



# Institute of Actuaries of Australia

9 May 2001

Mr J Cosgrove  
Review of Certain Superannuation Legislation  
Productivity Commission  
PO Box 80  
Belconnen ACT 2616

Dear John

The Institute of Actuaries of Australia (IAAust) is pleased to make this submission to the Productivity Commission's Inquiry into the *Review of Superannuation Industry (Supervision) Act 1993 and Certain Other Superannuation Legislation*.

Actuaries have a long history of involvement and innovation in the Australian superannuation system. The specialized training of actuaries in finance, mathematics and demography are fundamental to the central role that actuaries play in superannuation. This includes advising on the design and funding of sound superannuation arrangements to provide retirement incomes for plan members.

We believe that, given the importance of a sound superannuation system, a reasonable level of regulation of the system is required. Broadly speaking, the regulatory system that is currently in place (and is largely given legislative effect by the SIS Act and associated regulations) provides an appropriate level of regulation.

In particular, we believe the SIS Act appropriately recognises the special role of actuaries by requiring certain activities to be conducted only by members of IAAust. In our view, the mandatory involvement of actuaries in relevant areas increases the security of members' superannuation benefits, and the benefits of actuarial involvement generally outweigh any additional cost of compliance incurred.

There are aspects of the detail of the SIS legislation that we believe could be simplified or improved, leading to reductions in compliance costs. Although beyond the scope of this particular inquiry, similar comments apply in respect of some aspects of the Superannuation Guarantee legislation and the Tax Act related to actuarial certification in relation to superannuation.

The IAAust has expressed its support for a broad review of the superannuation system in a number of letters to, and discussions with, a wide range of politicians, advisers and industry organisations. A key criteria for, and outcome of, any such review should be simplification of a number of aspects of the legislation affecting the superannuation system. This would have a number of benefits, including reductions in compliance costs.

Our attached submission focuses particularly on the roles played by actuaries under the current SIS legislation. It also briefly addresses some of the other questions raised in the Issues Paper released by the Commission.

Representatives of IAAust look forward to discussing these issues further at the Commission's public hearing.

Yours sincerely

Helen Martin  
Senior Vice President  
Institute of Actuaries of Australia

Attachment

cc Jane Ferguson, Director, Public Affairs

## **1. The Role of Actuaries in Superannuation**

### **1.1 The Expertise of Actuaries**

Actuaries apply mathematical, statistical, economic and financial analyses that involve risk assessment to long term financial contracts in a wide range of practical business problems.

In addition, many actuaries participate in the operational management of financial institutions.

Life and general insurance, superannuation, stockbroking, investment, banking, health insurance and government are the more readily recognised areas in which actuarial services are utilised.

Within these, actuaries:

- design insurance policies, superannuation and other financial contracts;
- calculate premiums or contributions to be paid by members/participants in financial arrangements;
- advise insurance companies, superannuation funds and the like on the level of financial reserves required to meet claims, benefits and other outgoings;
- advise insurance companies on prudent distribution of profits;
- assist with investment policy and asset allocation;
- assess demographic influences on financial arrangements;
- act as consultants managing superannuation and other employee benefit plans;
- advise industry and commerce on a wide range of financial and statistical problems - e.g. compensation;
- design, manage or supervise financial policies for Government in areas such as social welfare, superannuation and pension funds.

In carrying out this work, actuaries often draw on resources provided by other professionals - legal, accounting, medical, economic. They refer to information provided in journals, mathematical tables, statistical and other records and use sophisticated computer programmes to process the relevant data.

### **1.2 The Institute of Actuaries of Australia**

The Institute of Actuaries of Australia (IAAust) is the sole professional body for actuaries in Australia. It is the public face of a learned profession, which represents the interests of its members within Government, the business community and the general public.

This is achieved through the activities of members in their roles as IAAust Councillors or members of Council-appointed special professional committees. Working within this structure the IAAust, a member of the Australian Council of Professions, is able to influence government legislation that relates to the Life Insurance Act, Superannuation and other areas of actuarial interest.

Committed to maintaining the quality, integrity and high professional standards of practicing actuaries, the IAAust has established a Code of Conduct requiring the development and review of Professional Standards. A disciplinary process has been established to enforce adherence to this Code and the Standards. In addition to these controls, the IAAust fosters growth within the profession by contributing to the education of aspiring actuaries and the continued development of its members. The primary focus of these initiatives is to enhance the role of the profession, for the benefit of the public.

The IAAust's Vision and Mission statement is as follows:

### ***Vision***

*To position the profession so that wherever there is uncertainty of future financial outcomes, actuaries are sought after for their valued advice and authoritative comment.*

### ***Mission***

*The Institute of Actuaries of Australia (IAAust) represents the actuarial profession, by creating, expanding and maintaining an environment where the skills of actuaries are widely used and valued.*

### ***The IAAust***

- *establishes and maintains professional standards for the protection of the public*
- *provides pre-qualification and continuing professional education*
- *creates forums for discussion about contemporary and relevant issues*
- *promotes research and the development of actuarial science, and*
- *contributes to and informs the debate on public policy.*

The Institute of Actuaries of Australia has a heritage that dates back to 1897. In that year the Actuarial Society of New South Wales was formed. By 1919 actuaries resident in other States and New Zealand had joined the Society and the name was changed to the Actuarial Society of Australasia.

The Society published its first bulletin in 1945 and the first of the now biennial conventions was held in 1953. Further name changes occurred up to 1963 when The Institute of Actuaries of Australia and New Zealand was incorporated. When New Zealand actuaries formed their own society in 1977, the name changed to The Institute of Actuaries of Australia.

As part of the worldwide actuarial profession, the IAAust maintains regular contact with overseas actuarial associations. In particular, the current examination system ensures close links with the Institute of Actuaries (London) and The Faculty of Actuaries (Scotland).

## **1.3 IAAust Membership**

There are four membership classifications within the IAAust. Although all members may attend General Meetings and take part in discussion, only Fellows have the right to vote.

### ***1. Fellow***

A Fellow is a member of The Institute of Actuaries of Australia, authorised by legislation to work in those areas of business requiring the services of a professionally qualified actuary.

The requirements for admission as a Fellow of the IAAust are:

- Passes in the Part I examinations (for which the UK Institute of Actuaries is the examining body), or exemption from the Part I subjects based on results at the required level in relevant university courses. Part I subjects cover basic actuarial techniques, including mathematics, economics, statistics, financial and stochastic modeling, demography and the like;
- Passes in (or exemptions from) Part II (the Actuarial Control Cycle), which applies the technical skills from Part I to a range of actuarial problems in a structured way;

- Completion of two examinations at Specialist Level in Part III (chosen from five subjects, including Life Insurance, General Insurance, Superannuation & Other Employee Benefits, Investment Management and Finance), for which the IAAust is the examining body.

It is also necessary for Australian residents to attend the IAAust's Professionalism Course and for overseas residents to attend a similar approved course.

## ***2. Accredited Member***

Fellows of some overseas actuarial bodies who have been working in Australia for a period of at least six months, have had appropriate actuarial experience during that period and have attended the IAAust's Professionalism Course, may be admitted as Accredited Members (or transferred to that class if they are already Associates). After three years' practice in Australia, Accredited Members may apply to become Fellows. A shorter period applies where mutual recognition agreements are in place with overseas actuarial bodies.

## ***3. Associate***

Student members who have been exempted from all Part I and Part II subjects are eligible to become Associates (AIAA).

## ***4. Student***

Student members must satisfy the entry standards laid down by Council.

### **1.4 What Roles Do Actuaries Play in Superannuation?**

Part of an actuary's professional work in superannuation is in conducting regular actuarial reviews of defined benefit funds. The requirement for an actuarial review is usually specified in the trust deed of the fund. An actuarial report is also required at least every three years under the regulations to the SIS Act.

Other roles of actuaries include:

#### **Legislative requirements**

- Certification of solvency, as defined in the SIS Regulations.
- Specifying of minimum contribution rates as required to maintain solvency under the SIS Regulations.
- Control of funds that, under SIS, are 'technically insolvent'.
- Certification of the "cost" of self-insuring death and disablement benefits when a deduction is to be claimed under s. 279 of the Income Tax Assessment Act (ITAA).
- Certification of the (employer) cost of 'minimum requisite benefits' provided by a fund for Superannuation Guarantee Charge (SGC) purposes.
- The calculation of the segregated pension assets which are not subject to tax or the determination of the portion of the fund's investment income attributable to pensions (that is exempt from tax) under s. 283 of the ITAA.
- The calculation of a fund's pre-1 July 1998 funding credit under Part 12 of the SIS Regulations.
- Certification of the basis for determining the notional surchargeable contributions for each member of a defined benefit fund.
- Certification of the adequacy of assets backing pension liabilities in a superannuation fund.

## **Other roles**

- assessing required or recommended contribution rates for a superannuation fund
- calculating the cost of proposed benefit changes and certifying the relevant trust deed changes where required
- apportioning the assets when a fund is wholly or partly terminated
- calculating transfer values when members are transferred from a defined benefit fund
- determining the defined benefit that can be purchased by a transfer value coming into a fund
- specifying commutation factors for converting pensions into lump sums and vice versa
- completing calculations under various accounting standards, eg. AAS 25 and FAS 87
- advising life offices and other financial services organisations that provide services to the superannuation industry, including the provision of group life insurance and annuity or income stream products.

In addition actuaries, through their training, are involved in a number of areas which are not their sole domain, including:

- determining a fund's investment policy and assisting in the selection of investment managers
- advising on crediting rate and reserving strategies
- measuring investment performance
- designing benefits and consulting on general superannuation issues.

## **1.5 Professional Standards**

The IAAust has issued a number of Professional Standards. Professional Standard Number 400 applies to actuarial investigations of defined benefit funds. This standard sets out the items that must be covered in an actuarial report on such an investigation. These include:

- the name of the fund
- the nature of the fund
- the taxation status of the fund
- the relevant trust deed provisions
- the financial statements
- the fund's experience
- the assets
- the investment policy
- insurance of risk benefits
- the recommended contributions
- the funding status.

There are other Professional Standards covering other aspects of an actuary's role in superannuation such as:

- the certification of the cost of self-insuring death and disablement benefits under s. 279 of the ITAA
- the calculation of segregated pension assets under s. 283 of the ITAA
- the certification of the employer cost of the minimum requisite benefits for SGC purposes
- the calculation of pre 1 July 1988 funding credits under the ITAA
- the 'level of employer support' for the purposes of Guideline 13 of the 'Guidelines for Avoidance of Discrimination on the Grounds of Sex, Marital Status or Pregnancy in relation to Superannuation'
- payments from superannuation funds to employers under the SIS Act
- compliance with the prudential reporting requirements under the SIS Regulations
- the preparation of funding and solvency certificates under the SIS Act

- the certification of the adequacy of assets backing pensions under the SIS Act
- continuing professional development requirements.

In addition, professional standards apply to actuaries working for life insurance and other financial services organisations that provide superannuation products.

### 1.7 **Are the Roles of Actuaries under SIS Appropriate?**

The key roles of actuaries under the SIS Act are:

- Carrying out actuarial valuations and investigations of defined benefit funds
- Certification of solvency, via Funding and Solvency Certificates
- Reporting certain breaches of the SIS legislation to the trustee and for APRA
- Actuarial management of technically insolvent funds.

We strongly believe that only Fellows or Accredited Members of the IAAust should be permitted to perform these roles. The roles require expertise in finance, investments, probability, statistics and economics, the combination of which is unique to the actuarial profession. Further, we believe that actuaries are the only specialists equipped by a rigorous education program directly related to these areas and who are subject to the standards and the Code of Conduct of a professional body. The involvement of actuaries in the areas described above increases the security of members' superannuation benefits and the benefits of such actuarial involvement outweigh any additional cost of compliance incurred.

We note that in most countries in the developed world actuaries have similar roles under superannuation or pension legislation. In some countries the local actuarial profession has an even broader statutory role.

## 2. **Inefficiencies due to 30 June Focus**

One problem with the current superannuation legislation is the focus on 30 June year-ends. Only a minority of superannuation plans have substituted accounting periods. The combination of SIS and the ITAA in effect forces 90% of superannuation funds to adopt a 30 June year end. This leads to requirements to produce, for the vast majority of funds:

- annual accounts and APRA returns by 31 October, and
- member benefit statements and trustee annual reports by 31 December.

This compresses the bulk of work in the superannuation industry into a six month period, resulting in inefficient use of resources and hence additional costs, some of which could be reduced or removed.

To alleviate this problem, the SIS legislation could allow annual accounts, APRA returns, member benefit statements and trustee annual reports to be prepared annually at 30 September, 31 December and 31 March dates in addition to 30 June. (Although a superannuation fund should generally be required to use the same date from year to year.)

On the separate question of investment reporting, IAAust has argued that if compulsory Choice of Fund legislation were passed, it would be desirable for investment reporting to be standardised at 30 June. This would greatly assist members to compare investment performance on a like-for like basis when looking at disclosure information from a number of funds. This

would not create the same concentration of work as referred to above, as most funds assess and monitor investment performance monthly or quarterly.

### **3. Regulation of Defined Benefit Funds**

Defined benefit funds have been in decline in Australia in recent years and at least some of this decline can be attributed to the additional legislative burden on defined benefit plans. In combination, all of the legislation governing defined benefit funds, including SIS, the SG legislation, the ITAA and the surcharge legislation, is significantly more onerous than the legislation applying to defined contribution funds. Choice of fund legislation, if passed, will exacerbate this problem.

There is a school of thought which suggests that promotion of defined benefit funds is in the public interest as these funds are economically more efficient than defined contribution funds because the employer bears the financial risks rather than members. Given that employers are generally less risk averse than members they tend to invest a higher proportion of assets in equity or growth investments, which earn higher returns on average in the long term and hence can reduce the cost of financing retirement incomes.

The Department of Treasury Retirement and Incomes Modeling Unit assumes in much of their work that defined benefit funds will earn investment returns of 1% pa more on average than accumulation funds because they invest a higher proportion of assets in equities. Studies in the USA have also shown that defined benefit funds earn average long-term investment returns of 1.5% to 2% pa more than accumulation funds because of their different investment policies. Differences of this magnitude over long periods have a significant impact on the costs of financing retirement incomes.

Therefore, additional legislative burdens placed on defined benefit funds can be argued to lead to higher social security costs to the extent that the legislative burden contributes to the move to defined contribution funds and hence results in less efficient allocation of employer contributions and/or lower final benefits.

We would support simplification of superannuation legislation to reduce some of the additional legislative burden on defined benefit funds and place them on a more equal footing with defined contribution funds from a legislative and compliance viewpoint.

### **4. Compliance Costs**

In general, the passage of more and more superannuation legislation over the last 15 to 20 years has caused significant increases in compliance costs for superannuation funds. The significant reduction in the number of superannuation funds (other than self-managed funds) can be attributed to these cost increases to some extent.

The introduction of the SIS Act itself was a cause of increases in compliance costs. We therefore suggest that any review of the SIS Act should have as an objective a reduction in the compliance burden on funds.

### **5. Too Much Black Letter Law**

As a general observation, we believe the SIS legislation contains too much black letter law. This is particularly the case in the area of member disclosure. In our view the variety of superannuation fund designs in existence is such that a less prescriptive approach would be preferable to the existing approach where the legislation includes, for example, long lists of what must be disclosed to members.



We believe a review of the SIS legislation, and in particular the member disclosure provisions, is required. The review should consider:-

- less prescriptive requirements
- allowing electronic provision of information
- consider allowing briefer annual reports, more likely to be read, with more comprehensive reports available on requests

We believe that simplified disclosure will result in a reduction in costs for funds without any material reduction in the understanding of members. This does not imply a weakening of disclosure standards. Rather, simpler, more understandable and hence more effective disclosure should in fact strengthen the standard of disclosure.

We note however that if compulsory Choice of Fund legislation is passed, some degree of prescription will be necessary to ensure members are "comparing apples with apples" when looking at disclosure information from a number of funds.

## **6. The Trustee Structure**

We believe that a trustee structure provides a sound prudential base for the superannuation system. We note that this structure is one adopted by many countries. We also believe that the introduction of equal member representation has been a success.

We are, however, concerned that the burden on trustees is becoming too great, given:

- the burgeoning volume of superannuation legislation
- the increasing complexity of the legislation, and
- the increasing legal burdens on trustees, such as the recent strict liability changes.

This is making it more and more difficult to find unpaid volunteers to act as trustees. Any review of the legislation should seek to simplify the legislative framework where possible to ease the compliance burden on trustees and encourage member representation on trustee boards.

## **7. Pension Certification**

The SIS legislation was recently amended to introduce a requirement for superannuation funds paying pensions to have annual actuarial certification of the actuary's opinion in relation to the probability that the pensions will continue to be paid. For the actuary to provide a positive opinion, the legislation effectively requires there to be a 70% probability (or more) that the assets are adequate to pay the pensions specified in the fund's governing rules. This generally compels a higher level of asset coverage than is required for other purposes.

We believe this part of the SIS Act warrants review because:

- it fails to increase the security of superannuation fund pensions, as it appears that the legislation effectively allows downwards adjustment of lifetime pensions after they have commenced to be paid, rather than requiring assets to be sufficient to meet the Act's probability test at the commencement of payment;
- it places additional costs on large funds, for the vast majority of which the adequacy of total fund assets to meet the relatively small pension liabilities is clear;
- the consequences of failing to meet the 70% test are unclear; and
- it is inconsistent with the requirements of the other legislation (e.g. the ITAA).

The requirement in relation to actuarial investigations of defined benefit pension funds was introduced at the same time as the probability certification requirement. We consider that this is a desirable prudential control within the current pension regime. However the overall defined benefit pension regulatory regime (encompassing tax and social security requirements as well as the SIS provisions) is unnecessarily complex, contradictory and inefficient, particularly for self-managed superannuation funds. We would therefore support a review of the legislative and regulatory measures affecting such pensions, including modification of the provisions related to the certification of probability of payment of pensions.

## **8. Other Actuarial Certification**

Although not strictly within the scope of this Inquiry, we believe that aspects of actuarial certification under the SG legislation and ITAA should be reviewed and simplified. For example, applying the requirements of s.283 of the ITAA to funds providing allocated pensions so that actuarial certification of the value of pension liabilities is required seems unnecessary. Aspects of the SG certification for minimum benefits and its interaction with the provisions of funding and solvency certificates is also overly complex and can lead to the need for reissue or replacement of actuarial certificates unnecessarily.

## **9. Application of the Legislation to Service Providers**

The Issues Paper raises the question of whether parties other than trustees (eg. administrators) should be subject to similar prudential regulations.

Having only trustees subject to prudential regulations supports the Government's moves towards having one legal entity fully responsible for each fund. The onus on the trustee is to delegate to administrators and others only after extensive due diligence. Putting in place appropriate contracts that spell out the duties of others is also strongly encouraged by APRA.

Directly regulating other service providers may take away from this concept of making a single legal entity (the trustee) fully responsible for superannuation plans. Further, a number of the service providers to which trustees delegate particular tasks (such as lawyers, accountants and actuaries) are subject to alternative "regulatory" approaches such as self-regulation. We would encourage consideration of such alternative approaches for other providers such as administrators, rather than moving towards direct regulation.

## **10. Encouraging Late Retirement**

The SIS legislation places significant restrictions on the involvement in superannuation of persons aged over 65 years of age. SIS places constraints on the acceptance of contributions from such persons, and links the eligibility to make contributions and/or receive benefits to the hours of employment worked by the person.

One of the practical outworkings of the complexity of this aspect of the superannuation system is that both members and fund trustees are often confused about their entitlement to access moneys and to accrue ongoing benefits once they have reached age 65. Trustees are usually unable to effectively monitor members' employment status on an ongoing basis, and members often feel that attempts at monitoring are an unnecessary intrusion on their affairs.

While it may be important to ensure that the rules do not allow money to be left in the superannuation system in order to defer tax, the current system does require simplification. For example, up to age 70, there should be no requirement to pay benefits because a member is not working sufficient hours. Also, up to age 70 all types of contributions should be allowed irrespective of the hours worked. Making it easier and less complicated for individuals to fund

their own retirement should have the added benefit of reducing the burden on the social security system – which seems desirable given Australia’s aging population.