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GUIDANCE NOTE 466

PROJECTED SUPERANNUATION BENEFIT ILLUSTRATIONS

PURPOSE

The purpose of this Guidance Note is to require that where projected superannuation benefit illustrations are made, sufficient and appropriate information is given to enable the recipient to understand the benefits illustrated and to appreciate the risks involved in the arrangement.

APPLICATION

This Guidance Note applies to any actuary advising an employer, trustee, existing or prospective fund member or other party in relation to a projected superannuation benefit illustration.

This Guidance Note concentrates on benefits being provided through superannuation funds, other than cases where insurance contracts such as insurance bonds or capital guaranteed products are used. While similar principles apply to most other investments, particularly managed fund investments, the Guidance Note does not seek to provide specific guidance in these cases. At a later stage, the Guidance Note may be expanded to more specifically cover these other cases.

LEGISLATION

The actuary needs to take into account the possible implications of the Financial Services Reform legislation for benefit illustrations. These include not only the content of the illustration report but also the possible licensing and other disclosure requirements for the actuary preparing the illustration and/or a person to whom the actuary provides the illustration who then passes on the illustration to an individual.

The actuary also needs to take into account the possible implications of Section 1041H of the Corporations Act which provides that a person must not engage in conduct in relation to a financial product or financial service that is misleading or deceptive, or likely to mislead or deceive.

As mentioned in section 2.5, the actuary needs to be mindful of the underlying principles expressed in ASIC's Policy Statement on "Prospective Financial Information" (PS170). This statement gives guidance on the use of prospective financial information such as financial projections.

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CLASSIFICATION

This is a non-mandatory Guidance Note issued to provide guidance for actuaries undertaking work in this area. Departure from this Guidance Note is not, in itself, unprofessional conduct, but the actuary involved must be able to demonstrate that there were reasonable grounds for such a departure.

1 INTRODUCTION

1.1 A projected benefit illustration (hereafter referred to as an "illustration") is defined as any estimate of an amount that may be received by an individual at some point in the future.

1.2 Before starting an assignment, the actuary should be clear about the purpose of the illustration and the nature of any benefit promise.

2 SCOPE

2.1 This Guidance Note covers illustrations of defined benefits (including defined contribution underpins and target benefit arrangements) and accumulation-based funds or products, including allocated pensions.

2.2 When benefits are taken as allocated pensions, illustrations relating to the draw-down period are also covered.

2.3 Illustrations covered by the Guidance Note include illustrations that will be used to compare defined benefit and defined contribution benefits.

2.4 This Guidance Note covers all illustrations including those that will be issued to plan members and those not related to specific individuals such as those provided to the press and thence used to advise the general public.

2.5 This Guidance Note does not overrule any regulatory requirements. If regulatory requirements apply, the actuary should consider whether further illustrations are appropriate. The actuary should be mindful of the underlying principles expressed in ASIC's Policy Statement 170, "Prospective Financial Information".

2.6 This Guidance Note covers illustrations provided in writing, or as the output of any form of computer software (including websites).

3 CALCULATIONS AND ASSUMPTIONS

3.1 The actuary should be satisfied that, in his or her professional opinion, the illustrations are meaningful and realistic for individual members at all relevant ages.

3.2 The assumptions used, or the range of assumptions allowed or recommended, should be consistent and reasonable. If superannuation fund members can select their own assumptions, then any assumptions outside an allowed range (or other than the default) should include a warning that these assumptions may be inconsistent with other assumptions and/or may produce illustrations which are unreasonable. Similarly, where the actual experience could be outside the allowed range (for example, short-term negative returns) then appropriate warnings should be included.

3.3 Existing assets and future contributions (if any) taken into account in the illustration should be measured on bases consistent with the assumptions used.

3.4 The assumptions should reflect the proximity of retirement. If a superannuation fund member draws his or her benefit at the illustrated retirement age shortly after receiving an illustration on the same terms, and the economic environment is substantially unchanged, he or she should receive a benefit broadly equal to the amount in the illustration. Where satisfying this is impractical, a warning or comment should be included.

3.5 The actuary should describe or illustrate how the result will differ if the assumptions used are not borne out. Possible approaches to illustrating volatility include:

3.5.1 providing multiple illustrated benefits with variations in the key assumptions, for example different investment return assumptions and annuity rates;

3.5.2 quoting the effect of an addition to and a deduction from the key assumption, for example investment return;

3.5.3 stochastic analysis, for example, illustration of a funnel of doubt or a demonstration using scenarios over a range of reasonably possible future investment returns.

3.6 The description or illustration referred to in section 3.5 above should, where appropriate, include a description or illustration as to how any income benefits or their expected duration will differ if the assumptions used (including annuity purchase rates) are not borne out.

3.7 If the illustration shows different investment returns for different investment choices, the illustration of volatility should also illustrate or explain the relative risks and possible differences in volatility of these different investment options.

3.8 Benefit illustrations may be in real terms or monetary terms. For illustrations in monetary terms, the requirements of section 4.3 must be considered and it must be pointed out that the projected amounts will not have the same purchasing power as applies currently.

The actuary should be mindful of the different results produced in real terms by deflating results using the rate of increase in salary (be it average weekly earnings or some other salary based measure of inflation) and price inflation. For illustrations that may be used to examine the adequacy of a benefit at retirement, it is preferable for future benefits to be deflated using a salary-based assumption in order to allow members to assess their relative purchasing power at retirement.

3.9 If a salary-based deflator is not used, a statement should be made that the illustration may overstate the member's income at retirement relative to other incomes (and also relative to their own pre-retirement income).

3.10 Administration, and other non-investment expenses (including those expressed as a percentage of assets) and contributions tax charged to a plan member's account or contributions must be taken into account in the illustration. The surcharge tax and Government co-contribution may or may not be taken into account but the approach taken should be clearly set out. Fees should be indexed in accordance with the basis disclosed in any relevant Product Disclosure Statement (PDS). If fees are subject to possible future change over and above this indexation, this should be stated.

Where the fees and expenses to be allowed for have not been taken from the PDS by the actuary, but have been provided by the client, the actuary should request a copy of the PDS. The actuary should then check that the fees and expenses to be allowed for are consistent with the PDS or that there is a valid reason for any variation. Where the fees and expenses assumed in the projection are not consistent with the PDS this must be disclosed.

3.11 The illustration may translate a lump sum benefit at a future date into an income amount to be expected over the member's lifetime. Where this is done, the actuary will need to make assumptions about rates of mortality, mortality improvement, indexation of payments and the investment returns expected on assets backing an annuity liability. In doing so, the actuary should be mindful of section 3.4 and try to ensure that the factors used to convert lump sums to income amounts are reasonably consistent with commercial annuity rates currently available where these are likely to be used to provide the income stream. Where conversion of lump sums to income amounts is available under the plan rules on a guaranteed basis, this basis may be adopted and if so, this should be clearly set out.

3.12 When communicating the assumptions to his or her client, the actuary should point out that while the assumptions are considered reasonable for the purpose of the illustration at the present time, the assumptions will need to be reviewed at the time any further illustrations are prepared. The actuary should also state that an illustration prepared more than (say) three years ago should not be used for any purpose without having the assumptions reviewed.

4 OTHER ISSUES

4.1 The actuary should use his or her best endeavours to ensure that the illustration is presented to the ultimate recipient in a clear, complete and balanced way. For example, if an illustration includes more than one column of figures, it is desirable that the relationship between figures in various columns is clearly explained (perhaps by use of an example).

4.2 The illustration should contain a statement of all assumptions. Where the impact of some assumptions on illustrated benefits is expected to aggregate less than 0.5% of the lump sum value of the benefit, those assumptions do not have to be disclosed. The statement should explain how investment expenses and any investment tax have been allowed for and, if potentially applicable, whether or not (and if so, how) benefit tax, excessive benefits, Government co-contributions and/or surcharge have been allowed for.

4.3 The actuary should ensure that sufficient information is provided to allow the ultimate recipient of the illustration to relate the benefits shown to his or her current income. The illustrated benefit may be a monetary amount (calculated in accordance with section 3.8), in real terms, or a percentage of projected salary.

4.4 The illustration should make clear what death and disablement benefits (if any) and what level of pension increases in payment (if any) have been allowed for in the calculation of the illustrated benefits.

4.5 In addition to providing basic information, the illustration should make clear:

4.5.1 which of the member's funds have been included in the illustrated benefits, for example whether the projection includes additional voluntary contributions;

4.5.2 what level of future contributions have been assumed (including increases to future contributions and Government co-contributions);

4.5.3 whether any adjustment has been made to future contributions, for example to cover the cost of insured death and disablement benefits;

4.5.4 if any asset values used are not market values, why these values have been used; and

4.5.5 what levels of administration charges and other non-investment expenses charged to a plan member's account have been allowed for (and the basis on which these expenses have been indexed in future years).

4.6 Where an illustration of benefits at retirement ages expresses the benefit as the income amount (annual or otherwise) to be expected over the member's lifetime, it is desirable that the illustration include an estimate of the social security pension which would be available. The basis of any social security estimate must be described (e.g. assumes the person is a long term Australian resident and that the social security pension rules remain the same as those currently applying. If the estimate assumes the person has no assets or income affecting the social security entitlement other than the superannuation benefit, this should be stated.) Where an income estimate includes an estimate of the social security pension, the illustration should show the split between the projected superannuation and social security income. Where an estimate of social security pension is not included in an illustration of expected retirement income, this should be pointed out.

4.7 Income draw-down illustrations should include an outline of the effect of mortality/ longevity and state whether or not social security pensions have been included (and if so, show the split between the projected superannuation and social security income and describe how means-testing has been allowed for). They should also explain the treatment of any minimum and maximum limits on the rate of draw-down.

4.8 Spurious accuracy should be avoided. For most illustrations, illustrated benefits calculated to 3 or 4 significant figures will be adequate.

4.9 All illustrations should include appropriate risk warnings and advise the ultimate recipient to obtain regular updates of the illustration.

4.10 The illustration should disclose the date that the benefit is projected to (for example, the member's 65^{th} birthday, or the 30 June in the year following the member's 65^{th} birthday).

4.11 The illustration should state who the projection has been prepared by and for. It should also state the purpose for which the projection has been prepared.

4.12 The actuary should advise his or her client that the projection has or has not been prepared in accordance with this Guidance Note and, if not, why not.

5 COMPARISON OF DEFINED BENEFIT AND DEFINED CONTRIBUTION BENEFITS

5.1 Particular care should be taken in preparing an illustration which will be used to compare defined benefits and benefits from defined contributions, since it is possible that a plan member will make an irrevocable choice of a future benefit arrangement based on such an illustration.

5.2 The actuary should be alert to the possible conflict between the provision of unbiased advice to plan members and the objectives of the employer or trustees in relation to such a comparison.

5.3 Given a comparable level of expected contributions, the essence of a choice between defined benefit and defined contribution is the relative risk borne by the employer and the employee. The actuary should ensure that the plan member is provided with sufficient information to understand this risk. In some cases the option to retain defined benefits will be restricted to past service benefits, or for other reasons the expected level of future contributions will not be comparable. The illustration will need appropriate modification in such cases.

5.4 An illustration prepared for this purpose might show separately the illustrated benefits from existing assets and the illustrated benefits from future contributions, if any, so the recipient can compare both current accrued benefits and ultimate retirement benefits assuming service continues to the illustrated retirement age.

5.5 The actuary should ensure that the illustration is unbiased and draws the member’s attention to all facets of the offer, including the possible advantages and disadvantages of making the change. The actuary should ensure that the information given to the member covers any effect of the change on other benefits such as death, disablement, and retrenchment benefits.

5.6 The assumptions used to project the defined benefit and defined contribution benefits should be consistent.

6 CHECKLIST

6.1 Identification

- Purpose of illustration
- Who illustration is prepared by and for
- Date illustration provided (or developed)
- Name and qualifications of the actuary

6.2 Assumptions

- Appropriateness
- Consistency
- Meaningful and realistic at all relevant ages
- Reflect the proximity of retirement
- Whether salary or price deflation used (if applicable)
- Administration and other non-investment expenses and indexation
- Investment expenses and investment tax
- Cost of insured death and disablement benefits (if applicable)
- Contributions tax and surcharge
- Disclosure of all significant assumptions

6.3 Information

- Investment choices and risks
- PDS fees and expenses
- Death and disablement benefits
- Pension increases
- Member’s funds included

- Contributions and contribution increases
- Government co-contribution
- Benefit tax, excessive benefits
- Non-market valued assets
- Date projected to

6.4 Results

- Real or monetary terms
- Translation into income stream (if applicable)
- Split/interaction with social security pension (if applicable)
- Demonstration of potential volatility
- Limitations and warnings
- 3 or 4 significant figures

6.5 Defined Benefit to Defined Contribution comparisons

- Unbiased
- Risks explained
- Advantages and disadvantages explained
- Other benefits (e.g. death, disablement, retrenchment)
- Consistent assumptions

6.6 Legislation

- ASIC's Policy Statement 170, "Prospective Financial Information"
- Financial Services Reform (disclosure and licensing) legislation
- Section 1041H of the Corporations Act
- Statements required under FSR licensing and other external standards or legislation (if applicable)

6.7 Reporting

- Clear, complete and balanced presentation of illustration
- Highlight the need for regular review/updating of illustration
- Statement of consistency with this Guidance Note (if appropriate).

END OF GUIDANCE NOTE 466*.*