

REPUBLIC OF SOUTH AFRICA

**PENSION FUNDS
AMENDMENT BILL**

(As introduced in the National Assembly)

(MINISTER OF FINANCE)

[B 43—9\$]

REPUBLIEK VAN SUID-AFRIKA

**WYSIGINGSWETSONTWERP OP
PENSIOENFONDSE**

(Soos ingedien in die Nasionale Vergadering)

(MINISTER VAN FINANSIES)

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GENERAL EXPLANATORY NOTE:

Words underlined with a solid line indicate insertions in existing enactments.

BILL

To amend the Pension Funds Act, 1956, so as to allow for the disposition of excess assets in certain circumstances; to amend the Income Tax Act, 1962, so that the disposition of excess assets from a registered fund is taxable; and to provide for matters connected therewith.

BE IT ENACTED by the Parliament of the Republic of South Africa, as follows:—

Insertion of section 14A in Act 24 of 1956

1. The following section is hereby inserted in the Pension Funds Act, 1956, after section 14:

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“Disposition of excess assets

14A. (1) In this section, unless the context indicates otherwise—

- | | |
|---|----|
| (i) ‘application’ means an application for approval as contemplated in subsection (2); (i) | |
| (ii) ‘chief actuary’ means the chief actuary of the Financial Services Board and any actuary authorised by him or her to perform the functions on his or her behalf entrusted to the chief actuary in this section; (v) | 10 |
| (iii) ‘excess assets’, in respect of a fund, means the total assets of the fund minus its minimum assets; (x) | 15 |
| (iv) ‘fund’ means a registered fund in respect of which—
(a) a valuator is appointed in terms of section 9A: and
(b) the rules provide for an application and other prescribed related matters; (iii) | |
| (v) ‘market value’, in respect of excess assets, means the market value of the excess assets determined to the reasonable satisfaction of the registrar by the relevant board or a person authorised by it: (viii) | 20 |
| (vi) ‘member’ means any person who has an existing or prospective claim to benefits from a fund, but not a person whose prospective claim is contingent upon the death of the first-mentioned person: (vii) | 25 |

- (vii) 'minimum assets', in respect of a fund, means assets having an actuarial value equal to the sum of—
- (u) the actuarial liabilities represented by the modified benefits applicable to the qualifying membership of the fund as at the date of an application; and
 - (b) a contingency reserve sufficient to protect the security of the modified benefits, as confirmed by the chief actuary; (ix)
- (viii) 'modified benefits' means benefits provided for in terms of the rules of a fund and modified, where necessary, to comply with the minimum prescribed requirements; (iv)
- (ix) "participating employer" means an employer who participates in the scheme or arrangement whereby a fund has been established; (ii)
- (x) "prescribed" means prescribed by the registrar by notice in the *Gazette*; (xi)
- (xi) 'qualifying membership', in respect of a fund, means—
- (a) all members of the fund as it existed at the date of an application; and
 - (b) all persons whose membership of the fund has terminated on the prescribed grounds within the prescribed period prior to the date of an application. (vi)
- (2) (a) The board of a fund may apply to the registrar, in the prescribed manner, for approval of the delivery of part or all of the excess assets of the fund to one or more participating employers.
- (b) All calculations for purposes of an application must comply with the basic standards prescribed from time to time, after consultation with the chief actuary and the president of the Actuarial Society of South Africa.
- (c) The board must provide evidence to the registrar that—
- (i) full details of the application have been disclosed to the members in a complete, precise and understandable manner;
 - (ii) the members have been given a reasonable opportunity to approve or disapprove the application; and
 - (iii) the members have been informed in the prescribed manner of their right to object to the application as envisaged in subsection(3)(a).
- (a') The board must supply the registrar with a certificate where it certifies that at least two-thirds of the members who responded to the request to approve or disapprove the application, have approved the application.
- (e) The registrar may request additional information required to assess an application.
- (3) The registrar may only approve an application—
- (u) after consideration of any objection to the application lodged with the registrar;
 - (b) after consultation with the chief actuary; and
 - (c) if the registrar is reasonably satisfied that—
 - (i) the board complied with subsection (2); and
 - (ii) the interests of the members and the public in general will not be prejudiced by the approval.
- (4) (a) The registrar may impose conditions when approving an application.
- (b) The registrar must provide reasons for—
 - (i) not approving an application;
 - (ii) the imposition of conditions, if so requested by the relevant board.
- (5) (a) Any deficiency in the financial condition or position of a fund reported upon by a valuator in terms of section 16 and confirmed by the chief actuary after the date of approval of an application by the registrar, shall be a debt due to the fund, and may be recovered by the fund in any competent court from a participating employer to whom excess assets have been delivered: Provided that the reporting of the valuator shall not relate to a date later than seven years after the said date of approval.
- (b) The fund may recover from the participating employer only the total portion of the deficiency, not exceeding the market value (as at the date of

approval of the application by the registrar) of the excess assets delivered to the employer.

(c) In the case of excess assets delivered to more than one participating employer, the deficiency may be recovered by the fund from the employers, *pro rata* to the total market value (as at the date of approval of the application by the registrar) of the excess assets delivered to each employer.

(d) The provisions of this subsection shall not be construed as affecting the right of the board under any other law to recover any deficiency referred to in paragraph (a).

(6) (a) The provisions of this section shall continue to apply—

(i) where delivery of part or all of the excess assets of a fund to one or more participating employers forms part of a dissolution of the fund in terms of section 28 or 29; and

(ii) as if the liquidator concerned were the board.

(b) Subsection (5) shall apply *mutatis mutandis* in the case of the dissolution of a fund in terms of section 28 or 29, where—

(i) the dissolution occurs within seven years after the date of approval of an application by the registrar;

(ii) excess assets are delivered to a participating employer; and

(iii) the employer concerned becomes a participating employer of another fund.

(7) Any delivery of excess assets to a participating employer not done in terms of this section and rules referred to in paragraph (b) of the definition of ‘fund’ in subsection (1), shall be null and void and may be recovered by the fund in any competent court from the participating employer.”.

Amendment of section 1 of Act 58 of 1962

2. Section 1 of the Income Tax Act, 1962, is hereby amended—

(a) by the insertion after paragraph (eA) of the definition of “gross income” of the following paragraph:

“(eB) any amount received by or accrued to such person as a participating employer as defined in section 14A of the Pension Funds Act, 1956 (Act No. 24 of 1956), by way of the delivery of excess assets as contemplated in that section;” and

(b) by the substitution for item (ee) of subparagraph (ii) of paragraph (c) of the definition of “pension fund” of the following item:

“(ee) for the administration of the fund in such a manner as to preclude the employer from controlling the management or assets of the fund and from deriving any monetary advantage (other than the delivery of excess assets as contemplated in section 14A of the Pension Funds Act, 1956 (Act No. 24 of 1956)) from moneys paid into or out of the fund, except that where the employer is a partnership, a member of the partnership may be permitted to derive such monetary advantage if he was previously an employee and, on becoming a partner, was permitted to retain his membership of the fund as though he had not ceased to be an employee, his contributions being based upon his pensionable emoluments during the 12 months which ended on the day on which he ceased to be an employee and his benefits from the fund being calculated accordingly;”.

Amendment of section 8 of Act 58 of 1962

3. Section 8 of the Income Tax Act, 1962, is hereby amended by the addition to paragraph (a) of subsection (1) of the following proviso:

“Provided that the provisions of this paragraph shall not apply in respect of any

amount so recovered or recouped which has been included in the income of such taxpayer in terms of paragraph (eB) of the definition of 'gross income' .“.

Short title and commencement

4. This Act is called the Pension Funds Amendment Act, 1998, which takes effect on a date determined by the President by proclamation in the *Gazette*. 5

**MEMORANDUM ON THE OBJECTS OF THE PENSION FUNDS
AMENDMENT BILL, 1998**

Part I

Objects

All private sector pension funds are required to register under the Pension Funds Act, 1956 (Act No. 24 of 1956) (the Act), and to comply with the provisions of the Act. The Act is administered by the Registrar of Pension Funds (the Registrar), acting under the supervision of the Financial Services Board.

Unless specifically exempted, each pension fund is required to undergo an investigation by an actuary at least once every three years. This investigation determines whether the fund is financially sound and whether any remedial or other action is called for. It often happens that such an investigation discloses that the fund has assets that are surplus (hereinafter referred to as "excess assets") to its requirements for meeting its obligations to its members. The board of the fund is then required to determine how those excess assets should be applied and currently the following options are normally available:

- (a) improve the benefits provided by the fund, meeting the cost of the improvement out of the excess assets; and/or
- (b) reduce or temporarily suspend (i.e. a "contribution holiday") payment of future contributions to the fund, meeting the non-payment or underpayment out of the excess assets; and/or
- (c) retain the excess assets by way of contingency reserves.

Several other countries, notably the United Kingdom, permit a fourth alternative, namely payment of the excess assets to the employer participating in the fund. Until 1994 this alternative was resisted by the Registrar, on the grounds that the Act did not provide for it.

In 1994 the Lintas Pension Fund successfully appealed to the Appeal Board, established in terms of the Financial Services Board Act, 1990 (Act No. 97 of 1990), against the refusal by the Registrar to register an amendment to the Fund's rules that would have permitted the said alternative. The Appeal Board emphasised that it was not pronouncing on the merits or otherwise of such payments to employers. but merely on the Registrar's grounds for arguing that the Act did not provide for such payments.

While the Appeal Board's decision was not regarded as a legally binding precedent, it did nevertheless indicate that clarification of the issue had become necessary. This was emphasised by the fact that several funds had as a result of the Lintas decision lodged similar applications.

The essential ground upon which certain funds argued that such payments should be permitted, was that:

- (a) the employer was obliged to do no more than pay a contribution sufficient to preserve the financial soundness of the fund;
- (b) if excess assets developed it meant that with the benefit of hindsight the employer had been overcharged in the past; and therefore
- (c) the employer was entitled to payment of the excess assets, effectively representing a "repayment" of the "overcharging".

The essential grounds upon which the principle of such payments was opposed were:

- (a) Assets of pension funds constitute trust monies, that may only be paid out by way of benefits to members.
- (b) Excess assets arise from past financial ill-treatment of members, such as minimal pension increases (if any) and low benefits on termination of service.
- (c) Employers are not legally obliged to make good a deficiency in a fund (assets less than liabilities to members), and they therefore cannot use this as an argument justifying payment to them of excess assets.

In order to resolve the matter. the Registrar sought guidance from the Pension Funds Advisory Committee constituted in terms of section 3B of the Act. which in turn established a task group with a brief to recommend legislation that would clarify the matter conclusively. The Bill embodies the result of the task group's work, as approved by the Pension Funds Advisory Committee.

The task group, chaired by the chief actuary of the Financial Services Board, was made up of representatives of the following bodies:

Academia
 Business South Africa
 Cosatu
 Fedsal (now Fedusa)
 Financial Services Board
 Institute of Retirement Funds
 Nactu
 SA Institute of Chartered Accountants
 SA Revenue Services

The task group had two options; it could recommend legislation that prohibited payments to employers, or it could recommend legislation that would permit such payments under controlled conditions. After extensive investigation of the implications of the two options, the task group opted for the latter and the Bill gives effect to this option.

In reaching this conclusion the task group noted the following significant factors:

- (a) From a financial point of view, payment of excess assets to an employer was simply a variation of the right that the employer under a defined benefit pension fund has to take a contribution holiday on the strength of the fund's excess assets.
- (b) There was clear evidence of excess assets arising from past financial ill-treatment of members but the opportunity now existed — via the conditions that could be imposed — to rectify the matter.
- (c) Similarly, while the financing of a deficiency is not normally a legal obligation upon the employer, this could now be made a condition of being allowed to withdraw excess assets.
- (d) Prohibiting payments to employers could well prove counter-productive and to the disadvantage of members, in that it could encourage employers to under-finance their funds or convert to defined contribution funds. In contrast, permitting such payments under specified conditions would encourage proper financing of funds, leading to greater security of members' benefits and greater possibilities of improvements in benefits.
- (e) Since employers are allowed to deduct contributions to pension funds from taxable income, any repatriation of surplus assets from a pension fund should give rise to the receipt of taxable income in the hands of the employer.

Part 2

Clause by clause analysis

2.1 Clause 1 provides for the insertion in the Act of a new section 14A, dealing with the disposition of excess assets to participating employers.

2.1.1 Subclause (1) defines the excess assets as consisting of the fund's total assets minus its "minimum assets". The "minimum assets" in turn consist of those necessary to ensure that the rights and reasonable benefit expectations of members are fully secured in the course of which certain mandatory improvements in benefits are provided for (such as pension increases and more appropriate benefits on termination of employment).

2.1.2 Subclause (2) provides, *inter alia*, for all calculations relevant to the transaction to be performed on prescribed basis. It furthermore provides for full consultation with the members of the fund and the seeking of the members' approval. If the requisite level of approval of members is not achieved, the transaction may not proceed.

2.1.3 Subclauses (3) and (4) deal with the Registrar's right to be satisfied that the proposed transaction is sound and acceptable and his or her right to reject an application or approve it subject to conditions.

2.1.4 Subclause (5) provides that if the fund subsequently develops a "deficiency" (i.e. the fund's assets fall below the value of its obligations to its members), that

deficiency will constitute a debt due by the employer to the fund. There is a time and a financial "cap" on this debt. The foregoing essentially considers the situation of an ongoing fund.

2.1.5 Subclause (6) indicates the corresponding application to a fund that is being dissolved, either immediately or within the ensuing seven years.

2.1.6 Subclause (7) provides that payment of excess assets to an employer other than by way of this new section will be null and void and can be recovered.

2.2 Clauses 2 and 3 set out the consequential amendments to the Income Tax Act, 1962, to make the repatriation of surplus assets taxable in the hands of the employer.

2.3 Clause 4 contains the short title and provides for the commencement of the provisions of the Bill.

Part 3

Consultation

An initial draft of the Bill and accompanying documentation, prepared by the Financial Semites Board, were exposed for comment to:

- Association of Black Accountants
- Association of Retired Persons and Pensioners
- Academia
- Actuarial Society of SA
- Business South Africa
- Consulting Actuaries Society of SA
- Cosatu
- Grey Power
- Institute of Retirement Funds
- Life Offices' Association of South Africa
- Pension Lawyers Association
- Policy Board for Financial Services and Regulation
- SA Institute of Chartered Accountants

In addition an explanatory circular was sent to all pension funds registered with the Registrar, with an invitation to request a copy of the aforesaid documentation and to make representations thereon. Media coverage has been encouraged and several representations have arisen from that source.

Wherever possible the exposure took the form of personal presentation to the body concerned by the chief actuary of the Financial Services Board.

While valuable comment was received from the bodies consulted, on points of detail (many of which were incorporated into the final draft of the Bill), the principles involved appear to enjoy general support.

The taxation consequences were approved by the Tax Advisory Committee and amendment to the Income Tax Act, 1962, was prepared by the South African Revenue Services.

Part 4

Parliamentary procedure

In the opinion of the Department of Finance and State Law Advisers the Bill must be dealt with in accordance with the procedure set out in section 75 of the Constitution.