

FINANCIAL SERVICES BOARD

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(To all approved administrators, privately administered funds and insurers who underwrite pension funds)

INTERPRETATION NOTE 1 OF 2010

PENSION FUNDS ACT, 1956 MINIMUM PENSION INCREASES

PURPOSE

1. The purpose of this Interpretation Note is to provide clarity on the application of minimum pension increases, within the ambit of the Pension Funds Act, 1956 ("the Act").

BACKGROUND

2. The 2001 amendment to the Act introduced the surplus legislation and at the same time minimum benefits were introduced in the statute. Thereafter, a further amendment was promulgated in 2007 which attempted to clarify certain aspects originally introduced in 2001.
3. Despite the intention of the 2007 amendment to provide clarification, there seems to be uncertainty in the industry relating to the provisions of the Act that deal with minimum pension increases, hence this Interpretation Note.

SECTION 14A(1)(d) – TIMING OF MINIMUM PENSION INCREASES

4. The board of a registered fund must at least once every three years perform a minimum pension increase test. Such test is usually performed as part of an actuarial valuation, by implication not necessarily a statutory actuarial valuation. The effective date of the test coincides with the effective date of performing the valuation.
5. For reasons of practicality, given that a fund should be valued to determine the affordability of the minimum pension increase, a six-month period has been introduced.
6. Where the result of the test indicates that a fund must grant a minimum pension increase, the effective date at which the board of the Fund awards the minimum pension increase must be awarded before the expiry of the six-month period, even if it is applied retrospectively.
7. The process of determining the minimum pension increase repeats itself at least once every three years. The effective date at which the board of a fund awards the minimum pension increase, where necessary, must be before the expiry of the six-month period from the effective date as at which the test was performed.

SECTION 14B(3)(a) – PENSION INCREASE POLICY

8. The board of a registered fund must establish and implement a pension increase policy that aims to award pension increases in line with a percentage of the consumer price index or some other measure of price inflation which is deemed suitable by the board.
9. As a result, the pension increase policy must be linked to a measure of price inflation. The pension increase policy cannot be determined both in relation to such a linked rate and a fixed rate. A pension increase policy structured in terms of the combination of a linked rate and a fixed rate obviates the need for minimum pension increase test, which could not have been the intention of legislature.
10. The pension increase policy cannot claim that a fund aims to award pension increases of a percentage of price inflation but in reality the funding target is a lesser amount.

SECTION 14B(3)(c) – EXEMPTION FROM MINIMUM PENSION INCREASES

11. In terms of section 14B(3)(c) of the Act, for certain classes of pensioners, an exemption from a minimum pension increase policy is granted.
12. It therefore follows that, as the provisions of section 14B(3)(a) are not required in these cases, the condition in line with section 14A(1)(d) cannot be complied with and hence such classes of pensioners are not subject to the minimum pension increase test as required by the latter section.
13. Where pensioner liabilities are outsourced and policies of insurance are purchased in terms of section 7 of the Long-term Insurance Act, 1998, the following should be noted:
 - 13.1 Outsourcing in the name of the pensioner is facilitated through an application in terms of section 14 of the Act which requires in section 14(1)(c) that the Registrar is satisfied that the scheme for the proposed transaction is reasonable and equitable and accords full recognition, *inter alia*, to the payment of minimum benefits in terms of section 14A. The Registrar will not be satisfied where a penal valuation basis in relation to the funding basis is utilised to facilitate the outsourcing.
 - 13.2 Outsourcing in the name of the fund is facilitated through a change in investment strategy. Funds should give due recognition to the principles outlined in paragraph 13.1.
14. Where pensioners elected to receive a level pension, or a pension with fixed increases, or a pension the amount of which is elected by the pensioner from time to time, paid from the fund in terms of the rules of the fund, it is only such portion of a pensioner's income that complies with this requirement in respect of which the exemption is granted.
15. In the case where a pensioner receives in addition to his pension from the fund (which is subject to the minimum pension increase provision) pension income from e.g. a living annuity policy, the exemption granted by subsection 3(c) only applies to the proceeds derived from the living annuity policy.

SECTION 14B(4)(a) – AFFORDABILITY OF MINIMUM PENSION INCREASES

16. Accrued liabilities of pensioners represent the present value of pensions in course of payment as at the valuation date. Such present value must take into account the rights and reasonable benefit expectations of pensioners, including, *inter alia*, any right or reasonable expectation in regard to increases in terms of the pension increase policy.
17. In determining the affordability of increases, the board of a fund should make due allowance for the balances of contingency reserves allowed for in terms of the rules of the fund, in a manner consistent with the way in which the test was applied at the fund's surplus apportionment date.

18. Following the minimum pension increase test, where there are insufficient assets to achieve the full increase, such statutory pension increase may be proportioned down in line with its affordability.

CONCLUSION

19. This Interpretation Note discusses only the broad principles in interpreting the minimum pension increase provisions in the Act. As the facts and circumstances pertaining to each fund may differ, the application of minimum pension fund increases in relation to each fund should be considered in accordance with this Interpretation Note and the Act.

QUERIES RELATING TO INTERPRETATION NOTE

20. Any queries relating to this Interpretation Note must be addressed to –

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AVAILABILITY OF INTERPRETATION NOTE

21. This Interpretation Note is available on the website of the Financial Services Board (www.fsb.co.za).

Yours faithfully



FOR REGISTRAR OF PENSION FUNDS