1. Draft Conduct Standard - Conditions for Living Annuities in an Annuity Strategy

Regulation 39 of the regulations issued in terms of the Pension Funds Act requires the boards of trustees of all pension, pension preservation and retirement annuity funds to establish an annuity strategy. The boards of provident and provident preservation funds whose rules enable a member to elect an annuity upon retirement, must also establish such a strategy.

The Financial Sector Conduct Authority (FSCA) during November 2018 published a draft Conduct Standard on the criteria for living annuities forming part of a fund's annuity strategy. The aforesaid draft Conduct Standard was revised after receiving comments from the retirement fund industry, and a revised draft Conduct Standard was published for public comment on 8 June 2020.

According to the revised draft Conduct Standard the annuity strategy must represent a fund's most appropriate proposal for the average member from a specific category of members, with the purpose of, amongst other things, assisting those members who do not feel comfortable making their own decision at retirement. The annuity strategy may be different for different categories of members.

When considering the inclusion of a living annuity in the annuity strategy, the fund's board must take into account the individual risks that pensioners are generally exposed to, for example, the risks of:

- retirement savings being depleted too soon;
- poor investment returns on capital; and
- excessive fees and charges.

A board may only include a living annuity in its annuity strategy if:

- more protection is afforded to members making use of this strategy compared to members who choose a living annuity based on their own circumstances and research; and
- the sustainability of income is regularly monitored, and clearly communicated to pensioners both at inception, as well as on a regular basis thereafter.

A fund must measure the sustainability of the income from the living annuity by considering the continued payment of a particular income over the lifetime of a pensioner, where the income payments increase in line with a targeted percentage of inflation. The targeted percentage of inflation may not be less than 66%.

Where the living annuity is provided by the fund, the sustainability of income must be monitored by the fund. Where the living annuity is purchased from an insurer, the fund must ensure that the sustainability of income is monitored by the insurer. The sustainable income level of the living annuity may result in a monthly pension which is lower than the amount required as a living income.

Members must at the inception of the living annuity be informed of the reasonably expected commencement income and drawdown rate, as well as details on the risks and sustainability of the annuity. Members must thereafter on at least an annual basis be provided with information on the performance of the annuity and an update on the continued sustainability of the annuity, including warnings where a pensioner is unlikely to achieve the increase targets or income in the long-term. Members must also clearly be informed that there is no guarantee that the annuity is sustainable, even if all the recommended actions are followed.

The Draft Conduct Standard lays down both recommended drawdown rates and maximum drawdown rates. The recommended drawdown rates are rates that a board should aspire to, which rates would result in a sustainable income with a 90% probability, based on an average life expectancy and a balanced investment portfolio.

The maximum drawdown rates are as follows:

Age	Maximum drawdown rate
55	6.5%
60	7.0%
65	8.0%
70	8.0%
75	8.5%
80	9.5%
85	11.5%

The board should encourage members to apply a lower drawdown rate than the maximum, especially in cases where:

- the underlying investment portfolio is conservative or aggressive; or
- the annuity is in respect of a couple.

In the statement supporting the draft Conduct Standard it is further stated that the board must apply their minds as to appropriate drawdown rates, and is expected to apply lower drawdown rates where applicable.

The Conduct Standard, once finalised, will take effect on the date of publication, but retirement funds will be afforded 6 months to adjust their annuity strategy in order to align with the requirements of the Conduct Standard. Further, the Conduct Standard will not apply to members who already retired with a living annuity before or within 6 months after the effective date.

Comments on the draft Conduct Standard must be submitted to the FSCA by 31 July 2020. Sanlam will provide comments via industry bodies.