

SAP 208: COSTING OF PAST SURPLUS UTILISED IMPROPERLY

Classification

SAP 208 is a Standard of Actuarial Practice (SAP) and compliance with it is mandatory. SAP 208 replaces PGN 208. Where legislation or other documentation refers to PGN 208 it should be interpreted as SAP 208.

Abstract

The Pension Funds Second Amendment Act, No 39 of 2001, introduced section 15B into the Act with effect from 7 December 2001. This section requires the *Board* of a fund to apportion existing actuarial surplus between stakeholders. As part of this apportionment exercise, section 15B(6) requires the *Board* of the fund to determine amounts of actuarial surplus used historically for purposes defined in that section as past surplus utilised improperly by the employer. An actuary may be requested by the *Board* to perform this function or render advice in respect of this function.

Purpose

The purpose of SAP 208 is to alert actuaries to certain problems associated with this activity and to require them to report their findings in a manner that will maintain the high levels of professional competence and integrity expected of the profession.

Legislation or Authority

Section 15B(6) of the Pension Funds Act, 1956, and PF Circular 113.

Application

This standard of actuarial practice is applicable in South Africa and applies to all members of the Society who may be requested to quantify uses of actuarial surplus in terms of section 15B(6) of the Act.

Author

Pension Funds Surplus Committee (This ad hoc committee was established during 2002 specifically to address the actuarial issues relating to the *Surplus Act*.)

Status

Version 1.0 Effective from 1 January 2005.

Definitions

Defined terms appear in italics when used in this standard of actuarial practice.

“Act” means the Pension Funds Act, 1956, as amended by the *Surplus Act*.

“Board” means the management board of a retirement fund as defined in the *Act*.

“*Surplus Act*” means the Pension Funds Second Amendment Act, No 39 of 2001.

1. Scope

- 1.1 The actuary may be asked to quantify the actuarial surplus used for one or more of the purposes defined in section 15B(6) of the *Act* as “past surplus utilised improperly by the employer” and to determine the corresponding amount to be included in the surplus apportionment exercise in terms of section 15B(5)(a).
- 1.2 The actuary is not responsible for establishing whether any improper use of surplus has taken place. He or she should therefore request full details from the *Board* of the improper uses that require valuation.
- 1.3 However, if the actuary is aware that a use of actuarial surplus did occur in the past which may fall within one of the uses defined in paragraphs (a) to (d) of section 15B(6) of the *Act*, the actuary should draw this to the attention of the *Board* and the representative of former members appointed in terms of section 15B(3) of the *Act*.

2. Difficulties in interpretation

- 2.1 There are a number of interpretational problems that have been raised with regard to the wording of section 15B(6). Some of these interpretational problems have been set out in the attached document entitled “Examples of interpretational problems with regard to the wording of section 15B(6) of the Pension Funds Act, 1956”. This document is not intended to detail all possible interpretational problems that may exist, but rather to draw the attention of the actuary to the fact that such problems exist.
- 2.2 Circular PF113 sets out the Registrar’s interpretation of certain other matters, such as whether an event, which took place earlier than 1 January 1980, should be included.
- 2.3 Where some provision of Circular PF113 or any interpretational issue, including, but not limited to those listed in the attached document, has a material impact, the actuary must take instruction from the *Board*.

3. Report

- 3.1 The actuary should report on each event that he or she has been asked to quantify.
- 3.2 The actuary should include a description of the method used to determine the cost.

- 3.3 The actuary should include a description of any assumptions used in the calculation.
- 3.4 The actuary should include a description of the basis adopted to allow for interest between the date of the event and the surplus apportionment date.
- 3.5 Where the actuary has taken instruction from the *Board* as to how a calculation is to be performed in the light of the interpretational difficulties mentioned, the actuary should attach that instruction to his or her report.

4. Conflict of interest

- 4.1 The actuary should ascertain whether he or she will experience any possible conflict of interest in performing any of these calculations between advice given to any of the stakeholders at the time that the event took place and the calculation that the *Board* has now requested in order to fulfil their duties in terms of the *Act*. If there is a possible conflict of interest, the actuary must act in accordance with the Professional Conduct Standards.

18 November 2004

**EXAMPLES OF INTERPRETATIONAL PROBLEMS WITH REGARD TO
THE WORDING OF SECTION 15B(6) OF THE PENSION FUNDS ACT, 1956**

1. The term "cost of" is used in connection with the events defined in paragraphs (a), (b) and (c) of section 15B(6). Taking into account the context, being the use of actuarial surplus, an actuary would reasonably interpret this term as the difference in the accrued liability caused by such event. It is understood that the term "cost of" may be interpreted in law as the actual amount expended (with the corollary that if no amount has been expended then there has been no cost). The difference in these interpretations is likely to be material.
2. There are significant differences of opinion as to the meaning of the term "selected members" in paragraphs (b) and (c) of the applicable section of the Act. At one extreme it may be interpreted as "any group smaller in number than all the members". At the other extreme the term may be interpreted to comprise members falling into some natural class, such as all pensioners, or members in respect of whom the action can be justified on moral or Constitutional grounds.
3. There are similarly widely different interpretations of the term "executives". At the one extreme the term may be defined, as the directors, the chief executive and those employees reporting directly to the chief executive, only. At the other extreme it may be interpreted to include whole classes of management.
4. Paragraph (b) refers to "additional pensions or deferred pensions". In some cases additional lump sum benefits have been awarded. There is uncertainty as to whether such lump sum benefits should be included within the scope of paragraph (b).
5. Paragraph (c) may be interpreted so as to exclude the award of service up to a member's normal retirement age when a member retires early.
6. There is doubt as to whether the award of a benefit improvement in terms of paragraph (a) or (c), which will vest only on retirement should be included.
7. From an actuarial point of view, it would be conventional, when determining the cost of an event at a historic date which is to be taken into account at a current date, to include interest, either at the rate assumed in the periodic valuations of the fund or at the investment return earned by the fund, net of expenses, from the effective date of the event to the current date. This is not, however, explicitly stated in paragraphs (a), (b) and (c), but is stated in (d) read with section 15A (3) of the Act. Therefore there is the potential that a legal argument (albeit different from the actuarial approach) could be made that no interest should be included from the date of an event in (a), (b) or (c) to the surplus apportionment date.

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