Financial Sector
Conduct Authority

FSCA CONDUCT STANDARD [-] OF 2020 (RF)

PENSION FUNDS ACT, 1956

FINANCIAL SECTOR REGULATION ACT, 2017

CONDITIONS FOR SMOOTHED BONUS POLICIES TO FORM PART OF DEFAULT INVESTMENT PORTFOLIOS

The Financial Sector Conduct Authority hereby, in terms of paragraph (c) of the definition of ‘default investment portfolio’ in the Regulations made in terms of section 36 of the Pension Funds Act, 1956 (Act No. 24 of 1956) and section 106(1)(a) of the Financial Sector Regulation Act, 2017 (Act No. 9 of 2017), prescribe the conditions that must be complied with for smoothed bonus policies to form part of default investment portfolios, and related matters, as set out in the Schedule.

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For THE FINANCIAL SECTOR CONDUCT AUTHORITY

Date of publication:

SCHEDULE

1. Definitions

In this Schedule, "**the Act**" means the Pension Funds Act, 1956 (Act No. 24 of 1956) and the "**Regulations**" mean the Regulations made under section 36 of the Act and any word or expression to which a meaning has been assigned in the Act or the Regulations bears the similar meaning, and unless the context indicates otherwise -

"Authority" means the Financial Sector Conduct Authority as defined in section 1 of the Financial Sector Regulation Act, 2017 (Act No. 9 of 2017);

"life insurance policy" has the meaning assigned to such term in section 1 of the Long-term Insurance Act, 1998 (Act No. 52 of 1998);

"market-value adjustment" or **"MVA"** means a reduction that is applied to the smoothed value of a policy to provide a value that is consistent with the market value of the policy; and

"**smoothed bonus policy**" or "**policy**" means a life insurance policy with discretionary participation features, underwritten by an insurer as defined in the Long-term Insurance Act, 1998 (Act No. 52 of 1998), 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 over the same period so as to smooth the portfolio return.

2. Conditions for smoothed bonus policies to form part of default investment portfolios

(1) In terms of paragraph (c) of the definition of 'default investment portfolio' in the Regulations, the conditions to be complied with for a smoothed bonus policy to form part of a default investment portfolio are prescribed in subparagraphs (4) to (6) below.

(2) A fund may only include a smoothed bonus policy as part of a default investment portfolio if the policy complies with regulation 37 and the definition of 'default investment portfolio' in the Regulations.

(3) A fund must ensure that a smoothed bonus policy is eligible for inclusion as a default investment portfolio as provided for in this Conduct Standard.

(4) To be eligible for inclusion as a default investment portfolio, a smoothed bonus policy must comply with the following criteria:

(a) A formulaic approach must be established to calculate and determine bonus declarations, both vested and non-vested;

(b) a formula for bonus declarations may allow for a deviation of not more than 2% per annum from the calculated target bonus to include allowance for expectations with respect to future market movements;

(c) the formulaic approach referred to in subparagraph (a) must -
(i) include triggers or factors that may result in the possible removal of non-vested bonuses and the method of removal;
(ii) provide for factors or triggers that dictate the provision of shareholder capital to maintain the financial soundness of the policy;

(iii) clarify the extent to which shareholder capital is viewed as a loan which will be repaid to shareholders with future investment returns versus a cash injection that will not be repaid from future investment returns;
(iv) specify the minimum and maximum levels of the stabilisation reserve and the remedial actions which will be taken should these limits be breached;
(v) limit the smoothing period by spreading any excess bonus stabilisation reserve over a period not exceeding 24 months;
(vi) have a long-term funding level target not exceeding 105%; and
(vii) be disclosed to all stakeholders;

(d) the smoothed bonus policy -
(i) may provide that the insurer may, in exceptional circumstances and with prior notification to the Authority, temporarily deviate from the provisions of sub-section (4)(c)(v) of this Conduct Standard; and
(ii) must provide, if relevant, that the deviation referred to in item (i) must be appropriately and timeously communicated to the fund;

(e) management actions that may be taken by the insurer to reduce the risk in the smoothed bonus policy must be properly disclosed and documented;

(f) the charge in respect of any guarantee provided in terms of the policy must be commensurate with the risk and there must be separate disclosures of guarantee charges and the other costs relating to the smoothed bonus policy;

(g) subject to subparagraph (h), the smoothed bonus policy may only allow an insurer to apply a market-value adjustment (MVA) in pre-determined circumstances as stipulated in the policy, provided that payment of any individual benefit under a policy triggered by non-voluntary events such as death, retrenchment or retirement are not subject to any adjustment;

(h) in respect of retrenchments,
(i) an MVA may be applied in the case of materially significant retrenchments by an employer if the application of an MVA in such circumstances is clearly specified and communicated prior to entering into a contract; and
(ii) an MVA may be applied in the case of retrenchments if the Authority is timeously notified of any MVA on particular retrenchments that is being considered, before any such MVA is applied; and

(i) the smoothed bonus policy may not allow for any disinvestment penalties to be levied by the insurer.

Asset allocation

(5)

(a) The asset allocation in a smoothed bonus policy must remain within the strategic asset allocation limits that have been disclosed and must comply with the asset spreading limits set out in regulation 28: Provided that the exclusion in regulation 28(8)(b)(iii) does not apply to a default investment portfolio.

(b) Where a material change in the strategic asset allocation is being considered, full disclosure must be made to all stakeholders and the Authority must be notified of the intent to change the strategic asset allocation, including reasons for the change and the scenarios envisaged, before such changes are given effect to.

(c) Where a change in asset allocation in a smoothed bonus policy is not in line with the communicated investment philosophy, 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, unless the change in asset allocation is required as a result of legislative changes.

Change in investment strategy underlying smoothed bonus product

(6) The smoothed bonus policy must provide that -

(a) where material changes to the strategic asset allocation (which are likely to result in lower long-term expected returns) are being considered to protect solvency, full disclosure must be made to all stakeholders; and

(b) a fund must notify the Authority, and include the information referred in subparagraph (5)(b), of any intent to change the strategic asset allocation.

3. Additional requirements relating to the fair treatment of members

(1) An insurer that provides a smoothed bonus policy to a fund as part of a default investment portfolio must –

(a) ensure that the conditions in paragraph 2 of this Conduct Standard is met;

(b) ensure that the fair treatment of the fund and its members are achieved in relation to such policy;

(c) in achieving the outcomes contained in Rule 1 of the Policyholder Protection Rules, have regard to the nature of, and specific risks inherent in, a smoothed bonus policy; and

(d) ensure that the communication it provides to the fund regarding the portfolio and its performance is accurate, relevant, simple and easy to understand.

(2) Information provided by the fund to its members in relation to default investment portfolios must be accurate, relevant, simple and easy to understand.

(3) A fund must ensure that -

(a) the smoothed bonus policies of an insurer that are considered part of a default portfolio take into account the fair treatment of, and meets the needs of, members;

(b) it is given clear information and kept appropriately informed before, during and after the time of entering into the smoothed bonus policy;

(c) it gives clear information to members whilst their monies are invested in a default investment portfolio; and

(d) appropriate channels exist for members to submit complaints in relation to default investment portfolios.

4. Short title, commencement and transitional arrangements

(1) This Conduct Standard is called Conditions for Smoothed Bonus Policies to form part of Default Investment portfolios, 2020.

(2) Subject to subparagraph (3), this Conduct Standard takes effect on the date of publication.

(3) Funds must comply with this Conduct Standard within 9 months after the effective date of this Conduct Standard.