GUIDANCE NOTE 465 - STATEMENTS OF OPINION
RELATING TO DEFINED BENEFIT PENSIONS
SIS REGULATION 9.31

APPLICATION

1. Actuaries making statements of opinion relating to the payment of defined benefit pensions from a defined benefit superannuation fund for the purposes of Regulation 9.31(1)(ba) of the Superannuation Industry (Supervision) Act 1993 (the SIS Act), inserted by Modification Declaration No. 23.

LEGISLATION

2. Regulation 9.31(1)(ba) of the SIS Act requires that a report on an actuarial investigation of a private sector fund or a fully funded public sector superannuation scheme must contain, among other things:

"For a regulated superannuation fund which has at least 1 defined benefit member who is being paid a defined benefit pension from the fund, a statement of the actuary's opinion on whether, at the valuation date, there is a high degree of probability that the fund will be able to pay the pension as required under the fund's governing rules".

Note that lifetime, life expectancy and fixed term pensions are generally defined benefit pensions but allocated pensions generally are not. In this Guidance Note, a statement from the actuary that there is a high degree of probability that the fund will be able to pay the pension as required under the fund's governing rules is referred to as a positive opinion.
3. It should be noted in particular that the statement of opinion is required for private sector and fully funded public sector defined benefit funds only. The statement of opinion is not required for public sector funds that are not fully funded (in terms of the SIS legislation). It should also be noted that certificates are required once a year unless a three year (or other period) exemption is obtained. It is expected that most employer sponsored defined benefit funds other than self-managed funds will wish to seek the exemption.

4. Actuaries should note also that the statement of opinion is not required to be made in relation to a lifetime or fixed term pension that is wholly determined by reference to life insurance policies that the Trustee has purchased or obtained solely for the purpose of providing that benefit. To the extent that a pension is partially insured, the opinion should be formed in relation to the uninsured portion of the pension only.

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CLASSIFICATION

6. Compliance with this Guidance Note is mandatory from 1 February 2001 in respect of funds paying pensions covered by the definition of "defined benefit pension" in SIS Regulation 1.03(1).
1 INTRODUCTION

7. The purpose of this Guidance Note is to provide guidance to actuaries in making a statement of opinion as required by SIS Regulation 9.31(1)(ba) relating to the payment of current pensions from a defined benefit superannuation fund.

8. The SIS legislation requires that the statement of opinion regarding current pensions must accompany or be part of a report on the actuarial investigation of the fund. The investigation and report itself continue to be subject to Professional Standard 400 (PS400).

9. The actuary’s statement of opinion may be used to determine the eligibility of the pensions for exemption from the social security assets test. A statement of opinion in the negative would result in this favourable treatment not being granted to the pensions. Actuaries should be aware of the potential adverse effects on pensioners of the removal of this exemption and should be prepared to discuss with trustees means of re-arranging the terms of the pensions and their funding to permit the Actuary to form a positive opinion. The Institute has been advised by the Australian Prudential Regulation Authority (APRA) that it would not have any other direct consequences (i.e. not a breach of the SIS Act). However APRA has stated that it would take note of a fund’s failure to obtain a positive opinion and may use this information (along with a number of other factors) as an indicator of the need for further investigation of the fund. In relation to small self-managed superannuation funds, actuaries should have regard to paragraph 31.

10. Actuaries should note that there may be some pensions included in the definition of defined benefit pension that are of such terms and conditions that no exemption from the assets test will be granted, regardless of the opinion of the actuary referred to in paragraph 2. In such cases, the requirements of Regulation 9.31(1)(ba) still apply.
QUANTIFICATION OF PROBABILITIES

11. It is not necessary that actuaries determine a precise probability of the fund being able to meet its pension obligations. Instead, it is acceptable for the actuary to specify a range within which the probability is judged to fall or to indicate that the probability is at least x%.” Discussions with APRA have suggested that a probability of at least 70% should be represented as being a high degree of probability for the purpose of Regulation 9.31(1)(ba).

MEANING OF HIGH DEGREE OF PROBABILITY

12. Having regard to Regulation 9.31(1)(ba) of the SIS Act and the level of probability referred to in paragraph 11, actuaries should interpret high degree of probability”as follows:

- Where an actuary determines the probability to be 70% or more, he or she is able to certify that there is a high degree of probability”without further investigation.
- Where the actuary determines the probability to be at least 50% but less than 70%, he or she would not normally be able to certify that there is a high degree of probability.” However in a case where the actuary believes that there are special circumstances, it may be possible for the actuary, in his or her professional judgement, to form a positive opinion.
- Where the actuary determines the probability to be less than 50%, the Institute does not believe that there would be any circumstances in which he or she could form a positive opinion.

“Special circumstances” for this purpose might arise, for example, owing to investment returns earned or contributions paid after the valuation date, but before the date of certification, such that the actuary determines that the probability would have been 70% or more had such investment returns or contributions been taken into consideration as at the valuation date. It should be noted that these are two examples are not intended to limit the actuary in determining what constitutes a special circumstance”however, it is expected that the range of situations which give rise to a special circumstance”would be relatively limited.
METHOD

13. In order to form the opinion required by the SIS legislation, the actuary may need to make a projection of relevant fund assets and pension payments over the period of payment of pensions to current pensioners. In relation to lifetime pensions, it will be necessary to extend the projections beyond the expected future lifetime of each pensioner, in order to examine the possible effect of pensioner longevity on the fund's capacity to meet future pension payments.

14. Alternatively, the actuary may be satisfied that the circumstances of the fund are such that it is clear by inspection that a positive opinion can be given. An example is where a fund has current pension and non-pension liabilities, with the assets exceeding the current pension liabilities by a large margin and the current pensions having a high priority over the assets, relative to other liabilities.

ASSUMPTIONS

Relationship with Investigation Assumptions

15. The initial assumptions used to make any projections or determine present values should represent the actuary's best estimate of future experience. The actuary should then consider any margins that could be incorporated as discussed in paragraph 21.

16. One assumption required will relate to future increases in pensions. While Paragraph 19 of PS400 states allowance should normally be made for ...pension increases as provided by the documentation, in accordance with precedent or the intentions of the trustees and/or employer-sponsor;" it is common for pension increases not to be guaranteed by the governing rules of a fund. Instead, such increases are usually granted at the discretion of the trustee or employer/plan sponsor.

17. SIS Regulation 9.31, however, makes it clear that the opinion should relate only to pension increases required under the fund's governing rules. Hence, it is considered appropriate that the assumptions for the purposes of the statement of opinion should allow for pension increases only to the extent required by the governing rules. In the statement of opinion, the assumed rate of pension increases, and whether there is any difference
between this assumption and the assumption used more generally in the actuarial investigation, should be stated clearly.

18. The remainder of this Guidance Note assumes the actuary is carrying out a full projection (i.e. paragraph 14 above does not apply).

19. In order to conduct projections of pensions and relevant fund assets, assumptions will be required relating to future rates of:
   (a) pension increases (which may in turn depend on future rates of price inflation depending on the governing rules of the fund);
   (b) investment returns on assets backing pensions;
   (c) pension-related expenses;
   (d) mortality of pensioners; and
   (e) less commonly, remarriage, separation or divorce, or commutation.

20. Assumptions relating to these items will have been selected for the purposes of the actuarial investigation. However, these assumptions will often be deterministic (i.e. a single number representing the relevant rate in each future year) and hence will not explicitly allow for the uncertainty associated with each assumption.

21. Nonetheless, the probability statement required by SIS Regulation 9.31 implies that such uncertainty - or variability - will be taken into account. A complete analysis would involve specifying the probability distribution of each of the above items and from these determining the probability of adequacy of the assets held. However, it is recognised that in many cases specification of such distributions and the subsequent calculations will not have an impact on the actuary’s ability to provide an opinion. Further, it is recognised that variability in underlying assumptions may be taken into account in an implicit manner, for example by incorporating margins relative to the best estimate and by sensitivity testing.

22. It is therefore considered that in most cases the relevant projections may be based on deterministic assumptions relating to items (c) and (e) above. For items (a), (b) and (d), actuaries should consider the effect of the variability of those items and an appropriate means to allow for it. In particular, any link between future investment returns on relevant assets and future pension growth (as in the case, for example, of inflation-linked pensions backed by assets with returns which may be correlated to
inflation) may be taken into account.

23. In deriving assumptions for (d) and (e), it is not necessary to investigate the individual circumstances or health of the members, though the actuary should not assume a member is in impaired health unless such an investigation has been completed.

**Assets, Future Contributions and Other Benefit Liabilities**

24. In forming an opinion, an actuary will need to identify the assets and future contributions from which future pension payments are assumed to be met, and the other benefit liabilities that are to be allowed for.

25. The principles that should be adopted in relation to such matters are:
   (a) Generally, funding methods should aim to ensure that pensions should be fully funded before the time a pension commences to be paid (PS400, paragraph 14). Consistent with this principle, it is generally considered inappropriate that future employer contributions be taken into account when valuing current pensions. However, there may be limited circumstances, as discussed in paragraph 30, whereby future contributions can be taken into account, particularly in relation to pensions in the course of payment.
   (b) All assets owned by the fund that would be available to meet current pension liabilities in the event of wind-up of a fund may be taken into account.
   (c) Benefit liabilities that rank ahead of, or equally with, the liability for payments to current pensions on wind-up of the fund must be taken into account.
   (d) Benefit liabilities that rank after the liability for payments to current pensions on wind-up of the fund need not be taken into account; however, the actuary must have regard to paragraph 30.

26. Principle 25(b) above may be followed even where assets relating to current pensions are held separately (either physically or notionally) for funding or taxation purposes. Where the actuary believes that there is no right of recourse to some assets in the event of a wind-up of the fund, these amounts should be excluded from consideration in forming the opinion. All the principles in paragraph 25 are subject to any restriction imposed by the Trust Deed and the SIS Act.
27. The priority of benefit liabilities should be determined by reference to the governing rules and by reference to any priorities imposed by SIS or other legislation. For example, in many funds, the governing rules clearly provide that, upon wind-up of the fund, pensions in payment will rank ahead of liabilities relating to actively employed members, although SIS requires certain minimum benefits to be given higher priority. In such cases, it would not be necessary to ensure that active members’ benefit liabilities are covered by assets other than to the extent required to satisfy the SIS minimum benefit requirement. The actuary should be aware of broader issues relating to the fund if the assets are insufficient to cover all members’ vested benefits.

28. It is envisaged that the principles above may be allowed for in most cases by reducing the assets taken into account in forming the opinion to allow for any benefit liabilities ranking equally with or ahead of pension liabilities on wind-up of the fund. That is, the value of assets that can be deemed as referable to the pensioners should be determined as follows:

\[ PA = \frac{(A - G) \times P}{P + E} \]

where

- \( PA \) = the adjusted net value of assets referable to benefits in respect of current pensioners;
- \( A \) = the net value of assets of the fund;
- \( G \) = the value of benefit liabilities (other than current pensioners) that rank ahead of current pensioners on wind-up of the fund;
- \( P \) = the value of liabilities relating to current pensioners; and
- \( E \) = the value of benefit liabilities (other than current pensioners) that rank equally with current pensioners on wind-up of the fund.

Note that liabilities in \( G \) above need be recognised only to the extent that they have not been allowed for in determining \( A \) above.
STATEMENT OF OPINION

29. Statements of opinion made in accordance with the SIS Regulation 9.31(1)(ba) will normally:
   (a) be made after an actuarial investigation of the fund in terms of PS400 has been made; and
   (b) accompany, or be part of, a report on the actuarial investigation required in accordance with the SIS Regulations and carried out under PS400.

OTHER ISSUES

30. The actuary should consider the likelihood that there will continue to be a high degree of probability in future years. If there is a reasonable likelihood that the probability will fall below the required level at some point, this should be drawn to the attention of the trustee. An example would be a fund with only a small number of pensioners where the actuary is able to provide a positive opinion at the outset but with little margin. If all or most pensioners survive over the years, the probability of the assets (in the absence of any future contributions) remaining adequate can be expected to decline over the years, thus preventing the actuary from giving a positive opinion at some later date. Another example would be where a benefit payment significantly greater than the amount funded has arisen between the date of valuation and the date of certification, such that the actuary, if taking such benefit into account, could not form a positive opinion. In these cases, the Trustee may be informed in order to give time to arrange potential additional funding that could potentially be taken into account under paragraph 12, thus allowing the actuary to give a positive opinion. Alternatively, the terms of the pension may be able to be modified, again permitting a positive opinion.

31. Small funds, and particularly self-managed funds, often have characteristics and objectives that are different from those of larger funds and corporate funds. Small funds are often established for different reasons than larger pension funds, for example, driven by a desire to retain control over investments and capital. It is expected that actuaries will take into consideration these differences, and should be familiar with the unique requirements and features of small funds and the differences in their regulation before giving advice in this area.
32. There are different Government authorities involved in pension funds for different reasons. The main authorities are APRA, the Australian Taxation Office and the authorities supervising social security entitlements. These authorities sometimes have conflicting objectives. Actuaries are expected to be aware of these different objectives to fully understand the consequences of their advice.

33. Actuaries should note that when they prepare certificates in accordance with this Guidance Note they are subject to the provisions of the SIS Act and Regulations, which require them to report certain information under certain circumstances to the trustee and/or APRA (see, for example, sections 129 and 130 of the SIS Act).

END OF GUIDANCE NOTE 465