Benefit Projections: South African Experience

Olano Makhubela: Deputy Registrar of Pension Funds

OECD/IOPS Global Forum on Private Pensions
26 October 2018
Beijing
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: difference 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