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## Simeka Comment Draft Default Regulations December 2016

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## 1. Executive summary

The second draft of the proposed retirement funds default regulations was gazetted by National Treasury on 23 December 2016. Final public comment is invited by 28 February 2017.

The first draft of the “default regulations” was published on 22 July 2015 and a process of engagement with key stakeholders followed. These regulations follow on the 2011 National Treasury paper, *Charges in South African Retirement Funds*.

The regulations seek to ensure that retirement savings of South Africans are invested in a prudent and cost-effective manner, that members enjoy value for their money and will be able to retire more comfortably. It re-emphasises that fund boards have the responsibility to protect the interests and investments of pension fund members during and post the accumulation stage.

International research shows that good defaults can significantly improve member outcomes. Another aim of default strategies is to reduce complexity by requiring retirement funds to develop relatively simple and standardised products -

- during the accumulation phase by adopting a default investment strategy,
- when members withdraw from funds before they retire by adopting a default preservation strategy, and
- when members convert their retirement savings into an income upon retirement by adopting an annuitisation strategy.

### Reform programme

The National Treasury (NT) media statement reiterates that the default regulations form part of a reform programme to deliver better customer outcomes across the financial sector. The implementation of Twin Peaks will see market conduct requirements centralised in a Conduct of Financial Institutions (“CoFI”) Act. Under this framework, persons participating in the pension fund sector will be required to take more responsibility for the impact of their decisions on members. Government is also considering how savings can be mobilised to better support the National Development Plan, with particular attention on transforming the sector into one that is more inclusive and sustainable, to serve South Africans better.

### Significant changes introduced

To their great credit, National Treasury implemented very many of the industry comments and proposals on the previous set of draft regulations. The revised draft regulations are much less restrictive, are more principle based than rule based and will therefore be easier to implement.

Following the public engagement programme National Treasury (NT) attempted to -

- Make compliance easy, thereby aiding in reducing compliance costs
- Enable flexibility by using more of a principles-approach to regulation
- Encourage and facilitate better and appropriate decision-making by members



The previous draft regulations have been changed in the following significant respects:

#### **Default investment portfolio**

- The prohibition on investment portfolios and products that have elements of a guarantee or smoothing or performance fees is abandoned.
- Boards will be required to “equally consider” both passive and active investment strategies.
- Clarification that counselling is limited to the provision of information and not advice. The requirement to appoint a counselor has been replaced with a requirement to provide counselling services.
- Clarification that the default investment portfolio is only applicable to retirement funds with a defined contribution category.

#### **Default preservation**

- The automatic ‘pot-follows member’ requirement on withdrawal has been abandoned. The members will have to decide if they want to transfer their paid-up benefits to their new employer’s fund.
- No *de minimis* withdrawal amount will be provided for.
- Clarification that only the investment fees in respect of paid up-members must be the same. Differentiation of administration fees is allowed in respect of paid-up members.

#### **Annuity strategy**

- Automatic default has been abandoned in favour of “an opt-in”, as certain annuity products could be irreversible. An “annuity strategy” with a proposed annuity is now preferred to a “default annuity strategy”.
- Both in-fund and out-of-fund annuities are eligible as part of the annuity strategy, provided that prescribed principles are complied with.
- National Treasury significantly reduced and simplified the proposed new regulations.

## **2. The defaults that funds will be required to implement into the draft regulations**

### **2.1 Default investment portfolio**

- Pension and provident funds (in respect of a DC component) will have to amend their rules to require the board of the fund to establish an investment policy statement which provides for a default investment portfolio (DIP).
- The retirement funding contributions of a member must be invested in this portfolio, unless the member instructs the fund differently where other portfolios are provided for in the investment policy statement.
- The DIP may differ for the members in different membership categories. The composition of the portfolio for members in one membership category (e.g. those who are invested in a life stage strategy) may differ from member to member based on the following factors, i.e. the age or likely retirement date of the member, the value of the retirement savings of the member in that fund, and the actual or expected retirement funding contributions of the member.



- Regulation 28 compliant portfolios will in principle qualify as a DIP but will have to comply with any conditions that may be prescribed. Special requirements are envisaged in respect of guaranteed type portfolios and portfolios that make provision for performance fees.

The duties of the board include the duty to ensure, and be able to demonstrate to the Registrar on request, that –

- Any DIP is appropriate for the members who will be automatically enrolled into them, taking into account the following:
  - The design of a DIP, (high-level objective; underlying asset allocation; fees and charges; and the expected risks and returns) must, as far as is reasonable, take account of the likely characteristics and needs of that category of fund members.
  - The composition and performance of the DIP must be adequately communicated to members.
  - DIPs must be cost effective, reasonable and competitive, taking a wide range of factors into account.
  - All fees and charges in respect of the DIP are disclosed as well as the impact that such fees and charges will have on members' actual and prospective benefits.
  - Both passive and active investment must be equally considered as DIP options.
  - No loyalty bonuses or other complex fee structures may be imposed in respect of the DIP. Fees may not depend on the length of time that a member has been a member of the fund, the number of contributions made by the member or any similar measure. Members may not be locked into the DIP if other portfolios are provided for.
  - The DIP must be reviewed on a regular basis.

## **2.2 Default preservation and portability**

- The rules of pension and provident funds will have to be amended to provide for members who terminate service before retirement to become paid-up in the fund.
- When members leave the service of a participating employer, such members must be made paid-up members of the fund until the fund is instructed by the member, in writing, to pay out or transfer the benefits.
- Such a member must be presented with a paid-up membership certificate within two (2) calendar months.
- Investment fees and charges must remain the same.
- The administration fees for paid-up members must also remain substantially similar.
- No fees may be charged as a direct consequence of a member becoming a paid-up member.
- The rules of the fund must allow for transfers to the fund from another fund.
- The fund must within four (4) months of a member joining the fund, obtain a list of all paid-up membership certificates in respect of any retirement savings of that member.
- Request whether the member wishes these benefits to be transferred into the fund; and



- if the member so elects, arrange the transfer of all such retirement savings into the fund. without levying a charge on such amounts in respect of the transfer.
- The fund rules should specify that in respect of paid-up members
  - no new contributions to the fund are permitted;
  - no deductions may be made in respect of risk benefits;
  - eligibility for retirement and early retirement for paid-up members is as per fund rules; and
  - members are given access to retirement benefits counselling before any withdrawal benefit is paid to them or any transfer is made on their behalf to another retirementfund.
- DB fund rules will also require an amendment to the effect that on preservation, a defined benefit amount of a member who withdrew from service may be converted to a defined contribution component and be preserved as such.

### **2.3 Annuity strategy**

The rules of pension, provident, retirement annuity and preservation funds must provide for the board to establish an annuity strategy. Members will be able to take guidance from the strategy and can opt-in, i.e. elect an annuity proposed as part of the strategy, should they wish.

Boards must ensure, and be able to demonstrate to the Registrar on request, that

- A proposed annuity that forms part of the fund's annuity strategy is appropriate and suitable for the members who will be enrolled into it.
- The proposed annuity should, as far as is reasonably ascertainable by the Board, consider the level of income that will be payable to retiring members; the investment, inflation and other risks inherent in the income received by retiring members; and the level of income protection granted to beneficiaries in the event of the death of a member enrolled into the proposed annuity.
- The objective, composition and performance of the proposed annuity are communicated to members.
- Proposed annuities have reasonable and competitive fees and charges.
- All fees and charges, and their impact on members' benefits are disclosed.
- Members are given access to retirement benefits counselling not less than three (3) months before their normal or selected retirement.
- The proposed annuity is reviewed annually.



### **Living Annuities**

- Living annuities can be paid from the fund or through a fund owned policy or sourced from a contracted third-party external provider as part of the proposed annuity solutions; provided that in each case, the investment choice is limited to four (4) investment portfolios and drawdown levels are compliant with the accepted industry standard.
- Where the living annuity is paid from the fund or through a fund owned policy, funds must monitor the sustainability of income drawn by retirees in these living annuities and make such members aware if their incomes are deemed not to be sustainable.
- Investment portfolios for a living annuity chosen should be consistent with regulation 37.

### **In-fund pensions**

- A pension payable by the fund in terms of its rules may be chosen as part of the proposed annuity solutions.
- Such a pension can be non-guaranteed, on condition that members are informed in clear and understandable language that the fund does not guarantee pension amounts, and that such pensions can fluctuate in line with the value of the underlying assets, longevity of fund members and any fund expenses.
- The assets relevant for the purposes of paying pensions and determining pension increases must be maintained separately and must be reduced by any pension payments made to pensioners and any fund expenses and increased with the relative return of the underlying assets.

### **Out of fund annuities**

- Guaranteed annuities provided by a long-term insurer may be provided as a proposed annuity subject to such conditions that the Registrar may prescribe.



### **3. Watershed development**

At Simeka we have embraced the default benefit strategies and have incorporated them into our benefit structure approach over the past decade. Many of our clients have already adopted the strategies with very positive results.

National Treasury has gone out of their way to rework the default regulations in order to remove obstacles and facilitate implementation in a cost effective way. We will work with them to address the remaining concerns.

Having said that, this development constitutes something of a watershed moment for many funds. It will require funds to expand their benefit structure to include retail type benefits in respect of former members with whom they have no further contact. Many stand-alone funds are understandably concerned about the additional risks and responsibilities they are required to deal with.

In contrast, top umbrella funds such as the Sanlam Umbrella Fund implemented such defaults within months of the changes to paragraph 4 of the Second Schedule of the Income Tax Act in March 2015. For umbrella funds it is a business imperative to offer their clients the most attractive, convenient and cost effective benefits – not just while they are employed by a participating employer but at any stage thereafter. The more attractive the fund's benefit structure, the greater the opportunity to grow and offer benefits of scale.

The world of work is changing along with advances in technology and the changing needs and behaviours that flows from interconnectedness. Retirement fund benefit structures also need to adjust and adapt.

We are developing strategies to make sure that our umbrella fund clients as well as our stand-alone clients will not only be able to comply with the new default regulations but implement the defaults it in a way that will enhance the value of their fund membership and give them even more assistance and support in achieving good retirement outcomes for their members.



## Appendix A - Extracts with comments

### 4. Default investment portfolio

#### 4.1 General observations and extracts from the explanatory memorandum

##### *The exclusion of products with elements of guarantee has been dropped*

Clauses that dealt with default investment portfolios being purely for investment purposes have been deleted. These clauses were interpreted as banning smoothing of returns. Smooth bonus policies are eligible for inclusion in default investment portfolios but will have to comply with conditions, rules and regulations to be set by the Financial Services Board (“FSB”).

##### ***The prohibition against performance fees was dropped***

Investments that have a performance fee element will be allowed subject to, in the interim, compliance with an industry standard that should simplify methodology and disclosure, and funds motivating their use to the FSB as part of their compliance with the default regulations and Regulation 28. The standard could ultimately be supplemented or replaced by an FSB regulatory standard. The appropriateness of performance fees will be monitored against the FSB standard, to enable review of the interim policy decision if necessary.

The revision is informed by the understanding that retirement funds, as institutional investors and therefore “qualified investors”, should be in a relatively better position to assess the appropriateness of performance fees, *vis-à-vis* retail investors. Secondly, the revision acknowledges that certain alternative asset classes which are already regulated under Regulation 28 and other frameworks could be useful in diversifying investment opportunities and risk, and thereby enhancing long-term returns.

##### ***Applicable level of customisation in umbrella funds***

The regulations do not prescribe whether umbrella funds should customise their default investment portfolios at fund level (i.e. across the entire fund) or at sub-fund level (i.e. at participating employer level).

In addition, the regulations only allow but do not require or compel funds to customise defaults based on the specified member variables (i.e. age or likely retirement date, value of retirement savings and actual/expected retirement funding contributions).



### ***Special Grandfathering arrangement***

On page 6 of the explanatory memorandum under the heading “Grandfathering” it is stated that “Default arrangements in place before the regulations come into effect will be exempt from this regulation unless their terms or conditions change. Any new default arrangements (investment, preservation and annuities) that are entered into after the effective date of the regulations should comply with this regulation.”

**Observation:** *We cannot see that it is stipulated anywhere in the draft regulations that existing default arrangements will be exempt from the regulations. We will ask for clarification.*

## **4.2 Amendment of relevant definitions**

(what follows is a reproduction of the draft regulation with our comments in italics)

**“default investment portfolio”** means an investment portfolio(s) in which the retirement funding contributions of a member of a fund must be invested unless the fund has been instructed by the member in writing to invest them in another investment portfolio; provided in terms of the investment policy statement of the fund or options available to members of the fund, and which portfolio:

- (a) complies with the requirements set out in regulation 37; and
- (b) the composition of the portfolio may differ from member to member in respect of:
  - (i) the age or likely retirement date of each member;
  - (ii) the value of the retirement savings of the member in that fund, and
  - (iii) the actual or expected retirement funding contributions of the member;
- (c) complies with any conditions that may be prescribed.

**Observation:** *The selection of default investment portfolios is typically done in respect of one or more membership categories in the fund. While this definition will work well with typical life stage type portfolios it does not provide clarity or impose a regime in respect of different categories of members or different participating employers in an umbrella fund.*

**“investment portfolio”** means an identifiable portfolio of assets whether those assets are

- (d) owned by the fund;
- (e) owned by an insurer which has issued to the fund a policy in terms of which policy benefits are directly or indirectly based on the returns on the investment of those assets;
- (f) assets held by a collective investment scheme or pooled fund of which the fund or an insurer contemplated in part (b) is a unit-holder,

in which the fund has invested retirement funding contributions of its members and/or has decided to include in the range of investment portfolios in which retirement funding contributions may be invested;



“**pooled fund**” means a collective investment undertaking, including investment compartments of a collective investment undertaking, constituted in any legal form, including in terms of a contract, by means of a trust, or in terms of statute, which—

- (a) raises capital from one or more investors, to facilitate the participation or interest in, subscription, contribution or commitment to a fund or portfolio, with a view to investing it in accordance with a defined investment policy for the benefit of the investors; and
- (b) does not require approval as a collective investment scheme in terms of the Collective Investment Schemes Control Act, 2002 (Act No. 45 of 2002);

#### 4.3 Regulation 37. Default investment portfolio

1. The rules of funds with a defined contribution category must provide for the board to establish an investment policy statement, which provides for a default investment portfolio.

**Observation:** *This will require an amendment to every DC fund's IPS (probably) during 2017.*

*In the explanatory memorandum it is argued that the default investment portfolio requirement does not apply to retirement annuity funds as for these funds the selection is made up front. The same may also apply in respect of preservation funds. The regulation however does not seem to support this interpretation and will require adjustment.*

2. The board must ensure, and be able to demonstrate to the Registrar on request, that –

*Default investment portfolio(s) are appropriate for the members who will be automatically enrolled into them*

- (a) the design of the default investment portfolio, including its
  - (i) high-level objective;
  - (ii) underlying asset allocation;
  - (iii) fees and charges; and
  - (iv) the expected risks and returns to which it exposes members whose retirement savings in that fund are or will be invested in the default investment portfolio of that fund;

takes account, as far as is reasonable, of the likely characteristics and needs of that category of fund members whose retirement funding contributions and retirement savings in that fund are or will be invested in the default investment portfolio of that fund;

**Observation:** *These requirements have been toned down somewhat. Part 4.B of the explanatory memorandum says “the requirement that boards must take into account the likely characteristics and needs of members whose retirement savings will be invested in the default investment portfolio has been deleted”. This requirement has however not been deleted. Regulation 37.2(a) still stipulates that the design of the default investment portfolio must take into account “the likely characteristics and needs of that category of fund members whose retirement funding contributions and retirement savings in that fund are or will be invested in the default investment portfolio”. All that was deleted, is the list of characteristics and needs contained in the previous draft of the regulations.*

*In terms of the current draft the board must ensure that the default will be appropriate for those who will be enrolled. This will require the following actions -*

1. *the benefit or communication consultant / the communication sub-committee will have to ensure that the fund has a good understanding of the profiles of the members of the fund, including their income levels, ages and needs.*
2. *the investment consultant will have to prepare and guide the trustees on the range and desirability of an appropriate default portfolio for their membership. Many consultants are likely to use a replacement ratio or projected pension calculation for each of the default*



portfolios over the longer term in order to compare and assess the portfolios. In such an exercise the implications of any high costs, risk and returns should clearly reflect in the projected long-term returns.

3. the trustees will be required to consider and sign off on the portfolios in terms of the regulations and TCF.

*The composition and performance of the default investment portfolio are adequately communicated to members*

- (b) the underlying asset allocation, and fund return net of all fees and charges in respect of the default investment portfolio are communicated to fund members on a frequency and format which may be prescribed;

**Observation:** *This will require fund trustees to make a communication to every member in every membership category the fund. A separate communication prepared for each category who are invested in any one of the default investment portfolios selected, will however be preferable.*

*Default investment portfolios are cost effective*

- (c) the fees and charges in respect of the default investment portfolio or the assets held in respect of the default investment portfolio are reasonable and competitive, taking account of market conditions, the size, asset allocation and other characteristics of the fund as a whole and the default investment portfolio in particular;

**Observation:** *This requirement is a complex one. Whilst we are in agreement with the general principles conveyed, the position relative to umbrella funds may be more complex and will in most cases require a separate regulation. The following comment by ASISA on the previous draft of the regulations was not addressed and is still valid:*

*“We do not agree with the requirement that fees take account of “the fund as a whole” if this is intended to prohibit sliding fee scales at participating employer level within commercial umbrella funds. Sliding fee scales at participating employer level allow for fee levels to be more closely related to actual servicing costs at these sub-fund levels.*

*It would be unfortunate if large participating employers in umbrella funds, because they are not allowed to be charged fees that relate to their asset size and sub-fund characteristics, elect to leave umbrella funds and opt for a free-standing arrangement that would be a less expensive option for them. This would result in only the small employer sub-funds remaining in the umbrellas, which would then lose the cost-effectiveness of scale and become more expensive.”*

*All fees and charges are disclosed*

- (d) all fees and charges, whether borne directly by the fund or paid directly or indirectly out of assets, or implicit in trading assets or in trading or holding derivative securities or policies purchased in respect of the default investment portfolio and the management of the underlying assets, as well as the impact that such fees and charges will have on members’ actual and prospective benefits, are disclosed on a regular basis to members, in a clear and understandable language, and in a format which may be prescribed;

**Observation:** *The requirement that “the impact that such fees and charges will have on members’ actual and prospective benefits” must be disclosed, supports the need for a replacement ratio type calculation that allows for easy comparisons.*



*Both passive and active investment must be equally considered as investment options*

- (e) boards should consider both passive and active investment strategies as part of the default investment portfolio;

**Observation:** *The section has been appropriately reworded to allow funds to equally consider both passive and active investment strategies when choosing investment portfolios as a default. This will nevertheless place pressure on investment consultants and boards of trustees to show why they believe that active will outperform passive or vice versa – especially in the context of a replacement ratio type calculation.*

*No loyalty bonuses or other complex fee structures*

- (f) no fees or charges deducted from or amounts credited to members' retirement savings or retirement funding contributions or otherwise paid to members by any service provider in respect of the default investment portfolio may depend on the length of time that a member has been a member of the fund, the number of contributions made by the member or any similar measure;

**Observation:** *Funds will have to determine if this requirement will have an impact on any standard current arrangement.*

*Members are not locked into the default investment portfolio*

- (g) members may instruct the fund to transfer their retirement savings from the default investment portfolio into any other investment portfolios offered in terms of the rules of the fund at intervals not exceeding one year, in respect of which transfer the fund may deduct reasonable administration costs from the account of members concerned;

**Observation:** *This provision merely allows member to transfer from the default portfolio to another portfolio - if more than one portfolio is offered in terms of the fund rules.*

*The default investment portfolio is reviewed*

- (h) the board must review the default investment portfolio on a regular basis to ensure that it continues to comply with this regulation.

**Observation:** *This requirement will typically be delegated to the investment consultant and the investment sub-committee of the board of trustees and reports and actions will have to be recorded in the fund governance plan.*

## 5. Default preservation and portability

### 5.1 General observation and extracts from the explanatory memorandum

*Automatic transfers to the default investment portfolio (proposed in previous version of draft regulations) abandoned*

Automatically moving preserved funds of members who resigned to be invested in the default investment portfolio is not practical as members must consent before preserved funds are transferred to another portfolio in the fund (unless the rules provide).

**Observation:** *The new action required on the part of the fund is to make the member paid-up. There is no requirement to have a default investment portfolio for paid-ups. The regulation has to be corrected and the reference to default investment portfolio removed.*



***Administration Fees for Paid-up members reformulated***

Administration fees are often expressed as a percentage of salary and not as per member amounts and will therefore differ in Rand terms between members. This method can therefore not be used if administration fees are not allowed to differ. Hence, the second draft has been amended to allow for different methods of calculation of administration fees.

However, investment fees should be the same for all members, hence an amendment to say investment fees and charges should not differ between active and paid-up members.

***“Pot-follows-member” requirement on withdrawal abandoned***

The “pot-follows-member” requirement on withdrawal is no longer a “sub-default” after in-fund preservation. This means that a member will become a paid-up member in the old fund (if no other election is made) and will remain paid-up, until consent from the member is provided for the member’s share in the old fund to be consolidated or transferred to the new fund.

The explanatory memorandum states that members should be able to access their default preserved funds anytime, and whatever amount. The regulations do not prohibit out of fund preservation. Members have the option of transferring their accumulated benefit to a preservation fund of their choice.

***DB benefits converted into a DC benefit once they have accrued***

In the case of DB fund benefits, the regulations have been clarified to state that a DB fund benefit should be converted into a DC benefit once they have accrued but before they are automatically preserved.

***Observation:*** *More work is however required to this regulation to ensure clarity and certainty.*

***No de minimis withdrawal amount will be provided for***

The regulations do not make provision for a de minimis amount for preservation. Any amount left by the member should by default be preserved until the member elects otherwise. NT is of the view that prescribing an amount below which preservation might not be possible could encourage unnecessary frequent withdrawals. Further, having a de minimis amount would imply that a member no longer preserves by default but as a choice and if the benefit is above the threshold. The regulations also do not prescribe an amount that a paid-up member can withdraw from the preserved benefit. NT explains that it is however, not an “all-or-nothing” rule as currently understood by commentators. Fund rules should, therefore, specify whether to allow withdrawal of the entire amount preserved or part withdrawals.

***Observation:*** *While we would welcome a position where a member can elect to receive a portion in cash and leave the balance in the fund as a paid-up benefit, this does not appear possible in terms of our interpretation of the Act. We are not clear on what is meant by “part withdrawals”. Paragraph 4(1)(a) of the Second Schedule to the Income Tax Act, stipulates as follows.*



*“Notwithstanding the rules of a pension fund, pension preservation fund, provident fund, provident preservation fund or retirement annuity fund, and subject to paragraphs 3 and 3A, any lump sum benefit shall be deemed to have accrued to a person who is a member of such fund on ... the date on which an election is made in respect of which the benefit becomes recoverable.”*

*If a paid-up member elects to receive a portion of his benefit in cash, his entire benefit will in terms of Paragraph 4(1)(a) of the Second Schedule accrue for tax purposes, in which case it would no longer be possible/viable for the member to remain a paid-up member. Part withdrawal of the paid-up benefit is accordingly not possible/viable.*

**Future paid-up member certificate depository:**

A process is currently underway at the FSB to resolve the issue of unclaimed benefits, part of the solution being to set up a centralised database. It is envisaged that this database would in the long run be extended to be a depository for the paid-up member certificates. In the interim, it is envisaged that a certificate will be issued by the fund to the paid-member. The new employer (or fund) should enquire about the certificate from the member and request for it if the paid-member decides to transfer the preserved savings in the previous employer's fund.

## 5.2 Amendment of relevant definitions

(what follows is a reproduction of the draft regulation with comments in italics)

“paid-up member” **means a deferred pensioner;**

“**paid-up membership certificate**” means a certificate issued by a fund in terms of regulation 38 in respect of a paid-up member which records, in a format which may be prescribed, at least the following:

- (a) the name, address, registration number and contact details of the retirement fund;
- (b) the name, address and contact details of the retirement fund administrator;
- (c) the name, address, ID number, tax number, fund membership number and contact details of the member in respect of whom the certificate is issued;
- (d) the date at which the member in respect of whom the certificate is issued became a paid-up member, and the date on which the certificate was issued;
- (e) the value of the member's individual account or member's individual reserve in respect of whom the certificate is issued, at the date on which such a member became paid-up;
- (f) the investment portfolios in which such retirement savings are invested; and
- (g) any other information which may be prescribed.

**Observation:** *While the fund should have most of the information required it appears essential for funds and administrators to adjust their processes to ensure that they obtain all the personal contact details from members when the exit is processed.*

*In our experience unclaimed benefits often follows absence without consent. We will request NT to insert such provisos as may be necessary to avoid confusion between unclaimed benefits and paid-up benefits.*



**“retirement benefits counselling”** means the disclosure and explanation, in clear and understandable language, including risks, costs and charges, of:

- (a) the available investment portfolios;
- (b) the terms of the fund’s annuity strategy;
- (c) the terms and process by which a fund, including a member’s new fund, handles preserved benefits in terms of regulation 38; and
- (d) any other options available to members.

**Observation:** *This definition makes it clear that counselling does not include any advice or guidance. It merely makes provision for information and explanations - possibly calculators and comparisons to show the difference between various options and products.*

*Based on this definition, this could be achieved in a number of ways all of which need not necessarily involve direct contact with a counsellor.*

**“retirement funding contributions”** in a defined contribution category of a fund as defined in the Pension Funds Act (Act 24, 1956), means that part of the contributions or transfer values paid to the fund by or in respect of a member, which are applied towards retirement savings in terms of the rules of the fund.

**“retirement savings”** in a defined contribution category of a fund as defined in the Pension Funds Act, means the member’s individual account.

### 5.3 Regulation 38 Default preservation and portability

1. If members are enrolled into a retirement fund as a condition of employment, the rules of that fund must provide for members to become paid-up in the fund.

**Observation:** *The rules of all pension and provident funds will have to be amended to provide for the default preservation of benefits. Although the explanatory memorandum states that the default regulations on preservation will not apply to retirement annuity funds the current wording may apply to some group retirement annuity funds.*

- (b) When members leave the service of a participating employer, such members—
  - (i) must be made paid-up members of the fund until the fund is instructed by the member, in writing, to pay out or transfer the benefits due to the member in terms of the rules, and
  - (ii) must be presented with a paid-up membership certificate within two (2) calendar months of becoming aware that the member has left the services of the participating employer,

**Observation:** *The default position is to make the member paid-up. Every fund will have to adjust its procedures to ensure that a member will continue to be paid-up until such time the member elects payment or transfer of the benefit occurs. There is no longer a requirement to implement a default investment for paid-up members. These members will (subject to the rules of the fund) typically remain in the invested in the same portfolio, until such time as they select another portfolio.*

*In addition, every fund will have to prepare and provide the member with a paid-up membership certificate. Presumably the 2-month period runs from the date the fund became aware that the member has left service.*



- (c) Investment fees and charges in respect of the portion of retirement savings that is invested in the default investment portfolio may not differ on the basis of whether members are paid-up members or are still in the service of the participating employer. The administration fees for paid-up members, if expressed in a similar way as active members, may not be more than the average of active members' administration fees.

**Observation:** *The wording of the first requirement of the regulation refers to the "default investment portfolio" which in respect of preservation strategies has been abandoned in favour of a requirement that the member be made paid up. As was stated in the explanatory memorandum the intention is to ensure that the asset management fee payable by paid up members is not higher than for contributory members.*

*The second requirement attempts to achieve the same in respect of the administration fees charged in respect of paid-up members. While we support the principle one will have to apply the various models to be able to see whether the new wording is able to achieve the objective without creating any anomalies.*

- (d) No charges may be levied on the retirement savings of a member as a direct consequence of that member becoming a paid-up member.

**Observation:** *The transfer of a contributory member to the status of a paid-up member must therefore be done as part of the standard administration service. An additional transaction fee cannot be charged.*

- (e) The rules of funds must make provision to accept any amount or amounts paid or transferred, or which will be paid or transferred, to the fund from another fund for the benefit of a member or members, provided that such transfers may comprise a defined contribution benefit component, and such funds must –
- (i) within four (4) months of a member joining the fund, obtain, in a manner which may be prescribed, a list of all paid-up membership certificates in respect of any retirement savings of that member;
  - (ii) request, for each paid-up membership certificate, in a manner which may be prescribed, whether members wish to allow the retirement savings held in respect of each paid-up membership certificate to be transferred into the new fund; and
  - (iii) if a member elects to transfer their retirement savings, arrange, on behalf of that member, in respect of each paid-up membership certificate, the transfer of all such retirement savings into the fund, without levying a charge on such amounts in respect of the transfer.

**Observation:** *The new fund will be required to obtain a list of the paid up benefits that the member has in other funds within 4 months. At present this can only be done in consultation with the new member. In future the regulator may lay down additional requirements to facilitate this.*

*The next step is for the fund to request the member to elect whether to transfer these benefits to the fund or not and, if requested to do so, arrange for the transfer of the benefits to the fund at no additional charge. The regulation requires the fund (or the administrator, the contracted benefit consultant or the fund counsellor on behalf of the fund) to engage with the member and follow a documented process relating to all other paid up benefits. The regulation does not mention or require similar action in respect of preservation funds but there appears to be no reason why the fund could not include these benefits in its investigation.*

*Part 4.C of the explanatory memorandum states "In the case of DB benefits, the regulations have been clarified to state that a DB benefit should be converted into a DC benefit once they*



*have accrued but before they are automatically preserved.” This aspect is not clearly articulated in Regulation 38.1(e) and will require more clarification.*

2. The fund rules should with respect to paid-up members specify that—
- (a) no new contributions to the fund may be permitted in respect of this class of member;
  - (b) no deductions may be made from the retirement savings of paid-up members in respect of risk benefits;
  - (c) a defined benefit amount, on preservation, may be converted to a defined contribution component and have it preserved as such;
  - (d) eligibility for retirement and early retirement for paid-up members is as per fund rules; and
  - (e) members are given access to retirement benefits counselling before any withdrawal benefit is paid to them or any transfer is made on their behalf to another retirement fund.

**Observation:** *The fund rules will have to be amended to ensure that no further contributions can be made to the fund by these members, their benefits cannot fund any risk benefits, paid-up members are included in the normal or early retirement requirements and that members will be given access to retirement benefits counselling.*

*The draft regulations no longer require the appointment of a counsellor, just the provision of access to retirement benefits counselling as defined. Based on this definition it would appear that this service can be provided on behalf of the fund in a number of ways. For example, a person with the required knowledge and insight should be allowed to do it on behalf of the fund.*

## 6. Annuity strategy

### 6.1 General observations and extracts from the explanatory memorandum

This section has been considerably simplified and reduced largely by introducing principles and conditions in preference to rules.

#### **“Default annuity” abandoned in favour of a “soft” default**

This was achieved by allowing members to “opt-in” instead of “opting-out”. This was done because being defaulted into an annuity like a life annuity, would not allow the member to opt-out once defaulted into the product. The “soft default” also obviates the need for extensive prescription in the regulations. Secondly, the default has been amended to take into consideration current trends and preferences and still protect members within their particular preferences and biases - a default loses its purpose if many participants opt out of it.

#### ***In and Out-of-fund annuities allowed***

The revised regulations make both in-fund and out-of-fund living annuities eligible annuities provided that the stipulated principles and conditions (yet to be provided) are met.



### ***Age based drawdown rates abandoned in favour of an industry standard on living annuities***

National Treasury agrees that there is a case to be made that drawdown rates for living annuities should actually be more guided by the capital at retirement, than only or largely by age at and in retirement. They now believe a combination of both age and capital factors could be appropriate. In the interim, the drawdown rates should be compliant with an industry standard on living annuities. The association of Savings and Insurance of South Africa ASISA has developed such standard NT says this could be further enhanced or replaced by an FSB standard.

#### *Application of section 37C of the Pension Funds Act to in-fund living annuities*

Currently, section 37C does not apply where individuals purchase living annuities outside the fund. No changes have been made to the regulations in respect of this concern. In the explanatory memorandum the point is made that the legal position appears to be ambiguous as some funds do apply section 37C to post-retirement benefits (i.e. annuities) while others do not.

As far as we are concerned action will be required as it is clear that section 37C should be applied in respect of an in-fund or fund-owned living annuity.

## **6.2 Amendment of relevant definitions**

(what follows is a reproduction of the draft regulation with our comments in italics)

**“annuity strategy”** means a strategy, as determined by the board, setting out the manner in which a member’s retirement savings may be applied, with the member’s consent, to provide an annuity by the fund or to purchase a proposed annuity on behalf of the member from an external provider, which annuities comply with the requirements of regulation 39 and any conditions that may be prescribed from time to time;

**“living annuity”** has the meaning assigned to it in section 1 of the Income Tax Act, 1962 (Act No 58 of 1962);

## **6.3 Regulation 39. Annuity strategy**

1. The rules of all retirement funds must provide for the board to establish an annuity strategy.

**Observation:** *This will require pension, provident, retirement annuity and preservation funds to make the required rule amendment. Beneficiary funds should be excluded from this requirement.*

2. Boards must ensure, and be able to demonstrate to the Registrar on request, that:

*The proposed annuity as per the annuity strategy is appropriate and suitable for the members who will be enrolled into it*

- (a) The proposed annuity should, as far as is reasonably ascertainable by the Board, consider: the level of income that will be payable to retiring members; the investment, inflation and other risks inherent in the income received by retiring members; and the



level of income protection granted to beneficiaries in the event of the death of a member enrolled into the proposed annuity.

**Observation:** *The board will have to ensure that the annuity strategy is appropriate for those who will elect to be enrolled into the fund's "proposed annuity". This is arguably the most complex decision a member ever has to make and because their needs and aspirations are so different only one proposed option is unlikely to be appropriate.*

*This will require -*

1. *the benefit consultant / member communication consultant / the communication committee to ensure that they have a good understanding of the projected pension ratios and other profiles of the retiring members of the fund and their likely income levels and needs.*
2. *the investment consultant to prepare and guide the trustees on the (degrees of) desirability of the default portfolio for its membership profile/s.*
3. *the trustees to consider, adjust or sign off on the strategy in terms of the regulations and TCF.*

*The objective, composition and performance of the proposed annuity are communicated to members*

- (b) *the high-level objective, average incomes and changes in the incomes in respect of the annuity option for fund members and former fund members whose retirement savings were used to provide a retirement income are communicated to fund members on a regular basis, in a clear and understandable language and in a format which may be prescribed;*

**Observation:** *Most funds will use calculators and models to help explain the alternatives to retiring members. It appears appropriate for the fund to update the assumptions on a regular basis and assist the member to plot progress as the indicators change along the retirement journey.*

*Proposed annuities have reasonable and competitive fees and charges*

- (c) *the fees and charges in respect of the proposed annuity or the assets held in respect thereof are reasonable and competitive, considering the benefits provided to members or former-members of the fund, the size, composition and asset allocation of the fund and the annuity in particular;*

**Observation:** *The reason why in-fund annuities were pushed in the first draft was probably to try and ensure that members will enjoy institutional and not retail asset management fees which would bring costs down. In this draft more default/proposed options are allowed but funds will still have to apply the principle of reasonable and competitive fees and charges.*

*All fees and charges, and their impact on members' benefits are disclosed*

- (d) *all fees and charges, whether borne directly by the fund or paid directly or indirectly out of assets, or implicit in trading assets or in trading or holding derivative securities or policies purchased in respect of the proposed annuity and the management of its underlying assets, as well as the impact that such fees and charges will have on members' actual and prospective benefits, are disclosed on a regular basis to members whose retirement benefits are provided in terms of this annuity, in a clear and understandable language, and in a format which may be prescribed;*

**Observation:** *The best way to explain the implications of costs and fees will be to make calculators and projection statements available to the members.*



*Members are given access to retirement benefits counselling*

- (e) members are given access to retirement benefits counselling not less than three (3) months before their retirement date as determined in the fund rules of the fund;

**Observation:** *An amendment to the fund rules will be required. Counselling on an annuitisation strategy is more complex and funds will have to provide the required modelling infrastructure with trained staff or secure the services of a contractor to provide such counselling on behalf of the fund.*

*The proposed annuity is reviewed annually*

- (f) boards must review the proposed annuity at least annually to ensure that the annuity continues to comply with this regulation.

**Observation:** *The benefit consultant in consultation with the investment consultant and actuary) will typically be contracted to do the research and provide the fund with a report and a recommended action plan on an annual basis.*

### **Living Annuities**

3. (a) Living annuities can be paid from the fund or through a fund owned policy or sourced from a contracted third-party external provider as part of the proposed annuity solutions; provided that in each case, the investment choice is limited to four (4) investment portfolios and drawdown levels are compliant with the accepted industry standard.
- (b) Where the living annuity is paid from the fund or through a fund owned policy, funds must monitor the sustainability of income drawn by retirees in these living annuities and make such members aware if their incomes are deemed not to be sustainable.
- (c) Investment portfolios for a living annuity chosen should be consistent with regulation 37.

**Observation:** *Living annuities can be provided by the fund in more than one way, including an annuity -*

1. *developed and maintained by the fund's own infrastructure ("paid from the fund"),*
2. *developed and maintained for and on behalf of the fund by a service provider / the fund administrator ("paid from the fund"),*
3. *a policy purchased from an insurer in the name of the fund for the benefit of a member ("paid through a fund owned policy"),*
4. *We are not clear on the additional alternative "sourced from a contracted third-party external provider" as part of the proposed annuity solutions and will require clarification. There was a time when National Treasury felt that they need to allow financial service providers other than insurers to provide living annuities to improve the level of competition. We don't know if this is the reason for using this term, instead of just referring to a long-term insurer.*

*In situations 1 to 3 the fund must monitor the sustainability of the annuity and where appropriate make the member aware. This will require the fund to establish and maintain a lifelong relationship with these members and provide them with important support along the way.*



### ***In-fund pensions***

4. (a) A pension payable by the fund in terms of the rules of the fund may be chosen as part of the proposed annuity solutions.
- (b) Such a pension can be non-guaranteed, on condition that members are informed in clear and understandable language that the fund does not guarantee pension amounts, and that such pensions can fluctuate in line with the value of the underlying assets, longevity of fund members and any fund expenses.
- (c) The assets relevant for the purposes of paying pensions and determining pension increases must be maintained separately and must be reduced by any pension payments made to pensioners and any fund expenses and increased with the relative return of the underlying assets.

**Observation:** *This option will only be appropriate for larger funds but may allow funds the opportunity to maximize benefits to members along a particular design.*

### ***Out of fund annuities***

5. Annuities other than living annuities provided by a long-term insurer may be provided as a proposed annuity subject to such conditions that the Registrar may prescribe.

**Observation:** *Our interpretation is that Guaranteed annuities may be provided subject any conditions imposed by the registrar.*

## **7. Short title and commencement**

These Regulations are called the Amendments to the Pension Fund Regulations, 2016, and shall come into operation on a date to be determined by the Minister in the Government Gazette.

## **8. Consultation**

Submissions are invited on the form and content of this regulation. Please send all comments before 28 February 2017, to Ms Alvinah Thela, Director: Retirement Funds, National Treasury, Private Bag X115, Pretoria, 0001. Submissions may also be submitted by fax to 012 315 5206; or by email to [retirement.reform@treasury.gov.za](mailto:retirement.reform@treasury.gov.za).