduced, there is the risk that the assets retained will be insufficient to cover the claims of possible members coming forward in the future. Boards should, therefore, provide for the manner in which the liability will be met, which should be reflected in the rules of the fund; and

- (d) Boards are reminded that in the event that the fund may need to transfer the obligation and assets in respect of unclaimed benefits to an unclaimed benefit fund, the unclaimed benefit fund may not be prepared to accept a transfer where the value of assets is less than the full value of unclaimed assets. The board should in such an event indicate its plan of action at the time of submitting the valuation report in term of section 16 of the PFA to the Authority for its consideration.



**OLANO MAKHUBELA
COMMISSIONER
FINANCIAL SECTOR CONDUCT AUTHORITY**

Date of publication: 10 December 2020