**SAP 201: RETIREMENT FUNDS - ACTUARIAL VALUATION REPORTS**

**Classification**

This document is classified as a Standard of Actuarial Practice (SAP) for statutory valuations of South African retirement funds, and as an Advisory Practice Note (APN) for other valuations, including valuations of funds not subject to the Act, or any work done for or advice given to funds that are exempt from the requirement of regular actuarial valuations under the Act. It applies to all members of the Actuarial Society of South Africa.

**Abstract**

This SAP attempts to ensure that valuation reports contain sufficient information to allow an adequate appreciation to be made of the financial condition of the fund by the reader, including an appreciation of any relevant material risks and uncertainties in this information. It also aims to ensure consistency between actuaries in the presentation of valuation reports.

The SAP is not intended to restrict the actuary's freedom of judgment in choosing the method of valuation or the underlying assumptions, although actuaries should be mindful of the need (where appropriate) for consistency within their own work, and with generally accepted actuarial practice in the profession and any basis prescribed by the regulators if applicable.

Funds differ vastly in nature, size, benefit structure, and complexity. It is therefore not possible to prescribe that all aspects of this SAP <u>must</u> be included in all valuation reports and the word "should" has been used instead. The expectation, however, is that all aspects are included for the vast majority of funds, and that the valuator would need to justify why a particular recommendation was excluded, allowing for the particular circumstances of the Fund. Where applicable, in the report, the valuator should note why the report differs from the standard report.

**Purpose**

This SAP has been prepared to assist actuaries in performing their duties to retirement funds in a manner that will maintain the principles of professionalism (competence, integrity and professional oversight) required by the Code of Professional Conduct.

**Legislation or Authority**

Pension Funds Act, 1956 and the Actuarial Society of South Africa.

**Application**

The note applies in respect of statutory valuations of South African retirement funds, which includes all funds registered under the Pension Funds Act ('the Act'), which in terms of section 16 of the Act are required to undergo periodic actuarial valuations, or other equivalent legislation regarding government or other funds. It should be read in conjunction with the relevant legislation and regulatory instruments, circulars and standards issued by the Financial Sector Conduct Authority ('the Authority').) This note replaces SAP 201 (August 2013) with effect from 1 March 2022.

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Actuarial Society of South Africa Retirement Matters Committee.

**Status**

Version 3 Effective 1 March 2022

## 1. Definitions

1.1. Terms used in this note are defined in the Act, and the various regulatory instruments issued by the Authority.

1.2. References in this practice note to a defined benefit fund or a defined contribution fund shall be taken to apply equally and respectively to a defined benefit category or defined contribution category within a hybrid fund.

## 2. Users and presentation of the report

2.1. The actuary should state clearly in the valuation report to whom the report is addressed. If the actuary is not prepared for the report to be relied upon by third parties, then this should be explicitly stated. In preparing the report, the actuary should be aware that it may be relied upon by users with varying levels of financial literacy and should attempt to use language and set out key conclusions and recommendations in a manner that will be understandable to such potential users. The actuary should be mindful of the need to provide adequate particulars to enable an independent valuator to form an opinion on the correctness/reasonableness of the results as set out in the report.

2.2. Where practical, the actuary should discuss the valuation with the client before commencing work to gain mutual understanding of the objectives, requirements and any special issues affecting the valuation and the fund in the future.

2.3. The valuation report should preferably be forwarded directly to the client. If the report is forwarded through a third party, then where possible, the actuary should take the necessary steps to ensure that the report is forwarded to the client without undue delay and that the format of the report is such that it can be forwarded without modification.

2.4. The actuary should attempt to explain the report to the client in person. If this is not possible, then the actuary should confirm in writing their availability to provide professional input and advice with respect to the report, if required.

2.5. The essential components of a valuation report are listed in appendix 1.

2.6. The valuation report should reflect the financial position before, and if applicable, after any approved and implemented recommendations as approved by the client. Any results based on recommendations that have not yet been approved or considered by the Trustees must be clearly indicated as "provisional" or "illustrative" results. The covering submission letter, where such letter is required by the Authority or other stakeholder, should similarly confirm the recommendations approved by the client.

## 3. Objectives of a valuation

3.1. The objectives of a statutory valuation are:

3.1.1. to investigate and report on the financial position of a fund, including results as required by the regulator;

3.1.2. to analyse the financial progress of the fund since the previous statutory valuation;

3.1.3. to review the assumptions used in the current valuation as a result of that experience;

3.1.4. to analyse the sources of any surplus or strain that has arisen in the period;

3.1.5. to review the requirement for, allocations to or from, and the build-up of, any contingency reserve accounts over the inter-valuation period or established at the valuation date (if applicable);

3.1.6. to recommend an appropriate contribution rate for the period to the next valuation in respect of future service accrual (if applicable) for a defined benefit fund,

3.1.7. to comment on the appropriateness of the investment strategy in place at the valuation date.

3.1.8. if applicable, to advise on the minimum pension increases as required in terms of the Act; including a comment on the sustainability of the targeted pension increase and the likelihood of it being realised, and the appropriateness of the investment strategy in this regard;

3.1.9. where applicable for a defined contribution fund, to recommend the allocation of fund return to member accounts and the management of any investment smoothing or processing error / mismatch reserve accounts; and

3.1.10. where required, in the case of defined benefit funds, to recommend an appropriate contribution rate to amortise any deficit, or in the case of defined contribution funds, recommend appropriate action to ensure the fund returns to a financially sound position.

3.2 It is recognised that valuations may be performed for purposes other than statutory reporting, in which case the objectives will differ from those outlined above. In this instance the actuary should clearly outline the purpose and objectives of the report. Further attention is drawn to the need to modify assumptions, reporting requirements or other aspects of the valuation as the actuary should deem appropriate in the circumstances. The actuary should highlight all modifications from a standard valuation and draw the client's attention to material deviations where relevant.

## 4. Valuation assumptions and data

4.1. The actuary should adopt a method and basis and recommend contingency reserve accounts appropriate to the circumstances of the fund and the nature of the valuation. In the case of defined benefit funds, a long term best estimate funding valuation basis with explicit solvency reserves, determined using a methodology that is consistent with regulatory requirements (as may be amended, revised or replaced) is required where the valuation has, as its main purpose, the determination of the financial position of the fund and the recommendation of contribution rates needed to secure the accrual of future benefits in an ongoing fund.

4.2. Such an approach may not be appropriate when the valuation is conducted for other purposes, such as the distribution of the assets on termination of the fund. The actuary should in such cases carefully examine the method and assumptions used to make sure that they are appropriate for the circumstances.

4.3. The assumptions, including the basis on which the contingency reserves are determined, must be stated and clearly motivated. The choice of post retirement interest rate is an important element of the valuation basis and should be consistent with the pension increase policy adopted by the client and the applicable requirements of the Authority in this regard. Where (due to the circumstances of the fund) the fund has no need to adopt a pension increase policy, the valuator should clearly explain the rationale for choosing a particular set of post-retirement assumptions, with reference to unofficial policy, other documentation of the fund or in accordance with other requirements.

4.4. The valuation report must reflect the financial results in terms of regulatory requirements. Where a different approach and/or basis is used but the valuator's results meet such regulatory requirements, this should be clearly demonstrated in the report.

4.5. The actuary should give consideration to the reasonableness of each actuarial assumption independently and also to the combined impact of all the assumptions, so that the overall result is reasonable in light of the circumstances of the fund.

4.6 The actuary is encouraged to discuss the proposed assumptions with the client. If these assumptions differ from those of the previous valuation, the reasons for the change must be explained in the report.

4.7. The actuary should undertake the necessary investigations to satisfy themselves that the data provided is sufficiently accurate and complete for the purposes of the valuation. As part of the valuation process, it is necessary to perform reasonability checks on the data and the administration of the fund over the inter-valuation period. For a defined contribution fund this may include a check of the reasonability of the build-up of individual member accounts and any reserve accounts over the valuation period, as well as the allocation of contributions over the valuation period.

4.8. Where the actuary has reservations about the data provided for the valuation, these should be noted. If the fund is not subject to audit and the valuation has therefore been completed based on un-audited financial statements, or if the financial statements are not yet available for a draft report, this should be noted and the report qualified accordingly.

4.9. In the case of defined benefit funds, the actuary should indicate that actual experience is likely to differ from the assumptions made and that the actual cost of the benefits will depend on the actual financial and demographic experience of the fund. In this regard the actuary is referred to section 12 of this note for consideration of sensitivity analysis and risk factors.

## 5. Valuation of liabilities

5.1. The valuation method must be described, with an explanation given as to why it is considered appropriate for the particular valuation, also commenting on the consistency of the basis of valuing the assets with that of valuing the liabilities.

5.2. Care should be taken to value the actuarial liabilities which arise not only in terms of the rules of the fund, but to include the requirement to meet prospective pension payments in terms of the fund's pension increase policy, or discretionary benefits payable on the retirement of members the likelihood of which is ascertainable from past practices and policies of the fund or the employer(s) participating in the fund.

5.3. A current cost method of valuing risk benefits before retirement is acceptable. The actuary must explain the implications of the method on the accumulation of reserves and comment on the likely future trend of such costs, particularly if it is expected to increase (for example, as a result of aging, changes in mortality, etc). The actuary should indicate the additional allowance, if any, made over and above the premium rates that are payable to the insurers of the benefits.

5.4. In the case of a defined benefit fund valuation,

5.4.1. If applicable, the actuary must explain what allowance is made for future new members in the valuation method.

5.4.2. The valuation method must allow for the projection of future salary increases to date of exit.

5.4.3. Provision must be made for legislated minimum benefits due to active members by reference to actual market conditions at the date of the valuation. (The actuary should further comment on the extent to which the legislated minimum benefits will be met in the event that the fund is terminated at the valuation date. Additional funding may be recommended if necessary.)

5.4.4. Provision for increases in pensions must be made to meet the reasonable benefit expectation of the members. The actuary should have regard to the fund's pension increase policy established in terms of section 14B of the Act, the provisions of the fund's rules, the past practice in granting pension increases, and communication from the fund or employer to the members regarding expected future pension increases. The actuary must clearly state what provision has been made for pension increases and whether the provision is consistent with the pension increase policy established, implemented and communicated in terms of section 14B(3) of the Act.

5.5. In the case of a defined contribution fund valuation,

5.5.1. The actuary must state how members' individual liabilities have been determined, in particular how fund return and expenses, including premiums for the insurance of death and disability risks, have been allocated.

5.5.2. If the client elects to smooth the fund returns allocated to members, the method of smoothing should be outlined with reference to the method of determination of the investment reserve. In addition, the method of adjustment to distribute the a proportionate share of the investment reserve and/or members surplus account to members at date of exit should be explained.

5.5.3. The actuary should consider whether the liabilities and assets are matched at an individual member level as well as fund level, and if necessary make recommendations regarding adjustments to ensure any mismatch is removed.

5.5.4. Where the fund is liable for the payment of pensions, the actuary should comply with 5.4.4 above.

5.5.5. Where reserves are held to stabilise costs in future, the actuary should release these reserves at a rate consistent with the client's intentions. The actuary should comment on the period for which the current level of subsidy can be maintained.

## 6. Notional pensioner accumulation amount

6.1. Where applicable, the actuary is required to determine the minimum pension increase based on the notional accumulation as set out in section 14B of the Act, and indicate how this notional accumulation amount has been taken into account in the fund liabilities.

6.2. The actuary should refer to Standard of Actuarial Practice 205 and to the regulatory instruments issued by the Authority, which seek to clarify the practical implementation of this section of the Act. Legal advice could be sought either by the fund or the actuary should there be any remaining doubt as to the correct interpretation.

6.3. The actuary should describe the method and assumptions adopted in calculating the notional pensioner accumulation amount.

## 7. Contingency reserve accounts

7.1. The actuary must motivate for the establishment of or continued necessity for any contingency reserve accounts, including the appropriateness of the balances in and transfers to or from those accounts. The technique used to determine such reserves must be described and follow generally accepted actuarial practice.

7.2. Once a reserve is established, the actuary should confirm that the reserve is managed in terms of the rules.

7.3. Contingency reserve accounts should not include the value of any liabilities and only act as a buffer against adverse experience

7.4. Where the contingency reserve accounts are not fully funded, the actuary should comment on the desirability of additional amounts being allocated by, or contributed to, the fund to meet the difference. Alternatively, where the actuary believes the balance in the accounts exceeds the amount required then he should comment on the appropriateness of releasing this.

7.5. Each contingency reserve account should take account of the balances held in other contingency reserve accounts, so that the aggregate value is not unreasonable in light of the circumstances of the fund.

## 8. Valuation of assets

8.1. The value placed on the assets must be compared with the fair value of the assets on the valuation date.

8.2. It is acceptable to use the fair value or the actuarial value of the assets in ongoing valuations. The actuary should however ensure that the bases used to value assets and liabilities are consistent, and be mindful of the extent of any mismatching (in excess of that provided for in the fund's solvency or investment reserve).

8.3. Where non-vested bonuses are included in the value of a policy of insurance in which the fund is invested, the actuary should state the amount of such non-vested bonuses relative to the gross value of the policy, and how such non-vested bonuses have been taken into account in the value placed on the assets.

## 9. Financial soundness

9.1. The term “financial soundness” is not uniquely defined. In respect of accrued liabilities distinction is drawn between the fund being financially sound and the fund having actuarial surplus that can be apportioned for the benefit of stakeholders. A fund may be declared financially sound for the purposes of actuarial certification of the valuation when the value of the assets (after deducting the balances in the member and employer surplus accounts) matches or exceeds the accrued liabilities (determined on a basis which complies with the requirements published by the Authority), ignoring the balances in contingency reserve accounts. This declaration can be made despite the balances in these accounts being lower than what the valuator deems prudent, or there being insufficient assets to enable such accounts to be established.

9.2. Actuarial surplus is determined as defined in the Act after taking all contingency reserves into account at the level recommended by the valuator and accepted by the client. The requirements published by the Authority in this regard must also be considered.

9.3. The actuary need not consider the future service contribution rates in determining the financial soundness in respect of accrued liabilities.

9.4. Where the valuation reveals a deficit, the actuary should recommend to the client to firstly debit the member and employer surplus accounts proportionately to eliminate as much of the deficit as possible, in terms of section 15H of the Act. The actuary should indicate the fund’s financial position before and after any such action. Thereafter, a scheme for funding of the deficit should be prepared in accordance with the requirements of section 18(1A) of the Act and any regulatory requirements as applicable. This may be prepared as a separate document to the valuation report.

9.5. Financial soundness in relation to any defined contribution categories in the fund should be interpreted in light of the adequacy of the assets to meet the balances in the respective members’ individual accounts. This test should be performed for each defined contribution sub category, or per investment portfolio. Small mismatches between portfolios may be managed by a mismatching reserve account.

## 10. Sensitivity analysis and risk factors

10.1. Whilst a fund may be financially sound at a point in time, it will continue to be exposed to risks that could affect its financial position in future. These risks include, for example, the risk that future fund returns relative to future salary increases (or other increases in liabilities) will be insufficient; and the risk that falls in asset values will not be matched by similar falls in the values of liabilities.

10.2 The actuary should indicate the nature and extent of any material uncertainty inherent in the ‘point estimate’ liabilities quoted in the report. This may for example be done by way of including a sensitivity analysis of each material assumption. Alternatively, stochastic modelling could be considered as a means of demonstrating the variability of future outcomes and the sensitivity to the assumptions chosen.

10.3 Alternatively, or in addition to this, the actuary should explain that despite the nature of the assumptions used, the reserves may be insufficient (or more than sufficient) and the likely impact on the fund in each of these circumstances.

## 11. Analysis of surplus

11.1. The actuary must analyse the change in the surplus or deficit since the previous valuation, and, where practical, quantify the effect of each material element affecting the financial condition of the fund. The analysis should compare the actual experience of the fund with the actuarial assumptions used.

11.2. In certain cases, including that of small funds, funds with incomplete historical data, and funds for which a valuation is being undertaken for the first time, a full analysis may not be practical. In these cases, an indication of the main sources of surplus or deficit will be sufficient.

11.3. The actuary's attention is drawn to the fact that users of the report may regard the analysis of surplus as a basis upon which to debate the apportionment of surplus in terms of section 15C of the Act. The actuary is advised to ensure that the analysis is presented in a clear and understandable manner. The actuary should be mindful to the fact that the relative contributions of items of surplus could change, depending on the order in which the items are analysed.

11.4. The employer may enjoy a contribution holiday to the extent that the rules and any balance in the employer surplus account permit this. The actuary should indicate the level of possible reduction in employer contributions and over what period this could apply.

## 12. Suitability of the investment strategy

12.1. When certifying the appropriateness of the investment strategy, consideration should be given to special circumstances and consequent needs of the fund which may include for example (but not limited to), closed defined benefit schemes, liquidity requirements, solvency objectives, impact of the investment strategy on pension increase policies etc.

## 13. Special circumstances

13.1. The valuation report must include a comment that the report has been prepared in accordance with the SAP and the relevant regulatory instruments as issued by the Authority or alternatively explain the reasons and instances where the valuation does not comply with the SAP or regulatory instruments in all respects.

13.2. The valuation report must include a comment on whether the report has been peer reviewed. The actuary should consider whether peer review is required, taking account of the guidelines in SAP 901 – General Actuarial Practice.

## Appendix 1:
## Information to Include in the Valuation Report

The items in the following list are regarded as essential components of a valuation report. The actuary should use their discretion as to the level of detail to include in a defined contribution valuation report. The actuary's attention is further drawn to the information that is prescribed by the Authority for inclusion in a statutory valuation report.

### Executive summary

1. An executive summary in line with the requirements of the Authority must be included.

### Introduction

2. An opening statement setting out to whom the report is addressed, the objectives of the valuation and the effective dates of the current and previous valuation. The valuator should highlight that, if the report is used by users other than the intended recipients and for purposes other than the stated objective, the information may not necessarily be relied upon.

3. A statement as to whether the report has been peer reviewed.

### Summary of the fund

4. A summary of the benefits, including the pension increase policy, and contribution rates used in the valuation.

5. In the case of defined contribution funds, the summary should state whether the expenses, including the premiums paid for the insurance of death and disability risks, are

   - included within the defined contribution,
   - paid in addition to them,
   - borne out of fund returns prior to distribution to members (if permissible), or
   - borne out of reserve accounts.

### Developments during and subsequent to the inter-valuation period

6. A description of all relevant developments since the previous valuation of the fund, for example:

   - changes in benefits or any of the fund's policies that may have a financial impact,
   - pension increases granted to pensioners,
   - fund return on the assets held by the fund (by portfolio as appropriate),
   - salary increases granted to in-service defined benefit category members,
   - fund returns allocated (by category of members or portfolio as appropriate),
   - discretionary benefits granted,
   - contribution rates paid, risk benefit premiums and expense charges due,
   - extraordinary changes in membership,
   - changes in investment strategy, or
   - any other change deemed relevant by the actuary.

7. A consolidated income statement showing cash flows and accruals over the inter-valuation period.

8. Comments on financially significant events that have occurred since the valuation date, or that may be imminent, and the allowance for these events in the valuation, if applicable.

## Member and financial data

9. A summary of the membership data used in the valuation as prescribed by the Authority.

10. A description of the measures taken by the actuary to ensure the completeness and accuracy of all data used, and if necessary, a qualification if the actuary has any reservations regarding the reliability of the data.

11. A summary of the assets of the fund including such additional detail as relevant to the circumstance of the fund, in accordance with the requirements of the Authority.

12. Details of the fund return earned over the period (per portfolio or categories of membership as applicable).

13. A description or summary of the client's investment strategy, including a general description of the details of the assets or investment portfolios.

14. The actuary should state whether the valuation has been based on audited financial statements.

## Actuarial certification

15. A section providing the actuarial certification as required by the Authority should be included.

## Valuation method and results

16. A description of the valuation method and assumptions used to value the assets and liabilities.

17. A description of what provision has been made for minimum benefits, the pension increase policy and the minimum pension increase, and on what basis minimum benefits are calculated.

18. Comment on the suitability of the fund's investments in relation to the liabilities. In this regard, the actuary is referred to the detail as outlined in paragraph 12 of the main note.

19. A comment on the appropriateness of reinsurance or self-insurance of risk benefits (if necessary), covering any reserves held and the contributions recommended for the future.

20. The ratio of the notional pensioner accumulation amount to the accrued liabilities in respect of pensioners and deferred pensioners, expressed as a percentage, where applicable.

21. The valuation results, dealing separately with pensionable service to the valuation date, and future service.

22. Where a fund has assets and liabilities that are ring-fenced in terms of the rules, for example for the benefit of a particular category of members, the valuation must report separately on each such category of members. For example, if the fund pays pensioners from the fund, and the assets backing pensions are ring-fenced, then the report should deal separately with the pensioners (both in terms of assets and liabilities, and suitability of the assets to the liabilities), and with active members.

23. A comparison of the valuation result with that at the previous valuation.

24. A statement on whether the valuation was performed on a basis prescribed by regulatory requirements. Where the valuation basis used is different from such a prescribed basis, then the report should include sufficient information to demonstrate that the basis used is no weaker than the prescribed basis.

25. Any disclosures required by regulatory requirements, for example reporting funding levels and contribution rates on prescribed valuation bases.

26. An analysis of the reasons for the change in surplus or deficit.

27. A summary of the valuation results and a formal certification by the valuator regarding the financial condition of the fund.

28. A statement as to the actuary's satisfaction with the material completeness and accuracy of all data supplied.

29. A statement on whether, in the actuary's opinion, the fund was administered in accordance with the rules.

30. Where the circumstances of the fund dictate special provisions may be required these should be highlighted as significant matters, eg for closed funds, bulk transfers, large scale retrenchments, terminating funds etc, where the investment strategy may need to be reviewed. Or, if for eg the valuator is concerned around the quantum of expenses relative to the size of the fund based on the valuator's experience and industry knowledge, this should be drawn to the board's attention.

31. A statement that the report complies with SAP201 and the applicable regulatory requirements. Alternatively, comment as to the instances where the report does not comply and the reasons for this.

32. The actuary's qualifications and the capacity in which the actuary has signed the report (for example, 'Actuary of ABC Consultants and Actuaries').

33. A statement as to the primary regulator of the actuary in his or her professional capacity.

34. Specific attention may need to be drawn to the additional requirements of an actuary if he is performing the valuations in a territory other than the Republic of South Africa. The actuary should ensure he is familiar with such necessary requirements and confirm compliance there-with if applicable.

**Detail for defined benefit categories of a fund**

35. A recommendation for the financing of any deficit disclosed by the valuation including the period over which the funding of the deficit has been determined, split if necessary between different components over different periods.

36. A recommendation regarding future contribution rates, or other steps as deemed necessary to ensure the fund remains in a financially sound position. If contributions are recommended, the valuator should indicate under what circumstances they are expected to remain constant, increase or decrease. The recommendation should specifically also consider the expenses of the fund and the manner in which these are funded.

37. Where the actuary has performed a sensitivity analysis per 10.2 above, this must be included in the report.

## Detail for defined contribution categories of a fund

38. A recommendation regarding an adjustment to the allocation of fund return to members or other steps as deemed necessary to ensure the fund is in a financially sound position.

39. In the case where the defined contribution rate includes expenses and risk premiums, the report should identify the current portion of the total contribution which is being saved towards retirement and the portion towards other funded benefits.

40. The report should detail the rates of fund return and expenses, including the premium rates deducted for death and disability benefits, accrued to individual members' accounts for the valuation period.

41. Other methods of recovery of expenses need to be highlighted if these are not deducted directly from the member accounts or from the contributions prior to investment. Funds in termination phase should also be carefully considered as the method of recovery of expenses could change. If applicable the possible disproportionate recovery from the last remaining member(s) should be considered with recommendations on alternative methods of recovery if possible.

42. Special attention is drawn to circumstances where the fees are quantified as a fixed rand amount which may impact on the retirement savings portion for lower income members. The valuator should also comment where applicable on the extent of any cross subsidy between categories of member, e.g. deferred retirees or paid up members and their contribution to administration and other expenses.

43. In the case of defined contribution funds with more than one investment portfolio, a comparison of the fair value of the assets held in respect of each investment portfolio against the accrued liabilities attributable to that investment portfolio should be shown. Steps to address significant mismatches, if applicable, should be included.