



**PROFESSIONAL STANDARD 407**

**SOLVENCY MANAGEMENT OF DEFINED BENEFIT SUPERANNUATION FUNDS**

May 2010

---

**INDEX**

<b>1.</b>	<b>INTRODUCTION</b>	<b>2</b>
1.1	Application	2
1.2	Classification	2
1.3	Background	2
1.4	Purpose	3
1.5	Previous versions	3
1.6	Legislation	3
<b>2.</b>	<b>COMMENCEMENT DATE</b>	<b>3</b>
<b>3.</b>	<b>DEFINITIONS</b>	<b>3</b>
<b>4.</b>	<b>FUNDING AND SOLVENCY CERTIFICATES : MINIMUM CONTRIBUTIONS</b>	<b>5</b>
4.1	Adequacy of minimum contributions	5
4.2	Best estimate	5
4.3	Assumptions regarding MRBs	5
<b>5.</b>	<b>FUNDING AND SOLVENCY CERTIFICATES : NOTIFIABLE EVENTS</b>	<b>6</b>
5.1	Specifying Notifiable Events	6
5.2	Notifiable Events to be considered	7
<b>6.</b>	<b>FUNDING AND SOLVENCY CERTIFICATES : ASSET VALUES</b>	<b>7</b>
<b>7.</b>	<b>FUNDING AND SOLVENCY CERTIFICATES : CONTENT AND DURATION</b>	<b>8</b>
<b>8.</b>	<b>ACTUARIAL CONTROL OF TECHNICALLY INSOLVENT FUNDS</b>	<b>8</b>
8.1	Control period	8
8.2	Means of control	8
8.3	Change of Responsible Actuary	9



## **1. INTRODUCTION**

### **1.1 Application**

1.1.1 This Professional Standard applies to a Member:

- (a) preparing a funding and solvency certificate for a Fund;
- (b) assuming actuarial control of a Technically Insolvent Fund.

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. This Professional Standard must be applied in the context of the Code.

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 this 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 this 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 An FSC is one leg of the framework which supports the security of superannuation guarantee entitlements in defined benefit funds. In an FSC, the Member certifies Solvency at a particular date, specifies minimum contributions designed to achieve Solvency at the expiration of the certification, and defines circumstances under which the Fund should be re-examined (prior to the normal expiry of the FSC).

1.3.2 The Solvency measure being certified is the coverage of MRBs by the Net Realisable Value of the Assets of the Fund.



#### 1.4 Purpose

The purpose of this Professional Standard is to provide Members with principles and directions that must be followed with regard to the work described in clause 1.1.

#### 1.5 Previous versions

This Professional Standard was first issued as Guidance Note 461 (Funding and Solvency Certificates) in December 1994. There are no other previous versions of this Professional Standard.

#### 1.6 Legislation

1.6.1 The legislation relevant to this Professional Standard is SIS Regulation 1.03 and Part 9 of the SIS Regulations.

1.6.2 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 takes effect from 1 May 2010.

### 3. DEFINITIONS

3.1 In this Professional Standard:

**'AMBI'** means adjusted minimum benefit index, as defined in SIS Regulation 9.15(2).

**'Benefit Certificate'** has the same meaning as set out in section 10 of the Superannuation Guarantee (Administration) Act 1992 (Cth).

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

**'FSC'** means a funding and solvency certificate required under SIS Regulation 9.09 or a special funding and solvency certificate required under SIS Regulation 9.18 (as the case may be).

**'Fund'** means a defined benefit superannuation fund covered by SIS Regulation 9.05.

**'Funded MRBs'** means the component of the MRB from time to time which had accrued at the Initial Date multiplied by the AMBI at the Initial Date, plus the full amount of the MRB which has accrued after the Initial Date.



**'Fund Sponsor'** means the employer-sponsor of a Fund (as defined in section 16 of the SIS Act).

**'Initial Date'** has the same meaning as set out in SIS Regulation 9.15(2).

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

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

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

**'Membership'** means, except where otherwise specified, the period used to determine benefits as appropriate in the particular circumstances.

**'MRB'** means minimum requisite benefit and has the same meaning as set out in SIS Regulation 1.03.

**'Net Realisable Value of the Assets'** has the same meaning as set out in either SIS Regulation 9.15(2) or SIS Regulation 9.21(1), as relevant.

**'Notifiable Event'** has the same meaning as set out in SIS Regulation 9.06(1).

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

**'Professional Standard'** is a document setting out practice requirements in a particular situation or area that has been: (1) prepared in accordance with the Institute's Policy for Drafting Professional Standards; and (2) issued by the Institute.

**'Responsible Actuary'** has the same meaning as set out in SIS Regulation 9.06.

**'SG Regulations'** means the Superannuation Guarantee (Administration) Regulations 1993 (Cth).

**'SIS Act'** means the Superannuation Industry (Supervision) Act 1993 (Cth).

**'SIS Regulations'** means the Superannuation Industry (Supervision) Regulations 1994 (Cth) (as modified by any Modification Declaration issued by the Australian Prudential Regulation Authority from time to time).

**'Solvency'** has the same meaning as set out in SIS Regulation 9.06(2).

**'Technically Insolvent'** or **'Technical Insolvency'** has the same meaning as set out in SIS Regulation 9.06(3).

3.2 A word that is derived from a defined word has a corresponding meaning.



## **4. FUNDING AND SOLVENCY CERTIFICATES : MINIMUM CONTRIBUTIONS**

### **4.1 Adequacy of minimum contributions**

The minimum contributions specified in an FSC must:

- (a) in the case of a Solvent Fund, be adequate, under reasonable expectations for future experience, to provide full coverage of the Funded MRBs throughout the period of the FSC; or
- (b) in the case of a Technically Insolvent Fund, be in accordance with the program developed by the Responsible Actuary under SIS Regulation 9.17.

### **4.2 Best estimate**

In determining the minimum contributions to be specified in the FSC under SIS Regulations 9.10(1)(f) or 9.18(9)(d) (as relevant) the Member must either:

- (a) determine the minimum contributions required to secure the Solvency of the Fund at the end of the relevant period based on "best estimate" assumptions; or
- (b) determine minimum contributions which are in excess of the minimum contributions which would be determined under paragraph (a). If the Member adopts minimum contributions that are in excess of those expected to be required to provide coverage only of Funded MRBs, the Member must state that this approach has been adopted in the FSC.

### **4.3 Assumptions regarding MRBs**

4.3.1 In projecting coverage of MRBs at the FSC's expiry date, the Member must reflect the total benefits expected to be payable over that period, not just the MRB component of benefits. If a benefit payable is subject to options which may alter the amount or the value of the benefit payable (including, but not limited to, a pension or lump sum at a Fund member's option), the Member must make reasonable assumptions about the proportions who exercise the various options. Such assumptions must be disclosed in the FSC either directly or by reference to the actuarial valuation report from which the assumptions are sourced.

4.3.2 An FSC may specify an assumed MRB basis for the period after the expiry date of a current Benefit Certificate and within the duration of the FSC, provided that the FSC includes, as a Notifiable Event, the failure to issue a Benefit Certificate on the assumed basis when that time comes. If an MRB basis is assumed as described above, the assumed MRB must be as clearly defined in the FSC as it would be in a Benefit Certificate or defined by reference to the continuation of the MRB in the Benefit Certificate.



## 5. FUNDING AND SOLVENCY CERTIFICATES : NOTIFIABLE EVENTS

### 5.1 Specifying Notifiable Events

5.1.1 A Member must specify, as a Notifiable Event, any event or combination of events which could warrant replacement of the FSC. The event or combination of events so specified by the Member must be specific and objective.

5.1.2 For a Solvent Fund:

- (a) an objective behind the specification of the set of Notifiable Events in an FSC is that the Fund would not fall into Technical Insolvency due to the occurrence of a reasonably foreseeable event that is not covered by the Notifiable Events specified in the FSC;
- (b) the trigger point of a Notifiable Event must be inside the level at which the Member reasonably expects that its occurrence may result in the Fund becoming Technically Insolvent during the period of the FSC; and
- (c) the replacement of the FSC is warranted if, in the Member's opinion, following the occurrence of a Notifiable Event, the Member may not be able to certify the Fund's Solvency for the remaining period of the FSC based on the minimum contributions and Notifiable Events specified in the FSC.

5.1.3 For a Technically Insolvent Fund, an objective behind the specification of the set of Notifiable Events is to facilitate detection of adverse experience that is, or may be, significant enough to warrant replacement of the FSC in order to:

- (a) increase the specified minimum contributions;
- (b) amend the scheme for approved payments from the Fund required in accordance with SIS Regulation 9.19; or
- (c) specify revised Notifiable Events.

5.1.4 The Member must not delegate responsibility for determining whether an event would qualify as a Notifiable Event to the Fund's trustee or another party.

5.1.5 In considering whether an event, or combination of events, needs to be specified as a Notifiable Event, the Member must consider:

- (a) the likely effect of the event or combination of events on the Fund, assuming that contributions are paid at the minimum specified rate only. In particular, the Member must consider the assumptions adopted in setting the certified contributions and how variation of experience from those assumptions will affect the coverage of funded MRBs;
- (b) the degree of conservatism in the assumptions used in setting contributions, or the margin between specified contributions and the minimum contributions expected to be required to fund MRBs;



- (c) testing how sensitive the projections are to the assumptions (including asset values); and
  - (d) the proposed duration of the FSC.
- 5.1.6 The Member must give due weight to the greater control over a Fund achievable through the specification of relevant Notifiable Events as compared with reliance on the exercise of any power available to the Member to withdraw an FSC under SIS Regulation 9.12(2)(e).

## **5.2 Notifiable Events to be considered**

5.2.1 In determining what to specify as a Notifiable Event, the following events must be considered:

- (a) significant numbers of early retirements;
  - (b) significant numbers of retrenchments;
  - (c) significant numbers of withdrawals in a Fund where the assets are less than the vested benefits;
  - (d) significant salary increases;
  - (e) a significant investment loss;
  - (f) a significant change in investment policy;
  - (g) any recommended constraints on the investment or insurance policies;
  - (h) an increase in benefits;
  - (i) the expiry or replacement of the Benefit Certificate which specifies the MRBs applying to the Fund; and
  - (j) significant exercise of a discretion to pay enhanced benefits other than as assumed in the certification.
- 5.2.2 In appropriate cases requiring flexibility of control, a Member must consider whether to specify, as a Notifiable Event, any additional potential event advised by the Member to the Fund's trustee during the course of the FSC.
- 5.2.3 The events listed in clauses 5.2.1 and 5.2.2 are not intended to be exhaustive of the events which might be specified by a Member as a Notifiable Event.

## **6. FUNDING AND SOLVENCY CERTIFICATES : ASSET VALUES**

Members must consider the purpose of the asset valuation when selecting a valuation methodology to determine the Net Realisable Value of the Assets of the Fund and comply with the requirements of Professional Standard 404 (Valuation of Superannuation Fund Assets).



## **7. FUNDING AND SOLVENCY CERTIFICATES : CONTENT AND DURATION**

7.1 In addition to the matters set out in SIS Regulation 9.10(1) or SIS Regulation 9.18 (as relevant), an FSC must also set out:

- (a) the name of the Fund;
- (b) the date of the Benefit Certificate which specifies the MRB to which the FSC relates, as well as the signing Member's name and the expiry date of the Benefit Certificate;
- (c) details of any occurrences after the effective date of the FSC that have been taken into account in preparing the FSC in accordance with clause 7.2 of this Professional Standard;
- (d) in the case of a special FSC, any scheme for payments from the Fund in terms of SIS Regulation 9.19(4)(b);
- (e) the name, business address and qualifications of the Member signing the FSC; and
- (f) a statement that the FSC has been prepared in accordance with this Professional Standard.

7.2 If the Member identifies any significant changes in experience between the effective date and the date of signing the FSC which would be likely to have a Material effect on the contents of the FSC, the Member must consider and document each of these matters and take them into account in preparing the FSC.

7.3 The Member must consider providing a shorter duration FSC if the Member has particular concerns about the Solvency of a Fund.

## **8. ACTUARIAL CONTROL OF TECHNICALLY INSOLVENT FUNDS**

### **8.1 Control period**

During the actuarial control period for a Technically Insolvent Fund, the Responsible Actuary must:

- (a) discuss options with the Fund's trustee and Fund Sponsor; but
- (b) assume responsibility for the program referred to in SIS Regulation 9.17(a).

### **8.2 Means of control**

8.2.1 The Responsible Actuary must investigate the reasons for the Technical Insolvency.





8.2.2 During the actuarial control period, the Responsible Actuary must consider the most appropriate course of action to return the Fund to Solvency including, but not limited to:

- (a) the level of contributions by the Fund Sponsor;
- (b) having the Fund Sponsor meet a proportion of the benefit payments arising during the period of control by way of additional contributions to the Fund (subject to the provisions of the Fund's governing rules);
- (c) having benefits paid in instalments over a period of time (subject to the provisions of the Fund's governing rules); and
- (d) having benefit entitlements retained within the Fund until Solvency is established.

8.2.3 The Responsible Actuary must consider whether any changes are desirable to reduce the chances of a recurrence. These may include: varying administrative practices such as the treatment of Fund expenses; revising the policy of determining crediting rates; and altering the reserving policy.

8.2.4 The Responsible Actuary must consider whether continuing certification should be subject to constraints on either or both of the investment policy and insurance policy.

### **8.3 Change of Responsible Actuary**

A Member who is requested to take the place of an existing Responsible Actuary under SIS Regulation 9.19 must consider the need to confer with that existing Responsible Actuary to ensure that there is no professional reason why the appointment should not be accepted. While this applies generally under the Code, it may be of particular importance in situations where a Fund's Solvency is of concern.

**END OF PROFESSIONAL STANDARD 407**