

FINANCIAL SERVICES BOARD

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

INTERPRETATION NOTE 3 OF 2010

PENSION FUNDS ACT, 1956 RESERVE ACCOUNTS IN RULES

PURPOSE

1. The purpose of this Interpretation Note is to clarify the Registrar's requirement to define, and to provide details on the operation of, reserve accounts in the rules of funds registered under the Pension Funds Act, 1956 ("the Act").

BACKGROUND

2. In terms of the Pension Funds Second Amendment Act of 2001 as well as subsequent amendments to the Act, funds were required to submit to the Registrar either a scheme for the apportionment of actuarial surplus or a nil return to satisfy the Registrar that the fund does not have actuarial surplus to apportion.
3. The Registrar issued Circular PF117 that sets out the standard for valuations to determine the actuarial surplus at the surplus apportionment date as well as guidance in relation to the contingency reserve accounts that may be established as at surplus apportionment date.
4. In terms of Regulation 35(2) to the Act, the establishment and magnitude of any contingency reserve account by a fund must be motivated by the valuator in the statutory actuarial valuation report and may, where the Registrar is not satisfied with any such motivation, be rejected by the Registrar.

5. In light of the above and to ensure compliance with the Act, the Registrar requires funds to make provision in their rules for the purpose and operation of reserve accounts.
6. Funds are not required to establish reserve accounts. However, once a reserve account is established, the rules must be amended to provide for it.

RESERVE ACCOUNTS

7. In terms of section 1(1) of the Act, “**reserve account**”, in relation to a fund, means a contingency or investment reserve account, as the case may be.
8. For funds with a defined contribution category of members, “**investment reserve account**”, means the difference between:
 - (a) the value of the assets held in respect of the members’ individual accounts and for any smoothing of investment returns to be credited to such accounts, with allowances for expenses; and
 - (b) the value of the balances in the members’ individual accounts.
9. Any other reserve account is therefore a “**contingency reserve account**” which, in relation to a fund, means an account of the fund, which has been amended in accordance with the requirements of the Registrar, or which has not been disallowed by the Registrar, and to which shall be credited or debited such amounts as the board shall determine, on the advice of the valuator where the fund is not exempt from actuarial valuations, in order to provide for explicit contingencies.

RULES OF A FUND

10. To ensure that funds comply with the Act, the Registrar requires that where a fund with a defined contribution category of membership smoothes fund return in relation to members’ individual accounts, the rules of the fund must make provision for the operation of such investment reserve account.
11. In addition, the Registrar requires that a fund makes provision in its rules for any contingency reserve account that the fund decides to establish.
12. The only practical manner in which the Registrar can exercise the discretion in terms of paragraph 9, granted to him under the Act, in respect of a contingency reserve account is by way of the submission to the Registrar of an amendment to the rules of a fund.
13. It is imperative when the Registrar needs to exercise his decision-making power in terms of section 14 of the Act and when he has to satisfy himself that the provisions of section 15G have been applied correctly that the rules provide for the establishment of a contingency reserve account in a fund, if the fund operates such contingency reserve account.

REQUIREMENTS IN TERMS OF CONTINGENCY RESERVE ACCOUNTS

14. In respect of each contingency reserve account that a fund decides to establish, the Registrar requires that the rules of the fund specify:
 - 14.1 the nature of the account, bearing in mind that it must provide for a specified contingency;
 - 14.2 the opening balance of the account and how it is determined;
 - 14.3 the items that will be credited to, and debited from, the account; and
 - 14.4 the manner in which the account will be dissolved, should its purpose become obsolete.
15. Where it is not possible to specify the items to be credited to and debited from the contingency reserve account (e.g. in the case of a solvency reserve), it would be acceptable to include the following in the rules of the fund:
 - 15.1 that the quantum of the account is determined by the board of the fund in consultation with the valuator at least as at the date of each statutory actuarial valuation; and
 - 15.2 whether or not the balance in the account is accumulated with fund return.
16. It is recognised that the valuator may wish to recommend a contingency reserve account at the time of doing the valuation. This would then have to be brought in line with the rules of the fund as the valuator would in effect be recommending the establishment of a new contingency reserve account. If this recommendation is accepted by the fund, the rules of the fund would need to be amended in line with this decision within 12 months following the submission of the statutory actuarial valuation report to the Registrar, or earlier in the case of section 14 transfers, where shares of such reserve accounts are being transferred.

ACCOUNTING AND VALUATION ISSUES

17. From the Registrar's perspective, it would not be necessary to include an actuarially updated figure as at the financial year-end of the fund in the financial accounts, where the fund is subject to audit. However, the fund is required to comply with the relevant accounting standards.
18. It is recognised that in many instances the quantum of a solvency reserve is determined triennially, and for the financial year-ends during this period, the amount standing to the credit of the solvency reserve may not be available when the financial accounts, where the fund is subject to audit, are to be submitted. In such cases a suitable approach needs to be decided upon in consultation with the auditors.

CONCLUSION

19. This Interpretation Note sets out the reasons why the Registrar requires funds to amend their rules to allow for contingency reserve accounts. As the facts and circumstances of each fund may differ, the establishment of contingency reserve accounts should be considered in accordance with this Interpretation Note.

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