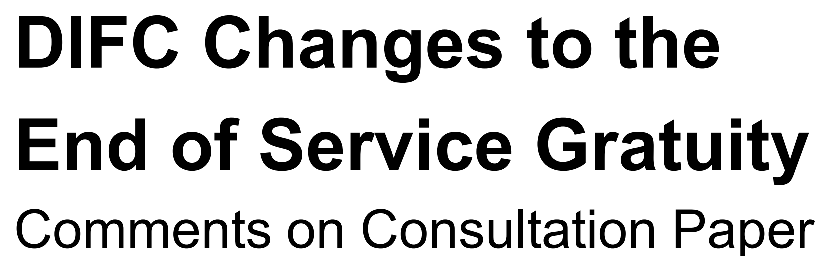

DIFC Changes to the End of Service Gratuity

Comments on Consultation Paper

25 October 2019

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Background

- Following ongoing review of the local End of Service Gratuity (EOSG) benefit, the **Dubai International Financial Centre Authority (DIFCA) has released a Consultation Paper** seeking feedback on proposed (draft) amendments to replace the EOSG with a funded defined contribution workplace savings regime with mandatory participation. The main drivers for the review were to:
  - Align with the global trend for moving towards defined contribution (DC) arrangements, and
  - Ensure the local retirement arrangement remains competitive and attractive for employees, particularly expatriates (non-GCC nationals).
- Note that the current EOSG regime, as well as the proposed changes, apply mandatorily to expatriate employees within the DIFC who, unlike GCC nationals, are not eligible to register for social security. The law does not entitle GCC nationals who are covered under social security to EOSG or the (proposed) Core Benefits.
- The paper provides welcome clarification on the DIFCA's intentions regarding:
  - Design features of the new statutory/default DIFC Employee Workplace Savings (DEWS) plan, and
  - Key requirements for Qualifying Schemes (QSs) which may be used by employers as alternatives to DEWS.
- The consultation is open to stakeholders (including employers, employees and advisors) until **18 November 2019**, after which the DIFCA will review comments and finalise/enact the legislative amendments. The original effective date of these amendments was to be 1 January 2020, and whilst the wording of the Consultation Paper does not commit to this timeframe, Aon's working assumption is that this remains the intended effective date (referred to as the Qualifying Scheme Commencement Date or "QSCD").
- This short document sets out a summary of the proposed amendments under consultation (which forms the framework for DEWS), as well as the key requirements for QS alternatives. It also signposts the consultation process and next steps to finalising and enacting the legislation.
  - **Note that this document is based on Aon's interpretation and understanding of the Consultation Paper, and does not constitute legal advice.** You should consult with your own advisors in relation to the Consultation Paper and its potential impact on you. Please see "Important Disclaimers" at the end of this document.
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Aon Overview of Consultation Paper

- The Consultation Paper contains three Annexes:
  - Annex A – showing the proposed amendments marked up against the current law (Employment Law 2019), the bulk of which are amendments to Article 66 (“Gratuity Payment and Qualifying Scheme Benefits”)*
  - Annex B – draft Regulations stipulating the requirements of a Qualifying Scheme (which therefore apply to DEWS, as well as to any alternative scheme an employer might wish to use instead in respect of employees who would otherwise need to be enrolled into DEWS).
  - Annex C – a Word document that can be populated by those wishing to respond to the consultation.
- Annex A provides clarity on the design features of DEWS, as summarised on the next three pages. They are broadly in line with expectations set by the DIFCA in the months leading up to now; however, we note the following discrepancies and open questions:
  - The proposed amendments appear to imply that employees commencing service less than one year before the Qualifying Scheme Commencement Date (i.e. starting after 1 January 2019 according to the assumed timeline) will not be entitled to an End of Service Gratuity benefit under current legislation (and nor to Core Benefits in lieu of this). It is unclear whether this is intentional;
  - The proposals continue to allow for any employee debts to the employer to be offset against the current End of Service Gratuity benefit, but are silent on whether this is permissible against Core Benefits paid to DEWS or another Qualifying Scheme;
  - It is unclear whether the proposed fine of USD 2,000 that can be levied on employers for non-compliance with the new regime is applicable per infraction, per employer, or per employee affected;
  - The DIFCA is considering further to what extent individuals such as equity partners or shareholders who draw partnership profits or shareholder dividends should be exempted from the provisions, and the consultation invites comments in this respect;
  - The working assumption remains that the legislation will be effective from 1 January 2020; however, employers are also advised not to implement any changes until the legislation is finalised and enacted. Clearly, that does not leave much time for employers to implement and communicate any changes. The consultation invites comments in this respect and leaves the potential for a possible extension to the effective implementation date.

**Additions shown in underline*

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Aon Overview of Proposed Legislation (1)

Current EOSG Eligibility

The proposed changes confirm that employee entitlement to the existing End of Service Gratuity benefit will continue to accrue up until the day before the new legislation is effective (the Qualifying Scheme Commencement Date or "QSCD"), under the same calculation methodology. It clarifies that although service period for the purposes of the calculation ends at 31 December 2019 (assumed), the Basic Wage the benefit is eventually calculated on will be that as at the future termination date. Whilst this is not unexpected, **employers should be aware that the liability to pay this amount will remain on the balance sheet and continue to grow in line with salary increases.**

*Reference: Paragraphs (1), (2), (3)**

Transfer into DEWS/ Qualifying Schemes

An employer can opt, without employee consent, **to transfer the value of the EOSG benefit into DEWS or a Qualifying Scheme** alternative after the QSCD; however**, the employer is liable to make up any eventual shortfall upon termination** between the value of the retirement savings in the Qualifying Scheme relating to the transfer and the EOSG benefit that would have accrued in absence of the transfer. By obtaining **prior written consent** from the employee, **the employer can be relieved of this liability**.

*Reference: Paragraph (5)**

**In proposed amendments to Article 66, Employment Law 2019.*

Aon Overview of Proposed Legislation (2)

Contribution Rates

It is confirmed that the **minimum monthly employer contributions** (the "Core Benefits") to be paid into DEWS or a Qualifying Scheme alternative are:

- 5.83% of Monthly Basic Wage during the first 5 years of service (including any period of employment or secondment served before the QSCD), and
- 8.33% of Monthly Basic Wage after the first 5 years of service.

This **mirrors the current calculation methodology** of providing 21 days' salary per year of service for the first 5 years, and 30 days' salary per year thereafter.

The Basic Monthly Wage must be at least 50% of the Monthly Wage, which is a continuation of the current EOSG legislation and is intended to protect employees' best interests by avoiding artificial reductions in benefits.

It is further confirmed that DEWS is defined contribution and that the investment risk is borne solely by the employee (save for any transfer of EOSG benefit made into such a scheme without employee written consent).

*Reference: Paragraphs (6), (7), (12)**

No Opt-Out for Expats

Expat employees (defined as those not required to register at the General Pension and Social Security Authority, i.e. non-GCC nationals) are entitled to receive Core Benefits and **cannot agree with the employer to waive this entitlement** or reduce entitlement below Core Benefits.

New hires must be enrolled by the 15th of the month following the month of employment (allowing for a short grace period to set up administration processes in respect of new joiners but with retroactive calculation to the employment start date).

*Reference: Paragraphs (10), (14); Schedule 1**

**In proposed amendments to Article 66, Employment Law 2019.*

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Aon Overview of Proposed Legislation (3)

Employer Practicalities

Mid-month terminations are subject to pro-rated contributions (with reference to number of days in the month, assumed to include non-working days).

Voluntary contributions can be made by employees; they must notify the employer in writing before any deductions can be made from pay. ***It should be clarified that this process can be carried out online***.

Employee debts to the employer can continue to be offset against the current End of Service Gratuity benefit, but it is **not clear whether this is permissible against Core Benefits paid to DEWS** or another Qualifying Scheme

Fines of up to USD 2,000 are enforceable for non-compliance; however, it is not clear whether this fine is per infraction, per employer, or per employee affected. Additionally, the amendments preserve an employee's right to sue the employer over non-payment of EOSG benefit and Core Benefits.

*Reference: Paragraphs (4), (6), (11), (13), (15); Schedule 2**

We understand from the draft Regulations that individuals who are not mandatorily required to join DEWS or a Qualifying Scheme may do so at the discretion of the employer or Operator on a voluntary basis. However, this does not exempt the employer from providing any mandatory benefits stipulated by the authorities in the relevant jurisdiction(s) such as the End of Service Gratuity in the wider UAE.

Use of Qualifying Schemes

Qualifying Schemes are defined as a scheme "approved under the Regulations"; **key requirements** are summarised on the next pages. The Regulations will be **subject to amendment from time to time**.

An employer wishing to use a Qualifying Scheme instead of DEWS will need to obtain a **Certificate of Compliance** in respect of each Qualifying Scheme. For current employees as at 1 January 2020 (assumed), this will need to be done in line with timeframes to be published by the DIFCA on finalising and enacting the legislation. It is implied further in the Regulations that applications for subsequent years will only be accepted in the December immediately prior.

*Reference: Paragraphs (8), (9)**

**In proposed amendments to Article 66, Employment Law 2019.*

Key Requirements of Qualifying Schemes (1)

Overview

Annex B (the draft Regulations) sets out the criteria that must be met for a scheme to be approved by the DIFCA and therefore be a Qualifying Scheme (QS) which can be used instead of DEWS. The scheme may be an existing scheme (with amendments to bring it in line with the criteria as needed), or a newly established scheme.

The key requirements are that the scheme or plan under consideration must:

- Be an Employee Money Purchase Scheme based on the definition of a UK DC retirement scheme
- Make provision for Employer contributions at least equal to minimum Core Benefits
- Pay benefits directly to the member
- Ensure key service providers are regulated by a Recognised Regulator (as determined by the DFSA)
- Be established as a DIFC trust if established in the DIFC

Reference: Paragraph (2.1.1) Annex B

A high-level summary of the key requirements with Aon commentary is shown on the next two pages (this is not exhaustive).

Potential Issue with Qualification

The Consultation Paper notes that the Regulations were drafted based on best practice in Australia, Hong Kong, Singapore, the Isle of Man and the UK. The organisational/governance structure in particular was drafted based on established practice in the Isle of Man, suggesting that the **intent is that International Pension Plans may be suitable vehicles** to be used/adapted as Qualifying Schemes.

Unfortunately, while the governance regulations as drafted fit the structure of the default DEWS arrangement, it does suggest that the majority of existing bona fide company pension arrangements in other countries such as the **UK and most International Pension Plans would NOT automatically meet the requirements** to be a Qualifying Scheme. This is because the definitions of roles of the Supervisory Body and Operator as set out in Annex B do not align with the role of the Trustee in other existing non-DIFC retirement arrangements, **unless discretion is exercised** by the DIFCA and DFSA in the application process.

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Key Requirements of Qualifying Schemes (2)

Requirement (paraphrased)	Aon Commentary
Design The plan must: a) Be an Employee Money Purchase Scheme; b) Stipulate mandatory employer contributions at least as favourable as DEWS; c) Pay out to members (or their legal successor) on termination of employment or reaching age 65 if sooner (with exceptions for voluntary contributions which may be drawn sooner if the plan rules allow, and further deferred payment if the plan rules allow or require); d) Stipulate that the plan Operator, Administrator, Investment Adviser and Fund Manager are regulated by a Recognised Regulator; and e) Be a DIFC Trust, if established within the DIFC.	"Employee Money Purchase Scheme" is as defined in Section 181B of the UK Pension Schemes Act 1993. Most Defined Contribution schemes will fit this definition. If attempting to obtain approval for QS status for an existing plan, contribution rates will need to be reviewed to ensure they meet the minimum of 5.83% of Monthly Basic Wage for those with up to five years' service, and 8.33% of Monthly Basic Wage for those with more than five years' service. Ongoing review will be required to take account of any future changes in legislation. Plans need to make benefits accessible on termination (i.e. should be akin to savings plans rather than retirement plans). International Pension Plans with unapproved status are more likely to qualify than approved pension plans in many markets. Plans permitting payment of Core Benefits before age 65 to individuals still working for the employer in the DIFC do not meet the Regulations. In-service withdrawals of voluntary contributions are allowed in a manner permitted in the plan rules. Recognised Regulators are financial services regulators who have approved status with the DIFC Board, following consultation with the Dubai Financial Services Authority (DFSA). The Operator, Administrator and Investment Adviser roles are mandated under Sections 2.3 to 2.5 of Annex B, and the Operator must meet with the Supervisory Body at least four times a year.
There must also be a Supervisory Body acting in the members' interests. The role of the Supervisory Body is mandated under Section 2.2 of Annex B, and holds responsibility for oversight of governance and other non-regulated activities of the Operator, including the power to appoint and remove the Operator. It must be independent and cannot have a financial service or fiduciary function.	The key issue is that it appears that both the roles of the Supervisory Body and Operator are provided by the Trustee in most bona-fide retirement arrangements including most UK Money Purchase Schemes. This creates a conflict with the draft Regulations in assessing Qualifying Schemes. The implication is that most schemes would need to rely on discretion in the assessment of their suitability as a Qualifying Scheme unless the Regulations are modified. **We suggest that companies intending to use their pre-existing pension arrangement should raise this in the DIFCA feedback**.

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Key Requirements of Qualifying Schemes (3)

Requirement (paraphrased)	Aon Commentary
Investments and Charges Each fund must be established and regulated in a Recognised Jurisdiction. The plan must have a default fund where members have not provided investment directions. There must be a Shari'a investment option. The plan cannot charge front-end investment fees in respect of investment of funds, nor rear-end fees in respect of disinvestment (e.g. on withdrawal of benefits). (Exceptions are made for banking charges and bid/offer spread in purchasing units.) Fund management, administration or trustee charges must be paid out of funds under the relevant fund manager's management and reflected in the unit prices relevant to a member account.	A Recognised Jurisdiction is a jurisdiction that has approved status with the DIFC Board of Directors, following consultation with the DFSA. Default fund options and fee structures should be reviewed to ensure compliance before seeking QS status; however, the requirements are in line with best practice. Most existing company arrangements do not currently offer a Shari'a compliant investment option. Adding Shari'a investment options has implications for existing scheme investment, administration and member communications. The plan's fee structure should be fully transparent for members, and implies an allocation of fees between the different providers is to be disclosed. The majority of the investment requirements are normal practice for most DC arrangements.
Operations The plan rules must make provision for: • Employer obligations with respect to the plan Operator and Administrator, to enable smooth operation and compliance with any Anti-Money Laundering requirements • Member onboarding communications • Annual member statements and a summary of the plan's Annual Report and Accounts	Although these provisions are in line with best practice, existing plan rules may not always make explicit, detailed reference to items such as member communications. The plan rules should be closely reviewed to ensure that they stipulate the relevant employer obligations and mandatory employee communications.

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Summary of Consultation Process

- The changes are open to public consultation until **18 November 2019**; the public consultation is aimed at:

  (a) employers and employees;

  (b) the finance, human resources and legal functions of employers; and

  (c) the representatives and advisors to any of the above.

- Comments can be provided by mail or email to:

  Jacques Visser, Chief Legal Officer
  DIFC Authority
  Level 14, The Gate, P. O. Box 74777
  Dubai, United Arab Emirates

  consultation@difc.ae

- The DIFCA has provided a template for comments, linked here.

- Broadly, the questions cover the following topics:
  - The proposals in general, including whether a DC savings plan such as DEWS is desirable;
  - Timelines to implement DEWS or Qualifying Scheme alternatives;
  - The DIFCA's approval process to decide what is a Recognised Jurisdiction and a Recognised Regulator;
  - Comments and suggestions in respect of the proposed Amendments and Regulations

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Next Steps and Timelines

Consultation Published
Consultation Paper published 17 October 2019. Employers and other stakeholders have **until 18 November** to provide feedback to the DIFCA on the proposed changes.

Finalise Legislation
Following the closure of the consultation window, the DIFCA will review feedback and finalise and enact the legislation, confirming the changes.

Key preparatory actions for employers are highlighted on the next page.

17 Oct 2019

18 Nov 2019

1 Jan 2020

Employer Engagement with DEWS
We expect the DIFCA to start engaging shortly with employers in the DIFC to discuss transition into DEWS.
Employers will need to act quickly to decide whether they wish to use an alternative Qualifying Scheme.

DEWS/Qualifying Scheme Commencement Date (proposed)
The DIFCA still intends to enact the amended legislation with effect from 1 January 2020, and launch DEWS on the same date.

Employers will need to be ready to make their first contributions for employees in service as at 1 January 2020 into DEWS – or their chosen Qualifying Scheme alternative – in line with January payroll.

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Immediate Actions for Employers in the DIFC

- Review the consultation materials and consider submitting feedback;
- Determine approach – enrol employees in DEWS or consider a Qualifying Scheme alternative;
- Review existing plans against the regulations if wanting to use these as a Qualifying Scheme alternative;
- Consider strategy regarding accrued EOSG benefit to 31 December 2019;
- Start communicating any changes to employees upfront.

Aon would be delighted to assist you in any of the above steps, and we would be happy to discuss alternatives to DEWS. Please do not hesitate to contact us for further information.

**Additions shown in underline*

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