SUPERANNUATION PRACTICE COMMITTEE

INFORMATION NOTE: USING ASIC CLASS ORDER CO 11/1227

March 2016

Contents

A. Purpose

1. This Information Note outlines the background of Class Order 11/1227 (CO), and the regulatory and client requirements that need to be considered when calculating benefit estimates for annual statements. An Appendix includes details of the calculations and data items.

2. While this document summarises the key data and methodology provisions in the CO, it does not in any way functionally replace the CO. The implementation of retirement estimates should not be undertaken without careful consultation of the source documents[1].

B. Background

3. ASIC Class Order CO11/1227 (CO) was released in December 2011 along with a regulatory guide (RG229).

4. Some confusion regarding the application of the CO in a number of areas led to a submission by the Actuaries Institute in April 2012 and a meeting with ASIC in June 2012. In particular, the Institute raised the issue of the CO methodology giving rise to misleading estimates for some members, with the only remedy to prevent this being to not issue an estimate for those members. It was agreed with ASIC after the meeting that some discretion could be used (by actuaries) in the interim, provided that any variation was disclosed and gave a better estimate. (This discretion informally concluded when RG229 was re-issued in November 2014.)

5. In 2010 and again in April 2012 the Institute and ASFA jointly lobbied for "class-order" projections to be permitted to include the Age Pension. Specifically, submissions to ASIC proposed the voluntary inclusion of the Age Pension in projections with a suggestion that its inclusion in projections become mandatory at a later date.

6. In March 2013 ASIC released a consultation paper (CP203) addressing some of the initial concerns with a view to increasing industry take-up. Included was a draft version of an amended CO, with a key improvement being the option to include an estimate of the Age Pension. The Superannuation Projections and Disclosure Sub-Committee made two submissions on behalf of the Institute. A new version of the CO, which permitted the inclusion of the Age Pension was eventually issued in November 2014.

7. Our understanding of ASIC's view is that the primary objective of the CO is to give trustees a way to initiate engagement with members around issues of retirement adequacy. The Commission sees proposal RG229.14 as adequate protection for trustees against action by members.

[1] http://www.comlaw.gov.au/Details/F2014C01259 and
http://download.asic.gov.au/media/2257747/rg229-published-13-november-2014.pdf

C. Limitations of the CO

8. Whilst the calculation methodology in the CO is clear and involves no discretionary components, careful consideration should be given to the range of data inputs that will go into the calculations. Users should consider circumstances where application of the methodology might be likely to result in a trustee providing misleading estimates to members, and rules for data validation and filtering applied to reduce the risk of misleading members in these cases.

9. Projections based on the CO can be a fairly blunt instrument for illustrating future retirement income. If the Age Pension estimate is not included then the resulting projections fall well short of a comprehensive assessment of standard of living in retirement. If the Age Pension estimate is included (based on assumptions as set out in the CO and the Appendix), the income estimate is limited to showing the total income one might expect in the first year of retirement only, as the amount of Age Pension will vary with the means tests over the course of retirement.

10. Care should be taken with the messaging around estimates that include the Age Pension given the changes to the assets test applying after 1 January 2017. In the 'taper range' where a part pension applies, an increase in projected balance will show a reduction in total income for the purposes of the CO. Additional disclosure that highlights the limited application of the Age Pension and total income figures should be considered.

11. A major limitation of the CO is that it requires a fixed real return for the projection to retirement and assumes a fixed real return for the period after retirement. This does not take into account the current or intended asset allocation of the member, or whether 3%pa above wage inflation (net of investment fees and costs and net of investment tax) is a realistic return.

12. One other key limitation is that the CO does not provide relief in respect of better projections that a trustee might be able to provide based on other information that might be available about a member. Such projections can only be provided as personal advice by a licensed entity with the accompanying documentary requirements.

13. Another important limitation is that the CO does not cover benefit estimates for members with defined benefits (and there is currently no other relief in respect of estimates for these members).

D. Disclosure text

14. The estimate must include the Lump sum, and the Annual income stream amount. The estimate may include the Age Pension amount and the Total annual amount.

15. The disclosure text is standard, except it must include the current balance, and the dollar-based and percentage-based fees and costs used in the member's calculation.

16. If an Age Pension estimate is included, the Institute suggests that the following disclosure (in italics) be included as an amendment to the disclosure in the third paragraph of 10A:

> *This amount is based on currently legislated pension rules as they will apply to all age pensioners from 1 January 2017.* Age pension rates and eligibility rules may change between now and when you retire. *This amount represents the annual rate of age pension you may be eligible for at the point of retirement, and should be considered as guide for the* ***first year of retirement*** *only.* The age pension amount shown at retirement age may ~~*also*~~ change during retirement as your personal circumstances *(including the value of your assets)* change.

17. Additional text may be added, provided it does not purport to represent another estimate of the member's projected benefit. The most obvious additional text would be a reference to the level of balance or income required to meet the ASFA Retirement Standards.

E. Rules and constraints

18. Some rules and constraints are mandated by the CO. A trustee may choose to apply further rules to the extent they do not conflict with the CO. Rules and constraints fall into categories as follows:

Mandated in CO	Not mandated in CO
Exclusion criteria (membership period and age) Calculation methodology Statement content (and location of prescribed text)	Statement design Other exclusion criteria (e.g. contributions) Data reliability Member engagement criteria Inclusion of Age Pension Inclusion of additional disclosure

F. Constraints in the CO

19. According to the CO (item 5), members who have not been in a fund for a full year and members aged 67 and over at the date of the estimate are to be excluded. This is a sensible approach that addresses credibility of data (to some extent) and usefulness to the member.

20. An obvious (but not stated) assumption in the CO is that it is not appropriate for defined benefit funds (RG229 states that an estimate is more likely to mislead when applied to defined benefit funds).

21. The CO goes on to specify the statement content requirements (in item 6, 6B, 7, 10 and 10A) and to outline the assumptions for the optional inclusion of an Age Pension estimate (in item 6A). Items 8 and 9 specify the calculation methodology (i.e. formula) and the data items to be included in the calculation.

22. The calculation methodology is simple and there is no scope for discretion. The detail of the calculations is included in the Appendix. The presentation and disclosure rules in the CO are also clear and any discretion relates to the design of the statement, and will not be dealt with any further in this document.

G. Other exclusion criteria and data validation

23. While the CO specifies the data items to be included in the benefit estimate calculation, and some definitions, it is silent about how to approach a situation where data is faulty, incomplete or otherwise unsuitable for the purpose of calculating an estimate. This is the key area where robust and comprehensive rules are required, and the remainder of this document deals principally with this situation.

24. The cleanest way to ensure that unsuitable data does not give rise to misleading estimates is to exclude membership records where data is suspect. This of course reduces the coverage provided by the benefit estimates.

25. Many of these situations relate to an asynchronous allocation of cash flows between periods, to the extent that the most recent period is not representative of future expectations.

26. Users should consider the following exclusion rules:

Criteria	Exclude these members	Comment
Age	No date of birth, invalid date of birth Under 18	Can't verify age Under 18s are unlikely to have a stable pattern of contributions
Account balance	Negative account balance (total balance) Also has TRAP account	Usually indicative of data problems or members who have exited the fund. Will not allow for complete situation

Criteria	Exclude these members	Comment
Contributions	No contributions Voluntary contributions >$X (say, 10,000) Negative total contributions of any type Total contributions < fees plus insurance premiums Breached contribution cap(s) Received SG vouchers Received employer untaxed amounts	Likely to have stopped working Potential for 'one-off' contribution Likely contribution refund for prior period May have left during the period Excess contributions tax likely Likely from another period Indicative of lumpiness
Fees	Fee charged has changed during the year	Last period's fee not appropriate for the future
Insurance	Paid or pending insurance claim of any type Major increase or reduction in cover	Unlikely to have typical retirement date Last period's premium unreliable
Tax	Paid excess contributions tax Not provided TFN	Tax will likely be levied out of period Tax likely to change if TFN provided
Category	Changed from active to retained or vice versa during year	Previous period contributions or fees unreliable

27. The following additional exclusion criteria could be considered on member engagement grounds:

Criteria	Exclude these members	Comment
Account balance	Low current balance	Unlikely to be only super account
Contributions	Low adjusted current contributions	May generate negative estimate
Projected benefit	Low projected benefit	May fuel disengagement or reduce credibility
Current investment strategy	Invested in a strategy with an expected real return significantly different from 3%pa	Potential to be misleading

28. The trustee may also have a view as to a minimum proportion of members that should receive a projection on their statement. This would inform the definition of 'Low' in the table above.

H. Age Pension

29. The CO includes optional allowance for the inclusion of an Age Pension estimate. The Institute prefers an Age Pension estimate to be included in the estimate, despite concerns about the fact that it is for the point of retirement only, on the grounds that some estimate of the Age Pension is more desirable than none. There will be some cases where an Age Pension estimate is not appropriate (e.g. where it is clear that the fund does not contain the majority of the member's benefit, or where the purpose is simply to provide an estimate of the income the member's super alone can produce). The calculation of the Age Pension amount is not given in the CO but is included in the Appendix to this Note.

I. Fees and Costs

Asset-based administration fees

30. An asset-based administration fee refers to asset-based fees and costs that are related to administration services only, excluding any investment management component. The CO states that the fee should be calculated for each member based on the rate charged for the preceding year. In practice, a better estimate might be obtained by using the actual rate that will be charged for the year to come.

31. The CO gives some examples of determining the asset-based fee where a tiered approach applies. The accuracy obtained by this method is spurious, and requires considerably more data than may be available. If intra-year balances are not available, it is acceptable to use the end of year balance to determine any asset-based fee where tiered fees apply. This is the more conservative approach (as tiered fees are generally inversely proportional to assets).

32. Care should be taken to ensure that this value is reasonable for future years.

Dollar-based administration fees

33. Dollar-based administration fees actually charged for the past year should be added to calculate the value of 'F' in paragraph 8 of the CO. Care should be taken that this value is reasonable for future years.

J. ASIC

34. A copy of this Information Note has been forwarded to ASIC. However it is preferred that any queries on the Note should, in the first instance at least, be directed to Richard Starkey (Richard.Starkey@mercer.com) or to any other member of the Institute Superannuation Projections and Disclosure (SPD) subcommittee.

APPENDIX

Technical specification for CO calculations

This Appendix covers the parameters and calculations required to prepare benefit estimates using the CO.

A. Key terms

Item	Definition
Benefit estimate (estimate)	The statement containing the lump sum and income stream estimates, and the required disclosure
Adjusted current contributions (*ACC*)	The total contributions paid for the previous year, less contributions tax and insurance premiums
Lump sum (*ProjBen*)	The projected benefit at retirement age[2]
Annual income stream amount (*AIS*)	The calculated income stream at retirement based on the Lump sum[2]
Age Pension amount (*AgePen*)	The calculated amount of Age Pension at retirement, based on the Lump sum[2]
Total annual amount (*T*)	The sum of the Annual income stream amount and the Age Pension amount[2]

B. Data items

Data required for the twelve months ending on the date of the estimate:

- All contributions paid to the fund on the member's behalf (SG, employer, salary sacrifice, post-tax, co-contributions etc)
- Contributions tax deducted from the member's account
- Insurance premiums deducted from the member's account
- The member's account balance (total benefit) at the end of the year (*Bal*)
- The member's age at the end of the year (to one decimal place) (*age*)
- Dollar-based administration fees charged to the member's account (*F*)
- Where the fund deducts percentage-of-balance based fees, the percentage rate at which administration fees have been applied, plus an allowance for indirect administration costs attributable to the member's account (*f*)

The CO states that age 67 should be used as the retirement age.

[2] The CO specifies that these figures must be shown to three significant figures in the benefit estimate.

Be sure to check the sign (+/-) of deductions data before calculating ACC.

C. Calculations

The calculation of the lump sum is a standard accumulation formula with continuous compounding:

$$ProjBen = (ACC - F) \times ((1.03 - f)^{(67 - age)} - 1) / \ln(1.03 - f) + Bal \times (1.03 - f)^{(67 - age)}$$

The calculation of the Annual income stream amount is:

$$AIS = ProjBen * 0.0566$$

(NB 0.0566 = $\frac{1}{\bar{a}_{\overline{25}|}}$ at 3%, the amortisation of a lump sum at 3% for 25 years continuously compounded)

D. Age Pension

The calculation of the Age Pension is not given in the CO. However, the CO does state several assumptions that must be made about the member and their partner. The Age Pension calculation is based on legislation (Section 43 of the Social Security Act 1991). Given the vast majority of recipients of these projections will spend the majority of their retirement under the means tests as they will apply from 1 January 2017, it is preferable to use this approach. Changes to Age Pension entitlements could occur in the future. Members are responsible for ensuring that the methodology below is appropriate before using.

The Age Pension amount (*AgePen*) for the purposes of the CO, requires the following inputs:

- Projected Benefit (*ProjBen*)
- Maximum Age Pension Amount per annum for a couple (*MaxPen*[3])
- Assets Test Threshold Couple Homeowner (*AssetThresh*)
- Assets Test Taper Rate per annum (*AssetTaper*)
- Income Test Deeming Threshold Couple (*DeemingThresh*)
- Income Test Deeming Rate High (*DeemingHighRate*)
- Income Test Deeming Rate Low (*DeemingLowRate*)
- Income Test Threshold per annum (*IncomeThresh*)
- Income Test Taper Rate (*IncomeTaper*)

We first calculate deemed income from super:

$$DeemedIncome = \text{Min}(2 \times ProjBen, DeemingThresh) \times DeemingLowRate + \text{Max}(2 \times ProjBen - DeemingThresh, 0) \times DeemingHighRate$$

[3] *MaxPen* should include any relevant supplements and allow for any minimum supplement requirement.

The calculation is then:

$$AgePen = \mathrm{Max}(0, MaxPen - \mathrm{Max}(0, (2 \times ProjBen - AssetThresh) \times AssetTaper, (DeemedIncome - IncomeThresh) \times IncomeTaper))/2$$

MaxPen, AssetThresh,AssetTaper, DeemingThresh, DeemingHighRate, DeemingLowRate, IncomeThresh and *IncomeTaper* are available from the Centrelink site. Ensure that *MaxPen, AssetTaper* and *IncomeThresh* are converted to annual (multiply by 26) before using. MaxPen is updated at 20 March and 20 Sept each year. Thresholds are generally updated at 1 July each year. The tapers and deeming rates are rarely updated.