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by Mercer Marsh Benefits

FSCA Communication 2 of 2019: Exemptions for Hybrid Annuities in an Annuity Strategy

Edition 47, September 2019



The Financial Sector Conduct Authority (FSCA) issued this notice on 1 August 2019. The notice is guidance to the industry.

A default annuity strategy

You will remember that most retirement funds, where the rules enable a member to elect an annuity, have to have a default annuity strategy in place for retiring members. This annuity strategy is not truly a default annuity strategy in that retiring members still need to elect what annuity they want.

The FSCA refers to the default annuity strategy as representing a fund's best proposal for the average member of that fund in order to assist those members who do not feel comfortable making their own decision at retirement.

Living annuities in a default annuity strategy

Regulation 39 to the Pension Fund Act provides for the inclusion of living annuities as part of a fund's annuity strategy. It also provides that living annuities must comply with regulation 37. Regulation 37(2)(g) provides that boards of funds must ensure and be able to demonstrate to the Authority that:

“where member investment choice is provided in the rules, members may, at least once every twelve (12) months, instruct the fund to transfer their retirement savings from their default investment portfolio into any other investment portfolios offered in terms of investment policy statement, in respect of which transfer the fund may deduct reasonable costs.”

Hybrid annuities

Hybrid annuities offer a combination of a living and guaranteed life annuity in a single product solution. Whilst the FSCA has no objection to funds including hybrid annuities in their annuity strategy, the Authority is of the view that hybrid annuities included in an annuity strategy require an exemption from the FSCA.

So, in summary, if you want to include a hybrid annuity in your annuity strategy you need to apply to the FSCA for an exemption (and comply with the conditions of the exemption).

Why is an exemption necessary?

The necessity for an exemption derives from the wording of the regulation set out above (Regulation 37(2)(g)). The Authority points out that:

“A life annuity has no viable surrender value. It would not be in the interests of members to be allowed to transfer out of the life annuity portfolio at least once every 12 (twelve) months because the surrender value will be significantly less than the interest held in a life annuity.”

In order to work around this, funds who offer hybrid annuities *in their annuity* strategy can apply for an exemption from regulation 37(2)(g).

How do we go about getting an exemption?

- The fund will need to apply to the FSCA for an exemption.
- There is a **prescribed form** for exemption requests for hybrid annuities in an annuity strategy.
- In addition, there are **conditions** that the fund will have to comply with to qualify for the exemption. These conditions are set out below.

Conditions for exemption

The fund must show that:

1. Retirement benefit counselling took place and that: It was done “in person”. The ordinary dictionary meaning of “in person” requires the person to be actually personally present. Some dictionary meanings continue “rather than talking on the phone, emailing or writing to the person”. This requires the retirement counselling to be done with the retiring member present. Counselling by way of a meeting must be recorded in writing and signed by the parties or recorded. That is, some evidence of the counselling must be kept.
2. The nature of the hybrid annuity was explained in clear and easily understandable language.
3. Specific emphasis was placed on the fact that the member cannot transfer his/her life annuity portfolio to another life insurer.
4. The member accepted this restriction in writing.

5. The member was advised he/she will be allowed to transfer their hybrid annuity to another service provider (if the service provider will accept it) every 12 months.

The implications for funds and administrators are as follows:

Apply for an exemption if you have a hybrid annuity in your annuity strategy.

- A member cannot automatically be transferred to a hybrid annuity unless the administrator receives confirmation of the benefit counselling having taken place in person. When applying for an exemption it may be worth talking to the FSCA about their interpretation of “in person”.
- Funds need to make sure there is “in person” counselling available to members who want to invest in a Hybrid annuity. Unfortunately funds may only learn of the member's choice after the application form is signed. This may lead to more than one counselling session if the hybrid annuity conditions were not met in the first counselling session.
- Amend administrators processes to ensure they check for confirmation of the conditions before payment to a hybrid annuity is made, for example confirmation of “in person” counselling and signed acceptance of the restriction that the member can't transfer the life annuity portion of the hybrid annuity to another insurer.
- Amend “options on leaving” form for the hybrid annuity conditions and what needs to be drawn to members' attention. (Do you need to amend your member booklet as well?)
- Amend your fund retirement notification forms to specifically point out what you are required to, to retiring members. Also create (on the form) a consent to the “restriction” and an “agreement” that the member has been given consultation “in person”.
- Funds also need to talk to their hybrid annuity provider and ensure that the provider will allow members to transfer to another provider at least every 12 months. We recommended that funds engage with their hybrid annuity providers to update the standard wording in the policies they issue to members to reflect this requirement.