FSCA

Financial Sector
Conduct Authority

# Benefit Projections: South African Experience

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# Regulatory Context

- Poor practices and conduct towards financial customers/fund members
- Treating Customers Fairly 6 outcomes (2011)
  - Organisation culture
  - Clear information to customers and keep them informed
  - Advice must be suitable
  - Products must perform to expectations
  - Products must meet needs of customers and target right customers
  - No unreasonable post-sale barriers to change or exit products (claims, complaints)
- Twin Peaks in 2017/18
  - FSCA born on 1 April 2018
  - Clear mandate to protect members - TCF and Financial education
- Behavioural economics important in designing policy and instruments
  - Overconfidence, inertia, herding, anchoring (rely on initial infor), myopia (shortsightedness)
  - Nudging important

# Why?

- **Manage expectations**
  - realism

- **Influence behaviour**
  - Information used to nudge
  - Eg contribution rates; extend period of saving; preservation

*Educating members will result in better retirement outcomes*

# What is required of funds

- Benefit statements to include benefit projections in **Simple** and **Clear**
- Use consistent methodology and assumptions
- Benefit calculators to follow same principles (*consistency*)
  - allow addition of benefits from various sources for planning
- Cost of producing the projections statements vs benefit of the information
  - Costs an issue, but don't cut to the bone
  - Instead use value as a determinant
  - Add to current annual benefit statements

*Simplicity and Value*

# Proposed Notice

**Frequency**

- On joining (*help decisions*)
- Annually (*as active member*)
- On withdrawal (*prompt preservation*)
- For living annuities, annually after retirement (*sustainability*)

**Communication**

- First disclaimer – this is Guidance and NOT Promise
- Second disclaimer – projections could differ from final benefits value

# What is to be disclosed – minimum key information

- **Distinguish between members making contributions and those not**
  - Projected benefit at retirement as % of CTC and not Pensionable Salary
  - Projected monthly pension as % of CTC; ie Net Replacement Ratio
  - *Projected monthly pension in current day terms*
  - *A note on risks and assumptions*
- **For non-contributing members, difference is there is no CTC base**
- **For living annuities (drawdown between 2.5% and 17.5% pa):**
  - Time until real income reduces
  - Time until savings decline (depleting capital)
  - Time until capital no longer supports current drawdown amount (with inflation)
  - A standard on the way for default living annuity – eg if 55 – male (4.5%); female (4%)

# Methodology and Calculations

- **DB - members projected benefit based on**
  - benefits payable as per fund rules
  - Projected service period to normal retirement
  - Current salary and its history

- **DC – members projected share of fund based on**
  - current net contribution rate as per fund rules
  - With real returns
  - Converted applying pension increase policy

- If no contribution, projection should reflect benefits based on accumulated contributions and future contributions - to show impact of missing contributions

# Methodology and Calculations

**Assumptions**

- Real Return (RR) = Rn – Inflation (and fees/expenses)
  - RR should reflect long term view of expected returns based on bond yields
  - ❑ **Return (nominal)** : Bond Yield (12+ years) plus risk premium
    - - Risk premium : proportion of growth assets (equity and property) multiplied by max equity risk premium of 3%
    - - NB Illustrative RR not to be higher than projected inflation + 4%
  - ❑ **Inflation** : <u>difference</u> between Nominal Bond Yields and Inflation Linked Govt. Bond Yields of same duration, plus inflation risk premium (irp)
    - - Max irp 0.5% and can factor in salary increases
- DC: Must also show a worse case: 2% lower real return (unless if portfolio guaranteed)
- May show other scenarios; but must not exceed above limits and if more than two rates are used the most optimistic rate must not exceed projected inflation + 5%

# Certification and Exceptions

Certification

- Trustees are responsible for ascertaining reasonableness of assumptions
- Valuator certify the assumptions once every 3 years
- Include assumptions in annual financial statements and reporting to the FSCA

Exceptions

- Beneficiary funds (inactive members, eg dependents and widows)
- Unclaimed benefit funds (inactive and difficult-to-trace members)

Note

  – Retirement annuities and preservation funds are required to comply (members still active)
  – Though fewer projections needed

# Progress

- Notice was issued for comment
- Comments received and notice to be reissued for second round
- Majority of comments
  - Requested clarification of some of the terms
  - Requested exemption from requirements for specific funds (unlikely to be granted)

# THANK YOU

FSCA