DASHBOARD
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AN UPDATE ON THE DEFAULT REGULATIONS

This publication provides an update on new information and requirements issued since the default regulations were published. Thus, this publication is not intended to provide a basic summary of the default regulation requirements.

What are the "default regulations"?

Regulation 37 to 40 to the Pension Funds Act are colloquially called the "default regulations". These amendments to the Regulations to the Pension Funds Act were published on 25 August 2017.

The default regulations aim to improve outcomes for members of retirement funds by ensuring that they are treated fairly at retirement, get good value for their savings and make informed decisions.

The onus for the facilitation and implementation of the regulations falls to the board of management ("the board") and it is, therefore, important that the board fully understands what is expected.

The regulations ultimately require every retirement fund to put in place and implement:

(Regulation 37)	(Regulation 38)	(Regulation 39)
A default investment strategy	The default preservation and portability	A fund annuity strategy

Guidance Notice 8 of 2018

Provides guidance on the default regulations and was issued by the Financial Sector Conduct Authority (the "Authority" or "FSCA") on 12 December 2018.

When must funds comply with the default regulations?

All funds are to comply with the default regulations by **1 March 2019**. This date has not been moved.

The FSCA has stated in Guidance Notice 8 of 2018 that it will be examining funds' compliance from 1 March 2019. This means that funds will need to retain evidence of compliance with the regulations from that date.

Ability to 'demonstrate' and evidence compliance

In terms of the default regulations, the board must be **able to demonstrate** compliance with the regulations. This requires that the board has been through a process of consideration and decision. Evidence of this should be retained by the board. For example, the board should be able to show that the design of its default investment portfolios is appropriate for members (or categories of members) – how will your board ensure that it can demonstrate this? A board could, by way of example, appoint investment experts and consider their report. In this case, the brief, report and minutes should be retained. Or for example, has the board considered all fees and charges and whether they are reasonable? How has the board considered this? Was there a comparison or benchmarking performed in relation to fees and charges? Has the board retained evidence of this?

In addition, evidence of the compulsory communication required in terms of the regulations should also be kept as of 1 March 2019.

The requirement to demonstrate what the board has done to ensure compliance with the regulations is not a new notion, however, we see more and more that evidence and the ability to demonstrate compliance is becoming more important and will be asked for by the Authorities more frequently than in the past. This requires boards to amend ways of working and recording information. This is evidence of the Authorities moving to a more intrusive and risk-based regulatory and supervisory model.

Which funds do each of the default regulations apply to?

The FSCA's Guidance Notice 8 of 2018 provides the following handy table that sets out to which type of fund each of the Regulations applies.

	PENSION FUND	PROVIDENT FUND	RETIREMENT ANNUITY FUND	BENEFICIARY FUND	PENSION PRESERVATION FUND	PROVIDENT PRESERVATION FUND	FUNDS IN VOLUNTARY LIQUIDATION
Reg 37[1]	YES	YES	NO	NO	NO	NO	NO
Reg 38[2]	YES	YES	NO	NO	NO	NO	NO
Reg 39	YES	No, unless the rules enable a member to elect an annuity	YES	NO	YES	No, unless the rules enable a member to elect an annuity	NO

[1] In relation to funds with defined contribution categories to which members belong as a condition of employment

[2] In relation to funds which members belong as a condition of employment

Exemptions generally

The FSCA may exempt a person (like a fund) or class of person (like a category of funds) from specific provisions of the default regulations.

If a fund applies to the FSCA for an exemption from any of the provisions of the default regulations the fund must comply with the below:

It must be the board of the fund that makes the decision as to whether to apply for an exemption or not	The board must specify from which regulation it is applying for exemption and ensure it is applying under the correct exemption	Apply via the FSCA's online system	Use the standard exemption request form attached to Guidance Notice 8 of 2018 (appended to this publication)	Supporting documentation must be attached to the application and the FSCA may ask for further documentation

Examples of supporting documentation that may be required are:

For terminating funds: section 14 approval letter, board resolution, etc	For asset values: extracts from financial statements, trial balance, etc	For membership certificates: extracts from the financial statements, membership reconciliations, etc	Any other document relevant to the application

When considering exemption requests, the FSCA will consider the public interest and the objects of the default regulations. Exemptions are granted in writing and published on the FSCA's website. This may prove useful as it will allow other funds to see what exemptions are permitted.

Regulation 37 - retirement fund investment strategy

Requirement to include default investment portfolio(s)

Regulation 37 provides that every fund **with a defined contribution category**, to which members belong as a condition of their employment, will need to amend their investment policy statement to include one or more default investment portfolios.

Retirement Annuity Funds, Beneficiary Funds, funds without a defined contribution category and funds in voluntary liquidation do not need to comply with Regulation 37.

Participating employer's role in relation to the board

FSCA Guidance Note 8 of 2018: the participating employer of a fund may choose the default investment portfolio that will apply to that participating employer's members. However the choice of default investment portfolios on offer, and that may be chosen from, **remains with the board**. The Guidance Note also provides that the requirement to ensure the appropriateness of the default investment portfolio, from which a choice may be made, **lies with the board**. In addition, although the employer may choose, the board must ensure the employer's selection is appropriate for the members related to that participating employer. Comment – participating employers may select from the default portfolios available, however, this does not dilute the board's responsibilities.

What if the fund has only one investment portfolio?

FSCA Guidance Note 8 of 2018: if there is **only one** investment portfolio in the fund, then this becomes the default investment portfolio and it must comply with the regulation.

Communication to members

Regulation 37 requires compulsory and extensive communication by boards to members regarding default investment portfolios. For example, about the composition of assets, the performance and fund returns as well as fees and charges.

FSCA Guidance Note 8 of 2018: requires that (a) the asset composition, (b) performance of the default portfolios compared to appropriate benchmarks, (c) top 10 holdings by value, and (d) fund returns for the current and last two previous financial years should be communicated to members at least every year.

The FSCA may, at some stage, issue standards for the communication.

Timing for compliance of existing default investment portfolios

FSCA Guidance Note 8 of 2018: from 1 March 2019 all default investment portfolios must comply with the regulations. If they do not comply, they will not be considered a default investment portfolio.

Members must be moved from old non-compliant default investment portfolios to new compliant default investment portfolios **before 1 March 2019**. Boards must communicate with their members about this move.

There are **no phasing-in provisions** that will allow non-compliant default investment portfolios, that already exist, to continue to exist after 1 March 2019.

Regulation 38 – default preservation and portability

Paid up members – no partial withdrawals

Note that paid-up members may **not** receive a **partial draw-down** on benefits that are paid up.

Compulsory certificate of paid-up membership

Regulation 38 requires that all retirement funds will need to provide their paid-up members with a **certificate of membership** within **two-months** of becoming aware that the member has left the service of the participating employer.

FSCA Guidance Note 8 of 2018: the FSCA has set out the format of the paid-up membership certificates and the Guidance Note requires that funds follow this format as far as possible.

Fees and charges

Regulation 38 further provides that the fund is permitted to charge the paid-up members fees and charges but that these fees and charges must not differ on the basis of whether a member is paid-up or not.

Guidance Notice 8 of 2018 expands on this to state that each individual member's investment fees must be calculated and charged on the same basis whether they are paid-up members or not.

Administration fees for paid-up members must be "fair, reasonable and commensurate" with the cost of in-service members.

It is also specifically required that an **initial once-off fee may not be levied** because a member becomes paid-up.

Guidance Notice 8 of 2018 reiterates the above but also provides for the following:

- Administration fees for paid-up members should, in the normal course, be **less** than the administration fees for in-service members. The FSCA attributes this to the fact that contributions do not need to be administered, nor are schedules required to be considered, monthly;
- Deduction of administration fees from paid-up benefits do not amount to a reduction of paid-up members' benefits;
- Importantly the FSCA requires that the board of a fund is required to administer paid-up benefits in such a way as to **avoid the paid-up benefits being eroded over time** by fund expenses;
- A member may elect **at any time to transfer-in a paid-up benefit** to the fund to which they belong. The fund may **not charge a fee** for this. Section 14 transfer fees would still be paid by the fund to the Authority.

Paid-up members can request transfer amounts into the fund at any time

As we know, Regulation 39 makes provision for the process of how members should be asked by their fund about whether they want to transfer paid up benefits in from other funds to the fund to which they belong now and sets a time period for this. No charges may be levied on these transfers.

It should be noted that the FSCA has made it clear that members may request transfer to the fund of these paid-up amounts at any stage of their membership.

Benefits for paid-up members and rule requirements

As we are already aware, in terms of Regulation 38, the rules of a retirement fund will need to be amended - the rules will need to be amended to at least deal with benefits for paid-up members.

The FSCA has clarified that eligibility for death benefits, retirement and early-retirement benefits for paid-up members will be what is provided in the rules. This pre-supposes that the rules deal with these benefits for paid-up members, where applicable, and state the benefits to which they are entitled. Note also that death benefits paid to paid-up members will be subject to section 37C of the Pension Funds Act, as per Guidance Notice 8 of 2018.

Paid-up members and conversion of defined benefit components to defined contribution components

Regulation 38 requires that the rules provide that upon a member becoming paid-up a defined benefit amount must be converted to a defined contribution component and be preserved as a defined contribution component. However, the FSCA has **exempted funds with a defined benefit category** from compliance with this provision. Thus, funds with a defined benefit category can decide whether they want to convert paid-up benefits to a defined contribution component or not. Fund rules must still deal with the benefit entitlements of paid-up members.

Database of paid-up membership certificates

The FSCA, in Guidance Notice 8 of 2018, let us know that it intends establishing a database of all paid-up membership certificates. Thus, once this has been established funds will be required to provide and update information for the database.

Retirement counselling will need to be provided on transfer out from paid-up status.

Regulation 39 - Retirement Fund Annuity Strategy

Requirement to have an annuity strategy

Regulation 39 requires that certain funds, being pension, pension preservation and retirement annuity funds, must have an annuity strategy for members who are retiring at retirement date.

Guidance Notice 8 of 2018: in terms of this Notice and the Regulations, provident funds and preservation provident funds are not required to have an annuity strategy **unless the rules of the fund enable a member to elect an annuity**.

Beneficiary funds and funds in voluntary liquidation are also not required to have an annuity strategy.

Provident fund members currently do not, by law, have to purchase an annuity at retirement. Members of provident funds can take their full accumulated benefit at retirement. Compulsory annuitisation has been postponed until 2021 by Treasury. Therefore, these regulations will only affect those provident funds (and provident preservation funds) which rules enable the members to elect an annuity at retirement. Where a fund is required to have a default annuity strategy, we know that this in not a true default but really simply the board's best view of annuity options. As the FSCA have succinctly put it in a draft conduct standard: "The default annuity strategy, established by the board, must represent a 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 at retirement".

Clarifications as regards an annuity strategy

Both traditional and living annuities may be paid directly from the fund, through a fund-owned policy or purchased from a financial institution. With respect to living annuities: the living annuity investment choice must be limited to a maximum of four investment portfolios. A fund may have only one living annuity investment and it may have up to a maximum of four.

The regulations provide that living annuity drawdown levels must be compliant with the prescribed standard. In addition, living annuities have to be compliant with regulation 28 and regulation 37 (default investment portfolios). The FSCA has issued a *draft* Conduct Standard which sets out drawdown rates and deals with other issues related to living annuities in default annuity strategies. This draft Conduct Standard has not yet been finalised.

Where the living annuity is paid by the fund or through a fund-owned policy the fund must monitor the sustainability of income drawn by retirees in these living annuities and make such members aware if their drawdown rates are deemed not to be sustainable. (The FSCA has issued a *draft* Conduct Standard dealing with drawdown rates and the meaning and measures of sustainability of income for living annuities that form part of the default annuity strategy. This standard has not yet been finalised.)

Retirement benefits counselling

As we know, withdrawing members and members coming up to retirement are required to be provided with retirement benefits counselling.

Retirement benefits counselling means the disclosure and explanation in a 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 handles preserved benefits (paid-up benefits); and
d. Any other options available to members. For example, this may include what type of fund a member may opt to transfer to.

Guidance Notice 8 of 2018 re-iterates the requirement that retirement benefits counselling must include the above components. All of (a) to (d) must be provided whenever a member withdraws from the fund.

Guidance Notice 8 of 2018 provides the following with respect to retirement benefits counselling:

- Retirement benefits counselling may be provided **in person or in a written format**. Comment - it is presumed that "written" in the Guidance Note includes an online training format;
- Funds must retain a record of the retirement benefits counselling provided to each paid-up member. Comment - funds should ensure that any service provider to the fund providing this counselling has contractually bound themselves to this requirement and that this clause will survive the termination of the agreement and/or that a proper hand-over of records to the new provider takes place;
- Persons providing retirement benefits counselling do not have to be registered Financial Service Providers or financial advisors under the Financial Advisory and Intermediary Service Act (FAIS). The Board must be satisfied that the person is **suitably qualified and experienced** and is able to **manage conflicts of**

interest. Comment - it is interesting to note the requirement if for such person to manage the conflicts of interest and that there is not a requirement that such a person should be free from conflicts of interest. This allows for "in-house" persons of service providers to provide the counselling to funds to which they provide services, so long as the conflict is managed. Funds will have to ensure they consider, from time-to-time, whether or not conflicts are being managed;

- Retirement benefits counselling **does not include advice**, even on tax matters. Members must be informed of this. If advice (including tax advice) is provided then such persons providing the advice must be registered as a financial advisor or a tax practitioner (whichever applies); and
- Access to retirement benefit counselling must be provided no longer than **six months before** the member's retirement. The board must make "every effort" to ensure that the information provided is still relevant and appropriate at retirement age. Comment - note that "every effort" requires more than a "reasonable effort".

In terms of the regulations, members must be given access to retirement benefit counselling **not less than three months** before their normal retirement age (determined from the rules). This format may also be prescribed. In terms of Guidance Notice 8 of 2018 the FSCA expects that funds will exercise reasonability and consider the interests of members as to when to provide counselling. The FSCA recommends that, to ensure relevancy of information, the counselling should take place **not longer than six months** before retirement. Thus, reading the regulations and the Guidance Notice together, retirement benefits counselling should be provided **between three and six months before normal retirement date**.

Note that in terms of the Guidance Notice, with respect to living annuity information to members about to retire, retirement benefit counselling **need only include**: the terms of the fund's annuity strategy and any other option available to the member when retiring.

Questions

If you have any questions about this publication, please refer these to your fund consultant.