Annexure B

FSCA

Financial Sector
Conduct Authority

CONSULTATION REPORT: DRAFT CONDUCT STANDARD:

CRITERIA FOR SMOOTH BONUS PRODUCTS IN DEFAULT INVESTMENT PORTFOLIOS

PENSION FUNDS ACT 24 OF 1956

1. The objectives of the Standard

1.1 The objective of this draft Conduct Standard is to determine criteria which must be complied with where the board of a fund intends to include smooth bonus products as part of the fund's default investment portfolios as required in terms of Regulation 37. The Conduct Standard provides for criteria to ensure that the relevant smooth bonus product -

(a) is appropriate for the members who will automatically be enrolled into it;
(b) limits the smoothing period by spreading any excess bonus stabilisation reserve over a period not exceeding 24 months;
(c) results in the long-term funding level not exceeding 105 per cent; and
(d) does not impose disinvestment penalties.

1.2 Smoothed bonus policies are perceived to be complex given the smoothing mechanisms and/or guarantees associated with them. Whilst the underlying mechanism may be complex, the provider must ensure that the communication it provides to the policyholders, regarding the portfolio and its performance, is accurate, relevant, simple and easy to understand. Equally, the information provided by the fund to its members must be accurate, relevant, simple and easy to understand.

Process and consultation

1. A draft version of the Standard was sent out for public comment on 21 February 2018, with comments required by 30 March 2018.

2. The comments received, as well as the FSCA's responses thereto, are enclosed below in the Schedule. As the comments necessitated principle changes to the document, the revised document is again sent out for public comment as a draft Conduct Standard: Criteria for smooth bonus products in a default investment portfolio.

SCHEDULE

COMMENT MATRIX: CONDUCT STANDARD FOR SMOOTH BONUS PRODUCTS

RESPONSE TO COMMENTS SUBMITTED FOR THE FIRST PUBLIC CONSULTATION PROCESS FOR THE DRAFT CONDUCT STANDARD FOR SMOOTH BONUS PRODUCTS

Date of publication of notice for comments: **21 February 2018**

Closing date for comments: **30 March 2018**

Number of days for comments: **37 days**

Commentators:

1. The Association for Savings and Investment in South Africa
2. Institute for Retirement Fund Administrators
3. Various Pension Fund Administrators
4. Pension Fund Valuators

Section	Comments received on Draft Notice	FSCA Response
1	“smoothed bonus policy” or “policy” means a life insurance policy with discretionary participation features, underwritten by an insurer registered in terms of the Insurance Act, 2018, in terms of which any bonuses declared over a period, whether such bonuses are vested or non-vested, may be different to the return earned on the underlying assets over the same period so as to smooth the ~~fund~~ **portfolio** return.	Amended
1	The commencement date of the Insurance Act still has to be proclaimed.	Now finalised
1	As drafted, we note that the Notice will apply to products which offer “smoothing with no guarantees” as well as conventional “guaranteed funds” – we support this.	Yes, it will apply to both
2	While we recognise that these products are complex, the Registrar should be careful not to discard the positive characteristics of this design. There was time when savers certainly valued the risk-pooling and long-term characteristics of these smoothed-bonus funds. It is only in more recent periods that a much stronger culture of individualism has arisen.	Agree. This is the reason for allowing them as the default portfolio, with limiting criteria to safeguard members.
2	There will be many retirement funds which are currently using a smoothed-bonus investment as part of their default strategy. In most cases the investment product will not comply with the prescribed conditions (after 1 April 2019), but it could be materially prejudicial to members for the fund to terminate the investment at that time. We request that some “grandfathering” conditions (or exemption conditions – we note that the Regulations already provides in principle for exemptions) are permitted, so that funds may retain such investments, if necessary on a closed-fund basis (i.e. only members invested in the strategy are allowed to continue to do so, and only new retirement-funding contributions may be invested, not lump-sum transfers in), to avoid prejudice to members. A Board seeking such an exemption should be able to demonstrate that the smoothed-bonus product has delivered decent inflation-beating returns over medium or long-term periods.	Noted. Amended.
3	What exactly is envisaged by “necessary governance and disclosure requirements” that the policy must contain?	The trustees must satisfy themselves that all of the conditions in the Standard are met to their satisfaction and that the policy sufficiently covers procedural and risk matters.
4	In terms of governance, any departure from an approved formulaic-based approach to bonus declarations needs to be in accordance with the approval of the statutory actuary – this possibly needs to come across clearer in Paragraph 4.	In order for the particular policy to be considered as a default portfolio, they need to follow the formulaic approach which has been communicated. No allowance for departures from this without new communication (including the option to opt out without penalties or market-value adjustments) will be considered for the default portfolio. This is not a simple decision taken with the approval of the statutory actuary.

4	It is not clear if the policy contract must contain or refer to each and every aspect mentioned in 4.1 to 4.5. Clarification is required.	As stated, the trustees must ensure that the policy chosen complies with all of the criteria noted.
4	A somewhat contentious issue in contract negotiations with the insurers is what should happen to any positive bonus smoothing reserve if the contract is terminated (and of course, what should happen if the bonus smoothing reserve is negative). Termination may be at the insurer's instigation, at the fund's instigation (full or partial termination), or as a result of a "default event" of some kind by the insurer (e.g. loss of licence) which triggers an automatic termination. Clearly there are different views on what is reasonable and fair in the various circumstances – the Registrar may wish to consider this and deal with this in the notice.	Such considerations would need to be negotiated with the insurers. The purpose of the Standard is to set out the criteria required to allow such a policy as a default investment, not to set out criteria for all smooth bonus products.
4	We do not agree with an approach that prescribes the specific parameter values of such a formulaic approach. There are various factors that influence the performance of smoothed bonus products, many of which are highly variable and dependent on the economic and other circumstances in which the product is managed.	
4	We caution against an approach that prescribes the specific parameter values of the formula because we do not believe a fixed formula can adequately deal with all potential future scenarios to ensure the best possible outcome for policyholders. As an alternative, we propose a principle-based approach where the Notice sets clear principles that: * requires insurers to develop a formulaic approach and * determines the most appropriate parameter values and * to then require full disclose of the formula and the parameter values.	This is what the Standard requires
4	It is not clear to us if the Draft Notice provides the option for an insurer to either change or temporarily suspend the formula in order to provide better outcomes to policyholders.	A change would require the need for communication and an opportunity to opt out of the default with no prejudice.
4	Also, in situations where the formula may dictate that non-vested bonuses could be removed, we believe that insurers should have the discretion to temporarily suspend the removal of non-vested bonuses provided that such a suspension will be in the best interest of policyholders.	The removal of non-vested bonuses is dealt with in section 3(3)(a)(i), where there is a requirement for the approach to include the triggers for the possible removal of the non vested bonuses. The word "possible" implies that this would not require the removal, but that in such cases, this would be a possibility open to the insurer.

4.1	ASISA members strongly support this requirement as it will give Boards and retirement fund members greater certainty of what to expect from these portfolios. However, ASISA members caution against an approach that is too prescriptive as far as the specific parameter values of the formula are concerned. We believe that full disclosure of the formula (whatever the insurer's parameter values may be) together with the objectives of the formula should be sufficient to achieve the objectives of the draft Notice. A more prescriptive approach may not adequately allow for potential future market conditions and could result in adverse outcomes for policyholders that are not in line with what retirement fund members expect from these products (more detailed comments/suggestions below).	The intention is for the default portfolios to be understandable and accountable to their original mandates and promises.
4.1	Points 4.1.1, 4.1.2 and 4.1.3 would not necessarily form part of the formulaic approach. Instead, these are principles based and form part of the management of smooth bonus business. We therefore suggest that the wording of 4.1. be changed to read as: "4.1. Disclosure on the management of smooth bonus business should include:"	The approach must include the various points noted. The wording has been amended to clarify this.
4.1	Is the intent for the bonuses declared to be derived solely from the formulae or will an element of insurer discretion still be allowed? Whilst we agree that a formulaic approach should be used, we believe that this should provide guidance during the bonus declaration process as a bonus formula cannot account for all factors, for example prospective views on market performance. There may be certain market conditions under which insurers may wish to exercise discretion. For example, we may wish to under-declare relative to the bonus formula during adverse market conditions. In addition to this, depending on the smooth bonus portfolio, there may be a need for discretion to account for business considerations, solvency requirements and any PRE/TCF issues that may arise.	The approach for the default portfolio must be a formulaic approach, so that members know what they are in line to receive. An allowance for a limited amount of discretion has been included, where this relates to future market expectations.
4.1.1	Suggested wording : a description of the triggers for the possible removal of non-vested bonuses and the method of removal;	Same meaning as wording used.
4.1.2	provide for the triggers that dictate the provision of shareholder capital **of the insurer** to maintain the financial soundness of the policy;	no need - clear already
4.1.2	We interpret the above to actually refer to the financial soundness of a smooth bonus portfolio. Under this assumption, we have no objections to disclosing this information as part of the management with respect to smooth bonus business. It should however be noted that shareholder capital may be provided for reasons other than maintaining the financial soundness of a smooth bonus portfolio. An example would be to support individual benefit payments within a scheme even though the portfolio is fully funded. We therefore suggest the wording be changed as follows: "4.1.2. a description of the circumstances under which there will be provision of shareholder capital"	The policy must specifically provide for the triggers that will result in shareholder capital to maintain financial soundness. The intention is to hold shareholders responsible for the promises made by the insurer. There is no need to mention other reasons for which shareholder capital may be provided.
4.1.4	"specify the levels of the stabilisation reserve at which remedial actions will be triggered as well as the nature of those remedial actions;"	This would require the minimum and maximum levels to be specified, as currently required. No change.

4.1.4	It will be difficult to specify absolute minimum and maximum funding levels due to the range of circumstances which can arise over the lifetime of a fund. Hence the revised wording rather refers to the levels of the stabilisation reserve which trigger remedial actions.	
4.1.4	Does "stabilisation reserve" refer to a reserve held by the insurer for the particular policy only or possibly to a reserve held for a pooled smoothed bonus product in which many policies (and funds) participate?	This is part of the product design of a smoothed bonus policy.
4.1.4	Consideration should be given to whether there is merit in stipulating the minimum and maximum levels of the stabilisation reserve (as was done in 4.1.6 with the average funding level)	This is fundamental in the smoothing and manner in which the cross generational subsidies will be managed.
4.1.4	Suggest wording be changed as follows : *specify the levels of the stabilisation reserve (both negative and positive) at which remedial actions will be triggered, as well as the nature of those remedial actions*	Minimum and maximum may not refer to positive and negative and is therefore better terminology.
4.1.5	Majority view alternative wording proposal:	
4.1.5	"limit the **spread of the stabilisation reserve to a** ~~smoothing~~ period ~~to~~ **not exceeding** ~~24~~ **36** months"	Amended to clarify that the excess stabilisation reserve must be spread over a period not exceeding 24 months.
4.1.5	The majority view supports the principle of limiting intergenerational cross-subsidies to a reasonable level (and in line with retirement fund member expectations). In fact one member feels that the period should remain at 24 months. However, it is not clear what is meant by this condition from a pure technical perspective. The proposed wording will be clearer and cause less disruption to existing clients.	
4.1.5	Minority view alternative wording proposal:	
4.1.5	"limit the smoothing period **by spreading the bonus stabilisation reserve over a specified, disclosed period of time** ~~to 24 months~~"	
4.1.5	While the minority view agrees with prescribing the formulaic approach and the full disclosure of the formula, it does not support any condition that specifies the value of a parameter in the formula (e.g. 24 or 36 months). This view considers that while a formula can be designed with the intention to limit intergenerational cross-subsidies, the actual experience in a particular market situation may be a protracted bull or bear market, which in turn could result in the need for a smoothing period that appropriately recognises this. Insurers are best placed to determine what the most appropriate parameter values should be and the Notice should instead focus on insurers being required to specify those values upfront and to fully disclose them.	The smoothing period must be limited, to limit the extent of intergenerational cross subsidies permissible.
4.1.5	"specify and fully disclose a target smoothing period for the distribution of the bonus stabilisation reserve and/or investment returns.	

4.1.5	We do not agree that all the specifics of the formulaic approach be prescribed by legislation. As a matter of principle, we do not support any condition that specifies the value of a parameter in the formula. We believe insurers are best placed to determine what the most appropriate parameter values should be and the Notice should instead focus on requiring insurers to specify those values upfront and to then fully disclose those values so that customers can make an informed decision and form realistic expectations. While a formula can be designed with the intention to limit intergenerational cross-subsidies, the actual experience in a particular market situation may for example be a protracted bull or bear market. This may in turn result in smoothing periods longer than 24 months. It is not clear how a formula can be designed to absolutely “limit the smoothing period to 24 months” in all potential market situations.	Given that this particular policy will be a default investment for the fund members, more stringent criteria are required to protect the members, as they are not making their own decision. Limiting the smoothing period will limit cross generational subsidies in the default portfolio. Other options offered to members can be structured with different smoothing periods and the relative advantages and disadvantages of this can be explained to individuals.
4.1.5	we believe the period of 24 months is too short and removes one of the key features of this product, namely the ability to maintain a long-term investment horizon (with more exposure to growth assets and the equity risk premium).	This is a compromise between significant intergenerational cross subsidies and smoothing.
4.1.5	Does the condition refer to the smoothing of investment returns or does it also include the period over which any bonus stabilisation reserve is distributed or recovered? Using shorter smoothing periods will reduce generational cross-subsidies compared to a longer averaging period. However, using a 24 month smoothing period is quite short when considered in the context of economic cycles that can span anything from 3 to 10 years. Under the assumption that the condition does refer to the smoothing of investment returns, we suggest a smoothing period of 36 months. Suggest the wording be changed as follows: *"limit the smoothing period of investment returns to 36 months"*	It relates to the period over which any excess bonus stabilisation reserve is distributed, not to the period over which returns are smoothed. Wording has been amended to clarify this.
4.1.5	It is not clear to us exactly what is meant by this condition and how a formula should be constructed in practice to achieve this outcome under all potential future economic scenarios.	This has been clarified and relates to the distribution of the excess stabilisation reserve rather than the investment returns earned.
4.1.5	One possible interpretation may be that the formula should be a moving average of the past 24 months’ investment returns earned on the underlying portfolio of assets. It is important to note that the bonus stabilisation reserve of a smoothed bonus portfolio is the result of a number of factors, of which past investment returns earned on the underlying assets is only one such factor. The cash flow experience of the product and the level of the stabilisation reserve at the times when cash flows occur will also have an impact on the level of the bonus stabilisation reserve. For this reason, a formulaic approach that focusses solely on past investment returns will not adequately take into account all the necessary factors to determine what an appropriate bonus should be.	
4.1.5	An alternative interpretation is that the formula should aim to spread any excess stabilisation reserves (above the long-term target range of between 0% and 5%), over a period not exceeding 24 months.	

4.1.5	Such an approach would be more appropriate compared to the moving average approach. However, we are still concerned that a period of 24 months may not be appropriate for a particular economic scenario. In particular, during a protracted bull or bear market, there may be a need to build up larger reserve levels to shield members against significant market movements. The main objective of smoothed bonus products is to shield members from excessive market volatility. Limiting the smoothing period to 24 months may not allow smoothed bonus products to deliver on these objectives given the potential length of economic market cycles.	The smoothing period was chosen to limit the impact of cross generational subsidies.
4.1.6	"**target a long-term average bonus stabilisation reserve** ~~result in a long-term funding level~~ not exceeding ~~105~~ **5** per cent"	
4.1.6	ASISA members agree that the bonus formula should not target an excessive long-term funding level (or bonus stabilisation reserve). However, market conditions may well result in high funding levels for an extended period of time.	The redistribution mechanism should not permit high funding levels over an extended period of time. The disclosed remedial action must be taken to avoid this.
4.1.6	"**target** a long-term **average** funding level not exceeding 105 per cent; and"	
4.1.6	Given that funding levels are changing according to current conditions (market returns, cash flows) while past returns are still in the process of being distributed, it is not clear how an actual long-term funding level will be determined at any particular point in time and whether the result of such a determination will be comparable to a specified limit. A more practical requirement, that can be measured, would be that the formulaic approach used must incorporate a target long-term average funding level not exceeding 105%.	Agreed. The long term funding level should not exceed 105% and the formulaic approach would be set to achieve this. No change to wording, as it is not the average that is being targeted, but the ongoing funding level
4.1.6	What is meant be long-term, i.e. how many years would constitute "long-term"?	This should be defined and should be acceptable to the trustees.
4.1.6	given our views on the long-term nature of such products, arguably a higher maximum funding level than 105% should be allowed, say 110%. (If the figure of 105% is intended to refer to an average over some period and not to a maximum, this should be clarified.)	The excess over this funding level, representing the stabilisation account, must be spread over the 24 months period in the previous point. Again, this is a compromise between the opposing objectives.
4.1.7	Is the intention that "stakeholders" should include anyone other than members investing in the default portfolio?	The insurer must disclose this to the fund and the fund must disclose this to all its stakeholders.
4.1.7	Although we are in agreement with disclosing the bonus formula, we require clarification on the actual disclosure. For example, do we need to disclose a formulaic version of the bonus formula or rather a layman's explanation of it? The former could be complex for clients to understand whereas the latter could be considered more client-centric. We suggest that the information be included in a separate disclosure document, together with the disclosures required as per the newly suggested 4.1. The reason for this is the onerous requirements and potentially costly exercise of updating the Principles and Practices of Financial Management.	The formula should be disclosed, as well as a simpler explanation of what this means.

4.2	If the management actions refer to actions by the insurer, then this should be stated. And by whom and to whom must such actions be disclosed?	This is clear. The standard notes that the insurer may deviate but that the disclosure must, again, be to all stakeholders.
4.2	In line with the above thinking, we also suggest that the wording of 4.2. be changed to read as below, with '4.1.4 – 4.1.7' being renamed to '4.2.1 – 4.2.4' and '4.2 – 4.5', being renamed to '4.3 – 4.6':	The current emphasis and requirements are aligned to the Authority's intentions. The approach applied must include all the items currently listed in section 4(3)
4.3	The charge in respect ~~cost~~ of any guarantee provided in terms of the policy must be commensurate with the risk and there must be separate disclosure of guarantee charges and other costs relating to the policy.	
4.3	ASISA members believe that insurers should provide a full Total Expense Ratio and Total Investment Cost breakdown, which must include a specific reference to the guarantee charges.	Agreed
4.3	"The **charge in respect of** any guarantee provided in terms of the policy must be commensurate with the risk…"	Amended
4.3	It should be borne in mind that the entity responsible (towards the Registrar) for compliance with the Notice is the fund. How will the fund know if the cost of any guarantee provided in terms of the policy is "commensurate"?	The trustees need to satisfy themselves that the cost of the guarantee is reasonable for the risk being taken by the insurer, to make sur that the members are receiving value for money.
4.3	Charges should be expressed as a % and in Rand terms (i.e. charges should not only be stated as 1.5% but like R50 for every R1000 in assets)	There is a separate consideration of expenses which would highlight the manner in which expenses should be considered and disclosed. The Standard deals only with the charges that are very specific to a smoothed bonus portfolio.
4.3	In terms of ensuring that the cost of the guarantee is commensurate with the risk, we propose that the FSB issue guidelines on how this should be determined. This will ensure consistency across the industry and allow clients to make comparisons on a like-for-like basis.	It is up to the insurer to be able to justify the cost of the guarantee against the risk that they are taking.
4.4	Is the intention that the term "policy contract" means something different from the defined term "policy"?	This is the contract behind the policy.
4.4	There could be an argument to add the following line at the end of 4.4: "The size of the MVA, if any, that may be applied needs to be disclosed periodically". In fact the 3rd TCF principle of providing relevant and appropriate information arguably requires this.	This is a Standard as to the conditions that the fund needs to ensure are present in order for it to choose to apply a smoothed bonus policy as a default portfolio. It is not intended to prescribe requirements for disclosure by an insurer. The trustees need to make appropriate arrangements with the chosen insurer to obtain the information they require.

4.4	we assume that a switch initiated at the member's request does not constitute an individual benefit payment. (There are smoothed-bonus products which currently apply MVAs on switches but not on benefit payments. The insurers will certainly argue that this is necessary to limit anti-selection.)	Agree - a switch is not the payment of a benefit.
4.4	We are in agreement with this condition provided that it is not prescriptive that retrenchments be included as an individual policy benefit.	A separate footnote on retrenchments has been included.
4.5	"no disinvestment penalties or **disinvestment** charges levied by the insurer"	Amended
4.5	It should be stated that any MVA is not regarded as a penalty or charge.	MVA is considered separately in section 3(3)(e)
4.5	There are no objections to this condition, provided this applies to the smooth bonus portfolio and not the product through which the client is invested.	The client must not be charged any disinvestment penalties or charges, whether through the policy or the portfolio?
5	Asset allocations between the different asset classes significantly affect investment risk and returns. Where a material change in the strategic asset allocation is being considered which is likely to result in lower long-term investment returns, full disclosure must be made to all affected parties and the Registrar must be notified of the intent to change the strategic asset allocation. ~~Participants must be given the option to opt out of the portfolio if there is a material change in the exposure, without any penalties or MVA applying.~~	The proposed change is not accepted. Where an insurer changes the fundamentals of the product, the policy must allow funds and their members to opt out. .
5	The principle that retirement funds should not be locked in or penalised if their reasonable benefit expectations are impacted by, for example, a change in asset strategy makes sense. But the clause is not helpful in a practical sense :	
5	(1) A change in legislation, e.g. Reg 28 asset class limits, could force a change in asset strategy – regulatory change would need to be excluded from the ambit of clause 5.	Amended
5	(2) If MV is above BV when the change is introduced, it would actually be unfair to pay only BV.	The decision to opt out is that of the policyholder. The full information must be disclosed to them, to allow an informed decision to be made.
5	(3) If MV is below BV at the time of the change, it probably suggests that the asset strategy was not sustainable. If an insurer is penalised by having to pay out more than MV, then they won't do this. As a result bonuses will decline and retirement funds will effectively be locked into an unsustainable asset strategy unless they terminate at the lower of book or market value.	Insurers must consider their asset strategy carefully when setting this, with particular regard to sustainability.
5	Another concern is that the paragraph seems to force insurers to rebalance portfolios during a market crash to remain within the disclosed limits – something that may not be in the retirement fund's or retirement fund members' best interest.	The purpose of an asset strategy is to set out the intended asset allocations and limits.

5	The central question which this section is presumably trying to address is how to avoid a situation where there is a conflict of interest. Conflicts of interest can potentially arise where there is a guarantee: an insurer charges for a guarantee, but then as it starts to "bite" the insurer changes the strategic asset allocation and effectively nullifies the value of the guarantee.	Yes, as well as the situation where the product deviates from what had been communicated when this was first chosen.
5	It should also be noted that a Smoothed Bonus product that offers a partial or full guarantee may be excluded from the limits set in Regulation 28 of the Regulations made under Section 36 of the Pension Funds Act No. 24 of 1956, as it provides a partial guarantee as described in paragraph 4.2(i) of FSB Directive 157.A.i (LT).	Any smooth bonus product that is chosen as a default portfolio must comply with Regulation 28, regardless of the product or the guarantee. There are no exclusions.
5	“Asset allocations between the different asset classes significantly affect investment risk and returns. Where a material change in the disclosed investment philosophy, which is likely to result in lower long-term expected returns, is being considered, full disclosure must be made to all affected parties and the Registrar must be notified of the intent to change the disclosed investment philosophy.”	
5	We do not believe it is necessary to require compliance with Regulation 28 asset limits in this condition. Regulation 28 adequately deals with investment strategies on its own. In addition, smoothed bonus products that offer a partial or full guarantee may be excluded from the limits set in Regulation 28 of the Regulations made under Section 36 of the Pension Funds Act No. 24 of 1956, as it provides a partial or full guarantee as described in paragraph 4.2 (i) of Directive 157.A.i (LT) issued by the Financial Services Board. Therefore we recommend that this requirement be removed.	The portfolio must remain within the limits set out in Regulation 28 to be considered as a default portfolio. The limits in regulation were designed to protect members and the default portfolio needs to be more prudent, given that the individuals are not making their own informed choice in this situation. There is no exclusion from this for the default portfolio, regardless of the guarantees.
5	Any specific strategic asset allocation may well become inappropriate in particular market circumstances. Hence in circumstances where the Market Value is significantly below the Book Value and the insurer will be penalised by having to pay out more than Market Value if a material change is made, retirement funds may effectively be locked into an unsustainable asset strategy unless they terminate at the lower of book or market value. We therefore propose that the last sentence be deleted as it is unlikely to have the desired effect in practice.	The intention is to ensure accountability. The strategy is set in advance and should consider possible market circumstances. If the underlying principles that were communicated are going to be changed, members must be provided the option of not being locked into something that they are no longer in agreement with.
5	We also note that some investment strategies may inherently involve material changes to asset allocations, for example dynamic asset liability management strategies. For this reason, the disclosure requirements should rather refer to “disclosed investment philosophy” rather than “strategic asset allocation”.	A disclosed philosophy is not measurable by the members.

5	If the intent of this section is to address the risk of an insurer materially changing the strategic asset allocation of a smoothed bonus portfolio in circumstances where the underlying guarantee is "biting" or likely to bite - i.e. where there is an inherent conflict of interest for the insurer. It is proposed that the wording on this section can be clarified to express this intent more clearly, for example to reflect that any change in the strategic asset allocation that materially impacts the cost of a guarantee must be notified to the Registrar.	While this is the main intention behind the requirement, the principle of allowing opt out on a fundamental change in strategy away from what was previously communicated would apply regardless of the reason for the change.
5	If the smoothed bonus policy qualifies as a guaranteed policy as contemplated in regulation 28 then the asset spreading limits do not apply. If the intention is that par 5 must “override” such principle for purposes of the Notice, then this should be stated. If so, will the policy then still be regarded as a guaranteed policy for purposes of regulation 28 reporting?	The exemption will not apply. This has been clarified.
5	How will the fund know if a material change in the strategic asset allocation is being considered? It seems that the fund must inform the Registrar must be informed in advance – how will the fund know what the insurer is contemplating?	The fund can agree the appropriate notification methodology with the insurer.
5	If “Participants” mean the members investing in the portfolio concerned, then this should be clarified. And don’t such members in any event have the option to switch to another portfolio if the fund has individual member choice?	The participants in an individual investment choice fund are the members invested in the portfolio. Members do have the option to switch. This point is referring to a very specific circumstance and the amount that must be switched.
5	How must the opt out apply in case of a fund that does not have individual member choice and invests in only one portfolio – is the intention that the members must then be given the option of another portfolio that the fund will have to arrange?	The participant here is the fund and the decision is that of the fund.
5	What is meant by “the exposure”?	Exposure to specific asset classes.
5	It would be in the interest of smooth bonus fund clients to change the asset allocation following a significant change in the smooth bonus funding level and future expected investment returns. However, allowing clients to exit with no MVA if the strategic asset allocation changes following such an event, will make it nearly impossible to provide a smooth bonus portfolio. Management actions may also include the ability to deviate from the strategic asset allocation. Given that the strategic asset allocation is inextricably linked to the bonus formula, management actions and guarantee charges, these elements should ideally be considered together and be internally consistent.	These need to be externally consistent too. The product was designed and sold on a particular basis, with a particular asset strategy and risks. It would be viewed as inappropriate to reduce risk for the insurer and returns for members when the very guarantees that are being paid for, need to be funded. Allowance for the investment philosophy has been included.
5	Also with the advent of liability driven investment strategies with continual changes in the asset allocation, this condition will be onerous to enforce. This clause will make it difficult to use dynamic hedging (or any other form of dynamic asset-liability management) for smooth bonus portfolios.	The asset strategy should be correctly formulated and explained.

5	We therefore suggest this clause be amended to offer an opt-out option without a penalty or MVA if there is material change to the portfolio's investment philosophy rather than the strategic asset allocation. The suggested wording is below:	
5	*... Participants must be given the option to opt out of the portfolio if there is a material change in the investment philosophy, without any penalties or MVA applying.*	
5	Smoothed bonus products that offer a partial or full guarantee may be excluded from the limits set in Regulation 28 of the Regulations made under Section 36 of the Pension Funds Act No. 24 of 1956, as it provides a partial or full guarantee as described in paragraph 4.2 (i) of Directive 157.A.i (LT) issued by the Financial Services Board. We therefor do not believe it is necessary to require compliance with Regulation 28 asset limits in paragraph 5 of the Draft Notice. Regulation 28 adequately deals with investment strategies on its own.	See previous comment. The default portfolio is not exempted and must follow the prudent allocation limits in Regulation 28.
5	We recognise the potential conflict of interest between shareholders and policyholders where an insurer is able to de-risk the underlying asset portfolio to avoid the need for shareholder support where guarantees are provided. Such a de-risking strategy could have a material impact on future returns for policyholders. Our understanding is that paragraph 5 intends to address this concern.	Agreed
5	However, the ability to apply an MVA in certain, clearly specified circumstances is a necessary protection and risk management principle to serve the best interest of remaining policyholders invested in the smoothed bonus portfolio. If an MVA is not applied when there is a voluntary surrender, it is the other policyholders, rather than the shareholder, that will have to absorb the "cost" of paying out more than the market value. It will not be fair to allow some members to exit without an MVA at the cost of remaining members. From a fairness to all policyholders' perspective, we therefor submit that this is not a viable solution to address the concerns around conflicts of interest.	No solution has been suggested that will also cover the concern that this paragraph was inserted to cover.
5	Furthermore, there may be valid reasons in extreme market conditions to change the investment strategy in order to ensure the ongoing solvency of the insurer to protect the interest of policyholders. Not allowing insurers to apply an MVA in these situations could have the unintended consequence of discouraging insurers to make changes that are ultimately in the interest of policyholders.	
5	We therefor suggest that paragraph 5 be simplified to read as follows:	
5	Asset allocations between the different asset classes significantly affect investment risk and returns. Where material changes to the strategic asset allocation, which is likely to result in lower long-term expected returns, is being considered, full disclosure must be made to all affected parties and the Registrar must be notified of the intent to change the strategic asset allocation.	This does not cover the concern noted.

6	Smoothed bonus policies are perceived to be complex given the **smoothing mechanisms and/or guarantees** ~~and smoothing mechanisms~~ associated with them. Whilst the underlying mechanism may be complex, the fund must ensure that the communication it receives from the insurer or	Amended
8	It needs to be acknowledged that several separate parties are involved, which are not always the same entity or within the same group of companies. Before these requirements are regulated, there should be clear understanding between industry and the regulator as to how the various TCF responsibilities are expected to be applied in the retirement fund context. It is also important to note that the policy is the contract issued by the insurer to the retirement fund. The policy can include reasonable, fair and appropriate terms, but the insurer cannot ensure that all of the TCF outcomes are achieved by the retirement fund in respect of its members.	As detailed in the notice, the fund is required to ensure that the policy complies. The responsibility is that of the fund and the fund may not chose a policy that does not meet these criteria. If an insurer wishes to have their policy considered as a default portfolio by a fund, the insurer would therefore need to prove compliance to the fund and would be held accountable for this. Clarified in Standard.
8	The reference to "the six TCF fairness outcomes" should be removed unless it is contained in legislation that can be referred to in the Notice.	The six outcomes are paraphrased in the Standard
8	Can reasons for smoothing be provided and how it works, the advantages and disadvantages and associated risks?	Funds must provide information to the members about any investment product, not only a smooth bonus product. Addressed in paragraph 4(5).
8.1	What firms that the members are dealing with are contemplated? Members would normally only have a relationship with the fund.	Clarified in the Conduct Standard
8.2	Does this mean that the policy must set out how it has been designed and targeted to meet the needs of the identified customer group? This could be difficult if the policy is issued to an umbrella fund that has participating employers of vastly different employer and employee profiles.	The insurer needs to set out how it was designed and targeted to meet specific needs and the fund needs to consider whether these design structures match the needs of their specific members for whom this would be the default.
8.2	We note that this TCF outcome is not relevant to this Notice because the default regulations explicitly exclude retail (RA and preservation funds) from the default investment portfolio requirements.	TCF outcome amended to require the products and services to be designed to meet the needs of identified members and targeted accordingly.
8.2	The Notice must be complied with by the fund. How can a fund comply with this general requirement which seems to be aimed at service providers?	The fund must consider whether the product they are choosing as their default meets the needs of the identified members and is targeted accordingly.
8.2	Delete the words "in the retail market" from this section	Amended
8.3	What contracting is envisaged? Pension and provident fund members have to become members in terms of their conditions of service and do not contract with the fund.	Amended

8.4	The POLICY can't be expected to deal with this. This is probably not even a FUND obligation in most instances, nor the Insurer's nor the POLICY. It is not reasonable to expect the POLICY issued to the Fund to deal with this.	This is the fund's obligation, where the advice is being provided by the fund or the fund's advisors. The fund must ensure that the information provided to the members is sufficient for an independent advisor to also be able to provide suitable advice.
8.4	It is not clear how this TCF principle can or should be applied in these circumstances - the retirement fund and its trustees cannot be held accountable for, or would not even be aware of, the appropriateness of the advice received by fund members (this assumes that the advice is received by individual members and not procured by the Fund on behalf of members).	Clarified. The information provided to the members should be sufficient to allow an independent advisor to provide suitable advice in these circumstances.
8.5	The POLICY can't be expected to deal with this. It is a FUND obligation to conduct a due diligence on investment products and to regularly review investment products in order to achieve this TCF outcome, not the Insurer, or the POLICY wording.	The fund must ensure the products perform as the they were led to believe. Similarly, it is a requirement for any policy that it should follow the TCF principles and the Insurer needs to ensure that the product performs as they communicated it would when this was chosen by the fund.
8.5	What firms are contemplated with regard to pension and provident fund members? Their only relationship is with the fund.	Revised
8.6	This does not seem relevant for pension and provident fund members.	It is relevant for members who want to move from one investment to another.