Superannuation benefit statement projections
Class Order 11/1227 calculations

Paul Thomson | July 2020

Cumpston Sarjeant
CONSULTING ACTUARIES

Table of contents

Executive summary

ASIC Class Order 11/1227 enables superannuation trustees to issue benefit projections on member statements. It provides a method for estimating a member's projected balance at retirement, and the income that this would provide in retirement. It also allows the trustee to provide an estimate of the age pension to which a member may be entitled at the time of retirement.

Ordinarily, providing such information would be considered a form of financial advice. As such, the trustee would usually be required to hold an Australian Financial Services License (AFSL) and to comply with the associated AFSL conditions. Trustees are relieved of these obligations in relation to benefit projections on statements if they adhere to the Class Order approach.

The Class Order prescribes:

- the member data that must be used in the projection (largely relating to the actual history of contributions, contributions tax, administration fees and insurance premiums over the previous 12 months);
- the investment return that must be adopted (a 3% pa real return);
- the assumed retirement age (67) and that the funds will provide income in retirement for 25 years; and
- the method that must be used for projecting the benefit at retirement and income in retirement.

Under the Class Order, benefit projections must not be provided to:

- members who are over the age of 67; and
- members who joined the fund within the past 12 months.

The Class Order provides a clear framework for benefit projections. Nonetheless, there are several issues which a fund must consider. The Class Order requires that a member's history in the past 12 months (including contributions made, tax incurred, fees and insurance premiums paid) must be assumed to continue each year to retirement. Following this strictly would result in unreasonable estimates for some members. In light of this, funds must consider how to treat some other groups of members:

- Members who have made very large non-concessional contributions in the past year, which are unlikely to continue each year going forward.
- Concessional contributions in excess of the cap
- Where non-concessional contributions are made, and the projected balance is in excess of $1.6m
- Information available to the fund which may suggest that the details over the past 12 month are less reliable indicators of future cashflows, for example: where a death or disability claim has been lodged; where insurance premiums have been paid in the year but it is known that the member no longer has insurance cover.
- Data issues such as negative contribution/fee/insurance amounts.
- Very young members

- Where issues arise due to the timing of contributions and tax. For example, personal contributions may be made in one financial year, but a notice of intention to claim a deduction is only received (and so the tax is only deducted) in the following financial year. Depending on the way in which such personal contributions and tax are recorded in the administration system, the past 12 months may capture a personal contribution but no tax, or conversely the tax on an earlier year's contribution, but not the contribution itself.
- Members with multiple accounts.
  If an age pension estimate is provided it will be less reliable for members who are known to have more than one account. This is because under the Class Order method there is no way of combining the balances of multiple accounts in order to estimate age pension entitlements.

The Class Order permits the trustee to provide an estimate of the age pension to which a member may be entitled. The Class Order specifies several assumptions that must be made in estimating the age pension entitlement, in particular it must be assumed: that the member is married, a homeowner, and that at retirement the member and their spouse will have equal superannuation balances.

There are a number of issues in these assumptions when preparing age pension estimates, and in the limited nature of the age pension estimate itself:

- There are well documented discrepancies between average superannuation balances of males and females at retirement. For heterosexual couples it is problematic to assume a member and their spouse will have an equal balance.
- No allowance is made for any other assets the member or their spouse may have outside of superannuation and the family home.
- The age pension estimate is only a snapshot of income at the point of retirement. It does not capture the way that over time, as a retired member withdraws funds from superannuation and their superannuation balance declines, their age pension entitlement will tend to increase.
  This also points to an important difference between the estimate of income from superannuation and the estimate of age pension income: the estimate of income from superannuation represents constant real income over the retirement period, but the age pension estimate is only a point-in-time estimate (and represents the lowest likely age pension income).

Given these problems, we recommend that funds include only the superannuation income in a benefit projection on statements and not the age pension estimate. Age pension estimates could then be provided in an online calculator. A calculator allows the user to enter the specific details for their spouse, assets outside of superannuation and is also able to show how age pension benefits are likely to increase in over the retirement period as superannuation assets are drawn down.

1. Introduction

This paper looks at the approach to estimating superannuation benefits under Class Order 11/1227. The Class Order is highly prescriptive. This paper explores the prescribed data requirements, assumptions, and methodology. The approach is however not appropriate for all members. The paper discusses groups of members which may be excluded from receiving projections.

Section 2 looks at the data which must be used and assumptions which must be adopted under the Class Order. Section 3 goes into the formulae underlying the class order calculations.

Section 4 looks at groups of members who may be excluded from receiving a projection. The Class Order explicitly requires some members to be excluded from receiving a projection. A fund may also wish to exclude other groups of members from receiving a projection in the interest of only providing reasonable benefit projections.

Section 5 looks at the age pension estimates in the Class Order: the assumptions that must be made, and some problems in the Class Order approach to age pension.

For funds considering including benefit projections in member statements, the following sections outline the key requirements and considerations: Section 2, for the data that has to be provided; Section 4.2, in considering what classes of members to exclude from receiving a projection (in addition to the exclusions which are prescribed by the Class Order); Section 5, in considering whether or not to include an age pension estimate.

2. Data requirements

The Class Order specifies the data that must be used in projecting the superannuation balance at retirement, and income in retirement. The following data is required for each member:

1. Member ID.

2. Current balance.

3. Date of birth.

4. Total contributions paid into the member's account in the previous 12 months.
   Note that this should exclude any amount transferred into the account as a rollover.
   For reasons discussed later, it is useful to separate concessional and non-concessional contributions.
   Co-Contribution and Low Income Superannuation Contribution amounts also need to be included; and again, it is useful to separately identify these amounts. It is also useful to separately identify SG vouchers.

5. Contribution tax paid in the 12 months to the statement date.

6. Insurance premiums paid in the 12 months to the statement date.

7. Administration fees charged on a "relevant basis".
   This includes administration fees charged as a:
   i. Flat dollar amount (for example $2.00 per week); or
   ii. Percentage of the member's contributions.
   For these administration fees the amount paid in the 12 months to the statement date is required.

8. Administration fees charged as a percentage of the member's balance.
   For asset based administration fees a description of how the fund's asset based fees are charged is required including any stepped bases or caps (rather than how much was charged to the member in the past 12 months).

3. Prescribed projection method

The Class Order prescribes the methods that must be used in projecting a member's superannuation balance at retirement and estimating the income that this could provide in retirement. The methods are based on standard accumulation and annuity formulae. This section looks at the method and formulae in more detail.

3.1 Assumptions

There are a number of important assumptions that the Class Order requires us to make in projecting a balance at retirement and income in retirement:

1. A real rate of return of 3% pa (after inflation and any investment related fees, but before administration fees)
2. Retirement at age 67
3. That the income in retirement lasts for 25 years from age 67 until age 92
4. There is also an implicit assumption that income in retirement from superannuation remains constant in real terms.

3.2 Method: Projected balance at retirement

The projected balance at retirement is the sum of: the Accumulation of the current balance; and the Accumulation of future contributions. In each case, basic current member data is multiplied by an accumulation formula:

	Accumulation of current balance	Accumulation of future contributions
Current member data	Current balance	Adjusted current contributions
	Multiplied by	
Accumulation formula	$(1 + 3\% - Asset\ based\ admin\ fee)^{Years\ to\ 67}$	$\dfrac{((1 + 3\% - Asset\ based\ admin\ fee)^{Years\ to\ 67} - 1)}{\ln(1 + 3\% - Asset\ based\ admin\ fee)}$
	Equals the projected balance at age 67	

1. "Adjusted current contributions": This represents the net cash flow into or out of the member's account in the last 12 months. This is calculated as: gross contributions less contributions tax less insurance premiums less administration fees charged on a flat dollar basis (as per point 7 in the previous section).

2. Asset based administration fee ("f" in the Class Order specification): For a simple fee arrangement without bands or caps (for example an administration fee of 0.5% pa on the member's balance) the fee percentage is used as is. Some funds have more complicated arrangements. For example, there may be a dollar-based cap on the asset fee or asset-based administration fees may be charged at different rates in different asset bands. In these cases, the fund arrangements are used to estimate an average percentage asset fee.

3. Years to age 67: The Class Order assumes that the member will retire at age 67. The period of future accumulation is then the length in years from the member's current age (given their date of birth and the statement date) to retirement at age 67.

4. Note that where the asset-based fee equals the real return of 3% (and so future investment returns and administration fees offset one another) the formula is:

Current Balance + (Adjusted current contributions x Years to age 67)

3.3 Method: Income in retirement

The income in retirement is calculated by multiplying the projected balance at retirement by a factor of 0.0566 (a factor which is prescribed in the Class Order).

This factor is the result of an annuity formula with prescribed parameters (as below). The Class Order retains the 3% real return from the accumulation period above (though makes no allowance for asset-based administration fees in the retirement period). The class order assumes a 25-year draw-down period (so drawdown is assumed to commence on the assumed retirement age of 67 and is based on the funds being exhausted by age 92).

The projected income in retirement is calculated as:

Projected balance at age 67 (from above)
Multiplied by (the annuity formula below)
$\dfrac{\ln{(1 + 3\%)}}{1 - (1 + 3\%)^{-25}} \quad (= 0.0566)$
Equals the projected annual income in retirement

4. Members excluded from receiving a projection

The Class Order requires that benefit projections should be excluded from some members' periodic statement (section 4.1). There are also some other members which could be excluded in the interest of providing reasonable benefit estimates to members (section 4.2).

4.1 Excluded under the class order

Members excluded from receiving a benefit projection by the Class Order are:

- Members over the age of 67.
  The Class Order assumes that members will retire at age 67, and that the income in retirement will last from age 67 to age 92.
  Those members already over age 67 are not permitted to receive a benefit projection.
- Members who have been with the fund for less than 12 months.
  The Class Order requires us to use data relating to member contributions, tax, insurance premiums and administration fees in the past 12 months. These are then assumed to continue each year going forward.
  The method relies on having a full 12 months of data for each member. There is no capacity in the prescribed methodology to estimate annual amounts based on data relating to less than a full year of membership.
  Where the member joined the fund within the last 12 months this data is not available, and so these members must not be provided with a benefit projection on their periodic statement.

4.2 Fund considerations

In the interests of providing reasonable benefit estimates, there are a number of other groups of members who could be excluded from receiving a benefit projection. Many of these exclusions arise due to the required Class Order assumption that whatever contributions have been made in the past 12 months will continue for each year between now and age 67. These exclusions could relate to:

- Members with high contributions
  Where a member has made very large non-concessional contributions over the past 12 months this is very unlikely to continue in the future.
  Similarly, concessional contributions in excess of the cap may be unlikely to continue in the future.
  A projection that relies on such contributions may not be realistic.
- Young members
  Given the changes that are likely to occur over the individual's working life, it will be less reliable to base a very long-term projections on salary-based contributions very early in the individual's career.
- Transfer balance cap implications
  Members who are currently making non-concessional contributions, but who are projected to have a balance exceeding the Transfer balance cap (currently $1.6m).
  The problem here is that individuals with a superannuation balance over the transfer balance cap are not permitted to make non-concessional contributions.

A member may be currently making non-concessional contributions, but if they have a projected balance over the transfer balance cap, at some point between now and retirement they will be required to stop making these non-concessional contributions.

The Class Order method does not allow us to cease such non-concessional contributions during the projection period.

- Data issues

  With large member numbers, almost inevitably some data issues arise.

  In some cases this may occur due to a reversal of a transaction in a previous financial year.

  For example, the data may have some negative contribution amounts, administration fees or insurance premiums.

- Issues with the timing of contributions and tax

  Personal contributions may be made in one financial year, but the notice of intention to claim a deduction may be received (and so the tax is only deducted) in the following financial year.

  Depending on the way in which such personal contributions and tax are recorded in the administration system, the past 12 months of data may capture a personal contribution but no tax, or conversely the tax on an earlier year's contribution, but not the contribution itself

- Other indications

  Information available to the fund which may suggest that the details over the past 12 month are less reliable indicators of future cashflows.

  For example: where a death or disability claim has been lodged; where insurance premiums have been paid in the year but it is known that the member no longer has insurance cover.

- Members with multiple accounts

  The age pension estimate is prepared based on asset and income tests in relation to a projected account balance.

  Where a member is known to have more than one account with the fund there is no way of combining the balances for age pension income and asset test purposes. Given that, age pension estimates will be less reliable for members who are known to have more than one account (see section 5 for more details).

- Projected lump sum

  Some funds feel that where the projected balance is less than a certain dollar threshold (eg less than $20,000) or if the projected balance is less than the current balance (due to ongoing fees and insurance premiums being higher than expected returns and contributions) the projection is of limited value.

5. Age pension estimates - calculation and issues

The Class Order allows the trustee to provide an estimate of the age pension amount to which a member may be entitled at the time of retirement. Where the trustee does provide such an estimate, the Class Order specifies several assumptions that must be made. There are however problems with these assumptions.

5.1 Assumptions and calculation

Where an age pension estimate is provided under the Class Order, it must be assumed that

- The member is married;
- The member is a homeowner;
- At retirement the member and their spouse will have equal superannuation balances.

Having estimated a member's balance at retirement (and assuming that the spouse has the same balance) an age pension estimate is then calculated based on Age pension asset and income tests.

5.2 Assuming equal superannuation balances between member and spouse

The first problem with the prescribed approach to estimating age pension entitlement is the requirement to assume that a member's spouse has the same balance at retirement as the member.

There are well documented discrepancies between average superannuation balances of males and females. For heterosexual couples it is therefore problematic as a general assumption to assume a member and their spouse will have an equal balance.

We have found that this leads to confusion among members who may have a spouse in the same fund, where the member and their spouse receive very different age pension estimates.

For example, if we were to take a heterosexual couple, both aged 40, with average superannuation balances and salaries for their age, the projected balance at retirement and age pension estimates would be:

	Female spouse	Male spouse
Age	40	40
Superannuation balance	$69,300	$100,300
Salary	$81,300	$94,500
Projected balance at retirement	$377,000	$478,000
Assumed assets for age pension test purposes (2x projected balance)	$754,000	$956,000
Age pension estimate	$5,400	$0

1. Superannuation balances are the mean superannuation balances for those aged 35-44 years, from the Australian Bureau of Statistics *Household Income and Wealth, Australia 2017-18.*

2. Salaries are Average Weekly Ordinary Time Earnings for Females and Males in May 2020, from the Australian Bureau of Statistics *Average Weekly Earnings, Australia*.

3. The age pension estimate is based on age pension rates of payment, and asset and income test thresholds, as at July 2020.

As can be seen, the requirement to assume the spouse has the same superannuation assets leads to very different estimates of age pension entitlement for each spouse.

5.3 Age pension estimate is a snapshot at retirement

The age pension estimate is only a snapshot at retirement (at age 67). It does not capture the way that as a retired member withdraws funds from superannuation and their superannuation balance declines, their age pension entitlement will tend to increase.

There are two problems with this. First, there is a mismatch in the nature of each estimate. The estimate of income from superannuation represents a constant income over the retirement period. The age pension estimate on the other hand represents only an estimate in the year of retirement. The second issue is that this understates the constant real income that would be able to be obtained.

The impact of the first issue can be seen if we continue the example of the female spouse in the previous section. Her superannuation benefit statement would show income from superannuation of $21,400 and age pension income of $5,400; total annual income in retirement of $26,800. The following chart however shows the expected pattern of age pension payments for this individual, assuming drawing down on superannuation in a manner consistent with the Class Order (and retaining the assumption of a spouse who has the same superannuation assets at retirement):
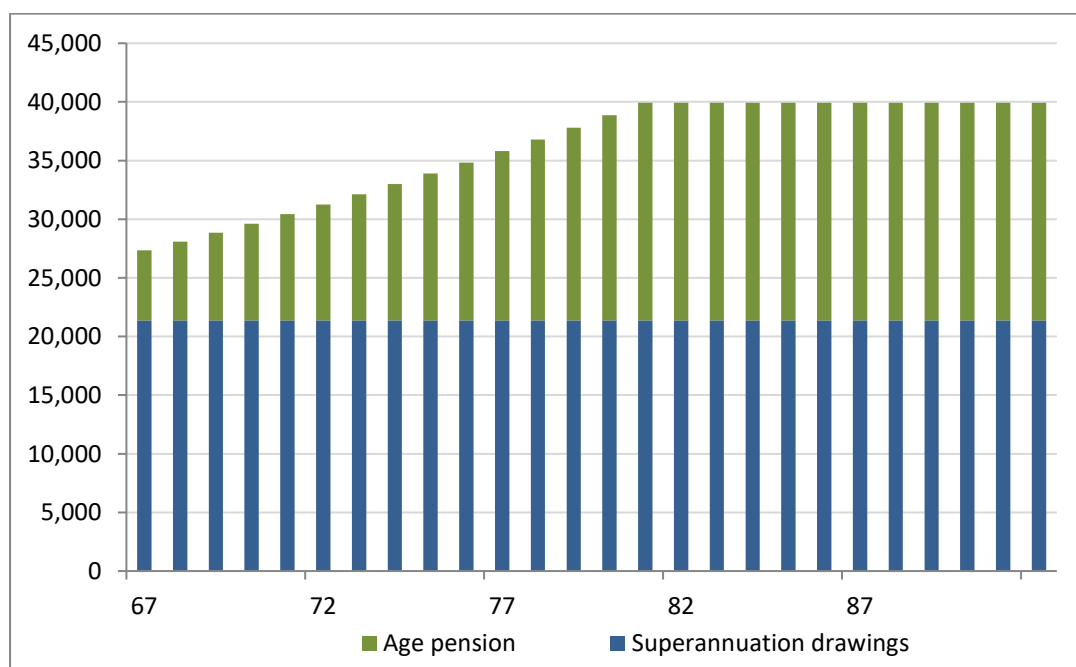
For this individual, as income is drawn from superannuation over the retirement period, the remaining superannuation assets reduce. With lower assets over time, the individual's age pension entitlements (under the age pension asset test) increase. This leads to the income pattern that can be seen above. Far from a level income of $26,800 throughout the retirement period (as would be shown on the member's benefit statement) this individual would be expected to have income gradually increasing in real terms to $40,000 by age 81.

The impact of the second issue can be seen by looking at this the other way: what would be this member's possible total income in constant real terms? Because age pension income increases with a reducing balance over the course of the retirement period, in order to achieve a constant real income one would withdraw more from superannuation initially and less later in retirement. The following chart shows the mix between age pension and superannuation drawings in each year in order to preserve a constant real income from age 67 to age 92:
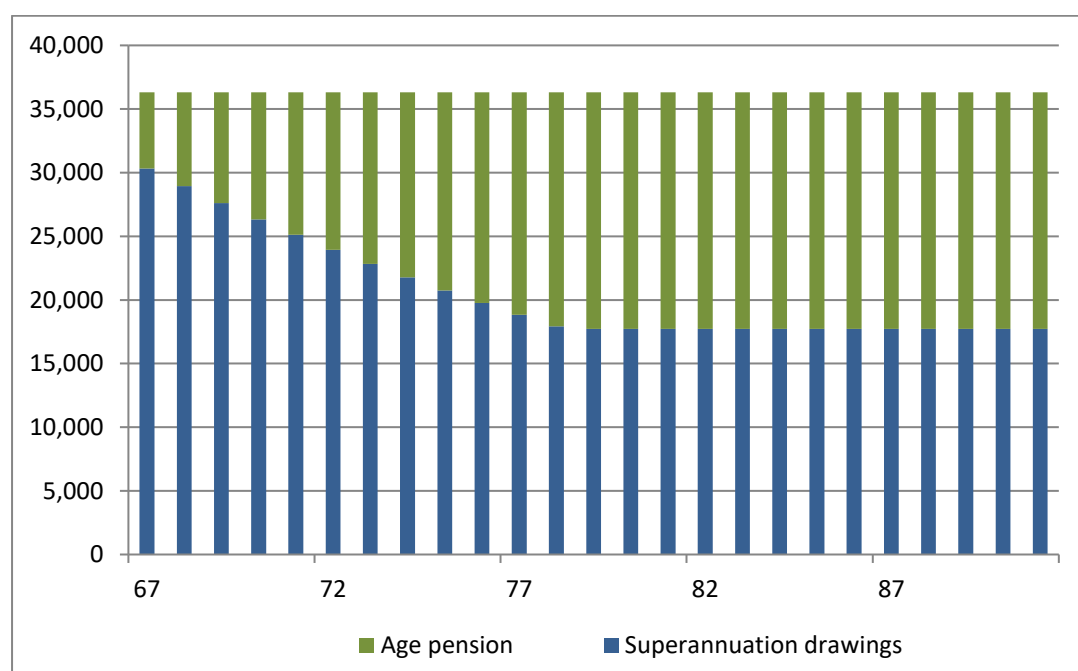
We saw above that this member's benefit statement would show income in retirement of $26,800. However if we properly allow for the increasing age pension over the retirement period, and make higher superannuation drawings in the early stages of retirement to reflect this, the member may actually expect to have constant real income of over $36,300 throughout the retirement period; a 35% increase on the estimate received in an annual benefit statement.

5.4 Other issues

There are other issues in the assumptions that must be made in order to provide age pension estimates on annual benefit statements:

- The assumption that everyone is married and a homeowner is not representative of the community.
- No allowance is made for any other assets outside of superannuation.

Given these significant issues, we recommend that benefit statements only include projections of superannuation assets at retirement and income from superannuation in retirement. The age pension estimate (and a better indication of expected overall real income) can be provided in an online calculator. A calculator enables the user to provide additional (more appropriate) assumptions such as marital and homeowner status and the spouse's current superannuation balance and earnings. A calculator also permits a more dynamic approach to the age pension, showing the way in which age pension entitlement changes over time. The shortcomings of the Class Order approach to the age pension, and the financial implications of this, may not be fully appreciated by the fund member.

6. What we do

Cumpston Sarjeant work with superannuation funds to comply with Class Order 11/1227. This includes:

- Ensuring appropriate data is used in the calculations;
- Working with the fund to establish a suitable series of criteria on which to exclude members;
- Performing the calculations in compliance with the Class Order;
- Preparing the benefit projection output to ensure it is in a format which can be used by the fund or the fund administrators in preparing the benefit statements.

We also have experience reviewing calculations performed by fund administrators or other providers.

We have an ongoing partnership with communication specialists AHC:

- AHC prepare member benefit statements in Australia, the UK and the US.
  AHC specialise in effective communication with members. Cumpston Sarjeant performs the Class order calculations that appear on the statements.
- In addition to paper and PDF statements, AHC also prepare personalised video statements. The benefit projections we prepare are able to be populated by AHC into video statements customised for each member.

AHC and Cumpston Sarjeant have also built the Lifetime Superannuation model. This is a web-based superannuation model, intended for superannuation funds to enrich their online offering. In partnership, we also provide tailor-made superannuation calculators for Australian superannuation funds.