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tennant administration services

Retirement fund defaults: draft Regulations to the Pension Funds Act

On 22 July 2015, National Treasury released draft Regulations to the Pension Funds Act for public comment. These Regulations prescribe three types of defaults for retirement funds and set out conditions surrounding their implementation. These fund defaults pertain to investments, default preservation provisions and default annuities.

The draft Regulations form part of the broader retirement and savings reforms initiated in 2011 and outlined in the 2014 Budget update on retirement reforms. The object of these Regulations is to improve market conduct in line with the Treating Customers Fairly initiative and the Retail Distribution Review.

A summary of the conditions pertaining to these defaults is set out below:

A. Default investment portfolio

1. Funds' rules will need to be amended to implement a default investment strategy for members who do not make investment choices. However, funds can apply for exemption from this, from the Registrar
2. Trustees must be able to demonstrate, that:
    - The default is appropriate for the fund members
    - The design of the defaults must include considerations of the high level objective, underlying asset allocation, fees and charges and risks and returns of the portfolio
    - As far as reasonable, the default takes into account the members' preferences for balancing risk and return, likely term of fund membership, financial sophistication and ability to access individual financial advice
3. The default's high-level objective, underlying asset allocation and fund return net of all fees and charges must be communicated to members clearly and understandably in a format which may be prescribed
4. Fees must be reasonable, competitive and regularly and accurately disclosed
5. No performance fees and loyalty bonuses will be permitted in default portfolios
6. Members may not be locked into a portfolio and must be able to switch between portfolios
7. The investment strategy must not contain any insurance element / risk benefits but must be purely for investment purposes
8. Trustees must at least consider the use of passive investments as part of the default.

B. Default preservation and portability

1. All retirement funds will be required to implement a default preservation strategy. Funds' rules will need to be amended to allow members exiting before retirement, to automatically become paid-up members in the fund
2. Funds will be required to provide members with a paid-up membership certificate within 1 month of leaving their employer, which records the following:
   - Details of the fund and its administrator
   - Details of the member
   - Date the member became paid-up and the fund value as at that date
   - Investment portfolios the benefit is invested in
3. Defined contribution paid-up members must have their fund savings invested in the fund's default investment portfolio, unless otherwise instructed by the exiting member
4. Paid-up members cannot continue contributing to the fund that they leave their benefits in and they are not eligible for risk benefits
5. After instructing the fund in writing, exiting members can choose to withdraw their fund benefit or preserve it in another fund. Members who wish to withdraw their benefits should be given access to a "**Retirement Benefits Counsellor**"
6. New members must be allowed to transfer monies in from other funds within 2 months of joining their new employer's fund and must produce their paid-up benefit certificates from previous funds
7. In respect of fees for paid-up members:
   - Recurring charges may not differ between active and paid-up members
   - No charges may be levied as a direct consequence of a member becoming a paid-up member.

Retirement Benefits Counsellor

This is defined in the draft Regulations as someone:
- With qualifications which are to be prescribed
- Who assists members by explaining the default preservation policy and default annuity strategy
- Who does not receive income directly or indirectly as a result of the choices made by the members as a consequence of their retirement or withdrawal from the fund, other than any income paid to them by the fund. This implies that brokers' commissions cannot be payable to a retirement benefit counselor. However, the fund may pay this counselor's fees.

C. Default annuity strategy

1. Funds' rules will need to be amended to implement a default annuity strategy
2. The strategy can be made conditional on the value of the retirement benefit, pensionable salary before retirement and health status of the members

3. In setting the default annuity strategy, trustees should be able to demonstrate that the following has been considered when setting this strategy:
   - The level of income to be provided to the retiree
   - Degree of income security required
   - Investment, inflation and other risks faced by the retirees
   - Ongoing decision making required by the retiree, taking into consideration the financial expertise of the fund members and their ability to afford on-going financial advice
   - Level of income protection granted to beneficiaries in the event of the early death of the retiree
4. The annuities utilised can include:
   - In fund guaranteed annuities
   - In fund annuities without guarantees
   - In fund living annuities, provided they comply with the requirements and drawdown rates specified in the Regulations.
   - Certain out of fund life annuities guaranteed by an insurer, subject to requirements set out in the Regulations
   - Trustees can provide a mix of annuity products as part of their strategy
5. Funds must make "**Retirement Benefit Counsellors**" available to retiring members not less than 3 months before their date of retirement, to assist them in understanding the default annuity strategy
6. The objective, composition, performance of the default strategy and the average income and changes in the income in respect of the default annuity strategy, must be communicated to retirees
7. Communication must be conducted in clear and understandable language and in a format which may be prescribed
8. The strategy must offer good value for money. All fees and charges must be competitive and must be disclosed, including the impact that such fees and charges will have on members' actual and prospective benefits. Fees must be reviewed regularly
9. Trustees will need to regularly review the default annuity strategy and maintain a separate pool of assets for the purposes of paying certain types of pensions. This pool of assets must comply with Regulation 28 and must comply with a mix of assets certified by the fund's valuator, in compliance with the Regulations' requirements. Furthermore, actuarial surplus or deficits arising, must be distributed to pensioners within 2 years in the form of increases or decreases to pension payments
10. Members will not be compelled to follow the default annuity strategy and will be able to opt out of the strategy into products they themselves choose, if they wish to.

Comments on the draft Regulations must be submitted by 30 September 2015 to:
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