Institute of Actuaries of Australia

PROFESSIONAL STANDARD 405

COST OF DEATH AND DISABILITY BENEFITS IN SUPERANNUATION FUNDS

June 2010

INDEX

1.	**INTRODUCTION**	**2**
1.1	**Application**	**2**
1.2	**Classification**	**2**
1.3	**Background**	**3**
1.4	**Purpose**	**3**
1.5	**Previous versions**	**3**
1.6	**Legislation and other requirements**	**3**
2.	**COMMENCEMENT DATE**	**4**
3.	**DEFINITIONS**	**4**
4.	**LIABILITY TO PROVIDE DEATH OR DISABILITY BENEFITS**	**5**
5.	**MAXIMUM LIABILITY**	**5**
6.	**ARM'S LENGTH PREMIUM**	**5**
7.	**APPORTIONMENT OF PREMIUM**	**6**
8.	**USE OF SECTION 295-465(2) OF THE ACT**	**6**
9.	**ACTUARIAL CERTIFICATE**	**7**

1. INTRODUCTION

1.1 Application

1.1.1 This Professional Standard applies to:

(a) a Member providing an actuarial certificate under section 295-465(3) of the Act; and

(b) the determination of the cost of death and/or disability benefits for the purposes of section 295-465 of the Act.

1.1.2 Work performed under this Professional Standard is Prescribed Actuarial Advice. Members' attention is directed towards the requirements of the Code in relation to Prescribed Actuarial Advice, as well as to Practice Guideline 199.01 (Prescribed Actuarial Advice Reporting).

1.2 Classification

1.2.1 This Professional Standard has been prepared in accordance with the Institute's Policy for Drafting Professional Standards, as varied from time to time. It must be applied in the context of the Institute's Code of Professional Conduct.

1.2.2 This Professional Standard is binding on Members of the Institute of Actuaries of Australia, in respect of all work covered by the Professional Standard.

1.2.3 Non-compliance with this Professional Standard by a Member engaged in work covered by the Professional Standard may constitute Actionable Conduct and may lead to penalties under the Institute's Disciplinary Scheme.

1.2.4 This Professional Standard in itself defines the requirements of the Institute in respect of all work covered by the Professional Standard. If a Member believes that the Professional Standard is ambiguous or for some other reason wishes to seek clarification of it, that Member may consult the Institute's Professional Standards Committee for guidance as to the interpretation of the Professional Standard. Apart from legislation or regulatory standards, no other document, advice or consultation (including Practice Guidelines of the Institute) can be taken to modify or interpret the requirements of this Professional Standard.

1.2.5 Members who find that they cannot carry out work in a manner that complies with this Professional Standard must decline to carry out the work, or terminate their agreement to do so.

1.3 Background

1.3.1 In this Professional Standard, benefits for which a tax deduction is available are referred to as death and/or disability benefits. Section 295-460 of the Act defines them to include:

(a) a superannuation death benefit (as prescribed);

(b) a superannuation disability benefit (as prescribed); or

(c) income stream benefits because of a plan member's temporary inability to engage in gainful employment (as prescribed).

1.3.2 Trustees must obtain an actuarial certificate prior to lodging a complying superannuation fund's income tax return in order to deduct:

(a) the amount the complying superannuation fund could reasonably be expected to pay in an arm's length transaction to obtain an insurance policy to cover it for that part of its current or contingent liabilities to provide benefits referred to in section 295-460 of the Act for which it does not have insurance coverage; or

(b) the proportion of insurance policy premiums attributable to the liability to provide benefits referred to in section 295-460 of the Act, where the proportion is not already specified in section 295-465(1) (items 1 to 5) of the Act.

1.4 Purpose

The purpose of this Professional Standard is to direct Members in relation to the preparation of certificates under section 295-465 of the Act relating to tax deductions for the cost of providing death and/or disability benefits.

1.5 Previous versions

This Professional Standard replaces Guidance Note 450 (Cost of Death and Disability Benefits – Certificates by Actuaries under Sub-section 279(3) of the Income Tax Assessment Act) which was last issued in April 1993.

1.6 Legislation and other requirements

1.6.1 This Professional Standard must be considered in the context of applicable legislation. If there is a conflict between this Professional Standard and any applicable legislation, then the legislation takes precedence, and any differences must be documented in the actuarial certificate provided under s295-465(3) of the Act. 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.

1.6.2 Taxation Ruling IT 2617 was issued by the Australian Taxation Office in relation to section 279 of the Income Tax Assessment Act 1936 (Cth). This legislation was replaced by section 295-465 of the Act from 1 July 2007, but Taxation Ruling IT 2617 continues to apply. It requires that an actuarial certificate under section 295-465(3) of the Act must include "confirmation that the valuation is consistent with any Guidance Notes issued by the Institute". Members are required to confirm that the valuation included in an actuarial certificate under section 295-465(3) of the Act is consistent with this Professional Standard.

1.6.3 A reference to legislation or a legislative provision in this Professional Standard 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 includes any modification or replacement of such.

2. COMMENCEMENT DATE

This Professional Standard commences on 1 July 2010.

3. DEFINITIONS

'Accrued Retirement Benefit' means the amount of a prospective retirement benefit attributable to past membership or service determined in accordance with Professional Standard 402 (Determination of Accrued Benefits for Defined Benefit Superannuation Funds).

'**Act**' means the Income Tax Assessment Act 1997 (Cth).

'**APRA**' means the Australian Prudential Regulation Authority.

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

'**Institute**' means The Institute of Actuaries of Australia (ACN 000 423 656).

'**Material**' means important or essential in the opinion of the Member. For this purpose, 'Material' does not have the same meaning as in Australian accounting standards. 'Materiality' has a consistent meaning to 'Material'.

'**Member**' has the same meaning as set out in the Code.

'**Prescribed Actuarial Advice**' has the same meaning as set out in the Code.

4. LIABILITY TO PROVIDE BENEFITS

4.1 Irrespective of whether the certificate is being prepared for the purpose of section 295-465(1) (item 6) or section 295-465(2) of the Act, it is necessary to calculate the “liability” or “liabilities” “to provide benefits referred to in Section 295-460”. “Liability” or “liabilities” for the purposes of these sections excludes the funded retirement portion of these benefits.

4.2 For the purpose of section 295-465(2) of the Act, to determine the liability to provide death and/or disability benefits where no insurance cover has been effected, a Member must define the unfunded element of the benefit on death and/or disability.

5. MAXIMUM LIABILITY

5.1 For the purposes of claiming a deduction under sections 295-465(1) (item 6) or 295-465(2) of the Act, the maximum amount of insurance cover, or notional insurance cover, for lump sum benefits is the death and/or disability benefit less the Accrued Retirement Benefit, unless the Member certifies that a greater amount of insurance cover or notional insurance cover is required.

5.2 In the case of a plan providing death and/or disability benefits in pension form, or where the retirement benefit is a pension, an additional factor is required to allow for the lump sum value of the pension benefit. The lump sum value of the pension benefit must be calculated consistently with Professional Standard 400 (Investigations of the Financial Condition of Defined Benefit Superannuation Funds).

5.3 Where the death and/or disability benefit is an income stream because of temporary inability to engage in gainful employment, the death and/or disability benefit will not usually include any funded element. In this case, it is not necessary to deduct the amount of the Accrued Retirement Benefit in determining the maximum insurance cover or notional insurance cover.

5.4 Circumstances where a greater amount of insurance cover or notional insurance cover is reasonable include plans where the aggregate of Accrued Retirement Benefits exceeds the value of plan assets. The amount insured or notionally insured would be calculated by deducting a funded element (such as a discounted Accrued Retirement Benefit) from the death and/or disability benefit, where the funded element is defined so that the aggregate of the funded elements is not Materially different from the value of the plan assets.

6. ARM’S LENGTH PREMIUM

6.1 Section 295-465(2) of the Act provides that the amount a complying superannuation fund could reasonably be expected to pay in an arm’s length transaction (the "arm's length premium") to obtain an insurance policy to cover the "liabilities" is an allowable deduction. In determining the underlying premium rates to be used in the calculation, it is not a requirement to seek quotations from insurers provided due consideration is given to:

(a) the definition of "arm's length" in section 995-1 of the Act; and

(b) if available, the circumstances and experience of the complying superannuation fund or, if not available, other relevant circumstances and experience.

If the Member has a Material doubt as to the rates to be used, quotations must be obtained where possible and used in determining an arm's length premium. Insurance policies sometimes allow a fund to share the profits with the insurer if experience is favourable and, where this is the case, the arm's length premium rates must exclude any profit sharing component.

6.2 In calculating the arm's length premium, allowance must be made for changes in plan membership throughout the year of income on an appropriate basis.

6.3 Not all death and/or disability benefits paid from a superannuation fund may meet the definition in section 295-460 of the Act. Where this occurs, the amount of premium must reflect the portion of the death and/or disability benefits that do meet the definition.

7. APPORTIONMENT OF PREMIUM

Section 295-465(1) (item 6) of the Act relates to insurance policies that are not included in items 1 to 5 of that section. It is necessary to determine the part of the premium that is attributable to the liability to provide death and/or disability benefits. The basis of such apportionment must recognise the underlying premium basis and produce results consistent with those which would be produced if the arm's length premium approach had been adopted.

8. USE OF SECTION 295-465(2) OF THE ACT

8.1 Section 295-465(2) of the Act can be applied to the extent for which the fund "does not have insurance coverage" for the "liabilities" to provide death and/or disability benefits. Use of section 295-465(2) of the Act is appropriate where a plan elects to self-insure either part or all of the unfunded portion of death and/or disability benefits, for example where:

(a) the plan does not insure the first $x of "liability" per plan member;

(b) all or certain plan members are not covered by insurance; or

(c) stop loss arrangements are in place.

8.2 If the level of insurance cover for a plan is less than that specified under clauses 5.1 to 5.4 above, it is permissible for the plan to also seek a deduction under section 295-465(2) of the Act for self-insurance of the difference between the maximum specified in clauses 5.1 to 5.4 above and the actual amount of insurance cover.

8.3 Where a plan has stop loss arrangements in place, it is appropriate to utilise section 295-465(2) of the Act and reduce the amount of the arm's length premium by the amount of the stop loss premium and claim a deduction for the stop loss premium.

9. ACTUARIAL CERTIFICATE

9.1 The actuarial certificate is required to be in a form as detailed in Taxation Ruling IT 2617. In this respect, Members' attention is drawn to clause 1.6.2 of this Professional Standard.

9.2 In addition to the items specified in Taxation Ruling IT 2617, where a deduction is being claimed under section 295-465(2) of the Act, the actuarial certificate must provide the following information:

(a) description of the data on which the actuarial certificate is based;

(b) the amount of the plan's "liability" to provide death and/or disability benefits not covered by an insurance policy, and the basis of determining that amount; and

(c) a statement of the underlying rates used in the calculation of the arm's length premium and a brief explanation of the basis of determining these rates.

9.3 In addition to the items specified in Taxation Ruling IT 2617, where a deduction is being claimed under section 295-465(1) (item 6) of the Act, the actuarial certificate must provide the information required by clause 9.2(a) above and detail the basis of apportionment.

END OF PROFESSIONAL STANDARD 405