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CIRCULAR PF NO. 92

(To all self-administered funds or their administrators (where applicable) and the administering insurers of funds exempted in terms of section 2(3)(a) of the Act)

PENSION FUNDS ACT, 1956 : HOUSING LOAN ADMINISTRATION

1. Purpose of the Circular

Section 19(5) of the Act permits the granting or guaranteeing of housing loans. The purpose of this section is to enable trustees to assist members to finance their genuine housing needs. It is not intended to be used as a method of accessing the member's retirement benefits prematurely. The purpose of this Circular is therefore to alert trustees as to their responsibility to prevent abuses, to explain the attitude of the Registrar to these abuses and to highlight and provide guidance in situations where abuses could take place.

Background

2. In terms of section 1 of the Act, the purpose of pension funds is to provide annuities or lump sum payments on retirement to members or to the dependants of members upon the death of members. Permitting housing loans was not intended to offer a means of reducing these benefits by allowing a set-off to take place. Accordingly there must be a real intention to repay a loan so as to reinstate the benefits to full value by the time they become payable on retirement of the members. Further it was not intended that loans should be granted for purposes other than housing as provided for in the Act.
3. Some of the abuses that have come to the attention of the Registrar are:
 - a) the redemption by funds of loans granted to members by persons other than the fund and which are not secured by mortgage bonds over immovable property (section 19(5)(a)(i));
 - b) the granting of housing loans by funds to members without prior exemption in terms of section 19(6)(a) of the Act, where the properties concerned do not belong to members or their spouses or are not occupied by members or dependants of the members. (Also refer to section 19(5)(d));

- c) the granting of housing loans by funds to members for the acquisition of holiday cottages or accommodation for children at University, and not for purposes of acquiring a Adwelling@ as envisaged by the Act;
 - d) the granting of housing loans by funds to members for purposes other than housing as contemplated in section 19(5)(a) of the Act;
 - e) the granting of housing loans by funds to members for amounts in excess of the cost of additions, alterations, maintenance or repairs (section 19(5)(a)(ii)).
AAccess bond@ schemes are also irregular if used for purposes other than the costs envisaged by the Act; and
 - f) the granting of housing loans by funds to members where the capital is not redeemable within 30 years or not payable in equal instalments that include interest, without obtaining exemptions in terms of section 19(6)(a) of the Act.
4. Of particular concern are reports to this Office that advances are being made to members by funds under the guise of housing loans, but are in fact applied to settle other debts of members to alleviate financial distress. This is clearly in conflict with the provisions of the Act.

5. **Responses to contraventions of the Act**

The Registrar will not hesitate to investigate and report to the Attorney-General instances where he becomes aware of a contravention of the Act. He will also, where appropriate, use the powers given in terms of the Financial Institutions Amendment Act, 1997, to bring civil actions so as to ensure compliance. Furthermore, if a specific practice or method of conducting business in connection with housing loans is found to be irregular or undesirable, the registrar will act in terms of section 32A of the Act and with the consent of the Minister, stop such an irregular practice or method.

6. **Problems which trustees may face**

If the rules so permit, a fund is allowed to deduct the amount of the loan from the member-s benefit as section 37A(3)(c) of the Act provides that the provisions of subsection (1), in terms of which a benefit is not reducible, transferable or executable, shall not apply towards reducing or obtaining settlement of a debt **Awhich a fund may reduce or settle under section 37D@** of the Act.

In the light of this enabling provision, trustees may well be faced with practical problems of conforming with the intention referred to in paragraph 2. The guiding principle should be that the repayment of loans or the settlement of guarantees out of the withdrawal benefit of members should occur only if, to the satisfaction of trustees, no other solution is possible.

Accordingly:

- a) In the case of the default in a loan repayment of a loan granted by the fund whilst the member remains a member of the fund.

Where a bond over the property serves as security for the loan on which the member defaults, an option is to foreclose on the property. This course of action can be detrimental to the fund because it assumes the responsibility for the disposal of a property or the holding of a non-performing asset. The alternative is to attach the withdrawal benefit of the defaulting member. In terms of section 37D(a) of the Act the **Afund may deduct any amount due to the fund in respect of a loan granted to the member in terms of section 19(5)(a) ... from the benefit to which the member ... is entitled in terms of the rules of the fund**A. This would obviously be **Athe amount of the benefit which the member would receive if he were to terminate his membership of the fund voluntarily ...**@ as prescribed in section 19(5)(c)(ii) of the Act. This latter alternative should be adopted only where it can be shown that it is in the wider interest of the members to do so.

- b) In the case of the default in a loan repayment of a loan guaranteed by the fund whilst the member remains a member of the fund.

Where the fund is required to settle its obligations under a guarantee given to a financial institution that granted a loan to a member, the trustees may decide to deal with the amount paid out as a loan to the member. In this situation they should ensure that this loan complies with the provisions of sections 19(5)(b)(iii) and (iv) of the Act regarding the prescribed rate of interest or the repayment conditions of the loan. Section 19(5)(a)(ii) of the Act provides for **Athe amount of the benefit which the member would receive if he were to terminate his membership in the fund voluntarily**@ to serve as security for such a loan. The alternative, which should only be adopted if a loan cannot be granted on satisfactory terms, is to deduct the amount of the loan in terms of section 37D(a) of the Act **Afrom the benefit to which the member is entitled in terms of the rules of the fund.**@

- c) In the case of outstanding loans, when members are transferred from one fund to another fund.

It is part of the trustees' duty to negotiate the repayment or transfer of housing loans as part of a scheme of transfer in terms of section 14 of the Act. Provided that the rules of the transferee fund permit housing loans and that fund is prepared to accept the terms of the loans arranged by the transferor fund, no problem should arise. Where the transferee fund rules do not permit housing loans, either they should be changed to enable the transfer to take place without repayment or alternative financial arrangements should be made to replace the loans for the members. Only if the trustees are unable to make any of these arrangements should the members be allowed to repay the loan by offsetting it against the transfer value before the transfer takes place.

Because there is at present doubt whether a voluntary transfer by an individual member is a scheme requiring a section 14 transfer, it is necessary to consider the circumstances under which the request to transfer arises. If the trustees consider the request arises from a deliberate intention to effect a repayment of the loan by requesting a transfer to a fund with rules which do not permit housing loans, they should seek to ensure that the member makes arrangements to borrow the funds from another source to avoid a

situation arising where the loan has to be repaid. Repayment of the loan through a deduction from the member's transfer value should only be permitted by the trustees if they are satisfied that no alternative arrangements can be made by the member.

Similarly, if the fund has guaranteed the loan granted by a financial institution and that institution does not agree to cession of the guarantee on the transfer of the member, the trustees should only allow repayment of the loan by deducting the amount owed from the member's transfer value prior to transfer if they are satisfied that no other arrangement can be made by the member.

7. Adequacy of interest rates

Since the primary object of a pension fund is to provide benefits for its members at some future date, the yield on its investments is important. In terms of section 7C(i) of the Act, trustees are required to act in the best interest of the fund and all its members when directing, controlling and overseeing the operation of the fund in accordance with the applicable laws and the rules of the fund. Accordingly the rate of interest on the loan should be carefully considered. Section 19(5) of the Act requires *inter alia*, that a fund **Amay, if its rules so permit, grant a loan to a member by way of investment of its funds®** and section 19(5)(b)(iii) provides that such an interest rate must not be lower than the rate prescribed by regulation.

The rate prescribed in regulation 27 (at present 15%) is the rate South African Revenue Services adopt for taxing fringe benefits and may not necessarily be a market related rate for the fund that satisfies the requirements of section 19(5)(a) of the Act. If the rate of interest charged is too lenient it will either result in the subsidisation of the member (in a defined benefit scheme) or inadequate retirement benefits (in a defined contribution scheme).

8. Exemptions from certain provisions of the Act

In terms of section 19(6)(a) of the Act, the registrar **Amay, under exceptional circumstances and on such conditions and for such periods as he may determine, temporarily exempt any fund from compliance with any provision of subsection ...(5) or (5B)(a)®**. It is the policy of the registrar to grant exemptions in respect of the following:

- a) ownership of the property and housing structure (19(5)(a))
- b) lower interest rate than prescribed (19(5)(b)(iii))
- c) unequal repayments not including interest in all the instalments (19(5)(b)(iv))

if the loan is used exclusively for housing purposes and exceptional circumstances exist to the satisfaction of the Registrar.

It should be noted that a condition for exemption would be that, where applicable, loans must comply with the provisions of Regulations No 3162 and 3163 in Government Gazette No 14410 dated 20 November 1992 made under section 15A of the Usury Act, 1968 (Act No 73 of 1968).

9. **Provisions of the Income Tax Act**

If, in unavoidable circumstances, repayment of a member's loan out of pension benefits does take place, a taxable benefit arises in the hands of the member and it is incumbent on trustees to ensure that the Income Tax Act is complied with.

Trustees should therefore approach the Commissioner of South African Revenue Services before authorising a transaction to redeem housing loans out of the benefit due to a member in the circumstances pointed out in this Circular to ensure that the tax implications of the transactions are not circumvented.

10. **Duty of the Auditor**

The auditors of funds should also take note of the actual or possible contraventions of the Act described above as they are required to submit a report annually in terms of paragraph 5 of Schedule I of the regulations to the registrar that they have **examined loans granted to members by the fund and report that these loans were granted in accordance with the provisions of section 19(5)(a) of the Act and that the interest on the loans has been charged in accordance with regulation 27".**

11. **Conclusion**

The decision as to whether or not to grant housing loans or to permit guarantees thereof and the terms on which they are granted are within the discretion of the trustees. Where trustees avail themselves of this discretion it is incumbent on them to ensure that abuse and/or prejudice to the fund or any of its members do not occur. If irregularities have been allowed to occur these should be rectified.

The relevant sections of the Act have served a useful purpose and in the vast majority of cases are being applied within the spirit and the letter of the law. It would therefore be unfortunate if the relevant legislation had to become more restrictive or repealed because of abuse and irregularities by a minority. Further action will, however, become necessary should abuses continue.

Kindly hand a copy of this Circular to the fund's or the insurer's auditor.

Yours faithfully

REGISTRAR OF PENSION FUNDS

Notes:

- (1) Circular PF No 91 on the topic of submission of financial returns and valuator reports of May 1997 was issued to all self-administered funds or their administrators (where applicable).
- (2) This Circular also appears on the Financial Services Board's Internet Site :<http://www.fsb.co.za>. Contact information /departments Retirement Funds and Friendly Societies.