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The Chairman
Australian Accounting Standards Board
PO Box 204
Collins Street West
VIC 8007
By email: standard@aasb.gov.au

Dear Sir,

AASB Exposure Draft ED 179: Superannuation Plans and Approved Deposit Funds

Mercer is pleased to respond to the Australian Accounting Standards Board's call for comments on Exposure Draft 179 in relation to a proposed new standard governing the financial statements of superannuation plans and approved deposit funds.

General comments

We have considered the proposed new standard mainly from the point of view of members of a superannuation plan, as they represent the main groups of users of these financial statements. Our comments, therefore, focus on how the proposals would aid members' understanding of their superannuation plan, relative to the costs that would be incurred in complying with the new requirements.

Whilst we agree with the Board's aim that the financial statements provide information that is appropriate for the needs of users, we believe that some of the requirements of the new standard will fail to achieve this aim. In particular, the proposed recognition method for defined benefit plan liabilities and the disclosure requirements for segregated groups within plans are likely to confuse members more than educate them, and will add significantly to the costs of producing financial statements.

We note that the scope of the recently announced (Cooper) review into the governance, efficiency, structure and operation of Australia's superannuation system includes "*ensuring the most efficient operation of the superannuation system for all members*" and "*ensuring … it operates in the most cost effective manner and in the best interests of members*". As we have outlined in our specific comments, some of the requirements of the proposed standard do not appear to meet these objectives.

Executive Summary

A summary of our comments follows:

Mercer recommends that vested benefits be reported in the financial statements of defined benefit plans

Vested benefits are easily understood by members and relatively simple to calculate. Reporting vested benefits in defined benefit plans will be consistent with the approach taken for defined contributions plans, which will also aid members' understanding. The proposed measure outlined in the Exposure Draft will require actuarial input and hence increase the costs of preparing the financial statements.

For plans that provide defined benefits and defined contribution benefits, Mercer recommends that the vested benefits for both be reported separately to show the relative significance of the defined benefit liabilities.

If the AASB decides that the total of vested benefits is not an appropriate measure of benefit obligations in a defined benefit plan, Mercer suggests that the AASB 119 liability be reported without adjustment.

Mercer does not believe that it is appropriate to value insurance risk in accordance with AASB 1038

The insurance arrangements adopted by superannuation plans generally do not meet the definition of insurance contracts in AASB 1038. Mercer recommends that instead of adding to costs by imposing a new valuation approach, the standard require each plan to disclose a description of its insurance arrangements. These disclosures should provide sufficient information to give readers an idea of the exposure of the plan to insurance-related risks.

Alternatively, for plans that self-insure their death and disability benefits, the value of the self-insured benefits could be included in the calculated AASB 119 liability (if this measure of recognising benefit obligations is adopted).

Mercer recommends that the circumstances in which plans must disclose separate financial information in respect of segregated groups of assets be clarified

If a plan is required to disclose separate financial information in respect of each sub-fund that operates and/or each investment option offered, this will add significant costs and time spent to the production of the financial statements. This will be particularly the case for large master trusts. The large amount of additional information provided will add no value to the readers of the financial statements.

Mercer suggests that the notes to the financial statements inform readers that they can obtain more detailed information on a particular segregated group of assets from the trustee of the fund.

About Mercer

Mercer is one of the leading providers of actuarial, consulting and administrative services to superannuation funds in Australia. We also operate one of Australia's largest superannuation master trusts.

Should you have any questions about the above comments or wish to discuss the matter further, please contact me on (03) 9623 5464.

Yours sincerely,

Dr David Knox
Senior Actuary

Appendix: Specific Matters for Comment (note that Mercer has not commented on all of the specific matters outlined in the Exposure Draft)

The AASB would particularly value comments on whether:

(a) the recognition principles in paragraph 10 of this Exposure Draft are appropriate for a superannuation plan or approved deposit fund;

(c) the guidance in paragraphs AG13-AG32 of Appendix B to this Exposure Draft is sufficient to facilitate reliable measurements of obligations for defined benefit members' accrued benefits and comparable measurements of such obligations between superannuation plans and over time. In particular, whether a superannuation plan with defined benefit members who will accrue materially higher levels of benefits as they near retirement age should be:

> *(i) permitted to use a method of its choosing to attribute such members' benefits to reporting periods, provided that the method is appropriate for the plan's circumstances, as proposed in paragraph AG17 of Appendix B to this Exposure Draft;*
> *(ii) required to attribute such members' benefits on a straight-line basis in a manner consistent with the approach required under AASB 119 Employee Benefits for defined benefit obligations; or*
> *(iii) required to attribute such members' benefits to reporting periods on a basis other than a straight-line basis;*

Mercer Response

We believe that the most appropriate measure for reporting the benefit obligations of a defined benefit plan in its financial statements is the total of vested benefits (ie the benefit entitlements were all members to leave service at the date of calculation). From the point of view of the main users of the financial statements, the members of the plan, this is the measure of liabilities that is the easiest for them to understand and the most relevant. A comparison of the total value of assets in the plan with the total of vested benefits gives members an idea of the security of their immediate benefit entitlements, which is likely to be their main concern when reading the financial statements.

By recognising vested benefits as liabilities in a defined benefit plan, there is also consistency with defined contribution plans, for which vested benefits is the most appropriate and only feasible measure. From a member's perspective, defined benefit and defined contribution plans have much in common and therefore the measurement of liabilities should be the same. Indeed, many individuals are members of both the defined benefit and defined contribution sections within the same fund. Using different approaches for the same member would lead to even less understanding. We also note the comment in the Basis for Conclusions that the AAS 25 requirement that defined contribution and defined benefit plans prepare their financial statements on different bases has some deficiencies.

If vested benefits are to be recognised in the financial statements, we recommend that the total of vested benefits be split between defined benefits and defined contribution benefits. This will show the relative size of the defined benefit liabilities and give the readers of the financial statements some information about the potential risks associated with the plan.

The advantages of using vested benefits as the measure of a defined benefit plan's liabilities include:

- It is generally a simple calculation that does not require actuarial input, thus reducing costs and time spent and thereby improving the timeliness of the reporting;
- The total of vested benefits is already used as a solvency measure, compared with assets to determine if a plan is in an unsatisfactory financial position for the purposes of the Superannuation Industry (Supervision) Act;
- The concept of vested benefits is familiar to members and is currently disclosed in the financial statements of superannuation plans;
- Members and other readers of the financial statements are likely to better understand the concept of vested benefits rather than an actuarial value of accrued benefits;

Currently, three different liability measures must be calculated for defined benefit plans for various purposes (fund accounting, company accounting, actuarial valuations):

- Vested benefits (as defined above; disclosed in the plan's financial statements and used to determine if the plan is in an unsatisfactory financial position);
- The present value of accrued liabilities calculated in accordance with AASB 119 (defined in the AASB 119 accounting standard; reported in the sponsoring company's financial statements); and
- The present value of accrued liabilities calculated for actuarial funding purposes (similar to the AASB 119 liability, but generally calculated using different assumptions; disclosed in the plan's financial statements and reported by the actuary in the plan's triennial actuarial valuation).

ED 179 proposes a fourth measure of liabilities. Whilst this is similar to the AASB 119 liability, the discount rate used to value future benefit payments is likely to be different. ED 179 refers to the use of a risk-free discount rate (generally considered to be a government bond yield), whilst the AASB 119 discount rate is expected to move to a corporate bond yield (assuming the proposed change to IAS 19 and AASB 119 comes into effect). Other differences may arise depending on the allowance for expected administration costs made, and if a higher level of benefits accrue as members approach retirement age.

We believe requiring a fourth measure of liabilities to be calculated will increase costs unnecessarily, without providing any additional useful information to readers of the financial statements. Indeed it is likely to increase confusion rather than be of benefit.

If the Board does ultimately determine that the total of vested benefits is not an appropriate measure for calculating the accrued benefits to be recognised as a liability, we suggest that the standard simply refer to accrued benefits as those calculated in accordance with AASB 119 with no adjustment (subject to the comments in the section on insurance below). Even this may involve significant extra work and expense, as the AASB 119 liability may not be automatically calculated as at the date of the financial statements each year, unlike vested benefits – e.g. where the sponsoring company's reporting date is different from the plan's reporting date, or where the plan is a multi-employer Superannuation Plan and the relevant criteria set out in AASB 119 are met permitting each individual entity to account for the plan as if it were a defined contribution Superannuation Plan.

The liability that would be shown in the financial statements of a public sector scheme also highlights a problem with reporting a AASB 119-style liability. Under the new proposed version of AASB 119, the calculation of the liability for a not-for-profit public sector entity would be different from the liability for other public sector entities. The former would use a government bond rate as the discount rate, the latter a corporate bond rate. So if a public sector fund sponsored by both not-for-profit and non not-for-profit public sector entities reported liabilities calculated in accordance with AASB 119, it would be adding together liabilities calculated on different bases and therefore be meaningless.

This potential inconsistency is yet another argument for the reporting of vested benefits in financial statements.

(e) there are any significant practical difficulties that would inhibit the reliable measurement of obligations and assets arising from insurance contracts issued by a superannuation plan or approved deposit fund in accordance with the principles and requirements applicable to life insurance contracts under AASB 1038 Life Insurance Contracts as proposed in paragraph 21 of this Exposure Draft. If so, please describe the nature of these difficulties and how they might be overcome;

Mercer Response

It is not clear from ED 179 what sort of insurance arrangements adopted by superannuation plans are intended to be covered by the requirements of the new standard. In the majority of cases a plan's death and disability benefits are insured with a third party insurer, and as a result the plan bears little or no residual insurance risk. In these cases the plan does not appear to have an insurance obligation that needs to be recognised as a liability in the financial statements.

The only situation in which a plan would take on significant insurance risk is where the death and disability benefits were self-insured. Many public sector schemes in Australia adopt self-insurance arrangements. We do not believe that these arrangements meet the definition of an insurance contract, however, as the plans themselves are not insurers. The Governments that sponsor the various public sector funds in Australia would certainly not be considered insurers. Therefore, we do not think it is appropriate for these insurance arrangements to be valued in accordance with AASB 1038.

Requiring superannuation plans to recognise assets and liabilities in accordance with AASB 1038 would result in significant additional costs arising from:

- the set up of a valuation model to calculate insurance liabilities;
- the setting of assumptions for the calculation of outstanding claims provisions; and
- the collection of data at the calculation date.

Any benefits of such measures would be far outweighed by the significant costs when the plan is not acting as an insurer.

Instead of requiring plans that self-insure to comply with AASB 1038, we suggest that the disclosures to the financial statements (for all plans) include a description of the insurance arrangements. The disclosures should include sufficient information to give readers of the financial statements an idea of the exposure of the plan to insurance-related risks and any reserves (or provisions) that may be established in respect of these risks.

If, as discussed in the previous section, the Board determines that defined benefit plans should recognise accrued benefits calculated in accordance with AASB 119, the value of self-insured death and disability benefits could be included in the calculated AASB 119 liability. It is likely that there would need to be some minor adjustments made to the calculation of the AASB 119 liability to incorporate this allowance for self-insured funds. We believe that this is a more appropriate approach to allowing for these insurance risks than introducing another valuation methodology.

(m) there are any significant practical difficulties that would inhibit a superannuation plan or approved deposit fund disclosing information in relation to any segregated groups of assets attributable to different groups of members, and the related obligations to those members, in accordance with paragraph 40 of this Exposure Draft and paragraphs AG80-AG88 of Appendix B to this Exposure Draft. If so, please describe the nature of these difficulties and how they might be overcome;

Mercer Response

Paragraph 40 of the Exposure Draft and the guidance in paragraphs AG83-AG88 requires a plan to disclose information on assets, the financial position and significant financial risks for each segregated group of assets within a plan. A segregated group of assets is defined as a section of a plan for which separate financial information is available and evaluated regularly by management of the Superannuation Plan to allocate resources and assess performance.

The Application Guidance to the Exposure Draft suggests that a plan with multiple investment options would not need to disclose separate information for each option, where financial information for management is prepared on a single plan basis. We support the conclusion in the example in paragraph AG81(b), whereby a fund that calculates investment returns/unit prices for each investment option and prepares other financial information on a single fund basis would not be required to treat each option as a separate segregated group of assets for disclosure purposes.

We do not believe that there are any circumstances in which disclosure of financial information for separate investment options is warranted. It is not clear from the guidance whether the following common situations satisfy the criteria for the management of assets and obligations on a "segregated basis":

- the actual allocation between different asset classes within a particular investment option is adjusted to match the stated benchmark allocations following movements in investment markets (eg to increase the allocation to equities following a devaluation of equity investments); and
- the actual allocation of assets between investment options is adjusted to match the obligations of members (eg to reflect changes in the options selected by members).

In each case a strict interpretation of the wording of the Exposure Draft could mean that the management of the plan is evaluating separate asset and obligation information for the purpose of allocating resources and assessing performance. We do not believe the fact that these tasks are undertaken from time to time should trigger the significant additional disclosures outlined in the Exposure Draft.

Requiring this level of detail would add significant additional costs and time spent on preparing financial statements. For example, the recent APRA publication of the level of investment returns for the 200 largest funds showed that more than 10% of these funds had more than 100 investment options.

It would appear from the guidance in the Exposure Draft that a sub-plan in a master trust would also be considered a segregated group of assets. For example, where a master trust contains defined benefit sub-plans, the Trustee would be provided with information on the performance of the sub-plans at regular intervals (at least once every 3 years). If this is the intention of the Exposure Draft, this would add significant additional time and expense to the preparation of the financial statements.

Some master trusts have tens or even hundreds of sub-plans – for example, the Mercer Super Trust has approximately 260 sub-funds, of which about 100 are defined benefit in nature. To require a master trust to disclose asset, profit or loss and financial position information for each sub-fund would be extremely onerous, particularly for the defined benefit sub-funds. It would add significantly to the size of the financial statements and hence the cost of producing them, and add little value to the readers of the statements.

If the requirements were extended to different investment options as well, this would add even more complexity to the financial statements of a master trust. Where a master trust has multiple sub-plans, each of which offers its members investment choice (such as the Mercer Super Trust), how would the plan determine the segregation of assets under the proposed requirements? Would it need to disclose separate information for each sub-plan, and then within each sub-plan separate information for each investment option? This would be totally impractical. The financial statements for the Mercer Super Trust could well run to thousands of pages if separate disclosures were required for every sub-fund and every investment option within each sub-fund. The sheer size of the statements would outweigh any possible benefit to readers (ie members) from the information disclosed.

An alternative to disclosing this information for every sub-plan or investment option could be to inform readers of the financial statements that they can obtain more detailed information on a particular sub-plan or investment option from the Trustee of the master trust (eg the report on the actuarial valuation of a defined benefit sub-plan).

If the AASB believes that there are circumstances in which separate disclosure is warranted, we suggest that the new standard is much clearer in defining segregation. The current wording of the standard and the guidance could easily be interpreted differently for the same set of circumstances, and plans could spend considerable time and expense producing information for disclosure that is not intended by the standard.