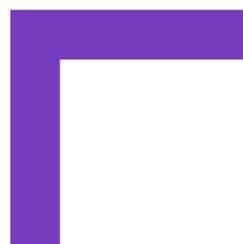


FSCA

Financial Sector
Conduct Authority



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 info), 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

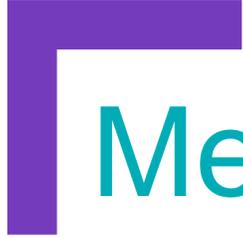
- First disclaimer – this is Guidance and NOT Promise
- Second disclaimer – projections could differ from final benefits value



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) = $R_n - \text{Inflation (and fees/expenses)}$
 - 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