



PENSION FUNDS ACT, NO. 24 OF 1956

DRAFT NOTICE NO. XX OF 2018

**DEFAULT INVESTMENT PORTFOLIO – PRESCRIBED CONDITIONS FOR ELIGIBILITY OF
SMOOTHED BONUS PRODUCTS**

I, Dube Phineas Tshidi, Registrar of Pension Funds, hereby publish for comment the proposed conditions to be prescribed that smoothed bonus policies must comply with, to be eligible as a default investment portfolio in terms of the definition in the Regulations made in terms of Section 36 of the Pension Funds Act, No. 24 of 1956, as set out in the Schedule.

It is intended that this Notice will take effect on 1 April 2019.

Comments must be forwarded to Alta Marais (Alta.Marais@fsb.co.za) before or on 30 March 2018.

A handwritten signature in black ink, appearing to read 'D.P. Tshidi', written over a horizontal line.

DUBE TSHIDI

REGISTRAR OF PENSION FUNDS

21 February 2018

SCHEDULE

Definitions

1. In this Schedule, unless the context otherwise indicates:

“the Act” means the Pension Funds Act, 1956 (Act No. 24 of 1956) and any word or expression to which a meaning is assigned in the Act shall have that meaning;

“market-value adjustment” 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 registered in terms of the Insurance Act, 2018, in terms of which any bonuses declared over a period, whether such bonuses are vested or non-vested, may be different to the fund return earned over the same period so as to smooth the fund return.

Conditions

2. The board of a fund registered in terms of the Act may include a smoothed bonus policy as a default investment portfolio, provided the policy complies with the requirements in Regulation 37 and the definition of ‘default investment portfolio’ in the Regulations made in terms of Section 36 of the Act.
3. The fund must ensure that the policy sets out the necessary governance and disclosure requirements and that it is eligible for inclusion as a default investment portfolio.
4. To be eligible for inclusion as a default investment portfolio, such policies must comply with the conditions as outlined below:
 - 4.1. A formulaic approach must be established to calculate and determine bonus declarations, both vested and non-vested, which approach must:
 - 4.1.1. include the triggers for the possible removal of non-vested bonuses and the method of removal;
 - 4.1.2. provide for the triggers that dictate the provision of shareholder capital to maintain the financial soundness of the policy;

- 4.1.3. 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;
 - 4.1.4. specify the minimum and maximum levels of the stabilisation reserve and the remedial actions which will be triggered should these limits be breached;
 - 4.1.5. limit the smoothing period to 24 months;
 - 4.1.6. result in a long-term funding level not exceeding 105 per cent; and
 - 4.1.7. be disclosed to all stakeholders.
 - 4.2. Any management actions that may be taken to reduce the risk on the policy must be properly disclosed and documented.
 - 4.3. The cost of any guarantee provided in terms of the policy must be commensurate with the risk and there must be separate disclosure of guarantee charges and other costs relating to the policy.
 - 4.4. The insurer may apply a market-value adjustment (MVA) in pre-determined circumstances as stipulated in the policy contract, provided that the payment of any individual benefit under a policy must not be subject to any adjustment, for example where such payment is triggered by death, retrenchment or retirement.
 - 4.5. There must be no disinvestment penalties or charges levied by the insurer.
5. Asset allocations between the different asset classes significantly affect investment risk and returns. The asset allocation of the policy must therefore remain within disclosed limits around the strategic asset allocation and must comply with the asset spreading limits in Regulation 28 made in terms of Section 36 of the Act. Where a material change in the strategic asset allocation is being considered, full disclosure must be made to all affected parties and the Registrar must be notified of the intent to change the strategic asset allocation. 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.

Treating Customers Fairly (TCF)

6. Smoothed bonus policies are perceived to be complex given the guarantees and smoothing mechanisms associated with them. Whilst the underlying mechanism may be complex, the fund must ensure that the communication it receives from the insurer or authorised provider regarding the portfolio and its performance is relevant, simple and easy to understand.
7. The TCF outcomes should address the management of this perceived complexity, mainly through adequate disclosure.
8. Funds must ensure that any such policy complies with the six TCF fairness outcomes, namely:
 - 8.1 Retirement fund members are confident that they are dealing with firms where the fair treatment of customers is central to the firm culture.
 - 8.2 Products and services marketed and sold in the retail market are designed to meet the needs of identified customer groups and are targeted accordingly.
 - 8.3 Retirement fund members are given clear information and kept appropriately informed before, during and after the time of contracting.
 - 8.4 Where retirement fund members receive advice, the advice is suitable and takes account of their circumstances.
 - 8.5 Retirement fund members are provided with products that perform as firms have led them to expect, and the associated service is both of an acceptable standard and what they have been led to expect.
 - 8.6 Retirement fund members do not face unreasonable post-sale barriers to change product, switch provider, submit a claim or make a complaint.