Mercer

welcome to brighter

Mercer Consulting (Australia) Pty Ltd
ABN 55 153 168 140
AFS Licence # 411770
One International Towers Sydney
100 Barangaroo Avenue
Sydney, NSW Australia 2000
GPO Box 9946 Sydney NSW 2001
T +61 414 887 137
timothy.jenkins@mercer.com
www.mercer.com.au

Ms Estelle Liu
Manager, Actuarial Practice
Aware Super

via email: Estelle.Liu@aware.com.au

15 July 2022

Subject: Actuarial Investigation of the VISSF DB Fund as at 31 January 2022
Summary of results and recommendations

Dear Estelle

We have undertaken an actuarial investigation of the VISSF DB Fund relating to each of the 13 participating Schools as at 31 January 2022 and have provided final reports for each of the 13 Schools. This letter provides a summary of the key results and recommendations contained within those reports.

Background

Under a successor fund transfer (SFT), all assets and liabilities of the Victorian Independent Schools Superannuation Fund were transferred to Aware Super on 30 November 2021. Defined benefit assets and liabilities were transferred to a new sub-fund within Aware Super, the VISSF DB Fund. A separate School Account is maintained for each participating school, and for the purpose of the actuarial investigation of the VISSF DB Fund each of these School Accounts is treated as a separate defined benefit sub-fund.

VISSF DB Fund members receive lump sum defined benefits on retirement, death or total and permanent disablement. Disability income benefits are also provided. The benefits provided vary between the different schools, and are summarised in Appendix A of each report. We understand that the benefit provisions are the same as those that previously applied in the Victorian Independent Schools Superannuation Fund.

Summary of Financial Position as at 31 January 2022

We summarise the financial position as at 31 January 2022 for each of the School Accounts below:

School Account	Number of Members	Net Assets ($'000s)	Vested Benefits ($'000s)	Ratio of Assets to Vested Benefits	Actuarial Value of Accrued Benefits ($'000s)	Ratio of Assets to Actuarial Value of Accrued Benefits	Average Age of Members	Defined Benefit Proportion of Actuarial Value of Accrued Benefits
Kingswood	3	1,814	1,202	151%	1,202	151%	61.2	0%
Korowa	7	3,525	2,718	130%	2,718	130%	61.6	0%
Lowther Hall	2	1,858	1,051	177%	1,051	177%	69.9	0%
Mentone	2	1,078	840	128%	823	131%	57.4	42%
MLC	19	12,047	8,679	139%	8,526	141%	57.7	86%
PLC	4	2,799	1,843	152%	1,843	152%	63.1	0%
Ruyton	2	1,871	1,363	137%	1,363	137%	59.4	24%
Shelford	1	773	206	375%	206	375%	56.6	0%
St Catherine's	1	761	440	173%	440	173%	69.8	0%
St Leonard's	1	3,430	604	568%	604	568%	60.8	0%
St Margaret's	1	946	603	157%	603	157%	60.3	0%
Tintern	3	1,338	831	161%	831	161%	60.2	0%
Westbourne	6	3,207	2,494	129%	2,494	129%	52.1	7%
Total	**52**	**35,448**	**22,874**	**155%**	**22,704**	**156%**	**59.2**	**36%**

Upon retirement, members receive the greatest of a salary based retirement benefit, an accumulation style resignation benefit or an accumulation style Superannuation Guarantee (SG) benefit. The final column 'defined benefit proportion' provides an indication of the type of benefit members are expected to receive on retirement (i.e. salary based or accumulation style). For 9 of the 13 Schools, all members are expected to receive accumulation style benefits, although this could change if investment returns are lower and/or salary increases are higher than those assumed for this investigation.

Significant Events since the Investigation Date

For Mentone, MLC, Ruyton and Westbourne (those schools with a defined benefit proportion greater than zero), the contribution recommendations take into account the actual investment return of -7.7% on the Aware Super Growth Option (and -4.0% on the Aware Super Conservative Growth Option) from 31 January 2022 until 17 June 2022.

For all other Schools, the negative return will increase the possibility that some members may receive salary-based benefits rather than accumulation style benefits on retirement. It will also reduce the amount of "surplus" assets available to meet the cost of ongoing benefit accruals and expenses. However, it is not expected to have a material impact on the findings or recommendations in the reports due to the accumulation nature of the benefits.

Recommended Contributions

Our contribution recommendations for each School specify the contributions required for the three years following 31 January 2022 in respect of:

- Defined benefit accruals (including insurance costs);
- Operating expenses; and
- Salary sacrifice contributions.

In addition, the contribution recommendations for each School specify the extent to which School Account assets can be used to finance:

- Award benefits for defined benefit members (where relevant); and
- SG contributions in respect of accumulation members of Aware Super (for those Schools where the Actuary had previously approved a request to use School Account assets for this purpose).

At the previous investigation, the recommended contributions for all Schools were nil in respect of defined benefit accruals and operating expenses, and all Schools were permitted to finance Award benefits for defined benefit members from School Account assets. MLC, Shelford, St Leonard's and Ruyton had received approval to finance SG contributions in respect of accumulation members (subject to specific conditions).

Our approach to determining the required level of School contributions was to project the future financial position for each School assuming a continuation of the "contribution holiday", including payment of Award contributions for defined benefit members from School Account assets and (where relevant) continued payment of SG contributions for accumulation members at the levels previously approved.

For all Schools other than Mentone and MLC, the coverage of Vested Benefits was projected to remain above 110% until at least 31 January 2025, and therefore no significant change in the previous recommendations was made[1]. For Mentone, we have recommended that contributions recommence from 31 January 2024. For MLC we have reduced the maximum amount of SG contributions that can be financed from School Account assets.

[1] For Ruyton and Shelford the recommendations include a minor change in the level of SG contributions which can be financed from School Account assets as they are based on the previous approvals less the **estimated** (rather than actual) amount financed prior to 31 January 2022. For St Leonard's, the level of SG contributions which can be financed from School Account assets was not previously subject to a maximum dollar amount, but as the maximum exceeds the SG contributions expected to be paid over the three year period, this is not expected to have any impact in practice.

We summarise below for each of the School Accounts our contribution recommendations for the next three years and the date from which we expect contributions to resume (where applicable):

School Account	Contributions to finance Defined Benefit Accruals and Operating Expenses	Maximum Contributions to be financed from School Account	Contributions Expected to Resume
Kingswood	Nil	Not Applicable	Not Applicable*
Korowa	Nil	3.0% Award for DB members	Not Applicable*
Lowther Hall	Nil	3.0% Award for DB members	Not Applicable*
Mentone	31 Jan 2022 – 31 Jan 2024: Nil 1 Feb 2024 onwards: 9.4% of salaries plus $43,000 per annum (increasing by 3.5% pa)	3.5% Award for DB members (until 31 January 2024)	1 Feb 2024
MLC	Nil	3.0% Award for DB members $1150,000 SG contributions	1 Feb 2026
PLC	Nil	3.0% Award for DB members	Not Applicable*
Ruyton	Nil	3.5% Award for DB members $177,000 SG contributions	1 Feb 2026
Shelford	Nil	3.0% Award for DB members $140,000 SG contributions	Not Applicable*
St Catherine's	Nil	3.0% Award for DB members	Not Applicable*
St Leonard's	Nil	3.5% Award for DB members $1,800,000 SG contributions	Not Applicable*
St Margaret's	Nil	3.5% Award for DB members	Not Applicable*
Tintern	Nil	3.0% Award for DB members	Not Applicable*
Westbourne	Nil	3.0% Award for DB members	1 Feb 2026

*We have only provided an estimated date where contributions are expected to recommence within 5 years of the valuation date.

In addition, all Schools are required to contribute any salary sacrifice member contributions.

The St Catherine's School Account has significant surplus assets and the one remaining member was close to age 70 at the investigation date. Given the age of the remaining member and the current level of surplus assets, we recommend that the Trustee discuss with the School its preferred approach for the use of any surplus assets. In particular, it would be desirable for the Trustee to confirm how the School wishes to use any assets remaining in the School Account following the retirement of the remaining member.

Note that the Award contribution rates set out above reflect those advised to us previously by the Victorian Independent Schools Superannuation Fund. In particular, we understand that all Schools decided not to increase Award contributions at 1 July 2021 (when the SG rate increased to 10%) and we have assumed adoption of the same approach at 1 July 2022 (when the SG rate increased to 10.5%).

The Trustee should ensure that the Award contributions are advised to the VISSF DB Fund administrator regardless of whether they are physically paid by the School or financed from the School Account. Further, the level of Award contribution (i.e. 3.0% or 3.5%) also affects the "notional contribution" that the Schools should advise the administrator for purposes of calculating of the SG minimum benefit. The Trustee should satisfy itself that the Schools are advising the correct Award and SG notional contributions, to ensure the SG requirements are being met.

Note that if an employer-sponsor does not contribute to the Fund in accordance with the actuarial recommendations, the SIS Act requires the actuary/auditor to report this to both the Trustee and to APRA. We recommend that the Trustee obtains formal confirmation from each School that it will contribute in accordance with the recommendations, and ensure that processes are in place to check that each School is contributing in accordance with the recommendations on a regular basis, say quarterly. These processes will need to include monitoring the level of SG contributions paid from School Account assets.

Other Findings and Recommendations

Statements Requires by APRA Prudential Standard SPS 160

We have included the statements required for the purposes of APRA Prudential Standard SPS 160 as Section 10 of each School report.

Suitability of Policies

We are satisfied that the following current policies for the VISSF DB Fund and/or School Account are suitable:

- The investment strategy (subject to the recommendation below);
- The insurance arrangements;
- The Shortfall Limit (for the purposes of SPS 160); and
- The Trustee's process for monitoring the financial position.

Recommendations

We recommend that the Trustee:

- Formally document the crediting rate, investment and expense allocation policies for the VISSF DB Fund;
- Discuss the current investment strategy for School Account assets with each School; and
- Engage with each School regarding the expected future expenses associated with the Fund and the School's willingness to continue its participation.

In respect of the St Catherine's School Account, we also recommend the Trustee discuss with the School its preferred approach for the use of any surplus assets.

Further commentary regarding these 'other findings and recommendations' is provided below.

Investment Strategy

The reports for each School include comments in relation to investment policy in Section 5 and discussion of the impact of investment volatility in Section 8.

Volatility in the School Account's investment returns affects the financial position of the School Account and potentially the required level of School contributions. Even for those Schools where most or all of the liabilities are linked to investment returns, volatility in the School Account's investment return will impact the dollar amount of "surplus" assets available to meet the cost of ongoing benefit accruals and expenses. Additionally, the nature of the liabilities could change if investment returns were significantly lower (or salary growth significantly higher) than the assumptions adopted for this investigation.

For MLC and Mentone, where a significant proportion of the liabilities are not linked to investment returns, volatility in the investment return has a more significant impact on the financial position and therefore the required level of School contributions (and/or the extent to which the School can finance contributions for accumulation members from School Account assets).

Whilst we are satisfied that the current investment policy is suitable, given the number and age of the remaining defined benefit members, the Trustee should engage with each School to ensure the School understands the risks associated with the current investment strategy.

Any review would need to take into account the fact that a proportion of the liabilities are linked to the investment returns on the Aware Super Growth investment option. Adopting a different strategy in respect of those assets which are supporting accumulation style liabilities would create a mismatch between the investment return on assets compared with the crediting rate applied to the liabilities. However, consideration could be given to moving some of the assets (those in excess of the accumulation style liabilities) to a lower risk strategy within the next 1-2 years in order to reduce volatility.

We note that MLC has in the past requested the Trustee to invest a portion of the assets more conservatively. However, it is not clear at this stage whether there is any intention to continue this approach. The MLC report includes consideration of the expected impact on long term costs of continuing to adopt a more conservative investment policy.

We would be pleased to prepare additional information to assist the Trustee and the Schools in further discussions regarding investment strategy, if required.

Expenses

For each School Account, fees represent a significant cost that the Trustee needs to carefully manage to ensure that the security of members' benefits is not eroded.

As outlined in Section 4 of each report, we have assumed that the expenses deducted from each School Account will average $40,000 per annum (increasing in line with salary increases) over the future term of the liabilities. This is based on the Trustee's estimate of future administration expenses, Mercer's estimate of future actuarial expenses and the Trustee's current policy of allocating expenses equally between the schools. This also assumes that all schools cease participation at the same time.

In practice, expenses are expected to increase significantly for those schools which continue participation after other schools cease. For example, if there were 4 schools remaining the estimated expenses would be $130,000 per annum. If there were only one school remaining the estimated expenses would be $520,000 per annum. Charging fees at this level could have a significant impact on the security of members' benefits.

We therefore recommend that the Trustee engage with each School to identify the:

- Expected timing of the remaining members' retirement (if known);
- Willingness of each School to continue participation in the VISSF DB Fund until the last members' retirement; and
- Willingness of each School to increase contributions (if necessary) to meet increasing expenses as other schools cease their participation in the VISSF DB Fund.

These discussions will allow the Trustee to better estimate the expenses that it is likely to charge to each School over the next five years. If the estimated expenses are significantly greater than those assumed in our actuarial investigation, the Trustee should seek our further advice to determine whether an adjustment to the recommended contribution rates (or other action) is required.

Insurance Arrangements

For all School Accounts the assets exceed the death and total and permanent disablement benefits, suggesting there is no need for insurance. However, at this point we have not recommended a reduction or cessation of insurance as this may have other unintended consequences. For example, under-insurance should the financial position deteriorate, possible underwriting issues in re-instating cover, unavailability of a continuation option where a member terminates employment, and additional complexities from an administration and insurance viewpoint, etc. We note also that uncertainties regarding the interpretation of SPS 160 in relation to self-insurance make it unclear whether a reduction in the level of insurance is permitted.

For three Schools – St Margaret's, St. Catherine's and Lowther Hall – the youngest member is either approaching or has exceeded age 60 and so a cessation of the death/TPD insurance coverage is expected, leading to a small saving each year in premiums.

Shortfall Limits

Section 10 of each report deals with Shortfall Limits. SPS 160 defines the Shortfall Limit as "the extent to which a fund can be in an unsatisfactory financial position with the trustee still being able to reasonably expect that, because of corrections to temporary market fluctuations in the value of the fund assets, the fund can be restored to a satisfactory financial position within a year."

Consistent with the approach adopted previously by the Victorian Independent Schools Superannuation Fund, the Shortfall Limit for each School Account is determined as 100.0%, where the number of members is fewer than 10 (i.e. all School Accounts other than MLC). For the only School Account with more than 10 remaining members, MLC, we have recommended the Trustee reduces the Shortfall Limit from 97.9% to 97.6%.

Crediting Rate Policy

We understand that Aware Super has continued to follow the crediting rate policy that applied in the Victorian Independent Schools Superannuation Fund. The main features of that policy (as adapted following the transfer of investments to Aware Super) were:

- Members' resignation benefits, where applicable, as well as their Superannuation Guarantee minimum benefits, are based on the accumulation of member and notional employer contributions with investment earnings at the Crediting Rate; and
- The Crediting Rate will be determined based on the on the investment return (after tax and investment fees) for the Aware Super Growth investment option, with no allowance for management costs, irrespective of how the School Account assets are invested.

Assuming that this policy is continued, this will be an important consideration for the Trustee and the School in considering any change to the investment strategy.

Monitoring Process

We understand that the Trustee has adopted a monitoring process which includes the following:

- The Trustee will ensure that the Fund Actuary undertakes a review of the financial position as at 30 June each year; and

- In addition, the Trustee will monitor investment returns. In the event that the year to date investment return is less than -5%, the Trustee will obtain advice from the Fund Actuary on the approximate estimated financial position of each School Account, taking into account primarily the impact of investment returns, but also the impact of any differences between expected contributions and the long-term contribution rate and significant membership movements. The update of the estimated financial position is intended to be an approximate and timely calculation, as an "early warning" to the Trustee as to whether a more detailed review of the financial position is required.

We consider that the adopted monitoring process is appropriate.

Actions

Based on our reports on the actuarial investigation, we recommend the Trustee consider each report and confirm its agreement (or otherwise) to the contribution and other recommendations. In particular, we recommend the Trustee take the following actions:

- Discuss each report and the recommendations made in the report with the relevant School, obtain the agreement of each School to contribute in accordance with the recommendations, and confirm that the School is comfortable with the investment strategy adopted;

- Liaise with each School on the factors influencing VISSF DB Fund expenses as outlined in the report;

- Ensure that processes are in place to check that each School is contributing in accordance with the recommendations;

- Formally document the crediting rate, investment and expense allocation policies for the VISSF DB Fund; and
- Formally instruct us as Fund Actuary to undertake a review of the financial position as at 30 June each year.

The next regular actuarial investigation of the VISSF DB Fund will be required at a date no later than 31 January 2025, and we will reassess the adequacy of the recommended level of School contributions at that time. As the VISSF DB Fund now has an administration review date of 30 June, we recommend that the next actuarial investigation be undertaken as at 30 June 2024

Yours sincerely,

Tim Jenkins, FIAA
Fund Actuary
Partner