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OVERVIEW OF NEW DRAFT DEFAULT REGULATIONS THAT AFFECT RETIREMENT FUNDS

National Treasury has published draft default proposals that follow from the Treasury paper, *Charges in South African Retirement Funds*, published in 2013. This paper highlighted the complex and opaque products with high charges in the SA retirement system. The draft default proposals are some of the first steps, together with the Treating Customers Fairly (TCF) initiative and the Retail Distribution Review (RDR), towards lowering charges and improving market conduct in the retirement industry.

Default options are automatic choices made on behalf of members who do not exercise a choice in a given situation. Retirement funds are not currently compelled to provide default options, and, where they exist, current defaults often favour the interests of service providers, potentially working against the interests of members.

The draft default regulations are published in terms of Section 36 of the Pension Funds Act. All retirement funds will be required to manage a set of default policies that are in the long-term interests of members rather than of service providers. The conditions that such default policies are required to meet are prescribed in the regulations. The various default strategies to be developed by funds should be compliant with all the standards, principles and rules prescribed in the default regulations, including Regulation 28.

The 3 default strategies that funds will have to develop are:

A. Default Investment Strategy

- All retirement funds, including retirement annuity funds, must put in place a default investment strategy for members who do not make an investment choice;
- The default strategy must be simple, cost-effective and transparent;
- The overall objective, composition and performance of the default investment portfolio must be appropriate for members;
- The default investment strategy must be adequately communicated to members in a clear and understandable language;
- Fees and charges in respect of the default portfolio, or the assets held in respect thereof, need to be reasonable, competitive and regularly and accurately disclosed to members;
- Performance fees, loyalty bonuses or similar charge structures are not permitted for default investment portfolios;
- Members may not be locked into a default investment portfolio, but should be able to transfer from one portfolio to another;
- Default investment strategies may not contain any insurance element, but must be purely for investment purposes;
- Payouts cannot depend in any way on the reason for a member's exit;
- Trustees are required to consider passive or enhanced passive investment as all or part of the default investment portfolio;
- The assets in the default investment portfolio must comply with Regulation 28;
- The default investment portfolio must be regularly reviewed by the Board of Trustees to ensure that it complies with the regulations.

B. Default Annuity Strategy

- All retirement funds, including retirement annuity funds, must put in place a default annuity strategy and the Fund rules will have to be amended accordingly;
- Various products can form part of the default annuity strategy. For example, in-fund guaranteed pensions, in-fund living annuities, in-fund with-profits pensions, and certain out-of fund life annuities guaranteed by a life office will all be allowed;
- Where an in-fund living annuity is offered the drawdown will be restricted to a maximum percentage based on age;
- Trustees may also mix different products as part of the strategy;
- The default annuity strategy must be appropriate for members;
- Members must be allowed to opt out and move into other annuity products of their choice if they wish;
- Retirement benefit counsellors (remunerated by the fund) must be made available to members on retirement to assist them in understanding the default annuity strategy;
- The default annuity strategy needs to offer good value for money;
- The default annuity strategy must be adequately communicated to members, before and after retirement;
- All fees and charges must be accurately disclosed and be reviewed regularly to ensure compliance with the regulations.

C. Default Preservation Strategy

- All retirement funds must put in place a default preservation strategy and the fund rules will have to be amended accordingly;
- Retirement funds are required to make provision for 'paid-up members' (members that are no longer employed by the employer and therefore no longer actively contribute to the fund);
- Exiting members must automatically be made 'paid up members' when they leave the employment of the employer and be presented with a paid-up membership certificate;
- Provision should also be made to allow new members to transfer retirement savings into a fund from other funds;
- When members join a new fund, the new fund must request their paid-up membership certificates and automatically transfer members' retirement savings in respect of those certificates into their new fund, unless members request otherwise;
- If members wish, they will still be able to withdraw their retirement savings when they leave the service of an employer, or preserve their funds in another fund or insurance policy of their choice, but such choices must be at their written request;
- A retirement benefits counsellor (remunerated by the fund) should be made available to all members who elect to take cash or who elect to transfer their benefit to another retirement fund;
- Recurring charges may not differ between active and paid-up members, and initial charges may not be levied when members become paid-up;
- No new contributions will be allowed and no risk benefits will be provided if a member opts to preserve within a fund of a former employer.

The draft default regulations are available on the National Treasury website (www.treasury.gov.za). Comments on the *Draft Default Regulations* may be submitted by 30 September 2015, to Ms Alvinah Thela, Director: Retirement Funds, Private Bag X115, Pretoria, 0001; or fax to (012) 315 5206; or per email to retirement.reform@treasury.gov.za. NMG supports National Treasury's objective and will be part of the industry discussions on the draft regulations. We will be issuing more detailed communication on each one of the proposed default strategies in due course.

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