

DRAFT
IAA GUIDELINES OF ACTUARIAL PRACTICE
FOR SOCIAL SECURITY PROGRAMS

A. Introduction

Many Social Security Programs (SSP) face major financial challenges in planning for the future due, among other things, to the effects of changing demographic structures over time. Important political decisions are being planned, considered and/or made in order to meet these challenges. In many cases, the main concern is future long-term costs. Therefore the need arises to perform financial projections and analyses of SSPs. This was acknowledged also as early as 1952 in Article 71 (3) of the Social Security (Minimum Standards) Convention, No. 102 of the International Labour Organisation (ILO).

Actuaries possess significant expertise in preparing long-term financial projections and therefore have an important role carrying out analyses of SSPs. Accordingly it is vital that all demographic and economic analyses carried out by actuaries provide reasonable projections of long-term future costs and financial impact on which those important decisions can be based.

In many countries, actuarial professional bodies set professional standards and guidelines of actuarial practice for insurance and pension programs, but generally they do not apply to SSPs. Actuarial work for SSPs is also carried out in many countries where the profession is not well developed and no standards of practice exist. The need for guidelines of actuarial practice in this area has also been identified by the International Social Security Association (ISSA) and the ILO. These IAA Guidelines of Practice were established to fill the gap and aim at ensuring that all actuaries involved in this type of work provide reliable financial evaluations.

Actuaries should take into account sound actuarial principles and actuarial standards set by any actuarial associations to which they belong. However, these Guidelines shall prevail only to the extent that they complement and are not in conflict with ~~legislative~~ **local** requirements in the country concerned, including provisions in the social security legislation ~~specifically~~ **specifically** referring to actuarial reviews of the SSP. Compliance with these Guidelines by practitioners should enable the users of such actuarial work to have confidence in the professionalism, objectivity and scientific rigour of actuaries. These Guidelines are also intended to promote the development of consistent actuarial practice throughout the world.

While these Guidelines are not binding on actuaries, all actuaries engaged in work of this nature are recommended to adopt them. The Guidelines will also provide a suitable framework for other experts working in this field **unless local actuarial standards or guidelines apply.**

These Guidelines become effective on January 1, 2003.

B. Scope

1. Type of program

These Guidelines cover SSPs having the following attributes:

- (a) Prescribed by legislation.
- (b) Covering a defined wide population, generally on a compulsory or automatic coverage basis.
- (c) The benefits provided by the program are generally payable in respect of one or more of the following: old age, retirement, death, disability, invalidity, survivorship, health, sickness, maternity, unemployment, work-related injuries.

These Guidelines apply to the above-mentioned programs irrespective of the manner in which they are financed.

Moreover, these Guidelines may also be appropriate for use, if not otherwise directed, by actuaries responsible for evaluations of public pension programs specifically sponsored by a government **or a quasi-governmental organization** as an employer for its employees, as well as for social security programs which are in accordance with the spirit of the scope of these Guidelines but are not covered by the precise wording.

2. Type of actuarial work

These Guidelines cover actuarial work including:

- Actuarial reports on the projected financial status of an SSP or equivalent reports
- Statements of opinion, papers or presentations on SSP policy matters, such as the adequacy of contributions and/or benefits relating to the existing provisions, or proposals for changes therein, **or establishment of a new scheme.**

When the SSP is operated by a separate entity, e.g. by an insurance company or a workers compensation board, these Guidelines do not apply to actuarial work related to the financial reporting of that entity, the calculation of its liabilities for year end or to the calculation of its premiums or rates for the immediately following fiscal periods or other similar work.

C. Principles of actuarial practice

In producing actuarial work with respect to SSPs the actuary should comply with the following principles:

1. Scientific rigour

The actuary should ensure that the methodology used for the long-term financial projections **is based on ~~validated and consistent with generally accepted~~ actuarial practice principles.** The actuary should comply with any general or specific professional guidance that may apply in the relevant circumstances. **The actuary**

should also ensure that the calculations accurately reflect the methods and assumptions adopted. In this context, the actuary should indicate in the report that assumptions, though reasonably determined, are not predictions and that eventual differences between future experience and the report's assumptions will be analysed and taken into account in subsequent reports.

2. Objectivity

If the determination of assumptions used for demographic and financial projections is part of the actuary's mandate, he/she should ensure that they are determined without inappropriate political or external influences. If the actuary is not mandated to determine the assumptions **but they are set by another entity**, and whenever external work is relied upon in the determination of assumptions, the actuary should state the origins of the assumptions and, when needed to give a fair view of the SSP, show a sensitivity analysis of the impact of alternative assumptions.

3. Transparency, explicitness, simplicity and consistency of the information supplied in the report.

When preparing a report, a paper or a presentation the actuary should aim to communicate as clearly as possible, having regard to the various audiences to whom it is addressed and the different stakeholders who will place reliance on the results. The actuary is accordingly recommended to include in the report an executive summary written in plain language, describing the purpose and the main findings of the report.

D. Information to be included in actuarial reports

Actuarial reports on SSPs should include **or make reference to** all relevant **and material** information taking into account the purpose of the report and to whom it is addressed. The content of an actuarial report varies depending upon the nature of the actuarial work involved. **Therefore the detailed lists of information in this chapter are only exemplary.** The following general list applies more specifically to reports on the projected financial status of an SSP or equivalent reports.

1. Executive Summary

- (a) Purpose of the report
- (b) Identification of the program
- (c) Identification of key assumptions
- (d) Main results of financial projections
- (e) Main conclusions

2. Introduction

- (a) To whom the report is addressed
- (b) Identification of the SSP under review
- (c) The purpose of the report, including a reminder that projections are dependent upon the underlying data, methodology and assumptions.

- (d) The starting and ending dates of the projection period.
- (e) Reference to the relevant preceding reports.
- (f) Contemplated date of next report.

3. Description of the provisions of the SSP concerned

Financial projections of an SSP depend, *inter alia*, on the provisions of the program. Written reports should accordingly include a description of the provisions of the program that are materially relevant to the projections, e.g. coverage, financing, benefits.

4. Data

~~The actuary should endeavour to obtain to carry out a rigorous analysis, an actuary should be able to rely on access to~~ reliable and sufficiently complete data materially relevant to the actuarial work, such as the:

- Demographic experience of the program and the country.
- Economic experience of the program and the country, such as contributions, benefits, investment earnings and assets if any.
- Number of contributors and beneficiaries of the program.
- **Payroll or exposure and loss information by workers' compensation classification or employment class.**

The actuary is reliant on the accuracy of data and should therefore take steps to assess how the information provided for the evaluation is consistent with relevant information from other sources.

The actuary should describe the relevant data used for the demographic and financial projections and comment on the sufficiency and reliability of the data. If some data are considered insufficient for the purposes of the financial projections, the report should mention the consequential limitations on the results.

The report should indicate the three main areas in which data was used for the purposes of the financial projections:

- (a) Starting point of the projection period;
- (b) Analysis of past experience as a basis for determining the assumptions used for the financial projections;
- (c) Validation of the projection methodology.

5. Assumptions

The assumptions should be chosen according to the purpose of the investigation.

Normally for an SSP, assumptions are expected to be determined on:

- (a) A realistic basis, as opposed to a conservative or a liberal basis, so as not to bias the financial projections. Each assumption should be individually realistic.
- (b) An explicit, as opposed to implicit, basis to the extent possible.
- (c) A basis taking into account:
 - Internal consistency, e.g. all assumptions should be mutually consistent by virtue of their correlation or interrelationship.

- Overall consistency, e.g. the economic and demographic assumptions used should be consistent with the long-term experience and the outlook for the economy.

The actuary should describe in the report the rationale used for the determination of all assumptions used for the projections.

Actuarial reports prepared for SSPs are often concerned with the long-term future and in such cases the assumptions should reflect expected long-term trends rather than giving undue weight to recent experience. However, where appropriate, estimates for the earlier years should take account of short-term trends, phasing in to the longer-term assumptions as necessary.

Given the uncertainty surrounding the assumptions, it **may be is** appropriate for the actuary to consult other professionals with relevant expertise **in on** deciding what assumptions to make about the future.

Where a report is part of a series, and there have been changes in assumptions from the previous report, the actuary should take steps to explain any material impact that changes in assumptions have on the financial projections.

6. Methodology

The methodology employed for the financial projections should be described in a manner that provides sufficient information for an actuary or other person with relevant expertise to assess the results of the report.

7. Results

The actuarial report should include all results of the demographic and financial projections that are relevant to the purpose of the report and to whom it is addressed. The actuary should present the results in a form that is consistent with the specific terms of reference of the evaluation or review and having regard to the nature of the SSP and the financing methods under which it is operating, particularly when these are laid down in the social security legislation.

The following model framework for the projection results to be included in the report is presented, it being understood that adjustments may need to be made to the framework to take into account the nature of the particular report. Most of the results would normally be found in either of the following two areas of the report:

Sections on data, methodology and assumptions

- (a) Population by age groups and sex and in total
- (b) Dependency ratios
- (c) Employment earnings by age groups and sex, and averages
- (d) Contributory earnings by age groups and sex, and averages
- (e) Pensionable earnings by age groups and sex, and averages
- (f) **Covered payroll and workforce by sector of economic activity**

Section on cash flow financial projections

- (g) Contribution rate
- (h) Pay-as-you-go-rate
- (i) Contributions
- (j) Investment earnings
- (k) Other income
- (l) Total income
- (m) Benefits
- (n) Administrative expenses
- (o) Total expenditures
- (p) Assets

The results should also make clear whether and to what extent expenditure other than benefits has been included and this expenditure should also be taken into account in the statements about adequacy of contributions.

Irrespective of the financing method, the results shown should include a summary ~~of the cash flow in respect~~ of the income, expenditure and assets of the program by calendar and/or fiscal year, or by other suitable intervals, in respect of both the past experience of the program and the projection period. The results should be shown as real values and, when needed, also as nominal values, or the effect of inflation should be shown in some other appropriate way. ~~Alternatively or in addition it may be appropriate to show the results in relation to some volume measure or the change in it. Due to the usual complexity of the benefit design, the report should show the projected amount of benefits, wherever applicable, by type of benefit, age, gender and any other factor serving as a basis for the determination of the benefit level.~~

8 Analysis of projection results

Besides the presentation of the financial projections discussed in the previous subsection, the report should also present an analysis of those results along the following lines:

- (a) Sensitivity analyses, showing the effects on the main projection results of variations in key assumptions, should be presented, in order to provide an indication of the degree to which the financial projections are affected by each assumption. The corresponding auxiliary results can also serve as a basis for deriving a reasonable approximation of the projected effect of changing in the values of one or more of the key assumptions.
- (b) Reconciliation with the previous report should be made and explanations of significant changes in results should be included in the report.
- (c) Explanations of the pattern of financial projections over the years (ageing of the population, maturing of the program, recent changes in the program financing or benefit provisions, etc.) and the implications thereof.
- (d) Effect, if material, on the financial projections of events subsequent to the beginning of the projection period.

9. Conclusions

The actuary may include remarks beyond those listed above but should bear in mind that the main objective of an actuarial report is normally limited to the presentation of the actuary's estimate of the costs and projected financial status of the existing program and/or proposed changes therein. It is important to ensure that the readers of the report will have a sound understanding of the future financial prospects for the SSP concerned, taking into account the inevitable uncertainties in making projections. In this connection, the report should provide an indication of the eroding effect of inflation on the real value of benefits for plans that do not provide full benefit protection against inflation.

10. Attestations

In the report, the actuary should provide an opinion regarding the:

- Sufficiency and reliability of data.
- Reasonableness of assumptions.
- Appropriateness of the methodology and its consistency with sound actuarial principles
- Report's compliance with, and departures from, any local standards and guidelines and the IAA Guidelines of Actuarial Practice.

Where specified in the terms of reference of the evaluation or review, or in the legislative requirement for an actuarial report, the actuary should provide any opinion required on the financial soundness or balance of the SSP, on the adequacy or otherwise of contributions or on the necessary future level of contributions.

The report should also include a reminder that the results of the evaluation are based on assumptions concerning uncertain future events and outcomes and that the eventual experience will most likely differ, possibly materially, from that indicated in the projections.

11. Actuary's Name, Signature, Position Held and Date