

FINANCIAL SERVICES BOARD

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

INTERPRETATION NOTE 1 OF 2012

PENSION FUNDS ACT, 1956

PENSION INCREASE POLICY

PURPOSE

1. The purpose of this Interpretation Note is to clarify the Registrar's position with regard to the obligations of a fund registered under the Pension Funds Act, 1956 ("the Act") in setting and complying with its pension increase policy.
2. In terms of the provisions of sections 14B(3)(a) and (b) of the Act, the board of a fund is required to establish and implement a policy with regard to the granting of pension increases with reference to a stated aim, which can be monitored by pensioners in the interests of transparency and certainty.
3. The board of a fund must be able to justify why, despite its published pension increase policy, it was unable to comply with that policy in any particular year. Therefore funds must take reasonable steps to ensure that appropriate policies are complied with.

OBLIGATIONS OF THE BOARD OF A FUND UNDER SECTION 14B(3)

4. The board of a fund must establish and implement a policy with regard to increases to be granted to pensioners and deferred pensioners.
5. The board cannot disregard the pension increase policy and must plan its affairs with the specific objective of aiming to award pension increases in accordance with the policy.
6. The pension increase policy must be communicated to pensioners and deferred pensioners when it is established and whenever it is changed. A policy which has been communicated to pensioners will inevitably create a reasonable expectation that the policy will be adhered to and that pensioners will receive pension increases in accordance with the policy.
7. The significance of the above is that pensioners are entitled to expect that a policy adopted by the board under legislative constraint will be followed unless there are valid circumstances, whether financial or other, warranting a departure from the set policy.
8. The communication to pensioners and deferred pensioners must disclose that there may be certain circumstances which could result in a fund being unable to provide increases in line with the pension increase policy.

FUNDING IN SUPPORT OF THE PENSION INCREASE POLICY

9. The board must properly plan for the pension increases aimed at, which depend to a large extent on proper funding. Proper and appropriate funding is necessary to ensure that, by using actuarial assumptions and taking account of the investment approach adopted by the fund and the uncertainty of investment performance, there is a reasonable likelihood that the target pension increase will be achieved over time.
10. Where a fund's investments suffer an unexpected setback, or the fund experiences unusual circumstances (e.g. a deviation from the expected experience based on an assumption made), which place the fund under financial strain, despite the fund's aim, the objective of the policy may be unachievable.
11. Similarly, a fund's ability to provide increases in line with the policy may be restricted by other factors such as actuarial losses as a result of pensioners living longer than expected.

PROFESSIONAL DUTY OF THE VALUATOR

12. A fund's valuation basis must be set in a manner consistent with its pension increase policy and the valuator must align the funding plans with the fund's pension increase policy.
13. A valuator must use a valuation basis which is expected to enable a fund to meet the target pension increase within a reasonable likelihood.
14. In discharging of his or her professional duties to a fund, the valuator must ensure that there is no disconnect between the pension increase policy and the valuation basis.
15. In terms of section 14B(3)(c) of the Act, a fund is exempt from the requirement of having a pension increase policy under certain circumstances. However, even under those circumstances, in order to enable the valuator to put a value on the liabilities of active members, assumptions must be made regarding the period after retirement of an active member. Under these circumstances it would still be necessary to have a pension increase policy to serve as reference for the valuator to base his or her assumptions on.

EXAMPLES OF NON-COMPLIANCE WITH SECTION 14B(3)

16. The board of a fund will not comply with its fiduciary obligation towards pensioners where the fund is in breach of the provisions of section 14B(3) of the Act, as may be illustrated by the following examples which are not exhaustive:
 - 16.1 the funding parameters adopted by the fund are such as to make it unlikely or impossible to achieve the targeted increase, e.g. by deliberately using a fixed post-retirement discount rate which will, based on the set of assumptions used, not allow the objective to be achieved. In such a case a clear dissonance exists between the stated aim and the likely result it "aims to award" and furthermore, it would be at odds with the reasonable benefit expectations of pensioners; or
 - 16.2 a pension increase policy is set which the board has no intention of following, or which it knows it will be unable or unlikely to implement (i.e. acting in bad faith). In these circumstances it will not "aim to award" the target increase and it would have misled pensions by creating expectations which are unlikely to be fulfilled.

QUERIES RELATING TO INTERPRETATION NOTE

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

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AVAILABILITY OF INTERPRETATION NOTE

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

Yours faithfully



FOR REGISTRAR OF PENSION FUNDS