

ASAP

Legal and Technical Update

The Corporate Retirement Annuity: Who is your client?

Background

Where an employer has a small number of employees, they often consider a CRA as an alternative to provide employees with some sort of retirement benefits.

A CRA is in fact a group of individual retirement annuities (each employee has their own retirement annuity policy) that are generally funded by one debit order against the employer's bank account. The 'scheme' is administered by way of a schedule that is updated monthly by the employer and that is used by the insurer to allocate the correct premium amounts to the right policies.

At the end of the tax year the insurer issues a contribution certificate to the individual member, (the employee), as proof of contributions made to the CRA.

From 1 March 2016, the employer will be able to deduct the contributions made to a CRA on behalf of an employee for income tax purposes in terms of section 11(l). The employer's contributions will be included in the gross income of the employee as a fringe benefit and will be fully taxable. However, the employee may then claim a deduction in respect of all retirement fund contributions made (by the employee and employer) to all retirement funds, limited to the lesser of:

- R350 000, or
- 27.5% of the greater of remuneration or taxable income, or
- Taxable income.

When determining the PAYE to be deducted or withheld from the employee's remuneration under the Fourth Schedule to the Income Tax Act, it must be calculated on the balance of the remuneration remaining after deducting the following:

- any contribution made by the employee to any pension fund which the employer is entitled or required to deduct from that remuneration, but limited to the deduction to which the employee is entitled to in terms of section 11(k);
- at the option of the employer, any contribution to a retirement annuity fund by the employee in respect of which proof of payment has been furnished to the employer, but limited to the deduction to which the employee is entitled to in terms of section 11(k);
- any contribution made by the employer to any retirement annuity fund for the benefit of the employee, but limited to the deduction to which the employee is entitled under section 11(k).

Why is a corporate retirement annuity proposed in the first place?

It is proposed as an alternative to an employer provided retirement fund in instances where there are small numbers of employees.

What are the differences between a CRA and an umbrella or standalone retirement fund?

	CRA	Umbrella / standalone retirement fund
Membership	The employer provides the employee with the opportunity to become a member. However, it is not an employer fund as the employer is not party to the contract. In some instances it may be a condition of employment in terms of the employment contract.	To become a member, there must be an employment relationship. The employee does not have a choice in the matter. Contributions to the fund are conditional on the employer-employee relationship remaining in force.
Contribution payment	The employer pays the contribution to the fund in terms of the employment contract. The contribution can consist of an employer and/or employee contribution and is reflected as either a % of the employee's salary or a fixed amount as per the employment contract.	
Payment of costs	The contribution less costs is allocated to the employee's fund value.	
Administrative control	The employee as the member of the fund has control over the RA. The member might be able to choose whether he wants to be a member, the size of the contributions, etc.	The trustees of the fund administer and control the pension fund. The rules of the fund and the special rules applicable to the employer, where relevant, will define the choices regarding contributions as well as available risk benefits.

Investment portfolio choice	<p>The employee as the member will have the discretion to choose the investment portfolio from those made available by the fund and it is only the employee's risk profile that will be relevant.</p> <p>The fund will be bound by regulation 28 of the Pension Funds Act that restricts the investment limits in respect of certain asset classes.</p>	
Access to benefits before retirement	<p>When employment is terminated, the employee retains the RA and cannot access the funds unless the RA is made paid up and the surrender value in the registered fund is less than R7 000.</p> <p>If the employee's surrender value exceeds the R7 000 threshold, he cannot access his benefit before reaching retirement age, which is 55 years old at the earliest or if the employee becomes permanently disabled.</p> <p>If the employee formally emigrates or where his visa expires, the benefit in the RA can be withdrawn (this only applies prior to retirement). Income tax will be payable on the withdrawal benefit.</p>	<p>When employment is terminated the employee has the following options:</p> <ul style="list-style-type: none"> - Transfer the resignation benefit to another approved retirement fund; - Withdraw a lump sum, which will be subject to income tax; - A combination of the above, or - Remain a non-contributing member of the fund.
Early termination penalty	<p>Early termination, meaning termination before reaching the policy maturity date or the employee's retirement age as specified in the RA contract, may result in an early termination penalty, which can be to the detriment of some members.</p>	<p>Not applicable</p>
Advice	<p>Although the scheme is normally linked to a financial adviser, it is possible to have a financial adviser per individual employee.</p>	<p>There will normally be only one financial adviser/broker house involved to provide advice to the employer. The extent of the advice provided to individual members will depend on the adviser's agreement with the employer.</p>

The dilemma

Most CRAs are concluded by consultation with the employer only, as the employer decides that the CRA is better suited to the employer's circumstances (based on the advice given by the financial adviser).

Even though the employer contracts with the employee to make the membership to the CRA a condition of employment and therefore compulsory, in essence the membership to the RA is not dependent on the employer-employee relationship and may continue long after that relationship has ceased.

Therefore, although the employer made the decision regarding the type of retirement vehicle to use to provide retirement funding for its employees, the employee is in fact the person that will live with the product until retirement, and will have fewer options compared to the umbrella or standalone retirement funds.

The Financial Advisory and Intermediary Act (FAIS) places an obligation on the financial adviser to make certain disclosures to the client, to do a financial needs analysis for the client and to fulfill all other record-keeping, and other duties in respect of the client.

Therefore it is very important to determine who the client is, as referred to in FAIS to ensure that the financial adviser fulfills his legal obligations.

FAIS definitions

In a quest to determine who the client is one has to take note of the definitions contained in this Act (definitions copied from the Act).

A client is defined as:

A specific person or group of persons, excluding the general public, who is or may become the subject to whom a financial service is rendered intentionally, or is the successor in title of such person or the beneficiary of such service.

Financial service is defined as:

Any service contemplated in paragraph (a), (b) or (c) of the definition of "financial services provider", including any category of such services.

Financial services provider is defined as:

Any person, other than a representative, who as a regular feature of the business of such person:

- a) furnishes advice; or
- b) furnishes advice and renders any intermediary service; or
- c) renders an intermediary service.

Advice is defined as:

Any recommendation, guidance or proposal of a financial nature furnished, by any means or medium, to any client or group of clients -

- a) in respect of the purchase of any financial product; or
- b) in respect of the investment in any financial product; or
- c) on the conclusion of any other transaction, including a loan or cession, aimed at the incurring of any liability or the acquisition of any right or benefit in respect of any financial product; or
- d) on the variation of any term or condition applying to a financial product, on the replacement of any such product, or on the termination of any purchase of or investment in any such product, and irrespective of whether or not such advice:
 - i) is furnished in the course of or incidental to financial planning in connection with the affairs of the client; or
 - ii) results in any such purchase, investment, transaction, variation, replacement or termination, as the case may be, being effected.

Intermediary service is defined as:

Any act other than the furnishing of advice, performed by a person for or on behalf of a client or product supplier –

- a) the result of which is that a client may enter into, offers to enter into or enters into any transaction in respect of a financial product with a product supplier; or
- b) with a view to—
 - i) buying, selling or otherwise dealing in (whether on a discretionary or non-discretionary basis), managing, administering, keeping in safe custody, maintaining or servicing a financial product purchased by a client from a product supplier or in which the client has invested;
 - ii) collecting or accounting for premiums or other moneys payable by the client to a product supplier in respect of a financial product; or
 - iii) receiving, submitting or processing the claims of a client against a product supplier.

Who is the client?

Without going into an academic discussion on each definition and the relevance of it, it is clear from the definitions that both the employer and the employee will be the client in terms of FAIS and therefore all the necessary steps and disclosures should be made to both the employer and employee.

Once the employer-employee relationship terminates, the financial adviser's relationship will continue with the employee in respect of that RA – unless the employee consciously changes the financial adviser on the product, in which case future advice will then rest with that adviser.

Other factors to consider:

When proposing the CRA to an employer, it is important that both the employer and employee understand the legal nature of the retirement vehicle.

Firstly, the employment contract should deal with the compulsory nature of membership to the CRA.

At the same time, both the employer and employee should understand that the RA's policy contract and fund rules will govern the relationship between the fund and the employee/member. The employer is not a party to that relationship, other than facilitating payment of the contributions in terms of the employment contract.

It is imperative that the legal structure of the RA fund, as well as the rules of the fund that govern the relationship between the member and the fund, are brought to the attention of the member. The member should be made aware of how the fund operates and what his rights and obligations are. In particular, he should understand that benefits can only be accessed in certain instances.

Since the RA contract is issued in the name of the individual member and not the employer, the commission arrangement is entered into between the member and the financial adviser. The fact that the employer has agreed to facilitate the arrangement, does not entitle the employer to unilaterally decide on the commission payable to the adviser, as it is deducted from the member's fund credit and will affect the total cost structure of the RA. The commission must at least be disclosed to the contract owner i.e. the member.

It is also important that there is some process followed when doing the investment portfolio selection for the member as the member's risk profile, investment objectives, overall retirement plan, etc, will impact the decision and the financial adviser should guide the client in making this decision.

Conclusion

When proposing a CRA to an employer as an employee retirement fund, the financial adviser should therefore take the following steps:

- Do a due diligence in which the CRA and all other alternatives are compared to allow the employer and employee to make an informed decision;
- It is suggested that the employer involves the employees in this decision from the start;
- To provide the employer with all the necessary disclosures in respect of the product, the commission payable, etc;
- To provide the employee with all the necessary disclosures and to consult with the employee when making the fund selection. The financial adviser must offer to do a financial needs analysis and if the employee refuses due to him having another financial adviser, this should be noted in the file and the client and that financial adviser should give direction to the fund selection that will suit that client;
- To highlight the nature of the CRA to the employee and employer and to emphasize when and how the employee will have access to the funds and when no access will be allowed.
