Legal Report November 2018

Insurance | Financial Planning | Retirement | Investments | Wealth

Newsletter of Sanlam Employee Benefits: Legal

1. Draft Conduct Standard for living annuities forming part of a fund's annuity strategy

Background

Regulation 39 in terms of the Pension Funds Act, which comes into effect on 1 March 2019 for funds registered before 1 March 2018, requires the boards of all pension, preservation and retirement annuity funds to establish an annuity strategy. The boards of provident or provident preservation funds whose rules enable a member to elect an annuity upon retirement must also establish such strategy.

Regulation 39(3) determines the requirements in respect of a living annuity where it is included as part of a fund's annuity strategy. Regulation 39(3)(a) requires that the drawdown levels from such living annuities must be compliant with a prescribed standard.

The Financial Sector Conduct Authority (FSCA) published for public comment a draft Conduct Standard on the criteria for living annuities in a "default annuity strategy". It should be noted that the draft Standard should rather have referred to a "proposed annuity", which is the term used in regulation 39, since it is not really a default annuity - the member has to consent to the annuity being provided.

According to the draft Standard, the board of trustees' chosen annuity strategy for a fund must represent the fund's best proposal for the average member of that fund in order to assist those members who do not feel comfortable making their own decision about which pension product to choose at retirement. The best proposal may, according to the draft Standard, be different for different categories of members.

Purpose of Standard

The draft Standard is aimed at:

- Providing guidance on the interpretation of sustainable income;
- Providing guidance on the need to monitor and communicate income sustainability to pensioners in the living annuity (forming part of a fund's annuity strategy); and
- Reducing the possibility of a reduction in income to pensioners placed in such living annuity by limiting the maximum drawdown possible.

Sustainability

Pensioners drawing an income from a living annuity are exposed to the risk of their retirement savings being depleted too soon if the drawdown rate is too high, or in the event of poor investment returns on the capital or excessive product fees and charges.

The framework for drawdown rates as proposed in the draft Standard attempts to reduce this risk by limiting the maximum drawdown rates for the average member, in order to improve sustainability of income. Sustainability in this context refers to how long the income will last, and not whether it is sufficient to sustain a particular living standard.

The draft Standard also intends to provide a common view on what could be considered a sustainable income in the context of a living annuity (forming part of a fund's annuity strategy), as well as to introduce the requirement for sustainability to be monitored and communicated to the pensioner on a regular basis - this will allow the pensioner to consider alternative actions.

The sustainability of income needs to be measured by considering the continued payment of a particular income over the lifetime of a pensioner, where the income payments increase in line with inflation. The draft Standard sets out various ways in which this can be measured.

Monitoring sustainability

The fund must establish a mechanism to determine and monitor the sustainability of the income from the living annuity (which forms part of a fund's annuity strategy) for any pensioner of the fund.

The fund or annuity provider must communicate the minimum requirements as set out in the draft Standard -

- At inception, to assist in setting a reasonable commencement income and drawdown rate;
- Annually, to provide an update on the continued sustainability.

Drawdown limits for living annuities that form part of a fund's annuity strategy

As indicated in the table below, the maximum drawdown rates contained in the draft Standard have been determined in bands by age and gender, setting out the limits to achieve sustainability by taking into account longevity.

Age	Males	Females
55	4.5%	4.0%
60	5.0%	4.5%
65	5.5%	5.0%
70	5.5%	5.0%
75	6.0%	5.5%
80	7.0%	6.0%
85	8.0%	7.0%

The trustees must apply their minds as to appropriate drawdown rates for the pensioner and are expected to apply lower drawdown limits, where applicable.

In the statement supporting the draft Standard, the FSCA states:

"While the prescribed drawdown limits are lower than the limits permissible in an industry living annuity, retiring members have the option to choose their own annuity, should they feel that the default is not appropriate. Member choice is, therefore, not negatively impacted."

Comments on the draft Standard may be submitted to the FSCA by 14 January 2019. Sanlam will provide comments via industry bodies.

2. Pension Funds Adjudicator's 2017/2018 annual report

The 2017/2018 annual report of the Pension Funds Adjudicator has been issued. In a media release of 14 November 2018 the Adjudicator, Ms Muvhango Lukhaimane, said that, yet again, 70% of complaints finalised by the Office of the Pension Funds Adjudicator (OPFA) during the last financial year concerned the non-payment of withdrawal benefits or dissatisfaction with the withdrawal benefit amount paid. Most of these complaints had to do with employers' non-compliance with section 13A of the Pension Funds Act, which contains the requirements in respect of the payment of contributions to retirement funds.

The Adjudicator said that in a notable number of instances the funds concerned responded quite late to employers' non-compliance in respect of the payment of contributions, at which time the employer could already be under business rescue or voluntary liquidation.

As in the past, a large number of complaints finalised were in respect of death benefit lump sum payments. According to the Adjudicator, the biggest issue with death benefit lump sums is the failure by funds to properly determine the actual extent of each dependant/nominee's financial dependency on the deceased. Often there is no supporting information or documentation to substantiate the extent of dependency. The Adjudicator said that the OPFA is working on a guideline to the retirement fund industry in respect of instances where the usual supporting documentation e.g. bank statements, etc. cannot be produced.

Another issue highlighted by the Adjudicator is that commercial umbrella funds simply liquidate employer participation within three to six months of non-payment of contributions without following the prescribed process to demand outstanding contributions from delinquent employers.

Retirement funds or other clients requiring more information should not hesitate to contact their consultant.