

## Ride smoothly into defaults and Regulation 37

**Sanlam**  
Wealthsmiths™

**Vital checklist for trustees**

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In August 2017, the Minister of Finance signed an amendment to S36 of the Pension Funds Act. This amendment contained the addition of regulations governing conditions for defaults.

Regulation 37, which covers default investment portfolios, applies to pension and provident funds. It excludes retirement annuity funds, beneficiary funds, preservation funds and funds in voluntary liquidation.

The amendments, effective from 1 March 2019, require retirement funds to ensure that they have a suitable default investment portfolio in place for pre-retirement savings. These portfolios must be appropriate, not excessively complex or unreasonably expensive. Importantly, the board of trustees must be able to demonstrate to the Registrar that its chosen default investment portfolio is appropriate.

Most retirement funds already have a default investment portfolio in place. For the Sanlam 2018 benchmark survey, 62% of funds indicated that they have a default portfolio where members have the option to choose an alternative portfolio should they wish.

The survey also found that a lifestage solution, followed by balanced funds and smoothed-bonus portfolios, are the most popular. Many funds also use a smoothed-bonus portfolio towards the end stage of their lifestage solutions.

### What is a default investment portfolio?

As defined in Regulation 37, a “*default investment portfolio means an investment portfolio in which the retirement funding contributions of a member must be invested unless the fund has been instructed by the member in writing to invest them in another investment portfolio provided in terms of the investment policy statement of the fund or options available to members of the fund*”.

As there are many retirement funds that use smoothed-bonus portfolios in their default investment strategy, let's unpack what these funds need to consider and do to demonstrate that they meet the requirements set out in Reg 37.

### **Demonstrating compliance**

The board of trustees should consider adding some or all of the following points as agenda items for their trustee meetings and then include the main points in their minutes. They can then be provided at a later stage if requested by the FSCA.

#### **Default investment portfolio(s) are appropriate for the members who will be automatically enrolled into them.**

Many retirement funds appreciate that smoothed-bonus portfolios provide smooth returns to members, preventing them from experiencing the roller-coaster that members may experience from market-linked portfolios. The guarantees are also valuable to members in a default portfolio as they protect members from potentially losing some of their capital in a portfolio they did not choose. This is particularly relevant to blue-collar members who are risk-averse as well as members close to retirement.

#### **The composition of assets and performance of the default investment portfolio are adequately communicated to members.**

Can members access the latest fund factsheets and quarterly reports? Sanlam provides various forms of communication which contain the asset composition and performance of funds e.g. monthly fund factsheets and quarterly reports for our smoothed-bonus portfolios.

#### **Default investment portfolios are reasonably priced and competitive.**

How do the fees compare to other similar portfolios? Sanlam's smoothed-bonus portfolios have competitive investment management fees that reduce as the size of invested assets increases. The guarantee premiums charged are favourable compared to competitor products that provide similar levels of guarantees.

#### **All fees and charges are disclosed.**

Sanlam discloses the fees and charges on all portfolios and provides the portfolio's Total Expense Ratio and Total Investment Costs to clients on request.

#### **No loyalty bonuses or other complex fee structures.**

Do trustees and members understand the underlying fees? The fees charged on the Sanlam smoothed-bonus portfolios are easy to understand and calculate. The portfolios have no loyalty bonuses.

#### **Members are not locked into the default investment portfolio.**

- Are there any unreasonable barriers to exiting the portfolio? Members can switch out of the Sanlam smoothed-bonus portfolios at any time. However, should this occur when the

portfolios are underfunded, members will receive the lower of book value and market value. Members who leave the portfolio for benefit-payment events (death, disability, retrenchment, retirement, resignation) will always receive book value.

- Funds are further required to record their default investment portfolio in their Investment Policy Statements. They are also required to record that the above conditions were considered when the portfolio was chosen. Additionally, trustees are encouraged to include the following:
- Set out in writing how and when the board will review (on a regular basis) the default investment portfolio to ensure it is still compliant with Reg 37;
- The merits of both passive and active investment and reasons for the decision to use either (or a combination of both).

The FSCA released a further standard with conditions that smoothed-bonus portfolios need to meet in order for them to be used as a default investment portfolio. This standard is currently in draft form.

Sanlam, as a leading provider of smoothed-bonus solutions, is engaging with the regulator and is fully supportive of the regulations' aims. Sanlam will keep clients updated with any new developments.

ENDS

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