



To:	AASB members	Date:	2 April 2014
From:	Angus Thomson	Agenda Item:	15.4
Subject:	Superannuation Entities	File:	--

Action

Note a number of further suggestions and clarifications on Issues 1, 2 and 4 in my memorandum dated 24 March 2014, based on feedback from a Board member and recent regulatory changes by the Australian Prudential Regulation Authority (APRA).

Issue 1. Disclosures when superannuation entities are acting in the capacity of insurers

Paragraph 10 of Draft AASB 105X *Superannuation Entities* (agenda paper 15.3) would probably apply in respect of very few defined contribution (DC) members because most entities are likely to be acting as agents in respect of insurance provided through membership of a plan. The guidance at paragraphs AG40 to AG44 is intended to help entities determine if they're acting in the capacity of agents or insurers.

Impact of SIS Regulations

There are some who think paragraph 10 would be redundant in respect of DC members in APRA-regulated entities by 1 July 2016 due to the recent Regulation 4.07E(4) of the *Superannuation Industry (Supervision) Regulations 1994*, which will prohibit most entities from 'self-insuring'. That Regulation will require superannuation entities to have insurance policies with registered insurers that 'fully support' insurance cover provided to members; with the only exception being insurance arrangements for defined benefit (DB) members that are grandfathered.

However, staff believe, in financial reporting terms, an entity could be acting as an insurer and also fully reinsure with a registered insurer. The 'supporting' contract with a reinsurer can still leave the superannuation entity acting in the capacity of a direct insurer of members in its own right. There are also public sector DC plans that are not APRA-regulated to which paragraph 10 could apply.

DB plans

In relation to DB plans, the trust deed specifies member benefits that often include benefits that could be considered to constitute insurance cover. The deed could be viewed as forming the basis of a contract between the member and the plan for insurance cover – so the plan could be regarded as acting in the capacity of an insurer.

The issue may not be significant in the private sector because:

- (1) the gap between account balances and death/disability amounts is shrinking – so the insured amounts are shrinking; and
- (2) those APRA-regulated entities that reinsure could probably use the reinsurance premium as the basis for determining a 'direct' premium for financial reporting purposes.

However, the issue is significant for DB plans in the public sector that are not APRA-regulated, and are often funded on a pay-as-you-go basis.

Staff note that a typical DB plan trust deed sets out multiple bases on which members might be paid their benefits and that the DB member liability measure is a function of the expectations around each of these bases [as noted in paragraph AG25(c)]. A deed might allow for benefit payment by:

- lump sum on retirement
- lump sum (now or deferred) on resignation
- lump sum on death/disablement
- pension on retirement for a member's remaining lifetime
- pension for the remaining lifetime of a spouse.

Staff note that the benefits in the last three dot points could meet the insurance contract definition because they involve the plan in bearing an element of death/disability/longevity risks. Staff consider a DB member liability should not be required to be split into its component parts (such as an insurance component), because the component parts are all inter-related.

Staff suggestion

Based on the above discussion, staff consider that the Guidance in paragraph AG45 relieving entities from separate presentation of an insurance component in DB member liabilities should be strengthened. Staff remain of the view that the relief from separate presentation should be extended to flows associated with insurance arrangements, but suggest further changed wording.

The staff suggestions could be expressed along the following lines:¹

10 When a superannuation entity acts in the capacity of an insurer in respect of defined contribution members, the income statement or notes to the financial statements shall separately present insurance premiums, claim expenses, reinsurance expenses, reinsurance recoveries, and the net result from insurance activities.

35 A superannuation entity acting in the capacity of an insurer in respect of defined contribution members that recognises insurance liabilities and assets in respect of insurance arrangements it provides to its members shall disclose information that provides a basis for understanding the amount, timing and uncertainty of future cash flows relating to those liabilities and assets arising from those arrangements.

AG45 Depending on the conditions set out in the relevant trust deed, defined benefit members or beneficiaries might be promised, for example, a lump sum benefit on retirement or resignation, a lump sum benefit on death or disablement, a pension on retirement for their remaining lifetime and/or a pension for the remaining lifetime of a spouse, and the pension may or may not be indexed in some way. The defined benefit member liability is effectively the sum of the expected values associated with the various ways in which members might be paid their benefits. It is relevant to consider the defined benefit member liability as a single item made up of inter-related components, rather than to seek to identify particular components for presentation purposes, such as an insurance component. Consistent with the presentation approach under AASB 119 Accordingly, liabilities and assets arising from insurance arrangements a superannuation entity provides to defined benefit members need not be presented separately from the entity's liabilities for such members' benefits in the statement of financial position. Furthermore, unless there are explicit direct premiums, claims, reinsurance premiums or claim recoveries relating to insurance risks; revenues and/or expenses that might explicitly or notionally arise from relating to insurance arrangements a superannuation entity provides to defined benefit members need not be presented separately in the income statement or statement of changes in member benefits.

1 The existing mark-ups in the paragraphs shown in agenda paper 15.3 have been accepted and the mark-ups shown here are for the new suggested text.

Issue 2. Definitions – ‘defined benefit member’ and ‘defined contribution member’

The definitions in the Draft Standard are based on the definitions of DC plan and DB plan in AAS 25. However, the Board deliberately wanted to get away from ‘plan’ terminology and wanted to use ‘member’ terminology because many superannuation entities have both types of members.

Staff have received feedback from a Board member that they would prefer not to make the change suggested by staff (in agenda paper 15.3) on the basis that the SIS Act definitions might change in a way that does not suit the Standard. Agenda paper 15.3 currently includes the following suggested changes in marked-up text.

defined benefit member	A <u>defined benefit</u> member <u>as defined in the Superannuation Industry (Supervision) Regulations 1994</u> whose benefits are specified, or are determined, at least in part, by reference to a formula based on their years of membership and/or salary level.
defined contribution member	A member <u>other than a defined benefit member</u> whose benefits are determined by reference to accumulated contributions made on their behalf and by them, together with investment earnings thereon.
superannuation plan	An entity that is: <ol style="list-style-type: none"> (a) <u>a regulated superannuation fund</u> under the Superannuation Industry (Supervision) Act 1993, or similar legislative requirements in the case of an exempt public sector superannuation plan; and (b) established and maintained: <ol style="list-style-type: none"> (i) in order to receive superannuation contributions; and (ii) for the primary purpose of providing benefits to members upon their retirement, death, disablement or other event that qualifies as a condition of release for member benefits.

The Board member providing feedback has suggested an alternative approach to dealing with the matter raised by constituents about the potential for confusion if the AASB has different definitions from the SIS Regulation by:

- * retaining the fatal flaw review Draft Standard definitions; and
- * commenting (probably in the Basis for Conclusions) along the lines that: “The AASB does not expect there to be any difference between those members identified as being either defined contribution members or defined benefit members based on definitions in this Standard and those members identified as being either defined contribution members or defined benefit members based on the defined benefit member definition under prudential regulation. The Board noted that the current prudential regulation is located in a number of places, including in the SIS Act, Regulations to the SIS Act and in Prudential Standards.”

Staff consider that the above alternative approach would solve the problem raised. It might also help overcome the fact that the definition of defined benefit member is covered in a number of places in slightly different ways. For example, the Prudential Standard SPS 160 *Defined Benefit Matters* effectively expands on the definition in the SIS Regulations by clarifying that a plan’s pensioners are defined benefit members.

Issue 4. *Measurement of defined benefit member liability*

On reflection, staff think it might be best to not add paragraph AG25(e) as a discrete paragraph [as suggested in the earlier agenda papers], and instead add to the existing paragraph AG25(d), which is already about identifying the relevant portfolio.

Instead, staff suggest adding two more sentences to paragraph AG25(d), along the following lines:

- (d) the investment returns relevant to measuring the liability are those expected on a portfolio of investments that reflects the opportunities available in investment markets and not necessarily the actual investments held by the superannuation entity to meet accrued defined benefit member liabilities. Accordingly, the measurement is not dependent on whether the benefits are fully funded, under/over funded or completely unfunded. However, in many cases there would be a strong relationship between the portfolio of investments used for measurement purposes and, where relevant, the superannuation entity's actual portfolio of investments, consistent with its investment strategy in respect of meeting defined benefit member liabilities. The relevant portfolio of investments would not necessarily be a portfolio of instruments that are expected to yield contractual net cash inflows that match the timing of the expected net cash outflows relating to the liability. It might be a portfolio that is expected to yield either contractual or non-contractual net cash inflows that match the timing of expected net cash outflows relating to the liability;

The emphasis of the suggested new text is on saying the expected net cash inflows do not need to be contractual. This is because some constituents had the mistaken impression that they would need to find a bond portfolio that would yield contractual interest and principal cash flows that are timed to match the cash outflows expected in relation to the liability, which would rarely be observable, particularly for long-duration DB member liabilities.