



**EXPLANATORY MEMORANDUM TO
PROFESSIONAL STANDARD 400:
INVESTIGATIONS OF THE FINANCIAL CONDITION OF DEFINED
BENEFIT SUPERANNUATION FUNDS**

August 2010

About this Explanatory Memorandum

This Explanatory Memorandum has been prepared by the Superannuation and Employee Benefits Practice Committee ("SEBPC") to assist Members in understanding changes to Professional Standard 400 ("PS 400").

Introduction

In December 2009, the SEBPC released the Second Exposure Draft of proposed amendments to PS 400, inviting Members to make comment. Three submissions were received. The SEBPC found the submissions very useful in finalising the standard and thanks Members for their comments.

The changes to the current PS 400 update the existing standard:

- ▶ in accordance with the Policy for Drafting Professional Standards; and
- ▶ for changes to the superannuation environment and actuarial practice in this area.

Key changes from the Second Exposure Draft

The key changes from the Second Exposure Draft include:

- ▶ work performed under this Professional Standard is Prescribed Actuarial Advice, (clause 1.1.2);
- ▶ additional wording in several clauses to recognise the particular circumstances of Public Sector Superannuation Schemes;
- ▶ the definition of Material has been amended to read "relevant to the Fund's circumstances and is either important or essential in the opinion of the Member";
- ▶ clause 4.2 sets out the requirements where a matter is not Material, replacing clause 5.1.4 and 6.2.4; and



- ▶ clarification on when the Member must include recommendations that the Trustee address Material Risks (clause 6.15.2).

Employer Covenant

One of the submissions received on the Second Exposure Draft raised the issue of the employer covenant and the role of the actuary, particularly in relation to developments in the UK.

The employer covenant may be defined as:

“the combination of (a) the ability and (b) the willingness of the [employer] to pay (or the ability of the trustees to require the [employer] to pay) sufficient advance contributions to ensure that the scheme’s benefits can be paid as they fall due.”¹

The SEBPC considered the issue in some detail.

In discussions, it was noted that the UK Institute’s Sponsor Covenant Working Party issued its final report on “Allowing for the Sponsor Covenant in Actuarial Advice” in November 2005. In that report, the working party recommended that:

“.....the Pensions Board adopts and publicises to pensions actuaries the view that:

- before advising on the assessment of a sponsor’s covenant in relation to actuarial advice, actuaries should consider carefully whether they are competent to do so, and
- the actuarial training and typical actuary’s experience is unlikely by itself to provide an actuary with this competence.

We recommend that this view should not be translated into formal guidance unless evidence indicates that the actuarial profession’s reputation is seriously at risk from the advice given by actuaries.”

The report further recommended that actuarial funding advice should distinguish between schemes that are “viable ongoing” or “in distress”, but that decision should be a matter for trustees to determine rather than the actuary.

The employer sponsor covenant was also discussed in a concurrent session at the 2010 Financial Services Forum.

¹ Sponsor Covenant Working Party Final Report, “Allowing for the Sponsor Covenant in Actuarial Advice”, November 2005, page 4.



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The SEBPC has decided to not explicitly include any additional requirements in PS 400 in relation to the employer sponsor covenant. Instead, the SEBPC considered that issues surrounding the employer sponsor covenant – such as the financial soundness of the employer – were adequately addressed through the requirements of clause 6.15 of the Professional Standard.

Commencement of the revised PS 400

This Professional Standard applies to Investigations with an Effective Date on or after 1 October 2010.

END OF EXPLANATORY MEMORANDUM