Actuarial Society of South Africa

EXAMINATION

17 October 2025

Subject F204 - Pensions and Other Benefits Specialist Applications

EXAMINER’S REPORT

Overall this was not considered a difficult exam, and gave sufficient opportunity for candidates to demonstrate mastery of the subject matter. There were many marks available, allowing for well-prepared candidates to score well. Candidates who are not working in the Pensions field or who are not getting a broad enough exposure to the pensions field would struggle to demonstrate enough competence to qualify as a pass.

QUESTION 1 [36 Marks]

Candidates did very poorly in the question which was unexpected. There were many obvious points to make to explain why benefit projections change but candidates missed all but the points relating to the legislative change. fit.

i. **Explain the points the Board could make to members in response to the complaints. Include an explanation of the main factors that could have resulted in the changes in the current benefits and projected benefits reported over the years.**

[14]

- The projection for new entrants shows a NRR of over 75%
- This is considered a good outcome
- a new entrant and younger member who save for their full careers are likely to achieve a reasonable retirement savings outcome which implies that as a combination the overall strategy and design of the Fund is reasonable:
    - the Investment policy statement / strategy is likely to be appropriate
    - the net contribution towards retirement is likely to be reasonable
    - the retirement age (between 60 and 65 based on chart) is reasonable
    - assumed fair and reasonable annuity conversion terms for in-fund pensions

- The question states the outcome for new entrants has not changed and therefore:
- it is unlikely that the design has changed significantly if at all since the previous projections
- can assume that the projections applied a consistent assumed rate of future return and/or an unchanged investment strategy
- assume contribution structure remained the same
- all members have the same normal retirement age

- If we assume that some of the complaints are valid and the results are understood correctly then it implies that:
    - Actual experience over the past few years has not been as expected and/or
    - Member behaviour has had some influence on their outcomes

Actual Experience

- Actual investment performance may have been worse than expected over the past few years:
    - The projection model assumes an expected level of returns would be earned to achieve a certain expected member balance in the future
    - The return is an assumed long-term average
    - Relative to the expected return members may have earned lower returns and as a result have a lower current member balance than may have been expected based on past projections

    - This means that projecting this lower current balance at the same expected returns implies a lower balance at retirement
- Actual cost of risk benefits and fund expenses may have been different to that expected over the long term
    - The projections would be based on an expected net contribution
    - Lower net contributions due to higher costs would result in lower current member balances which imply lower projected future balances
- There is no mention of a change in normal retirement age so the overall expected projection period is unlikely to have changed and affected the current results
- It is possible that there have been changes to the in-fund annuity factors but given the new entrant projection results this is unlikely to be a factor

- A highly likely and significant contributor under the newly implemented 2-pot regime is that members have been accessing their savings components
- They would be allowed to access their full savings pots once every tax year and could have been doing this consistently each year
- The projections may have assumed members retain all their benefits across the three components
    - If this is the case the Fund may want to consider this assumption in future
- The initial savings allocations would have resulted in members being given access to a portion of their past savings too
- through the seed capital being allocated from the vested component to the savings component
- therefore having similar effect to exiting without preservation
- this would lower the current overall level of benefits being used to project into the future and would therefore influence the future projections

Possible other points (more general)

Member behaviour

- Lower levels of service or high staff turnover in the industry is unlikely to affect individual members unless they themselves had left the fund and returned in between
- We must assume the members complaining have been in the fund over the period in order to have past projections to which they are comparing
- But this is an industry fund and as such you would expect that even as they move around the industry, they should remain members of the Fund BUT
- This may not be enforced and they may have been able to access vested benefits
- This would lower the current level of benefits being used for the future projection

- The above assumption could be wrong and there may also be new members complaining and comparing to their old or past funds
- This might imply a potential lack of preservation and past savings being transferred or included in the projection
- Or for new members there could be a host of other issues with the design compared to their previous funds

ii. **Discuss the points that you would make in your response. [7]**

- The trustee may be correct to some extent
- The legislation now effectively allows all members to access a third of all future contributions subject to certain restrictions
- This means that these members will have lower overall savings at retirement when compared to the case of not withdrawing the savings component
    - However:
- The main reason for poor retirement outcomes in general is a lack of preservation of benefits throughout a member's working lifetime
- Members were able to access 100% of their benefits on exit before retirement
- They are therefore likely to rejoin their new employer fund with no savings
- And may only start to become aware of the impact or adjust their behaviour closer to retirement where it is likely to be too late
- The legislation has an important aspect the impact of which may not be fully understood and that is that in additional to allowing access to savings there will be no access under any circumstances to the retirement component
- At least 2/3rds of all contributions in future would therefore have to remain invested
    - Either in their current or their future fund
- This is the expected true benefit of the legislation when compared to the prior regime
- It is also worth noting that the NRR projection assumes the members do not access any lump sum on retirement and use the full benefit as a pension
- This is unlikely to be the case for the majority of members
- They were therefore able to access up to 1/3rd as a cash lump sum on retirement meaning their true secured income post-retirement would likely to be lower
    - Dependent on how the lump sum was used
- In essence the access to savings is an early access to their retirement lump sum as any withdrawals would reduce the available lump sum on retirement
- Members would not be able to access 1/3rd of the retirement component
- There is a significant tax disincentive for accessing the savings which may or may not have some influence
- Members can however still access their vested component on resignation so it is likely to take some time before the true benefits of the changes will be seen
- New entrants to a retirement fund post 2 -pot are expected to be better off than the majority of current participants

iii. **Explain how the Board could develop a communication strategy for the fund, including regulatory requirements and the various mechanisms that would be used to deliver the strategy. [10]**

- In developing a communication strategy the Board will need to consider the requirements of
    - The Pension Funds Act and their associated duties of care
    - PF130 and appropriate fund policy
    - Evolving legislation around Treating Customers (members) Fairly

- The Board would need to start by reviewing the current policy and strategy
- Identifying the needs of members
    - Where is there a lack of understanding

    - What information do members need at a minimum and
    - What would the fund ideally want members to know and understand

- This would then allow the Board to identify the short comings in the current strategy that could be enhanced or improved and/or the focus areas of a new strategy

- The Fund is likely to require a strategy that focuses on:
    - General financial planning awareness and education
    - Fund specific awareness and education
    - Individual Member specific information
        - Appropriate and easy to use general and member specific tools

General financial planning awareness and education

- should include
    - The importance of budgeting and managing a budget
    - Which translates into understanding their general income and expense needs
    - Allowing them to understand their post retirement income requirements
    - With clear goal the importance of saving or retirement can be emphasised
    - Pitfalls of not preserving and or accessing savings
- Strategy aim to achieve this through:
    - General financial and educational media
    - Short videos, newsletters, phamplets
    - Member presentations
    - Employer Induction programs

Fund specific awareness and education

- should include
    - Detailed understanding of the fund
    - How it works and runs
    - The benefit structure
    - The investment strategy and any choices including impact of choices
- through:
    - Awareness of fund rules and where to find them
    - Benefit summaries, member booklets
    - Roadshows and Member presentations, Fund specific short video, Employer Induction programs
    - General benefit counselling

  Individual Member specific information
    - Members own current savings
    - Current contributions and or membership category
    - Expected retirement outcomes
- through:
    - benefit statements
    - online and smart phone portals, apps, ussd options
    - which include summary information and
    - Appropriate and easy to use general and member specific tools
    - Showing impact of preservation and impact of savings withdrawals

iv. **Draft your response to the Board member's question.** **[5]**

- An in-fund annuity offers the following advantages:
  - Allows members better planning for the post-retirement benefit,
  - Security and comfort of not needing to leave the fund
  - Easier to understand the in-fund options compared to wide range of external products and providers
  - Pricing that is on a fair and reasonable non-profit basis
  - Reduced initiation and long-term costs
  - Potentially greater transparency in the pension conversion terms
  - Ability to use the in-fund conversion terms to improve accuracy of the NRR projection tools
  - Ability to structure investments to match the transition at retirement

Under the two-pot arrangement:

- The advantages of the in-fund solution do not change and remain appropriate
- Two pot requires the retirement component (ultimately in the long term 2/3rds of contributions) to remain in a fund only to be accessed to purchase a pension
- This implies a potentially greater portion of benefits that will remain available and need to be used for a pension in future
- Compared to the past regime:
- (provident funds where lump sums could be accessed)
- (funds in general where benefits could be fully access pre-retirement)
- Members will have a greater need for pension products
- And to take advantage of the in-fund cost effective solutions

QUESTION 2 [35 Marks]

This question asked candidates to examine a change in normal retirement age from 60 to 65, following a corporate takeover. The question required candidates to consider all aspects of the fund impacted by the change, including risk benefits and investments. There were calculations required to assess the change. This question was not considered difficult and was poorly answered. It is particularly disappointing how poorly the candidates scored in the calculation questions given the basic nature of these. Again, for parts i. and ii. candidates did not provide sufficient breadth or depth in their answers to score well.

i. Explain the change in normal retirement age including the impact on Kesla and its employees. [10]

- The majority of South African occupational retirement funds offer retirement ages of 65
- Age 60 is therefore relatively early and an unusual change
- Although the State Old Age Pension Age is 60
- What do competitors in same industry use?
- Life expectancy has been increasing which makes a reduction in NRA seems counterintuitive
- Trend towards later retirement ages
- How will this affect employment? What happens with employees already over age 60 years?
- Presumably there will be some cut-off age above which employees will remain until 65 years?
- Cut-off age will need to be less than 60 years to allow members time to adjust retirement plans
- Unless Kesla is prepared to compensate members for leaving earlier than planned
- Impact on expected retirement benefits will negative as:
    - Short savings period
    - Longer payment period

Will be an impact on risk benefit costs:

- Kesla offers GLA and Income disability – will expect cost of these benefits to reduce although may be a delay while older members (above cut-off age) move out of the system.
- GLA rates will decrease as staff get younger on average.

- Income disability will decrease immediately – any claims after the change will be paid for 5 years less (except potentially for older members)
- Impact the same whether the risk benefits are approved or unapproved
- Will need to reconsider targeted retirement benefits and whether Kesla and or member contributions need to be increased
- Good for employment rates in SA as lower working life
- Need to consider impact on Kesla for staff with specialist skills if they retire sooner than planned.

ii. Comment on the practical matters Kesla and the Trustees need to take into account to implement this change. [13]

Approvals

- Employer approval would be required – possibly board approval
- Approval by trustees to change retirement fund rules
- Rule change requires approval by FSCA
    - Cannot be implemented in the fund until this
- Letters and contracts of employment likely to refer to the NRA from the rules. Would therefore require approval of staff to change existing terms and conditions of employment
- Allow time for staff to consider the change

Communication

- profile of staff
    - younger staff may not care as much,
    - older staff would be more engaged in the communication
    - May need one on one consultations
    - Revised projections at retirement

Transition arrangements

- Staff close to age 60 and over age 60, what are the plans for them?
- Can make it voluntary – existing staff can choose to retire at 60 or up to 65

Risk benefits

- Assuming (as expected) new NRA will apply to risk benefits
- But would need to decide this
- Also transitional arrangements – all staff? Or new?
- If all staff, what happens for those already over 60
- If insured – would need to get new quotes
- May be underwriting implications

Investments – will need to adjust glide path for the lifestage investments

  - Adjustment to the investment policy statement may be required
  - No immediate change to where assets are invested.

- If option is given to remain on 65 may end up with two different lifestage models – adds complexity and cost, but should not be a major impact.
- If option is given to retire from 60 to 65, more complexity in default investment.
- Could simplify to one lifestage model
  - But a one-size-fits-all lifestage model could result in those retiring at close to age 60 having a larger than normal sized switch to a more stable portfolio
  - Timing of this may not be optimal.

iii. Estimate the impact of the changed retirement age on the projected retirement pension of this member. State any assumptions you make. [8]

Final value at 65 less 5 years' interest

Impact : 2 400 000 / $(1.10/1.06)^5$ = R1 994 239

Contributions will be 5 years' less

In current salary terms so salary remains at R200 000 throughout

PV of 5 year's contributions at age 60

= 200 000*.14 * a60/12 *(at i' = (1.10/1.06)^(1/12) -1)*

= 28 000/12*54.68702

= R127 603

Candidates who use a return different to 10.0% can earn up to 1 mark for justifying why (carry through the credit to the calculations). Give credit for alternative calculation methods.

Estimated Fund Value at age 60 = 1 994 239 – 127 603 = 1 866 636

Annuity at 60 lower than that at 65

Ann65 = 16.00

Discount annuity for 5 years and add PV of 5 years payments

One estimate

Ann60 = 16/(1.1/1.06)^5) + 5 * a5 at i = 1.1/1.06-1 = 3.77%

Ann60=17.80

Give credit for any reasonable approach

Combined impact

Est annual pension at retirement at age 65 = 2 400 000 / 16 = R150 000

Est annual pension at retirement at age 60 = 1 866 636/17.8 = R104 867

Total expected pension decreases by R45 132 per annum, -30%

iv. Comment on the revised contribution rate to retirement required to target a net replacement ratio of 75% of salary under the new normal retirement age. [4]

- NRR at 14.0% contribution at NRA 60 = 104 867/200 000 = 52.43%
- New member so can just ratio up
- Cont rate = 14% /52.43%*75% = 20.0%

Comment

- Existing NRR is 75% of salary. Common industry target (but pensionable vs actual salary might be an issue)
- So 52.43% of salary is a big reduction.
- 20% of salary towards retirement benefits would mean probably 23% plus in total contributions.
- High by SA standards.

QUESTION 3 [29 Marks]

This question asked candidates to compare two possible risk benefit designs that are being considered by a newly established IT company. This is the question had the highest average mark of the three questions but was still poorly answered with candidates not following basic benefit design principles in their responses, and missing the context and the likely implications of the very specific context provided.

i. Outline the legislative (including taxation) environment under which its proposed retirement, death, disability and funeral benefits would be established. [8]

Retirement benefits
Registered retirement fund
Governed in terms of the Pension Funds Act, 1956, as amended
Establish as a Trust – needs a Board of Trustees
Sponsor would be the employer
Allows for provident and pension funds to house retirement savings
Retirement benefits are approved from an income tax perspective - Income Tax Act allows for tax deductibility of contributions, investment income does not attract tax in the accumulation phase

Death benefits
Can be approved – tax deductibility on contributions – benefits are taxed
Could be facilitated through the Fund – insurance premiums paid from the fund and claims paid by the fund
Governed by Section 37C on the PFA – Distribution of death benefits – responsibility of trustees to allocate death benefit to beneficiaries
Could also be unapproved – no tax deductibility on insurance premiums, death benefits not subject to tax
Not technically run through the retirement fund, but the fund can act as conduit of the payment of premiums and benefits
If not approved, benefits paid to beneficiaries per the member's nomination – no involvement of trustees

Disability benefits
Lump Sum
Depending on the definition of disability, the lump sum benefit can be considered an accelerated death benefit and treated as part of the approved lump sum death benefit.
Would fall under the same tax treatment as the approved death benefit – tax deductibility on premiums, benefits are taxable
Included as part of the benefits of the registered retirement fund

Income
Not an approved benefit- premiums paid from after tax income, benefits are free of tax
Insurance policy would be employer-owned and benefits do not technically form part of the retirement fund's offering, although premiums and claims can be paid through the fund for practical purposes, even though they fall under different taxation structures

Funeral benefit
Will not form part of the fund – not an approved benefit
Insurance policy will be in the employer's name, with premiums payable from after tax income and benefits paid directly to beneficiaries

ii. Compare the death and disability benefits of the two proposed benefit structures including the appropriateness for IT Inc. [14]

Death Benefits
Very different structures
Benefit Structure A allows for a smaller lump sum plus a pension for spouse and child dependents
Will be valued by members with such dependents but means that the benefit for those without dependents is much lower (only 2x salary)
Given the nature of the business, expect that the employees might be on average younger and may not need this level of benefit
May be considered unfair if all members pay the same level of death benefit premiums but benefit levels are ultimately different
Not easy to understand how valuable the dependent pensions are – may not fully value the benefit
Insurance cost expected to be higher than for B
Benefit structure B – the same lump sum for all can be considered fair
6x is generous
Although would need to compare to what other IT employers are offering
Will be more than needed for younger members with no dependents
Easy to understand
Expensive if not needed or valued by members
Death benefits across the board will reduce the amount going to retirement
Staff may prefer a structure that targets a level of benefit that is appropriate to their individual needs
Both
Younger members will cross-subsidise older members if paying the same rate
Exacerbate with Benefit structure A as the level of benefits for young members also expected to be lower

Disability benefits
Structure A – Lump sum benefit likely to be integrated into the death lump sum
Considered an accelerated death benefit
2x is not very generous – will be the only benefit the member receives on disability
Much less generous than the death benefit – may not be appropriate if the average employee is young – may value the disability benefit more
Structure B – pays an income of 75% of salary on disability
Contributions to retirement benefits usually continue, and the disability benefit stops at retirement – when the retirement benefit is accessed
Meets an ongoing need for income while disabled and unable to perform occupation
More valuable than the lump sum benefit
Will result in higher insurance premiums, and lower savings for retirement
Younger employees may value this protection more than retirement savings which seem very far away
May value the benefit more than the death benefit
Younger employees will again subsidise older members who have a higher likelihood of claiming this benefit – but equity in the benefit design
And younger employees who claim will possibly be paid for much longer

Appropriateness for IT Inc

Given the likely profile of employee – benefit structure B would seem to be more appropriate
Employees may value the income disability benefit more
Death benefit may be too high for a young staff complement, but may be necessary for a competitive benefit offering

iii. Draft the points you would make in response to the company's question. [7]

Offering the same benefits is easier from a management perspective
Could argue that equal benefits for all staff is fair
Would need to consider the employment market in each jurisdiction – likely that this type of staff member would be in demand, and would not like to risk offering benefits that are not competitive
Different countries have different mortality/ morbidity experience etc
Therefore cost of the same level of benefits may not be the same
Staff may value different benefits differently in the various countries – i.e. may value death benefits more highly
As the company is planning to insure the benefits, the insurance market in each country will need to considered
Again, could lead to different costs of the same level of benefits
Cost of living in each country different – likely to result in different remuneration package across the board
Will impact the retirement and risk benefit offering too
The different countries will have different regulatory environments – would need to consider any minimum benefits that need to be provided etc
Tax treatment of the benefit provision may impact the level and form of the benefits
Each country will have its own social security structure
May need to integrate benefits into a state provided set of benefits
At the very least would need to make sure benefit provision remains appropriate in the light of a country's state benefits
Likely going to need a locally appropriate benefit structure for each jurisdiction