

EXERCISING ACTUARIAL DISCRETION IN THE PRICING OF TRANSFER VALUES

By MW Lowther

ABSTRACT

This paper considers professional aspects of how actuaries should determine retirement-fund transfer values subsequent to the introduction of statutory minimum benefits in South Africa. It reviews past practices and in particular the exercise of actuarial discretion. It concludes that, in the future, there will still be scope for actuarial discretion when transfer values are determined. In exercising this discretion, actuaries must take decisions that are justifiable in terms of the reasons given, report adequately on such decisions and the impact thereof, and clearly indicate that the information should be distributed to all the parties concerned.

KEYWORDS

Professionalism; transfer values; statutory minimum benefits; actuarial discretion

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1. INTRODUCTION

Generally, the actuarial profession has not served fund members well in the past, often working in cahoots with employers against the interests of ordinary members.

—B Cameron, *Personal Finance*, 2003

1.1 The fundamental motivation for this paper is professionalism. It is hoped that busy practitioners can use it as a stimulus for analysing and evaluating their own practices. The paper, therefore, does not prescribe any ready-made solutions.

1.2 Because this work did not produce a practical logical solution, the value of this work has been questioned. This perception goes right to the nub of the matter. The paper motivates why each transfer situation requires independent actuarial thought and discretion—just as is required for statutory valuations, but even more so because exit prices are being determined, not just funding rates.

1.3 It is also hoped that this historical and philosophical review may serve as:

- a text for actuarial students; and
- a reference document for legal disputes (where some past judgments have, in my opinion, been based on a misunderstanding of the transfer process).

1.4 Section 2 describes the challenge that transfer values set for actuaries.

1.5 Sections 3 to 6 form a literature review and may be skipped over by those up to date in the subject. Information is presented regarding the transfer debates in the UK and South Africa, pricing methodology, and recent court and adjudicator rulings.

1.6 The new minimum-benefits legislation is discussed in Section 7. It is apparent that there will still be scope for actuarial discretion in the new environment. Section 8 draws on the above information to outline areas in which actuaries might wish to re-evaluate their practice. Some personal conclusions by the author are given in Section 9.

1.7 It is good practice in contemporary research for researchers to acknowledge their positions. I came to this project as a result of experiences both as a retirement-fund trustee receiving advice from actuaries, and as an expert actuarial witness in various retirement-fund disputes. If I am perceived to be critical of any past practices, I nevertheless acknowledge that I was not in the firing line at the time!

2. THE CHALLENGE OF TRANSFER VALUES

I believe, however, that your assertion that the actuarial profession has generally not served fund members well in the past, is an unfortunate and unjustified generalisation. I believe that the opposite is indicated by the success of the retirement fund industry, the security that funds have generally offered members, the high regard many employees have for retirement benefits and, in my personal experience, the high regard many fund trustees have for actuaries. I believe that the actuarial profession and actuaries, though far from perfect, can be proud of their contribution to the retirement fund industry.

—J Ferreira, ASSA President, 2003, in reply to B Cameron

2.1 Stocker *et al* (1999) believe that the nature of retirement provision within a country reflects the culture of the country, and changes naturally as the underlying cultural values and imperatives change. Referring to the United Kingdom, they note that the 1960s and early 1970s were characterised by the cultural values of loyalty and collectivism. This tendency was reflected by defined-benefit pension funds (DBPFs), which mainly rewarded long-serving employees by awarding pensions that were calculated as a fraction of their lifetime earnings. However, as high inflation caused concerns over the worth of such ‘career-average’ pensions (as they were known) the benefit was often changed to a fraction of the employee’s final salary. This change had the unintended effect of increasing the disparity between the rate at which a member’s benefits accrued and the rate at which they were funded. This situation would, however, not occur under some less common funding methods—such as deferred annuities.

2.2 From the late 1970s, the cultural values of individualism became dominant, and accordingly, solidarity and paternalism started to disappear from pension-fund designs. Two of the key elements of a pension funding arrangement are contributions and benefits.

In some arrangements, a member's benefits are strongly related to his/her contributions. 'Solidarity' could be interpreted as the extent to which benefits are provided "to each according to their needs". In South Africa, the state old-age pension gives the most solidarity, followed by defined-benefit (DB) funds, defined-contribution (DC) funds and individual retirement annuities.

2.3 Where members share no risks with each other, it is usually simple to earmark such members' past contributions to the fund, plus debits and credits, as equal to their liabilities. There is thus a match between assets (contributions) and liabilities (benefits). As more and more risk sharing is introduced, there is a mismatch between the assets contributed by (and on behalf of) the individual and the liabilities undertaken by the fund in respect of that individual—as seen in the extreme example of a state old-age pension, where taxpayers contribute but only eligible citizens may benefit.

2.4 The word 'transfer' is sometimes used to refer to a benefit specified in the rules of a fund. For example a defined benefit payable on resignation may be transferred to another pension fund. In this paper, however, the subject under discussion is the transfer of a member's interest in one fund to another fund—a quid pro quo for a member who gives up the right to various benefits in the fund. The quantification of such interest is problematical where there is an element of solidarity in the fund; and even more so when the rules are silent. This state of affairs is the challenge that actuaries are uniquely placed to resolve using actuarial judgement.

2.5 As will be discussed in some of the court cases in Section 6 of this paper, actuarial judgement is not judgement made by an actuary but rather judgement made by an actuary using actuarial techniques. A comprehensive description of the general principles of actuarial science was compiled by a working party of the Society of Actuaries in America under the chairmanship of Gutterman (1998). They stated *inter alia* that:

The primary focus of actuarial work is on the financial and economic consequences of events involving risk and uncertainty. Actuarial practice involves the management of these implications and their associated uncertainties. To gain insights about future possibilities, the actuary depends on observation and wisdom gained through prior experience. The actuary uses these observations and this experience when constructing, validating and applying models.

3. THE UK TRANSFER DEBATE

If the worst comes to the worst, do you want a pension or a job?

—J Goford, Presidential Address to the Institute of Actuaries, 2002

3.1 GUIDANCE NOTES

3.1.1 The Faculty and Institute of Actuaries (to which most South African actuaries belong) have a number of standing guidance notes (GNs) which are relevant to transfer values. In this paper, the author has quoted from a 2000 edition of the Guidance Notes. In practice, they are continually updated.

3.1.2 GN11 seeks to ensure that members of retirement benefit schemes exercising a right to a transfer value can be assured that it fairly reflects the benefits otherwise available following withdrawal with entitlement to a deferred pension. At 3.1 it is stated:

It is a fundamental requirement that a transfer value should represent the actuarial value of the benefits which would otherwise have been preserved for the member. Such actuarial value should represent the expected cost within the scheme of providing such benefits and should be assessed having regard to market rates of return ...

3.1.3 This guidance only applies to UK pension funds, and indeed compliance with GN11 is a requirement of UK legislation. Following a recent change in legislation, GN11 now provides that a transfer value may be reduced if there is a deficit in the transferring pension fund; and it also permits discretionary benefits to be ignored in certain circumstances. The actuary must provide a report to the trustees on any reduction, and such a report may be based on an approximate valuation of the assets and liabilities.

3.1.4 GN16 covers the certificate that an actuary is required to issue should trustees wish to effect a bulk transfer of retirement-fund members without their consent. The actuary has to consider the credits that the transferring members will receive in the transferee scheme, and does not have to consider the reasonableness of the amount of the bulk transfer value. In the case of a transfer, without consent, from a DBPF to a DC scheme, a certificate cannot be given. However, there would be nothing against a transfer to a DC fund if the member were to give informed consent.

3.1.5 GN27 advises actuaries on the valuation basis for the minimum funding requirement (MFR) required by the Pensions Act of 1995. Very briefly, this act requires schemes to have assets at least equal to the total of all member's notional transfer values, calculated on a comprehensively specified basis. Discretionary benefits may be ignored, and liabilities calculated using long-term rates of discount have to be adjusted to allow for current market conditions. GN27 is expected to become obsolete soon because the minimum funding requirement is being discontinued.

3.1.6 GN29 discusses the duties of actuaries advising trustees or employers regarding retirement benefit schemes. The actuary's duty of care is stated to extend to persons and organisations who can reasonably expect to rely on the advice and information for the purposes for which it is given. The conflict of interest which arises when an actuary advises both the trustees and the employer is explored.

3.1.7 GN34 covers the illustration of DC pension benefits. The purpose is to require that appropriate illustrations are made and sufficient information is given to enable the recipient to appreciate the risks involved in a DC arrangement. This guidance may be superseded by a new statutory illustration basis, which does not require risks to be identified.

3.2 THE TRANSFER DEBATE BEFORE 1997

3.2.1 Before the passing of the Social Security and Pensions Act of 1985, there was no obligation on UK funds to offer a transfer value at all. Thereafter, members of

retirement funds had a right to a 'cash equivalent', but the amount was left solely to the discretion of the trustees and actuaries, in the latter case guided by GN11. In Institute of Actuaries (2002), Mr L Edmans recalled a 1993 survey of transfer value bases then in use by various actuaries. The range for a man aged 30 for an identical paid-up pension of £1 000 sterling at age 65 was a transfer value of between £500 and £6 000. The range for a man at age 45 was between £3 000 and £6 250, and the range for a man at age 60 was between £6 300 and £11 000. Edmans also noted that the transfer values calculated by consultants were approximately 15% less than those that were quoted by actuaries employed by insurance companies.

3.2.2 Although there was some criticism within the profession that such variances were inappropriate, there were also arguments in mitigation. For example, in a statement issued by the Faculty and Institute of Actuaries¹ it was stated:

In our opinion, it takes a very experienced practitioner to know and be able to evaluate all the factors that ideally would be taken into account when advising an individual on the pro's and con's of transferring paid-up benefits from any given pension fund.

3.2.3 The Faculty and Institute went on to suggest what the author would describe as a 'freedom with disclosure' approach by calling for retirement funds to provide details to potential transferees of the benefits given up, the basis of calculation, whether discretionary benefits were taken into account, and any reduction on account of a deficit in the fund. They noted that discretionary benefits could not be a mandatory item in a transfer calculation, otherwise these benefits would no longer be discretionary. They cautioned actuaries to note the effect of transfer values on the security and solvency of the fund and its remaining members.

3.2.4 Other writers noted that the fund should not be seen in isolation from the employer. Singer² asked:

Why should employers who have carefully considered the appropriate investment policy for their schemes, choosing largely equities with the aim of minimising their long-term costs, be forced to pay increased transfer values reflecting a more costly method of pension provision?

Cox (1995) drew attention to the future intentions of the employer, noting that the likelihood of the employer's business continuing as a going concern should be taken into account. Arthur³ made similar remarks.

3.2.5 An important aspect of freedom with disclosure as regards bulk transfers was the detailed procedures generally followed by the parties involved. Ure (2000) compiled a practical handbook on pension transfers and wind-ups in the UK. He reports that a bulk transfer would normally be preceded by an agreement between the parties regarding the calculation of the retirement-fund transfer values. This agreement would

1 Faculty and Institute of Actuaries (1994). Transfer values and opt-outs

2 Singer C (1996). Transfer values and the minimum funding requirement *The Actuary*, May

3 Arthur TG (1994). Cautious actuaries? *The Actuary*, November

cover, *inter alia*, the date of transfer, the actuarial method, the benefits, the assumptions, the asset valuation, post-calculation events, costs and dispute resolution mechanisms. The actuarial aspects would be provided by the so-called ‘actuary’s letter’, to which the transferee actuary would need to agree. The transferor actuary would make the calculations accordingly, and the transferee actuary confirm their accuracy, or at least reasonability.

3.3 THE RISE AND FALL OF MFR

3.3.1 Individual transfer values had to be increased, if necessary, to the MFR basis, once it became operative in 1997. Critics of the minimum basis argued that it was arbitrary, complex and often unsuitable for particular schemes. For instance, Mr MR Slack, in Institute of Actuaries (2002) argued that:

If you set a minimum, people say: “If that is the minimum, why do I have to pay any more?”

In fact, the Chairperson of the Pensions Board of the Faculty and Institute of Actuaries issued a letter in 2002 to all scheme actuaries pointing out that the MFR test had progressively weakened because, *inter alia*, it had not been updated to allow for falling yields, inflation and life expectancy. He described the payment of transfer values on the minimum basis as ‘close to untenable’. Everett⁴ gives an analysis of these events. Thornton⁵ made similar remarks, but added also that differences in transfer values over time within one scheme were more concerning than contemporaneous differences between schemes. Supporters pointed out that the MFR basis did, at least, limit the range of transfer values and did something towards getting fair value for transferees.

3.3.2 The Myners Report on institutional investment⁶ recommended the abolition of the MFR from the point of view of its main function of enhancing members’ security. A recent green paper has proposed that the MFR be replaced with a scheme-specific funding regime agreed by the trustees and employer on the advice of the scheme actuary. It therefore appears that there will no longer be a statutory underpin to transfer values.

3.4 THE WAY FORWARD

3.4.1 Anticipating the demise of the MFR, the Institute of Actuaries (2002) held a debate on the desirability of a statutory minimum transfer basis. Thirty-eight of those present voted for a statutory minimum, whilst twenty-nine voted against. Perhaps more importantly, vital issues were explored—such as the desirability of professional judgement, and the need for transparency. In that debate, Mr JM Lowes argued that infallible rules would be the ideal system, but were probably unattainable. Failing that, there should be agreed principles, and failing even that, freedom with disclosure. The

4 Everett (2003). Returning transfer values to fair value *PMI News*, January

5 Thornton P (1994). Transfer values and minimum solvency *The Actuary*, May

6 Myners P (2001). Institutional investment in the United Kingdom *HM Treasury*

third approach, however, relies on the buyer having the freedom to choose between different products, and also being able to understand the disclosure given. Ms WM Beaver's (*ibid.*) opinion on this issue was:

If there were to be no statutory minimum cash equivalent transfer value, then clearly, we in the profession should look to ways of maintaining a reasonable uniformity of approach to the calculation, but that should not get in the way of individual professional judgement. I should like to look for some sort of norm from which the actuary was entirely free to depart where the circumstances justified it. I would also suggest ... a standard document for disclosure to the members, which set out clearly what the policy of the trustees was for calculating transfer values ...

3.4.2 However Mr JG Spain (*ibid.*) doubted whether the general public understood these issues, and that, in his view, was the problem of DBPFs.

Trying to set up a transparency statement along the lines of 'Myners' is going to be great work for consulting actuaries who are experts in communications, trying to explain these to members of pension schemes who, after three minutes, will nod off and later ask the chap next door: "Did you understand what was going on?"

3.4.3 The author's own enquiries have indicated that current practice for bulk transfers usually involves separate actuaries advising each side, as set out by Ure (2000). Disputes will inevitably arise, partly because of the level of scrutiny, and these are sometimes settled commercially. Individual transfer liabilities are predominantly discounted at an average of long-term gilt and equity yields, in proportion to the fund's asset profile. In current market conditions, the actuary will also consider action to ensure that transfers do not damage the interests of continuing members.

3.4.4 What is also notable at the time of writing is the paucity of bulk transfers because very few schemes can afford to pay what a buyer would want.

4. THE TRANSFER DEBATE IN SOUTH AFRICA BEFORE MINIMUM BENEFITS

When the trustees of the fund spoke about the full actuarial reserves being transferred, we took it at face value and on trust that the full value of reserves set aside for our members would be transferred. We did not expect the trustees to hold back 40% of our members' money based on a play of words.

—M Samela, *Sandton Chronicle*, 2000

4.1 SECTION 14 OF THE PENSION FUNDS ACT

4.1.1 Transfers of pensions business in South Africa are regulated by section 14 of the Pension Funds Act⁷. Accordingly, the Registrar of Pension Funds has to be satisfied that a proposed transfer is reasonable and equitable and accords full recognition to the rights and reasonable benefit expectations of the persons concerned in terms of the

7 Pension Funds Act, Act No. 24 of 1956

rules of a fund and established practice. The Registrar must also be satisfied that the proposed transfer will not endanger the financial soundness of any fund.

4.1.2 Accordingly, the Registrar issues guidelines from time to time, the latest being PF Circular 78 of February 1993. (A revised guideline was imminent at the time of writing.) In this circular it is stated that the valuator of the transferor fund must submit a report setting out

- the basis and method used to calculate the transfer values;
- whether this basis differs from that of the previous valuation (and if so, why);
- sufficient particulars to enable the Registrar to determine whether transferring members' reasonable benefit expectations (RBEs) have been met;
- the valuator's opinion as to whether the transferring members' RBEs have been met;
- the valuator's opinion as to whether the RBEs of non-transferring members have been detrimentally affected; and
- how the funding level of the fund is reflected in the transfer values.

4.1.3 A similar report is required, *mutatis mutandis*, from the valuator of the transferee fund. The principal officer must certify that members have been properly informed, in writing, of the effect of the proposed scheme.

4.1.4 It is noteworthy that the current process does not require certification from the trustees of the fund. However, in terms of the exposure draft of the proposed new circular, the trustees will have to take joint responsibility with the valuator for equity and RBEs.

4.1.5 There is also a requirement in the Registrar's PF Circular 86 regarding transfers as a result of a conversion from defined benefits to defined contributions. Information that should be provided to transferring members should consist of a personal benefit statement illustrating the effect of the conversion, stressing the difference in benefit structure and the resultant transfer of investment risk.

4.1.6 Milburn-Pyle (1994) writing in his personal capacity of experiences at the Financial Services Board (FSB), noted how some valutors' section 14 reports were exemplary, whereas others were "to say the least careless or casual (almost implying contempt for the Act requirement)." He reported that his decision referent for approval of a section 14 application was whether the pro-forma questions had been answered satisfactorily in the valutors' reports. Evidence in the Pepkor matter (see section 6 of this paper) confirmed how little scrutiny the Registrar's office is able to give to a section 14 application, and by implication, how much the Registrar has to depend on the valutors' reports.

4.2 PROFESSIONAL CONDUCT STANDARDS

4.2.1 Unlike the UK professional bodies, the Actuarial Society of South Africa (ASSA) has not hitherto issued any guidance notes specifically dealing with the pricing of transfer values. Limited guidance may be derived from the general Guide to Professional Conduct⁸, which states:

8 Actuarial Society of South Africa (1995). Guide to Professional Conduct

3.3 If a member has reason to believe that any advice that he [*sic*] gives will be transmitted to a third party he must take all reasonable steps to ensure that his authorship and responsibility are acknowledged to the third party, that any implications of the advice to which he has drawn attention are stated and that his advice is not presented in a way likely to give a misleading impression.

7.2 A member will exercise his best judgement to ensure that any advice given by him is based on sufficient and reliable data, on adequate and appropriate assumptions and on sound actuarial principles. The implications of the advice being given should always be explained and in terms suitable to the circumstances.

4.2.2 ASSA has issued three guidance notes specific to retirement-fund matters. These include only passing references to transfer values. PGN 201 (Retirement Funds – Actuarial Valuation Reports and Related Topics⁹) is classified as mandatory for statutory valuations, but only as best practice for other valuations. Other valuations are listed as including the group transfer of members. At 13.1, it is stated that:

In such cases, the actuary should carefully examine the method and the assumptions used in the valuation to make sure that they are appropriate for the circumstances.

PGN 204 (Actuarial Discretion in terms of Retirement Fund Rules, *ibid.*) came about as a result of the Sentrachem matter (see Section 6 of this paper). This guidance note does not recommend any particular practice. Rather, it encourages actuaries to alert trustees to the need for fund rules or practice notes to provide clarity as to how the actuary should approach a particular situation, such as pricing a member's so-called 'actuarial interest in the fund'.

4.3 GENERALLY ACCEPTED ACTUARIAL PRACTICE

4.3.1 The author has heard the term 'generally accepted actuarial practice' used, particularly during litigation. As far as he is aware, the term does not appear anywhere in ASSA's professional guidelines, and the concept seems to have the potential of being so malleable that it can support any particular action under dispute. In any event, it may not be an adequate defence to claim that "everyone else does it" (Lowther & Mort, 2002).

4.3.2 That said, Berg¹⁰ compared what he considered common transfer methodologies at the time in the UK and South Africa. The UK approach was to calculate the present value of accrued benefits, with no allowance for future salary increases, but limited allowance for pensions increases. Benefits were discounted at long-term gilt and equity rates. A market-value adjustment was then applied to allow for market values, which at the time usually increased the transfer value. By comparison, the South African approach was to calculate the actuarial reserve used for long-term funding purposes, which allowed for future salary increases. Market-value adjustments (or a share of

9 Actuarial Society of South Africa (1999). Professional Guidance Notes

10 Berg MW (2001). Actuarial practice in South African and UK pensions *The Actuary*, March

investment reserves) were not usually incorporated. Interestingly, Berg made sample calculations which showed that the two methods produced fairly similar results, South Africa paying slightly more for younger transferees, and the UK benefiting the older ones.

4.3.3 Asher (2001) concurred with this description of common South African practice:

The actuary will, in almost all instances, base the transfer values on the actuarial reserves calculated on the same basis as used in the previous valuation. Problems may arise if the method and assumptions used to calculate the reserves are imprudent, or fail to take all considerations into account. In particular ... members being transferred may need some compensation for the loss of the protection offered by contingency reserves frequently included in an actuarial balance sheet ...

4.4 REASONABLE BENEFIT EXPECTATIONS

4.4.1 Mr CC Newell led a task force of ASSA to investigate whether guidelines could be formulated for the recently introduced concept of RBE. Because of the extremely wide range of benefits and situations that the team envisaged could arise, it was decided to express the guidelines in terms of general principles against which any particular situation could be tested. Principles 3.4 and 3.5 read (Newell, 1992):

3.4 The determination of any RBE, the level of which is expressed in terms of a calculation of an actuarial nature ... must be done on the basis used at the last statutory valuation ... Any deviation from such basis in calculations which reflect benefit expectations must be justified by the actuary and will be subject to the prior approval of the Registrar of Pension Funds.

3.5 In the event of a deficit in a fund, all classes of membership concerned in a transaction must be dealt with equitably so that the RBE of any member or class of member shall not be prejudiced relative to any other party.

4.4.2 These principles are motivated as giving proper effect to intentions expressed via the funding programme to determine the real value of a benefit. Newell goes on to discuss potential defects in his proposals. One is that they do not prevent so-called 'cherry-picking', a ploy by which the surplus or the investment reserve of a pension scheme is engineered to benefit a few members only. But he suggests that this is best dealt with by other means. Another is that future death benefits based on past service are surely an RBE, yet there may be no reserve held in that respect because of a current-cost funding method.

4.5 THE 'R80 BILLION' SURPLUS

4.5.1 A number of writers have described how surpluses arose in many South African DBPFs as a result of the bulk transfer of many members to DC schemes during the 1980s and 1990s. It need not be debated here whether the surplus really amounted to R80 billion as suggested, and if so, whether all the surplus arose from transfers. D Lester (unpublished) quotes incomplete data received from the FSB, indicating that the surplus

was actually in the region of R30 billion. There was certainly some fire behind the smoke, enough to prompt Gluckman & Kamionsky (1997) to raise a number of concerns.

4.5.2 They first noted that employers, trustees, actuaries and consultants operated in an environment with very little explicit legislation applicable to conversions, virtually no legal precedent, no actuarial guidance notes and no controls over who might advise on conversions. Their understanding was that the practice of many actuaries had been one of merely certifying that the transfer value in respect of each member represented full value for accrued rights in the transferor fund. This value would typically be calculated as an actuarial reserve using the same method and basis as employed for the most recent statutory actuarial report, hence releasing the investment reserve to surplus.

4.5.3 They referred to work by Messrs Le Roux and Pillay, which had been written in their personal capacities, although both were employees of the FSB. Le Roux and Pillay had made the point that actuarial reserves, while appropriate in a funding situation, are not necessarily appropriate in a transfer situation. Le Roux and Pillay believed that the valuator must apply his or her mind to determine whether such a value is a proper and fair value in the specific circumstances. Gluckman & Kamionsky (*op. cit.*) took this to imply that certain senior FSB officials did not share the official view that to transfer actuarial reserves would satisfy members' RBEs. If every member agreed to the transfer after properly understanding the terms and conditions of the transfer—as well as the potential effect on their benefits—then there would have been a more fair test of the attainment of RBEs.

4.5.4 Gluckman & Kamionsky (*op. cit.*) also argued that if the actuary had felt it was fair to make an adjustment to asset values for purposes of the statutory actuarial valuation, then the implication was that this adjustment should be reflected in conversion values if the intention was to offer a fair value on conversion.

4.5.5 Introducing Gluckman & Kamionsky (*op. cit.*) at the ASSA convention of 1997, Le Roux expanded on his view as follows:

... I have some arguments against the use of withdrawal decrements where they affect the actuarial reserves adversely (usually when withdrawal benefits are inferior to other benefits) ... An actuarial value incorporating withdrawal decrements actually penalises a member for the possibility of future withdrawal. If a member stays on to retirement in a defined benefit fund, that penalisation falls away. By transferring the actuarial reserve to a defined contribution fund, that penalisation is entrenched in the new fund—even for those members who stay on to retirement ... I am convinced that the minimum conversion value should be at least equal to the present value of the accrued pension, i.e. an actuarial reserve with no withdrawal decrements.

4.6 THE ASSA RETIREMENT FUND SURPLUS COMMITTEE

4.6.1 In February 2001, ASSA received the report of its Retirement Funds Surplus Committee. This committee had been appointed to inquire into matters regarding transfers, with particular reference to the disposal of retirement-fund surpluses. The Committee posed the question whether there was any justification for the actuarial profession to support or promote measures that might be regarded by some as interference

in the affairs of employers. The Committee's view was that the implementation of minimum bases and standards of practice was justified on the following grounds:

- Although the provision of retirement benefits is voluntary, membership of a retirement fund, where it exists, is compulsory for eligible employees in terms of existing income tax legislation. An employee who is unhappy with the employer's retirement funding arrangement is therefore at a disadvantage, which increases the onus on those concerned with the management of the fund (including the actuary) to protect the interests of the members. [However, Mort (unpublished) shows how difficult it is for members to enforce their rights.]
- There has been a steadily increasing flow of complaints, allegations and media reports over the past few years involving dissatisfaction with transfer and other termination benefits. It is evident that the absence of a measure of consistency in the actuarial determination of such values has led to some confusion in the eyes of the public with regard to the role of the actuary. Differences in values that may be explained and justified in actuarial terms are seldom understood and appreciated by the general public.
- Despite a significant trend towards improving the benefits of early leavers, many funds still provide inadequate withdrawal benefits. This tends to reinforce a view that seems to be held by many people, namely that retirement funds represent poor value for money and that actuaries should partly carry the blame.
- The profession has recently placed much more emphasis on the need for actuaries to have regard to, and better serve, 'the public interest'. This concept, which is closely related to that of 'reasonable benefit expectations', calls for a rethink of past practices.

4.6.2 The Committee noted that a minimum view of RBE would be formed (in a generally descending order of importance) by:

- the rules of the fund as set out formally and in summary booklets;
- what had been formally communicated to members by trustees and the employer;
- the past practice of the fund; and
- the practice of other funds.

However, the Committee was inclined to support a wider view. It was suggested that a member who has moved between retirement funds during his or her career and has preserved the amounts available on each change of employment, should have a reasonable expectation of receiving an acceptable pension on retirement.

4.6.3 Regarding professional issues, the Committee stated:

- It is not necessarily the responsibility of the actuary to advise on benefit design. The 'Notes issued by Council ...' make it clear however, that the actuary should be completely free to raise the possibility of extending the scope of any advice he gives. In this context, the Committee believes that actuaries should comment on benefits or transfer values that may be inappropriate or unfair.
- While actuarial methodology can be complex, it is incumbent on the actuary to be entirely transparent in showing his or her assumptions and methodologies. The Guide to Professional Conduct is clear in section 3.3 that the actuary should take care that third parties are not misled by his or her report. The financial consequences of any decisions being debated ought to be clear to all interested parties.

4.7 CONSUMERISM AND COMMERCIALISM

4.7.1 Andrew (1998) suggested a draft code of conduct for actuaries in situations such as the distribution of surplus in a retirement fund:

- The actuary should be impartial.
- The actuary should be prepared to give the same advice to any of the stakeholders.
- The actuary should avoid any statements which might mislead any of the stakeholders.
- Where one or more stakeholders will be given a choice between several actions, sufficient information must be given to enable a proper choice to be made.

For these purposes, a deficit could be thought of as a negative surplus.

4.7.2 Andrew (unpublished) noted how actuaries were biased by training to the collective rather than the individual. Thus, when society was moving to individualism, such inclinations could be seen as anti-consumerist:

There is still a role for judgement in cases which do not fit the exact scenarios of the professional standards, but there will have to be a high degree of certainty that ten different actuaries, faced with the same non-standard scenario, would each separately combine judgement with technique to arrive at something acceptably close to the same answer.

4.7.3 These issues were also discussed at ASSA sessional meetings on professionalism in September 2003. It was suggested that an actuary might take a different approach in his/her report if it was known that all parties to a transaction were being advised by their own actuaries. Such situations made it easier for an actuary to serve the client.

5. PRICING THEORY

Modern finance theory ... has thrown new light on ... the fundamental question of how individuals and society allocate scarce resources.

—H Davis, Lubbock Lecture, 1996

5.1 A key concept behind funding valuation is that the assets and liabilities are projected within a consistent framework. Consistency is taken to force the use of a single rate of interest for discounting liabilities and the assets which are employed to fund them, irrespective of the risk profiles of the assets and liabilities. To the extent that the assets enjoy a risk premium in their expected returns, and the funding method discount rate reflects this, a lower valuation for any associated liabilities will result.

5.2 Exley, Mehta & Smith (1997) examined DB pension schemes using insights from financial economics, in which market values are generally used for decision-making. In contrast to a funding valuation, the market approach would use different discount rates for cash flows of different risk. To value a set of liabilities, therefore, one first needs to identify a set of traded cash flows (the ‘hedge portfolio’), and then observe the market price of the traded cash flows. They pointed out that traditional funding methods do not price liabilities. Discounting is merely a convenient shorthand to show the funding level. Funding levels can also be shown through cash flow projections, and other methods. This is not to say that traditional funding methods are inappropriate for the right purpose. They can and do fulfil

our actuarial motto of ‘making financial sense of the future’. However, any putative ‘price’ extracted from a traditional funding method is incidental to its main objective.

5.3 Exley, Mehta & Smith (*op. cit.*) put transfer values in an interesting perspective by noting that the same methodology should apply to a transfer value as to a shareholder calculating the spot price of an employee’s benefits in a labour negotiation.

5.4 Having surveyed the then current British practice, they concluded:

When actuaries talk with economists about valuation, there is plenty of scope for confusion over terminology. An actuarial funding valuation has a different purpose from an economist’s value, and the different methods employed reflect this. However, there is a remarkable lack of clarity, not only as to when one method or another should be used, but also to the theoretical basis for calculations currently carried out as a matter of routine. Worryingly, this confusion seems to extend even to standard student textbooks on the subject.

5.5 Students sitting for their final examination in pensions in the last two years will be familiar with the classic paper by Head *et al* (2000) on the subject of pension fund valuations and market values. The paper was the output of a working party assembled by the Faculty and Institute of Actuaries.

5.6 Head *et al* (*op. cit.*) agree with the comments of Exley, Mehta & Smith (*op. cit.*) that valuations have different purposes such as funding, commercial, accounting and regulation. They then note how the market value of a portfolio of assets is the result of a balance between supply and demand, and that whilst individual market participants may make their own assumptions and judgements, the market price represents a ‘democratic financial decision’ which, actually, is not driven by any particular set of assumptions at all:

In principle, a pure application of financial economics to the valuation of liabilities would lead to a ‘market price’ of the liabilities, which is similarly derived from market price information, without any individual or subjective assumptions or judgements. In practice, ... there are aspects of systemic risk within pension schemes which cannot be priced from the market very well, if at all. Examples of this are the extent to which future real salary growth net of price inflation will vary according to changing economic conditions, and demographic factors such as unknown future rates of withdrawal from service, early retirement, etc.

5.7 Head *et al* (*op. cit.*) thus concede that there is not a uniquely correct market price for any given pension liability because there is no traded market in final salary pensions. Nevertheless, financial economics offers a methodology for establishing an economic or ‘market-consistent’ valuation. This term denotes a valuation that would be consistent with the feasible range of market prices, if a true market were actually to exist. Furthermore, the concept of a range of price is not uncommon within asset pricing

generally. Head *et al* (*op. cit.*) thus see financial economics offering the opportunity for a more explicit and transparent approach to setting assumptions and applying judgement.

5.8 Thomson (2002) proposed that, for a given market in equilibrium, and a given stochastic asset–liability model, the liabilities of a DBPF are uniquely determined. This thesis is not inconsistent with Head *et al* (*op. cit.*) since the latter proposed that “there is no unique price, so we need a model” whereas Thomson puts it in reverse: “If we have a model, then there is a unique price”.

5.9 Head *et al* (*op. cit.*) described four broad groups of valuation methods which take assets into account at market value, as well as the so-called traditional method. Briefly these are:

- the traditional method, in which both assets and liabilities are valued by discounting cash flows, the difference between the actuarial value of assets and the market value being known as the market-value adjustment (MVA);
- method 1, the MVA approach, in which the inverse of the MVA is applied to the liabilities derived under the traditional method to give a market-adjusted value;
- method 2, which uses an asset-based discount rate, i.e. an average of the implied market discount rate for each asset class, weighted by the actual distribution of assets;
- method 3, the economic value based on bond yields, in which the inflation rate, the discount rate and related assumptions are derived directly from market information (this is the method derived from financial economics); and
- method 4, which uses bond yields plus a risk premium, the discount rate in method 3 being adjusted to take account of returns other than bonds.

5.10 It is interesting to note from the survey by D Lester (unpublished) of twenty-two South African retirement fund valuers, only four actuaries used straight market values for statutory valuation purposes. Preferred choices were the use of discounted cash flows, or a rolling average or percentage of market value.

5.11 Head *et al* (*op. cit.*) conclude:

All of these methods allow for subjective input (both demographic and economic), to a greater or lesser extent, and so all can be called methods that allow for actuarial judgement, although some methods require less judgement than others. It is not impossible, therefore, to arrive at similar (or even identical) liability calculations using different methods with appropriate actuarial judgement. It is also possible to have very different answers using some particular method or differing judgement. This shows us, once again, the power and professional responsibility that lies with actuarial judgement, and hence the requirement to apply this judgement correctly in terms of both the choice of method and any subjective assumptions used. Inherent with this responsibility is a prerequisite to understand the purpose of the valuation and implications of the application of actuarial judgement. We therefore conclude that the profession should extend its education process to cover the understanding of methods of determining liabilities on a basis consistent with market values.

6. ACTUARIAL DISCRETION

Judges naturally hesitate to perform the tasks of a brain surgeon. Actuaries are entitled to similar deference. Accordingly, the test for judicial intervention must be constrained to testing the reasonableness and rationality of actuarial methods.

—J Murphy (The Pension Funds Adjudicator), Affidavit in *Kransdorff v Murphy*, 1999

6.1 THE SENTRACHEM CASE

6.1.1 In the *Sentrachem* case¹¹, the applicant contended that his withdrawal benefit was neither fair, nor in terms of the rules of the pension fund, nor in terms of his contract of employment. The Pension Funds Adjudicator determined that the benefit was in terms of the rules, that fairness was not a requirement for a defined benefit (as opposed to a transfer in terms of section 14 of the Pension Funds Act), and that labour issues were beyond his jurisdiction.

6.1.2 Nevertheless, because the operative withdrawal rule defined the benefit as the greater of reserve value and twice accumulated contributions, the Adjudicator addressed himself to the computation of reserve values. The rules of the *Sentrachem* Pension Fund defined the reserve value as an amount:

... equal to the present value as determined by the actuary of the benefits accumulated in terms of the rules in respect of the member for completed service, provided that if the actuary is of the opinion that the financial position of the fund requires it, the actuary may reduce such amount to the extent which in his opinion is required by the financial position.

6.1.3 The Adjudicator carried out a diligent survey of the nature of retirement funds, and the extent to which actuarial discretion should be subject to judicial supervision. He quoted with approval from Nobles (1993):

The peculiar expertise of the actuary is the ability, using assumptions and methods to make decisions about the future: in the context of pension schemes, to determine what level of assets will be required to pay for a given level of pensions. But the question which remains is whether actuarial judgements are made according to strict criteria, so that the involvement of this profession enhances the protection offered by trust law. Or are actuarial judgements so flexible that the involvement of the actuary may operate so as to disguise what is, in effect, managerial control of pension scheme funding?

6.1.4 The Adjudicator declined to enter substantively into the fray with brain surgeons and actuaries. Rather, he concluded that limitations on actuarial discretion, where appropriate, could reduce the potential for disputes. Thus he stated:

Actuaries traditionally have had significant influence on the content of pension fund rules. Those rules, as stated, routinely grant actuaries wide discretions. It is, therefore, incumbent on the actuaries to ensure that discretions are circumscribed by appropriate decisional referents, as required by the Constitution, and that such discretions are exercised reasonably and fairly in accordance with such decisional referents.

11 *Kransdorff v Sentrachem* [1999] 9 BPLR 55 (PFA)

6.1.5 ASSA responded to this challenge by issuing Guidance Note 204, ‘Actuarial Discretion in Terms of Retirement Fund Rules’, in August 1999. This brief guidance note states that it is best practice for actuaries to bring instances of discretion to the attention of trustees, and to suggest appropriate referents for their approval. However, the guidance note does not prescribe what such appropriate referents might be.

6.1.6 Continuing with his Sentrachem determination, the Adjudicator nevertheless let it be known that, where rules did not stipulate clear decisional referents for reserve-value calculations, it could be expected that he would prescribe the use of the projected unit credit method together with the valuation assumptions contained in the previous valuation report. With respect, this paper suggests that other methods and other assumptions might be more appropriate, depending on circumstances.

6.1.7 In the Sentrachem matter, after a linguistic and factual analysis of the circumstances, the Adjudicator ruled:

- (a) that it was not necessary to include an investment reserve as part of the reserve value;
- (b) that it was acceptable to ‘decay’ the value of accrued benefits because of the chance of future withdrawal and death-before-retirement; and
- (c) that the intended meaning of reserve value was the fund’s pension liability for retirement rather than the present value of the pension at retirement.

As discussed in the next section, many of these issues have since been legislated by the introduction of minimum benefits on transfer in terms of the Pension Funds Second Amendment Act of 2001¹².

6.2 THE UNISA CASE

6.2.1 In the UNISA case¹³, the Supreme Court of Appeal overturned the decision of the court *a quo* in a matter concerning actuarial discretion. UNISA employees who had previously accepted an offer to transfer out of the Associated Institutions Pension Fund (AIPF) subsequently challenged the method used by the actuary in determining their transfer values. The regulated terms of the transfer required each member to be credited with an amount equal to the funding percentage multiplied by the actuarial obligation of the fund in respect of that member as determined by the actuary on the date on which membership of the fund was terminated. The funding percentage was, in turn, defined as the market value of the net assets of the fund on a fixed date, expressed as a percentage of the calculated aggregate obligation of the fund on that date, as determined by the actuary.

6.2.2 At the previous valuation, approximately three years before, the actuary was concerned about the state of the data, and had accordingly created a reserve. For various reasons, the transfer calculations were performed before the results of a new valuation, including an audit of the data, were known. Had the updated data been used, the funding percentage—and therefore the transfer values—would have been higher. The court *a quo*

12 Pension Funds Second Amendment Act, Act No. 39 of 2001

13 *AIPF v Le Roux* [2001] 8 BPLR (A)

decided that the phrase ‘calculated by the actuary’ meant that the transfer value had to be determined on reliable data, and that just because the calculation had to be made by an actuary, this did not mean that the actuary was free to decide when, what and how. The actuary’s determination was struck down, and he was requested to redo it with accurate data.

6.2.3 However, on appeal, Cameron JA was of the opinion that linguistic analysis of the regulation showed that the actuary had to perform an actuarial function, i.e. the attributes of professionalism and skill peculiar to that field of expertise. The uncontested evidence of the actuary should be accepted—that the transfer could not be performed with mathematical precision, bereft of assumptions, allowances or margins in regard to uncertain facts and figures. Thus, the actuary’s original determination of the transfer values was reinstated.

6.2.4 Nevertheless, Cameron JA did state that, in terms of the (interim) Constitution, an actuary’s determination had to be lawful and procedurally fair as well as justifiable in relation to the reasons he or she gave for it.

6.3 THE UP CASE

6.3.1 In the UP case¹⁴, employees of the University of Pretoria launched a similar challenge to that of their contemporaries at UNISA. This time, actuarial experts were called on by both sides, firstly to clarify exactly what had happened, and secondly to debate whether the transfer values could pass the test imposed by Cameron JA’s abovementioned constitutional dictum. Arguments were led for and against the need to distribute a share of the reserves to transferring members, and whether the reserves were justifiable in terms of the reasons given. Also, in the absence of a report to members by the actuary or the fund on the transfer methodology, arguments were made regarding the steps that the members should have taken to double-check the actuary’s calculations. The Court did not definitively decide this issue, except to state that the transferring members could reasonably expect the actuary to do a professional job, and thus had no duty to check their transfer values.

6.3.2 Arguments were also put forward regarding the calculation of the funding percentage. For various reasons, the funding percentage had been calculated at a particular time, and then updated over a period of fifteen months to reflect changes in the market value of the original assets. It was alleged that this method ignored various interim developments such as the fact that contributions had been increased in order to improve the funding percentage. In his judgment, Botha J expressed the view that the term ‘market value’ in the regulations connoted the actual value and not a notional value established by projections. He stated:

It was argued that the phrase ‘as determined by the actuary’ refers to the determination of the market value. I cannot agree. In my view it refers to the ‘calculated aggregate actuarial obligation of the fund’. It tells one who is to calculate the aggregate actuarial obligation of the fund, namely the actuary appointed in terms of the regulations. I cannot see any licence in this phrase to the actuary to determine asset values that are not market values.

14 *Van Zyl v AIPF* unreported case 18773/99 (T)

6.3.3 Botha J accordingly came to the conclusion that to determine the funding level with reference to notional values of assets was *ultra vires* the regulations. The transfer values were set aside and must be recalculated. However, the matter has subsequently been taken on appeal.

6.4 THE LANGEBERG CASE

6.4.1 In the Langeberg case¹⁵, a group of pensioners contended that a scheme involving the transfer of their pensions to an insurer was unreasonable and inequitable. Based on the results of an interim valuation (effective January) pensioners and members of a DB fund were asked in mid-August to decide by mid-September on an offer to outsource their pensions or transfer to a DC fund (effective October). Most of the pensioners accepted the offer, even though active members were to receive a greater nominal increase in benefit than pensioners, and a substantial portion of the surplus was to be retained in the rump of the DB fund.

6.4.2 On enquiry, some of the pensioners were informed of the estimated allocation of the surplus between pensioners, active members and the fund. In fact, the amount of surplus retained in the fund turned out to be several times larger than the estimates, mainly because of good investment performance during the nine months since January, the non-disclosure of an investment reserve, and a profit arising from the outsourcing of the pensions at a price less than the reserves held for pensioners in the fund.

6.4.3 The pensioners first raised their objections with the Registrar of Pension Funds. In response to an enquiry from the Registrar, the actuary stated that the surplus position of the funds was, in the opinion of the trustees, not relevant to the choice that the pensioners had to exercise. The surplus information was therefore not generally made available, but was given to those who asked. The Registrar then confirmed his decision to grant a section 14 certificate.

6.4.4 In his determination, the Adjudicator noted that, before issuing such certificate, the Registrar had to investigate the legality, reasonableness, equity, financial soundness and actuarial prudence of any scheme. However, in terms of statutory or common law duties, the board of management must also ensure that the scheme is reasonable and equitable, and accords full recognition to the rights and reasonable benefit expectations of the persons concerned. (This duty of the board of trustees is expected to be formalised when the FSB issues its revision to circular PF78.) The Adjudicator quoted from Lord Justice Staughton in a UK case, *Stannard v Fisons Pensions Trust*, as follows:

It therefore seems to me that ... there was some degree of likelihood that the Fisons fund would continue to be in surplus for the foreseeable future; and there was some degree of likelihood that the existing employees and pensioners would receive some benefit from the surplus in the future, in the form of increased pensions or other benefits. When the trustees came to consider what was just and equitable upon a division of the fund ... they ought to have borne those points in mind and made some evaluation of them.

15 *Adriaens v Langeberg Foods Pension Fund* [2001] 1 BPLR (PFA)

6.4.5 The Adjudicator believed that surplus information is highly relevant, and pensioners granted an option to transfer their investment from one vehicle to another have a clear right to be furnished with adequate appropriate information to enable them to make an informed choice about which vehicle to invest in. He continued:

Accurate information about the current financial position of the fund is a prerequisite to a proper choice. ... It may indeed not be [the actuary's] duty to predict the residual surplus, but it was his duty to ensure that the transfer of business was reasonable and equitable and as such based on reliable current information. Accepting that the scheme invariably will be required to be worked out in advance, it does not follow that the trustees and the fund actuaries can simply take outdated historical information into account and ignore developments and the financial situation at the actual date of transfer. If circumstances change which significantly impact upon the investment of the fund between the time when the section 14 scheme was devised and the effective date of transfer, there is to my mind some duty to make an appropriate adjustment.

6.4.6 The Adjudicator therefore declared the section 14 scheme to be unreasonable, inequitable and an improper exercise of the power of the trustees.

6.5 THE PEPKOR CASE¹⁶ ('PEPKOR')

6.5.1 In the Pepkor case, the Supreme Court of Appeal upheld the decision of the court *a quo* to allow the Registrar to rescind a section 14 certificate. It was alleged that information provided in the section 14 documentation regarding the size and allocation of the surplus was incorrect. *Inter alia*, this was alleged to imply that members who transferred did so without knowledge of a substantial surplus.

6.5.2 Regarding the question of informed consent, Rogers AJ stated in the court *a quo*:

It might be highly desirable that members should be fully informed of such matters, but the fact of the matter is that this is not amongst the requirements listed in section 14, nor, in my view, is it implicit ... It appears that the legislature was content to appoint the Registrar as the protector and guarantor of [members'] interests.

He nevertheless noted that adequate information was a requirement in terms of the Registrar's PF Circular 78.

6.5.3 Regarding the alleged exclusion of certain assets from the surplus calculation provided to the Registrar in terms of PF Circular 78, Rogers AJ stated, in similar vein to the UP matter:

I can see no basis on which the exclusion of any of the three special surpluses could be defended. Their exclusion strikes me as entirely arbitrary.

6.5.4 In similar vein to the Stannard matter referred to above, Cloete JA remarked in the judgement on appeal:

¹⁶ *Pepkor Retirement Fund v FSB* unreported case 198/2002 (SCA)

It is true that [the members] were not legally entitled to participate in the surplus, but they had not only the hope that the trustees might use the surplus to pay increased benefits but also the peace of mind in knowing that their benefits would be more than adequately protected.

6.5.5 And in similar vein to the UNISA matter, Cloete JA referred to section 33 of the Constitution in terms of which everyone has the right to administrative action that is lawful, reasonable and procedurally fair.

6.6 THE TEK CASE

6.6.1 No review of recent pension fund litigation would be complete without a mention of Tek¹⁷, which decided the age-old question “Who owns the surplus?” In 1994, in the Lintas matter, the FSB Appeal Board found it acceptable that surplus could be paid to an employer on liquidation. The Registrar initially followed this guidance, but after taking legal advice, subsequently refused to register any such rule. The FSB Appeal Board confirmed its opinion in 1999 in the Paarl Widows matter, after the initial hearing of Tek.

6.6.2 In his appeal judgment, Marais JA declared that the surplus belongs to the fund. It followed that all stakeholders needed to negotiate the allocation thereof. In passing, he also referred to the difficulties that actuarial science has in being exact, since:

Some of the data available may be relatively immutable and provide a secure foundation ... much is not.

6.7 OFF THE RECORD

6.7.1 Not all disputes go as far as the judgment stage, or even to litigation at all. There have been other recent disputes regarding the exercise of actuarial discretion and the transparency of the actuarial process. Naturally, these cannot be identified, nor do they constitute any sort of legal precedent.

6.7.2 The author has been informed by the Executive Director of ASSA that, in the last five years, four disciplinary investigating committees have been set up in connection with an actuary’s role in the transfer of pension benefits, whilst a fifth case is pending the result of an arbitration hearing. Some investigations have resulted from complaints received, whereas others have been initiated by the President. One investigation is still in progress. Of the others, two were dismissed by the investigating committee, and one referred to the Tribunal, which, in turn, dismissed the complaint. The actuaries in question all exercised their right that no publicity be given to an unsuccessful complaint.

17 *Tek Corporation Provident Fund & Others v Lorentz* 1999 (4) SA 884 (SCA)

7. MINIMUM BENEFITS

The position has, we believe, become close to untenable

—R Bowie, Chairperson of the Pensions Board of the Faculty and Institute of Actuaries, 2002, referring to actuaries recommending transfers at the UK statutory minimum basis

7.1 THE SURPLUS ACT

7.1.1 Transfer values from South African DBPFs will soon be subject to a statutory minimum, as described below.

7.1.2 The Surplus Act¹⁸ came into effect from 7 December 2001. It amended the old section 14(c) to require that transfers must accord recognition to the minimum benefits now specified in the new sections 14A and 14B as discussed below. In terms of section 14A, the benefit paid to a member who ceases to be a member of the fund before retirement in circumstances other than liquidation of the fund shall not be less than the minimum individual reserve (MIR). On liquidation, and on an internal reorganisation from defined benefits to defined contributions, such reserve may be reduced to reflect any deficit in the fund. Also, minimum pension increases are to be awarded to pensioners and deferred pensioners.

7.1.3 The MIR in a defined contribution fund is the member's account plus a proportionate share of any surplus and contingency accounts as decided by the trustees. This trustee decision must not be arbitrary. In a DB fund, the MIR is the fair-value equivalent of the present value of the member's accrued deferred pension (where the assumed future rates of pension increase, discount and mortality are prescribed by the Registrar). This value is subject to a minimum based on member contributions. The trustees must apply their minds as to whether a proportionate share of surplus and contingency accounts should be included.

7.2 BOARD NOTICE

7.2.1 The Registrar duly prescribed that, in calculating the MIR for a DB fund, the capitalisation of the pension at date of retirement should normally use the same assumptions as those used by the actuary in the preceding statutory actuarial valuation. For the period before retirement, a discount rate was prescribed. This was either 40% of the earnings yield on the JSE all-share index, or the index-linked gilt yield less an adjustment of 0.95% to allow for retirement-fund tax, equity premium, salary increases in excess of changes in the consumer price index, and investment management fees. Adjustments could be made to reflect any hedging strategies in place. It was also prescribed that no allowance should be made for the chance of death or resignation before retirement.

7.2.2 It is stated that the Surplus Act's requirement of 'fair value equivalence' is achieved through the use of current market yields on index-linked gilts, or the equivalent all-share earnings yield method. No further adjustment is needed. (This will be seen to be method 3 of Head *et al*, 2000).

18 Pension Funds Second Amendment Act, Act No. 39 of 2001

7.3 DRAFT GUIDELINES FOR BOARDS AND ACTUARIES CONCERNING CONTINGENCY RESERVES AND CHANGES OF BASIS

7.3.1 In this draft document, which has yet to be published officially, the Registrar draws attention to the competing interests of stakeholders. Although this document is primarily concerned with the impending surplus apportionment required by the Surplus Act, the guidance will be relevant to future transfers as well. Some types of contingency reserve which the Registrar could consider acceptable are described, including a capital-adequacy-type ‘solvency reserve’—see 7.6 below.

7.3.2 Test calculations made by the Registrar’s office show that the financial effect of minimum benefits on the ‘average’ retirement fund is expected to be small. The author suggests, however, that there are a number of large, mature ‘non-average’ funds which will be thrown heavily into deficit and see their employers’ rates of contribution increase considerably.

7.4 ASSA REPORT ON THE SURPLUS BILL

ASSA gave input in the deliberations leading to the Surplus Act. In a 2001 submission, they suggested that employees should have a reasonable expectation of receiving an acceptable pension on retirement, appropriate in relation to the employee’s earnings and period of fund membership. It was therefore felt that a minimum benefit should be payable on any form of exit from a retirement fund.

7.5 ASSA RETIREMENT FUND SURPLUS COMMITTEE REPORT, 2001

7.5.1 The ASSA Retirement Fund Surplus Committee was appointed to inquire into the bases for calculation of transfers, conversions, and related issues, and to establish appropriate minimum bases and standards for practical application. Specifically regarding the calculation of minimum benefits, they recommended¹⁹ that termination benefits that are based on passively calculated reserve values should be adjusted to take account of market conditions so that members transferring or withdrawing from a fund are able to replace their benefits at market rates.

7.5.2 The Committee believed that an investment reserve held to reduce asset values might instead more properly be regarded as an adjustment to increase liabilities to a consistent level. Such a reserve is in no way to be regarded as surplus, and members might justifiably argue that they had some expectation of sharing in it. However, if the actuary’s basis for the calculation of liabilities does reflect the fair value of those liabilities, then an investment reserve may validly be held so as to smooth the required rate of employer contributions. In such cases, the investment reserve is properly seen as part of the fund’s surplus.

7.5.3 The Committee then suggested a minimum basis very similar to that subsequently enacted by the legislator. It was noted that, in the case of a compulsory transfer, the minimum may well be inadequate in ensuring that the RBE of members will be met. For example, in the event of a compulsory transfer from a DB to a DC fund, there

19 Actuarial Society of South Africa (unpublished). Retirement Fund Surplus Committee Report

is an argument for making up the loss of the future cross-subsidy the member would have enjoyed in the DB fund as he or she got older. However, it was felt that this was an obligation of the employer rather than the fund, and therefore the employee could be compensated in other ways. The actuary nevertheless had an obligation to ensure that the employer and the employees fully understood the loss of the future cross-subsidies caused by the transfer.

7.6 DRAFT ASSA GUIDANCE NOTE CONCERNING THE SURPLUS ACT

7.6.1 At the time of writing this paper, a proposed guidance note concerning the Surplus Act has been drafted for discussion purposes only, and is not to be quoted.²⁰ However, it appears that it does not concern itself with transfer values, except to the extent that minimum benefits should be valued in a statutory valuation. Nevertheless, guidance as to the justification and operation of solvency and contingency reserves will impact on future transfer values.

7.6.2 A. Lester (unpublished) has proposed a basis for solvency reserves that essentially tops up a fund's asset requirements to what would have been required under a fully matched investment strategy. This strategy appears to be method 3 of Head *et al* (2000). A Lester (*op. cit.*) does not, however, offer an opinion as to whether a share of the solvency reserve should be distributed to transferring members. Since the MIR is already required to be calculated on such a basis, the answer may well be 'not necessarily'.

8. ACTUARIAL DISCRETION IN THE PRICING OF TRANSFER VALUES

"Upon the king! Let us our lives, our souls, our debts, our careful wives, our children and our sins, lay on the King!"

— William Shakespeare, King Henry the Fifth

The preceding sections have gathered together information on past practices, pricing theory, case histories and legislative changes. This section draws on that information to highlight areas of possible concern for the profession.

8.1 THE ACTUARY DOES NOT HAVE A FREE HAND

8.1.1 Candidate actuaries of ASSA are required to attend a seminar on professional behaviour. A similar requirement exists in other countries. One of the major themes of the professionalism course is the challenge of upholding professional standards in the hurly-burly of the commercial world. Students work through case studies, suggesting a variety of possible courses of action, and often no perfect solution can be found.

8.1.2 There are two important practical issues that do not emerge from the preceding historical and philosophical review of transfer value pricing. The first is the extreme suspicion that frequently arises between the transferor and transferee funds. The second is that transfer values must not only satisfy the requirements of professional soundness, but

²⁰ Actuarial Society of South Africa (unpublished). Draft Professional Guidance Note: Pension Funds Second Amendment Act, 2001

also of acceptability to the parties to the transfer as well as the regulatory authority. In short, the actuary does not have a free hand in setting transfer value bases. It has been suggested to the author by an authoritative source that it was these practical issues that had given rise to the encouragement of actuaries in PF Circular 78 of the FSB (see Section 4.1) to use the same technical bases as those applied at the most recent statutory actuarial valuation.

8.1.3 These issues would (and should) make an excellent case study on the professionalism course. However, the fact remains that, by following the default option of the Regulator, South African actuaries have elicited the criticisms referred to in sections 4 and 6 above, as well as the opening quotation to section 1. Gluckman & Kamionsky (1997) amongst others have pointed out why the Regulator's default option can be unprofessional.

8.1.4 If the actuary comes to the conclusion that a transfer value should be higher than the amount funded for, who is to bear the cost? The employer could be asked to pay up, or the remaining members' security could be reduced, or the transferring member could be given a lower transfer value. There is no easy answer, except that—at the minimum—the actuary must apply his or her mind, and come up with a decision that is justifiable in terms of the reasons given. Swanepoel *et al* (unpublished) quote the Manhart case in the USA where the Court decided that a reduced transfer value was acceptable to avoid endangering the solvency of the fund.

8.1.5 From a more international perspective, Daykin (2003) considers how actuarial professionals can maintain or restore the trust of their clients. He problematises the concepts of openness, transparency and accountability of O'Neill (2002), and suggests that a better objective for the actuary might be 'to proactively limit obfuscation'.

8.1.6 When engaged to perform bulk transfer calculations, the actuary may indeed not have a free hand. However, this does not mean that he or she should throw in their hand. There are other stakeholders' interests to be considered besides those of the negotiating businesses; and there are also a number of strategies available to the actuary that could 'proactively limit obfuscation'. These range from the negotiation of appropriate terms of reference right through to declining to act at all. The actuary can find her- or himself presented with a transfer package agreed as a *fait accompli* between the negotiating businesses. In one of the unreported cases (section 6.7) the actuary found himself in exactly this situation, but was able with some ingenuity, to find an acceptable solution. This will not always be possible.

8.1.7 The seminars held by ASSA in 2002 on the subject of conflict of interest evolved out of a complaint regarding an actuary advising both employer and trustees in a medical-scheme matter. GN29 (Section 3.1) gives guidance to retirement-fund actuaries in this regard. Milburn-Pyle (1994) acknowledged the pressure that actuaries may experience from different stakeholders, although the proposed revision to PF Circular 78 will firmly join the actuary and the trustees as joint decision makers in future section 14 transfers (section 4.1). Even in the current dispensation, much of the actuary's work takes the form of proposals for the trustees to accept or reject as they see fit. Sentrachem (section 6.1) urges the need for decision referents to avoid some of these conflicts; a suggestion that was taken up in PGN 204 (section 4.2).

8.1.8 In transfer situations, there will always be some unhappiness, and it is easy to accuse the actuary—particularly consultants (section 3.2)—to be favouring the interests of the employer. On the other hand, the employer has legitimate interests and rights—usually including the right to cease contributing to the fund. The author suggests that, in the spirit of PGN 204, actuaries should encourage trustees to set up a procedure for section 14 transfers, which can be called upon whenever a transfer looms.

8.2 FREEDOM WITH DISCLOSURE

8.2.1 Historically, UK actuaries have had a great deal of freedom in their actuarial determinations compared with the more regulated environment of their counterparts in continental Europe. Presumably, the theory is that there will be a greater benefit to society if actuarial judgement can be used to its maximum, with the proviso that all stakeholders will be given the opportunity to know, understand and object to what the actuary has done.

8.2.2 Section 3.2 highlights the wide range of transfer values that were being calculated in the UK before MFR. However, the statement by the Faculty & Institute of Actuaries²¹ argued in mitigation of such variances, because of the complexities of retirement funds, and suggested a ‘freedom with disclosure’ approach. Some of this disclosure was achieved (in bulk transfers) by the almost universal practice of obtaining a so-called actuary’s letter, detailing the nitty-gritty of the calculation. This letter is used, *inter alia*, by the actuary of the transferee fund to confirm the reasonability of the transfer values received. Such letters have hitherto not been common practice in South Africa—and in the spirit of PGN 204, the author suggests that actuaries should recommend their use. Such letters may well have avoided at least some of the disputes in the UNISA and UP matters. The FSB’s draft new Section 14 transfer procedure, whereby transfers may be approved in advance, will encourage these details to be documented.

8.2.3 Section 3.4 records a debate amongst leading members of the UK actuarial profession on the need for regulated minimum transfer values. A majority voted for regulation, and two serious problems with the freedom approach were raised. The first was that ‘freedom with disclosure’ is only appropriate where the buyer has the ability to shop elsewhere; and the second was that, despite all efforts, the average pension-fund member may never understand the workings of a DBPF.

8.2.4 In Langeberg (section 6.4) the adjudicator believed that members were entitled to adequate information and transparency. However, in Pepkor (section 6.5), the judge pointed out that informed consent was not a requirement of section 14 of the Act, and that the legislator had appointed the Registrar to look after members’ interests. Pepkor also revealed how little attention the Registrar was able to give to this task over the years. It appears that, in order for an actuary to comply with the requirements of Sections 3.3 and 7.2 of the Code of Conduct regarding third parties and transmission of advice, it is not sufficient merely to comply with the requirements of PF Circular 78 (Section 4.2). A report of some sort seems to be necessary from a compliance viewpoint,

21 Faculty and Institute of Actuaries (1994). Transfer values and opt-outs

as well as desirable from a professional viewpoint. The FSB's draft new procedure for section 14 transfers encourages the board of trustees to inform members about a proposed transfer, and give them the opportunity to object. This surely cannot be done without a report from the actuary on the details and implications of the transfer.

8.2.5 Andrew (1998) made a similar call (section 4.7), as did the Retirement Fund Surplus Committee in 2001 (section 4.6).

8.3 DUE DILIGENCE

8.3.1 Acting as an actuary is not the same as acting as the 15th century king quoted at the start of this section. An absolute monarch, once anointed, used whatever processes he saw fit—arbitrary or considered—to solve the problems laid 'upon the king'. Actuaries also have lives, souls and debts laid upon them, but they must use the techniques of their profession. This may seem obvious, but the record shows how 'actuarial judgement' has sometimes merely been the judgement of an actuary. Milburn-Pyle (*op. cit.*) (section 4.1) referred to careless and casual actuarial reports, whereas the Code of Conduct and Guidance Notes (section 4.2) are clear on the need for actuarial work to be based on accurate data, and to use appropriate methods and assumptions.

8.3.2 In *Sentrachem*, it was held that actuarial discretion must be subject to the law (section 6.1) although in *UNISA* it was allowed that an actuarial function cannot be performed with mathematical precision (section 6.2). However, in the latter matter, it was decided that an actuarial determination must be justifiable in terms of the reasons given for such decision. In *UP*, the court overturned an actuarial determination on the grounds that it was not appropriate to estimate market values when the exact market values could have been obtained (section 6.3). In *Langeberg*, it was held that an actuarial determination must be based on reliable and up-to-date information (section 6.4). In *Pepkor*, some of the actuary's work was described by the judge as arbitrary (section 6.5).

8.3.3 Of course, these cases represent the sensational minority of actuarial involvement with transfer values. Milburn-Pyle (*op. cit.*) also spoke about 'exemplary' reports, and the overwhelming majority of transfers have not led to disputes.

8.3.4 In applying his or her mind, the actuary must also be aware of labour law, such as the recent case of *Telkom v Blom*²². For example, if withdrawal decrements are not used in the calculation of a transfer value (as suggested by *Le Roux*—section 4.5) the actuary should look to the circumstances of the transfer to decide whether it was appropriate to continue using future salary increases or change to deferred pension increases. There may be times when the actuary can countenance an inadequate benefit if it is known that the employer will make good the shortfall (section 7.5).

8.4 PRICING METHODS

8.4.1 Funding methods are not pricing methods (although it is possible that the same methodology might serve for both in some circumstances). There may have been reasons why this axiom was not understood by some actuaries in the past. There can be no

22 *Telkom SA Ltd v Blom* unreported case 227/02 (SCA)

excuse in the future, after analyses such as those by Exley, Mehta & Smith and Head *et al* (*op. cit.*) (section 5), Gluckman & Kamionsky (*op. cit.*) and Le Roux (section 4.3), and Lester (*op. cit.*) (section 7.6).

8.4.2 It is therefore surprising, at first sight, that the Registrar uses the previous statutory valuation basis as the default method both in section 14 transfers and in the post-retirement portion of MIRs. In both the Pepkor and UP matters, a former Registrar testified along the lines that this basis was necessary to prevent abuse. Newell (*op. cit.*) (section 4.4) also recommends this default in his draft RBE proposals. Yet PGN 201 (section 4.2) clearly indicates that valuations for transfer purposes are different from statutory valuations, and requires the actuary to carefully examine the method and assumptions to make sure they are appropriate. A similar call was made by the ASSA Retirement Fund Surplus Committee (section 7.5).

8.4.3 The use of the previous statutory valuation basis is not mandatory, since, in both regulatory cases mentioned above, the actuary may motivate for a different basis to be accepted. Such motivations should surely be the rule rather than the exception. However, the solvency reserve basis proposed by A Lester (unpublished) may well mean that accrued liability on the basis used at the previous valuation, plus a share of the solvency and other reserves, will generally suffice.

8.4.4 A pricing basis has been incorporated into the pre-retirement portion of MIRs by the Registrar (section 7.2). The prescribed basis is essentially method 3 of Head *et al* (section 5), the method they described as being derived from financial economics, and therefore potentially very suitable for use as a pricing method. However, they did note that all their methods still allowed for subjective input, which means that a particular answer could be derived from any of the methods with the appropriate input. One shortcoming of the MIR basis is the lack of allowance in the discount rate for the chance of insolvency by the employer, as discussed further by Thomson (*op. cit.*) (section 5). This ‘shortcoming’ will of course be seen as a ‘strength’ by transferring members, and could be justified on the grounds that the fund should be independent of the fortunes of the employer.

8.4.5 For capitalisation of pensions at retirement, the MIR basis prescribes the parameters used in the previous statutory valuation. These could be unrealistic for various reasons. Use of such parameters in the MIR process, without justification, could lead to transfer values that are inequitable one way or another. It appears²³ that part of the reason for this basis was to reduce the complexity of the calculations. Having separate bases for statutory valuations, section 14 transfers and MIRs—not to mention International Accounting Standards—is seen as being difficult to regulate as well as difficult for retirement fund members to understand.

8.4.6 It must be remembered that MIRs are exactly that—a statutory underpin, not a prescribed value. The actuary and trustees are free to use another basis, as long as the minimum is exceeded. The ASSA Retirement Fund Surplus Committee gives an example where RBEs will not be met by MIR (section 7.5).

23 Personal correspondence with the Regulator

8.4.7 In the UK (section 3.3) the introduction of a statutory underpin had the unfortunate effect of bringing the more generous values down to the minimum, and then the minimum basis itself devalued. Everett²⁴ draws lessons from this experience as follows:

... if fair value is to mean anything, then transfer values must increase, with proper protection for schemes that are under-funded on such a test ... The lesson for trustees is that pensions are bond-like and that any [minimum] standard that says otherwise will break down when the equity and bond markets decouple as they have done so severely this year. The lesson for the actuarial profession is to be reluctant to take part in any Government [minimum] standard setting. When the message is unwelcome, any amendments to the basis may be inadequate.

8.4.8 It appears that bulk section 14 transfers will be problematical if a fund is in deficit, unless the transfer values are well in excess of MIRs (section 7.1). Trustees may have to seek a partial liquidation in these circumstances, and thereby shift the liability for the shortfall to the employer in terms of section 30(3) of the Surplus Act.

8.4.9 Section 15G of the Surplus Act requires transferees to share in reserves (section 7.1). Actuaries need to consider carefully how any estimate of the reserve at date of transfer will be calculated. An FSB official gave his opinion, at their recent workshop on the Surplus Act, that an annual calculation of investment reserve as a percentage of liabilities would suffice. This seems inappropriate in a market-value environment. The recent amendment to GN11 (section 3.1) allows that estimates can be made. However, if an estimate can be successfully challenged, the transferring members are given a one-way option against the fund (as in UP, section 6.3). Similar remarks apply to the use of a previous statutory valuation result to estimate values at a later date (as in Langeberg, section 6.4)

8.4.10 The acid test of a transfer method remains (section 7.4) that transferees should have a reasonable expectation of receiving an acceptable pension on retirement. Andrew (section 4.7) cautions that ten different actuaries should each be able to combine judgement with technique to arrive at something acceptably close to the same answer.

8.5 PENSIONER BUY-OUTS

8.5.1 A section 14 transfer certificate is required for the transfer to an insurer of the liability of a fund towards a pensioner. Thus, the actuary needs to consider whether the rights and RBEs of transferring and remaining members have been met. Theoretically, this should be a simple exercise, since, unlike in the case of the transfer of liabilities for active members, there is a market for pensioner liabilities, so the liability can be priced precisely.

8.5.2 There is a matter under arbitration at present regarding certain actuaries' advice in a pensioner buy-out. The author is not aware of any decided cases specifically concerning the pension received by the pensioners from the insurer compared with their original benefit promise. In Langeberg (section 6.4), it was reported *inter alia* that the

24 Everett (2003). Returning transfer values to fair value *PMI News*, January

fund made a profit from outsourcing the pensioners at a price less than the reserves held in the fund. However, the Adjudicator's decision to declare the section 14 transfer scheme unreasonable was based on the fact that pensioners did not get enough information to make their choice, not that the fund was obliged to buy them higher pensions.

8.5.3 Regarding the purchase of individual annuities on retirement, a section 14 certificate is not required if the purchased annuity "provides a stream of income equivalent to the pension expected by the member from his fund". Taking this as a guide for bulk transfers, the problem is that the quantum of future pension increases that will be paid by the insurer or by the fund is usually unknown. The insurer could be quoting a competitive price through, for example, optimistic mortality assumptions.

8.5.4 The Surplus Act and Board Notice do not deal specifically with this eventuality, although it would seem that an MIR equivalent to the present value of the member's pension on the basis of the last statutory valuation should apply. If the insurer quotes on a conservative basis through, for example, pessimistic mortality assumptions or high expense loadings to pay agents' commission, then the MIR may have little chance of replacing the lost pension. This would certainly be one of those cases where a mechanical application of the MIR would be inappropriate. As pointed out in ¶8.4.6, and elsewhere, the MIR is only a minimum benefit, not a prescribed benefit.

8.5.5 As before, at the very least, the actuary needs to apply his or her mind to these complex issues, and disclose to the parties what has been done, and the implications thereof. Pricing is of course only one of an interlinked web of pensioner buy-out issues. Other issues that the actuary could be drawing to the parties' attention include being tied to a single insurer, being tied to a single investment manager, possible transfer from a market-linked basis to a smoothed, guaranteed basis, cutting of the umbilical cord with the employer, and issues around dependants' pensions.

8.6 BULK versus INDIVIDUAL TRANSFERS

8.6.1 There does not seem to be any difference, in principle, between the requirements for a bulk and an individual transfer. GN16 (section 3.1) gives guidance for any transfers without consent, and will only apply to a transfer between DBPFs.

8.6.2 In practice, it may be acceptable to pay out a transfer value, without reduction, to an individual when the fund is in deficit. On the other hand, the requirement that there should be no reduction may rule out the possibility of a bulk transfer, because of the effect on the remaining members of the fund.

8.6.3 Even in terms of the Registrar's proposed new guidelines on section 14 transfers, it will still be possible for a transfer to occur without the consent of the member. Communication of the method used and the implications thereof are vital in these cases. One could envisage, however, that it would be more cost-effective to produce the necessary actuary's report for a bulk transfer than for an individual transfer.

8.6.4 In section 8.4 above, it is noted that the MIR makes no allowance for the risk of insolvency of the employer. Thus, a transfer value presents the transferring member with a guarantee of future benefits that is not available to remaining members. This seems intuitively more acceptable in a transfer without consent.

8.7 EDUCATION

Both Exley, Mehta & Smith (1997) and Head *et al* (2000) referred to a lacuna in the UK professional courses on the subject of the pricing of transfer values. In the past, most South African students studied the UK courses, and local professors have confirmed a similar lacuna here. This can perhaps be remedied in the syllabus for the new South African fellowship courses. With respect, it is hoped that this paper can go some way to filling the gap. Even though the DBPF is becoming an endangered species, and even though minimum benefits have been legislated, there will still be a need for actuarial judgement in transfer values in the future. Some of the issues will also apply to DC funds—for example those with investment-smoothing reserves or other distributable contingency reserves.

8.8 VOLATILE TRANSFER VALUES AND UNFAIR DISCRIMINATION

8.8.1 The use of pricing methods based on market values means that transfer values will be volatile. Members with identical service records but slightly different dates of exit may receive quite different benefits. In the words of Head *et al* (2000):

The adoption of a market value for assets must mean a volatile value for any comparable calculations of liabilities. This leads to volatile funding levels and volatile contribution requirements. It would appear to us that the holy grail of an objective methodology and smooth results is unattainable. Some compromise (or actuarial judgement) will still be required.

8.8.2 This leads to the wider subject of unfair discrimination, which is prohibited by the Constitution and subsidiary legislation. Swanepoel *et al* (unpublished) discussed the issue with reference to the life-insurance industry, but no study has yet been undertaken with regard to retirement funds. The Pension Funds Adjudicator has made *obiter* comments from time to time about the apparent unfairness of different transfer values for retirement-fund members with identical service records, but different ages. However, a suitable test case has not yet been decided. Unfair discrimination in transfer values can also stem from unfair discrimination in pension-fund design as a whole, and that is where this nettle will have to be grasped. As described in section 2 above, DBPFs were in fact designed to be discriminatory. However, actuaries should remember that their determinations are subject to all the basic human rights afforded by the Constitution.

9. MEETING THE CHALLENGE

We actuaries need to be certain that we can justify our numbers as fair and equitable in all cases where any such an impression has been given to members. We represent the profession that claims to be able to make financial sense of the future. This places us in a particularly precarious position. Other professions may be able to validly claim that they did not understand the financial implications of these fund conversions. Actuaries will not be able to utilize this line of defence.

—Gluckman & Kamionsky (*op. cit.*)

9.1 It is easy to allege that “generally, the actuarial profession has not served fund members well in the past” (section 1), but much harder to refute—or prove. Nevertheless, it is an important part of a democratic society that the media and other interested parties probe perceived weaknesses. Actuaries must never forget that they are advising on what is often the member’s only life savings.

9.2 Bellis (2000) described how, from a sociological perspective, the project of a profession was to capture a field of enterprise for the self-enrichment of the members. Gutterman (1998) has set out some of the essential principles of the work of the actuarial profession. The actuarial control cycle is very appropriate to long-term financial management. The methods have been very successful for life offices and pension funds for many years. However, the calculation of a transfer value does not easily fit the model of the actuarial control cycle. It is a once-off commercial transaction, which has to be priced rather than budgeted.

9.3 Not only is there a theoretical lacuna, but also the topic is hardly addressed in the actuarial education process, either in South Africa or in the UK.

9.4 ASSA had the opportunity to develop theory and practice when Newell (*op. cit.*) and Gluckman & Kamionsky (*op. cit.*) reported to the respective conventions. These opportunities were missed. Since those days, ASSA has created its Professional Development Committee specifically for this purpose, and it is the author’s hope that that committee will take up this issue and canvass a definitive response from the profession.

9.5 That response could conceivably be that actuaries do not have the techniques to determine transfer values, and (*à la* Bellis, 2000) this part of the field should be surrendered to pricing experts such as financial economists. Or, more likely, it could be that traditional actuarial techniques do not fit the bill exactly, but still have much to offer. Actuarial assessments of the quantum of damages may be criticised in the same way, yet South African courts have found them essential for many years.

9.6 This paper indicates that, even after the introduction of minimum benefits, there will still be scope for discretion when transfer values are determined. If actuaries are to continue to provide advice that can only ever be approximate, then, at the least, when exercising their discretion, they must take decisions that are justifiable in terms of the reasons given, report adequately on such decisions and the impact thereof, and clearly indicate that the information should be distributed to all the parties concerned.

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