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## PROFESSIONAL STANDARD 407

### SOLVENCY MANAGEMENT OF DEFINED BENEFIT SUPERANNUATION FUNDS

March 2020

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## **1. INTRODUCTION**

### **1.1 Application**

1.1.1 This Professional Standard applies to a Member:

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

under part 9 of the SIS Regulations.

1.1.2 This Professional Standard also applies to Members supporting the Member providing a service specified in clause 1.1.1.

1.1.3 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 the Fund's 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.

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

1.1.5 Legislation and other requirements which may be relevant to the work covered by this Professional Standard include:

- (a) the Superannuation Guarantee (Administration) Act 1992 (Cth)
- (b) the Superannuation Guarantee (Administration) Regulations 2018 (Cth)
- (c) the Superannuation Industry (Supervision) Act 1993 (Cth); and
- (d) the Superannuation Industry (Supervision) Regulations 1994 (Cth).

1.1.6 A Member who provides advice under clause 1.1.1 of this Professional Standard:

- (a) must be an Eligible Actuary; and
- (b) must exercise his or her independent professional judgement and give impartial advice.

Work performed under this Professional Standard is designated as an Applicable Service. As such, the Member's attention is directed towards the requirements of Practice Guideline 1 (General Actuarial Practice).

1.1.7 This version of the Professional Standard incorporates additional conformance changes to align with the Institute's new Code (effective 31 March 2020).

## **1.2 Previous Versions**

- 1.2.1 This Professional Standard replaces the version of Professional Standard 407 (Solvency Management of Defined Benefit Superannuation Funds) issued in May 2010.

## **1.3 About this Professional Standard**

- 1.3.1 This Professional Standard:
- (a) has been prepared in accordance with the Institute's Policy for Developing Documents to Guide and Regulate Professional Practice;
  - (b) must be applied in the context of the Code;
  - (c) binds Members of the Institute when they perform work that the Standard covers; and
  - (d) defines the Institute's requirements for all work the Standard covers.
- 1.3.2 If a Member believes that this Professional Standard is ambiguous or wishes to seek clarification of it, then they may consult the Institute's Professional Standards Committee for an interpretation.
- 1.3.3 If a Member finds that they cannot carry out their work in a way that complies with this Professional Standard then they must either:
- (a) decline to carry out the work; or
  - (b) end their agreement to do so.
- 1.3.4 If a Member does not comply with this Professional Standard, then that may constitute Misconduct under the Institute's Disciplinary Scheme.
- 1.3.5 This Professional Standard does not constitute legal advice. Any interpretation or commentary within this Professional Standard regarding specific legislative or regulatory requirements reflects the expectations of the Institute but does not guarantee compliance under applicable legislation or regulations. Accordingly, Members should seek clarification from the relevant regulator and/or seek legal advice in the event they are unsure or require specific guidance regarding their legal or regulatory obligations.

## **1.4 Other relevant documents**

- 1.4.1 This Professional Standard must be applied in the context of the relevant law, and relevant accounting and auditing standards.
- 1.4.2 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 that Professional Standard.

- 1.4.3 Apart from the Code, from legislation or from 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.
- 1.4.4 If there is a conflict between this Professional Standard and any legislation, then the legislation takes precedence. 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.

## 2. COMMENCEMENT DATE

This Professional Standard applies to FSC's signed on or after 31 March 2020.

## 3. DEFINITIONS

- 3.1 In this Professional Standard:

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

**'Applicable Services'** means Services that are designated in an Institute Professional Standard or Practice Guideline as being Applicable Services.

**'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 Conduct of the Institute.

**'Disciplinary Scheme'** means the document of that name prepared by the Institute setting out the rules and procedures governing professional discipline of a Member, as amended by Council from time to time.

**'Eligible Actuary'** means:

- (a) a Fellow or Accredited Member of the Institute; or
- (b) a Member who is eligible to act in an actuarial capacity pursuant to a requirement under legislation.

**'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).

**'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'.

**'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).

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

**'SG Regulations'** means the Superannuation Guarantee (Administration) Regulations 2018 (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.

3.3 Other capitalised terms used in this Professional Standard have the same meaning as set out in the Code.

#### **4. EFFECTIVE DATE AND EFFECTIVE PERIOD OF A FUNDING & SOLVENCY CERTIFICATE – LEGISLATIVE REQUIREMENTS**

##### **4.1 Effective Date of a new FSC**

4.1.1 Subject to the regulations referred to in clauses 4.1.2 to 4.1.5, SIS Regulation 9.11 provides that the effective date of an FSC:

- (a) may be a date earlier than the date on which the actuary signs the certificate but must not be more than 12 months earlier than that date, however
- (b) if the effective date of the certificate is earlier than the date on which the actuary signs the certificate, the actuary must only sign the certificate if he or she is not aware, and makes a statement in the certificate that he or she is not

aware, of any occurrence between the effective date and the date of signing that would affect the contents of the certificate.

- 4.1.2 Where a new FSC is required as a result of an event referred to in clause 4.3.1(b), SIS Regulations 9.13(5) and 9.14(4) provide that the effective date of the new certificate must be the day after the cessation date of the previous FSC.
- 4.1.3 Where a special FSC is required as a result of the commencement of a period of Technical Insolvency, SIS Regulation 9.18(5) requires that the effective date of the first special FSC must not be more than 9 months earlier than the date on which the actuary signs the certificate.
- 4.1.4 Where a new special FSC is required as a result of a special FSC reaching its expiry date, SIS Regulation 9.18(8) provides that the effective date of the new certificate must be the day after the expiry date of the previous special FSC.
- 4.1.5 Where a new defined benefit fund is established, SIS Regulation 9.11(1) provides that the effective date of the first FSC must be the date on which the fund is established.

#### **4.2 Expiry date of a new FSC**

- 4.2.1 SIS Regulation 9.10(2) provides that the date specified in an FSC (other than a special FSC) as the date on which the certificate expires must be a date that is:
- (a) not less than 12 months; and
  - (b) not more than 5 years;  
after the effective date of the certificate.
- 4.2.2 SIS Regulation 9.18(10) provides that the date specified in a special FSC as the date on which the certificate expires must be 12 months after the effective date.

#### **4.3 When an FSC ceases**

- 4.3.1 Under SIS Regulation 9.12 an FSC ceases on whichever of the following first occurs:
- (a) the expiry date; or
  - (b) the date on which:
    - i. amounts are released to an employer-sponsor of the fund under s117 of the SIS Act; or
    - ii. another FSC takes effect; or
    - iii. a notifiable event occurs in relation to the fund; or
    - iv. an employer-sponsor of the fund fails to pay the contributions as recommended by the actuary; or
    - v. the actuary, in the performance of his or her actuarial functions under the SIS Act or SIS Regulations forms the opinion that the

certificate is no longer appropriate and withdraws the certificate by giving written notice of its withdrawal to the trustee.

#### **4.4 Timing requirements for replacement of a lapsed or expired FSC**

4.4.1 If an FSC other than a special FSC does not lapse as a result of an event referred to in clause 4.3.1(b), SIS Regulation 9.14(2) requires that the certificate must be replaced:

- (c) In the case of a certificate having a term of 4 years or less – on or before the date on which 75% of the term expires; and
- (d) In the case of a certificate having a term of more than 4 years – not less than 12 months before the end of the term.

4.4.2 If a special FSC does not lapse as a result of an event referred to in clause 4.3.1(b), SIS Regulation 9.18(7) requires that the certificate must be replaced within 3 months of its expiry date.

4.4.3 If an FSC or a special FSC has lapsed as a result of an event referred to in clause 4.3.1(b), other than event (ii), SIS Regulations 9.13(3) and 9.14(3) require that the certificate must be replaced within 3 months of its lapse date.

#### **4.5 Multiple notifiable events**

4.5.1 An FSC will lapse on the date a notifiable event occurs and must be replaced by an FSC effective from the day after the lapse date. These requirements are not affected by the subsequent occurrence of an event that would have been a notifiable event if the lapsed FSC was still current. In these circumstances and if considered appropriate, the actuary may be able to specify the notifiable events in the new FSC in such a way that they do not include the subsequent event that has occurred since the effective date. Also note the requirements of clauses 8.1(c) and 8.2 of this Professional Standard in regard to subsequent events.

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

#### **5.1 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.

#### **5.2 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.

### **5.3 Assumptions regarding MRBs**

- 5.3.1 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.
- 5.3.2 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.

## **6. FUNDING AND SOLVENCY CERTIFICATES : NOTIFIABLE EVENTS**

### **6.1 Specifying Notifiable Events**

- 6.1.1 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.
- 6.1.2 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.



- 6.1.3 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.
- 6.1.4 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.
- 6.1.5 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.
- 6.1.6 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).

## **6.2 Notifiable Events to be considered**

- 6.2.1 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.
- 6.2.2 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.
- 6.2.3 The events listed in clauses 6.2.1 and 6.2.2 are not intended to be exhaustive of the events which might be specified by a Member as a Notifiable Event.

## **7. 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).

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

- 8.1 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 8.2 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.
- 8.2 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.

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

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

### **9.1 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).

### **9.2 Means of control**

- 9.2.1 The Responsible Actuary must investigate the reasons for the Technical Insolvency.

- 9.2.2 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.

- 9.2.3 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.

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

### **9.3 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**