(DRAFT) PF NOTICE … OF 2015

FINANCIAL SERVICES BOARD

PENSION FUNDS ACT, NO. 24 OF 1956

SECTION 18 – FUND NOT IN SOUND FINANCIAL CONDITION

Section 18(1) of the Pension Funds Act, 1956 ('PFA') was amended by the Financial Services Laws General Amendment Act, 2013 and came into operation with effect from 28 August 2014.

In terms of section 18(1) of the PFA, read with the definition of "actuarial surplus" in section 1(1) for funds that are not valuation exempt:

- a valuation basis; and
- conditions for financial soundness,

may be prescribed by the registrar by notice on the web site of the Financial Services Board (www.fsb.co.za).

Furthermore, in terms of section 18(1), the registrar may direct a fund that is not in a sound financial condition to submit a scheme setting out the arrangements that have been made, or which it intends to make, to bring the fund into a financially sound condition within such period, and subject to such conditions, as determined by the registrar.

I, **Dube Phineas Tshidi**, registrar of pension funds, by this notice and with effect from the date of publication of this notice in the *Government Gazette*, prescribe the criteria for financial soundness and the valuation basis in terms of which financial soundness is determined as well as particulars relevant to a scheme of arrangement, as set out in the Schedule.

DP TSHIDI
REGISTRAR OF PENSION FUNDS

SCHEDULE

1. Definitions – In this Schedule –

'fair value' has the meaning assigned to it in financial reporting standards and includes any other conditions as may be prescribed;

'funding level' means the ratio, expressed as a percentage, of the value of the assets of a fund, less any credit balances in the member and employer surplus accounts, to the value of its liabilities plus the credit balance of any contingency reserve in the fund, excluding a solvency reserve;

'PFA' means the Pension Funds Act, 1956 (Act No. 24 of 1956), as amended, and any word or expression to which a meaning is assigned in the PFA has the same meaning in this notice; and

'scheme of arrangement', in relation to a fund, means the remedies employed by the board of a fund to bring the fund into a financially sound condition, subject to the conditions and periods prescribed in this notice.

2. Prescribed valuation basis

2.1 In a statutory actuarial valuation, the assumptions that the valuator uses to calculate the value of liabilities must be consistent with those used to calculate the value of the assets and these assumptions must reflect market conditions prevailing as at the valuation date.

2.2 Any assumption used, or statistical evidence that may be used to substantiate any assumption, must not amount to unfair discrimination or result in outcomes that are unconstitutional.

2.3 The prescribed basis for the determination of actuarial surplus for a fund that is subject to valuation is as follows, dealing in turn with assets, liabilities and contingency reserves:

Assets

2.4 The value of the assets of a fund at the valuation date must reflect their fair value.

2.5 Where the fair value of an asset cannot be determined, or where the fair value of an asset is not available, the valuator should determine the value of such asset by using a reasonable approximation based on accepted market valuation techniques, or rely on the value placed on such asset by a suitably qualified and experienced professional.

Liabilities and contingency reserves

2.6 In the determination of the value of a fund's liabilities, any actuarial assumption must:

2.6.1 be realistic;

2.6.2 have regard to the nature of the fund concerned; and

2.6.3 be guided by past experience, as modified by knowledge or reasonable expectation of changes in the future, including events such as expected changes in taxation regimes or other legislation, which impact the expected experience of the fund.

2.7 Any margins of conservatism must be separately identifiable in the valuation basis.

2.8 A valuator must motivate the choice and relevance of the assumptions which motivation may include a reference to any of the following:

2.8.1 the experience of the fund, taking into account the size of the fund and underlying trends in that experience where the actuary deems it appropriate to do so;

2.8.2 statistical evidence emanating from:

- other funds in general (if applicable), or
- relevant published information about annuitant or in-service mortality or morbidity rates, including the effect of HIV/AIDS, or
- an investigation performed within a firm of valuators in respect of funds advised by that firm

where that evidence may relate to demographic items or to economic items.

2.9 The assumption for general price inflation must be based on information about market expectations at the valuation date commensurate with the term and currency of the liabilities.

2.10 Demographic assumptions must be determined in a manner that is relevant to the membership of the fund for whom the liabilities are calculated.

2.11 There must be consistency between the financial assumptions used to value liabilities related to in-service members and pensioners respectively.

2.12 In order to arrive at a discount rate, two generally accepted approaches are recognised, namely a risk-free and a risk premium approach.

2.13 In terms of a risk-free approach, the valuator must select a proxy for risk-free rates available in the market, i.e. the discount rate must reflect market yields on government bonds commensurate with the duration, nature and currency of the liabilities.

2.14 In terms of a risk premium approach, the valuator must determine a risk-free rate of discounting similar to above, but a risk premium is added to the risk-free rate to reflect the expected investment returns to be earned based on the investment strategy of the fund.

2.15 At the date of valuation, the funding level of a fund must be determined on the following two bases:

2.15.1 A risk premium approach in terms of which the full equity risk premium does not exceed 3.0% p.a.; and

2.15.2 A risk-free approach;

and any basis that is more optimistic than the less conservative of the two bases can be applied to fund its liabilities.

2.16 A fund's actuarial surplus is quantified in terms of the more conservative of the two bases indicated in paragraphs 2.15.1 and 2.15.2, and such actuarial surplus may be apportioned in terms of section 15C of the PFA.

3. Financial Soundness Criteria

3.1 The registrar may prescribe criteria for financial soundness in terms of section 18(1) of the PFA and a valuator is required to certify the financial condition of a fund in the statutory actuarial valuation report.

3.2 In the case of a deficit, taking into account the provisions of section 15H of the PFA, the valuator must state the measures taken or recommended to eliminate such deficit and the expected period within which it is anticipated that the deficit will be eliminated, with the consent of the board of the fund and / or the sponsor where deemed necessary.

3.3 Any deficit in a fund, which cannot be dealt with in the manner prescribed in this notice, must be dealt with in consultation with the registrar.

Minimum Funding Requirement

3.4 The funding level determined in terms of the less conservative of the two bases indicated in paragraphs 2.15.1 and 2.15.2 must equal to exceed 100% for a fund to be financially sound.

3.5 Where the funding level referred to in paragraph 3.4 is less than 100%, a scheme of arrangement, as set out in this notice must be submitted to the registrar.

4. Scheme of arrangement

4.1 In terms of section 18(1) of the PFA, when any return under the PFA indicates that a registered fund is not in a sound financial condition, the registrar may, save as provided in section 29 of the PFA, direct the fund to submit a scheme setting out the arrangements which have been made, or which it intends to make, to bring the fund into a financially sound condition within such period, and subject to such conditions, as determined by the registrar.

4.2 In terms of section 18(1A) of the PFA, when any return under the PFA indicates a deficiency in a registered fund, the fund shall, within three months from the date of such return, submit a scheme to the registrar setting out the arrangements which have been made or which it is intended to make to eliminate the deficiency, together with a report thereon by a valuator.

4.3 Within the context of section 18 of the PFA, the deficiency contemplated by sub-section (1A) should be restricted to a financial deficiency, i.e. a deficiency which will or may impact the financial condition of a fund. As such, a deficiency may be identified by the board of a fund which may not have caused, or not yet have caused the fund to be in an unsound financial condition. Therefore, where the board of a fund identifies a deficiency in the fund, the provisions of section 18(1A) will apply.

4.4 The scheme of arrangement must:

4.4.1 contain the particulars of the remedies which the board of the fund intend to employ to bring the fund into a financially sound condition;

4.4.2 include a projection of the financial condition of the fund, taking into account the effect of the remedies once implemented; and

4.4.3 indicate the timeframe within which financial soundness is anticipated to be restored.

4.5 A fund that is not financially sound and is required to submit a scheme of arrangement must restore financial soundness within 3 years from the valuation date at which it was confirmed that the fund is not financially sound.

4.6 Notwithstanding the provisions of paragraph 4.5, in the cases where:

4.6.1 a new fund is established and prior service is recognised as being pensionable; or

4.6.2 retirement or other benefits are augmented with retrospective effect,

funds are reminded of their obligations in terms of the provisions of section 12(3) of the PFA to obtain a certificate from a valuator which confirms the financial soundness of these provisions and the scheme of arrangement submitted to the registrar must include reference to the special contributions that must be made to bring the fund into a financially sound position with a period of 9 years from the effective date contemplated in paragraph 4.7.1 or 4.7.2.

4.7 Rule amendments that form part of a fund's scheme of arrangement and which involve a retrospective enhancement of benefits may be considered for registration in terms of the provisions of section 12(4) of the PFA, provided that these increased benefits can be funded at an acceptable level. The board of the fund and sponsor are required to endorse the certificate produced by the valuator, and the certification must be submitted together with the rule amendment.

5. Format and submission of a scheme of arrangement as well as any scheme submitted under section 18(1A)

5.1 There must be a resolution by the board of the fund confirming the adoption of the scheme of arrangement and any scheme of arrangement submitted to the registrar must be duly signed by the chairperson, a member of the board, the principal officer and be certified by the valuator.

5.2 Where the scheme of arrangement requires the consent or commitment of the employer or any third party to the fund, confirmation of such consent must be included in the submission.

5.3 The submission to the registrar must be made through the official web site (www.fsb.co.za) in portable document format (PDF).

5.4 The provisions set out in paragraphs 5.1 to 5.3 apply *mutatis mutandis* to any scheme of arrangement formulated by a board to eliminate any deficiency in terms of section 18(1A) of the PFA.

6. Short title – This notice is called the Notice on Financial Soundness, 2015.