NON-BANK FINANCIAL INSTITUTIONS REGULATORY AUTHORITY (NBFIRA)

PENSIONS PRUDENTIAL RULES

In terms of Section 50 of the NBFIRA Act – Section 51 on Reporting

PFR7

Conditions for Exemption from Actuarial Valuation

Effective March 1, 2012

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1. Introduction

1. All pension funds are required to submit an actuarial valuation report (PFR6) to the NBFIRA triennially, unless exempt from actuarial valuation. This document sets out the conditions under which exemption from actuarial valuation is allowed.

2. The Certification from Actuarial Exemption forms part of the required statutory returns which comprises of five sets of documents:

    a. PFR3 is the annual Pension Fund Return, which contains relevant financial data about the fund
    b. Pension Fund Annual Financial Statements
    c. PFR9 is the Risk Questionnaire, outlining the key risks faced by the fund and its management of those risks
    d. PFR6 is the Actuary's Report
    e. PFR7 Application for Exemption from Actuarial Valuation
    f. PFR8 Certification of Suitability of Investments

3. PFR7 applies to all pension funds operating in Botswana.

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2. Conditions of Exemption

4. A board of trustees may apply for a fund to be exempted from actuarial valuation. Such application will be considered only if an actuary certifies that he/she has scrutinised the rules and method of operation of the fund, a sample explanatory booklet given to members, and a sample of an individual member's benefit statement and has found that:

2.1. *No Pensions are Paid from the Fund*

5. No pensions are paid from the fund. On retirement, the fund must purchase an annuity policy from a registered insurer and the fund must have no liability in respect of the pension payable that is not matched by this policy. After purchase of the annuity policy and payment of any portion of the benefit in cash, the fund must have no liability towards the member.

2.2. *Benefits are Secured for Members on a Defined Contribution Basis of Funding*

6. The fund is operated in such a way that the assets will always match or exceed the liabilities at the end of the financial year. Either through an equitable share mechanism or proportional apportionment of gains or losses over the year.

   a. Assets and liabilities are equalised through an equitable share mechanism at the end of the financial year where, any surpluses or strains will be distributed amongst members in a manner which is equitable between classes of member and by duration of membership, and which is consistent with the nature of the surplus or strain; or

   b. Any realised or unrealised capital gains or losses, any investment income, any expenses in excess of any amounts deducted from contributions prior to these being credited to a member's individual account, and any gains or losses experienced through operation of an interim bonus mechanism, must be credited or debited to members' individual accounts in proportion to the account balance prior to such apportionment at the end of the financial year, or expressed as a rate of fund return and applied for the benefit of members.

7. Any strain arising in the fund that is passed onto members does not conflict with the reasonable benefit expectations of members.

8. The actuary should comment on the appropriateness of the assets in comparison with liabilities and, where known, reasonable expectations. A full asset-liability modelling exercise would not be necessary and a comment in general terms would suffice.

2.3. *Allocation Method of Investment Returns and Expenses*

9. The method used to allocate investment returns (positive or negative) and expenses (including premiums for the insurance of death and disability benefits) to members' individual accounts is reasonable.

10. The Actuary should take particular note of how non-vested bonuses will be treated in the event that such bonuses are reduced at some time in future. If there is no mechanism to protect the fund from such an event, the fund cannot be exempt.

11. The investment return credited to members can differ from the actual underlying returns. This in itself is not a reason to withhold the exemption. However, it is important that the method of

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operation is based on sound principles. It is advised that the Actuary discusses the matter with the NBFIRA and that they agree on the matter.

12. The method in which expenses had been allocated to individual member accounts, or deducted from contributions paid, and whether it is based on sound principles and do not endanger the financial position of the fund. It does not mean that no cross-subsidies are allowed, but there should not be gross inequities between different groups of members or generations of members.

2.4. *Smoothed Investment Return*

13. If investment return credited to members' individual accounts is smoothed, the rate is reasonable in relation to the gross investment return earned by the fund less such expenses as are reasonable to deduct from the investment return, the rate does not endanger the financial soundness of the fund, and the corresponding investment reserve does not hold a debit balance at the end of the financial year.

2.5. *Fully Insured Benefits*

14. If any benefit payable to a member exceeds the value of the member's individual account, the excess is fully insured with one or more registered insurers.

15. There must be a provision in the rules of the fund that restricts the amount of any risk benefit to the amount that may be recovered from an insurer.

2.6. *Reserve Accounts*

16. No reserve accounts other than an investment reserve account and an expense reserve account are held. Neither the investment reserve account nor the expense reserve account may hold a debit balance after the end of the financial year – the equitable share or fund return mechanism is used to debit the members' individual account if there was a debit balance prior to the end of the financial year.

2.7. *Investment strategy*

17. The investment strategy is suitable to the nature of the fund and its expected liabilities.

18. A copy of a Certificate of Suitability of Investments (PFR8) must be attached alongside the Certificate of Exemption.

2.8. *Period of Exemption*

19. Such exemption will only be granted for a period of three years. The fund must obtain a further certificate for the exemption to be renewed before the end of this period. In considering whether to issue such a certificate the actuary must examine the financial statements and method of operation of the fund, before certifying that the fund continues to satisfy the criteria above for exemption from actuarial valuation.

20. If the fund no longer qualifies for exemption the fund should submit PFR6 i.e. the Actuary's Report to the NBFIRA.

2.9. *Qualified Certification*

21. It is permissible for an Actuary to provide qualified certification even if the fund does not fully comply with the PFR7. However, the Actuary needs to justify very carefully why he/she believes

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that exemption is still appropriate in the particular case. The Regulatory Authority will then determine whether or not exemption can be granted despite the Actuary's qualified certification.

2.10. *Other Matters*

22. The Actuary may add any other matters relevant to the principles on which valuation is sought.

23. If the Actuary becomes aware of an event that may be grounds for exemption to be withdrawn earlier than the end of the three year period for which exemption has been granted, the Actuary must advise the board of management of the fund and the Regulatory Authority that the fund may no longer qualify for exemption. Such an event may include a change to the rules of the fund or the manner in which the fund is administered. Following such advice, the fund shall either submit an actuarial valuation in format PFR6 or a certificate by an Actuary that the fund continues to satisfy the conditions for exemption after such event.

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Addendum: Certificate of Exemption (FORM PFR7)

CERTICATE BY THE ACTUARY IN SUPPORT OF AN APPLICATION FOR EXEMPTION

Name of the fund: ……………………………………………………………….

I have scrutinised:

(a) the rules and the method of operation of the fund since the issue of the previous certificate;
(b) a sample explanatory booklet given to members; and
(c) a sample of an individual member's benefit statement.

In respect of the period since the issue of the previous certificate:

(a) The method used to allocate investment returns to individual account has been as follows:

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(b) Expenses (including the premiums paid for the insurance of death and disability risks) have been handled as follows:

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(c) Members of the fund were/were not (delete whichever is not applicable) provided with projections of their expected ultimate benefits. If they were provided with such projections, the basis of such projections, the basis of such projections was/was not approved by an actuary (delete whichever is not applicable)
(d) All risk benefits falling due were fully covered by insurance or reinsurance.
(e) All pension payments falling due were fully recovered by annuities from an insurer.
(f) The assets of the fund at all times adequately matched its liabilities.

Having taken account of the manner in which expenses, including the premiums paid for the insurance of death and disability risks, investment returns and any surpluses or strains will be distributed between members in future, I am satisfied that:

(a) all members of the fund, other than pensioners, are entitled to a defined contribution type benefit;
(b) all risk benefits falling due were fully covered by insurance or reinsurance;
(c) the assets of the fund at all time adequately matched its liabilities;

(d) all benefits, other than those fully secured by an insurer, are limited in value to the contributions, net of expenses including the premiums paid for the insurance of death and

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disability risks, accumulated with investments return as determined by the person managing the business of the fund;

(e) all periodic retirement benefit payments will be fully secured by the purchase of annuities from an insurer;

(f) any surplus or strains will be distributed amongst members such that the value of the accrued liabilities of the fund will not exceed the market value of the assets of the fund. Such method of distribution of surpluses or strains is equitable between classes of member and by duration of membership, is consistent with the nature of the surpluses or strains, and will not conflict with the reasonable benefit expectations of member;

(g) the fund does not have any reserve accounts, other than an investment reserve account; and

(h) members of the fund **were/were not** (delete whichever is not applicable) provided with projections of their expected ultimate benefits. If they were provided with such projections, the basis of such projections was/was not approved by an actuary (delete whichever is not applicable).

In my opinion, continued exemption in terms of the rules is warranted.

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For funds applying for the renewal of exemption from actuarial valuation

In respect of the period since the issue of the previous certificate:

a. The method used to allocate investment returns to individual accounts is based on sound principles, and has been as follows:

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....

b. The rate of investment return is not smoothed, i.e. the full net investment returns are passed on to members. Such mechanism does not endanger the financial soundness of the fund; or

c. The rate of investment return passed on to members is smoothed, and I am satisfied that:

   i. the rate is reasonable in relation to the gross investment return earned by the fund, net of reasonable expenses, and

   ii. the mechanism used to smooth the rate does not endanger the financial soundness of the fund.

d. The treatment of expenses (including the premiums paid for the insurance of death and disability risks) is based on sound principles and has been as follows:

...………………………...
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....

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General provisions

The assets exceeded the liabilities of the fund at the effective date of this certificate.

The assets are suitable considering the liabilities of the fund.

To the best of my knowledge, there is no danger of the fund not complying with the conditions of a to e above.

The assets are suitable for the liabilities of the fund (as per PFR8).

In my opinion, the appointment of an Actuary and triennial valuations as contemplated in PFR6 and PFR7 are unnecessary.

Signed: ……………………………………………………

Name: …………………………………………………….

Actuary: ……………………………………………….

Qualifications: ………………………………………

Date: ……………………………………………………

Notes:

(1) Where the actuary is unable to make the statements above, without qualification, but feels that the refusal of exemption would be unduly harsh, the actuary must qualify the statement above, where appropriate, and give reasons why exemption should still be granted.

(2) The actuary may add any other matters relevant to the principles upon which exemption is sought.

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