



**NAMIBIA FINANCIAL
INSTITUTIONS SUPERVISORY AUTHORITY**

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**ALL PRINCIPAL OFFICERS OF PENSION, PROVIDENT, RETIREMENT
FUNDS AND RETIREMENT ANNUITY FUNDS
ALL PRINCIPAL OFFICERS OF INSURED FUNDS
ALL PENSION FUNDS ADMINISTRATORS & CONSULTANTS**

Circular: PI/PF/3/2003

**INTERPRETATION OF HOUSING LOANS AND GUARANTEES AS
PROVIDED UNDER SECTION 19 (5) (a) OF THE PENSION FUNDS ACT OF
1956**

1. Purpose of the Circular

Retirement funds (pension, provident, preservation, retirement funds and retirement annuity funds) are established to provide annuities or lump sum payments on retirement of a member or to the dependant of a member upon death of the member. However, the fund may also, if its rules so permit grant a loan to a member by way of investment of its funds or guarantee a loan granted to its member by a financial institution.

Section 19(5) of the Act permits the granting and guarantying 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 aim of this Circular is mainly to clarify the Registrar's interpretation of the administration of housing loans and/or guarantees as provided under section 19 (5) (a) of the Pension Funds Act 1956, to alert trustees to their responsibility to prevent abuse, to explain the attitude of the Registrar to these abuses and to highlight and provide guidance in situations where abuses could take place.

2. Background

(1) 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.

Any housing loan to a member must be made as an investment by the fund of its assets and all the risks associated to such an investment must be carefully considered. Persons acting as trustees of any pension fund have a fiduciary duty to the members of the fund. If the investment by way of housing loan is made frivolously or where trustees have not applied their minds and the fund suffers monetary loss, the trustees may be held liable to make good the loss to the fund.

In the process of considering whether the fund should make a housing loan investment, the following conditions apply (section 19(5))

1. The loan may be made to the member to settle a loan a person (such as a bank) made to the member with immoveable property belonging to such member or his or her spouse given as security. Additionally there must be a residence on the immoveable property in which the member or his or her dependant will stay, or a residence will be built to be occupied by the member or his or her dependant.

2. The loan may also be given to a member to purchase a residence or a piece of land to erect a residence on it. The member or his or her dependant must stay in the residence.

3. The loan may also be given to a member to make improvements to a residence belonging to the member or his or her spouse. Such residence must be occupied or will be occupied by the member or his or her dependants.

4. (1) Moreover section 5(b) stipulates that the loan may not be granted unless first secured by a mortgage bond and/or a pledge on the benefits to which the member is entitled. If the loan is secured by mortgage bond, the loan may not exceed 90% of the market value of the property being bought.

- (2) If the loan is secured by a pledge on the member's benefits, the loan may not exceed the amount of the benefit he or she would receive upon voluntary termination of membership or the market value of the property, whichever is smaller.

(3) If the loan is secured by both mortgage and pledge, the loan may not exceed 90% of the aggregate of the market value of the property being bought and the smaller amount of the benefit he or she would receive upon voluntary termination of membership or the market value of the property.

(4) If the employer of the member gives an irrevocable guarantee to the fund in respect of so much of the loan that exceeds the 90% set out above, the fund may give a loan of 100%.

(5) Essentially the market value means the price estimated by a person appointed by the fund for that purpose. See however, section 19(5)(d) for exceptions.

6. The fund may not give a housing loan to a member if the member already owes the fund for another housing loan.

7. The fund may not make the loan at an interest rate lower than the prescribed rate.

8. The capital sum must be repaid over a period of not less than 30 years in equal installments (monthly or weekly) which must include the interest on the capital outstanding.

9. Finally, section 5(5B) states that a loan may not be granted to a company or subsidiary of that company, controlled by an officer or a member of the fund or the director or the administrator, neither may the fund invest in the shares of such a company.

Since the granting of such a loan is made as an investment there are grave dangers to the fund if the fund is allowed to grant a loan to a member to purchase property in a close corporation or a company. Currently there are no requirements for the selling of a close corporation or a company owning immovable property. Therefore if a member sells his or her interest in a close corporation or shares in a company, the fund loses the security of the loan and thus the investment becomes an unsecured loan. This poses grave dangers to the investments of other members of the fund.

3. ABUSES OF SECTION 19(5)

Some of the abuses that have come to the attention of the Registrar are:

- (1) (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 the 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 the purposes of acquiring a "dwelling" 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)) "Access bond" schemes are also irregular if used for purposes other than the costs as envisaged by the Act; and

(f) the granting of housing loans by funds to members where capital is not redeemable within 30 years or not payable in equal monthly instalments that include interest, without obtaining exemptions in terms of section 19(6)(a) of the Act.

- (2) 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.

4. 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 (Investment of Funds) Act, 1984, 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.

5. PROBLEMS WHICH TRUSTEES MAY FACE

If the rules so permit, a fund is allowed to deduct the amount of the loans 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 "which 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 to the intention referred to in paragraph 2(1) above. 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. It is advisable in any event to seek the opinion of the Registrar in all matters where the Trustees are faced with the afore discussed situation

Accordingly three scenarios may arise:

- (1) Where a member defaults on 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 "fund 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". This would obviously be "the 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.

- (2) Where the member defaults on 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 section 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)(c)(ii) of the Act provides for "the 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 37D(a) of the Act "from the benefit to which the member is entitled in terms of the rules of the fund"

(3) 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 reckon that 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 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 arrangement 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 objective 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 "may, 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 of the Regulations made under the Act is at present 16% and may not necessarily be a market related rate that satisfies the requirement of section 19(5)(a) of the Act. It is important to note that 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. EXEMPTION FROM CERTAIN PROVISIONS OF THE ACT

In terms of section 19(6)(a) of the Act, the registrar "may, under exceptional circumstances and on such conditions and for such periods as he may determine temporarily exempt any fund from the compliance with any provision of subsection... 5(b) 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(5a))
- (b) lower interest rate than prescribed (19(5)(b)(iii))
- (c) unequal repayments not including interest in all the installments (19(5)(b)(iv)),

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

9. PROVISION OF THE INCOME TAX ACT, 1981

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 Inland Revenue before authorizing 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".

CONCLUSION

The decision as to whether or not to grant housing loans or to permit guarantees thereof and the terms on which they will be 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 abuse continue.

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



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