

Trustees: are you ready for the defaults?

Karen Wentzel of annuities at Sanlam Employee Benefits, sets out to help.

By regulation from the beginning of March 2019, all defined-contribution retirement funds – including retirement-annuity funds – must have in place a default investment, preservation and annuity strategy. This guide is intended to assist trustees who've not yet finalised their funds' annuity strategy:

First, the proposed strategy must be appropriate and suitable for members of the fund. The annuity strategy may include a few options for members with different risk profiles and income levels, as one annuity may not be suitable for all members.

Second, the fees and charges of the proposed annuity or assets must be reasonable and competitive. Trustees will have to negotiate reasonable and competitive fees, and pricing with insurance companies, to ensure members have a cost-effective annuity option at retirement to consider. At present, individual members do not have access to institutionally-priced annuities.

The strategy must be reviewed annually. It may include traditional life annuities and living annuities being paid from the fund or an external provider. Both life and living annuities are allowed.

For living annuities the investment choice is limited to four portfolios compliant with Regulations 28 and 37 under the Pension Funds Act. The prescribed standard for drawdown rates is in draft with ASISA.

Third, members are given access to a retirement benefits counsellor (RBC) not less than three months before retirement date. Choosing an annuity might be daunting. Most members make the choice without sufficient financial knowledge or understanding the effects of longevity.

Members will at least need to consider the trustee-endorsed, competitively-priced annuity strategy. Access to an RBC will hopefully improve retirement outcomes.

Trustees should see the regulation as an opportunity to improve retirement outcomes for all their fund members.

Will the solution be in-fund or out-of-fund?

It could be either or a combination of the two. An in-fund strategy

may have some cost efficiencies for larger funds and offer a seamless transition to retirement, but it will also put a much bigger responsibility on the trustees from compliance and governance perspectives. If an in-fund annuity strategy is not managed effectively, members may be worse off.

What annuity type will be offered?

For both the in-fund and out-of-fund options, trustees need to decide on the type of annuity to offer. Both life and living annuities are possible, each having pros and cons.

Despite the attractive features of living annuities, investors must consider the impacts of longevity and investment choice. People living longer than average are highly exposed to the risk of running out of cash.

While it is attractive to enjoy the facility of managing one's own investments post-retirement, this does place a great responsibility on the investor. There are no investment guarantees, so a general decline in the market will reduce the investor's funds and the impact on future pension amounts.

Different **life annuity options** include:

- Level annuities
- Guaranteed escalation annuities
- Inflation-linked annuities
- With-profit annuities
- Index-linked annuities

For all guaranteed life annuities, the pension payment will be guaranteed for life, with no longevity or investment risk to pensioners. Trustees may select the following benefits for their fund's default life annuity offering:

- Spouse reversion annuity (joint life policy)
- Guaranteed period
- Thirteenth cheque

For the selection of **living annuities**, trustees should consider administration, advice, asset choice, asset charges and an all-in-one solution to members.

The aim of the investment strategy is to give protection and real



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returns to pensioners over the long term. Fees for the investment strategy should be at the rate of institutionally-priced portfolios.

In considering the investment portfolios allowed, important factors are:

- Proposed investment default strategy and methodology
- Asset management fee
- Performance fee
- Investment returns for proposed strategy over 1, 3, 5 and 10 years

Who to use as an insurance company partner?

When considering an out-of-fund solution, these criteria may be used for comparisons:

- History of service provider
- Shareholdings in other companies and their business activities
- Organisational structure of service provider
- BEE level of service provider
- Transformational goals and strategies
- Potential conflicts of interest
- Certificates which allow provision of living annuities
- SARS tax clearance
- Assets under management respectively for all group and living-annuity products
- Current institutional default living annuity appointments
- Number of members in annuity products

What are the administration capabilities of the provider?

When comparing different administrators, ask them for information on:

- Current number of members under administration
- Online access
- Cost of administration
- Whether the offering can be a combined life and living annuity

What pre-retirement assistance is available to the fund and trustees?

Pre-retirement marketing creates awareness for members about six months prior to retirement. It will help members to make informed decisions and consider the cost-effective offerings, alongside other options, with or without their financial advisors.

Training, brochures, roadshows, payslip inserts and website information -- provided with assistance from the insurer -- will assist RBCs adequately to inform members.

What counselling and advice options are available at retirement and thereafter?

Our objective is for every fund member to get as close as possible to an ideal solution. A key is to balance the level of advice offered with an appropriate fee structure. Another crucial factor is a scalable proposition that works for the trustees of a fund that has thousands of members. With the right modelling, optimal solutions can be created.

Through advice, for instance from RBCs, members should get information on the material advantages and disadvantages of all annuity types, including the risks of living annuities. It could help in assisting members across the spectrum. A recommended standard on proposed drawdown rates for sustainable income will be advantageous. Members in a living annuity will also have the right to convert into a life annuity at any stage during retirement.

Best solution

Details of the specific annuity strategy offered to the fund should be refined on an ongoing basis in a working group between the insurer and the fund to determine what's best for all members.

The aim is a straightforward, cost-effective solution that meets members' needs.

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