



**STATEMENT SUPPORTING THE DRAFT CONDUCT STANDARD ON THE  
CONDITIONS FOR SMOOTH BONUS POLICIES TO FORM PART OF  
DEFAULT INVESTMENT PORTFOLIOS**

**1. Introduction**

- 1.1 On 25 August 2017, the Minister of Finance made amendments to the Regulations issued in terms of section 36 of the Pension Funds Act, 1956 (Act 24 of 1956)(the Act). In particular, some definitions were amended and Regulations 37 to 40 were inserted with effect from 1 September 2017. The former Registrar of Pension Funds exempted all funds from the provisions of the Regulations until 1 March 2019.
- 1.2 This statement relates to the publication of the draft Conduct Standard to be made in terms regulation 37, read with paragraph (c) of the definition of 'default investment portfolio' and section 106(1)(e) of the Financial Sector Regulation Act, 2017 (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(1)(a) of the FSR Act.
- 1.3 Regulation 37(1) requires that the board of a fund with a defined contribution category, to which members belong as a condition of employment, must include in its investment policy statement the provision of one or more of the default investment portfolios.
- 1.4 A default investment portfolio is defined in section 1 of the Regulations. Paragraph (c) of the definition empowers the Financial Sector Conduct Authority

(Authority) to prescribe conditions that a default investment portfolio must comply with.

- 1.5 The aim of the draft Conduct Standard is to prescribe the conditions with which a smooth bonus policy must comply in order to be considered for inclusion as a default investment portfolio. .

## **2. Statement explaining the need for the draft Conduct Standard**

- 2.1 A smooth bonus policy aims to smooth returns over time, which creates inter-generational subsidies. In addition, the inclusion of guarantees in the design of some of these policies means that the capital costs are higher.
- 2.2 This Conduct Standard aims to provide additional protection to members who are defaulted into a smooth bonus policy since they may not fully understand the default being provided. The extent of smoothing, the triggers and asset allocations are prescribed as conditions that funds must consider before including a smooth bonus policy in its default investment portfolio.

## **3. Intended operation**

- 3.1 A fund wishing to include a smooth bonus policy in its default portfolios must ensure that the fund's investment policy sets out the necessary governance and disclosure requirements and that the smooth bonus policy is eligible for inclusion as a default investment portfolio.
- 3.2 The draft Conduct Standard intends to determine the conditions with which a smooth bonus policy must comply to be included as default investment portfolios.
- 3.3 The draft Conduct Standard will take effect on 1 March 2019, being the date the Regulation must be complied with.

- 3.4 Any applications for exemption from any of the provisions in the draft Conduct Standard would be considered on a case by case basis.

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

The Conduct Standard will impact the various stakeholders in different ways:

- 4.1 The limitations being imposed on the smoothed bonus portfolios will result in portfolios which smooth less, over shorter periods. Together with the intended reduction in intergenerational cross subsidies, the reduction in the smoothing period will lead to more volatile returns for members.
- 4.2 Boards will need to follow a more onerous process, should they opt to include a smoothed bonus policy in their default investment strategy. This will result in more time being spent, as well as more checks and balances being required. This may disincentivise board from opting for smoothed bonus policies as defaults for their members. The members for whom smoothed returns would be preferable, would then need to specifically opt for these themselves.
- 4.3 Insurers wishing to have their smoothed bonus policies included in funds' default investment portfolios will need to ensure that their smooth bonus policies comply with the requirements. While many of the triggers are already part of the processes of the insurers, the Conduct Standard will allow the Insurers less flexibility. While this makes the processes more explicit and therefore less open to manipulation, it will result in a reduced ability to act speedily and to mitigate risks. This may have an impact on the cost of any guarantees provided and might limit the number of Insurers willing to offer smooth bonus policies that complies with these criteria.
- 4.4 A separate smoothed bonus policy that complies with the conditions to form part of the default investment strategy may be required. This will split investments and there may be an increase in the number of portfolios available for investment; a

smoothed bonus policy that complies to be part of the default and a traditional smoothed bonus policy that is an investment choice.

## 5. Conclusion

- 5.1 The draft Conduct Standard will be published in terms of section 98(2) of the FSR Act for a period of six weeks for public comment.
- 5.2 Submissions received on the draft Conduct Standard will be considered and where appropriate, necessary changes will be effected. The updated draft Conduct Standard will be 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 also be updated to reflect the expected impact of the draft Conduct Standard.