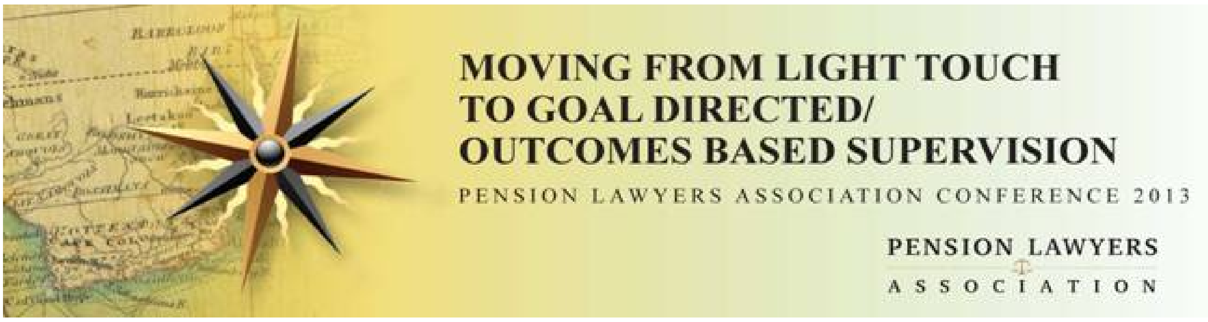

BREAKAWAY 2: PRESERVATION AND ANNUITISATION ISSUES

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1. Compulsory preservation proposals

In its discussion paper *Preservation, portability and governance for retirement funds* released in September 2012, National Treasury has proposed the following:

Compulsory preservation: Five alternatives offered for comment:

1. Full withdrawal still allowed but tax threshold will be increased
2. New defaults are implemented and monitored for three to five years
3. A partial withdrawal of one third is allowed but the balance must be preserved
4. For the unemployed an additional monthly income will be allowed: the lesser of R5 000 or 3 per cent per annum
5. Full preservation will be enforced and no withdrawals will be allowed pre-retirement

Vested rights will be protected

On the date of implementation the value of withdrawal benefits will be recorded and they will remain subject to current rules. Only the growth on these amounts and any new contributions will be subject to the new dispensation.No implementation date is suggested. The earliest possible date appears to be 1 March 2014.

Retirement funds must encourage preservationby –

- accepting the transfer to it of a new member's retirement savings accumulated in a previous fund;
- establishing preservation accounts within the funds in which retirement savings can be preserved;
- making preservation the default option i.e. a member's retirement savings will be preserved unless the member instructs the fund otherwise; and
- not accepting an alternative instruction unless the member has first obtained advice from a financial adviser on the matter.

Provident funds proposals:Options to align provident and pension funds offered for comment:

1. Current rights to lump sum benefits at retirement remain protected, but not the growth thereon,nor any newcontributions.
2. Changes to be phased in over 10 years: Those aged 60 at date of implementation can take a lumpsum of one third and 100% of the balance. Those at 51 can take a lump sum of one third and 10% ofthe balance. Members aged 50 and below will therefore only be able to take a one third lump sum atretirement from the date of implementation.

2. Annuitisation issues

In its discussion paper *Enabling a Better Income in Retirement*released on 12 September 2012, National Treasury assessed the annuities market. It acknowledges that the means test could discourage people from purchasing conventional annuities and might encourage low-income workers to choose living annuities and withdraw their assets quickly in order to qualify for the old persons grant at a later date.

Current shortcomings in the annuities market are structural and requires significant reform,
Living annuities are very popular but the charges are very high. With the median level of charges at 2%, it represents 40% of the income a 65-year-old in good health (assuming a realistic 5% p.a. drawdown). Drawdown rates are also high, exposing the longer-lived to substantial risks of poverty - the median after charges being close to 10% exposing pensioners to substantial risks of declining real income. This places additional pressure on the old persons grant and the cost of retirement provision for the State.

The overall conclusion that National Treasury arrived at is that the current shortcomings in theannuities market are structural, requiring significant regulatory reform and consequent shifts by all key players. The main suggested options are as follows:

- *Reforming living annuities to increase competition, to reduce the amount of financial advice they require and to reduce their costs.*
- *Increasing the degree of automation in the retirement process by requiring all retirement funds to choose a default product into which all retirees must be enrolled.*
- *Increasing the degree of longevity protection for most retirees, without unduly sacrificing their ability to invest in risky assets or to protect capital for their heirs, should they so wish.*

Proposed default annuity arrangement
It is proposed that each fund must offer its retiring members a default annuity. A framework is proposed within which the default will have to be structured. In respect of retirement benefits up to R1.5 million, a member may only take a combination of a cash withdrawal (a maximum of one third) and a guaranteed annuity. Only thereafter may a living annuity be purchased (to be remodelled into a Retirement Income Trust).The default annuity product will have to comply with certain minimum requirements such as a five year guarantee; spouses cover and may have to be inflation linked.

In addition measures need to be taken to avoid that lower income earners, who tend to have shorter life expectancies, subsidise the higher income earners. The proposal is that in addition to age and gender, factors such as income should be taken into account (Once in place, a guaranteed annuity will provide lower income earners with better annuity rates). While a member will not be forced to agree to such a guaranteed annuity the only alternative on the market will however be a Retirement Income Trust.

Retirement Income Trusts (RIT)
The proposed new RIT will replace the living annuity allowing much less choice, no commission, lower fees and lower costs. Existing living annuities may also be transformed.
Another two new products have beenproposed. They will offer a combination of the features of a guaranteedannuity and a living annuity or RIT.

The second is a Default Retirement Income Trust. These default RITs are described as a sequential hybrid, starting off as phased-withdrawal products, but shifting individuals into conventional life annuities as they get older. They may not offer investment choice, but could invest in risky assets.

The third is a variable annuity. This is a form of insurance policy in which purchasers share risks with the insurance company that writes the products, much like a with profits annuity. The policyholders take part in the long-term risks through changes to the income that they receive.

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