AON Hewitt

The Private Pension Schemes Act 2012

Patience is bitter, but its fruits are sweet.

˜ Jean Jacques Rousseau

A decade-long process

A decade-long process around legislative reforms of the private pension sector was concluded recently when the Private Pension Schemes Act 2012 was voted in parliament. The present Minister of Finance kept his promise. He stuck to the time table prepared just after the last budgetary exercise whereby he scheduled the issue of this Act for mid 2012. With the call for a new Financial Stability Assessment (FSA) exercise by the International Monetary Fund (IMF), the shaping of the pension legislation was imminent given the fact that the previous FSA report in 2003 recommended that Mauritius "strengthen regulation and supervision of occupational pension funds". Even the 2008 update of the FSA found the pension fund regulation fragmented among several laws and tax regulations. This will no longer be the case once the Private Pension Schemes Act is promulgated overriding at least three pieces of legislation governing private pensions till now.

Regulating and modernising the private pension industry has become urgent and crucial for the development of financial services. Especially with higher life expectancy and ageing population leading to greater dependency ratio, and with increasing labour mobility, pension reform has become a must. A new, modern, comprehensive, legal framework for regulating and promoting the private pension industry will help avoid that living standards of employees fall unexpectedly after retirement while, at the same time, maintain the affordability of pension schemes to the various stakeholders.

The current legislation

Mauritius has a multi-tiered pension system. The first tier is the Basic Retirement Pension which is paid out of general taxation, in tier two we have the National Pension Fund and the National Savings Fund for example and finally the third tier is the voluntary private pension sector. While the first two tiers are clearly defined under their respective legislations, the legislation and supervision of the third tier has been fragmented and subject to a wide variety of regulators. Approval and supervision of pension schemes has been shared between the Registrar of Associations under the Employees Superannuation Fund Act 1954, the Mauritius Revenue Authority under the Income Tax Regulations 1996 and the Financial Services Commission (FSC) under the Financial Services Act and the Trusts Act.

The private pension sector consists of about 1,500 private pension schemes approved by the Mauritius Revenue Authority under the Income Tax Regulations 1996. However, only around 50 of these schemes are registered with the Registrar of Associations under the Employees Superannuation Fund Act, some 15 schemes are set up under the Trusts Act and the vast majority are schemes managed by insurance companies and forming part of their long term insurance business. These private schemes cover more than 100,000 employees with funds estimated at more than Rs 34 billion and are expected to grow further both in terms of number of employees covered by these schemes as well as the value of funds involved. Furthermore, figures show that our

population is ageing which will lead to increasing dependency ratio and reliance on private savings.

Our fragmented legislation is not the right platform for a growing vibrant pension industry especially when we want to position ourselves as a sound and competitive international financial services centre. Absence of effective supervision raises questions as to the soundness of the pension schemes and protection of beneficiaries. In order to protect the interest of members and beneficiaries, there should be a mechanism through which we can ensure a fair, safe and efficient functioning of the pension schemes and at the same time provide a business friendly environment for the industry to grow further. Promulgation of the Private Pension Schemes Act just before the next Financial Stability Assessment is the right step towards showing our commitment to making our financial services sector well legislated in line with the norms and standards of the International Organisation of Pension Supervisors and the OECD Guidelines on governance.

Proposed changes

The new legislation is expected to provide a comprehensive and modern regulatory and supervisory framework for the operation of private pension schemes in order to ensure the protection of members and beneficiaries and the soundness of such pension schemes. While it is a general framework defining the roles and responsibilities of each stakeholder, the important aspects of the legislation will show up with the rules and regulations to be issued by the FSC or the Minister of Finance in due course. Our comments in this News Alert are therefore general at this stage, pending the issuance of such rules and regulations which we expect will also be open for consultation with operators as well as other stakeholders so as to ensure the objectives defined in the Private Pension Schemes Act are achieved.

The Act is a well thought over framework capturing all private pension schemes in or concerning Mauritius. It automatically brings under its purview all existing private pension schemes registered in Mauritius for the benefit of the local population with the exception of schemes and funds set up under existing legislation like the National Pensions Act or the Sugar Industry Pension Fund Act, and provident funds registered under the Registration of Associations Act which provide retirement benefits to their members. Besides the local pension schemes, it will also cover external pension schemes (private pension schemes set up as global businesses in order to promote Mauritius as an international centre for the provision of pension scheme services) and foreign pension schemes (private pension schemes registered in foreign jurisdictions but authorized to operate in Mauritius so as to cover, for example, Mauritian employees who become members of those schemes rather than purely local pension schemes). The foreign and external pension schemes will enjoy greater flexibility in the sense that they may be exempted from certain provisions of the Act by way of regulation or consultation with the Minister of Finance and the FSC as unique regulator.

Under the general framework laid down in the Act, the FSC will be able to license, approve, monitor, supervise and control the private pension industry in Mauritius so as to meet international standards. The Act includes the following regulatory objectives:

- maintain a fair, safe, stable and efficient private pension industry for the benefit and protection of beneficiaries;
- promote confidence in the private pension industry;
- ensure fair treatment to beneficiaries;
- mitigate the risk that the pension business is used for a purpose connected with a financial crime, and
- ensure orderly growth of the private pension industry in Mauritius.

The Act lays down requirements as regards the types of private pension schemes and the basic requirements for the licensing of each type of scheme. Although the FSC Rules will provide more details later, we understand that the current intention is for the FSC to license or authorize pension schemes that are set up as trusts or foundations only in the future. In particular, the Employees Superannuation Fund Act is being repealed and funds already registered under that Act can continue to operate but no new funds will be registered under that Act. We also understand that the assets of occupational pension schemes that are managed by insurance companies within their long term insurance business will have to be transferred to master-trust type arrangements to comply with the FSC Rules, which can help to improve transparency in these plans.

The Act provides for FSC Rules to be made regarding the constitution and management of private pension schemes, duties and functions of the pension scheme governing bodies, administrators and professional advisers, the rights and obligations of members and requirements of providing financial statements. Every private pension scheme will have to be administered by a pension scheme administrator licensed by the FSC for this purpose. Alternatively, and subject to FSC Rules, the scheme's governing body or a long-term insurer licensed by the FSC may be authorized to administer the scheme.

The Act provides for further FSC Rules regarding the management and valuation of the assets and obligations, expenses, qualifications and experience of the actuary and auditor as well as their appointment, resignation, removal, powers and duties. Furthermore, there may be restriction or regulation of the investment and borrowing powers of private pension schemes. In terms of record keeping and communications, maintenance of records on transactions and financial position as well as preparation of periodical reports and communication of those reports to the FSC and the beneficiaries will be covered.

Details about the requirements of the above will be defined in the FSC Rules and other regulations. While the framework covers the whole functioning of the private pension industry from licensing, monitoring, supervision to control, details regarding requirements under each of these elements will be crucial in determining if the market, operators and other stakeholders perceive that the FSC Rules and regulations are in line with the objectives set out in the Act. As some members of parliament and stakeholders in the industry have rightly observed, "the devil lies in the details".

It took ten years to shape the Mauritian private pension industry legislation so far. It is expected that, with this new legislation, the governing bodies will have a clearer view of their roles and responsibilities in looking after the funding and investment needs of the plans leading to greater security for the beneficiaries. The beneficiaries can expect more regular information on how their plans are doing and what they can expect from them in terms of benefits. Increased member confidence and transparency should help the industry flourish in a controlled and healthy business environment. So as to reach this equilibrium, the FSC Rules and regulations should provide for an optimum in terms of regulation and supervision. Consultative discussion with the operators and major stakeholders in the industry will ensure a drive towards this equilibrium. The Minister of Finance assured during the parliamentary debates that the FSC Rules will be as widely discussed with the industry as was the Bill leading to the Act.

We at Aon Hewitt Ltd have had the privilege of participating in this consultative process in the last 10 years and we are generally pleased that most of our recommendations seem to have been taken on board in the Act.

In particular, we welcome the FSC becoming a one-stop shop for approval of new pension schemes, the move towards trusts becoming the preferred legal vehicle for local pension plans and the revoking of regulation 5 of the Income Tax Regulations 1996 which will remove some of the more historical and unnecessary restrictions on pension plan design (unless they come back in the form of FSC Rules).

We hope to continue to be consulted in the development of the FSC Rules and other regulations which we understand could start to be issued by October this year. In the meantime, we outline below some of the key factors that we hope will be covered in the FSC Rules and other regulations.

What we hope will be addressed in the FSC Rules and other regulations

Several sections of the Act refer to a new technical funding requirement aimed at improving the security of members' benefits. This is in line with our previous recommendations that private pension schemes be subject to regular funding assessments and corrective measures be applied in cases of serious underfunding. However, we are aware that, for historical reasons, many private pension schemes in Mauritius have funding deficits when measured in line with the IAS 19 accounting standard for example. In general, we hope that the FSC Rules will provide for such funding deficits to be corrected over a number of years instead of just a few years or even immediately, which could cause significant upset and perhaps trigger the winding-up of such schemes to the detriment of the long-term interest of the members.

For example, we set out in the table below a summary of the funding position of the main

pension plans sponsored by several large listed companies according to the IAS 19 disclosures in their latest available annual reports which show the significance of some of the funding deficits. In some countries, the timeframe for eliminating any funding deficits may be several years (we would recommend the average remaining service of employees which would typically be 15 to 20 years) but the timeframe for reducing the funding deficit to a maximum acceptable level (e.g. 10% of the liabilities or minimum funding ratio of 90%) may be only one year. The last column in the table shows that this may be too drastic a requirement for many listed companies in Mauritius.

Quoted Companies	Pension plan assets (A) Rs M's	Pension plan liabilities (B) Rs M's	Funding ratio (A/B) %	Funding surplus/(deficit) (A-B) Rs M's	Injection required to bring funding ratio to at least 100% Rs M's	Injection required to bring funding ratio to at least 90% Rs M's
Mauritius Commercial Bank Ltd	3,786	4,060	93%	(274)	274	0
State Bank of Mauritius Ltd	616	590	104%	26	0	0
New Mauritius Hotels Ltd	1,854	2,541	73%	(686)	686	432
ENL Land Ltd	120	228	53%	(107)	107	85
Terra Mauricia Ltd	220	410	54%	(190)	190	149
Rogers and Company Ltd	1,154	1,145	101%	9	0	0
Ireland Blyth Ltd	600	810	74%	(210)	210	129
Bramer Banking Corporation Ltd	21	40	53%	(19)	19	15
Omnicane Ltd	143	180	79%	(37)	37	19
Vivo Energy Mauritius Limited	190	242	79%	(51)	51	27

Source: Annual reports of the respective companies for their financial year ending in 2011

Another area of potential concern relates to the investment rules and restrictions to be covered in FSC Rules. In general, we would welcome the introduction of prudential limits on self-investment and concentration of investments so as to improve the security of members' benefits, but again setting these limits and the timeframe for achieving them at the right level will be important.

For example, self-investment occurs when a pension scheme invests part or all of its assets in the sponsoring employer's securities, loans or property used by the employer. The risk here is that, if the sponsoring employer gets into financial trouble, the members may lose both their jobs and their pension benefits. Some countries advocate zero self-investment but most accept an upper limit of 10% for example on self-investment, which may be right for Mauritius as long as there is also a reasonable transition period for bringing down higher levels of self-investment to the upper limit.

Concentration of investments occurs when the pension scheme invests more than, say, 10% or 15% of its assets in a single security or property investment. Here, the risk is that, if such an investment fails, the funding ratio would go down significantly and reduce the members' security of benefits accordingly. Again, it is important that a balance is struck between a limit which is too low and impractical for Mauritius or too high to be effective.

While contributions to approved pension schemes from employers are tax deductible, similar contributions from individuals are not directly tax deductible for them. Such a system makes savings towards retirement taxed twice for individuals, initially when contributing and afterwards when receiving the benefits at retirement, eroding any incentive to save towards retirement. We will continue to urge the Government to reconsider this issue. Alternatively, an incentive in another form like tax credits/savings credit would also be welcomed. We have previously proposed a system of savings credit and/or tax credits like the Saver's Credit in the USA whereby anyone who makes an effort to set aside funds for retirement is rewarded through an additional State contribution which can be limited up to a ceiling in order to prevent abuse and to target only those in need of such additional income.

Although members of occupational pension schemes are allowed to request a transfer of the value of the pension rights when they change

employment, the portability rights that are transferred from defined benefit schemes do not necessarily make allowance for any protection against future inflation. The consequence is that employees may have unrealistic expectations as to the true value of their portability rights. Deferred pensions should ideally be protected against the eroding effects of inflation or, at the very least, members of such occupational schemes should be made aware of potential pension losses on leaving their employment through better disclosure and regular employee communications.

During the parliamentary debates on the Bill, one of the members suggested that there should be a requirement for pensions in payment to be increased in line with the increase in the CPI each year to protect the pensioners' purchasing power during their retirement. This is indeed a desirable feature of pension plan design which could be encouraged but which, in our view, cannot be made compulsory in the context of pension plans set up voluntarily by employers. In order to avoid imposing unduly high and unexpected costs on current schemes, this requirement could apply only to future service benefits under current schemes or new schemes set up in the future. However, we would not recommend even such a limited move which has been made in the UK several years ago and which has not prevented a massive closure of defined benefit plans there to the detriment of many members.

Finally, we hope that the fees imposed by the FSC on private pension schemes or their licensees would be rational and well thought out. High compliance cost may have a negative impact on the pension industry.

Conclusion

The decade-long process of Government consulting with the different stakeholders around the legislation of the pension industry, together with local and international advisers, is bearing fruit. We appreciated the fact that the Ministry of Finance and Economic Reforms and the Financial Services Commission have actively engaged all stakeholders including us at Aon Hewitt Ltd and seem to have taken on board most of our comments and suggestions. We hope to continue in the same line and are eager to provide our support and experience, acquired while working with numerous local and international pension schemes, towards consultation regarding the FSC Rules and other regulations to follow later this year.

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