Actuaries Institute.

3 May 2024

Attorney-General's Department
3-5 National Circuit
Barton ACT 2600

Email: FLSregulations@ag.gov.au

Dear Sir/Madam,

Consultation: Exposure Draft of the Family Law (Superannuation) Regulations 2024

The Actuaries Institute ('the Institute') welcomes the opportunity to provide feedback on an exposure draft of the *Family Law (Superannuation) Regulations 2024* (the **New Regulations**) and the accompanying Consultation Paper. These are intended to replace the existing *Family Law (Superannuation) Regulations 2001* (the **Current Regulations**).

The Institute is the peak professional body for actuaries in Australia. Our members have had significant involvement in the development and management of superannuation in Australia, and work across APRA regulated funds, SMSFs and public sector funds.

Our submission focuses on matters raised in the consultation relating to scheme-specific methods and factors. The Institute broadly supports the position of the Australian Government Actuary (**AGA**) that scheme-specific valuation methods and factors should be based on more up-to-date actuarial assumptions.

Supportive of a requirement to review and update assumptions

Scheme-specific actuarial assumptions under the Family Law Method (**FLM**) have not been reviewed, and therefore have remained unchanged, for more than a decade. Given the scheme-specific experience that has emerged over this time, along with economic and demographic assumptions, a review to ensure scheme-specific FLM actuarial assumptions are up to date may reveal significant differences in valuations for updates to other material assumptions (such as, for example, the proportion of members that opt to convert their defined benefit growth-phase interest to a pension).

Noting the anticipated commencement of the proposed Division 296 Tax from 1 July 2025 which relies heavily on the FLM to value Defined Benefit (**DB**) interests, the Institute supports a requirement for trustees to review and update, if appropriate, their scheme-specific factors under the FLM. We also note that these revised assumptions would likely remain in-force for several years.

However, we recommend that the explanatory materials accompanying the New Regulations explicitly recognise that the assumptions used for the scheme-specific valuations:

- May differ over time from the "in force" assumptions, and
- That trustees with scheme-specific methods have the option to apply for updated factors when scheme-specific actuarial assumptions are determined to be out of date.

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Not supportive of a requirement on all trustees to review valuation methods

We see some ambiguity in the Consultation Paper proposals, in whether a review of assumptions *and* factors would automatically flow through to a requirement to review valuation methods. These two areas should be distinguished, noting that a review of the appropriateness of existing valuation methods would be a time intensive and costly exercise if trustees were to be required to complete this. We recommend that the New Regulations take the simpler approach of requiring trustees to consider whether the existing methods have material limitations which require a revised approach.

Further, we foresee circumstances where there are no members remaining in certain categories with prior scheme-specific approvals. In such circumstances, if a review of methods is mandatory, we propose that the scheme be permitted to advise that there are no longer members in that category.

Noting potential complications associated with use of FL values for Division 296 Tax purposes

We understand that the Family Law (**FL**) factors, including scheme-specific methods and factors, may be used for determining Total Superannuation Balance (**TSB**) for Division 296 Tax purposes. This is a new application, and it brings an additional set of considerations in the scheme-specific approach. Notably, accuracy and transparency may now be given a higher weighting in any assessment of scheme-specific approach, and this may lead to revised or new scheme-specific methods with greater complexity and cost in some contexts.

We foresee a situation where some schemes that did not have scheme-specific methods might now choose to apply for a scheme-specific method. This is particularly so if a judgement was made two decades ago that for FL purposes simplicity outweighed accuracy for the small number of members impacted, but now that the method will be used to determine tax components for all or many members, then accuracy is seen as a more important consideration.

We are not confident that it is feasible for all relevant schemes to complete reviews and implement updated scheme-specific FL factors, and for the further implementation steps such as review by the AGA and the finalisation of the New Regulations, in time for those factors to be used for the first Division 296 Tax reporting of values as at 30 June 2025.

Ensuring orderly implementation

As noted in the Consultation Paper, the Current Regulations containing default valuation factors and methods of calculation are due to sunset on 1 April 2025 and will be remade.

We are concerned that the new default methods, assumptions and factors prepared by the AGA have not been provided within the consultation process. **We urge that the revised default valuation factors, underlying assumptions and calculation methods are released on a targeted basis no later than 30 June 2024.**

If the FL scheme-specific methods are to be updated and ready to use by commencement on 1 April 2025, the timeline is already very short. We are not confident that it is feasible for all relevant schemes to complete reviews and implement updated scheme-specific FL factors in time for those factors to be used for the first Division 296 Tax reporting of values as at 30 June 2025. There may be a need for some form of transitional relief, such as an ability to use the old methods and factors for a period after 1 April 2025.

Our detailed responses to several of the questions in the Consultation Paper are set out in the Attachment to this submission.

The Institute may be contacted in relation to any questions on this submission. If you would like to do so, please contact the Institute via (02) 9239 6100 or public_policy@actuaries.asn.au.

Yours sincerely

(Signed) Tim Jenkins

Chair, Superannuation and Investments Practice Committee

Attachment: Responses to selected Questions raised in Consultation Paper

Question 4: Innovative Retirement Income Stream Products (IRISPs)

The Consultation Paper states:

> *"The new Regulations make it clear that the 'default' methods and factors are not to be used to determine the value of innovative superannuation interests, which means that if a method or factors have not been approved for the interest under section 62 or section 68 of the new Regulations, the court must determine the value of the interest by such method as it considers appropriate."*

The Consultation Paper suggests that in practice it will be left to the Court to determine a value of these based on expert evidence. Given the likely time and cost involved, this does not seem to be a desirable outcome.

We agree that it is not feasible to develop a statutory FL valuation formula or approach for IRISPs given the significant range of features that they will have. However, rather than leaving this value to be determined by a Court, we consider it preferable for the law to require an actuarially certified FL valuation basis to be obtained by the scheme trustee/product provider, subject to AGA or Ministerial approval.

Question 7: no default method for certain fixed term and lifetime annuities

The Consultation Paper states:

> *"Section 35 of the new Regulations applies where a trustee establishes a new annuity, or transfers, rolls over or pays an amount, in satisfaction of the non-member spouse's entitlement under a superannuation splitting agreement or order. In order to calculate the non-member spouse's entitlement, the value of the member spouse's annuity must be determined first. Where the non-member spouse's entitlement arises from a superannuation agreement, subsection 35(3) of the new Regulations requires that the value of the member spouse's annuity be calculated using a basis agreed upon by the parties. Where the non-member spouse's entitlement arises from a superannuation splitting order, the court must determine the value of the annuity by such method as it considers appropriate."*

We note and agree with the observation made by the AGA that the current default factors "are no longer fit for purpose, due to the increasing variation in the types of superannuation annuities available for purchase by retirees and the potential for variations in assumed mortality rates".

In the Consultation Paper it is suggested that in practice it will be left to the Court to determine a value of these based on expert evidence. Rather than leaving this value to be determined by a Court, we consider it preferable for the law to require an actuarially certified FL valuation basis to be obtained by the scheme trustee/product provider, subject to AGA or Ministerial approval.

Question 8 – comments on new methods or factors

The AGA has identified a range of circumstances where additional default factors will lead to increased accuracy in certain circumstances. It is possible that some existing scheme-specific approaches will no longer be required because of these additional default approaches, and this is welcome.

We are concerned that the new assumptions and factors prepared by the AGA have not been provided within the consultation process, as:

- Actuarial approaches often require a balance between complexity and materiality. This means that, for example, a decision by scheme stakeholders to seek or not seek a scheme-specific approach will be influenced by the default factors, which are not yet available. This leaves scheme actuaries in the invidious position of having to advise trustees on whether to seek a scheme-specific method without full information.
- There is some risk that the new assumptions and factors will be found to be inappropriate in some contexts once scheme actuaries see them. We accept the general reasoning for withholding those factors currently but observe that this increases the risk that a late change to a scheme-specific method may be required.
- One of the difficulties in actuarial valuation where economic assumptions are set by a different process or by different parties than demographic assumptions is that typically some demographic assumptions are linked to the economic scenario. For example, commutation/pension take-up assumptions are partly linked to investment return expectations, and resignation assumptions are to some extent linked to economic expectations. This means that it is unsafe to determine appropriate demographic assumptions for scheme-specific methods without also knowing the economic assumptions. Any delay in release of the economic assumptions (and potentially demographic assumptions) by the AGA leads to an information gap for actuaries that is difficult to bridge.

We foresee challenges in the orderly implementation of new default methods and factors, including sufficient time for superannuation actuaries to assess and recommend changes to scheme-specific Family Law factors, potentially in conjunction with assessing Alternative Valuation Methods (**AVMs**) to implement the proposed Division 296 Tax for DB interests, along with six months for the necessary system changes. We note in this regard that there are only a small number of DB superannuation scheme administrators, some dealing with hundreds of defined benefit category designs, which will be facing a significant amount of system changes to configure Family Law or AVM calculations effective 1 July 2025 (the proposed start date of the Division 296 Tax).

We urge that the revised default valuation factors, underlying assumptions and calculation methods are released on a targeted basis no later than 30 June 2024.

Question 9 – commencement

We do not have any firm views on the best commencement date for the New Regulations. However, we note that the timeframes for the various steps for preparation of new scheme-specific methods and/or factors are quite long, and it appears unlikely that this could be completed any sooner than 1 April 2025.

We seek clarity on the following transitional arrangements:

- Will the New Regulations apply to all FL settlements that occur after commencement, or only those meeting certain criteria, eg date of separation after the commencement date? If the former, will this require new valuations to replace valuations performed under the Current Regulations? Given the delays in the FL settlement process, this may effectively place a pause on family law valuations in the few months before the New Regulations commence, and hence also a delay in settlements post-commencement as any backlog of valuations is cleared.
- If valuations under the Current Regulations will be allowed in some circumstances, how is a court to decide between valuations on the Current and New Regulations?

Question 24: What barriers would prevent trustees from reviewing and updating their approved methods and factors and information determinations?

The initial process of developing scheme-specific methods over 20 years ago was a significant exercise involving many stakeholders, including scheme actuaries, trustees, employer-sponsors and state government superannuation policy officers. It typically required approaches to be considered and assessed from the perspectives of accuracy, cost, equity for the member and non-member spouse, practicality, ease of administration, and transparency. Necessarily, compromises were made in deciding whether a scheme-specific method was required, and in developing the methods.

Notably, given the potential use of FL values for determining Division 296 TSB, accuracy and transparency may now be given a higher weighting in any assessment of scheme-specific approach, and this may lead to revised scheme-specific methods with greater complexity and cost in some contexts, or more schemes and categories with scheme-specific methods.

Much or all of the corporate knowledge that underpinned those judgements over 20 years ago may now be lost, and this makes any review of existing methods more challenging.

There could be a substantial cost imposed on trustees to have the methods/factors reviewed and to implement them from an administration point of view. This would apply particularly if there were to be any changes to methods, or any methods applying to new schemes or new categories of member in existing schemes.

While there is an expectation for assumptions to be updated in a current review, it is not clear whether there is also an expectation that methods would be reviewed in detail, nor whether the assessment would be from the slightly simpler perspective of considering whether the existing methods have obvious flaws and need to be changed. Either way, a review of methods for determining the value of superannuation interests is expected to be a complex and onerous task, and the timeframe for review of methods and implementation of any revisions is much longer than that for factors/assumptions alone. We do not believe a strict requirement to review and update valuation methods is necessary. However, we urge that a clear process and timeline for revision of methods be established, for those schemes where stakeholders consider a revision is necessary.

One of the key steps in the previous process of making scheme-specific applications was detailed consultation with staff at the AGA, including careful vetting by AGA of applications. There are likely to be some changes to what the AGA might consider useful to have included in the applications, and the attitude of the AGA to the importance of various considerations, e.g. the trade-off between accuracy and simplicity. We understand from discussion with the AGA that as part of an application for new factors, there may be a new requirement, being for the actuary to include the impact of the change in assumptions on the factors. This may be difficult, particularly if there are changes to method as well as factors.

This question appears to be predicated on the assumption that no additional schemes would apply for scheme-specific factors. Even if a streamlined process for reviewing methods for existing schemes is developed, this could not also apply for applications for new schemes or categories of members, and a more detailed consultation and vetting process would be required.

Question 25: How much notice would trustees need to update their approved methods and factors, if a requirement to review was imposed in legislation?

The initial application process in the early 2000s took more than two years to complete. While we do not think that a second pass would require as much time, and for some schemes the process would be

straightforward, we do consider that the time required for some schemes is substantial. This would particularly apply for schemes where the original reasoning for the various decisions in the process is lost, or where new or altered methods are adopted. We estimate six months for the actuary to consult with the trustee and other stakeholders, consider alternatives then prepare an application for revised methods and/or factors in accordance with whatever requirements are specified in the New Regulations or by the AGA. We then expect there may be substantial time for the AGA/AG to review applications in some contexts, particularly where any change of method is proposed. The previous process involved some iterative consultation between the AGA and schemes, and this may again occur in some contexts, further extending the timeline.

If FL values are to be calculated on scheme administration systems, further time will then be required for this functionality to created and/or updated. We would expect this to take a number of months at a minimum.

The timeline for new applications would ideally not start until the new AGA-set factors and underlying assumptions are made available to actuaries and schemes preparing applications for scheme-specific methods. This is because:

- The process for updating methods and factors commences with an assessment of whether a scheme-specific process produces values which are significantly different from the default factors. It is not possible to undertake this step without knowing the default factors
- The process of setting demographic assumptions for a scheme-specific process would ideally consider the interrelationship between the demographic and economic factors, with the economic factors dictated by the AGA
- It may be convenient in a scheme-specific approach to set demographic assumptions which are the same as the AGA assumptions, for some or all assumptions. But the appropriateness of this cannot be assessed until the AGA assumptions are released.

We note that, in conjunction with the methods and factors approved in legislation, some scheme-specific arrangements also have a separate set of factors used for determining adjustments to scheme interests, which are based on scheme best estimate assumptions. These would need to be updated to reflect any new methods, as part of any review of methods and factors.

We consider that it is very difficult to predict what issues may arise. For example, it appears possible that under the new assumptions there will be more or less need for scheme-specific factors, or greater differentiation between categories of members. It is not reasonable to assume that actuaries can just apply the new assumptions and obtain appropriate new factor tables without a deeper consideration of circumstances.

The timeframe for updates to scheme-specific FL factors must allow for review by the AGA and drafting of relevant New Regulations. This is likely to stretch AGA resources (and possibly regulation-drafting resources) given there may be 30-plus funds, some of which have highly complex arrangements. We doubt that even a 12-month timeframe would be sufficient to enable all trustees with scheme-specific factors to have updated factors in place for use in determining Division 296 values as at 30 June 2025.

Our overall observation is that if the FL scheme-specific methods are to be updated and ready to use by commencement on 1 April 2025, the timeline is already very short. There may be a need for some form of transitional relief, such as an ability to use the old methods and factors for a period after 1 April 2025.

Use of FL factors for Division 296 TSB

As noted earlier, we understand that the FL factors, including scheme-specific methods and factors, may be used for determining TSB for Division 296 tax purposes. This is a new application, and it brings an additional set of considerations in the scheme-specific approach. Notably, accuracy and transparency may now be given a higher weighting in any assessment of scheme-specific approach, and this may lead to revised or new scheme-specific methods with greater complexity and cost in some contexts.

We foresee a situation where some schemes that did not have scheme-specific methods might now choose to apply for a scheme-specific method. This is particularly so if a judgement was made two decades ago that for FL purposes simplicity outweighed accuracy for the small number of members impacted, but now that the method will be used to determine tax components for all or many members, then accuracy is seen as a more important consideration.