Institute of Actuaries of Australia

EXPLANATORY MEMORANDUM TO PRACTICE GUIDELINE 499.02

PROJECTED SUPERANNUATION BENEFIT ILLUSTRATIONS

April 2009

A. Background

The purpose of Practice Guideline 499.02 ("PG 499.02") (and the previous Guidance Note 466) is, in cases where "Projected Superannuation Benefit Illustrations" are made, to guide Members in providing sufficient and appropriate information to enable the recipient to understand the benefits illustrated and to appreciate the risks involved in the arrangement. It relates specifically to benefits being provided through superannuation funds, other than cases where insurance contracts (such as insurance bonds or capital guaranteed products) are used.

Guidance Note 466 was issued in October 2004. The Guidance Note was modeled on the UK Institute of Actuaries' Guidance Note 34.

The Superannuation and Employee Benefits Practice Committee (SEBPC) and the Benefit Projections Working Group (BPWG) consider that Guidance Note 466 has assisted Members to produce professional, thorough and effective benefit projections.

B. Why has this Practice Guideline been developed?

In June 2006 the Institute issued a new Policy for Drafting and Developing Practice Guidelines. Concurrent with changes stemming from that policy, it was considered appropriate to make further technical improvements and to update some minor aspects of the previous Guidance Note 466.

C. Principal changes from Guidance Note 466

The principal changes in PG 499.02 from Guidance Note 466 are set out below.

C.1 Illustrating volatility and assumption uncertainty

[GN 466 – section 3.5; PG 499.02 – section 5.5]

The previous section related to "possible approaches to illustrating volatility". This has been expanded to also cover "assumption uncertainty". In addition, slight changes have been made to the examples in the three sub-sections to limit deterministic variations or additions to the projection end point ("at retirement") and to refer to historical as well as stochastic scenarios. Further, the following new sentence has been added at the end of the section:

> "The use of two or more Illustrations showing deterministic year-by-year projected benefits is generally to be avoided, unless an explanation or further information is added so that such Illustrations do not give the misleading impression that any variation from, for example, the assumed investment earning rate, will be constantly higher or lower than the assumed rate and/or always within the limits of the two or three deterministic results."

Information about the reasons for this sentence may be found in an article on pages 19 to 21 of the May 2007 issue of Actuary Australia.

C.2 Terminology

[PG 499.02 – section 5.9]

In April 2008 the BPWG issued a Discussion Paper entitled "Outstanding Issues for Benefit Projections and Online Calculators". Section 4 of that paper commenced:

> "The use of different deflators (CPI and salary-based) is a major source of discrepancy between different online calculators. We believe that different approaches to deflating future dollar benefits is an issue which generates significant consumer confusion.
>
> The Institute Guidance Note and the Institute's September 2002 Report to the Senate Select Committee on Superannuation (which is referred to in the ASFA discussion paper) both recommend the use of a salary or wage-based deflator rather than a CPI deflator. The following is an extract from the Institute's September 2002 recommendations:
>
> ... the IAAust view is that adequacy of retirement income is best viewed as a relative concept, comparing retirement income to living standards and earnings at the time of retirement. The alternative approach of viewing adequacy as an absolute concept based on current living standards projected 30 or more years ahead is problematic because of the general change (usually an increase) in living standards that occurs over such periods. Increased community living standards lead to expectations of increased retirement incomes to maintain adequacy.
>
> The use of a CPI deflator (as has been used in the Treasury model) will produce results that are consistent with other Government projections. However other Government projections are usually undertaken over relatively short time frames (less than five years or so). For longer-term projections, such as are required when assessing adequacy of retirement incomes, IAAust believes it is more consistent to use an AWOTE deflator to ensure comparability with living standards at the time of retirement."

In September 2008, the BPWG discussed this matter with representatives of the Australian Investments and Securities Commission (ASIC) and understands that ASIC endorses the above views and intends to continue using a salary or wage-based deflator in its FIDO calculators together with the terminology "in Today's Dollars". The BPWG further understands that ASIC intends to clarify the wording used in the Guides which accompany the FIDO calculators to make it clearer that the deflation used covers inflation plus increases in community living standards, not just inflation.

Consistent with these developments, the following new section 5.9 has been added to the Practice Guideline:

> Preferred practice in respect of the use of terminology in an Illustration is that:
>
> "**Today's Dollars**" refers to projected amounts which have been deflated to the calculation date using an income (eg salary, AWE or AWOTE) based assumption. It may be characterised as the sum of a price inflation component and a component reflecting increases in community living standards;
>
> "**Future Dollars**" is used for situations where there are no adjustments; and
>
> "**Deflated Dollars**" is used for adjustments which include only price inflation.
>
> The following is an example of a possible explanation of "Today's Dollars" for use with Illustrations:
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>> "Today's dollars" converts your future retirement benefit or income into today's relative buying power. It takes the future dollar amount and discounts (or deflates) it at the rate of salary inflation (assumed to be ... pa). Wages, salaries and community living standards and the cost of living have tended to grow faster than price inflation, and converting to "today's dollars" means you can better decide if your future retirement benefit or income will be adequate compared to your current income or salary.

C.3 General updating

To reflect legislative and taxation changes since Guidance Note 466 was issued over four years ago, changes have been incorporated to reflect:

- the Corporations Act and Regulations;
- account-based pensions;
- fees and costs;

- income amount to be expected over the plan member's lifetime or other specified period; and

- obsolete references to surcharge and excessive benefits.

D. Member consultation

In November 2008, all members were invited to make submissions on an earlier draft of PG 499.02. Two submissions were received and the very constructive and helpful comments – involving slight rewording changes to clarify intention and, in some cases, include brief additional explanations – were taken into account in developing the final of PG 499.02.

As such:

- there has been proper consultation with relevant and interested members of the Institute and, where necessary, external parties; and

- given the number and nature of the submissions, the guidance set out in PG 499.02 represents generally accepted actuarial practices and techniques, and has the support of members.

E. Statement of compliance with Institute policy

Practice Guideline 499.02:

- has been drafted in accordance with the Policy for Drafting and Developing Practice Guidelines; and

- is consistent with the Code of Professional Conduct, Professional Standards, and any relevant legislation or regulatory standards.