Actuaries Institute.

PRACTICE GUIDELINE 499.10

SELF-INSURANCE ARRANGEMENTS AND PRUDENTIAL STANDARD SPS 160

December 2023

INDEX

1 INTRODUCTION

1.1 Application

1.1.1 This Practice Guideline applies to a Member providing advice about a DB Fund's Self-Insurance arrangements in accordance with APRA Prudential Standard SPS 160 Defined Benefit Matters.

1.1.2 This Practice Guideline also applies to Members who support another Member in providing advice about a DB Fund's Self-Insurance arrangements in accordance with this Practice Guideline, as relevant to their contribution to the Services.

1.1.3 This Practice Guideline has been prepared on the basis that the risks relevant for the determination of Insured Benefits include death and disability risks, including income stream disability risks with a limited payment period eg 2 years, to age 65. This Practice Guideline does not include guidance on other defined benefit funding risks, which include:

(a) worse than expected financial or demographic experience;

(b) a member attaining the eligibility age for an early retirement benefit;

(c) a member exercising an option or an employer exercising a discretion, such as a member exercising an option to receive a pension rather than a lump sum;

(d) investment and longevity risks associated with a beneficiary being in receipt of, or entitled to receive at a future date, a defined benefit pension. This includes contingent rights; and

(e) a member receiving a retrenchment/redundancy benefit.

1.1.4 Legislation and other requirements which may be relevant to the work covered by this Practice Guideline include:

(a) Prudential Standard SPS 160 Defined Benefit Matters;

(b) Prudential Practice Guide SPG 160 Defined Benefit Matters;

(c) the Superannuation Industry (Supervision) Act 1993 (Cth);

(d) the Superannuation Industry (Supervision) Regulations 1994 (Cth); and

(e) Professional Standard 400 Investigations of the Financial Conditions of Defined Benefit Superannuation Funds.

1.1.5 A Member who provides advice under this Practice Guideline as an RSE Actuary in accordance with SPS 160:

(a) must be an Eligible Actuary; and

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

Members providing advice under this Practice Guideline, but not as an RSE Actuary, and Members supporting the Member providing advice as an RSE Actuary under this Practice Guideline are not required to be an Eligible Actuary.

1.1.5 All work performed under this Practice Guideline, whether by the Member providing advice or by a Member supporting the Member providing advice, is designated as an Applicable Service. As such, the Member's attention is directed towards Practice Guideline 1 (General Actuarial Practice). In the case of a Member supporting the Member providing advice, Practice Guideline 1 applies as relevant to their contribution to the Services.

1.1.6 There are no previous versions of this Practice Guideline. It replaces Information Note: Self-Insurance Arrangements and Superannuation Prudential Standard 160.

1.2 About this Practice Guideline

1.2.1 This Practice Guideline:

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

(b) is to be applied in the context of the Code.

1.2.2 This Practice Guideline is not mandatory. Even so, if this Practice Guideline covers the Services a Member provides, then the Member should consider explaining any significant departure from this Practice Guideline to the Principal, and record that explanation.

1.3 Relationship to Practice Guideline 1

1.3.1 Compliance with Practice Guideline 1 is a pre-requisite to compliance with this Practice Guideline References in Practice Guideline 1 to 'the applicable Professional Practice Document (PPD)" or "all applicable PPDs" should be interpreted as applying equally to this Practice Guideline, as appropriate.

1.4 Other relevant documents

1.4.1 This Practice Guideline must be applied in the context of the relevant legislation, regulation and accounting standards. If there is a conflict in wording, then the legislation, regulation and accounting standards take precedence over this Practice Guideline.

1.4.2 In this context, legislation, regulation and accounting standards include laws, regulations, prudential standards, subordinate standards, rules issued by government authorities and standards issued by professional bodies which have the force of law. Also included are relevant modifications or substitutions of these. Similarly, a reference to a Professional Standard or Practice Guideline includes any modification or replacement of that Professional Standard or Practice Guideline.

1.4.3 Apart from the Code or a Professional Standard, from legislation or from regulatory standards, no other document, advice or consultation can be taken to modify or interpret the requirements of this Practice Guideline.

1.4.4 This Practice Guideline does not constitute legal advice. Any interpretation or commentary within this Practice Guideline 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.

2 COMMENCEMENT DATE

This Practice Guideline applies to advice provided by a Member about a DB Fund's Self-Insurance arrangements that is signed on or after 1 February 2024 and will, or may, be used by the DB Fund's Trustee in meeting the requirements of SPS 160 relating to ongoing actuarial oversight of the self-insurance arrangements.

3 DEFINITIONS AND INTERPRETATION

3.1 In this Practice Guideline:

'**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.

'**Code**' means the Code of Conduct of the Institute.

'**DB Fund**' has the same meaning as applies to 'defined benefit fund' for the purposes of SPS 160.

'**DB Fund Member**' means a defined benefit member of a DB Fund, where defined benefit member has the same meaning as set out in the SIS Regulations.

'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.

'Insured Benefit' for a member, means a right for the member's benefits to be increased on the realisation of a risk, as defined in the SIS Regulations 4.07C.

‘**PS 400’** means Professional Standard 400 Investigations of the Financial Conditions of Defined Benefit Superannuation Funds

‘**Self-Insurance’** means provision of an Insured Benefit without the benefit being fully supported by an insurance policy provided by an insurer.

‘**SIS**’ means the SIS Act and SIS Regulations together.

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

‘**SIS Regulations**’ means the Superannuation Industry (Supervision) Regulations 1994 (Cth).

‘**SPG 160’** means APRA Prudential Practice Guide SPG 160 Defined Benefit Matters.

‘**SPS 160**‘ means APRA Prudential Standard SPS 160 Defined Benefit Matters.

‘SPS 250’ means APRA Prudential Standard SPS 250 Insurance in Superannuation.

‘**Trustee**’ has the same meaning as set out in section 10 of the SIS Act.

‘**Unsatisfactory Financial Position’** and ‘**Unsatisfactory**’ are as defined in PS 400.

‘**Vested Benefit’** is as defined in PS 400.

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

3.3 Other capitalised terms used in this Practice Guideline have the same meaning as set out in the Code.

4 LEGISLATION

4.1 The SIS Act and the SIS Regulations place restrictions on Self-Insurance and the types of insurance that may be provided by superannuation funds.

4.2 APRA has set out requirements for DB Funds that Self-Insure in SPS 160.

4.3 Section 5 of this Practice Guideline provides guidance on the restrictions in the SIS Regulations on Self-Insurance and on the permitted types of insured benefits.

4.4 Section 6 provides information on the SPS 160 requirements for DB Funds that Self-Insure, along with guidance on implications and matters such as the treatment of claims provisions and insurance reserves for the calculation of funding status measures and the frequency of detailed reviews of Self-Insurance arrangements.

4.5 APRA may impose additional restrictions on a DB Fund’s ability to provide Self-Insurance as part of the trustee’s licence conditions. Any such restrictions are not considered in this Practice Guideline but should be taken into account by the Member where relevant to the Applicable Services.

4.6 PS 400 sets out requirements that members must comply with in respect of Self-Insurance when preparing a report to which that Professional Standard applies. Additional guidance is included in this Practice Guideline on several matters that PS 400 requires Members to consider or do while preparing a report to which PS 400 applies.

4.7 Funds which Self-Insure must also meet the requirements of SPS 250 in regard to their insured (including Self-Insured) arrangements. However, these additional requirements are not dealt with in this Practice Guideline.

5 SIS REGULATIONS REQUIREMENTS

5.1 Insured Benefits

5.1.1 A superannuation fund can provide an Insured Benefit via external insurance or (where permitted) via Self-Insurance or a combination of external insurance and Self-Insurance.

5.1.2 SIS Regulation 4.07D limits the types of Insured Benefit that can be offered or provided to a member (for example, some types of Insured Benefit that can be maintained for an existing member under transitional arrangements cannot be provided to a new member or to an existing member who does not already have that Insured Benefit).

5.2 Restrictions on Self-Insurance

SIS Regulations provisions

5.2.1 SIS Regulation 4.07E places the following restrictions on Self-Insurance:

(a) No fund can provide Insured Benefits for accumulation members through Self-Insurance (except in limited circumstances where the Commonwealth or a State government provides or guarantees the Insured Benefits); and

(b) DB Funds can provide Insured Benefits for DB Fund Members (including new DB Fund Members) through Self-Insurance only if the DB Fund Self-Insured such benefits on 1 July 2013 (and so long as APRA did not prohibit Self-Insurance for that DB Fund as a condition of its licence). APRA Modification Declaration No. 1 of 2014 adds another sub-regulation to Regulation 4.07E which allows successor funds to Self-Insure in the same circumstances as the original DB Funds.

5.2.2 The ability to continue Self-Insuring DB Fund Members only relates to the particular types of risks which were Self-Insured as at 1 July 2013 (“permitted Self-Insured benefits” for ease of reference). It does not extend to new types of Self-Insured risks. For example, a DB Fund which was Self-Insuring death and permanent incapacity (but not terminal medical condition) risks as at 1 July 2013 would not be able to introduce benefits on terminal medical condition or temporary disability unless these new benefits were fully insured by an insurance policy issued by an insurer.

5.2.3 However, a Trustee is able to amend the formula for calculating the amount of the permitted Self-Insured benefits after 1 July 2013 (subject to paragraphs 36 and 37 of SPS 160, in particular paragraph 36(b) that requires the trustee to attest annually that in formulating and maintaining Self-Insurance it continues to act in the best interests of beneficiaries).

Funding shortfalls not Self-Insurance

5.2.4 Funding shortfalls in a DB Fund are not considered to result in new or increased Self-Insured benefits. Similarly, funding shortfalls arising in relation to a target funding level set above 100% of Vested Benefits may also not be regarded as Self-Insurance.

5.2.5 Nevertheless, there may be situations where the Member considers it appropriate to recommend an increase in the level of insurance coverage in response to a funding shortfall, having regard to all the relevant circumstances including:

(a) the level of the shortfall;
(b) whether there is a change in the target funding level;
(c) the expected period to restore the target funding level;
(d) the impact that paying Insured Benefits would have on the funding level; and
(e) the employer's willingness and ability to bring forward any additional contributions which may be required to fund the shortfall (if any) relating to exits, including deaths and disablements.

5.2.6 If there is not a reasonable expectation that the sponsoring employer(s) will meet the funding shortfall, a range of broader issues would also need to be addressed.

Reasonable Insured Benefit approximations do not give rise to Self-Insurance

5.2.7 In many funds which externally insure, the insured amount is equal to the death or disablement benefit less an amount representing the member's funded interest. The choice of Insured Benefit formula depends on both the benefit design and the funding target.

5.2.8 For example, a fund with a funding target of 100% of Vested Benefits could reasonably externally insure the total death or disablement benefit less the vested benefit. It may also be reasonable to externally insure the total death or disablement benefit less the accrued retirement benefit. This is more likely to be reasonable if the accrued retirement benefits are not significantly higher than Vested Benefits.

5.2.9 A consequence of this is that, where a DB Fund has no external insurance for a benefit which falls within the definition of Insured Benefit (such as an ill health benefit) and is equal to the accrued retirement benefit, then it does not necessarily constitute Self-Insurance.

5.2.10 Another specific example of Insured Benefit approximation is where a lump sum amount is insured in relation to pension benefits. This is discussed further in paragraphs 5.2.17 to 5.2.20 below.

5.2.11 It is expected that the Member would consider the appropriateness of the external insurance formula and the materiality of any potential differences between the sums insured arising from the formula adopted and the excess of the death and/or disability benefits over the funding target. Provided the Member is satisfied that the insurance arrangements are such that adverse death and disablement experience would not be expected to have a material adverse impact on the financial position of the DB Fund, it is appropriate to consider that there is no Self-Insurance.

Waiving of offset clauses

5.2.12 Most funds have offset clauses that enable the fund to reduce a member's death or disablement benefit where external insurance or Self-Insured cover is declined or restricted in some manner.

5.2.13 Some funds which are generally fully externally insured may have decided, by agreement between the sponsoring employer and the Trustee either in particular cases or in all cases, to waive the offset clause and provide the full benefit, even though a member's insurance cover is restricted in some way and the insurance claim will be restricted in some circumstances.

5.2.14 Such arrangements would be considered to result in Self-Insurance. It is permissible to continue Self-Insuring such uninsured risks for DB Fund Members, subject to the legislated requirements including the trustee licence conditions.

5.2.15 Where such Self-Insurance is not permitted or is no longer considered appropriate by the Trustee, a possible means of continuing to provide full benefits to DB Fund Members who have restricted external insurance cover, may be for the employer to undertake to request (or agree to) a benefit augmentation where necessary which would be funded by additional employer contributions. Careful communication would be required to ensure it was clear to the affected members that the restricted benefit would apply in the absence of an augmentation.

5.2.16 Note that such additional employer contributions (or a discretionary allocation from a reserve) may be treated as concessional contributions which could have adverse tax implications for the member.

Self-Insurance and defined benefit pensions

5.2.17 Where an Insured Benefit relates to a contingent defined benefit pension that becomes payable on death, disability or ill health, such as a lifetime pension, it will generally only be possible to externally insure a lump sum amount.

5.2.18 In such cases, it is necessary to make assumptions in order to determine an amount to insure and the Trustee and employer sponsor/s would generally retain the risk that the increase in benefit liabilities arising from a death or disability may exceed the lump sum insured amount. It is expected that assumptions made for this purpose would be reasonable and appropriate having regard to the circumstances and the funding assumptions. For example, it may be appropriate to assume:

(a) a proportion of pensioners will have a spouse at death without determining how many members are currently married; and/or

(b) an average number and age of children at death without determining how many children each member currently has.

5.2.19 It is expected that the appropriateness of the assumptions would be considered having regard to the number of members entitled to the relevant benefits (and hence the likelihood of actual experience being in line with the assumptions), as well as the consequences for the DB Fund's financial position of actual experience varying from the assumptions. Thus, for smaller DB Funds, it might be assumed that all members will have an eligible spouse at death and the spouse will opt for the most valuable benefit, which may differ from the funding assumptions.

5.2.20 Provided these options/contingencies are taken into account in determining the externally insured amount, and the Member is satisfied that the insurance arrangements are such that adverse death and disablement experience would not be expected to have a material adverse impact on the financial position of the DB Fund, both on a windup and continuing basis, it may be appropriate to consider that there is no Self-Insurance.

6 SPS 160 REQUIREMENTS

6.1 Self-Insurance provisions of SPS 160

Paragraphs 36 and 37 of SPS 160 set out APRA's requirements in relation to Self-Insurance in DB Funds. Paragraphs 38 to 42 of SPG 160 provide guidance on the requirements.

6.2 Requirement for reserves or other arrangements

6.2.1 Paragraph 36 of SPS 160 requires that reserves must be established and maintained or alternative arrangements must be approved by APRA. PS 400 requires the Member to consider and document the adequacy of the reserves or other arrangements in place.

6.2.2 An alternative arrangement for which approval could be sought from APRA in respect of Self-Insurance arrangements relating to defined benefit members, is that:

(a) provisions relating to incurred claims, including pending, Incurred But Not Reported ("IBNR") claims and if applicable outstanding disability income benefits, where the amount is material, are either included in the value of liabilities for funding calculations (including funding status measures such as Vested Benefits) or deducted from the available asset value; and

(b) allowance for the expected cost of future Self-Insured claims is included in the future benefit projections and the recommended employer contribution program.

6.2.3 It would not usually be appropriate for a Member to recommend an alternative arrangement where reasonably expected fluctuations in Self-Insured claims may have a significant impact on the DB Fund's financial position unless a provision to allow for that volatility in claims is also made, as described in Section 6.4.

6.3 Frequency of review of Self-Insured arrangements

6.3.1 The reference in paragraph 37 of SPS 160 to regular investigations would include both triennial and annual investigations (as required under SPS 160 for the particular DB Fund) and hence any such actuarial investigation report must include matters relating to the Self-Insurance arrangements as specified in SPS 160 and PS 400.

6.3.2 For many DB Funds, only triennial actuarial investigations are required under SPS 160 and a detailed review of the Self-Insured arrangements will also usually only be necessary once in every three year period. Where DB Funds are required under SPS 160 to undertake actuarial investigations more frequently than triennially (for example, annually) PS 400 only requires certain matters to be considered every three years.

6.3.3 The Member may be asked to complete a review of the Self-Insurance arrangements that is not contained in a report to which PS 400 applies. Such a review should always be within three years of a report to which PS 400 applies because such reports are required at least every three years. Such reviews would normally not need to include the matters that are required by PS400 only every three years.

6.3.4 However if the purpose of the separate review of the Self-Insurance arrangements is to meet the requirements of PS 400 relating to analysis and consideration of Self-Insurance matters which PS 400 only requires every three years, then the review will need to satisfy the relevant PS 400 requirements. For example, this approach may be used to reduce the work required at the triennial actuarial investigation by doing detailed triennial Self-Insurance reviews on a different cycle and referencing it in the primary PS 400 report.

6.4 Self-Insurance reserves/other arrangements and funding calculations

6.4.1 In the case of a DB Fund that does not maintain Self-Insurance reserves, and for which APRA has approved an "other arrangement", the Member will need to have regard to the approved arrangements when advising the Trustee. For example, if the approved arrangements are as indicated in Section 6.2.2 of this Practice Guideline, in relevant advice regarding funding matters, the Member should ensure that the incurred claims provision is either included in the value of liabilities or deducted from the available asset value. This applies both to funding calculations for the purpose of determining future contributions and to the calculation of funding status measures such as Vested Benefits coverage (including for the purpose of determining if a fund is in an Unsatisfactory Financial Position).

6.4.2 The determination of appropriate reserves or provisions for incurred claims may have regard to the variability of the amounts and their materiality for the DB Fund's financial position. Where the size of the DB Fund means that the amount of the reserve or provision required is not able to be accurately determined, a larger reserve or provision is generally considered appropriate. PS 400 effectively requires a more detailed assessment to be made of the Self-Insured arrangements at least every three years, with a short-hand approach (based on the results of the previous detailed assessment) being acceptable between triennial reviews.

6.4.3 Where a DB Fund utilises Self-Insurance reserves, these reserves can usually be divided into at least two components:

(a) an incurred claims component (including pending, Incurred But Not Reported ("IBNR") claims and if applicable outstanding disability income benefits, which relates to events which have occurred); and

(b) an allowance for claim fluctuations.

6.4.4 Pricing and premium reserves will generally not be relevant to DB Funds. Where a DB Fund provides a Self-Insured income protection benefit a provision for the remaining payments in respect of claims currently being paid is appropriate.

6.4.5 In a large DB Fund, claim fluctuations (excluding a catastrophe) may be very small relative to the reserve required for pending and IBNR claims and/or to total accrued liabilities. This amount may also be very small relative to contribution requirements, with contribution requirements regularly needing adjustment to fund for any variation in financial and other demographic experience. In such circumstances, it may reasonably be determined that it is not necessary to hold specific reserves for the second component (paragraph 6.4.3(b)).

6.4.6 In calculating funding indices (including in determining if a DB Fund is in an Unsatisfactory Financial Position), or recommending employer contribution rates, it is appropriate to deduct the incurred claims part of the reserve (that is, component (a) in paragraph 6.4.3 above) from the available assets.

6.4.7 However, in the case where the DB Fund also maintains a reserve for component (b) in paragraph 6.4.3 above (that is, for future claim fluctuations), this reserve does not need to be deducted from the available assets for the purpose of calculating past service funding indices, including Unsatisfactory Financial Position, because it does not relate to past service liabilities and is not needed if the DB Fund were to be terminated.

6.4.8 Where the component in respect of incurred claims could be material for the funding of the DB Fund the Member would generally calculate the appropriate incurred claims reserve or provision annually.

6.4.9 In other circumstances, irrespective of whether a reserve is being held or another arrangement approved by APRA applies, it is usually sufficient for the Member to calculate the appropriate incurred claims reserve or provision in triennial Self-Insurance reviews and assume it remains unchanged in between reviews.

6.5 Actuarial Oversight

6.5.1 Where PS 400 applies to an actuarial investigation that provides actuarial oversight to a Self-Insurance arrangement, it sets out the matters that must be considered. It may also be relevant for Members to consider the PS 400 requirements when undertaking reviews of Self-Insurance arrangements that are not covered by PS 400, refer paragraph 6.3.3.

6.5.2 In considering the potential Self-Insurance risk, the Member would be expected to consider:

(a) The total amount of Insured Benefits that are Self-Insured relative to the available assets;
(b) Any concentration of risk by age or other demographic factor, or in respect of any particular cohort of members;
(c) Potential volatility in experience; and
(d) The impact of a catastrophe.

6.5.3 In regard to catastrophe risk, in many cases it is highly unlikely to be feasible for a fund to hold reserves sufficient to provide meaningful protection against a major catastrophe. However, the Member would be expected to consider and assess the risk of various types of catastrophe scenarios (taking into account the specific circumstances such as the concentration of Self-Insured risks at particular locations and any special risks associated with the locations and/or the type of work undertaken at those locations) and include the results of this assessment in advice regarding the adequacy of the Self-Insurance reserves or arrangements. Catastrophe scenarios may include the risk of a pandemic, major accidents and events such as a natural disaster or terror attack.

6.5.4 Members may consider recommending that the Trustee investigates the availability and cost of catastrophe or stop loss insurance.

6.5.5 It is expected that the results of the Member's assessment of catastrophe risk, along with the employer sponsor's views about the risk and impact of a catastrophe on its funding obligations, would be taken into account by the Trustee in its annual determination of whether or not continuation of the Self-Insurance arrangements is in members' best interests.

6.5.6 In any assessment of Self-Insurance, it is expected that the Member would consider specifying events which would trigger an interim review of the Self-Insurance arrangements in advance of the next regular actuarial investigation or separate three yearly review of Self-Insurance arrangements (where applicable). PS 400 requires such a consideration to be made where the assessment is included in a report to which that Professional Standard applies. Such events could include:

(a) employer gives notice of cessation of contributions;

(b) where the Self-Insurance reserve falls below a certain amount or a certain percentage of premium or a certain percentage of the recommended level of reserve;

(c) a material change to the total amount of Self-Insured or externally insured benefits or the formula to calculate those benefits;

(d) a material increase in claim amounts or the occurrence of a major claims event; and/or

(e) a material change in the membership.

6.5.7 A large adverse movement in asset values or funding indices may also be used as a trigger for a review. This will generally be more relevant to the overall funding position than to the adequacy of the Self-Insurance arrangements, but may be relevant to the latter for some DB Funds.

6.5.8 There may also be circumstances, such as where Self-Insurance is immaterial, where specifying trigger events may not be necessary. In determining any triggers, it may also be appropriate to consider whether annual or triennial reviews take place.

6.5.9 Where triggers are specified, it is important that monitoring for those triggers occurs. It is expected that the Member would consider making recommendations as to the mechanics of the monitoring process – for example, the effective dates at which monitoring should be carried out, the data required, the timelines by which results should be reported and to whom.

7 REPORTING

7.1 When reporting the results of the analysis undertaken, Members are reminded of their reporting responsibilities as set out in Paragraph 6 of the Code and clause 3 of Practice Guideline 1.

7.2 Often a report providing actuarial oversight on Self-Insurance will be provided in a report to which PS 400 applies. In such circumstances, PS 400 includes reporting requirements in respect of such Self-Insurance. It may also be relevant for Members to consider the PS 400 requirements when preparing reports on Self-Insurance arrangements that are not covered by PS 400, refer paragraph 6.3.3.

END OF PRACTICE GUIDELINE 499.10