



**STATEMENT SUPPORTING THE DRAFT CONDUCT STANDARD ON THE  
CRITERIA FOR LIVING ANNUITIES IN A DEFAULT ANNUITY STRATEGY**

**1. INTRODUCTION**

- 1.1 On 25 August 2017, the Minister of Finance signed amendments to Regulations issued in terms of Section 36 of the Pension Funds Act, 1956. In particular, this amended some definitions and inserted Regulations 37 to 40.
- 1.2 Regulation 39 introduced by this amendment requires the boards of all pension, preservation and retirement annuity funds to establish an annuity strategy. These default regulations come into effect on 1 March 2019.
- 1.3 Regulation 39(3) of the regulation determines the requirements in respect of living annuities, where it is included as part of the annuity strategy. In particular, regulation 39(3)(a) requires that the drawdown levels from such living annuities to be compliant with a prescribed standard. The purpose of the Standard and Schedule thereto is therefore to prescribe the drawdown levels as required in regulation 39(3).
- 1.4 This statement relates to the publication of the draft Conduct Standard to be made in terms regulation 39(3) of the Regulations, as well as section 106(1)(a) read with section 108(1) of the Financial Sector Regulation Act 9 of 2017 (“FSR Act”). The purpose of this statement is to explain the need for, expected impact and intended operation of the draft Conduct Standard as required by section 98 of the FSR Act.

The draft Conduct Standard is aimed at:

- 1.4.1 providing guidance on the interpretation of sustainable income;
- 1.4.2 providing guidance on the need to monitor and communicate income sustainability to pensioners in the default living annuity; and
- 1.4.3 reducing the possibility of a reduction in income to pensioners placed in a default living annuity, by limiting the maximum drawdown possible.

## 2. STATEMENT OF NEED

- 2.1 Where a pensioner elects a living annuity on retirement it could result in poor retirement outcomes for the pensioner, such as unsustainable income streams and a reduction in affordable annuity payments over time. These risks, amongst others, are-
  - 2.1.1 the living annuity (retirement savings) being depleted too soon if the draw-down rate elected is too high;
  - 2.2.2 poor investment returns on their capital; and
  - 2.2.3 excessive fees and charges.
- 2.2 The framework for drawdown rates as proposed in the Conduct Standard attempt to reduce this risk by limiting the maximum drawdown for the average member, 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.
- 2.3 The standard also intends to provide a common view on what could be considered a sustainable income in the context of a living annuity, as well as to introduce the requirement for sustainability to be monitored and communicated to

the pensioner on a regular basis, which will allow the pensioner to consider alternative actions.

### 3. INTENDED OPERATION

- 3.1 The draft Conduct Standard is consistent with the objectives of the FSR Act, specifically the mandate of the FSCA to protect financial customers by promoting the fair treatment of financial customers (including pensioners of a pension fund) by financial institutions (including pension funds).
- 3.2 Pension funds are required to comply with Regulation 39 on annuity strategies and the draft Conduct Standard proposes the prescribed drawdowns required in terms of this, as well as a framework to measure sustainable income for the pensioner.
- 3.3 Any exemption applications from the provisions in the draft Conduct Standard will be considered on a case by case basis.

#### A. Sustainable income

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 standard sets out various ways in which this can be measured.

Sustainable income level might result in a monthly pension which is below the amount needed to live on yet sustainable for a period anticipated to cover the lifetime of the pensioner.

## **B. Monitoring sustainability**

In line with the Treating Customers Fairly objectives (in this case, for members), the fund must establish a mechanism to determine and monitor the sustainability of the income from the default living annuity for a particular pensioner of the fund.

The fund/annuity provider must communicate the minimum requirements as determined in the Conduct Standard –

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

## **C. Drawdown limits for a default annuity strategy in the form of living annuities**

The maximum drawdown rates have been determined in bands by age and gender setting out the limits to achieve sustainability by taking into account longevity. The Trustees must apply their minds as to appropriate drawdown rates for the pensioner and are expected to apply lower drawdown limits, where applicable.

## **4. Statement of expected impact**

- 4.1 Regulation 39 determines that a fund must establish an annuity strategy and communicate the asset class composition of investments, their performance and changes in the incomes in respect of a living annuity on a regular basis, in a clear and understandable language to its members.

- 4.2 The Conduct Standard provides guidance with respect to the measurement of sustainable income, which is not envisaged to have an adverse impact on the fund or its members.
- 4.3 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.
- 4.4 Financial services providers may wish to design specific product offerings that comply with the criteria to be offered as the default annuity strategy, as part of their product development.
- 4.5 The draft Conduct Standard is likely to lead to improved outcomes for pensioners due to the improved communication and the limits on drawdown rates.

## 5. Conclusion

- 5.1 The draft Conduct Standard will be published in terms of section 98(2) of the FSRA for a period of 6 weeks for public comment.
- 5.2 Submissions received on the draft Conduct Standard will be considered and, where appropriate, the necessary changes will be effected and submitted to Parliament for a period of at least 30 days while Parliament is in session.
- 5.3 Once submissions have been received and considered, this statement supporting the draft Conduct Standard may be updated to reflect the expected impact of the draft Conduct Standard.