

PRACTICE GUIDELINE 499.02

PROJECTED RETIREMENT BENEFIT ILLUSTRATIONS

September 2020

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1. INTRODUCTION

1.1. Application

1.1.1. This Practice Guideline applies to any Member advising a Client or other party in relation to a Projected Retirement Benefit Illustration.

1.1.2. This Practice Guideline relates to benefits being provided in relation to 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, this Practice Guideline does not seek to provide specific guidance in such cases.

1.1.3. Illustrations covered by this Practice Guideline include Illustrations:

- a. of defined benefits (including defined contribution underpins and target benefit arrangements) and accumulation-based funds or products, including account-based pensions;
- b. relating to the draw-down period, when benefits are taken as lump sums, account-based pensions or other retirement income streams (immediate or deferred);
- c. that will be used to compare defined benefit and defined contribution benefits;
- d. that will be issued to plan members or more generally (such as those provided to the press and then used to advise or inform the general public);
- e. classed as financial product advice and those covered by regulatory relief, to the extent that the calculation methodology and disclosure is at the Member's discretion; and
- f. provided in a document, or as the output of any form of computer software (including websites).

1.1.4. The purpose of this Practice Guideline is, in cases where Projected Retirement 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.

1.1.5. This version of the Practice Guideline replaces the version issued in January 2018. The January 2018 version replaced the version issued in April 2009, which itself replaced the Guidance Note 466 (Projected Superannuation Benefit Illustrations) which was issued in October 2004. This version of the Practice Guideline updates the terminology to give more clarity on discount rates (wage-adjusted and price-adjusted dollars) and incorporates additional conformance changes to align with the Institute's new Code (effective 31 March 2020).

1.2. About this Practice Guideline

1.2.1. This Practice Guideline:

(a) has been prepared in accordance with the Institute's Policy for Developing Professional Practice Documents; and

(b) is to be applied in the context of the Code.

1.2.2. This Practice Guideline is not mandatory. Even so, if this Practice Guideline covers the Services a Member provides, then the Member should consider explaining any significant departure from this Practice Guideline to the Principal, and record that explanation.

1.2.3. This Practice Guideline does not constitute legal advice. Any interpretation or commentary within this Practice Guideline regarding specific legislative or regulatory requirements reflects the expectations of the Institute but does not guarantee compliance under applicable legislation or regulations. Accordingly, Members should seek clarification from the relevant regulator and/or seek legal advice in the event they are unsure or require specific guidance regarding their legal or regulatory obligations.

1.3. Other relevant documents

1.3.1. This Practice Guideline must be applied in the context of the relevant law, and relevant accounting and auditing standards.

1.3.2. A reference to legislation or a legislative provision in this Practice Guideline includes any statutory modification, or substitution of that legislation or legislative provision and any subordinate legislation issued under that legislation or legislative provision. Similarly, a reference to a Professional Standard or Practice Guideline includes any modification or replacement of that Professional Standard or Practice Guideline.

1.3.3. Apart from the Code or a Professional Standard, from legislation or from regulatory standards, no other document, advice or consultation can be taken to modify or interpret the requirements of this Practice Guideline.

1.3.4. If there is a conflict between this Practice Guideline and any legislation, then the legislation takes precedence. In this context, legislation includes regulations, prudential standards, subordinate standards, rules issued by government authorities and standards issued by professional bodies which have the force of law.

2. COMMENCEMENT DATE

This Practice Guideline commences on 1 November 2020.

3. DEFINITIONS AND INTERPRETATION

'**AWE**' means average weekly earnings.

'AWOTE' means average weekly ordinary time earnings.

'Code' means the Code of Conduct of the Institute.

'Act' means the Corporations Act 2001 (Cth) and any regulations made thereunder, as amended or replaced from time to time.

'Illustration' has the same meaning as Projected Retirement Benefit Illustration.

'Material' means relevant to the circumstances and either important or essential in the opinion of the Member.

'Projected Retirement Benefit Illustration' means the presentation of any estimate of an amount that may be received by, or cash flows that may be paid to, an individual in the future.

Other capitalised terms used in this Practice Guideline have the same meaning as set out in the Code.

4. ASSIGNMENT CLARITY

Before starting an assignment, Members are reminded to be clear about the purpose of an Illustration and the nature of any benefit promise.

5. LEGISLATION

- 5.1. Legal requirements for Illustrations may arise from the Act as a result of financial services reforms. These include not only the content of an Illustration report, but also the possible licensing and other disclosure requirements for a Member preparing an Illustration, and/or a person to whom a Member provides an Illustration and who then in turn passes on that Illustration to another individual.
- 5.2. Legal requirements may also arise from section 1041H of the 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.
- 5.3. A number of regulatory instruments have a bearing on Projected Retirement Benefit Illustrations. The ASIC Corporations (Generic Calculators) Instrument 2016/207 sets out conditions under which calculators can be provided without an Australian Financial Services Licence. Class Order 11/1227 prescribes a formula and methodology by which superannuation estimates can be included on periodic statements without requiring compliance with advice laws. Members need to be mindful of the underlying principles expressed in Regulatory Guide 167 ("Licensing: Discretionary Powers"), Regulatory Guide 170 ("Prospective Financial Information") and Regulatory Guide 229 ("Superannuation Forecasts") issued by the Australian Securities and Investments Commission ("ASIC") which give guidance on the use of prospective financial information such as financial projections.

6. CALCULATIONS AND ASSUMPTIONS

- 6.1. It is generally accepted that a Member should be satisfied that, in his or her professional opinion, Illustrations are meaningful and realistic for individual plan members at all relevant ages.
- 6.2. Generally, the assumptions used, or the range of assumptions allowed or recommended, should be consistent and reasonable. Common practice is that if users can select their own assumptions, then any assumptions outside what is considered to be a reasonable range (or other than the default) would include a warning that these assumptions may be inconsistent with other assumptions and/or may produce Illustrations which are unreasonable. Alternatively, when assumptions are outside what is considered to be a reasonable range, the production of Illustrations might not be feasible. Similarly, common practice is that where the actual experience could be outside the reasonable range (for example, short-term negative returns) then appropriate warnings are included.
- 6.3. Assumptions used generally reflect the investment time horizon of the plan member. If a plan member draws their benefit at the illustrated retirement age shortly after receiving an Illustration on the same terms, and the economic environment is substantially unchanged, they would expect to receive a benefit or income stream which is consistent with the amount in the Illustration, taking into account any risks which were disclosed in the illustration. Thus, in cases where commercial annuities might be used to provide an income stream, there may be a need for special treatment in the illustrations for persons close to the retirement age. Where satisfying both this and section 6.2 is impractical (for example, where Illustrations are required for all members of a large plan), a warning or comment is usually included. Where Illustrations cover the retirement phase, the time horizon includes the assumed period in retirement.
- 6.4. A key requirement in the Code in providing actuarial advice and in peer review is to address any Material uncertainty implicit in the advice. General practice is that an Illustration will describe or illustrate how the result will differ if the assumptions used are not borne out. Possible approaches to illustrating volatility and assumption uncertainty include:
- (a) providing multiple illustrated benefits **at retirement** with variations in the key assumptions (for example, different investment return assumptions and annuity rates);
 - (b) quoting the effects **at retirement** of an addition to, or a deduction from, the key assumption (for example, investment return);
 - (c) stochastic or historical analysis (for example, a demonstration **using scenarios** over a range of reasonably possible future investment returns); and
 - (d) **stochastic analysis** (for example, illustration of a 'funnel of doubt', based on a specified model, from a specified probability distribution based on a wide range of reasonably possible future investment returns).

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.

- 6.5. The description or Illustration referred to in section 6.4 above will usually, 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.
- 6.6. If an Illustration shows different investment returns for different investment options, the illustration of volatility generally also illustrates or explains the relative risks and possible differences in volatility of those different investment options.
- 6.7. Illustrations may be in real terms or nominal terms. For Illustrations in nominal terms, Members' attention is drawn to the guidance given in section 7.3 below and to the accepted practice of pointing out that the projected amounts will not have the same purchasing power as applies currently.

Different results may be produced in real terms by deflating results using the rate of increase in salary (be it an AWE or some other salary-based measure of inflation) rather than price inflation. For the period between the date of the Illustration and the projected retirement date, it is preferable for future benefits to be deflated using a wage-based deflator in order to allow plan members to assess their purchasing power at retirement relative to their salary at retirement.

For Illustrations covering the post-retirement period, it is acceptable to use either a price- or wage-based deflator. The Member should consider which is more appropriate, taking into account the nature of the Illustration.

If a wage-based deflator is not used, a statement is generally made that the Illustration may overstate the plan member's income at retirement relative to salaries (and also relative to the plan member's own pre-retirement salary).

- 6.8. Preferred practice in respect of the use of terminology in an Illustration is that:
 - (a) "wage-adjusted dollars", "today's dollars (wage-adjusted)" or "in real terms (wage-adjusted)" refers to projected amounts which have been deflated to the calculation date using a wage (for example, salary, AWE or AWOTE) based deflator. It may be characterised as the sum of a price inflation component and a component reflecting increases in community living standards;
 - (b) "future dollars" is used for situations where there are no adjustments; and
 - (c) "price-adjusted dollars", "today's dollars (price-adjusted)" or "in real terms (price-

adjusted)" is used for adjustments which include only price inflation.

The following is an example of a possible explanation of "wage-adjusted dollars" for use with Illustrations:

"Wage-adjusted dollars" converts your future retirement assets or income into today's relative buying power. It takes the future dollar amount and discounts (or deflates) it at the rate of wage inflation. Wages, salaries and community living standards have tended to grow faster than prices, and converting to "wage-adjusted dollars" means you can better decide if your future retirement assets or income will be adequate compared to your current standard of living.

The most important aspect is that the terminology is clear and consistent with respect to the basis for deflation.

- 6.9. Insurance premiums, administration and other non-investment fees and costs (including those expressed as a percentage of assets) should be taken into account in an Illustration, as well as contributions tax charged to a plan member's account or contributions. Any Government contributions may or may not be taken into account, but the approach taken should be clearly set out. Fees should be indexed in accordance with any basis disclosed in any relevant Product Disclosure Statement ("PDS"), or if silent, with wage growth. The basis for indexation of fees should be stated.
- 6.10. An Illustration may translate a lump sum benefit at a future date into an income stream to be expected over the plan member's lifetime or other specified period. Where this is done, a Member will need to disclose the assumptions made about conversion rates.
- 6.11. When communicating the assumptions to a user, the usual practice is to point out, that while the assumptions are considered reasonable for the purpose of the Illustration at the date of the Illustration (which should be clearly disclosed), the assumptions will need to be reviewed at the time any further Illustrations are prepared. Usual practice is also to state that an Illustration prepared more than (say) two years ago should not be used for any purpose without having the assumptions reviewed.

7. OTHER ISSUES

- 7.1. It is always preferable that an Illustration is presented to the ultimate recipient in a clear, complete and balanced way, with attention drawn to the most important results and assumptions.
- 7.2. An Illustration generally contains a statement of all Material assumptions. The statement usually explains whether and, if so, how allowance has been made for:
 - (a) the financial goals and circumstances of the end-user;
 - (b) investment fees and costs, and any investment tax;

- (c) the environment in which the modelling is assumed to occur (legislative constraints, thresholds, contribution and benefit taxes, social security);
 - (d) the benefits, payment rates and provisions allowed for in the product, plan or investment vehicles modelled (see sections 6.9 and 6.10 above) and any limitations; and
 - (e) the future indexation (or otherwise) of any of these assumed quantities.
- 7.3. Accepted practice is that sufficient information is provided to allow the ultimate recipient of an illustration to relate the benefits shown to his or her current income. An illustrated benefit may be:
- (a) a nominal amount (but see section 6.7 above);
 - (b) in real terms (as discussed in section 6.7 above); or
 - (c) a percentage or multiple of projected salary.
- 7.4. In addition to providing basic information, the usual practice is for an illustration and/or accompanying explanatory notes to make clear:
- (a) which member data has been used (including data provided by the member in the course of preparing the illustration);
 - (b) how that data is validated, modified and used in the calculations;
 - (c) which of the plan member's funds have been included in the illustrated benefits (for example, whether the projection includes additional voluntary contributions);
 - (d) what level of future contributions has been assumed (including increases to future contribution rates and inclusion of Government co-contributions);
 - (e) whether any adjustments have been made to future contributions (for example, to cover the cost of insured death and disablement benefit); and
 - (f) if any asset values used are not market values, and if so, why those values have been used.
- 7.5. Where an illustration of benefits at retirement age expresses the benefit as an income amount (annual or otherwise), it is desirable that such an illustration includes an estimate of the social security pension which may be available at the point of retirement. (Where an estimate of the social security pension at retirement is not included in an illustration of expected retirement income, it is desirable that this be stated.)

Where an income estimate includes an estimate of the social security pension at retirement, an illustration would usually show the split between the projected

superannuation and social security income at retirement. Generally, the basis of any social security estimate at retirement would be described. A number of assumptions need to be made to make such an estimate. Except perhaps for an individual case or for a very small plan, it is unlikely anything will be known about the person's circumstances in respect of some of the following, and the assumptions made would be described.

- (a) **Social security rules used:** Generally, it would be stated the estimate assumes the social security pension rules will remain the same as those legislated at the effective date of the illustration.
- (b) **Australian residential requirements:** Qualifying for the Age Pension currently requires a minimum period of residence in Australia or a recognised alternative. A statement that the estimate assumes the person satisfies such residential requirements would generally be made.
- (c) **Partner and homeowner/renter status:** Currently the pension entitlement varies according to whether the person is regarded as single or as a member of a couple, as well as whether the retiree is a homeowner or renter, for social security purposes. Note that even where the person's current status is known, this could change before the Illustrated retirement benefit becomes payable. Some estimates may assume each person is a member of a couple who own their own home at retirement. Others may assume the person's current status, if known, remains applicable at retirement.
- (d) **Assets or income affecting social security entitlement:** Generally, the estimate would allow for the effect of the superannuation benefit covered by the Illustration, and this would be stated. If allowance for any other assets or income is made, this would also be stated.

7.6. Income draw-down Illustrations generally:

- (a) include an indication of the effect of mortality/longevity risk;
- (b) state whether or not social security pensions have been included; and
- (c) explain the treatment of any minimum and maximum limits on the rate of draw-down.

7.7. Unnecessary accuracy should be avoided. For most Illustrations, illustrated benefits calculated to 3 or 4 significant figures are considered adequate.

7.8. Where a Member is involved in the preparation of multiple Projected Retirement Benefit illustrations in relation to one client (for example a written statement and an online calculator), it would normally be expected that the illustrations provide consistent results if the same inputs are used. Where this is not the case the advice should include sufficient information for the client to understand the reason/s for any inconsistency and convey this information to end-users where appropriate.

- 7.9. Standard practice is for an Illustration to:
- (a) include appropriate risk warnings and advise the ultimate recipient to obtain regular updates of the Illustration;
 - (b) disclose the date to which the benefit is projected (for example, the plan member's 67th birthday, or 30 June in the year following the plan member's 67th birthday); and
 - (c) state by whom and for whom the Illustration has been prepared, as well as the effective date of the Illustration and the purpose for which it has been prepared.
- 7.10. Members providing (or providing advice on) online calculators for consumers should consider:
- (a) the currency of the calculator;
 - (b) the recommended frequency of updates required;
 - (c) whether the calculator complies (see section 5) with advice regulations or with the conditions of exemption from advice regulations; and
 - (d) the appropriateness of the range of permissible input values.

8. COMPARISON OF DEFINED BENEFIT AND DEFINED CONTRIBUTION BENEFITS

- 8.1. 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.
- 8.2. Consistent with the Code, Members should be alert to the possible conflict between the provision of unbiased advice to plan members and the objectives of the employer in relation to such a comparison.
- 8.3. 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. Common practice is to 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. In such cases, it is usual for an Illustration to be appropriately modified.
- 8.4. An Illustration prepared for the purpose described in section 8.1 above 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.

8.5. General practice in providing an Illustration is to ensure that:

- (a) the plan member's attention is drawn to all facets of the offer, including the possible advantages and disadvantages of making the change; and
- (b) the information given to the plan member covers any effect of the change on other benefits such as death, disablement and retrenchment benefits.

8.6. Generally, the assumptions used to project the defined benefit and defined contribution benefits should be consistent.

9. CHECKLIST

The following checklist is provided for assistance only and may not be exhaustive. A Member should consider what is appropriate in the particular circumstances and use his or her own judgment as to an Illustration and what to include in a report of an Illustration.

9.1. Identification

- ▶ Purpose of Illustration
- ▶ By whom and for whom the Illustration is prepared
- ▶ Date to which Illustration is provided (or developed)
- ▶ Name and qualifications of the Member preparing the Illustration

9.2. Assumptions

- ▶ Appropriateness
- ▶ Consistency
- ▶ Meaningful and realistic at all relevant ages
- ▶ Match the investment time horizon of the member
- ▶ Whether wage-based or price-based deflation used
- ▶ Administration fees and costs and indexation
- ▶ Investment fees and costs and investment tax
- ▶ Other fees and costs (e.g. insurance, indirect costs, advice fees)

- ▶ Contributions and benefits tax
- ▶ Disclosure of all significant assumptions

9.3. Information

- ▶ Investment options and risks
- ▶ PDS fees and costs
- ▶ Insurance premiums
- ▶ Death and disablement benefits
- ▶ Pension increases
- ▶ Plan member's data allowed for
- ▶ Contributions and contribution increases
- ▶ Any Government contributions
- ▶ Date to which projected

9.4. Presentation of Results

- ▶ Disclosure of deflation basis
- ▶ Translation into income stream (if applicable)
- ▶ Split/interaction with social security pension (if applicable)
- ▶ Demonstration of potential volatility
- ▶ Limitations and warnings
- ▶ Three or four significant figures

9.5. Defined Benefit to Defined Contribution comparisons

- ▶ Unbiased
- ▶ Risks explained
- ▶ Advantages and disadvantages explained
- ▶ Other benefits (for example death, disablement, retrenchment)

- ▶ Consistent assumptions

9.6. Legislation

- ▶ ASIC's Regulatory Guides 167, 170 and 229 and Corporations (Generic Calculators) Instrument 2016/207
- ▶ Corporations legislation (disclosure and licensing)
- ▶ Section 1041H of the Act
- ▶ Statements required under licensing and other external standards or legislation (if applicable)

9.7. Reporting

- ▶ Clear, complete and balanced presentation of Illustration
- ▶ Highlighting the need for regular review/updating of Illustration
- ▶ Statement of consistency with this Practice Guideline and relevant law (if appropriate)

END OF PRACTICE GUIDELINE 499.02