TOWERS WATSON

Philip Collins

Level 4, 1 Collins Street
Melbourne
VIC 3000
Australia

T +61 3 9655 5222
D +61 3 9655 5412
M +61 439 667 658
F +61 3 9654 8227

philip.collins@towerswatson.com
towerswatson.com

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The Chairman
Australian Accounting Standards Board
PO Box 204
COLLINS STREET WEST VIC 8007

Dear Sir

This letter is intended to provide the AASB with:

- Some important practical considerations associated with the proposed measurement of accrued benefits under ED179 (as decided in the AASB's meeting on 9-10 December 2009). We strongly believe these issues require the consideration of the AASB prior to implementation of a AASB119 based measure for accrued benefits; and

- A review of the proposed assessment of insurance obligations under ED179, namely those that cross refer to the existing AASB1038 accounting standard for insurers.

Issues relating to the proposed measurement of accrued benefits

Prior to industry adopting the new measurement approach, we strongly recommend the AASB address the issues below:

- Calculating the required value of accrued benefits for accounting disclosures within the regulator's reporting timeframe will require computational shortcuts. Whilst such shortcuts are used to meet tight *corporate* reporting deadlines, special guidance on materiality guidelines will be required to allow similar shortcuts for *fund* reporting.

  Currently, the AASB119 liabilities disclosed by companies for *corporate financial disclosures* commonly use data from a pre-balance date, which is then rolled forward in order to meet the corporate reporting deadlines. Such computational shortcuts have been acceptable for AASB119 on materiality grounds. This is because any level of estimation differences arising from such shortcuts on the AASB119 measure are extremely unlikely to be material when compared to the sponsoring employer's corporate balance sheet as a whole.

  APRA requires financial reporting to be completed and audited within four months of the end of each plan year. Typically, final membership and vested benefit data only becomes available at the very end of a year-end annual administration review cycle and actuarial valuations normally need this data as a starting point for the accrued benefits calculation. Therefore, calculating the value of accrued benefits accurately before the end of the 4 months annual return reporting deadline, using year end data, for all funds will be impossible. (Currently, the vested benefits figure is usually one of the final figures to be inserted in draft financial statements.) In order to meet the four month APRA reporting deadline, earlier dated membership data will need to be used.

However, the ED179 Accrued Benefits measure will represent virtually all of the full value of the Fund's obligations. From this reporting entity's perspective (i.e. the Fund itself) the difference may therefore be material. In summary, different materiality thresholds for corporate versus fund disclosures will mean different calculation approaches and hence the disclosed liabilities will differ. Therefore, the AASB will need to provide specific clarification on such materiality thresholds in order for this work to be undertaken within APRA timeframes.

- As highlighted in our earlier submission on ED179, the AASB119 measure will often record a liability measure that is *greater* than net assets, even though the financial position (as monitored by APRA, as well as that used for funding purposes by the Trustee and actuary) shows the Fund to be in a *satisfactory* financial position i.e. vested benefits are *less* than net assets. Similarly, the actuarial value of past service benefits used by the Trustee and actuary to guide cash funding decisions may also be a lower figure than the AASB119 figure for such benefits.

  Therefore, Trustee communications to members will become critical, if members are not to be misled about the actual financial position of the Fund. For example, Trustees may consider it necessary to caution members that the measurement of the benefits for accounting purposes is different to the benefits they actually receive and different to the measurement basis applied by the Fund actuary, Trustees and APRA in monitoring the financial strength of the Fund (as well as the long term basis on which the plan is funded). In this respect, Trustees will need to caution users of the financial statements to seek advice on the disclosed measurement (advice which requires an accurate understanding of this issues which may not be reliably available from financial planners).

  Would such Trustee disclaimers and reliance on financial planners to clarify the differing measure of the obligation be of concern to the AASB?

- A current lack of consistency in discount rate selection and methodology in Australia still requires AASB guidance if the accounting objective of "comparability" between superannuation funds is to be met.

  The requirements of measuring an AASB119 obligation will depend on assumptions and actuarial methodologies (as opposed to a vested benefit measurement which typically requires no assumptions or methodologies to determine, except in relation to the value of pensions in payment). However, Australian Funds have retained significant differences in the recognition of future obligations for investment and contribution taxes in their sponsoring employers' AASB119 measurement. Whilst such inconsistencies may not have been addressed for corporate reporting purposes in the past (again, largely due to the materiality of such results in the corporate context) this will be a more important issue given that the accrued liability measurement represents broadly the full obligation of the Fund. Trustees may also have a different view of these issues to that of the Fund's sponsoring employer. The treatment of taxes therefore becomes areas of primary concern rather than a matter of detail.

  We understand that the AASB does not usually wish to become involved in preparing detailed implementation guidance. However, given the significant investment of time required in rewriting this accounting standard, will the AASB work with the industry to develop a "safe harbour" interpretation of the new requirements particularly in relation to the application of taxes. AASB involvement is required to clearly articulate its expectations for reporting.

Review of insurance provisions within ED179

In our view, the measurement approach set out under AASB1038 is complex compared with what is actually needed (and currently used) in measuring the death and disability obligations of a superannuation plan. Furthermore, most fund trustees (and their advisors) are unlikely to be able to reliably assess the claims provisioning etc on any other basis than what is already priced into either the AASB119 calculations (if a defined benefit fund) or cash insurance premiums (if a defined contribution fund).

The complexities of AASB1038 are required to control the timing of a life office's recognition of profits and losses over the expected life of their policy contracts. By way of example, many traditional life insurance policies typically charge *level* premiums across the life of an individual (despite the underlying risks actually increasing over the age of the individual being insured). Also, the base premiums are somewhat loaded in initial years to recover the cost of provisioning and upfront commissions. An AASB1038 provision is therefore calculated as the present value of all future death and disability claim amounts, less the present value of all future insurance premiums paid.

By contrast, the measurement of obligations of superannuation funds can be more simply captured.

Insured defined contribution funds:

For these funds, the best estimate of the cost of insurance is most objectively and reliably priced by setting this equal to the cash insurance premiums paid.

- Insurance policies held by superannuation funds are annual renewable policies, rather than long term contracts. For this reason:
  - policy premiums depend on the fund's actual age profile in that year; and therefore
  - the cash premiums paid are the best estimate of the value of the insured risk that year (we would not expect the Trustee to have access to more credible data about the value of the insured risk than those already implicitly built into the insurance premiums paid).

Therefore, expensing the cost of insurance on any other basis than the cash insurance premiums on most private sector superannuation funds would be spurious at best.

Note: In our view, a fund might need over (say) 30,000 members to begin to place any reasonably credible statistical estimate of mortality and morbidity rates (and even then, rates at many ages would be based on relatively small experience). Even if this was the case, it is difficult to argue that a trustee or its actuarial advisor would be able to price such risks more reliably than its insurer – whose pool of experience will still be multiple times as great as that of the individual fund.

- The insurance premiums paid on group life policies already include the expense of various outstanding claims provisions (e.g. incurred but not yet reported claims) required at the end of each policy. This is because the policy is renewable annually; the insurer must therefore price such premiums to fully cover the costs of any such unknown claims. Again, life insurers are best positioned to estimate such provisions based on claims emergence data from their larger pool of experience.

- Such premiums are generally also competitively tendered by the trustees every few years.

We have considered some elements that could *potentially* have an attaching balance sheet provision. But generally, we would not expect that such provisions could be reliably priced by trustees (and if that were possible, we would not expect it to be material):

- Claims reported and approved by the Trustee, but not yet paid. We would expect that such claims would already be included under existing financial disclosures, as part of Benefits Payable.

- Claims approved by the Trustee, but for which the insurer has declined to approve a claim on the policy. Again, we would expect the financial cost of such claims would already have been included as part of Benefits Payable as and when such claims are approved. In practice, trustees would seldom grant such benefits and/or trust deeds will (or could be amended to) amend the member's rights if the insurer refuses to pay out a claim.

- Claims approved, but for which the insurer is yet to determine whether to approve a claim on the policy. In practice, we would not expect trustees to approve any such benefits prior to knowing the outcome of the Insurer's assessment.

- Claims incurred but not yet reported. As highlighted above, the insurance premiums paid would already factor in the expense of such unknown claims (and far more credibly than any estimate that a trustee could determine based on their own fund's limited experience).

- Prepaid insurance premiums (e.g. if the insurance policy period does not coincide with the Fund's reporting period). This would be uncommon, but we believe that simply accruing such provisions based on a simple calendar based proportion would be materially the same at the Fund level, as applying life office methodologies for valuing premiums received but not yet earned.

Defined benefit plans (insured or self insured)

An AASB119 measurement already includes:

- The past service component of any death and disability benefits, within the AASB119 past service liability. The actuary may have used mortality and morbidity tables based on some pool of comparable experience, or the rates implied by the insurance premiums actually paid by the Fund; and

- The expected one year cost of the insurance component (whether self-insured or otherwise), within the Service Cost calculation (again, based on the actuary's chosen mortality and morbidity tables).

We would not expect the AASB119 past service provision to differ materially from the AASB1038 obligation. We therefore do not recommend "overwriting" the measurement of death and disability benefits under AASB119 by replacing this element of the costs with AASB1038 requirements. Importantly, to do so would also create yet another actuarial measure of the benefit obligation and difference from the AASB119 measurement.

Conclusion

We strongly urge the AASB to:

- Address the implementation issues caused by the AASB119-based measure for accrued benefits under ED179, prior to its introduction.

- Remove the proposed assessment of insurance obligations under ED179, namely those referencing AASB1038, and instead:

  1. For insured defined contribution superannuation funds, we recommend expensing based on insurance premiums paid (if necessary, accrued based on a proportion of the remaining calendar year). We do not consider the other claims provisions can be reliably estimated by the Trustees, nor would we expect these to be material for most remaining Australian superannuation funds, even if such valuation was possible.

  2. For defined benefit or self-insured superannuation Funds, we recommend expensing and provisioning based on (unadjusted) AASB119 methodologies (as described above).

Yours sincerely

Andrew Boal
Managing Director

Brad Jeffrey
Director

Philip Collins
Senior Consultant

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