

TRUSTEES TURN THEIR ATTENTION TO PENSIONERS

Craig Aitchison, Head of OMAC Actuaries & Consultants



With a growing number of South African pension funds having finalised their surplus apportionment exercises, trustees are turning their attention to using any remaining surplus to improve the financial position of their pensioners.

Pension fund surplus legislation, introduced in South Africa at the end of 2001, provided for the apportionment of surplus in each fund at the date of the first statutory valuation falling due after 7 December 2001. In terms of the legislation, current and former members, pensioners and employers could benefit from the surplus that had built up in a pension fund.

It also introduced a statutory minimum for exit benefits and a mechanism to ensure that pensioners receive fair increases relative to inflation, and the investment returns achieved in the fund.

Most pension funds carried out their surplus apportionment exercises with an effective date

between 2002 and 2004. Since then, the equity markets have performed quite well, despite last year's declines. In many cases, this has resulted in a build-up of surplus in the funds, which trustee boards are now looking to allocate to improve their pensioners' monthly income.

We are talking to a number of funds whose pensioners receive low annual increases. Most of these funds have completed their surplus apportionment exercises and now have the freedom to move forward and address this issue.

There are a number of options available to trustees looking to improve the position of pensioners. Pension Funds that have purchased annuities for pensioners can buy higher expected increases or guaranteed CPI increases. Alternatively, funds can increase pensions, purchase new pensions or even make once-off lump sum cash payments to pensioners. Trustees going through this exercise should also take the opportunity to investigate the possibility of completely removing the pensions from the fund, through a process known as outsourcing.

Outsourcing involves the fund transferring the existing pensioner

liability to an insurance company, and retirees purchasing annuities in their own names. All current and future pensioners will thus own individual annuity contracts in their own name and have relationships with the insurer instead of the fund.

In the current environment, outsourcing pensioner liabilities may create a win-win solution for employers, retirement funds and most importantly, the pensioners themselves. Pensioners who rely on their former employers for their monthly pensions may be out of pocket if the business gets into financial difficulties. A business in financial distress may not be able to continue contributing to the company pension fund, thus leaving the fund vulnerable to funding deficits.

By outsourcing the pensioner liability to an insurer, the fortunes of the pensioners and the employer are split. This means the pensioners do not carry the risk that the employer might go under or cannot afford pension increases any longer. As insurers are required to maintain a minimum capital adequacy ratio, the assets of a large, stable insurer are generally considered to be far more secure.

Besides the extra security offered by insurers, in the often complex retirement funds environment, outsourcing provides access to the insurer's investment knowledge and expertise.

The insurer managing the pensioner assets has a focus on optimising returns for the pensioners. Having a larger pool of assets to manage enables effective diversification of investment risk, thus increasing the stability of returns. Pensioners will enjoy greater security in the long term, while still reaping the rewards of time in the market. ♦

