**Actuarial Society of South Africa**

# EXAMINATION

**21 May 2021**

# Subject F204 - Pensions and Other Benefits Specialist Applications

# EXAMINER'S REPORT

*Overall this exam gave sufficient opportunity for candidates to demonstrate mastery of the subject matter, and there were many marks available, allowing for candidates to score well. The main issue for candidates who did not do well remains the inability to cover the wide range of issues needed to score well.*

## QUESTION 1

*This was the question the candidates scored the highest marks on of the 3 questions. The question required candidates to explain the risks faced by members and beneficiaries of a defined contribution retirement fund and how the South African regulatory structure is designed to address these risks. Candidates were then also asked to explain the process that would be followed if the employer was in distress and the fund was closed. This was a straightforward question and most candidates understood what was being asked. There were many marks on offer, so better candidates could score well if they covered the wide range of points available.*

**i) Explain the risks that a member, and his or her beneficiaries, of the AD Provident Fund are exposed to within the fund. [11]**

*This asked candidates to set out the risks faced by DC member and their beneficiaries. This was a straightforward question, with many marks available and most candidates scored well.*

**Financial (including investments):**

- Insolvency of the fund
  - leading to insufficient assets in the fund to pay for liabilities as they fall due
- High expenses
  - eroding levels of benefits
- High inflation
  - Low real returns
  - Salary increases high and returns not keeping pace
- An investment strategy that is inconsistent with the objectives of the fund
  - leading to members taking on more investment risk than they are aware of
- Incorrect benchmarks used to monitor the performance of the investments
  - leading to incorrect investment decisions being made, and potentially lower investment returns for members
- An investment strategy that is not executed correctly (possibly being too vague)
  - again potentially leading to mismatching of assets and liabilities, increased risk and potentially negatively impacting member's returns
- Poor overall investment performance
  - leading to lower benefits
- Late payments of contributions
  - Leading to late investment of contributions and lower returns
  - Possibly compensated by late interest
- Volatility risk

    - investment volatility can lead to trustees or members making decisions out of a reaction to the volatility, and not based on investment fundamentals.
    - Could also directly impact the level of members' benefits if disinvestments take place at the low point in the market
- High cost of insurance if risk benefits are insured
    - Reducing amounts available for retirement savings
- Insurer failure
    - leading to potential non-payment of death and disability benefits
- Fraud
    - Trustee or other person misappropriating/stealing funds leading to reduced or no benefits payable

**Risks in respect of benefits:**

- Benefits not meeting members' (and dependants') expectations
    - Leading to reputational risk of the employer if retiring employees are left with insufficient funds to live on
    - Leading to dissatisfied employees
- Benefits not meeting members' (and dependants') needs
    - Caused by insufficient accumulation of benefits to retirement
    - Members' might need to delay claiming benefits – may not be possible
    - Members' may not be able to sustain themselves after retirement
- The incorrect allocation of death benefits
    - Resulting in the wrong beneficiary being awarded the benefit, and the beneficiaries with the most need not receiving the benefits
- Administration errors
    - Leading to incorrect benefits being paid
    - Potentially leading to lost investment returns as a result of administrative delays
- Conversion terms at retirement poor
    - Caused by low interest rates
    - Caused by increased longevity
    - Resulting in the annuities secured by benefits lower than anticipated
- Contribution rates set at a low level without option for members to make any additional voluntary contributions

**ii) Name and state the roles of the three main regulatory bodies responsible for the regulation of private retirement funds in South Africa. [6]**

*Candidates were asked to name the three regulatory bodies in the South African retirement landscape, and to explain the role of each. This was also a straightforward question with most candidates scoring a pass for this question.*

1. **Financial Sector Conduct Authority**

Functions:

- Enhance and support the efficiency and integrity of financial markets
- Protect financial customers
    - Promoting fair treatment
    - Providing education
- Assist in maintaining financial stability

2. **The South African Reserve Bank (and/or the Prudential Authority)**

- promote and enhance the safety and soundness of financial institutions that provide financial products and securities services
- promote and enhance the safety and soundness of market infrastructures
- protect financial customers against the risk that those financial institutions may fail to meet their obligations
- assist in maintaining financial stability

3. **The South African Revenue Services**

In the context of retirement funds, SARS administers the implementation of the tax concessions granted on contributions, the roll-up of investment returns and some qualifying retirement fund benefits.

**iii) Analyse how the functions of, and regulations issued by, these regulatory bodies address the risks faced by members in i). [11]**

*Candidates were asked to analyse the functions of the regulators and explain how the regulations in place that are designed to address the risks highlighted in part i). This was a slightly more difficult question, asking candidates to analyse the risks in light of the regulations. Most candidates did this competently, but this was the part of Question 1 where the candidates scored the lowest marks. Again, there was a wide range of points that candidates could have made to score marks. Credit was given for other valid points.*

- PFA establishes the funds as separate legal entities (trusts)
  - Assets belong only to beneficiaries/members
  - Management of trusts per Act
- Regulate service providers who give financial advice – eg investment/financial advisors (FAIS).
  - Ensure they are qualified and licensed,
  - and advice guidelines are followed (needs analysis)
  - Regulate fees charged by advisors
- Require minimum levels of communication to be given to members to ensure they know what benefits they can expect from their fund
  - Annual benefit statements
  - Member booklets
  - Projections
- Require regular certification that a fund is financially sound (valuation)
- or continued recognition that it is highly unlikely for the fund to become insolvent (valuation exemption certificate)
- Regulations around investments
  - Investment policy statement must be set (PF130) to ensure investment strategy is clear and appropriate for the nature of the fund
  - Regulation 28 sets limits for asset classes that the fund can invest in
    - Diversification – limit volatility

    - Default investment strategies set
    - Annuity strategies set
- Limits on taking monetary amounts from retirement funds – require preservation to maximise benefits saved in funds
- Default regulations (Regs 37 to 40) – aim for simple, cost-effective and transparent defaults and options intended to minimise costs and maximise benefits for the average member
- Regulations around the composition of the retirement fund's Board of trustees (Section 7 of the Pension Funds Act) to ensure the Board is properly constituted and able to perform its duties with due care and diligence
    - Insurer and other service provider selection
    - Setting investment strategies
    - Setting defaults

- Provision of tax incentives to encourage savings, to increase levels or benefits available from funds
- Regulation around the distribution of death benefits (section 37C)
- Regulation of all insurers
    - Minimum solvency requirements to prevent failure
- Limits on tax-free amounts that can be taken from pension funds to ensure a portion of members' benefits are annuitised with the aim that these last a member's lifetime

**iv) Compare the role of the employer and the nature of the sponsor covenant in place between AD Trading and The AD Provident Fund and what the employer role and sponsor covenant would have been if the fund were a defined benefit fund. [6]**

*Candidates missed the points where the sponsor covenant is the same and focused predominantly on the ownership of the investment and mortality risk, so most candidates missed easy places to score marks on this question. Fair attempt by most candidates.*

- Both DB and DC
    - Employer 'sponsors' the establishment of the fund
    - Sets up the legal entity
    - Determines eligibility (e.g. permanent employees can become members)
    - Sponsors what is needed to support the entity
        - provides employer and member trustees from staff
        - facilitates administration of membership, contributions and benefits through HR department
    - Responsible for complying with fund rules once established
    - once set up, employer cant change benefits specified in the rules unless trustees approve such change (ie both employer and member representatives)
    - - employer (trustees) have no voting rights on any member surplus account once surplus is allocated to this account

- Sponsor covenant in DB environment
  - much more onerous than DC
  - Employer promises defined benefit – pays balance of cost required to secure the promised benefit
  - Risk costs and expenses funded by the employer
    - Even as they increase
  - Responsible to fund deficits
  - Will determine pace of funding, and hence security of benefits
  - Financial strength of the employer becomes more important when the fund is underfunded – or just funded
  - Deficits on wind-up become debt on the employer
  - Investment and mortality risk taken on by employer
- Sponsor covenant in DC environment
  - Employer responsible for payment of defined contributions
    - Increases in risk costs or expenses do not generally increase employer contribution requirement
    - Therefore, costs risks taken by member
    - Unless the scheme exclusive of costs
  - Investment and mortality risk taken by member

**v) Set out the points you would cover in your memorandum to the Trustees, addressing the steps to wind up, issues arising and further information required. [17]**

*Although most candidates made a fair attempt at the question, given the broad range of issues that could have been discussed, and the number of sign-posts given in the question, it would have been expected that the candidates would have scored more highly here. Most candidates also assumed the fund would be liquidated, but this was not specified in the question, so marks were available for discussing both deregistration and liquidation.*

**General**

- All assets and liabilities of the fund would need to be settled before the fund could be closed
- As the employer is being liquidated, the fund rules will dictate how the fund closure should happen – eg. Deregistered (orderly disposal of assets and liabilities) or liquidated
  - Fund could be deregistered
  - Must comply with the FSCA's requirements for deregistration
    - With assistance of fund consultant and administrator
    - Would usually require a final valuation
    - Trustees would be in place until fund is finally deregistered
      - Would take longer than employment of trustees is likely to last

        - Could appoint a trustee in terms of section 26 of the PFA

    - Fund might be placed under liquidation
        - Liquidator would then take over the complete management of the fund and the distribution of assets and liabilities
        - Trustees will lose all links with the fund and have no more decision-making powers
- Whichever route is taken, likely to take a while (expect more than a year)
    - Liquidation likely to take longer
- Assets belong to the beneficiaries of the fund
    - Any outstanding monies due to the fund would have to be collected
    - These could be reinsurance recoveries etc.
    - Outstanding contributions from the employer are also due and will be a debt on the employer
    - Would need a budget for the costs of the closure of the fund
    - Fund may be in surplus or deficit (after allowing for all costs)
        - If in surplus, need to make decisions about how to distribute
        - Deficit highly unlikely due to DC fund, however, if in deficit, employer would either have to fund (unlikely) or benefits would be reduced, and decisions would need to be taken around how this is to be done
- If no contributions have been paid for 6 months, this means that member contributions have been deducted from employees' salaries and not paid over. The employer would also then owe this.
- As contributions have not been paid, it is unclear if risk premiums are also outstanding, or if these have been funded from the assets of the fund.
    - If the premiums have not been paid, it is possible that members did not have death and disability cover
    - This could potentially impact the new risk claimants
        - The fund would still owe these benefits
        - Would place strain on the fund's funding position
        - Possibly also a debt on the employer
        - It is expected that the employer would not have ready cash to pay these
- Would expect all monies owed to the fund from the employer would either not be recoverable, or would only become available once the liquidation of the employer is complete and the assets of the employer are sold and creditors are paid
    - Will take a very long time
    - Unlikely to get full amount owed, if anything
- Active members are due their full shares of fund – minimum benefits
    - These will form the largest portion of the fund's liabilities
    - These can be paid in cash as the members' are terminating employment with AD Trading
        - Would require disinvestment of assets
        - Could be at inopportune time in the market
        - Members benefits will then be reduced
    - Could be transferred to a preservation fund
    - Or to the new employer's fund for staff who have found new employment

    - Also possible to transfer to an annuity provided if the member is close enough to retirement to buy an immediate annuity directly
- Long-outstanding unclaimed benefits would need to transferred out of the fund
    - Could be transferred to unclaimed benefit fund
    - Via Section 14
    - Would need to do some tracing of members to make sure all those who can be found are traced and paid
- Would need to actively process current outstanding claims
    - Withdrawal benefits should be reasonably straightforward
    - Any disability claims would need to be assessed and paid
        - Timeframe and complexity would be dependent on nature of disability
        - Also type of benefit
            - Lump sum disability would require the nature of the disability to be total and permanent – may take a while to assess
            - Income disability benefit would require ongoing management and payment
                - Could potentially secure an impaired life annuity for these claimants
                - This would apply to new and ongoing claimants
        - Death benefits would need to be distributed by the trustees in terms of Section 37C
            - Would require investigation and take time
- Even if the fund is to be liquidated in terms of the rules, it is beneficial if the trustees try to tidy up as many of these elements as possible before the liquidator is appointed
- Notice would have to be given to all service providers
    - Administrators, investment managers and consultants etc.
- SARS registration would need to be cancelled

Closure of bank accounts when all monies have been settled

## QUESTION 2

*This question asked candidates to discuss the implications of a defined contribution fund ceasing contributions, as the employer is operating at 30% as a result of the Covid-19 pandemic. The question covered the regulatory aspects, as well as the considerations for members. This question was the most poorly answered of the 3 questions in the exam, which was surprising given how topical this issue is.*

**i) Outline the requirements of the FSCA for Company A to cease contributions. [4]**

*This question was straightforward with candidates either scoring very well or very poorly.*

- In response to the National State of Disaster declared in South Africa
- The FSCA sent out a communication in March 2020 dealing with employer and member contribution cessation, or partial cessation, and what a fund must do
- The fund's rules must allow for a cessation of contributions or reduction in service
- Some funds already have this in rules dealing with temporary absence / break in service / reduced pay
- Where the rules don't allow for a full or partial cessation a rule amendment must be made to allow for this.
- The amendment should also set out the effective date of the agreement between the employer and the fund.
- In practice the FSCA also insisted on a maximum term for contributions not being paid (typically up to 6 months but in some case up to 12 months was allowed)
- FSCA undertook to expedite such amendments on the condition that the amendment did not deal with any other non-related matters
- The FSCA requested funds to attempt to ensure that risk benefit premiums were still paid
- Funds need to keep a proper record of the members affected by the contribution cessation.
- Members must be informed of the contribution cessation within 30 days of it being enacted.

**ii) Set out the advice you would provide to the Trustees in respect of the defined contribution members. [8]**

*This was generally fairly answered, but most candidates did not deal thoroughly with the risk benefit or investment elements of the question.*

- The request is reasonable given the impact of Covid 19 on the employer. The Trustees should try accommodate it.
- However, the 1.5% of salaries allocated to disability benefits is not a fund benefit. Employer would still need to pay this contribution to the insurer. The fund cannot pay it.
- Fund will need to meet expenses and ideally retain the death benefit insurance. See if Employer can continue with these contributions
- Alternatively see if these can be met from any ESA in the fund
- If not, then allow for deduction from member Fund Credits to meet premiums and expenses. This will need to be allowed for in the rules (would ideally have been included in the rule amendment)
- Might be an issue for new members with small Fund Credits
- Could remove death benefit for 4-month period as a last resort. Not recommended, especially with Covid 19 potentially increasing the number of deaths
- Highlight to Company that if any new employee joins the fund during the 4 months they might not have risk cover unless the Company contributes
- The fund must reassess its cashflow requirements. No contributions coming in and potentially larger benefits outflow due to possible retrenchments. Discuss latter with company.
- May require some changes to the investments held by the Fund by investing more in money market / cash
- Disinvestment may happen at low point in the market – affects returns for remaining members
- Some members may not be affected with the reduction in work and may want to continue contributing. Allow members to make new AVC election for the 4 month period.
- Whatever decisions are made, it is crucial to communicate this effectively to members so that they are aware of their options and prevent rumours from spreading. It is particularly important to communicate the impact on death and disability benefits, if any.

**iii) Suggest three additional considerations that apply to defined benefit members. [3]**

*Question was poorly answered, demonstrating a possible lack of mastery of defined benefit considerations.*

- For the 4 months, with no contributions, the members will lose 4 months of pensionable service.
- If the death benefit is based on pensionable service in some way (e.g. potential service), then ideally would not want death benefit reduced. May require some rule amendment and some form of contribution from the employer.
- May need to consider how the actual employer contribution rate relates to the cost of benefit accrual e.g. if the actual contributions being paid are far lower than the cost of benefits (due to an ESA or contribution reserve), might be unreasonable to deduct the full period of non-contribution from pensionable service.
- But then DB members should be asked to contribute. Small group of older DB members means retirement is likely to be their focus as far as benefits are concerned. Convincing them to contribute should be manageable.
- If service is not credited and DB members then contribute, check that rule make provision for AVCs and how to treat them when a benefit becomes payable. May require a rule amendment.

**iv) Assess the trustee's suggestion from the point of view of Company A. [4]**

*This was poorly answered by most candidates, with the implications from the company's financials perspective being missed, as well as the implications of the member contributions also having ceased.*

- Company A will have to recognise the promise in its financial statements as a liability
- Member contributions also ceased, so the member would need to refund this to be in the same position as the employer unlikely to pay these
    - If the member does not repay, then will not be in the same position
- Company A will then only have a cashflow benefit by deferring the contributions.
- This might be in order for Company A if it does not have much debt on its balance sheet.
- And might be well received by employees
- Would need to consider what happens to benefit payments in the interim. Will Company A be requested to make payment earlier in such cases?

- Company A might want to rather make the promise more vague by making it contingent on it meeting certain financial targets in future (just enough to not result in a liability being raised).
- Links to a possible payback period – can specify the term over which missed contributions and returns would be funded
- Company A can also push back on this request by informing employees that without the contribution cessation it may well have to cut more jobs and this is one way that employees can assist in minimising any job losses

**QUESTION 3**

*This question is also based on a topical retirement issue and focussed on the provision of annuities to defined contribution members, in particular living and life annuities, given recent regulatory changes. This question was reasonably answered with the smallest spread of marks, but the expectation was that candidates would score more highly in this question than they did.*

**i) Describe the default regulations the trustees of SA Inc Provident Fund must consider in establishing an annuity strategy at retirement. [5]**

*This was a straightforward question asking candidates to explain the recent default regulations regarding annuity strategies. Good attempt by all candidates.*

- Regulation 39 deals with annuities strategies at retirement
- pension fund, pension preservation fund and retirement annuity funds are required to establish an annuity strategy which sets out the manner in which annuity benefits are provided.
- Not strictly a default
- member's consent is required before the annuity is determined
- Provident and provident preservation funds need only establish an annuity strategy if members can elect to take part or all of their benefits in the form of an annuity,
- post annuitisation this will apply to all provident funds
- Members must receive retirement benefits counselling not less than three months before normal retirement date.
- Trustees must closely examine all aspects of the default annuity or annuities that are made available to members as part of the strategy to ensure that the features are appropriate to the members and that the fees and charges are reasonable and adequately communicated to members.
- Annuities may be provided from the fund or by a long-term insurer.
- Annuities can be provided from the Fund via a policy held by the Fund, or paid from the assets of the Fund (i.e. on a self-insured basis).
- Living annuities should have no more than 4 investment options, and drawdown levels should be compliant with a prescribed standard.
- Where the fund is paying the living annuity, the fund must monitor the sustainability of income drawn by pensioners, and inform members where their drawdown rates are deemed to be not sustainable.

**ii) Discuss the issues trustees need to consider in offering in-fund pensions. [6]**

*This was surprisingly poorly answered, with candidates being unable to generate a wide range of considerations. Most answers were limited to the loss of valuation exemption. Candidates failed to consider the members' interests, which would be part of the Trustees' duties.*

***Retail annuities vs in-fund pensions***

- Many DB or hybrid funds still allow members to retire in the fund and receive a pension from the fund.
- This is less popular in DC funds where the Fund and employer have typically chosen to remove as much risk as possible from the arrangements

The trustees also have several issues to consider when offering in-fund pensions:

- Any guarantee may have an impact on the solvency of the fund and have subsequent implications for the employer.
- The trustees can place specific limits on the pensions, for example, limits on drawdown if a living annuity-type pension is offered.
- However, too many restrictions may reduce the take-up of the in-fund solution.
- The fund maintains a relationship with the pensioners.
- Pensioners may lodge complaints with the fund or the Pension Funds Adjudicator.
- The additional administrative burden increases the risk to the fund, for example, incorrect benefit payments. The fund may incur further costs as it will not qualify for valuation exemption.
- The trustees have to weigh up the advantages and disadvantages when deciding whether to offer an in-fund pension to retirees.
- The potential take-up (and therefore number of retirees) is also an important consideration to ensure the necessary volume is achieved to make the pension offering cost-effective.
- However, low take-up of in-fund pensions can result in high relative cost due to poor economies of scale.
- Any lump sum death benefit is subject to the Pension Funds Act. Trustees have to apply their minds to distribute the benefit to the financial dependants of the pensioner, which may not be in line with the pensioner's wishes, and the benefit may take up to 12 months to be paid (to allow for a thorough investigation of the financial dependants of the deceased).

The trustee must also consider member's interests and issues arising here include:

- The main advantage to the pensioner of an in-fund pension is the potential lower cost due to the fund's access to institutional investment and administration fees and the no profit objective of the fund.
- In-fund pensions do, however, have several disadvantages to the individual:
- Retirement savings in other savings vehicles cannot be transferred into the fund at retirement, and the pensioner may receive income from different sources.
- This will complicate the advice process and result in income tax issues.
- A large insurer may offer better security of the pension than a much smaller retirement fund.

**iii) Compare living annuities to life annuities including the advantages of each annuity type. [7]**

*This was a straightforward question asking candidates to compare life and living annuities. The question specifically asked for advantages only – it is assumed that an advantage of one type might be considered a disadvantage of the other type and asking only for advantages would be expected to cover all elements. The question was answered well by all candidates.*

*Living annuities vs life annuities*

- A living annuity is defined as: an arrangement whereby a retiring member, instead of drawing his/her pension, invests his/her capital value and draws on that and its investment income at a rate within the limits allowed by the South African Revenue Service (SARS).
- Living annuities, therefore, require ongoing monitoring and advice
- to ensure the member selects an appropriate investment strategy
- and draws a sustainable income.
- Life annuities on the other hand, provide an income for life.
- The member may include a spouse's pension, which will continue until the death of the spouse should the member pass away first.
- The pension increases are specified at the time of purchase and this determines the price of the annuity.
- Investments are managed by the life office issuer, not the member

*The advantages of living annuities compared to life annuities are:*

- The balance of the capital value is payable to a nominated dependent on the death of the pensioner.
- This feature makes living annuities popular, as people do not like the idea of losing their lifetime retirement savings should they pass away soon after retirement.
- The pensioner can select the level of pension to draw.
- If the individual is in poor health and unlikely to live long in retirement, a high drawdown rate might be appropriate and will provide an income that exceeds that from a life annuity.
- The pensioner can still purchase a life annuity with the capital value of the living annuity at a later stage.
    - This is referred to as deferred annuitisation.
    - It is usually not possible to opt out of a life annuity due to the risk of selection to the insurer.
- The pensioner benefits directly from high investment returns.

*The advantages of life annuities compared to living annuities are:*

- Life annuities are guaranteed for life.
- The pensioner therefore avoids the risk of depleting his/her retirement savings.
- A spouse's pension and guarantee period can be included to provide some benefit to dependants on the death of the pensioner.
- Pension increases are fairly certain depending on the type of annuity purchased.
    - Inadequate returns on a living annuity will result in low pension increases or the pensioner running out of capital sooner.
- Life annuities require little, if any, ongoing maintenance.

    - Living annuities require ongoing consideration of the investment strategy and drawdown rates.
- To many retirees, the idea of leaving money to their descendants is attractive (i.e. leaving a legacy), which leads towards selecting the living annuity option.
- Often the risk that this could lead to their pension falling short of requirements due to longevity or poor returns (and that having to be supported as a result will leave a negative legacy) is not fully considered.
- Another factor to consider is that in many cases dementia in old age manifests in a reduced capability to manage and appreciate money, and in such cases, pensioners could be protected against their diminishing capabilities to an extent by a life annuity.

**iv) State the principal conditions of this FSCA draft conduct standard, including:**

**a. General conditions**

**b. Measuring and monitoring sustainability**

**c. Communication to members.**

**[6]**

*This was a straightforward question, but was generally poorly answered.*

*General Conditions summary:*

When including a living annuity in an annuity strategy the board must take into account

- The annuity strategy should represent the average member of a specific category
- Should assist those who may not feel comfortable making a decision
- Should consider the general risks that members are exposed to
    - of retirement savings being depleted too soon,
    - poor returns on invested capital
    - and excessive fees
- may have different strategies for different categories
- Where including a living annuity:
    - It must be appropriate and must offer more protection where this is a default rather than a specific choice;
    - Sustainability of income must be measured and monitored and communicated

*Measuring and monitoring sustainability:*

- Fund must measure sustainability by considering the payment of a particular income over the expected lifetime of the pensioner
- Where income payments increase in line with a targeted percentage of inflation, the chosen target should be communicated
- Can be measured:
    - As a monetary amount that is likely to continue to be paid based on capital and reasonable assumptions; or
    - As the expected number of years until the capital no longer supports the drawdown level
- Must ensure that:
    - where the living annuity is provided by the Fund this is monitored by the Fund; and
    - Where purchased on behalf of a member is monitored by the external provider applying the same criteria that would be applied by the fund

- The sustainable income level may result in a monthly pension that is lower than the required living income

*Communication to members:*

- Where living annuity is part of the strategy and paid by the fund or a fund policy must communicate to members:
    - At inception the expected commencement income and drawdown rate and risk and sustainability of the annuity;
    - Subsequent to inception information on the performance, updates on the continued sustainability and warnings where increase targets or targeted income may not be achieved
- Where purchased from external provider:
    - Agree that the external provider communicates on the same basis;
    - And monitors this communication.
- There must be clear communication that this type of annuity provides no guarantees

**v) Explain how the recommended, maximum and fund-specific rates should be determined? [6]**

*Candidates made a fair attempt at this question, but most candidates did not get the marks available for the more technical elements. Candidates also did not distinguish between the recommended published rates, and those that would be appropriate for the fund.*

- The published rates would have provided a maximum and a recommended scale on the basis that there might be some ideal targeted drawdown that would sustain a pensioner based on a reasonable assumption around their life expectancy and an assumed return on investment
- The ideal targeted drawdown would likely assume a reasonable probability of achieving the result and as such may have some margins included and may have been tested at a high probability of success
- Drawdown rates should be attractive so as not to push members out of an annuity strategy
- The maximum drawdown would then likely have been based on the ideal target but with all margins removed and to some extent a assuming a best estimate case (perhaps a 60% probability of success)
- The maximum rate is intended to provide protection to the individual from drawing excessive amounts and depleting their savings too soon
- The rates of drawdown would have been based on age on the basis that ultimately the drawdown is intended to provide for the remainder of the pensioner's lifetime and in theory may include some allowance for the spouse to continue to draw thereafter
- The older the pensioner the lower the expected lifetime and the higher the potential drawdown rate could be to sustain that pensioner.
- In determining the Fund's own drawdown strategy, the following should be taken into account:
    - The age of the pensioners;
    - The fund's best estimate of future mortality;
    - A potential margin for improvements in mortality over the lifetime of the pensioner;

- Consideration of whether allowance should be made for a spouse to continue to draw on the pension;
- The investment portfolios that may be available to the living annuity account including expected and targeted returns and expenses;
- The margin of safety that the Fund would wish to build into the model, i.e. the greater the desired probability of success the greater the margins required and the lower the recommended drawdown rates would be