

**Minimum Benefits and the “Regulations”
Practical Approaches
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Background Cont.

- **Surplus Apportionment**
 - Existing surpluses, after adding back employer improper uses, must be apportioned between stakeholders (as defined)
 - Treatment of future surpluses may also be addressed

Progress Since Implementation Cont.

- Draft PF circular on surplus apportionment, minimum benefits and Section 14 procedures
- Legal opinions requested by National Treasury

Progress Since Implementation Cont.

- Position of valuation exempt funds has not been fully clarified
- Further (unpublished) draft with National Treasury
-“we’ve been thrown into the depths of the unknown”

The problem with no Regulations cont.

- Apportionments cannot take place
- Expensive AC116 reporting becomes futile
- Managing stakeholder expectations

The problem with no Regulations cont.

- Actuarial scenario testing and legal opinions are expensive
- Investment hedging has massive opportunity costs

The problem with no Regulations cont.

- Liquidations and subsequent payments cannot take place
- Legal clarity is outstanding and many issues are open to interpretation
- etc, etc, etc

The Minimum Benefit to Future Leavers from Defined Benefit Arrangements

The problem with an independent basis

- If more conservative, pressure on funding levels, therefore possible liquidation of fund, removing member security?
- If less conservative, actuaries may tend to weaken assumptions, less contributions into fund, therefore less security for members

So what's the problem (Continued)

- Payment of withdrawal benefits now becomes administratively complicated (2 new additional calculations) and more costly (actuaries aren't cheap !!!), creating further delays
- The notion of "vested employer contribution" in a defined benefit fund doesn't really make sense?
- "Floating" basis means different bases for different generations of exits

Pension increase policy (Cont.)

- Is there an “affordability” link?
 - If so, DEFINE this clearly, by setting out method / formula!
- Frequency of increase (what about hyper inflation?)
- Historical practice and reasonable pensioner expectations

Pension increase policy (Cont.)

- Impact on Fund liabilities and ultimate level of surplus
- Employer “hook”
- Impact of current market conditions on next increases

Pension increase policy

The Notional Pension Account

- Is historical data available?
- If not, reasonable “proxies” should suffice
- Calculation is complicated and should be discussed in consultation with the actuary

Minimum benefits for DC Funds

Minimum benefit =

- Member contributions,
- plus net employer contributions,
- plus fund return,
- plus share of investment reserves,
- plus members surplus accounts and other contingency reserve accounts as the board determines

Reserve accounts in DC funds (Cont.)

- Agterskot payments, or, as-and- when or both ?
- Negative reserves ?
- Monthly audits / reviews or cross subsidies ?

Practical solutions

1. Surplus apportionment process

- Agree surplus apportionment date
- Find / reconstruct former member records
- Appoint former member representative

Practical solutions

- Identify possible improper uses and seek legal clarity
- Investigate financial history, historical ER and EE contribution levels, and agree on principles in apportioning surplus between member and employer surplus accounts

Practical solutions

- Insure against capital loss (NB!)
- Put process in place to manage member queries
- Perform actuarial valuation on previous basis
- Seek extension for valuation submission and scheme of apportionment
- Communicate regularly to manage expectations

Practical solutions

2. Minimum benefits for DB members

Whilst regulations are outstanding

- Do NOT change existing benefits
- Withdrawn members will be taken care of in surplus apportionment
- Former member enhancements just cannot be performed

Practical solutions

2. Minimum benefits for DB members

When regulations are published

- Finalise actuarial valuation
- Finalise top ups to former members, and members who left 12 months following SAD
- Amend Rules to allow for changes

- Agree administrative procedures to deal with exiting member benefits, for example:
 - Calculate top up as and when people leave
 - Calculate top up from member surplus accounts at every valuation date

Practical solutions

3. Pensioner issues

- Agree pension increase policy and implement (employer concurrence, rule change, communication etc)
- Adjust pensioner liability (and in service member liabilities) in order to reflect agreed pension increase policy

Practical solutions

- Notional pensioner account (NPA) calculation can be an approximation, but must use judgement on extent of detail in calculating the NPA
 - Number of pensioners and relative level of liability
 - Availability of historical pensioner data
 - Historical increases and levels of investment performance
 - Equity and pension increase practices
 - Decision should be well thought through and properly justified and recorded
- Re-look at pensioner liability investment strategies

Practical solutions

4. Defined contribution schemes

- Perform actuarial review and agree explicit contingency reserves
- Amend withdrawal benefit to equal full Fund Credit
- Distribute investment reserves by declaring huge bonus immediately or agree smoothing mechanism (consider danger)

Practical solutions

- Agree extent of distribution on exit of contingency reserves and any investment smoothing mechanism, and manner with which it is to be dealt with, for example:
 - as and when people exit, enhancement is paid
 - as at actuarial review date, enhancement is calculated to each exited member.
- Minute decisions and check rules

Conclusion (Cont.)

- However, Trustees should avoid delays, and address at least those issues highlighted in this presentation
- Importantly, expectations need to be managed, and regard must be given to communication and capital insurance needs
- Begin today what is inevitable tomorrow!