MERCER
MAKE TOMORROW, TODAY

Mercer Consulting (Australia) Pty Ltd
ABN 55 153 168 140 AFS Licence #411770
Collins Square, 727 Collins Street
Melbourne Vic 3008
GPO Box 9946 Melbourne Vic 3001
61 3 9623 5561 Fax 61 3 8640 0800
david.scott@mercer.com
www.mercer.com.au

16 July 2019

Mr N John
Fund Secretary
The Victorian Independent Schools Superannuation Fund
GPO Box 4974
MELBOURNE VIC 3001

Dear Neville

Actuarial Investigation as at 31 January 2019
Summary of results and recommendations

We have undertaken an actuarial investigation of the defined benefit sections of the Fund relating to each of the 13 Fourth Schedule Schools as at 31 January 2019. Accordingly we now attach final reports for each of the 13 defined benefit sections.

Summary of Financial Position as at 31 January 2019

A summary of the financial position as at 31 January 2019 for each of the defined benefit sections is set out below:

Defined Benefit Section	Net Assets ($'000s)	Vested Benefits ($'000s)	Ratio of Assets to Vested Benefits	Value of Accrued Benefits ($'000s)	Ratio of Assets to Value of Accrued Benefits	Weighted Average Future Service (years)	Defined Benefit Proportion of Vested Benefits
Plan B	2,091	1,550	135%	1,547	135%	5.1	35%
Plan C	3,541	2,810	126%	2,773	128%	5.7	65%
Plan E	1,450	791	183%	791	183%	4.4	0%
Plan F	1,768	1,500	118%	1,505	117%	5.2	24%
Plan G	13,961	10,990	127%	10,495	133%	6.2	78%
Plan H	2,411	1,585	152%	1,577	153%	5.1	26%
Plan I	2,027	1,524	133%	1,489	136%	6.6	26%
Plan J	1,888	1,341	141%	1,341	141%	5.7	11%
Plan L	588	329	179%	323	182%	2.2	100%
Plan M	4,258	1,485	287%	1,445	295%	4.4	71%
Plan N	1,238	934	133%	934	133%	4.0	0%
Plan O	1,038	619	168%	621	167%	6.5	27%
Plan P	4,331	3,513	123%	3,507	123%	7.4	30%
Total	**40,589**	**28,970**	**140%**	**28,349**	**143%**	**6.0**	**45%**

Note that it has been not been necessary to produce a report for the Plan A and Plan D defined benefit sections as no defined benefit members remain as at 31 July 2019.

Recommended Contribution Rates

The contribution recommendations vary between the Schools and can broadly be categorised into contributions required:

- In respect of defined benefits, and
- To finance the Award benefit for defined benefit members.

We have undertaken projections of the future financial position for each School, although we have not included these in the report where the School has only one defined benefit member. Our approach to determine the required level of School contributions is to aim for a ratio of assets to Vested Benefits of 110% around 31 January 2022. Where the ratio is projected to exceed 115% at that date, we have also recommended that Award contributions can be financed from the defined benefit assets, at the option of the School. Both conditions apply to all Schools.

A summary of the minimum contributions recommended for each of the defined benefit Schools is provided below:

Defined Benefit Section	Defined Benefit (% of salaries)	Award Contributions (% of salaries)
Plan B	Nil	not applicable
Plan C	Nil	3.0% or nil at the option of the School
Plan E	Nil	3.0% or nil at the option of the School
Plan F	Nil	3.5% or nil at the option of the School
Plan G	Nil	3.0% or nil at the option of the School
Plan H	Nil	3.0% or nil at the option of the School
Plan I	Nil	3.5% or nil at the option of the School
Plan J	Nil	3.0% or nil at the option of the School
Plan L	Nil	3.0% or nil at the option of the School
Plan M	Nil	3.5% or nil at the option of the School
Plan N	Nil	3.5% or nil at the option of the School
Plan O	Nil	3.0% or nil at the option of the School
Plan P	Nil	3.0% or nil at the option of the School

Note that for Plan F, Plan I, Plan M and Plan N, we understand the decision taken by the School when the Superannuation Guarantee (SG) rate increased above 9% was that they would increase their Award contributions in line with the increase in the SG rate. Thus we have assumed that they are making Award contributions of 3.5% of salary from 1 July 2014 (from the defined benefit assets in the case of Plan F, up to 31 January 2019). For other Schools with Award contributions, we understand the rate has remained at 3%.

Whether the Award contributions are physically paid by the School or financed from the defined benefit assets, the amount still needs to be advised to the administrator. Whether the Award contribution is 3.0% or 3.5% should also affect 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.

The level of contributions will be reviewed at the next actuarial valuation due no later than 31 January 2022, although a review of the financial position should be undertaken as at 31 January 2020 and 2021 following completion of the administration review, in accordance with the Trustee's Defined Benefit Policy, and may be undertaken earlier depending upon experience.

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 obtain formal confirmation from each School that it will contribute in accordance with the recommendations, and checks that each School is contributing in accordance with the recommendations on a regular basis, say quarterly.

Investment Policy

The reports for each defined benefit section include comments in relation to investment policy. We generally noted that the current investment policy was suitable for the liabilities in the short term. However, we recommend that the Trustee:

- Engage with each School to ensure the School understands the risks associated with the current investment strategy and the implications of a more conservative investment strategy;
- Develops a policy in relation to investment strategy to accommodate the reducing expected future term of the liabilities; and
- Raise with relevant Schools^ the possibility of investing a portion of the assets in the Cash investment option, reflecting the projected benefit payments over the next three years, for the purpose of financing benefit payments in the short term as a strategy to protect the financial position of the School's defined benefit section of the Fund.

^ All schools except Plan E, Plan L and Plan N. Investment of part of the assets in the Cash investment option for these Schools is not relevant given the accumulation nature of their liabilities (Plan E and Plan N) or for Plan L as the expected timing of the remaining member's retirement should be taken into account before considering the investment strategy.

Investment strategy is ultimately a decision for the Trustee and, even where a School makes no specific request of the Trustee to move to a more conservative investment strategy, the time is likely to arise when the Trustee should consider such a move and engage in dialogue with the School.

The position is complicated by the proportion of benefits of defined benefit members that are effectively of an accumulation nature, potential changes to that proportion over time and the use of a crediting rate based on the Balanced investment option irrespective of the underlying investment strategy.

We note that the weighted average term of the defined benefit liabilities is now less than five years for a number of Schools and is approaching the point where consideration should be given to a more conservative investment strategy, given the time horizon implied by the Balanced investment option. In particular, we have recommended that the Trustee should communicate with Plan L to identify the likely timing of the remaining member's retirement and then consider the investment strategy further.

A more conservative investment strategy would be expected to result in reduced variability although the long-term investment return would also be expected to be lower. That is, an increase in the underlying long-term cost of providing the defined benefits would be expected. However, given the sound financial position of Schools' defined benefit sections, a change in investment strategy is unlikely to require any immediate increase in School contributions.

Insurance Arrangements

For all but two defined benefit sections – Plan G and Plan P – the assets exceed the death and total and permanent disablement benefits, suggesting there is no need for insurance. However, at this point we have generally not recommended a reduction or cessation of insurance as this may have other unintended consequences, e.g. under-insurance should the financial position deteriorate and possible underwriting issues in re-instating cover, unavailability of a continuation option where a member terminates employment, additional complexities from an administration and insurance viewpoint, etc.

However, for three of these schools – Plan M, Plan N and Plan E – given a high ratio of assets to Vested Benefits and that only one remaining member who is close to age 60 still has death/TPD insurance, a cessation of the death/TPD insurance is recommended, leading to a small saving each year in premiums.

We would be happy to further investigate the implications of reducing the level of death/TPD insurance for other Schools if required.

Retirement Benefits

Rule 4.4.1 of the Fourth Schedule defines the retirement benefit as a multiple of Final Salary. It also states:

> *"If the School consents, the benefit must not be less than a benefit calculated under Rule 4.9 at the date the Member retires from the service of the School."*

Rule 4.9 relates to the member's resignation benefit.

We understand that Plan L has not consented to subjecting the retirement benefit to a minimum of the resignation benefit. Whilst this is not currently an issue for the one remaining defined benefit member, it is possible that the resignation benefit will exceed the retirement benefit in the future.

We recommend the Trustee seek the agreement of Plan L that the retirement benefit be subject to a minimum of the resignation benefit, unless the member's retirement is imminent. For the purposes of this and previous actuarial valuations for Plan L we have assumed that the retirement benefit is always subject to a minimum of the resignation benefit in projections of the financial position and calculation of the required School contributions. Accordingly, adopting the above policy for Plan L will have no impact on the contribution recommendations.

The retirement benefit for Plan P is not subject to a minimum of the resignation benefit, reflecting the historical benefit design with the resignation benefit limited to the discounted accrued retirement benefit. Retirement benefits are however subject to a minimum of the SG Minimum Benefit. No change is recommended.

Shortfall Limits

Section 10.1 of each report deals with Shortfall Limits, which are also covered in Section 3 of the Trustee's Defined Benefit Policy. Our letter of 21 August 2013 recommended that the Shortfall Limit for each defined benefit section be determined as 100.0%, where the number of members is fewer than 10, but otherwise as:

(100% - 3% x proportion of Vested Benefits that are defined benefit)

On this basis the Shortfall Limits adopted, as detailed in Section 3.3 of the Trustee's Defined Benefit Policy, were as shown below, along with recommended new Shortfall Limits:

Defined Benefit Section	Shortfall Limit	Recommended New Shortfall Limit
Plan B	98.4%	100.0%
Plan C	98.8%	99.7%
Plan E	100.0%	Retain
Plan F	98.7%	100.0%
Plan G	97.9%	Retain
Plan H	98.6%	100.0%
Plan I	98.8%	100.0%
Plan J	100.0%	Retain
Plan L	100.0%	Retain
Plan M	98.1%	100.0%
Plan N	99.3%	100.0%
Plan O	100.0%	Retain
Plan P	98.5%	99.4%

As part of the actuarial investigation we have reviewed the Shortfall Limits and recommend revised Shortfall Limits of:

- 100.0% for Plan B, Plan F, Plan H, Plan I, Plan M and Plan N, as these sections now have fewer than 10 members; and
- 99.7% for Plan C and 99.4% for Plan P, reflecting changes to the proportion of benefits that are of an accumulation nature.

Whilst application of the formula outlined in our letter of 21 August 2013 would lead to a change in the Shortfall Limit for Plan G, given the small change we confirm that the current Shortfall Limit remains appropriate.

Other Matters

The Plan N and Plan E defined benefit sections have three and two members, respectively. The benefits for all these members are currently of an accumulation nature, and projected to be of an accumulation nature in the future. Plan L has only one remaining member, although that member has a salary related benefit. Given the small number of members, we recommend the Trustee engage with these Schools in relation to the potential wind-up of the defined benefit section.

The Plan M defined benefit section has a significant excess of assets over Vested Benefits and only four remaining members, all over age 57. The Trustee and School should consider the management of the financial position as the membership declines.

Funding and Solvency Certificate

The Funding and Solvency Certificate (FSC) prescribes the minimum level of employer contributions required by each School in order that the School's defined benefit section under the Fourth Schedule will remain solvent in respect of the SG minimum benefit as provided for under the Benefit Certificate. The FSC also specifies the contributions required for non-defined benefit Schools so that the Third Schedule remains solvent. The Trustee must monitor the notifiable events listed in the Appendix to the FSC and advise the actuary if any of these occur.

The FSC takes the form of a certificate plus Appendix together with a separate attachment for each defined benefit section and a further attachment for all other non-defined benefit Schools. A copy of the certificate with the applicable attachment needs to be provided to each School, although we understand the Trustee has an exemption from APRA from providing the FSC to non-defined benefit Schools.

Statements Requires by APRA Prudential Standard SPS 160

The statements required for the purposes of APRA Prudential Standard SPS 160 *are* included as Section 10.4 of each report.

Actions

Based on our reports on the actuarial investigation, we recommend the Trustee take the following actions:

- Seek formal confirmation from each School that the School will contribute in accordance with the recommendations;
- Ensure that the Schools are advising the correct Award and SG notional contributions;
- Monitor that Schools are contributing in accordance with the recommendations;
- Adopt the recommended new Shortfall Limits;
- Engage with each School to ensure the School understands the risks associated with the current investment strategy and the implications of a more conservative investment strategy;
- Develop a policy in relation to investment strategy to accommodate the reducing expected future term of the liabilities;

- Raise with relevant Schools the possibility of investing a portion of the assets in the Cash investment option, reflecting the projected benefit payments over the next three years, for the purpose of financing benefit payments in the short term as a strategy to protect the financial position of the School's defined benefit section of the Fund;
- Seek agreement from Plan L for their retirement benefit to be subject to a minimum of the resignation benefit, unless the remaining member's retirement is imminent;
- Raise with Plan L the likely timing of the retirement of the remaining defined benefit member, the investment strategy and the future of their defined benefit section;
- Raise with Plan M the significant excess of assets over Vested Benefits and agree with the School an approach to managing the financial position as the membership declines; and
- Raise with Plan E and Plan N the potential wind-up of the defined benefit section given the small number of members and nature of the liabilities.

Note that we have provided a copy of the FSC, Appendix and relevant Attachment to each School along with the report on the actuarial investigation of their defined benefit section.

Please contact me should you require any further information.

Yours sincerely

David A Scott
Fellow of the Institute of Actuaries of Australia