

16. Nevertheless, even though the SIS Act requirements permit a restoration period (to a solvent position) of up to 5 years where a fund is technically insolvent, it would be expected that the actuary and trustee would put in place a restoration plan which aimed to restore a SFP within the shortest practical period, which would usually be shorter than 5 years.

C. Monitoring of financial position against shortfall limit

17. SPS 160 states:

“13. The Board must determine and implement a monitoring process designed to detect, on a timely basis, when the fund has, or may have, fallen into an unsatisfactory financial position and/or breached the shortfall limit.

18. SPG 160 states:

23. SPS 160 requires the Board to determine and implement a monitoring process so that deterioration in the defined benefit fund's financial position may be detected in a timely manner. In APRA's view, a monitoring process might include a regular estimate of vested benefits and of the value of fund assets. Alternatively, the process might be based on the regular monitoring of investment returns, with adverse experience triggering an estimate of vested benefits and the value of fund assets. The frequency at which such estimates are undertaken would be expected to increase with market volatility, and may also be related to the margin by which current and projected VBI exceeds 100 per cent. For example, an annual review may be adequate where the fund has a sufficient buffer above 100 per cent VBI, with the sufficiency of the buffer assessed after taking into account the extent to which vested benefits are linked to the investment return on defined benefit assets. Some form of stress testing may be needed to determine the potential impact of movements in investment markets on the fund's VBI level.”

19. Whilst the Board is responsible for determining and implementing a monitoring process, it is likely the actuary will be asked to advise on an appropriate process. It is also possible that the actuary could be involved in preparing or reviewing the figures underlying the VBI calculation.

20. Ideally, the monitoring process will provide appropriate monitoring information on a timely basis without imposing unnecessary additional work.
21. In general, monitoring on a quarterly basis would seem to be appropriate. However, as indicated in SPG 160, for a fund in a strong financial position it may only be necessary to monitor the VBI on an annual basis. (It is also worth noting that Reporting Standard SRS 160.1 ("SRS 160.1") requires vested benefits in respect of defined benefit interests to be reported to APRA quarterly.)
22. SPG 160 indicates that the frequency of monitoring would be expected to increase with market volatility. It is expected that this comment would often relate to where there is an unusually large market fall. Whether additional monitoring is appropriate will depend on factors such as:
 - (a) the frequency of monitoring (if the monitoring is only annual, then it is more likely additional monitoring would be appropriate);
 - (b) the level of the VBI and its sensitivity to adverse investment experience (accumulation components of benefits may reduce the impact of investment experience on the VBI);
 - (c) the investment strategy – additional monitoring is more likely to be appropriate the more sensitive the investment returns are to market falls (for example, a high exposure to listed equities); and
 - (d) the impact of cash flow on the VBI and the risk of having to redeem assets with depressed values to meet short term benefit payments.
23. A reasonable process in such circumstances would be for the trustee to seek the advice of the actuary as to whether it was considered necessary to bring forward the next scheduled monitoring date (say from the end of the current quarter). Where monitoring is quarterly, it is expected that the need to bring forward a quarterly review because of a market downturn would arise very infrequently.
24. It is noted that SPG 160 refers to estimates of vested benefits and assets. There are several areas where it may be appropriate to use estimated values where the VBI is being calculated at a date other than the fund's year end. Examples include:
 - (a) the use of "roll-forward" methods for assets or liabilities;
 - (b) valuing pensions;

- (c) valuing benefit options; and
 - (d) estimating contribution accruals.
25. In determining whether it would suffice for an estimated (rather than actual) value to be used, it is expected that consideration would generally be given to the potential variation between the estimated and actual amounts and the value of the particular item relative to the total value of vested benefits or assets. Another relevant consideration would be how close the VBI is to 100%.
26. It would also generally be expected that:
- (a) the values and estimates used when monitoring the shortfall limit would be consistent with the values and estimates used for reporting under SRS 160.1; and
 - (b) the method of calculating vested benefits and assets, particularly any estimates used, would be consistent from period to period.
27. Other items which could be included as part of the monitoring process are:
- (a) the total minimum requisite benefits ("MRBs") and the coverage of MRBs (the "MRBI"); or
 - (b) an indication of the level of the VBI which would correspond to an MRBI of 100%.

D. Action on breach of shortfall limit

28. SPS 160 states:

"17. An RSE licensee must:

- (a) appoint an RSE actuary to carry out an actuarial investigation for a defined benefit fund as soon as practicable if:
 - (i) it appears to the RSE licensee that the fund is or may be in breach of its shortfall limit; and
 - (ii) a regular investigation scheduled under paragraph 14 is not due for six months or more; or

- (b) seek actuarial advice from an RSE actuary as to whether action should be taken prior to the completion of the next regular investigation if:
- (i) it appears to the RSE licensee that the fund is or may be in breach of its shortfall limit; and
 - (ii) the next regular actuarial investigation under paragraph 14 is due to commence within six months
- unless an investigation is currently taking place, a restoration plan is already in place under paragraph 32 or the fund is technically insolvent."

29. SPG 160 states:

"25. If, during the period between regular investigations, it appears to an RSE licensee that the defined benefit fund is or may be in an unsatisfactory financial position and also is or may be in breach of its shortfall limit, SPS 160 requires that it appoint an RSE actuary to undertake certain actions. If the next regular investigation is not due for six months or more, it may be brought forward. Alternatively, an interim investigation could be undertaken which, at a minimum, must contain a reasonable estimate of vested benefits and of the value of fund assets and a finding as to whether that value breaches the shortfall limit. If the next regular investigation is due within six months, the RSE licensee must seek the advice of an RSE actuary as to whether earlier action should be taken."

D.1 Regular actuarial investigation not due within 6 months (paragraph 17(a) of SPS 160)

30. It is understood that, in paragraph 17(a)(ii) of SPS 160, the words "a regular investigation scheduled under paragraph 14 is not due for six months or more" is intended to be read as "a regular investigation scheduled under paragraph 14 is not due to commence for six months or more", consistent with the wording of paragraph 17(b)(ii) of SPS 160. Further, the date an actuarial investigation is 'due' or 'due to commence' means the 'valuation date', being the effective date of the actuarial investigation as per paragraph 21 of SPS 160.

31. If it appears that the shortfall limit has been breached, and the effective date (valuation date) of the next regular actuarial investigation is not within 6 months, either an interim investigation is required (refer section E of this Information Note) or the next regular actuarial investigation can be brought forward to a date within 6 months. If the latter action is taken, paragraph 17(b) of SPS 160 then applies.
32. Matters to consider in deciding whether or not to recommend bringing forward a regular investigation may include:
 - (a) the availability of sufficiently reliable member and financial data at a suitable date within the next 6 months;
 - (b) whether the fund's annual review date can be used – if not, then if the next regular investigation is brought forward, the following regular investigation period may also need to be shorter than the usual 1 or 3 years;
 - (c) whether the reasons for the shortfall limit breach are apparent – if it is not feasibly due to known or readily identifiable experience (for example, investment returns), a thorough analysis of the financial position via a regular investigation may be desirable; and
 - (d) the requirements of PS 400 and SPS 160 in regard to regular actuarial investigations.
33. It is also noted that a fund found to be in a UFP but above its shortfall limit is not required to establish a restoration plan if the investigation is an interim investigation, but is required to establish a restoration plan if the investigation is a regular investigation.

D.2 Regular actuarial investigation due within 6 months (paragraph 17(b) of SPS 160)

34. If it appears that the shortfall limit has been breached, and the next regular actuarial investigation is due within 6 months, an interim investigation is not required. However, the trustee is required to seek actuarial advice from an RSE actuary as to whether action should be taken prior to the completion of the next regular investigation.
35. A decision to take no action prior to the completion of the next actuarial investigation could mean, in theory, a difference of up to 12 months in the date by which advice must be provided to the trustee.
36. In determining whether action should be taken prior to the completion of the next actuarial investigation, it is expected that the actuary would generally consider, amongst other things:

extension in the period; a change to a later valuation date; earlier provision of data; or a change to data requirements and methodology.

Annexure: Examples re interim investigations

Please refer to the Annexure for a number of practical examples illustrating the application of the requirements of SPS 160 regarding interim investigations.

F. Restoration plan – statements under paragraph 31 of SPS 160

54. Paragraphs 30 and 31 of SPS 160 state as follows:

Unsatisfactory financial position – actuarial requirements

“30. Paragraph 31 applies where an RSE actuary:

- (a) conducting an initial or regular investigation, makes a finding, in the actuarial report of the investigation, that:
 - (i) the fund is to be treated as being in an unsatisfactory financial position; or
 - (ii) the financial position of the fund is likely to become unsatisfactory; or
- (b) conducting an interim investigation makes a finding, in the actuarial report of the investigation, that:
 - (i) the fund is in an unsatisfactory financial position; and
 - (ii) the fund is in breach of its shortfall limit

unless a restoration plan is already in place under paragraph 32 or the fund has been declared to be technically insolvent under regulation 9.16(1) of the SIS Regulations.

31. An RSE actuary must, in the situations identified in paragraph 30:

- (a) prepare a statement that, at a minimum:
 - (i) describes the recommended actions to be taken to address the financial position; and

- (ii) contains a recommendation, or sets a date by which a recommendation will be made, in respect of a contribution rate or level that, on reasonable expectations, will restore the fund to, and maintain it in, a satisfactory financial position, within a time period that is reasonable in the circumstances of the fund but which must not exceed three years from the valuation date, or, in the case of an interim investigation, the later of the valuation date and the date the RSE licensee determined that an interim investigation was required under paragraph 17; and
- (b) provide the statement to the RSE licensee as soon as practicable and, in any event, within 15 business days of making a finding, in the actuarial report of the investigation, that the financial position is to be treated as unsatisfactory, or is likely to become unsatisfactory or that the shortfall limit has been breached.

F.1 Paragraph 30 of SPS 160 – regular investigations

55. In the absence of any contrary guidance from APRA, the SPC considers that, for the purposes of paragraph 30(a)(i) of SPS 160, it would be appropriate for a fund to be treated as being in a UFP if:

- (a) in the actuary's opinion, the fund was in a UFP at the valuation date and the actuary has not determined that the fund has returned to a SFP by the date the report is signed; or
- (b) in the actuary's opinion, the fund was in a SFP at the valuation date, but has since fallen into a UFP and the actuary has not determined that the fund has returned to a SFP by the date the report is signed

where UFP and SFP are as defined in paragraph 8 and footnote 6 of SPS 160.

56. Paragraph 30(a)(ii) of SPS 160 refers to a finding that 'the financial position of the fund is likely to become unsatisfactory'. Neither SPS 160 nor SPG 160 provide any clarification as to what is meant by 'is likely to become unsatisfactory'. In the absence of any contrary guidance from APRA, the SPC's view is that it would be appropriate for a fund to be considered 'likely to become unsatisfactory' if it would be considered that it "may be

about to become unsatisfactory” as set out in SIS Regulation 9.03(1); that is, essentially this requires an assessment of whether the fund is projected to fall into a UFP at any time over the three years from the valuation date, based on ‘the actuary’s reasonable expectations’. (Note that, although SIS Regulation 9.03(1) refers to an assessment at the end of the specified three year period, PG 499.03 indicates that actuaries should interpret this as a continuous test.)

57. In the event that the fund is not currently in a UFP but is projected to fall into a UFP within the next three years:
- (a) it may be possible to modify the recommended contribution program so that a projected UFP is avoided; in this case, neither paragraphs 30(a)(i) or (ii) of SPS 160 would apply and so a restoration plan would not be triggered;
 - (b) if (a) is not possible, it would appear that a restoration plan would be required (even though the fund is not currently in a UFP). It is suggested that a reasonable interpretation of paragraph 31(a)(ii) of SPS 160 in these circumstances is that the remedial contribution program would need to be directed to achieving a projected SFP three years after the valuation date (or such earlier date as is reasonable in the circumstances).

F.2 Paragraph 30 of SPS 160 – interim investigations

58. In the case of an interim investigation where the fund is in a UFP **and** in breach of its shortfall limit, paragraph 31 of SPS 160 will be triggered (unless a restoration plan is already in place or the fund has been declared to be technically insolvent) at the date the interim investigation report is completed and signed with these findings (“Report Date”). (Also refer to Sections E.2 and E.3 of this Information Note regarding the need for the findings to take account of subsequent events from the investigation date up to the date of the report.)
59. In the case of an interim investigation, note that paragraph 31 of SPS 160 is not triggered if the fund (i) is in a UFP but has not breached its shortfall limit or (ii) has breached its shortfall limit but is not in a UFP. This latter provision is presumably to cater for cases where a shortfall limit of more than 100% is breached (in practice, it is expected that shortfall limits of more than 100% will be either rare or non-existent).

F.3 Paragraph 31 of SPS 160 – UFP statements

60. Paragraph 31 of SPS 160 requires an actuary finding an existing or likely future UFP in the circumstances referred to in paragraph 30 of SPS 160, to prepare a statement setting out recommended actions to address the UFP (“UFP Statement”).

F.3.1 Timing of UFP Statement – interim investigation

61. The actuary will be required to issue the UFP Statement within 15 business days of the Report Date. The trustee will then have three months from the date it receives the UFP Statement ("UFP Statement Date") to develop and approve a restoration plan under paragraphs 32 and 33 of SPS 160.
62. Paragraph 31 (a)(ii) of SPS 160 allows the actuary to include in the UFP Statement 'a date by which a recommendation will be made' in regard to the remedial contribution program, rather than including a recommended remedial contribution program in the UFP Statement. However, note that taking this option will not extend the date by which the trustee must approve a restoration plan under paragraphs 32 and 33 of SPS 160 – this is three months from the UFP Statement Date even when the UFP Statement does not include contribution recommendations.
63. Note also that, in the case of an interim investigation, the maximum three year restoration period starts at the later of the investigation date and the date the trustee determined that an interim investigation was required. As such, the time taken to prepare the investigation report and the UFP Statement and any subsequent contribution recommendations will absorb part of, rather than push out, the maximum three year restoration period.

F.3.2 Timing of UFP Statement – regular investigation

64. Note that paragraph 31 of SPS 160 is not triggered until the investigation report is issued with a relevant finding. This is likely to be some time after the actuary becomes aware that the fund is in a UFP. In such cases, it is expected that the actuary would consider whether it is appropriate to make any interim recommendations pending completion of the investigation and the report (refer to Section D.2 of this Information Note for comments on possible issues to consider). There may also be time for consultation with the trustee and employer on the remedial contribution program and other potential recommendations before the report is finalised, which may streamline the preparation and implementation of the restoration plan under paragraph 32 of SPS 160. It is noted that any delays in finalisation of the report would not extend the latest end date of the restoration program, which is three years from the valuation date.
65. In the absence of any contrary guidance from APRA, the SPC considers that, for regular investigations:
 - (a) a UFP Statement could be issued ahead of the completion of the investigation report; or

- (b) if the approach in the preceding paragraph (a) is not applied, the recommended actions and recommended remedial contribution program required under paragraph 31 of SPS 160 must be included in the investigation report; that is, the reference in paragraph 31(a)(ii) of SPS 160 to 'or set a date by which a recommendation will be made' and paragraph 31(b) of SPS 160 are overridden by the requirement in paragraph 23(d) of SPS 160 that, if the actuary finds that the financial position is to be treated as unsatisfactory, the report must contain the information set out in paragraph 31(a) of SPS 160.

- 66. In the case described in paragraph 65(b) above, the UFP Statement will be in the investigation report and so the trustee will have three months from the date it receives the report to develop and approve a restoration plan under paragraphs 32 and 33 of SPS 160.

F.3.3 Contents of UFP Statement

- 67. Paragraph 31(a)(i) of SPS 160 refers to the actuary's recommended actions to address the UFP. Potential topics for recommendations might include:

- (a) contribution rates (dealt with specifically in paragraph 31(a)(ii) of SPS 160);
- (b) frequency of contributions and the date by which each contribution should be paid;
- (c) benefit payments – in some cases, this may include recommendations regarding temporary or permanent deferral or reduction of benefit payments (note also paragraph 32(c) of SPS 160 in this respect). In other cases, monitoring of the level of benefit payments may be recommended with either specified top-up contributions or referral to the actuary for assessment of the need to bring forward top-up contributions when exits occur (refer sections G.1 and G.2 of this Discussion Note for further comments);
- (d) crediting rates, where the rates are in the control of the actuary and/or the trustee;
- (e) investment strategy (for example, if substantial benefit payments are expected in the short-term or there are other reasons why it may be appropriate for the actuary to recommend a change to a lower volatility strategy for some or all of the DB assets). (Note also that paragraph 33(b) of SPS 160 requires the trustee to consider the investment strategy and the need to balance long-term and short-term requirements in this respect. For example, while a highly equity-oriented investment policy may lead to a lower long-term cost, it is also likely to lead to more volatile investment returns.);

- (f) insurance strategy or level of insurance;
 - (g) exercises of discretion (for example, in relation to higher benefits on leaving service or indexation of pensions); and
 - (h) monitoring process during the restoration period and action if progress is unsatisfactory.
68. Paragraph 31(a)(ii) of SPS 160 sets out a timeframe for the restorative contribution plan, being a period that 'is reasonable in the circumstances of the fund' and no longer than three years from the valuation date (or in the case of an interim investigation, three years from the date the trustee determined that an interim investigation was required, if later).
69. The Actuaries Institute suggests that the strategy should seek to restore the fund to a satisfactory position as soon as is practical and that the actuary's primary concern in advising on such a strategy must be for the overall security of the members' benefits. While PS 400 does not apply to interim actuarial investigations, much of the PS 400 guidance on the setting of contribution rates will also be relevant to interim actuarial investigations.
70. There will be some difficulties in balancing competing aims, particularly where the actuary's recommendation might precipitate a wind-up of the fund or some other action which is clearly contrary to members' interests. In such situations, paragraphs 32 and 34 of SPS 160 hopefully provide scope for a revised program acceptable to all parties to be agreed.
71. It may be desirable for the recommended restoration contribution program and period to be designed having regard to the feasibility of options for adjusting the restoration plan in the event of adverse experience. For example, setting an initial remedial contribution program that is expected to restore a SFP in a period shorter than three years may afford greater flexibility to respond to adverse experience – in particular, an extension of the additional contribution program might be less problematic for the employer than would be an earlier step-up in the level of contributions caused by poor experience.

G. Restoration plan – trustee requirements

72. Paragraph 32 of SPS 160 states (*paraphrase* and **emphasis** added):

"32. When an RSE licensee receives a statement from the RSE actuary under paragraph 31, the RSE licensee must:

- (a) provide a copy of the statement to APRA ... (*within 15 business days*);
- (b) consult with each employer-sponsor (as relevant) about the content and implementation of the recommendations of the RSE actuary, which may include an increase in the contribution rate or rates or change to the pattern or frequency of contribution payments;
- (c) appoint an RSE actuary to be responsible for provision of advice to the RSE licensee in regard to actuarial management during the period in which the fund is in an unsatisfactory financial position, including advice as to whether, under the governing rules of the fund, there can be any reduction in the amount of any benefit payments from the fund, or deferral of payment of any part of the benefit, during the period;**
- (d) set out a plan (restoration plan) to return the fund to a satisfactory financial position ... (*which*) may be developed in consultation with the employer-sponsor and the RSE actuary and must be approved by the Board within three months of receiving the statement (*under paragraph 31*) from the RSE actuary;
- (e) provide a copy of the restoration plan to APRA and the RSE actuary ... (*within 15 business days*); and
- (f) implement the restoration plan ..."

73. Paragraphs 27 to 32 of SPG 160 provide guidance on requirements for a restoration plan.

G.1 Actuarial management during restoration period and dealing with exits (paragraph 32(c) of SPS 160)

74. Whilst 'actuarial management' is not defined, this requirement appears to mirror the requirement in SIS Regulation 9.19(3) that the trustee of a technically insolvent fund must appoint an actuary to be responsible for the 'actuarial management' of the fund during the period of technical insolvency.

75. In the context of a UFP, 'actuarial management' presumably includes the process by which the actuary works with the trustee to monitor and review the progress of the

restoration plan in accordance with paragraph 33(d) of SPS 160, but could also include advice relating to the other aspects listed in that paragraph in respect to the restoration plan (that is, contributions, investment strategy and benefit payments), as well as other matters which impact (or may impact) on the plan's financial position such as crediting rates (where applicable) and the fund's insurance strategy or arrangements.

76. Another matter which may be relevant is whether there is a need for a review of the shortfall limit after the fund has returned to a SFP, or whether the current shortfall limit is still considered appropriate.
77. The following comments are provided to assist actuaries in formulating advice relating to the treatment of benefit payments during a UFP:
 - (a) "including advice as to whether, under the governing rules of the fund, there can be any reduction in the amounts of any benefit payments ... or deferral of payment of any part of the benefit ...". This apparently requires the RSE actuary to interpret "the governing rules of the fund" in regard to reduction or deferral of benefit payments;
 - (b) "reduction" would typically not be allowed except in specifically defined circumstances, for example fund termination or cessation of employer contributions. Where the RSE actuary is of the view that "reduction" is (or may be) permitted under the fund's governing rules in the circumstances of the current UFP, it would generally be prudent to seek legal advice to confirm the position and, if reductions are recommended, to assess from a legal viewpoint the suitability of the proposed process for determining and applying reductions. The RSE actuary could reasonably expect that the trustee obtains this legal advice;
 - (c) note that, whilst SIS Regulation 9.19(4) gives the actuary power to restrict benefit payments from a technically insolvent fund, there is no corresponding power under the SIS Act for the actuary to restrict benefit payments from a fund which is in a UFP but not technically insolvent;
 - (d) in practice, it is likely that an ongoing fund is more likely to consider the "deferral of payment of any part of the benefit" provision in paragraph 32(c) of SPS 160. Again, it would generally be prudent for the RSE actuary and the trustee to seek legal advice to confirm whether, and in what circumstances, the fund's governing rules may allow such deferral. Furthermore, clarification would be required from APRA as to the applicability of the 3-day portability rollover requirements under the SIS Act in these circumstances. Whilst defined benefits are exempt from the portability requirements, it is likely that this exemption would not extend to lump

sum defined benefits that have crystallised due to termination of service – and usually these will be the very benefits that the actuary would recommend be subject to deferral (in full or part). Hence specific approval may be required from APRA to facilitate any deferral of benefit payments;

- (e) if recommending reduction or deferral of benefit payments, the actuary may need to consider the treatment of both accumulation benefits and defined benefits;
- (f) except for particular defined benefit funds where short-term benefit payments may have a material impact on funding, it would not usually be necessary to reduce or defer benefit payments even where permitted by the Trust Deed if a restoration plan is able to be put in place that is expected to return the fund to a SFP;
- (g) even where short-term benefit payments may have a material impact on funding, if the contribution portion of the restoration plan builds in a process for identifying whether or not special 'top-up contributions' are required from the employer when benefit payments occur, then no "reduction" or "deferral" of benefit payments may be necessary. Examples of suitable arrangements may include:
 - (i) for each benefit payment, the employer is to pay a top-up contribution equal to the estimated underfunded portion of the benefit adjusted for tax (for example, top-up contribution = benefit amount x (100% - VBI%) / 0.85). The VBI% to use in each case would be as recommended by the actuary (for example, based on the estimated VBI% around the time of the exit or at the end of the previous quarter). (An estimated VBI is prepared on a quarterly basis for APRA reporting purposes.) The top-ups could be paid at the time of each exit or, depending on the number of exits and the trustee's view about the willingness and ability of the employer to meet the top-up payments, quarterly in arrears or on such other basis as is considered appropriate by the trustee; or
 - (ii) where the restoration plan requires specific additional contributions to be made on a regular basis to restore a SFP, it may be agreed that a top-up contribution for an exit would only be required where the aggregate of the additional contributions paid during the restoration plan does not exceed the aggregate of a calculation similar to that in the preceding paragraph in respect of all benefit payments made during the restoration plan.

This approach is based on the premise that, at least in some cases, it should be acceptable for the regular additional contributions agreed as part of the

restoration plan to be regarded as being used first to fund any shortfalls in respect of exits during the restoration period. This approach has the following advantages:

- (1) the employer is more likely to agree to a higher regular additional contribution program as it reduces the likelihood of additional calls being made on the employer (compared with requiring a top-up for each exit); and
- (2) it is administratively simpler than requiring specific top-ups for each exit.

The main disadvantage is that it can result in a poorer outcome for remaining members should the fund wind-up before a SFP has been restored. Hence, in considering this approach, the trustee's view about the willingness and ability of the employer to meet the restoration plan will be important.

Variations on this approach would include:

- (1) an assessment on the above basis (that is, regular additional contributions versus shortfalls on exits) for each quarter, rather than looking back over the whole prior period of the restoration plan; and
 - (2) counting a proportion (for example, 50%) of regular additional contributions as being available to fund any shortfalls on exits;
- (iii) usually top-ups on exit would only relate to defined benefits, but there may be some circumstances where, having regard to the size of the deficit, the likelihood of wind-up and relative priorities on wind-up, the actuary may recommend that the trustee also consider requiring top-ups for accumulation benefit payments;
- (iv) additional top-up contributions relating to exits – to the extent that they relate to vested benefits (refer to the next paragraph for other examples) – will reduce the deficit and effectively constitute a 'bringing forward' of part of the future regular additional contributions in the restoration plan. Hence, it would be acceptable for such top-up contributions to be offset against future regular additional contributions. For example, if exit top-up contributions of \$100,000 were required at the end of a quarter and regular additional contributions were \$50,000 per month, then two months of regular additional contributions could be brought forward and paid early to cover the exit shortfall, rather than the \$100,000 being paid in addition to the scheduled regular additional contributions. (Obviously, it would be

preferable, from a security of member benefits viewpoint, if the \$100,000 was paid in addition to the scheduled regular additional contributions, as this would bring forward the expected date of return to a SFP.);

- (v) where there are benefit options or discretions (for example, to receive an early retirement benefit with employer consent between age 55 and 60) which result in benefit payments in excess of the vested benefit, a special top-up contribution may be appropriate equal to the difference in benefit amount, adjusted for tax. Retrenchment benefits may be another example of where this type of special top-up contribution may be appropriate;
 - (vi) another special situation is the potential termination of a DB fund which has only 1 or 2 remaining members and the employer is keen to ensure that fund assets do not exceed the remaining members' benefits plus fund wind-up costs (due to difficulties in recovering any surplus assets after the last DB member terminates). Note that any variation from the requirements of SPS 160 in such situations would require APRA approval; and
- (h) the "deferral" of benefit payments, if permitted under the governing rules and legislation (see comments above), may be considered appropriate until any associated top-up contributions are paid (for example, in the various scenarios outlined in paragraphs 77(g)(i)-(vi) above. However, the trustee is expected (refer paragraph 18 of SPG 160) "to assess the financial strength of the employer-sponsor(s) and their willingness and capability to pay contributions ...". This assessment will presumably assist in determining whether "deferral" of any benefit payment, or part thereof, would be considered prudent.

G.2 Contents of restoration plan and monitoring process (paragraph 33 of SPS 160)

78. Paragraph 33 of SPS 160 states:

"33. At a minimum, a restoration plan must outline:

- (a) the RSE licensee's view of the likelihood that contributions will be made as recommended, taking into account the obligations of each employer sponsor under the governing rules of the fund, and the outcome of the RSE licensee's consultation with each employer-sponsor;
- (b) any changes to the investment strategy of the fund determined by the RSE licensee to be necessary;

- (c) the likely impact on benefit payments during the period of the plan; and
- (d) the process by which the RSE actuary and the Board will monitor and review progress towards restoration of the fund to a satisfactory financial position."

79. Paragraphs 34 to 37 of SPG 160 provide guidance on monitoring and adjustment of a restoration plan.
80. Paragraph 33 of SPS 160 sets out the minimum requirements for a restoration plan. It does not mention including the recommended contribution program (perhaps it was considered unnecessary to mention this), but clearly this will be a key component of the restoration plan. In this respect it is expected that the restoration plan would usually set out:
- (a) the recommended rate(s) and/or amount(s) of employer contributions to be paid during the restoration plan;
 - (b) the date by which each contribution should be paid; and
 - (c) whether special top-up contributions are or may be required in respect of benefit payments (see further comments in section G.2.3 of this Information Note).
81. As well as the monitoring process, the restoration plan may also set out the process and timing for determining and making adjustments to the contribution program in response to variations in experience from the assumptions made in setting the initial remedial contribution program (refer section G.3 of this Information Note).
82. Sub-paragraph 33(c) of SPS 160 relates to 'the likely impact on benefit payments'. Refer to Section G.1 of this Information Note for comments on consideration of the possible treatment of benefit payments. It seems desirable that the treatment determined be set out in the restoration plan. It would also seem desirable for the recommended contribution program set out in the restoration plan to include:
- (a) if, and when, top-up contributions would be required on exits (which may differ between types of exit);
 - (b) how, and when, those top-up contributions would be determined; and
 - (c) by when the top-up contributions would be due to be paid.

83. In regard to sub-paragraph 33(d) of SPS 160 (the process for monitoring and reviewing progress towards restoration of a SFP), the remaining material in this Section may assist actuaries in providing advice to the trustee.

G.2.1 Monitoring of payment of contributions

84. It will be particularly important during a UFP that the trustee's process for monitoring that contributions are paid as recommended works effectively and on a timely basis. A reminder process may be appropriate in advance of the latest payment date, particularly if there are additional contributions with a timing different from regular contributions.

85. It seems desirable that the escalation process where contributions remain unpaid at the due date be clear and include notification to the actuary, as:

- (a) the actuary may be required to notify APRA; and
- (b) non-payment or late payment may result in lapsing of the funding and solvency certificate and/or a need to review the restoration plan.

G.2.2 Monitoring of financial position/experience

86. What is monitored?

- (a) Financial position and/or experience: The monitoring process may include an updated estimate of the DBVBI or simply whether investment experience (and possibly the level of benefit payments – see Section G.2.3 below) is within an acceptable range specified by the actuary.
- (b) This monitoring could be done by the actuary or by the trustee. In the latter case, possible approaches include:
 - (i) for the actuary to define what experience items need to be monitored and what results would require referral to the actuary for further actuarial assessment; or
 - (ii) for the results for each quarter to be referred to the actuary and the actuary to then advise whether any action is required.

87. How frequently?

- (a) Normally, quarterly might be considered an appropriate frequency.

- (b) Trigger points for an additional review within a quarter could be set if considered necessary or appropriate (for example, benefit payments for the quarter to date in excess of \$Y or a fall in the ASX200 of X% or a fall in the ASX200 of X% **and** benefit payments for the quarter to date in excess of \$Y). This could be a Information point with the trustee and employer – for example, even where no immediate action is considered to be required, the employer may prefer early warning that an event has occurred which may require a review of the restoration program or greater top-ups for exits.

G.2.3 Monitoring of the level of benefit payments

88. This may be particularly important for small funds. For example, in some funds where a single payment could be material, the actuary may wish to be notified of each exit (depending on the level of the VBI) so that the need for any top-up contribution can be assessed on a timely basis (see section G.1 of this Information Note).
89. For larger funds, quarterly may be considered appropriate or it may be sufficient for actuarial advice to be sought only if there are special events which may result in abnormally high levels of benefit payments (such as a retrenchment program).

G.3 Restoration plan amendments (paragraph 35 of SPS 160)

90. Paragraph 35 of SPS 160 states:

35. During the period that a restoration plan is in effect, and if it appears that the funding position is not likely to be restored by the end of the period, APRA may, at a minimum:
- (a) permit a variation to the period in which the funding position is expected to be restored;
 - (b) require the RSE licensee to seek further actuarial advice;
or
 - (c) vary any reporting requirements imposed under paragraph 34.

91. Paragraphs 34 to 37 of SPG 160 provide guidance on monitoring and adjustment of a restoration plan.
92. Listed below are some considerations that may be relevant in determining when and how the recommended contribution program is to be adjusted:

- (a) in some cases, it may suit the employer and trustee for the contribution program to be adjusted following each quarterly review. However, in many cases, such frequent adjustments to the level of current contributions are likely to be considered undesirable (and possibly unworkable for some employers) due to budget constraints and/or administrative inefficiency;
 - (b) particularly where the investment strategy has significant exposure to listed growth assets, it should be recognised that fluctuations are expected to occur and that there may be gains in one quarter that are offset by losses in another quarter. As such, the trustee and employer may agree that no adjustments will be made unless certain triggers occur, or that once yearly adjustments may be appropriate and practical;
 - (c) there is a potential argument that the level of current contributions should only ratchet upwards, as presumably the existing contribution program is affordable and the objective is to return to a SFP as soon as practicable. On this rationale, positive experience would result in a contraction of the expected restoration period rather than a reduction in the level of current contributions. By contrast, if there was adverse experience resulting in the expectation that the program was likely to fall short of restoring a SFP within 3 years (or lower target period), an increase in the level of recommended contributions would be required;
 - (d) however, in practice, there may be cases where the employer is only willing to agree to a restoration plan on the basis that positive experience would (at agreed review points) permit a reduction in the level of current contributions rather than a contraction of the expected restoration period. Member should also note that SPG 160 indicates that adjustments may take place in response to over-performance as well as under-performance (refer paragraph 36 of SPG 160);
 - (e) another possible arrangement would be for the remedial contribution program to be set to target a return to a SFP in a period shorter than 3 years (for example, 2.5 years) with agreement that the period could extend up to a further 6 months if further adverse experience occurs (refer to the example set out in paragraph 95 below); and
 - (f) the need for APRA approval in some circumstances (refer the commentary in paragraphs 93 and 94 below).
93. APRA approval for some adjustments may be required. In particular, paragraph 35 of SPS 160 requires APRA approval of any extension to the duration of a restoration plan.

94. As noted in Section G.2 of this Information Note, in some cases the restoration plan may specify the process and timing for determining and making adjustments to the contribution program in response to variations in experience from the assumptions made in setting the initial remedial contribution program. Where an adjustment to the contribution program is in accordance with the restoration plan previously submitted to APRA (including any variations to that plan that were required or permitted by APRA), it is understood that the adjustment would not require APRA approval.
95. For example, say the valuation date of the interim investigation is 31 December 2019 and the latest end date permitted for the restoration plan under SPS 160 is 31 December 2022. The employer indicates that it is willing to commit to additional contributions of up to \$100,000 per month. The actuary determines that, on reasonable assumptions, additional employer contributions of \$100,000 per month from 1 April 2020 would be expected to restore a SFP by 31 March 2022 (that is, 24 months of additional employer contributions of \$100,000 per month). The employer indicates that, if there is adverse experience, it will not be able to increase the additional contributions paid up to March 2022, but expects to be able to continue making the additional contributions of \$100,000 per month beyond March 2022 if required to restore a SFP. It is therefore agreed that the additional employer contribution component of the restoration program will be additional employer contributions of \$100,000 per month until the earlier of 31 December 2022 and the date that a SFP is restored.
- (a) If APRA does not seek any variation to this aspect of the restoration plan under paragraph 34 of SPS 160, then it is understood that APRA approval under paragraph 35 of SPS 160 would not be required unless the trustee wished to extend the duration of the restoration plan beyond 31 December 2022.
- (b) If, on the other hand, the restoration plan was simply to restore a SFP by additional employer contributions of \$100,000 per month for the 24 months beginning 1 April 2020, it appears that APRA approval under paragraph 35 of SPS 160 would be required to extend the restoration plan beyond 31 March 2022.
96. Note that paragraph 35 of SPS 160 only applies if “it appears that the funding position is not likely to be restored by the end of the period” and hence APRA approval does not appear to be required either to:
- (a) increase the additional employer contributions so that a SFP is restored by March 2022; or
- (b) cease the additional employer contributions before March 2022 in the event that a SFP is restored earlier than initially expected.

97. However, it is noted that paragraph 37 of SPG 160 indicates that APRA 'would expect early contact from an RSE licensee seeking a variation to the duration of the plan, or an early end to the plan'. The SPC understands that APRA expects that it would be notified if there is an increase in, or a cessation of, contributions.

H. Self-insured funds

98. Paragraphs 36 and 37 of SPS 160 set out requirements for funds which self-insure insured benefits. The SPC has issued a separate Information Note *Self-insurance Arrangements and Superannuation Prudential Standard 160* to assist actuaries deal with these requirements.

END OF INFORMATION NOTE

Annexure: Examples re interim investigations

The following examples are provided to assist RSE actuaries to understand the requirements of SPS 160 regarding interim investigations.

Fund information

The Fund is a complying funded defined benefit superannuation fund that does not have any pensioners. The annual review date is 1 July (it is problematic for accurate member and asset data to be obtained at other dates) and the effective date for the next regular actuarial investigation (triennial) is 1 July 2020.

The Fund has a shortfall limit of 98% and therefore, if the shortfall limit is breached, the Fund is also in an unsatisfactory financial position. Prior to the market crash referred to below, the Fund was in a satisfactory financial position and no restoration plan was in place.

The examples below assume that:

- ▶ a market crash has occurred which immediately caused the Fund to breach its shortfall limit; and
- ▶ there has not been a subsequent turnaround in markets which would change this situation.

General reporting requirements

Where the RSE actuary provides a regular valuation report, the report must include, at a minimum, the items listed in paragraph 23 of SPS 160. Where the RSE actuary provides an interim investigation report, the report must contain, at a minimum, a reasonable estimate of the value of assets and whether that value is in breach of the shortfall limit.

If either:

- ▶ a triennial valuation report is being provided and the financial position of the Fund is, or is likely to become, unsatisfactory; or
- ▶ an interim investigation report is being provided and the Fund is in an unsatisfactory financial position and in breach of its shortfall limit,

then the report will be required to include the statement required by paragraph 31 of SPS 160, unless:

- ▶ this statement has been provided earlier; or

- ▶ in the case of an interim investigation report, the paragraph 31 statement is to be provided within 15 business days of the report; or
- ▶ the Fund has become technically insolvent (in which case the SIS Regulations relating to technically insolvent funds must be followed).

Example 1: Market crash between 1 January 2020 and 30 June 2020

The RSE Licensee determines that the shortfall limit is likely to have been breached. However, as the next regular actuarial investigation (triennial) is due within 6 months, an interim investigation is not required. The RSE Licensee is required to seek advice as to whether any action is required before the 1 July 2020 triennial actuarial investigation is completed. The triennial investigation report must be provided by 31 December 2020.

The latest end date for the restoration period (if required and unless otherwise approved by APRA) will be 30 June 2023, being 3 years after the valuation date.

Example 2: Market crash between 1 July 2020 and 31 December 2020 and regular actuarial investigation (triennial) has not yet been completed

The RSE Licensee determines that the shortfall limit is likely to have been breached. However, as an investigation is currently taking place (the triennial investigation as at 1 July 2020), an interim investigation report is not required. The triennial actuarial investigation will be required to consider post-valuation events, including the impact of the market crash. The RSE actuary may make interim recommendations if considered necessary prior to completion of the triennial investigation.

The latest end date for the restoration period (if required and unless otherwise approved by APRA) will be 30 June 2023, being 3 years after the valuation date.

Example 3: Market crash between 1 July 2020 and 31 December 2020 and regular actuarial investigation (triennial) has been completed beforehand

The RSE Licensee determines on a particular day after the market crash (the "Breach Identification Date", which is assumed to be on or before 31 December 2020) that the shortfall limit is likely to have been breached. The RSE Licensee and the actuary agree that it is not appropriate to bring forward the next regular actuarial investigation (triennial due as at 1 July 2023). An interim investigation will be required. The RSE Licensee and the actuary discuss options for the valuation date of the interim investigation. These include:

- (a) 1 July 2020, using the triennial investigation data and results updated to allow for significant post-valuation date experience (including the market crash). The report is

required to include an estimate of assets and vested benefits at the valuation date of 1 July 2020 which will be readily available from the triennial investigation report. As indicated in Section E of this Information Note, in this case it seems desirable that the report also include an estimate of the DBVBI at a date subsequent to the market crash, to support the findings in regard to the position of the Fund at the report date (that is, whether it is in an unsatisfactory financial position and in breach of its shortfall limit). The report will be required to be completed no later than 3 months after the Breach Identification Date. Based on paragraph 15(b) of SPG 160, APRA would expect that the report will be completed no later than 31 December 2020, being six months after the valuation date.

The latest end date for the restoration period (if required and unless otherwise approved by APRA) will be 3 years after the Breach Identification Date;

- (b) the earliest convenient date on or after the Breach Identification Date, using the triennial investigation data and results updated to allow for significant experience over the period from 1 July 2020 to the valuation date chosen (including, in particular, investment experience).

Say the valuation date chosen is 31 December 2020. The report is required to include an estimate of assets and vested benefits at 31 December 2020. The report will be required to be completed by no later than 3 months after the valuation date (that is, 31 March 2021). The RSE actuary may make interim recommendations if considered appropriate prior to completion of the interim investigation. (Note that the RSE Licensee would need to be satisfied that using a valuation date of 31 December 2020 was justifiable in terms of the requirement that the interim investigation be carried out as soon as practicable.)

The latest end date for the restoration period (if required and unless otherwise approved by APRA) will be 31 December 2023, being 3 years after the valuation date.

Example 4: Market crash between 1 January 2021 and 30 June 2021 after regular actuarial investigation (triennial) has been completed (or between 1 January 2022 and 30 June 2022)

The RSE Licensee determines on a particular day after the market crash (the “Breach Identification Date”, which is assumed to be on or before 30 June in the relevant year) that the shortfall limit is likely to have been breached. The RSE Licensee and the actuary agree that it is not appropriate to bring forward the next regular actuarial investigation (triennial due as at 1 July 2023). An interim investigation will be required. The RSE Licensee and the actuary discuss options for the valuation date of the interim investigation. These include:

- (a) the earliest convenient date on or after the “Breach Identification Date” but before 30 June, using the prior 1 July annual review data (being the latest available) and a ‘roll-forward’ method to estimate assets and vested benefits at the valuation date. The report will be required to be completed no later than 3 months after the valuation date.

The latest end date for the restoration period (if required and unless otherwise approved by APRA) will be 3 years after the valuation date;

- (b) 1 July 2021 (2022), using the updated data from the annual review at that date. The report is required to include an estimate of assets and vested benefits at the valuation date. The report will be required to be completed by no later than 30 September 2021 (2022). The RSE actuary may make interim recommendations if considered appropriate prior to completion of the interim investigation. (Note that the RSE Licensee would need to be satisfied that using a valuation date of 1 July 2021 (2022) was justifiable in terms of the requirement that the interim investigation be carried out as soon as practicable.)

The latest end date for the restoration period (if required and unless otherwise approved by APRA) will be 30 June 2024 (2025), being 3 years after the valuation date.

Example 5: Market crash between 1 July 2021 and 31 December 2021 (or between 1 July 2022 and 30 June 2022)

The RSE Licensee determines on a particular day after the market crash (the “Breach Identification Date”, which is assumed to be on or before 31 December in the relevant year) that the shortfall limit is likely to have been breached. The RSE Licensee and the actuary agree that it is not appropriate to bring forward the next regular actuarial investigation (triennial due as at 1 July 2023). An interim investigation will be required.

As accurate member and asset data is generally only available at 1 July and the next annual review is more than 6 months away, the main option is to:

- ▶ choose the earliest convenient valuation date on or after the Breach Identification Date; and
- ▶ use the previous 1 July data and a ‘roll-forward’ method to estimate assets and vested benefits at the valuation date.

The due date for the report will be no later than 3 months after the valuation date.

The latest end date for the restoration period (if required and unless otherwise approved by APRA) will be 3 years after the valuation date.

Example 6: Market crash between 1 January 2023 and 30 June 2023

The RSE Licensee determines that the shortfall limit is likely to have been breached. However, as the next regular actuarial investigation (triennial) is due within 6 months (that is, as at 1 July 2023), an interim investigation is not required. The RSE Licensee is required to seek advice as to whether any action is required before the regular actuarial investigation is completed. The triennial investigation report must be provided by 31 December 2023.

The latest end date for the restoration period (if required and unless otherwise approved by APRA) will be 30 June 2026, being 3 years after the valuation date.

END OF ANNEXURE