CORPORATE SUPER ASSOCIATION

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The Chairman
Australian Accounting Standards Board
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Dear Sir

AASB EXPOSURE DRAFT ED 223: SUPERANNUATION ENTITIES

The Corporate Superannuation Association appreciates the opportunity to comment on the above Exposure Draft Standard issued in December 2011.

Background – Corporate Superannuation Association

Established in 1997, the Association is the representative body for large corporate superannuation funds and their employer-sponsors. The Association represents a total of 33 funds controlling $33 billion of assets. In general, the funds are sponsored by corporate employer sponsors with membership restricted to employees from the same holding company group, but we also include in our membership a few multi-employer funds with similar employer involvement and focus.

Our funds typically are established without shareholder interests in the governing body, and no profit is derived from the operations of our funds. This also means that any cost of compliance increase has a direct impact on members' benefits. The funds are run as mutual entities, where the decisions are the responsibility of a trustee board. In general, such boards provide equal representation for employer and employee interests.

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Comment on ED 223

Our Association recognises the need to keep the accounting standard for superannuation funds under review, including consideration of consistency of reporting requirements for items addressed under other accounting standards and, where appropriate, consistency with international practice. However, we believe that the primary focus should be on consideration of the ways in which the accounts are actually used in the Australian context.

Users of accounts

The needs of Australian superannuation stakeholder groups are diverse. These needs are not met through the full financial reports, but through specific tailored reports derived from the systems and sources used to prepare the financial reports:

- ***Existing members***: these are catered for by specific member statements which reflect the movements in their own interest in the fund. Aggregate movements in member accounts would be reflected in the financial reports, but would not normally be of strong interest to a specific member. For collated information, the members have access to the fund's Annual Report which contains abridged financial reports.
- ***Potential members and potential contributing employers***: the needs of these parties are met through product disclosure statements (the contents of which are regulated, and which provide information about investments, performance and fees) and published annual reports, which contain abridged financial reports.
- ***Contributing employers***: these will receive purpose-designed reports on their participation, and have access to the fund's Annual Report which contains abridged financial reports.
- ***Regulators***: these have their own purpose-designed reporting requirements through which their specific needs are met.

We conclude that:

- it is important that full financial reports be prepared, as a matter of proper trustee reporting, and these reports need to be audited;
- however, because the needs of users of the reports are so disparate, special statements have evolved to meet these needs. These reports are derived from the same sources and records as are used to prepare the full financial reports.
- From the above, it appears that few use the full financial reports. The reports are of importance mainly as an output from the reporting systems, as an indicator of their robustness and as a reflection of the integrity of those who manage the fund. The audit will focus on these systems and on the reports derived from them.

Our view is that given the restricted use to which the full financial reports are put, the vital aspect is that they should form a suitable basis for audit, and as a resource from which information can be compiled for communication to members and other users by way of the abridged report in the fund's Annual Report. Hence, we believe that the focus in ED 223 should be on ensuring that the financial reports provide:

- a satisfactory reflection of the custody of the fund in a format that is, above all, in a suitable format for the auditors to provide assurance on the accounts; and
- a suitable resource from which the abridged version is prepared for the users of the Annual Report. The focus in funds' Annual Reports is on clear and concise communication.

Although the full reports provide output from systems from which user reports are prepared, it is our view that they are not in themselves used as the basis for user decision-making. We value the function that the full reports perform in demonstrating trustees' fulfilment of fiduciary duty, but we believe that the detailed reporting and disclosure requirements under the new standard should be framed with this background in mind.

Relationship of Australian fund reports to reports prepared in other jurisdictions

We recognise the general objective of comparability between jurisdictions. However, Australian funds are generally constituted as trusts. There are distinctions between the legal position and the appropriate reporting requirements for a trustee and the reporting requirements of, say, an employer-sponsor providing retirement benefits through a corporate structure.

Hence, the alignment of employer obligations in employer accounts with the trustee's obligations may not be appropriate. Further, given the trust structure and the separate obligations of the trustee, we consider that the focus on the credit-worthiness of the employer-sponsor when considering defined benefit obligations is being given too much weight in the proposals.

Other technical observations

In the context of the above user focus we have provided comment on the following aspects of the proposals:

- Defined benefit liability reporting;
- Risk relating to employer-sponsor;
- Consolidation of controlled investment entities;
- Insurance issues; and
- Commencement date.

Valuation of defined benefit liabilities and corresponding impact on income statement

We note that the method of valuation proposed in ED 223 would have the advantage of consistency with the method of measurement of employer liabilities in AASB 119. However,

- the user requirements for a fund accounting standard are not consistent with an AASB 119 approach to valuing employer obligations; and
- it is not clear that the AASB 119 approach to valuing employer obligations has been helpful or meaningful in stating employer-sponsor obligations.

Hence, the alignment with AASB 119 appears misguided.

In fund accounts as proposed under ED 223, the users would be faced with three different methods of valuing obligations to members. These are vested benefits, accrued benefits as used for actuarial funding purposes, and accrued benefits as measured under the AASB 119 method. We do not consider the addition of the third measure desirable.

AASB 119 valuation method

The AASB 119 valuation method does not use the discount rate typically used by an actuary in planning the funding and financial health of the fund, using instead a single external long term bond rate. When the actuary is considering the financial condition of the fund, he or she uses the projected long-term earning rate of the fund in planning to maintain the financial health of the fund.

We accept that the AASB 119 approach has, perforce, become an established method of reporting employer obligations. We recognise that if the fund's obligations to members were reported using the same measure, these obligations would then be reconcilable. However, this single advantage may be insignificant given the relative materiality of obligations in the employer sponsor's accounts and those in the fund's accounts, and will be outweighed by the unsuitability of the AASB 119 valuation method in the context of the trustee's situation and obligations and the needs of the users of fund accounts.

In addition, given that the AASB 119 information is already published and available to users by way of the employer-sponsor's accounts, we cannot see value in publishing the same information in the context of the fund's accounts, where it does not have relevance, given the user requirements indicated below.

User requirements

Our members and their actuarial advisers would generally support measurement of fund obligation to members based on either vested benefits, or accrued benefits as measured for funding and solvency purposes, for reasons as follows.

- The Accrued Benefits approach favoured in ED 223 does not bear a close relation to the method by which actuaries measure benefits for funding and benefit certificate purposes. For benefit certificates for superannuation guarantee purposes and for funding purposes, the actuary is required to take into account the expected long-term cost of funding benefits, which will generally involve assumptions about the differential between long term earning rates and long term rates of salary inflation. This differential does not depend on the assumed risk free rate.
- The ED 223 Accrued Benefits measure will be a misleading measure of "benefit security". Because of the discount rates chosen, funds may be satisfactorily funded on a Vested Benefit and longer term actuarial funding basis, but still disclose a deficit to members on the proposed measure. This

will be confusing and therefore may ultimately mislead defined benefit members (and their financial advisors) into making poor decisions.

- Vested Benefits will be understood by members, and are consistent with the financial monitoring measure reported to APRA. Vested Benefits will also tend to be close to long term measures of Accrued Benefits used by actuaries for funding purposes. Vested Benefits are also quickly and cost effectively available - and therefore can be calculated within statutory reporting deadlines. Because virtually all of Australia's corporate defined benefit plans are now closed to new members, cost of compliance is a key issue.

All in all, the proposed method of valuing liabilities in ED 223 is misleading, giving rise to an impression that defined benefit funds are in a different funding position to that projected by their actuarial advisers. We do not believe that it is appropriate to provide financial information that gives a misleading impression of a fund's financial position.

Credit risk – employer-sponsor

We note the proposed requirement for the disclosure for an entity with defined benefit members, of qualitative information that provides users with a basis for understanding non-performance risk and/or economic dependency risk to which the plan is exposed in relation to the employer sponsor(s) of such members.

The extent of the proposed disclosures **(**qualitative disclosures that are consistent with the types of information disclosed in accordance with paragraph 33 of AASB 7) would impose very significant costs on superannuation entities and are inappropriate for the following reasons:

- The legal arrangements between trustee and employer differ greatly between those that apply between commercial contracting entities.

- There is no analogous requirement placed on companies to disclose the risk profile of individual debtors.

- It is the trustee that is responsible for and has control over the solvency position of the fund.

- Many defined benefit funds are multi-employer funds and the process of assessing the proposed risk would be very complex and costly.

Consolidation of controlled entities

We take the view that our funds are passive investors and do not generally seek control of investment entities. Although they may sometimes control voting and policy in investment entities, this does not reflect the same situation as that which applies with corporate controlled entities, where commercial and business strategies and assets are controlled. Consolidation would give a misleading and inflated impression of assets controlled, conjoined with the inappropriate intrusion of minority interests (which should have no place in the balance sheet of a superannuation fund). We would prefer to reflect investments in reports at fair value as investments without the issues of consolidation and minority interests.

We note that the IASB has issued an exposure draft, reflected in AASB 220, regarding the above topic and that international opinion favours the treatment of the holdings of investment entities as investments at fair value. We support this approach.

Insurance issues

Our primary concern is to establish clearly the situations where the AASB would consider that a fund's trustee is acting as agent for an insurer. We believe that the AASB may interpret the meaning of "agent" more broadly than as understood and practiced in the insurance industry. We are happy with this approach if we have understood it correctly, but would welcome clarification.

Trustee as agent

In the insurance industry, agency normally implies a relationship between the insurer and another party (which could be the trustee) whereby that party (the trustee) sells policies of the underwriter to third parties. This situation is common for trustees offering voluntary additional life insurance and disablement cover for members.

Trustee as the insured party

In the other common situation for fund trustees, the trustee is the insured party. Many trust deeds will specify, as standard benefits, death and total and permanent disablement benefits for members which the trustee will then seek to insure in the market, to cover amounts payable that exceed the member's account balance at the time of the payment. In many circumstances this cover will be tailored to recognise the needs of members in a specific occupation or industry. The policy entered into by the trustee in these circumstances involves insuring a risk to which the trustee is exposed, that the death or disablement benefits (in excess of account balance) will need to be paid. The party responsible for paying the benefits under the deed in the first instance is the trustee, who then insures the risk. In these circumstances there can be some residual risk carried by the trustee that the insurer will not pay all or part of a benefit to which the trustee is committed, resulting in a minor self-insurance aspect.

Clarification

The issue we would like clarified is whether the AASB includes the above situation where the trustee is the insured party in its reference to "agency" or whether it considers that this approach involves the trustee providing insurance to members as principal and then laying off the risk (reinsuring it). We see a possible implication in ED 223 that in such circumstances the funds need to apply full reinsurance accounting. From a materiality view point of view, given the minor extent of residual risk carried by the trustee, we consider that such disclosure is unwarranted.

Commencement date

It is imperative that there should be time for comparatives to be prepared for the year prior to the commencement date. If the effective date is the year ending 30 June 2014 then some changes in reporting will be needed from 1 July 2012, and it does not appear likely that the final standard will be established by that date. It would be helpful if the effective commencement date were to be for the first reporting period ending after 30 June 2014 so that changes can be made from 1 July 2013.

Conclusion

We would favour a simple and concise model for reporting, consistent with SIS Act requirements, which can be used as the basis for presentation of brief financial reports in the fund's published Annual Report. We do not favour the presentation of fund surplus or deficit following a valuation method alien to that used in regulatory returns and reports to members. We do not support the disclosure of information on employer sponsor risk that is hard to obtain and has little value to account users. We do not favour the presentation of major investments as controlled entities, an approach that is alien to the function of an investment entity such as a superannuation fund. We seek clarity of the term agency in the context of insurance.

Yours faithfully

Bruce McBain
Chief Executive Officer
Corporate Superannuation Association