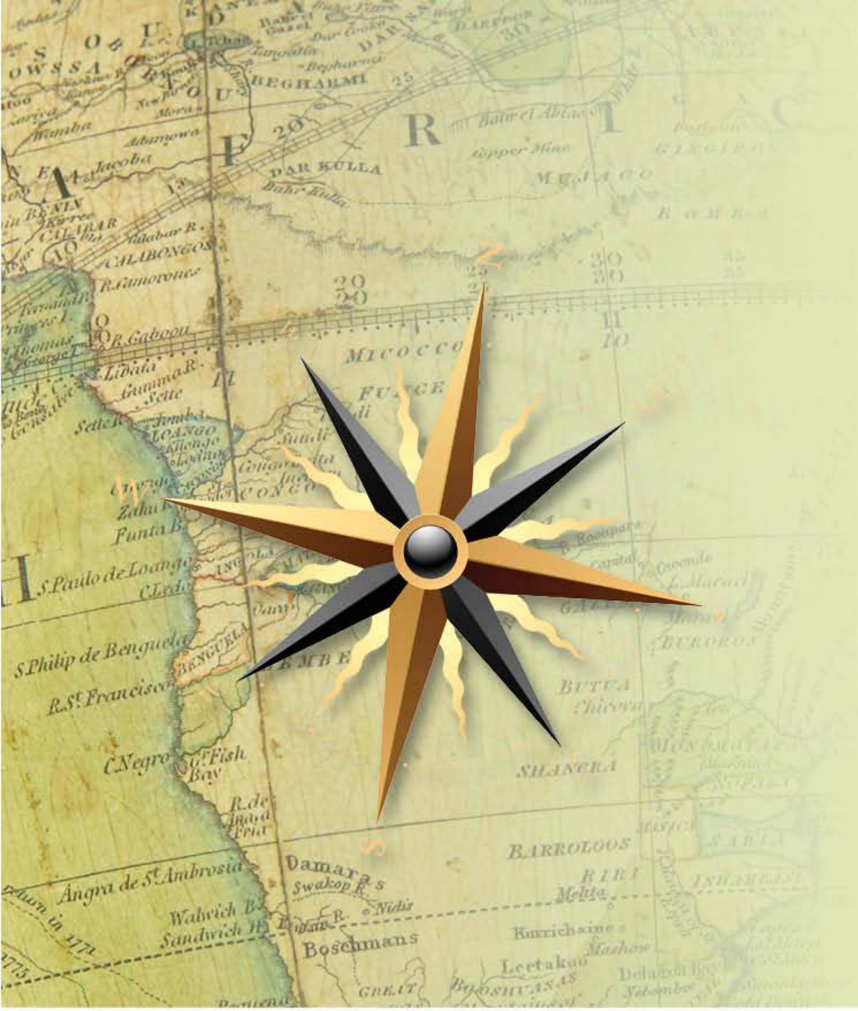

Breakaway Session 2

ANNUITISATION AND PRESERVATION ISSUES

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Reform Themes

2013 Retirement reform proposals

- Trustee mind shift: compliance with the law v ensuring a good outcome
- Reduce the cost of retirement provision for Government
- Develop savings culture
- Focus on the member outcomes first
- Then review the process
- Phase changes in – route of least resistance
- Easy / cheap to administer
- Retirement fund investment v tax free investment

Pre-retirement preservation I Withdrawal benefits

Summary

- From P-day withdrawal benefits may not be paid in cash but will be paid into a default type preservation fund.
- Out of the preservation funds members will be allowed to make limited withdrawals once a year (the greater of 10% of the amount transferred or an amount equal to the old age pension - R15 120 pa). Unused amounts may be carried forward.
- All vested rights will however be protected. Only new contributions will be subject to the maximum withdrawal requirements.
- So members will still be able to transfer their vested withdrawal benefits in cash but from the preservation fund not the fund they withdraw from.

Pre-retirement preservation I Withdrawal benefits

Pension and provident funds

- The balance that individuals have in their pension or provident funds on P-day, plus the growth on that balance (up to the date they leave that fund) will be protected. Members will continue to be able to withdraw this amount in cash – even if it is via a preservation fund.
- Pension funds and provident funds will be required to **identify a default preservation option** for their members. This fund could either be a section inside the fund, or be a separate fund. Trustees must abide by a set of principles in the selection or design of this fund, including: charges, transparency, investment strategy and investment options.
- Trustees could be given some **legal protection** in respect of the choice of the default, provided that the aforementioned conditions are met and provided members are given access to independent financial advice when they leave the fund. These costs must be paid for by the fund on a salary or fee-for-time basis. It may not be commission based.
- From P-day, pension and provident funds will not be permitted to pay **cash withdrawal** benefits to any member who withdraws from the fund before retirement. Instead, all individuals must have their entire balance paid either into the default preservation fund or fund section, or into their new employer's fund, or into a preservation fund they have chosen. This requirement will apply to all benefits, including those to which vested rights apply. The member's entire balance must be paid into a single fund – no splitting will be allowed. Smaller amounts may be allowed to be taken in cash in terms of a *de minimis* provision (to be announced).

Pre-retirement preservation I Withdrawal benefits

Preservation funds

- On P-day, the rules on preservation funds will change as follows:
- The restriction on the maximum number of withdrawals will be removed.
- Members will be able to **withdraw "vested cash withdrawal benefits" at any time**.
- In respect of the rest members will **once a year** be able to withdraw an amount equal to the greater of the state old-age grant (OAG)(R15 120) or 10% of their initial deposit, excluding any portion to which vested rights apply.
- Any unused withdrawals may be carried forward. To reduce administrative costs, individuals will be limited to one withdrawal per calendar year or part thereof.
- Members' initial deposit will be deemed to be equal to the value of their preservation fund on P-day. Vested rights will apply to this amount if they have not used their single withdrawal. **If they have used their single withdrawal, vested rights will not apply.**

Retirement annuity funds

- Retirement annuity (RA) fund members may be allowed to **transfer their balances to preservation funds**, under some conditions to prevent tax arbitrage. These conditions may include preventing individuals who have transferred funds out of an RA fund from rejoining that fund, or alternatively from receiving a tax deduction in respect of any RA contributions, for a period.

Post-retirement preservation

Provident fund benefits at retirement

The rules on cash retirement benefits will change as follows on T-day:

- The means test of the OAG will be phased out by 2016. The secondary and tertiary rebates will be adjusted over the same period to preserve equity (these are the tax rebates for persons older than 65 and 70 respectively).
- Contributions made to provident funds after T-day, and the growth on these contributions, will be subject to the **same annuitisation requirements that pension funds** and retirement annuity funds will be subject to. This means that two thirds of any pension benefit must be utilised to purchase a life annuity. Two exceptions will apply:
  - Members 55 years and older will not be subject to annuitisation requirements - even on their new contributions. This is intended to ease the transition into retirement for those who are already eligible for early retirement.
  - Amounts below the *de minimis* threshold can be taken in cash. The current threshold of R75 000 will be increased to R150 000.
- A member's balance in a provident fund at T-day (on or after 2015), plus any growth on that amount will not therefore be subject to the new annuitisation requirements. Provident fund members will, in most cases, have many years to plan for the change.

DISCUSSION POINTS 1

2013 Retirement reform proposals

- Vested WD benefits transferred to a preservation fund – inclusive of investment returns?
- No commission on default preservation funds
- If independent advice is provided by the fund, the default may enjoy some protection …
- Cost of straight through processing v The preservation opportunity once in the preservation fund
- To get access to an RA benefits in a life crises - transfer to a preservation fund
- De minimus threshold on withdrawal?
- Cost of straight through processing v The preservation opportunity once in the preservation fund

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Cost of straight through processing v The preservation opportunity once in the preservation fund

- Already invested in the fund,
- Was no / limited costs and commission deductions
- No Income Tax, CGT, Dividend Withholding Tax, Estate Duty – tax haven
- Institutionally priced costs
- Can take full amount plus growth in cash at any time
- Only pay tax on withdrawal
- Can withdraw as often as you want

Is there a better investment?

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Retirement income I New annuitisation requirements

Summary

- National treasury is no longer convinced that they have to do a total structural reform and get rid of living annuities.
- Funds will still be required to implement a default annuitisation strategy with institutional pricing.
- These defaults may be given legal protection if the fund also offers independent financial advice and support for members at the fund's cost.
- For a living annuity to qualify as a default it will have to limit choice and drawdown rates. Default not compulsory
- The means test of the old age grant will be phased out by 2016.

Retirement income I New annuitisation requirements

The rules on annuitisation will change as follows on P-day:

- Rules for splitting annuities will be reformed to allow easy splitting and to ensure that the *de minimis* provision only applies once. This will make it easier for individuals to purchase a combination of conventional and living annuities to suit their preferences.
- Although trustees' formal responsibilities may end at retirement, the primary purpose of a retirement fund is to provide members with an income in retirement. It is therefore part of the **responsibility of trustees to guide members through the process** of converting their defined contribution lump sum accumulation into an income. An FSB directive will therefore be issued, outlining the minimum requirements that trustees must meet in this regard.
- All retirement funds will be required to select a **default annuity** for their members, and to automatically enrol members into this product unless they request otherwise. The default may be either inside or outside the fund. Individuals will be free to opt out of the default if they wish.
- Trustees should be guided by a set of principles in making this choice, including value-for-money and managing conflicts of interest. A process will be set in motion to determine a suitable set of principles.

Retirement income I New annuitisation requirements

The rules on annuitisation will change as follows on P-day:

- **Living annuities**, whether within or outside the fund, will only be permissible for defaults if they meet strict conditions, including on design (default strategy, limited investment choices, limited drawdown rates) and costs.
- Trustees could be given some **legal protection** in respect of the choice of the default provided that certain conditions are met, including that members are given access to commission-free independent financial advice at retirement, paid for by the fund on a salary or fee-for-time basis.
- The **living annuity market will be opened to more competition** by allowing registered Collective Investment Scheme (CIS) providers to create a CIS-like living annuity to compete alongside life insurers.
- The FSB currently has two processes underway which may result in lower charges for living annuities. This includes the Treating Customers Fairly initiative and an investigation of rebates paid for by investment platforms.

DISCUSSION POINTS 2

2013 Retirement reform proposals

- It is part of the responsibility of trustees to guide members through the annuitisation process…
- The Default annuity for members with low NRRs will be different…
- Once-off withdrawal from a preservation fund will be held against you…
- No commission on default annuities
- Trustees could be given some legal protection in respect of the choice of the default – Canadian safe haven rules?
- Individuals will be free to opt out of the default if they wish.

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Individuals will be free to opt out of the default if they wish.

- With a low NRR the normal default annuity will provide to low pension
- But the person will also qualify for a OAG
- A living annuity may give a better result in the short term –
  - But with higher retail fees
  - OK if your health is not great or if you are desperate