PROFESSIONAL STANDARD 410

STATEMENTS OF OPINION RELATING TO DEFINED BENEFIT PENSIONS

March 2020

INDEX

1. INTRODUCTION

1.1 Application

1.1.1 This Professional Standard applies to Members making statements of opinion relating to the payment of defined benefit pensions from a defined benefit superannuation fund for the purposes of Regulation 9.31(1) of the Superannuation Industry (Supervision) Act 1993 (the SIS Act), and clause 23 of SPS160 Defined Benefit Matters.

1.1.2 This version of the Professional Standard incorporates additional conformance changes to align with the Institute's new Code (effective 31 March 2020).

1.1.3 A Member who provides advice performed under this Professional Standard:

(a) must be an Eligible Actuary; and

(b) must exercise his or her independent professional judgement and give impartial advice.

Work performed under this Professional Standard is designated as an Applicable Service. As such, the Member's attention is directed towards the requirements of Practice Guideline 1 (General Actuarial Practice).

1.2 About this standard

1.2.1 This Professional Standard:

(a) has been prepared in accordance with the Institute's Policy for Developing Documents to Guide and Regulate Professional Practice;

(b) must be applied in the context of the Code;

(c) binds Members of the Institute when they perform work that the Standard covers; and

(d) defines the Institute's requirements for all work the Standard covers.

1.2.2 If a Member believes that this Professional Standard is ambiguous or wishes to seek clarification of it, then they may consult the Institute's Professional Standards Committee for an interpretation.

1.2.3 If a Member finds that they cannot carry out their work in a way that complies with this Professional Standard then they must either:

(a) decline to carry out the work; or

(b) end their agreement to do so.

1.2.4 If a Member does not comply with this Professional Standard, then that may constitute Misconduct under the Institute's Disciplinary Scheme.

1.2.5 This Professional Standard does not constitute legal advice. Any interpretation or commentary within this Professional Standard regarding specific legislative or regulatory requirements reflects the expectations of the Institute but does not guarantee compliance under applicable legislation or regulations. Accordingly, Members should seek clarification from the relevant regulator and/or seek legal advice in the event they are unsure or require specific guidance regarding their legal or regulatory obligations.

1.3 Other relevant documents

1.3.1 This Professional Standard must be applied in the context of the relevant law, and relevant accounting and auditing standards.

1.3.2 A reference to legislation or a legislative provision in this Professional Standard includes any statutory modification, or substitution of that legislation or legislative provision and any subordinate legislation issued under that legislation or legislative provision. Similarly, a reference to a Professional Standard includes any modification or replacement of that Professional Standard.

1.3.3 Apart from the Code, from legislation or from regulatory standards, no other document, advice or consultation (including Practice Guidelines of the Institute) can be taken to modify or interpret the requirements of this Professional Standard.

1.3.4 If there is a conflict between this Professional Standard and any legislation, then the legislation takes precedence. In this context, legislation includes regulations, prudential standards, subordinate standards, rules issued by government authorities and standards issued by professional bodies which have the force of law.

1.4 Legislation

1.4.1 Regulations 9.31(1) (c) & (d) of the SIS Act require that a report on an actuarial investigation of a defined benefit fund or sub-fund that is a SMSF must contain, among other things:

a statement of the SMSF actuary's opinion on whether, at the valuation date, there is a high degree of probability that the defined benefit fund will be able to pay the pension as required under the fund's governing rules.

In forming that opinion the actuary must consider the position of the fund or sub-fund at the valuation date; and the likely future position of the fund or sub-fund during the 3 years immediately following the valuation date, based on the SMSF actuary's reasonable expectations.

1.4.2 SPS 160 requires:

"23. An RSE licensee must ensure that an actuarial report of an initial or regular

investigation for a defined benefit fund (including a fully funded public sector superannuation scheme) contains, at a minimum: ...

(h) if the fund is paying a defined benefit pension to at least one defined benefit member of the fund, a statement of the RSE actuary's opinion on whether, at the valuation date, there is a high degree of probability that the fund will be able to pay the pension as required under the fund's governing rules."

In this Professional Standard, a statement from the actuary that there is a high degree of probability that the fund will be able to pay the Defined Benefit Pension as required under the fund's governing rules is referred to as a positive opinion.

The statement of opinion is required for private sector and fully funded public sector defined benefit funds paying a Defined Benefit Pension. The statement of opinion is not required for public sector funds that are not fully funded.

1.4.3 The statement of opinion is not required to be made in relation to a Defined Benefit Pension that is wholly determined by reference to life insurance policies that the Trustee has purchased or obtained solely for the purpose of providing that benefit. If a Defined Benefit Pension is partially insured, the opinion must be formed in relation to the uninsured portion of the pension only.

2. COMMENCEMENT DATE

This Professional Standard takes effect in respect of valuations on or after 31 March 2020.

3. DEFINITIONS

3.1 In this Professional Standard:

'**Actuarial Value**' means the present value of a future payment, making allowance for the probability of survival to the date on which the benefit falls due, and for the expected (or, where appropriate, notional) investment return which may be earned during that period.

'**Act**' means the Income Tax Assessment Act 1997 (Cth).

'Applicable Services' means Services that are designated in an Institute Professional Standard or Practice Guideline as being Applicable Services.

'APRA' means the Australian Prudential Regulation Authority.

'Asset' means an investment owned by the superannuation fund from which future economic benefits are expected to flow to the superannuation fund.

'**Benefit**' means the amount of a benefit to which the member has an absolute or potential entitlement.

'**Benefit Liabilities**' means the Actuarial Value of Benefits.

'Centrelink' means the Centrelink agency of the Australian Government Department of Human Services, '**Code**' means the Code of Conduct of the Institute.

'Defined Benefit Pension' is as defined in SIS Regulation 9.04E or SPS 160 (where SPS 160 applies).

'Defined Benefit Pension Liabilities' means the Actuarial Value of Defined Benefit Pensions.

'Defined Benefit Superannuation Fund' has the same meaning as 'defined benefit fund' for the purpose of SIS Regulations or SPS 160 (where SPS 160 applies). The term includes:

(a) any Fund from which one or more Defined Benefit Pensions are paid, where those pensions are not fully backed by annuity contracts or otherwise fully insured; and

(b) a defined benefit sub-fund where so required by SIS Regulations or SPS 160 (as applicable).

'Disciplinary Scheme' means the document of that name prepared by the Institute setting out the rules and procedures governing professional discipline of a Member, as amended by Council from time to time.

'Eligible Actuary' means:

(a) a Fellow or Accredited Member of the Institute; or

(b) a Member who is eligible to act in an actuarial capacity pursuant to a requirement under legislation.

'**Fund Sponsor**' means either the employer-sponsor of a superannuation fund (as defined in section 16 of the SIS Act) or, in the case of a Self -Managed Superannuation Fund, the individual or individuals who make, or ordinarily make, contributions to the Self-Managed Superannuation Fund.

'ITAR' means the Income Tax Assessment Regulations 1997 (Cth).

'**Material**' means important or essential in the opinion of the Member. For this purpose, 'Material' does not have the same meaning as in Australian accounting standards. 'Materiality' has a consistent meaning to 'Material'.

'**Net Assets**' means the assets that are available to meet superannuation liabilities after making appropriate adjustments for any accrual items such as receivables, payables and other amounts due. Net Assets includes any assets set aside in an APRA regulated fund to meet the Operational Risk Financial Requirement in accordance with SPS 114.

'**Operational risk financial requirement (ORFR)**' is the amount determined as per paragraph 8 of Prudential Standard SPS 114**.**

'**PS 400'** means Professional Standard 400.

'**Registrable superannuation entity'** (RSE) means a regulated **superannuation** fund or an approved deposit fund or a pooled **superannuation** trust but does not include a self-managed **superannuation** fund. Registration of RSEs is effected under Part 2B of the **Superannuation** Industry (Supervision) Act 1993 (the SIS Act). Small APRA funds are RSEs.

‘**RSE actuary’** has the meaning given in section 10(1) of the SIS Act (a person who is or has been appointed as an actuary of a registrable superannuation entity).

‘**Self-Managed Superannuation Fund**’ is as defined in section 17A of the SIS Act.

‘**SIS Act**’ means the Superannuation Industry (Supervision) Act 1993 (Cth).

‘SIS Regulations’ means the Superannuation Industry (Supervision) Regulations 1994 (Cth) (as modified by any Modification Declaration issued by the Australian Prudential Regulation Authority from time to time).

‘SMSF’ means Self-Managed Superannuation Fund**.**

‘SPS 114’ means APRA Superannuation Prudential Standard 114.

‘SPS 160’ means APRA Superannuation Prudential Standard 160.

‘Value of Liabilities’ means the Actuarial Value of Accrued Benefits as defined in PS400. The Member must consider whether the total Value of Liabilities should be subject to a minimum of the relevant total Vested Benefits or total benefits that would be payable upon wind-up.

‘Vested Benefits’ is as defined in PS400.

3.2 A word that is derived from a defined word has a corresponding meaning.

3.3 Other capitalised terms used in this Professional Standard have the same meaning as set out in the Code

4. LEGISLATIVE REQUIREMENTS

4.1. The SIS Regulations (for Self-Managed Superannuation Funds) and SPS 160 (for other Defined Benefit Superannuation Funds) require that the statement of opinion regarding current pensions must accompany or be part of a report on the actuarial investigation of the fund. The investigation and report itself are also subject to Professional Standard 400 (PS400).

4.2. The actuary’s statement of opinion may be used to determine the eligibility of the Defined Benefit Pensions for exemption from the social security assets test. A statement of opinion in the negative would result in any favourable treatment being removed if the Defined Benefit Pensions are being paid from a SMSF or a small APRA fund. The relevant Determinations[1] require a positive opinion only for SMFSs and Small APRA Funds.

Actuaries must be aware of the potential adverse effects on pensioners of the removal of a full or partial exemption. The Institute has been advised by the Australian Prudential Regulation Authority (APRA) that it would not have any other direct consequences (i.e.

[1] Social Security (Actuarial Certificate—Lifetime Income Stream Guidelines) Determination 2012
Social Security (Actuarial Certificate—Life Expectancy Income Stream Guidelines) Determination 2012

not a breach of the SIS Act). However APRA has stated that it would take note of a fund's failure to obtain a positive opinion and may use this information (along with a number of other factors) as an indicator of the need for further investigation of the fund.

4.3. There may be some pensions included in the definition of "Defined Benefit Pensions" whose commencement date or terms and conditions are such that no exemption from the assets test will be granted, regardless of the opinion of the actuary referred to in paragraph 4.2. In such cases, the requirements of Regulation 9.31(1) or SPS160 (as applicable) regarding high probability statements still apply.

5. QUANTIFICATION OF PROBABILITIES

5.1 It is not necessary that actuaries determine a precise probability of the fund being able to meet its Defined Benefit Pensions obligations. Instead, it is acceptable for the actuary to specify a range within which the probability is judged to fall or to indicate that the probability is "at least x%". Discussions with APRA have suggested that a probability of at least 70% should be represented as being a high degree of probability for the purpose of Regulation 9.31(1) and SPS160.

6. MEANING OF HIGH DEGREE OF PROBABILITY

6.1. Having regard to both Regulation 9.31(1) of the SIS Act and SPS160 and the level of probability referred to in paragraph 5.1, actuaries must interpret "high degree of probability" as follows:

- Where an actuary determines the probability to be 70% or more, he or she is able to give a positive opinion that there is a "high degree of probability" without further investigation.

- Where the actuary determines the probability to be at least 50% but less than 70%, he or she would not normally be able to give a positive opinion that there is a "high degree of probability". However, in a case where the actuary believes that there are special circumstances, it may be possible for the actuary, in his or her professional judgement, to form a positive opinion.

- Where the actuary forms the opinion that the probability is less than 50%, the actuary must not form a positive opinion.

6.2 "Special circumstances" for this purpose might arise, for example, owing to investment returns earned or contributions paid after the valuation date, but before the date of certification, such that the actuary determines that the probability would have been 70% or more had such investment returns or contributions been taken into consideration as at the valuation date. These two examples are not intended to limit the actuary in determining what constitutes a "special circumstance" however, it is expected that the range of situations which give rise to a "special circumstances" would be relatively limited.

7. METHOD

7.1 In order to form the opinion required by the SIS Regulations or SPS 160, the actuary may need to make a projection of relevant fund assets and Defined Benefit Pension payments over the period of payment of Defined Benefit Pensions to current Defined Benefit Pensioners.

7.2 Alternatively, the actuary may be satisfied that the circumstances of the fund are such that it is clear by inspection that a positive opinion can be given. An example is where a fund has current Defined Benefit Pension and non-pension liabilities, with the assets exceeding the current Defined Benefit Pension Value of liabilities by a large margin and the current Defined Benefit Pensions having a high priority over the assets, relative to other liabilities.

8. ASSUMPTIONS: RELATIONSHIP WITH INVESTIGATION ASSUMPTIONS

8.1 The initial assumptions used to make any projections or determine present values must represent the actuary's best estimate of future experience. The actuary must then consider any margins that could be incorporated as discussed in paragraph 8.7.

8.2 One assumption required will relate to future increases in Defined Benefit Pensions. Paragraph 5.5.4(a) of PS400 states in respect of the funding method that:

"the method must aim to provide that:

(a) *members' benefit entitlements (including any pension increases provided by the Trust Deed or in accordance with either precedent or the intentions of the Trustee and/or Fund Sponsor) are fully funded before the members retire."*

8.3 It is common for pension increases not to be guaranteed by the governing rules of a fund. Instead, such increases may be granted at the discretion of the trustee or Fund Sponsor. SIS Regulation 9.31 and SPS 160, however, make it clear that the opinion relates only to Defined Benefit Pension increases required under the fund's governing rules. Hence, it is considered appropriate that the assumptions for the purposes of the statement of opinion allows for Defined Benefit Pension increases only to the extent required by the governing rules. In the statement of opinion, the assumed rate of Defined Benefit Pension increases, and whether there is any difference between this assumption and the assumption used more generally in the actuarial investigation, must be stated clearly.

8.4 The remainder of this Standard assumes the actuary is carrying out a full projection (i.e. paragraph 7.2 above does not apply).

8.5 In order to conduct projections of Defined Benefit Pensions and relevant fund assets, assumptions will be required relating to future rates of:

(a) Defined Benefit Pension increases (which may in turn depend on future rates of price inflation depending on the governing rules of the fund);

(b) investment returns on assets backing Defined Benefit Pensions;

(c) Defined Benefit Pension-related expenses;

(d) mortality of Defined Benefit Pensioners; and

(e) less commonly, remarriage, separation or divorce, or commutation.

8.6 Assumptions relating to these items will have been selected for the purposes of the actuarial investigation. However, these assumptions will often be deterministic (i.e. a single number representing the relevant rate in each future year) and hence will not explicitly allow for the uncertainty associated with each assumption.

8.7 Nonetheless, the probability statement required by SIS Regulation 9.31 and SPS160 implies that such uncertainty or variability will be taken into account. A complete analysis would involve specifying the probability distribution of each of the above items and from these determining the probability of adequacy of the assets held.

However, it is recognized that in many cases specification of such distributions and the subsequent calculations will not have an impact on the actuary's ability to provide an opinion. Further, it is recognized that variability in underlying assumptions may be taken into account in an implicit manner, for example by incorporating margins relative to the best estimate and by sensitivity testing.

8.8 It is therefore considered that the relevant projections can be based on deterministic assumptions relating to items (c) and (e) above. For items (a), (b) and (d) actuaries must consider the effect of the variability of those items. Any link between future investment returns on relevant assets and future Defined Benefit Pension growth (as in the case, for example, of inflation-linked Defined Benefit Pensions backed by assets with returns which may be correlated to inflation) can be taken into account.

8.9 In deriving assumptions for (d) and (e), it is not necessary to investigate the individual circumstances or health of the members, though the actuary must not assume a member is in impaired health unless such an investigation has been completed.

9. ASSETS, FUTURE CONTRIBUTIONS AND OTHER BENEFIT LIABILITIES

9.1 In forming an opinion, an actuary will need to identify the assets and future contributions from which future Defined Benefit Pension payments are assumed to be met, and the other benefit liabilities that are to be allowed for.

9.2 The principles that must be adopted in relation to such matters are:

(a) Generally, funding methods must aim to ensure that a Defined Benefit Pension is fully funded before the time it commences to be paid (PS400, paragraph 5.5.4). Consistent with this principle, it is generally considered inappropriate that future employer contributions be taken into account when assessing high probability statements. However, there may be limited circumstances, an example of which is discussed in paragraph 6.2 where future contributions can be taken into account, particularly in relation to Defined Benefit Pensions in the course of payment.

(b) All assets owned by the fund that would be available to meet current Defined Benefit Pension Liabilities in the event of wind-up of a fund must be taken into account.

(c) Benefit Liabilities that rank ahead of, or equally with, the liability for payments to current Defined Benefit Pensions on wind-up of the fund must be taken into account.

(d) Benefit Liabilities that rank after current Defined Benefit Pension Liabilities on wind-up of the fund need not be taken into account; however, the actuary must have regard to paragraph 11.1.

9.3 Principle 9.2 (b) above must be followed even where assets relating to current Defined Benefit Pension Liabilities are held separately (either physically or notionally) for funding or taxation purposes. Where the actuary believes that there is no right of recourse to some assets in the event of a wind-up of the fund, these amounts must be excluded from consideration in forming the opinion. All the principles in paragraph 9.2 are subject to any restriction imposed by the Trust Deed, SIS Act and SIS Regulations.

9.4 The priority of Benefit Liabilities must be determined by reference to the governing rules and by reference to any priorities imposed by the SIS Regulations or other legislation. For example, in many funds, the governing rules clearly provide that, upon wind-up of the fund, Defined Benefit Pensions in payment will rank ahead of Benefit Liabilities relating to actively employed members, although the SIS Regulations require certain minimum benefits to be given higher priority. In such cases, it would not be necessary to ensure that active members' Benefit Liabilities are covered by assets other than to the extent required to satisfy the SIS Regulations minimum benefit requirement. The actuary must be aware of broader issues relating to the fund if the assets are insufficient to cover all members' vested benefits.

10. STATEMENT OF OPINION

10.1 Statements of opinion regarding a high degree of probability made in accordance with SIS Regulation 9.31(1) or SPS160 (as appropriate) will be part of a report on the actuarial investigation required in accordance with the SIS Regulations or SPS 160 and carried out under PS400.

10.2 The documentation must be provided as required by PS400.

10.3 The effect of subsequent events must be treated as required by PS400.

11. OTHER ISSUES

11.1 The actuary must consider the likelihood that there will continue to be a high degree of probability in future years. If there is a reasonable likelihood that the probability will fall below the required level at some point, this must be drawn to the attention of the trustee.

11.2 An example would be a fund with only a small number of Defined Benefit Pensioners where the actuary is able to provide a positive opinion at the outset but with little margin. If all or most Defined Benefit Pensioners survive over the years, the probability of the assets (in the absence of any future contributions) remaining adequate can be expected to decline over the years, thus preventing the actuary from giving a positive opinion at some later date.

11.3 Another example would be where a benefit payment significantly greater than the amount funded has arisen between the date of valuation and the date of certification, such that the actuary, if taking such benefit into account, could not form a positive opinion.

11.4 In these cases, the trustee must be informed in order to give time to arrange potential additional funding that could potentially be taken into account under paragraph 6.2, thus allowing the actuary to give a positive opinion. Alternatively, the terms of the Defined Benefit Pension may be able to be modified, again permitting a positive opinion.

END OF PROFESSIONAL STANDARD 410