



PRACTICE GUIDELINE 499.02

PROJECTED SUPERANNUATION BENEFIT ILLUSTRATIONS

April 2009

1. INTRODUCTION

1.1 Application

1.1.1 This Practice Guideline applies to any Member advising an employer, trustee, existing or prospective plan member or other party in relation to a Projected Superannuation Benefit Illustration.

1.1.2 This Practice Guideline relates to 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, this Practice Guideline does not seek to provide specific guidance in such cases. At a later stage, this Practice Guideline may be expanded to more specifically cover such other cases.

1.2 Classification

1.2.1 This Practice Guideline has been prepared in accordance with Council's Policy for Drafting and Developing Practice Guidelines, 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 Practice Guideline is not mandatory.

1.2.3 Nevertheless, if the Professional Services provided by a Member are covered to any extent by this Practice Guideline, a Member should consider explaining any significant departure from this Practice Guideline to the Principal, and document such explanation.

1.3 Background

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 account-based pensions;
- (c) that will be used to compare defined benefit and defined contribution benefits;
- (d) 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 or inform the general public); and
- (e) provided in writing, or as the output of any form of computer software (including websites).

1.4 Purpose

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

1.5 Previous versions

This Practice Guideline replaces Guidance Note 466 (Projected Superannuation Benefit Illustrations) which was issued in October 2004.

1.6 Legislation

- 1.6.1 Possible implications for Illustrations arise from the Corporations Act and Corporations Regulations 2001 (Cth) as a result of financial services reforms. These include not only the content of an Illustration report, but also in relation to 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.
- 1.6.2 Possible implications may also arise from 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.
- 1.6.3 Members also need to be mindful of the underlying principles expressed in Regulatory Guide 170 ("Prospective Financial Information") issued by the Australian



Securities and Investments Commission (“ASIC”) which gives guidance on the use of prospective financial information such as financial projections.

- 1.6.4 In the event that there is or may be a conflict between legislative requirements and this Practice Guideline, the legislative requirements override this Practice Guideline to the extent of the inconsistency.

2. COMMENCEMENT DATE

This Practice Guideline commences on 17 April 2009.

3. DEFINITIONS

‘**AWE**’ means average weekly earnings.

‘**AWOTE**’ means average weekly ordinary time earnings.

‘**Code**’ means the Code of Professional Conduct of the Institute.

‘**Corporations Act**’ means the Corporations Act 2001 (Cth).

‘**Illustration**’ has the same meaning as Projected Superannuation Benefit Illustration.

‘**Institute**’ means The Institute of Actuaries of Australia (ABN 69 000 423 656).

‘**Material**’ means important or essential in the opinion of the Actuary.

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

‘**Principal**’ has the same meaning as set out in the Code.

‘**Professional Services**’ has the same meaning as set out in the Code.

‘**Projected Superannuation Benefit Illustration**’ means any estimate of an amount that may be received by an individual at some point in the future.

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. CALCULATIONS AND ASSUMPTIONS

- 5.1 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.
- 5.2 Generally, the assumptions used, or the range of assumptions allowed or recommended, should be consistent and reasonable. Common practice is that if plan members can select their own assumptions, then any assumptions outside an allowed 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 an allowed range, Illustrations might not be produced. Similarly, common practice is that where the actual experience could be outside the allowed range (for example, short-term negative returns) then appropriate warnings are included.
- 5.3 Existing assets and future contributions (if any) taken into account in an Illustration are usually measured on bases consistent with the assumptions used.
- 5.4 Assumptions used generally reflect the proximity of retirement. As such, if a plan 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 would receive a benefit broadly equal to the amount in the Illustration. Where satisfying this is impractical (for example, where Illustrations are required for all members of a large plan), a warning or comment is usually included.
- 5.5 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 effect **at retirement** of an addition to, and 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.

- 5.6 The description or illustration referred to in section 5.5 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.
- 5.7 If an Illustration shows different investment returns for different investment choices, the illustration of volatility generally also illustrates or explains the relative risks and possible differences in volatility of those different investment choices.
- 5.8 Illustrations may be in real terms or monetary terms. For Illustrations in monetary terms, Members' attention is drawn to the guidance given in section 6.3 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 an Illustration 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 plan members to assess their relative purchasing power at retirement.

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

- 5.9 Preferred practice in respect of the use of terminology in an Illustration is that:

"Today's Dollars" refers to projected amounts which have been deflated to the calculation date using an income (for example, salary, AWE or AWOTE) based assumption. It may be characterised as the sum of a price inflation component and a component reflecting increases in community living standards;

"Future Dollars" is used for situations where there are no adjustments; and



“Deflated Dollars” is used for adjustments which include only price inflation.

The following is an example of a possible explanation of “Today’s Dollars” for use with Illustrations:

“Today’s dollars” converts your future retirement benefit or income into today’s relative buying power. It takes the future dollar amount and discounts (or deflates) it at the rate of salary inflation (assumed to be ... pa). Wages, salaries and community living standards and the cost of living have tended to grow faster than price inflation, and converting to “today’s dollars” means you can better decide if your future retirement benefit or income will be adequate compared to your current income or salary.

- 5.10 Administration and other non-investment fees and costs (including those expressed as a percentage of assets), as well as contributions tax charged to a plan member's account or contributions, are usually taken into account in an Illustration. Government co-contributions may or may not be taken into account, but the approach taken is generally clearly set out. Fees are usually 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 is usually stated.

Where the fees and costs to be allowed for have not been taken from the PDS by a Member, but have been provided to the Member by the client, common practice is for the Member to request a copy of the PDS and then check that the fees and costs to be allowed for are consistent with the PDS or that there is a valid reason for any variation. Where the fees and costs assumed in the projection are not consistent with the PDS, common practice is to disclose this circumstance.

- 5.11 An Illustration may translate a lump sum benefit at a future date into an income amount to be expected over the plan member’s lifetime or other specified period. Where this is done, a Member will need to make assumptions about rates of mortality, mortality improvement, indexation of payments, fees and costs and the investment returns expected on assets backing an annuity liability. In doing so, a Member’s attention is drawn to section 5.4 above regarding the possible need for special treatment of persons close to the retirement age used in the Illustration. In cases where commercial annuities are likely to be used to provide the income stream, accepted practice for converting lump sums to income amounts is to use factors consistent with current commercial annuity rates. 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, usual practice is to clearly set this out.

- 5.12 When communicating the assumptions to a client, the usual practice is to point out that, while the assumptions are considered reasonable for the purpose of the



Illustration at the then present time, 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) three years ago should not be used for any purpose without having the assumptions reviewed.

6. OTHER ISSUES

- 6.1 It is always preferable that an Illustration is presented to the ultimate recipient in a clear, complete and balanced way. For example, an Illustration which includes a number of columns of figures may be made clearer by explaining the relationship between figures in various columns (perhaps by use of an example).
- 6.2 An Illustration generally contains a statement of all Material assumptions. The statement usually explains how allowance has been made for:
- (a) investment fees and costs and any investment tax; and
 - (b) if potentially applicable, benefit tax and/or Government co-contributions.
- 6.3 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 monetary amount (but see section 5.8 above);
 - (b) in real terms (as discussed in section 5.8 above); or
 - (c) a percentage or multiple of projected salary.
- 6.4 An Illustration will generally make clear what death and disablement benefits (if any) and what level of increases in pension payments (if any) have been allowed for in the calculation of the illustrated benefits.
- 6.5 In addition to providing basic information, the usual practice is for an Illustration and/or accompanying explanatory notes to make clear:
- (a) which of the plan member's funds have been included in the illustrated benefits (for example, whether the projection includes additional voluntary contributions);
 - (b) what level of future contributions has been assumed (including increases to future contributions and Government co-contributions);
 - (c) whether any adjustment has been made to future contributions (for example, to cover the cost of insured death and disablement benefits);



- (d) if any asset values used are not market values and, if so, why those values have been used; and
- (e) what levels of administration fees and other non-investment costs charged to a plan member's account or contributions have been allowed for (and the basis on which these fees and costs have been assumed to increase in future years).

6.6 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 would be available. (Where an estimate of the social security pension 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, an Illustration would usually show the split between the projected superannuation and social security income. Generally the basis of any social security estimate 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 currently applying.
- (b) **Australian residential requirements:** To qualify for the Age Pension currently requires a minimum period of residence in Australia or other recognised alternatives. A statement that the estimate assumes the person is a long term Australian resident would generally be made.
- (c) **Marital status:** Currently the pension entitlement varies according to whether the person is regarded as single or as a partner of a couple 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. So some estimates may assume each person is a partner of a couple 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.

6.7 Income draw-down Illustrations generally 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 allowance has been made for means-testing). Such illustrations would also generally explain the treatment of any minimum and maximum limits on the rate of draw-down.

- 6.8 Spurious accuracy should be avoided so that, for most illustrations, illustrated benefits calculated to 3 or 4 significant figures are considered adequate.
- 6.9 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 65th birthday, or 30 June in the year following the plan member's 65th birthday); and
 - (c) state who the projection has been prepared by and for whom, as well as the purpose for which the projection has been prepared.

7. COMPARISON OF DEFINED BENEFIT AND DEFINED CONTRIBUTION BENEFITS

- 7.1 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.
- 7.2 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.
- 7.3 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.
- 7.4 An illustration prepared for the purpose described in section 7.1 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.

7.5 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.

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

8. 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.

8.1 Identification

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

8.2 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 fees and costs and indexation



- ▶ Investment fees and costs and investment tax
- ▶ Cost of insured death and disablement benefits (if applicable)
- ▶ Contributions tax
- ▶ Disclosure of all significant assumptions

8.3 Information

- ▶ Investment choices and risks
- ▶ PDS fees and costs
- ▶ Death and disablement benefits
- ▶ Pension increases
- ▶ Plan member's funds included
- ▶ Contributions and contribution increases
- ▶ Government co-contribution
- ▶ Benefit tax
- ▶ Non-market valued assets
- ▶ Date to which projected

8.4 Results

- ▶ Real or monetary terms (or a percentage or multiple of projected salary)
- ▶ 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



8.5 Defined Benefit to Defined Contribution comparisons

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

8.6 Legislation

- ▶ ASIC's Regulatory Guide 170 ("Prospective Financial Information")
- ▶ Corporations legislation (disclosure and licensing)
- ▶ Section 1041H of the Corporations Act
- ▶ Statements required under licensing and other external standards or legislation (if applicable)

8.7 Reporting

- ▶ Clear, complete and balanced presentation of Illustration
- ▶ Highlight 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