

DRAFT CONDUCT STANDARD ON LIVING ANNUITIES: GOOD NEWS FOR RETIREES?

On the 7 November 2018 the Financial Sector Conduct Authority (FSCA) published a Draft Conduct Standard for Living Annuities for comment. The Draft Conduct Standard seeks to provide a guide for retirement funds to ensure the sustainability of retirees' income in retirement when using investments in a living annuity.



DENVER KESWELL
SENIOR LEGAL ADVISOR

The benefits of this kind of legislative support for retirees are many. By establishing new maximum drawdown rates, the Draft Conduct Standard will oblige retirement funds to monitor the drawdown rates of retirees and to communicate regularly with individuals who are in danger of being unable to sustain their income.

Essentially, retirees will not only have the support of their retirement fund leading up to retirement but also in retirement, a time where one is most financially vulnerable.

The Draft Conduct Standard is in lieu of Section 39(3) (a) of the Pensions Fund Act (PFA) No. 24 of 1956, which states that living annuities may be provided as a part of your annuity strategy, provided the drawdown levels are compliant with a "prescribed standard". It is this "prescribed standard" that the FSCA is trying to introduce.

HOW WILL IT WORK?

As mentioned, the Standard requires that a (retirement) fund must establish a mechanism to monitor the sustainability of the income from the default living annuity for any pensioner of the fund. In addition to this the Standard also requires that, to achieve the sustainability requirement, the fund must enforce a maximum drawdown rate for annuitants in a default living annuity in terms of the following table:

Heading		
Age	Males	Females
55	4.5%	4.0%
60	5.0%	4.5%
65	5.5%	5.0%
70	5.5%	5.0%
75	6.0%	5.5%
80	7.0%	6.0%
85	8.0%	7.0%

Source: PFA Draft Conducts Standard of 2018

This means that a 65-year-old female may not take a yearly income of more than 5% of their retirement fund value if she opts into a default living annuity.

CHOOSING A DEFAULT LIVING ANNUITY VERSUS A "NORMAL" LIVING ANNUITY

A retiree requiring a living annuity will be faced with the decision of opting into a default living annuity, with potentially reduced costs, or a "normal" living annuity, which allows them to choose an income between 2.5% - 17.5% annually.

Whilst the default living annuity may be the best option for a retiree, funds may struggle to convince retirees to opt-in if they are not able to convince retirees that it is in their best interest to ensure that their drawdown levels do not exceed the proposed maximums.

On 14 December 2018 the FSCA issued PFA Guidance Note No. 8 of 2018 to provide guidance on the application of Default Regulations. Paragraph 4.8 of the guidance note deals with the exemption process. It indicates that the FSCA may exempt any person or class of persons from a specified provision of the Default Regulations. It further states that the FSCA will take into account

that the Default Regulations are meant to improve the outcomes for members of retirement funds by, among other considerations, ensuring that they get good value for their savings and make informed decisions. From a practical point of view, this may be of concern to trustees if they need to apply for each former member in a default living annuity who believes that they should not be subject to the prescribed maximums.

While living annuities have always, rightly or wrongly, been the favoured annuity option at retirement, it will be interesting to see how many retirees will opt into the default living annuity as opposed to a default traditional guaranteed annuity or a "normal" living annuity given the way the Standard is currently drafted.

THIRD PARTY PRODUCT PROVIDERS

Another contentious issue that the Standard introduces is that it requires trustees of a retirement fund to monitor sustainability (and therefore enforce maximum drawdown levels) even though a retiree chooses a default living annuity with a third-party product provider. This could result in funds contractually enforcing their own default living annuity drawdown maximums on third party product providers - which in turn means product providers of default living annuities will have to develop their systems and processes to accommodate fund-enforced drawdown maximums.

There is no doubt that the intention behind this Draft Conduct Standard on Living Annuities is to drive positive savings behaviour. What remains to be seen is how the issues above will be addressed and how this will practically affect retirement funds and retirees.

Along with the Draft Standard the FSCA also published a statement explaining the need for; the expected impact of; and the intended operation of the Draft Conduct Standard. Comments were due by the 14 January 2019 and we will be engaging with industry with regards to these comments and will follow developments with interest on behalf of our clients. ■

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