NON-BANK FINANCIAL INSTITUTIONS REGULATORY AUTHORITY

(NBFIRA)

PENSIONS PRUDENTIAL RULES

In terms of Section 50 of the NBFIRA Act

PFR8

Suitability of Investments

Effective March 1, 2012

Contents

1. Introduction

1. The inclusion of an Actuary's certification of the suitability of pension fund investments forms part of the documents required at registration and returns to the NBFIRA and is mandatory for all pension funds.

2. This document sets out the requirements for the Certification of the Suitability of Investments for pension funds. The aim is to help ensure consistency and completeness of processes followed by the actuary in assessing the suitability of the investments.

3. The Certification of the Suitability of Investments forms part of the required statutory returns, and comprise 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 for Actuarial Valuation
   f. PFR8 Certification of Suitability of Investments

4. The assessment of the suitability of investments is adapted from professional guidance prepared by the Actuarial Society of South Africa ("ASSA"). PFR8 applies to the assessment of the suitability of investments in respect of all pension funds operating in Botswana, regardless of the actual professional affiliation of the Actuary.

5. These considerations are aimed at providing guidance on assessment of the suitability of the investments and the investment strategy.

2. Certification Considerations

2.1. General Considerations

6. The actuary should ensure that he or she has an adequate understanding of the fund's investment strategy before certifying the appropriateness of the fund's asset structure. All funds are required to develop an investment strategy according to PFR2.

7. There is no requirement for a fund to engage an actuary to assist with the development of the investment strategy. The fund may engage an investment advisor or may develop its own investment strategy if there is sufficient investment skill among the board of trustees.

8. The actuary should advise the trustees of the issues that he or she will consider when he or she comes to review the asset structure for certification purposes.

9. In most cases there are a range of strategies that could be considered appropriate, rather than a single investment strategy. In certifying the appropriateness of the structure of assets the actuary must ensure that the asset structure falls within the range of appropriate investments.

2.2. Assets Structure Relative to Liabilities

10. The key considerations when considering the appropriateness of any asset structure relative to any set of liabilities are:

    a. The long term returns expected to be earned from the assets relative to the returns required to finance the liabilities;
    b. The potential mismatch between the assets and the liabilities in terms of the incidence of cashflows, or liquidity requirements;
    c. The potential uncertainty in terms of the returns earned by the assets over both the shorter term and the term of the fund's liabilities;
    d. The risk of capital loss arising from market fluctuations before maturity, including potential early termination penalties in respect of structured products and smoothed bonus policies; and
    e. The risk that short term investments may not be able to be reinvested at the same rate as the original investment, to deliver the required return over the full term of liabilities.

2.3. Defined Benefit Funds

11. In addition to the considerations set out in paragraph 10 above, in order to certify the appropriateness of the structure of the assets relative to the liabilities of a defined benefit fund or of defined benefit liabilities within a hybrid fund, the actuary should consider the following specific issues:

    a. The term of the fund's liabilities in comparison to that of its assets;
    b. The nature of the fund's liabilities (whether contractual or discretionary) compared to the fund's assets;
    c. The fund's pension increase policy, where applicable;

d. The funding position of the fund;

e. The extent to which the fund's assets are invested in a manner such that the net returns expected to be earned (after pension or provident fund tax and fees) are likely to be adequate to meet the fund's liabilities in terms of the fund's actuarial funding basis;

f. The extent of any contingency reserves that may be drawn on to fund liabilities; and

g. In a "balance of cost" situation, where such information is available, the willingness and ability of the employer to pay additional contributions to meet any shortfall that emerges.

2.4. Defined Contribution Funds

12. Defined contribution funds will broadly fall into one of two categories, viz. those that operate a single investment channel in respect of the fund's total liabilities and those that operate multiple investment channels. In the latter case the different investment channels might be allocated to different groups of members on the basis of some factor such as age, or term to retirement, or be made available to members on a choice basis, or both.

13. Where a single investment channel is operated in respect of the fund's total membership, the actuary should consider the following factors which will influence the appropriateness of a particular strategy:

    a. The objectives of the fund as stated by the fund's trustees;

    b. The policy regarding investment smoothing and the existence and size of any investment reserves;

    c. The potential for negative returns to significantly erode the benefits of members close to retirement;

    d. The likelihood of significant disinvestment to meet future benefit payments; and

    e. Communication provided to members which might influence members' expectations.

14. Where multiple investment channels are provided it would be usual for at least one investment channel to be growth focused and at least one to be capital preservation focused. In such a fund, in order to provide the required certification, the actuary should be satisfied that the underlying asset structures are consistent with the stated objectives of each channel.