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

GUIDANCE NOTE 459
PAYMENTS FROM SUPERANNUATION FUNDS TO EMPLOYERS

APPLICATION

Actuaries certifying whether a complying superannuation fund would remain in a "satisfactory financial position" after the repayment of an amount to an employer.

LEGISLATION

This Guidance Note applies to the certification by an actuary that a complying superannuation fund would remain in a satisfactory financial position under Section 117 of the Superannuation Industry (Supervision) Act 1993.

FIRST ISSUED

August 1994

CLASSIFICATION

Compliance with the Guidance Note is mandatory.

DEFINITIONS

"The Act" means the Superannuation Industry (Supervision) Act 1993.

"SGC" means Superannuation Guarantee Charge.

"The Regulations" means Regulations made under the Superannuation Industry (Supervision) Act 1993.

1 "SATISFACTORY FINANCIAL POSITION"

1.1 A defined benefit superannuation fund can be regarded as being in a "satisfactory financial position" for the purposes of Section 117 if and only if all of the following are satisfied, after any payment from the fund to the sponsoring employer (other than payment of a reasonable amount for services rendered in connection with the management or operation of the fund) and after any benefit improvements which may be provided in conjunction with such a payment.

(a) The actuarially determined value of the fund's assets exceeds the present value of accrued benefits, based on projected salaries; and

(b) The net market value of the fund's assets exceeds the total value of vested benefits ie the benefits which would be payable if all members voluntarily left service; and

(c) If the fund is being used by any employer to offset the employer's SGC obligation in respect of some of its employees, any existing funding and solvency certificate remains valid or the actuary can sign a new funding and solvency certificate; and

(d) The actuary can positively make the statement required under Regulation 9.31(1)(d) of the Regulations (or Regulation 17(2)(d) of the Occupational Superannuation Standards Regulations where relevant) in respect of the following three year period.

(e) The fund's financial position would not be regarded as unsatisfactory, or about to become unsatisfactory, for the purposes of Section 130 of the Act.

1.2 A defined contribution superannuation fund can be regarded as being in a "satisfactory financial position" for the purposes of Section 117 if and only if the net market value of the fund's assets exceeds or equals the total member account balances, ignoring any vesting factor which may apply on voluntarily leaving service (ie assuming maximum vesting applies).

The remainder of this Guidance Note deals primarily with defined benefit superannuation funds. However, some elements of the Guidance Note are also relevant to defined contribution funds, for example parts of Sections 2 and 3 and in some cases parts of Sections 8 and 9. In general however, apart from this paragraph 1.2, it is not considered that further specific guidance in relation to defined contribution funds is necessary.

1.3 Section 117 does not apply to a fund which has always had fewer than five members at all times after 30 November 1993. However, if an actuary is nevertheless asked to provide a certificate for such a fund as if Section 117 did apply, the actuary should comply as far as is reasonable with this Guidance Note when preparing the certificate.

1.4 The actuary is reminded of the Code of Conduct when signing a certificate in circumstances where another actuary has recently provided actuarial advice in relation to the fund.

2 THE EFFECTIVE DATE

Section 117 of the Act requires the trustees to obtain a certificate from an actuary prior to resolving to make a payment to the employer and prior to giving members three months notice of the intention to make a payment to the employer.

Thus it will not be possible to carry out the necessary calculations and sign the required certificate at the same time as the repatriation of surplus occurs.

Because a fund's financial position varies from day to day, the actuary will need to allow for differences between:

(i) the effective date of the calculation;
(ii) the date of signing the certificate; and
(iii) the date of the payment.

Because of the nature of Section 117, the payment date will be the last of these three dates. The actuary should, in the certificate, alert the trustees to the possible need to vary the amount paid to the employer to allow for events occurring between the effective date of calculation and the date of the payment.

The actuary should also consider other significant events of which he or she is aware, which have occurred between the effective date of the calculations and the date of certification, and determine whether to take such events into account in the calculations, or whether to alert the trustees to their general effect.

The actuary should take all practical steps to ke ep the period between the effective date of calculations and the date of certification as brief as possible, and in no case should this period be more than twelve months.

3 VALUATION OF ASSETS

For testing against vested benefits, that is, test (b) in Section 1 above, assets must be valued at net market value. For testing against the present value of accrued benefits, that is, test (a) in Section 1 above, assets may be valued at net market value.

Net market value is market value, net of realisation c osts, determined in a manner consistent with Australian Accounting Standard AAS25.

The actuary should give careful consideration to the valuation of:

- direct property investments
- unlisted shares
- other assets where no objective market valuation is available
- in-house assets

- single assets representing a significant proportion of the overall asset value
- future income tax benefits (including any benefits arising as a result of the payment to the employer)

The actuary may wish to consider v aluing such assets conservatively and/or alert the trustees to the nature of these assets and the possible consequences of future events which have the potential to adversely affect the value of a particular asset.

The valuation method must be consistent with the requirements of Professional Standard 400 and the method must be explained in the actuarial certificate.

The actuary may need to consider which particular assets will be sold to engineer the payment to the employer, and therefore which assets will remain afterwards. The actuary should also consider the need to allow for any tax liability arising due to the sale of assets necessary to achieve the payment to the employer.

4 APPORTIONMENT OF BENEFITS BETWEEN PAST AND FUTURE MEMBERSHIP

4.1 Where some members of a defined benefit fund have their benefits expressed entirely in accumulation form, it will normally be appropriate to take the relevant account balance as the present value of accrued benefits. The remainder of Section 4 covers benefits which are in defined benefit form.

4.2 The actuary is free to determine a reasonable basis for apportioning benefits between past and future membership. However, the basis chosen must be appropriate having regard to the definition of benefits, in particular the early retirement benefits, under the governing rules of the fund.

"Membership" for the purposes of this Guid ance Note can be taken to include periods during which benefits have accrued while not a member where the actuary considers this appropriate.

The actuary may make appropriate adjustments where different benefit accrual rates have applied.

4.3 **Retirement Benefits**

The two most frequently encountered approaches for determination of accrued retirement multiples are:

(a) **Proportionate Basis**

The accrued retirement benefit multiple under the proportionate basis is:

$$\text{Retirement Benefit Multiple at Normal Retirement Date} \times \frac{\text{Membership to Date}}{\text{Membership to Normal Retirement Date}}$$

If there is no one *"Normal Retirement Date"*, the actuary should choose the most appropriate *"Normal Retirement Date"* for the purpose of the calculation.

An appropriate adjustment should be made where benefits accrue at different rates in respect of different periods.

(b) **Actual Accrual Basis**

The accrued retirement benefit multiple under the actual accrual basis is:

The product of the accrual percentage applicable to a member and the period of completed membership relating to the particular accrual percentage. If there is more than one accrual percentage, then the products are summed to obtain the total accrued retirement benefit multiple for a particular member.

Under either approach, membership should include an appropriate allowance for membership of any previous fund the assets of which have been incorporated in the current fund.

The accrued retirement benefit should be calculated by multiplying the accrued retirement multiple by final average salary or by current salary. If current salary is used as the base, final salary averaging should be allowed for when projecting current salary.

4.4 Death and Disablement Benefits

There are two frequently used approaches:

(a) Accrued Retirement Benefits

The death and disablement benefit to be valued is equal to the product of the accrued retirement benefit multiple and the appropriate definition of salary.

If the death and disablement benefit does not equal the retirement benefit then this product might be increased or decreased by the ratio of the death and disablement benefit to the retirement benefit.

(b) Proportionate Membership

The death and disablement benefit to be valued is:

$$\text{Total Death Benefit Payable in year } \mathbf{t} \times \frac{\text{Membership to Date}}{\text{Membership at end of year } \mathbf{t}}$$

Where t is the variable for each future year of membershi p until the Normal Retirement Date.

4.5 Resignation Benefits

Resignation benefits relating to member contributions and interest should only relate to member contributions payable up to the date of calculation. Similarly, resignation benefits related to a defined accrued retirement benefit should only relate to membership up to the date of calculation in a manner consistent with the calculation of accrued retirement benefits.

There are two frequently used approaches to vesting, where a vesting scale applies on resignation.

(a) **Use Vesting Factor at Valuation Date**

This means the vesting factor based on membership/service to the valuation date and is not increased for each year thereafter.

(b) **Use Vesting Factor at Assumed Resignation Date**

Under this approach the vesting factor is the factor applying according to membership or service assumed to have been completed at each future year of the projections.

5 VALUATION ASSUMPTIONS

The financial assumptions used to determine the actuarial value of accrued benefits should reflect individual best estimates for each assumption, having regard to the term of the liabilities. The assumptions as a whole should be reviewed for consistency having regard to the relationship between the assumptions over the relevant period.

The demographic assumptions should reflect best estimates of the future experience of the fund, based on past experience of the fund, or of similar employees, and based on expectations as to future experience.

The assumptions need not be the same as those used at any previous actuarial valuation of the fund, nor need they be the same as any assumptions used for accounting purposes. However, the actuary should consider the need to explain the reasons for, and effect of any differences to the trustees.

6 VESTED BENEFITS

The value of total vested benefits should be determined in accordance with Professional Standard No 400.

It is only necessary to take account of benefits payable on voluntarily leaving service.

Where the member has a choice of benefit on exit, for example a cash lump sum or an alternative deferred benefit, the value of the vested benefit should be determined using the approach the actuary would have adopted for the purposes of Professional Standards No 400 and 401. The actuary may make reasonable assumptions about the probability of the higher benefits being taken.

Where a higher level of benefit is subje ct to a certain period of notice being provided by a member, in determining the value of the vested benefit it should be assumed that such notice has been given.

Where a higher benefit is available subject to employer discretion, and such discretion has generally been exercised in the past, it should be assumed that such discretion would have been exercised had the member left service at the relevant date.

In valuing discretionary pension increases for the purposes of valuing a vested benefit, the assumptions used should be consistent with those which have been used in past valuations, unless practice has clearly changed since the last valuation.

7 RETRENCHMENT BENEFITS

It is normally necessary that the net market value of assets exceeds the total value of the benefits which would be payable if all members were to be retrenched on the relevant date, for the actuary to be satisfied that the fund is in a "satisfactory financial position". However, there may be exceptions.

Where the actuary considers that taking into account the size of the fund, the amount of retrenchment benefits and the likely circumstances of the employer in the foreseeable future, the probability of future retrenchments jeopardising the fund's financial position is negligible, the actuary may provide the requested certificate, even if assets do not cover total retrenchment benefits.

Whatever the case, the actuary must indicate the ratio of the net market value of assets to the value of total retrenchment benefits.

The trustees should be alerted to the potential impact of future retrenchments on the fund's financial position, where it is relevant to do so.

Where the retrenchment benefit takes the form of an equitable share of the assets, or some comparable approach, the actuary should alert the trustees to the likely effect of the payment to the employer on the potential size of members' retrenchment benefits.

Where the retrenchment benefit is an actuarial reserve, or some comparable approach, the actuary should advise the trustees whether the payment to the employer will have any effect on the potential size of members' retrenchment benefits.

In relation to the two preceding paragraphs the actuary's attention is drawn to the requirements of Regulation 13.16, prohibiting an adverse alteration to the amount of, right to, or claim to accrued benefits by any act carried out, or consented to, by the trustees.

There may be other contingencies the actuary should consider. For example a higher benefit than the vested benefit may be payable, subject to the exercise of a discretion. In such cases similar principles should be applied to these contingencies as to those applying to retrenchment benefits as described above.

8 EVENTS FOLLOWING THE EFFECTIVE DATE OF THE CALCULATION

The actuary should take into account known events occurring between the effective date of the calculation and the certification date as described in Section 2 of this Guidance Note.

The actuary should also consider events which may occur in future to the extent that it is necessary to do so to meet the requirements of parts (c), (d) and (e) of Section 1 of this Guidance Note.

It is not necessary to consider any other potential future events for the purposes of certifying whether the fund will be in a "satisfactory financial position" immediately following any payment to the employer. In other words the certificate is simply in the nature of a "snapshot".

However, the actuary should alert the Trustees to possible future events which could result in the fund's financial position becoming unsatisfactory. Such events could include:

- payment of employer contributions at less than the recommended rate
- investment returns which are lower than anticipated
- salary increases which are higher than anticipated
- large numbers of retrenchments
- certain exercises of employer discretions
- expected increases in vested benefits and expected exercises of trustee discretions (for example due to members being eligible for early retirement).

This list is not intended to be all-inclusive. The objective should be to ensure that the trustees are fully informed when making any decision to approve a payment to the employer.

Potential adverse future events need to be considered particularly carefully where the coverage of vested benefits is marginal.

The actuary may wish to place an "expiry date" on the certificate, such that if the proposed payment to the employer is made after that date, a new certificate is required.

9 FUTURE CONTRIBUTIONS

The actuary should include in the certificate a recommended employer contribution rate, or rates following any payment to the employer.

The recommended contributions should be determined using the principles described in Professional Standard No. 400. The contributions should also take account of any funding and solvency requirements under the Regulations.

The Trustees should be informed that continuation of a "satisfactory financial position" is likely to be dependent on contributions being paid at the recommended rate, and on future experience being in accordance with the actuary's assumptions.

The actuary should consider whether a change in investment policy is appropriate as a result of the repatriation, and whether a change in crediting rate policy is desirable as a result. The actuary should also consider whether a change to the fund's insurance arrangements is desirable after the payment.

Essentially, a review of the fund's new financial circumstances following the payment should be carried out and the actuary should have regard to the requirements of Professional Standard 400 in carrying out such a review.

10 CONTENT OF THE ACTUARY'S CERTIFICATE

The following information must be provided in the actuary's certificate where relevant, except that the information in (c) to (g) and (i) to (p) may be varied in circumstances such as those discussed in Section 11 below. The information below may also be varied in accordance with Sections 12 or 13, where relevant.

Satisfactory Financial Condition

(a) Certification that, following the proposed payment of the specified amount to the employer and any associated benefit improvements, the fund will remain in a satisfactory financial position.

Coverage of Value of Accrued Benefits

(b) The actuarial value of assets, before and after the payment.

(c) The present value of accrued benefits (before and after any benefit improvements if there are any).

(d) The ratio of (b) to (c), before and after the payment (and any benefit improvements).

(e) A description of the method used to apportion benefits between past and future membership.

(f) The key assumptions used in the valuation.

(g) A description of the method of valuing the assets, where this is other than net market value.

Coverage of Vested Benefits

(h) The net market value of assets, before and after the payment.

(i) The value of total vested benefits (before and after any benefit improvements).

(j) The ratio of (h) to (i), before and after repatriation (and any benefit improvements).

(k) Any assumptions used in determining the value of total vested benefits.

Coverage of Retrenchment Benefits etc

Note: The items in (l) to (o) below assume that the retrenchment benefit is clearly defined. Where the retrenchment benefit is in the nature of an "equitable share" or an "actuarial reserve" which is not clearly defined, these items should be replaced by information which meets the requirements of Section 7 of this Guidance Note.

(l) The value of total retrenchment benefits (before and after any benefit improvements, if there are any) if appropriate.

(m) The ratio of (h) to (l), before and after the payment (and any benefit improvements).

(n) Any assumptions used in determining the value of total retrenchment benefits.

(o) If the ratio in (m) is less than 1 after the payment, an explanation of why the actuary considers that the fund is in a satisfactory financial position, despite the fact that the ratio is less than 1.

(p) Similar information to that in (l) to (o) above, in relation to any contingent benefits other than retrenchment benefits.

Future Funding

(q) Recommended future contributions after the payment.

(r) A statement equivalent to that required under Regulation 17 (2)(d) of the Occupational Superannuation Standards Regulations, or Regulation 9.31(1)(d) of The Regulations.

(s) If there is a funding and solvency certificate in force in relation to the fund, confirmation that either:

- the existing funding and solvency certificate will remain valid after the payment (and any associated benefit improvements); or

- a new funding and solvency certificate will be able to be prepared, with contribution rates no higher than those given in (q) above.

(t) Discussion of the potential impact of future events on the fund's financial position in accordance with Section 7, 8 and 9 above.

(u) A statement to the effect that, while the actuary is certifying that the fund would be in a "satisfactory financial position", the actuary gives no undertaking or guarantee in relation to the fund's future financial position, which will depend on future events which cannot be predicted in advance.

Certification

(v) A statement that the actuarial certificate complies with this Guidance Note.

(w) The name of the actuary.

(x) The name of the Fund.

(y) The name/s of the employer/s to which the proposed payment/s is/are being made.

(z) The type of assets which should be sold, if relevant.

(aa) The effective date of the calculations.

(ab) The date of signing the certificate.

(ac) The "expiry date' (if any) of the Certificate.

11 ALTERNATIVE SIMPLE APPROACH

Sections 1 to 9 of this Guidance Note set out general principles to guide the actuary in drawing a dividing line between a satisfactory and an unsatisfactory financial position.

In some cases, the fund may be so far above this dividing line, or the nature of the fund's financial condition may be so obvious, that detailed calculations are unnecessary. For example, a fund may have an accrued benefits index of say 120% or more after the payment to the employer (and no problem with retrenchment benefits or other contingent benefits as discussed in Section 7), or a simple accumulation fund may be involved.

It is not necessary for the actuary to carry out all the calculations implied by the earlier sections of this Guidance Note, provided the actuary is quite certain that if the calculations were carried out the result would be that the fund would be demonstrated to be in a satisfactory financial position.

In such a case it is not necessary to include in the certificate al l the items listed in Section 10 above. Instead the actuary should ensure that the certificate contains enough information to ensure the trustees are sufficiently well informed as to the fund's financial position following the payment to enable them to make a sound decision as to whether to permit the repatriation.

The actuary must provide at least the information in (a), (h), (q) to (z), (aa) and (ab) in Section 10 above, where relevant.

A review of the fund's future financial circumstances followi ng the payment should be carried out, in accordance with Section 9 above.

12 PAYMENT BY INSTALMENTS

In some cases the proposed payment may be by way of a series of instalments, for example ten half-yearly amounts. In this case it is not necessary to produce separate actuarial certificates, each of which complies with this guidance note, every time an instalment is due.

It would normally be appropriate to provide a certificate at the outset, following the principles in this guidance note, but treating the present value of the instalments as if it were a lump sum payment to the employer. However, before providing this certificate the actuary should ensure that based on the assumptions used, the fund is still expected to be in a satisfactory financial position after each future instalment is paid, and convey this to the trustees.

The actuary should advise the trustees to check with the actuary at least annually that the fund's financial position is expected to remain satisfactory after the planned future payments. The actuary should provide a new certificate each year (or more frequently if the actuary considers it necessary) if satisfied that the fund is still in a satisfactory financial position. These subsequent certificates need not include all the items specified in Section 10, but should be consistent with the overall principles in this Guidance Note. The need for, and extent of any further actuarial calculations is a matter for the actuary's professional judgement.

13 USE OF A FORMULA APPROACH

In some cases the actuary may wish to use a formula rather than a dollar amount as the proposed payment to the employer. For example the actuary may wish to certify that the fund would remain in a satisfactory financial position after payment of an amount to the employer equal to the value of the assets less a percentage of the accrued benefits at the date of repayment.

This approach has some attractions in that it deals conveniently with the time lags involved in the process.

However,

(i) Section 117 of the Act consistently uses the word "amount"; and

(ii) In most cases of payment to the employer there will be accompanying benefit improvements. The trustees will need to balance the interests of the employer and the members, which generally cannot be done properly without quantifying the payment to the employer; and

(iii) The trustees need to be in a position to assess the financial position of the fund after the repayment of surplus.

As a result the Institute considers it essential that where a formula is used, a dollar amount obtained by applying the formula be calculated as at an effective date which is not more than twelve months prior to the date of certification, or an upper limit, expressed in dollars, be placed on the amount actually repaid. This upper limit should be specified in the certificate and should be such that had the actuary applied the formula as at the effective date, the result would have been no less than the upper limit.

The above paragraph implies that the certificate must include -

- An effective date not more than twelve months prior to the date of certification (whether or not any actual calculations have been carried out); and
- A dollar amount of payment to the employer as at the effective date, or as an upper limit on the actual payment; and
- The relevant formula, which should clearly define all the elements used.

Where a formula approach is used, the actuary must be certain that the principles in paragraph 1.1 of this Guidance Note have been applied, whether or not any actual calculations are carried out. The actuary may vary from the requirements of Section 10 of this Guidance Note to the extent necessary to cater for the formula approach used.

END OF GUIDANCE NOTE 459