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To all self-administered funds, fund administrators, valuers, and administering insurers of funds exempted in terms of section 2(3)(a) of the Pension Funds Act, 1956

CIRCULAR PF NO. 116

TIMING OF THE FIRST STATUTORY MINIMUM PENSION INCREASE, PENSION LIABILITIES AT THE SURPLUS APPORTIONMENT DATE, AND SUBSEQUENT STATUTORY MINIMUM PENSION INCREASES

INTRODUCTION

1. Timing of the first statutory minimum pension increase

1.1. Intention of the Legislature

1.1.1. Section 14A(1)(d) of the Pension Funds Act, 24 of 1956, requires the statutory minimum pension increase provisions to be introduced “starting with the pension increase to be granted on the effective date of the first actuarial valuation following the commencement date”.

1.1.2. The statutory minimum pension increase should be applied as soon as practicable after the commencement of the Pension Funds Second Amendment Act, 39 of 2001, on 7 December 2001. Practicality will normally dictate that a fund is valued to ensure that an increase is affordable (as the pension increase policy is likely to include such a requirement). The intention was therefore clearly to introduce the statutory minimum pension provision as soon as possible, subject to there being an actuarial valuation at the effective date from which the increase is granted.

1.1.3. The Act defines a statutory actuarial valuation as “an investigation by a

valuator contemplated in section 16". Section 16(1) says that "a registered fund shall, once at least in every three years, cause its financial condition to be investigated and reported upon by a valuator, and shall deposit a copy of such a report with the registrar..." Regulation 15, framed in terms of section 16(7), prescribes the content of that report.

- 1.1.4. The term "actuarial valuation" is a formal investigation into the ability of a fund to meet its liabilities but one that does not necessarily meet all the requirements for a statutory actuarial valuation.

1.2. Implementation at the first pension increase after 7 December 2001 where an actuarial valuation has been performed to determine affordability

- 1.2.1. If an actuarial valuation is conducted at a date between 7 December 2001 and the surplus apportionment date in order, inter alia, to estimate the affordability of a pension increase, which is granted before the surplus apportionment date, the first statutory minimum pension increase should be implemented coincident with this pension increase.
- 1.2.2. This will give effect to the intention of the Legislature as expressed in section 14A(1)(d).
- 1.2.3. The effective date of this valuation could be coincident with or earlier than the effective date of the pension increase. A slightly earlier valuation would enable the financial position to be ascertained prior to deciding the pension increase and could enable the board to avoid a retrospective pension increase.
- 1.2.4. If no pension increase policy was in place before this increase, the board must establish one, and implement it as part of this first statutory minimum pension increase.

1.3. The latest date on which the statutory minimum pension increase provisions can be applied for the first time will be the surplus apportionment date

- 1.3.1. Section 15B requires a statutory actuarial valuation to be performed at the surplus apportionment date. Unless advanced, the surplus apportionment date is the date of the first statutory actuarial valuation due after 7 December 2001. Therefore the latest date on which statutory minimum pension increase provisions will apply for the first time is the surplus apportionment date.

2. Section 14A(1)(d) does not apply if no actuarial valuation is performed

- 2.1. If a normal pension increase is given before the surplus apportionment date and no actuarial valuation is conducted, either at the same time or, in order to determine whether or not the increase can be afforded, prior to that date, section 14A(1)(d) does not apply and may be ignored.
- 2.2. This could for example occur where the board determines the normal annual pension increase by reference to the net investment return earned.
- 2.3. If there is a pension increase policy in force at the time of the increase this policy must be followed to determine the increase. A pension increase policy is required after 7 December 2001, in terms of section 14B(3).

3. Pension increase policy to be applied at the surplus apportionment date before the application of sections 15B(5)(b) and 15B(5)(c)

- 3.1. Section 15B deals with the apportionment of actuarial surplus.
Actuarial surplus is determined after the value of the accrued liabilities and any contingency reserve account balances have been deducted from the value of the assets.
- 3.2. The accrued liabilities in respect of pensioners represent the present capitalised value of the pensions in course of payment at the surplus apportionment date.

Such present value must take account of the rights and reasonable expectations of the pensioners, including, inter alia, any right or reasonable expectation in regard to increases in terms of the pension increase policy.

- 3.3. A statutory minimum pension increase must be granted at the surplus apportionment date (section 15B(5)(b)). But this statutory minimum pension increase ranks equally with the enhancement of benefits paid previously to former members.

If there are insufficient assets to achieve both in full, the statutory minimum pension increase and the enhancement to former members must both be proportioned downwards.

- 3.4. The board may therefore provide, in the accrued liabilities as at the surplus apportionment date, for:-
- 3.4.1. a normal increase in terms of the pension increase policy prior to the determination of the actuarial surplus and its apportionment in terms of section 15B; and
 - 3.4.2. future increases in terms of the pension increase policy. In particular, this provision can incorporate valuation of the accrued liabilities at a discount rate selected by the actuary in consultation with the board in order to achieve the objective of the board's pension increase policy. When applying the discontinuance matching approach in determining the solvency reserve, if applicable, the discount rate should similarly allow for the board's pension increase policy.
- 3.5. Part of the solvency reserve, if applicable, may relate to pensioners, provided it has been determined as set out in the PF Circular No. 117.
- 3.6. The board may not provide for any amount in respect of the statutory minimum pension increase at the surplus apportionment date prior to the determination of the actuarial surplus and its apportionment (in terms of section 15B.)
- 3.7. Where the statutory minimum pension increase provisions were applied for the first time before the surplus apportionment date, the pensioner liability at the surplus apportionment date will include the pension increases that resulted from that earlier application of the statutory minimum pension increase provisions.

4. Apply the statutory minimum pension increase provisions at the surplus apportionment date as part of former member and pensioner top-up (section 15B(5)(b))

The statutory minimum pension increase at the surplus apportionment date must be provided for in terms of sections 15B(5)(b) as part of the surplus apportionment.

5. A contingency reserve account may be established to hold any excess of the notional pensioner accumulation over the pensioner liability as part of the application of section 15B(5)(c)

- 5.1. Any provision for future statutory minimum pension increases - over and above the provision achieved in the discount rate applied by the actuary to value the pensioner liabilities - and the corresponding part of the solvency reserve, in respect of pensioners (if applicable), can only be funded (in terms of section 15B(5)(c)) out of the actuarial surplus equitably allocated for the benefit of pensioners.

In particular this will apply to the excess of the notional pensioner account (determined in terms of section 14B(4)(b)(i)) over the pensioner liability at the surplus apportionment date, which the Registrar recommends is set aside in a

contingency reserve account after the apportionment scheme has been approved.

- 5.2. Any other interpretation of the Act will be inconsistent with the equal ranking of the statutory minimum pension increase with former members' enhancements in terms of section 15B(5)(b).

REGISTRAR OF PENSION FUNDS