THE INSTITUTE OF ACTUARIES OF AUSTRALIA
A.C.N. 000 423 656

GUIDANCE NOTE 455
PRE 1 JULY 1988 FUNDING CREDITS (PJFCs)

APPLICATION

This Guidance Note is to be used by actuaries in the calculation of fund's PJFC at 30 June 1988 (or other approved effective date for a fund). A PJFC may apply for a Superannuation fund, under Section 15D of the Occupational Superannuation Standards Act. This Guidance note also covers transfers of PJFCs, and adjustments resulting from changes to benefits where the change constitutes a "Prescribed Event".

LEGISLATION

Occupational Superannuation Standards Act Section 15D covers the application for, and granting of, a PJFC for a fund.

Part 3B of the Occupational Superannuation Standards Regulations covers the calculation of the initial PJFC.

Sections 275A and 275B of the Income Tax Assessment Act (ITAA) cover the use of the PJFC.

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CLASSIFICATION

Compliance with the provisions of this Guidance Note is mandatory.

1.PURPOSE

1.1 The purpose of this Guidance Note is to provide guidance to actuaries on the calculation of the initial PJFC for a fund. The PJFC will be calculated at 30 June 1988, or such other date as applies under Regulation 23PT. Subsequent "prescribed events" may also involve advice from the actuary, as will transfers of PJFCs.

1.2 The Treasurer's supplementary statement on Superannuation Tax Reform (Press Release 60, 20 June 1988) introduced the concept of non-taxed contributions to "discharge funding requirements in respect of benefits accrued relating to service prior to 1 July 1988, subject to the provision of satisfactory actuarial evidence to the Insurance and Superannuation Commissioner".

1.3 Subsequent announcements relating to PJFCs were made in -

- Treasurer's Press Release (No.82) 11 August 1988
- ISC Information Circular 15 (Interim arrangements) March 1990
- Treasurer's Press Release 10 October 1991

1.4 Statutory Rules No 149/1993 inserted into OSS Regulations a new part, Part 3B, which specified the manner of calculation of the initial credit. It also inserted a requirement in Regulation 17 for a statement to be included in an actuarial report under that Regulation as to whether a prescribed event has occurred.

Briefly the credit is the lesser of -

- unfunded liabilities at 30 June 1988 on the fund actuary's chosen valuation basis (generally based on the basis used for the latest actuarial investigation completed prior to 25 May 1988), and

- unfunded liabilities at 30 June 1988 on a control basis

plus any "late payments" of outstanding contributions (if any) as at 30 June 1988 (`late payment amounts' are as defined in Regulation 23PB - refer Section 7 below).

ISC Circular 35 issued in July 1993 provided further details of the application process.

1.5 The benefits valued are to be those which applied as at 30 June 1988 based on the rules governing the fund as at 25 May 1988 unless the benefits have been reduced by 30 June 1988. If benefits were subsequently altered in a manner which reduced accrued benefits at 30 June 1988, the provisions of a "prescribed event" will apply at the amendment date. (Refer Section 5 below)

2.ACTUARY'S CHOSEN BASIS

2.1 The unfunded liability on the actuary's chosen basis is determined as:

> the value of accrued benefits at 30 June 1988 (referred to as Value A in the Regulations) less the actuarially determined value of fund assets (calculated in a manner consistent with the latest actuarial review completed prior to 25 May 1988) as at 30 June 1988,
>
> multiplied by
>
> the ratio of net market value of assets to the actuarially determined value of assets as at 30 June 1988.

2.2 Except as provided in paragraphs 2.3 to 2.5 be low, the actuarial basis used for the latest actuarial review of the fund completed prior to 25 May 1988 is to be used to value benefits. The date of completion for this purpose is the date the report is signed.

2.3 The variation required to the actuarial basis previously used is that no death or disablement decrements are to be used.

The Government's view is that this is appropriate due to the deductibility of insurance costs under Section 279 or 279B of the ITAA.

In limited circumstances, other assumptions may be used in place of one or more of those adopted in the actuarial review completed prior to 25 May 1988. Such cases must be referred to the Commissioner (refer Regulation 23PE(6)).

2.4 Accrued benefits at 30 June 1988 are to be determined on the basis used in the last completed actuarial review prior to 25 May 1988.

If accrued benefits were not determined for that review, or if the actuary believes that the basis used is not appropriate for this purpose, the actuary should refer the preferred basis to the ISC under the provisions of Regulations 23PE (4) or (6).

Features the actuary should consider when determining the approach used include:

- whether the rate of accrual of retirement (or withdrawal) benefits has been increased or decreased for some or all members at some date prior to 25 May 1988.

- whether members have changed benefit categories prior to 1 July 1988, with a consequent change in the rate of accrual of retirement benefits.

- whether any member has transferred into the fund prior to 1 July 1988 a transfer amount (whether applied to direct or indirect purchase of a period of past service, or applied to an accumulation only).

This list of circumstances is not intended to be comprehensive. The actuary should consider the significance of any feature which may alter the value of accrued benefits (and consider whether the control basis value is likely to apply) before embarking on extensive recalculation of accrued benefits at 30 June 1988.

2.5 Benefits are to be valued as follows:

- allowing for the assumed rate(s) of salary escalation.

- (if benefits are not salary related) allowing for any benefit increases in a manner consistent with past practice.

- applying early retirement and withdrawal decrements in the usual manner.

- applying other decrements (e.g. ill-health, but not death or total permanent disablement), except where part of the relevant benefit is implicitly or explicitly insured and the cost is deductible under Sections 279A and 279B or 279C of the ITAA.

  (Thus, if any part of an ill-health benefit is self-insured, and deductions are claimed for the certified cost, relevant ill-health decrements may not be used)

- converting pension benefits to lump sum equivalent values at the date of pension commencement (in a manner consistent with that used in the latest investigation completed prior to 25 May 1988).

- reflecting discretionary pension increases only if increases have been made to all pension benefits on at least 3 occasions prior to 1 July 1988, including at least once in the three years to 30 June 1988.

- making no allowance for the tax on investment income introduced by the 25 May 1988 Statement.

- allowing for withdrawal benefits which are related to accumulated member contributions with interest using either:

  - the vesting factor at 30 June 1988, or

  - the vesting factor at assumed exit date,

  and applying this to the accumulated member contributions at 30 June 1988, together with accrued and subsequent interest additions.

2.6 Where a fund has not had an actuarial review prior to 1 July 1988 or has had a review prior to that date which was completed on or after 25 May 1988, the basis is to be referred to the ISC (under Regulation 23PE(4)). The actuary should select a basis which is consistent with the approach detailed in Section 2.5 of this Guidance Note.

This requirement can apply to new funds, and funds which were segregated from larger funds. In this latter case, the basis used for the previous actuarial review of the larger fund should be used as the starting point for the valuation basis of the fund. Any variation (e.g. to salary increase rates) should be justified by the actuary by referring if possible, to identifiable actual experience of the segregated group of members.

2.7 The value of accrued benefits for each member is subject to a minimum of the vested benefit at 30 June 1988. Any regular exercise of discretion should be used to determine vested benefit (e.g. on early retirement) except for `associated employees' (as defined in the ITAA).

3.CONTROL BASIS

3.1 A control basis has been specified. The basis for determining the value of accrued benefits ("Value B") is detailed in Regulation 23PF, and the resulting unfunded liability (using net market value of assets) is applied as the maximum value of the shortfall-in-assets component of a PJFC in Regulation 23PC.

The Government considers that, without the control basis, an overly conservative valuation basis may have been used in some cases, resulting in an unreasonably large tax concession.

3.2 The unfunded liability on the control basis is calculated as:

the value of accrued benefits as at 30 June 1988,
less
the net market value of fund assets as at 30 June 1988.

3.3 The Economic components of the valuation basis are

fund earning rate 10% p.a.
salary escalation rate 8½% p.a.
CPI increases 7% p.a.

The fund earning rate is to be used to discount expected benefit payments. No adjustment to the rate may be made for tax on earnings, or investment management expenses. It should also be used for amounts which accumulate with interest (e.g. member contributions).

The salary escalation rate is to be used to project salaries from 30 June 1988. No further allowance is to be made for promotional increases.

The CPI increase rate is to be used to project future benefits where the amounts of such benefits are not salary based, and the fund's past experience shows that benefit levels are reviewed from time to time in light of changes in the costs of living.

3.4 No decrements should be used except for normal retirement. Thus, no allowance should be made for death, disablement, ill health or early retirement, or withdrawal decrements (refer Regulation 23PF(2)(a)).

3.5 Accrued benefits are to be calculated on a proportionate basis only, using membership to 30 June 1988 divided by membership to date of assumed exit. In general, membership is to be measured from the date the member joined, or last joined, the fund (refer Regulation 23PG(2)).

For the purpose of this Guidance Note, the Institute interprets a period of fund membership as including allowance for a period of fund membership of a former fund to which the member belonged, where an amount has been transferred into the current fund in respect of former fund membership and has been converted into an additional period of membership, or an additional multiple of final salary or final average salary. The allowance should be based on the additional period of membership granted (either explicitly or implicitly by way of the additional multiple).

Where the amount transferred is accumulated with interest and payable in addition to other benefits in the current fund, the amount of the accumulation at 30 June 1988 should be deducted from the asset values used, and no allowance should be made in the Value A or Value B of accrued benefits for the benefit which is so payable.

3.6 Pensions are to be valued using 10% p.a. interest.

Where the fund allows for adjustments to pensions at the discretion of the Trustees, increases in pensions should be based on the average annual percentage increase in pension benefits (if any) over the period 1 July 1985 to 1 July 1988, subject to a maximum of 7% p.a.

Where the fund allows for adjustments to pensions other than at t he discretion of the trustees, increases in pensions to compensate for increases in the cost of living are to be assumed at the rate of 7% p.a.

Where the fund allows for adjustment of benefits in accordance with the amount or rate of salary of members, increases in salary are to be assumed at a rate of 8.5% p.a.

3.7 In limited circumstances, other assumptions may be used, on application to the Commissioner (refer Regulation 23PF(4)).

4.ASSET VALUATION

4.1 Asset values for the Control Basis are to be d etermined at net market value at 30 June 1988. In determining net market value the actuary should take account of any charges incurred in the normal course of operation of the fund (e.g. when assets are realised to meet benefit payments and regular costs such as insurance premiums and management fees).

Investment termination penalties (e.g. for Life Office `Capital Guaranteed' contracts) would not normally be taken into account.

4.2 Asset values for the actuary's chosen basis are to be determined using a method that is consistent with the method used in the relevant actuarial investigation prior to 25 May 1988.

The resultant unfunded liability is adjusted for the ratio of net market value to actuarially determined value, to give the shortfall-in-assets component of the PJFC (refer Regulation 23PC(1)).

5.PRESCRIBED EVENTS

5.1 Actions relating to prescribed events, as defined in Regulation 23PJ, are detailed in Section 15D of the OSS Act subsections (4) to (6).

5.2 A prescribed event is, in terms of Regulation 23PJ, any alteration to benefits which, in effect, reduces the pre 1 July 1988 benefit entitlement. Under Regulation 23PJ(1), a prescribed event applies to a fund which had been previously granted, or had transferred in, a PJFC.

5.3 If a prescribed event occurs, the actuary should determine the reduction in 30 June 1988 value of accrued benefit for the affected members (which may not be the same group as actual 30 June 1988 membership).

The reduction should be calculated in the manner detailed in section 2 or 3 of this Guidance Note, using the basis which generated the fund's actual PJFC at 1 July 1988 (e.g. on the actuary's basis only if the PJFC was determined as the amount in Regulation 23PC(1)(a)).

The value of the reduction calculated at 30 June 1988 should be adjusted in accordance with subsequent indexation applied to the PJFC.

5.4 The intention of the Government is that a reduction in benefits accrued prior to 1 July 1988 will generate a prescribed event.

A reduction in the rate of accrual of retirement (or other) benefits accruing after 1 July 1988 may have the effect of generating a "Prescribed Event" under the Regulations. This is a result of the proportioning approach specified for the control basis, which - as specified in the Regulations - would reduce the calculated accrued benefit at 30 June 1988.

This is not the intended effect, and the Government Actuary has agreed that the alteration of benefits after 1 July 1988 which does not affect the calculation of benefit relating to service prior to 1 July 1988 will not result in a "Prescribed Event".

6.TRANSFERS

6.1 Transfer of members with PJFCs is covered in Section 15D of the OSS Act, subsections (7) and (8), and Regulations 23PL and 23PM.

6.2 Transfer of a PJFC is an action which Trustees are unlikely to undertake lightly.

The actuary should ensure that the transferring and remaining members, to whom any PJFC relates, are treated equitably (generally the equity is actually between the employer sponsors of the relevant funds giving and receiving the transferred PJFC amount).

6.3 The actuary for the transferring fund is required to certify that the amount of PJFC transferred is reasonable having regard to the amount of unfunded pre 1 July 1988 liability being transferred in relation to the amount remaining.

The actuary is also required to certify that sufficient information is available about the accrued entitlements of transferred members to enable calculations to be made about possible subsequent prescribed events.

The actuary of the transferee fund should consider whether the amount of the PJFC applying in that fund is reasonable in light of the amount which would have applied were the benefits of the transferee fund provided by way of amendment to the governing rules of the transferor fund. The consequence of this may be that some of the PJFC transferred may be relinquished by the transferee fund in the manner applying to a prescribed event.

6.4 In determining the unfunded pre 1 July 1988 liability from time to time, the actuary should consider the following

- initial unfunded liability, and any PJFC transferred in or out at any time
- subsequent retirements of members who were members at 30 June 1988, or transferred in with an attached PJFC
- contributions made from time to time to reduce the PJFC
- whether any prescribed event has occurred
- indexation applied to PJFC

6.5 The actuary should notionally treat contributions paid to reduce the PJFC firstly to fully fund any remaining unfunded liability from 30 June 1988 for exiting (retiring etc.) members.

Generally, the balance should be notionally applied to reducing the unfunded liability in inverse proportion to the remaining term to retirement per unit of unfunded liability. However, if the funding method being used renders this approach inappropriate, the actuary may adopt an alternative method for the notional amortisation of PJFC.

This approach recognises the priority of fully funding benefits for members prior to their exit from the fund.

6.6 Notwithstanding the above, the amount of PJFC transferred must be no more than the least of:

- The liability in relation to pre 1 July 1988 benefits being transferred (which means that PJFCs cannot be transferred unless a corresponding pre 1 July 1988 funding liability is also transferred);

- The shortfall between the value of assets being transferred and the value of accrued liabilities being transferred (if there is no such shortfall then no transfer of PJFCs is permissible, which means that a PJFC cannot be transferred unless it can be directly attributed to the transferring members); and

- The unused PJFCs in the transferring fund immediately before the transfer. (The fund must ensure that its indexed balance of PJFCs is sufficient to satisfy the transfer. The ISC will use ATO records to verify the validity of the transfer).

6.7 The transferred PJFC should be calculat ed in the manner detailed in section 2 or 3 of this Guidance Note, using the basis which generated the transferring fund's actual PJFC at 1 July 1988 (e.g. on the actuary's basis only if the PJFC was determined as the amount in Regulation 23PC(1)(a)).

7.LATE PAYMENT AMOUNTS

7.1 Regulation 23PB refers to an amount of contribution in respect of a member who is "an associate of the employer-contributor" which that employer-contributor was obliged to pay as at 30 June 1988 in accordance with the determination of an actuary.

7.2 In determining what the fund's outstanding contribution for such members was at 30 June 1988, the actuary should have regard to the contributions recommended for such a class of members at the latest actuarial investigation, or time of any other actuarial advice relating to those members (e.g. on the establishment of a new fund).

8.ACCUMULATION BENEFITS

8.1 Accumulation style funds may have been in deficiency at 30 June 1988 (measured against vested benefits or full retirement credits).

Regardless of the extent of any such deficiency , a PJFC arises for these funds only under the late payment amount definition in Regulation 23PB.

8.2 To be consistent with the approach detailed above, if a defined benefit fund has a subsection of accumulation based members, for whom an identifiable asset value is available (e.g. via a separate body of assets, or a sub-account in a pooled fund) any deficiency in such a subsection should not be included in the fund's PJFC, unless it meets the definition of a late payment amount in Regulation 23PB.

To effect this, the asset values used should be net of the amounts identifiable for these members. If assets are not separately identifiable, the retirement credits at 30 June 1988 should be taken as the value of accrued benefits.

9.MISCELLANEOUS

9.1 An actuary providing a certification of a PJFC should note the requirements of Regulation 23PS, and confirm in the certification given that the method used was in accordance with this Guidance Note and the Occupational Superannuation Standards Regulations. The actuary should state whether the data upon which calculations were based was considered reliable.

9.2 A certificate detailing the fund's PJFC should include

- the name of the fund
- the effective date of the calculation (usually 30 June 1988).
- the amount of the PJFC, separated into "late payment amount" and "shortfall-in-assets amount" together with a statement that the "shortfall-in-assets component is not greater than the maximum allowed under the control basis
- the assumptions used in the actuary's chosen basis, the amount of the Value A of accrued benefits, the actuarially determined value of fund assets, and details of any variations from the assumptions used in the latest Actuarial Investigation completed prior to 25 May 1988
- the net market value of the fund assets at 30 June 1988
- the date of the last actuarial investigation completed prior to 25 May 1988, and the date of the completion of that report
- the name, business address, qualifications and signature of the actuary
- the date of signing of the certificate.

END OF GUIDANCE NOTE 455