Local Authorities
Superannuation Fund

Report on the Actuarial Investigation as at 30 June 2020

The City of Melbourne Plan

18 December 2020

Towers Watson Australia Pty Ltd
ABN 45 002 415 349   AFSL 229921

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Section 1: Executive Summary

1.1 We are pleased to present our report on the triennial actuarial investigation of the City of Melbourne plan (COM plan) of the Local Authorities Superannuation Fund (the Fund). This report has been prepared for Vision Super Pty Ltd, the Trustee of the Fund.

1.2 Please refer to Section 2 for the detail of the reliances and disclaimers in respect of this advice.

Results of previous actuarial investigation

1.3 The previous actuarial investigation was conducted by Matthew Burgess, FIAA, on behalf of Willis Towers Watson as at 30 June 2017. The results of that valuation were published in a report dated 1 November 2017.

1.4 In that review, the recommended funding arrangements comprised of the following:

a A contribution rate of 13% (inclusive of 1% salary continuance cover) of salaries for Division D members;

b If the VBI is below 100% and in any event upon retrenchment, top-up amounts for exiting members equal to the following amount increased for contribution tax:

Benefit Payment less (Vested Benefit x VBI)

Top-up payments were to be calculated and invoiced quarterly in arrears. Top-up payments were required for all retrenchments (VBI capped at 100%), but for other exits only when the VBI is below 100%. Benefit payments exclude the amount of any insurance proceeds.

c City of Melbourne also needed to contribute the amount of members' salary sacrifice contributions.

1.5 We suggested that Vision Super finalises members' superannuation salaries with City of Melbourne and keeps them as updated as practical.

1.6 Under the valuation assumptions these contributions were expected to be more than required to meet funding requirements, and following discussions with Vision Super, we recommended it consider whether a lower risk investment strategy was appropriate at that time. If a lower risk investment strategy was not adopted a large surplus was expected to remain after the last member is paid based on the contribution recommendation. Alternatively, it was reasonable for City of Melbourne to have a contribution holiday and maintain the current investment strategy.

1.7 We also recommended that the Board consider a plan to reduce the exposure to illiquid assets in the COM plan to zero over time given the maturity of the plan and the possibility of large benefit payments

1.8 We also recommended that Vision Super review the insurance policies, and update where necessary, to ensure it was satisfied that any self-insurance was not material.

1.9 Vision Super decided to lower the risk of investment strategy and City of Melbourne contributions remained unchanged. There also remains small elements of self-insurance. Otherwise these recommendations have been implemented.

Assumptions for this actuarial investigation

1.10 The financial assumptions used in this actuarial investigation are summarised below:

a Net investment return: 1.1% p.a.

b Salary Inflation: 2.0% p.a. for two years, 2.75% p.a. thereafter

c Price Inflation: 2.0% p.a.

1.11 We increased the administration expense assumption from 4.5% to 6% of active members' salaries. Otherwise assumptions remained unchanged.

Results of this actuarial investigation

Funding Status Measure

1.12 This actuarial investigation has shown that the COM plan's financial position has improved following the last review as at 30 June 2017, and remains satisfactory.

30 June 2020 Funding Indices	
	%
Vested Benefit Index	136.9[1]
Discounted Accrued Benefit Index	125.4[2]
Minimum Requisite Benefit Index	185.1[3]

1. Vested Benefits are the benefits payable if all members resign/retirement immediately
2. Discounted Accrued Benefits discount the future benefits expected to be paid in respect of completed membership to a present value.
3. Minimum Requisite Benefits are the minimum Superannuation Guarantee benefits

1.13 The improvement in the vested benefit index is primarily due to financial experience (excess of investment return above salary increase) being higher than assumed, coupled with a strong return on surplus and also the contributions being made expected to be more than required.

1.14 The above indices were determined using the financial assumptions as summarised in Section 1.10. We were advised by Vision Super there was a revision to the investment strategy of the COM plan effective 17 July 2020. Accordingly, some of the COM plan's allocation towards fixed interest has shifted towards alternative debt and equities. The Fund's asset consultants, Frontier, have advised the net investment return of this investment strategy is expected to be 1.9% p.a.. The change in asset allocation is not expected to affect the coverage of Vested Benefits and Minimum Requisite Benefits at 30 June 2020. However, adopting a net investment return of 1.9% p.a. increases the Discounted Accrued Benefit Index to 130% at 30 June 2020. Whilst we consider the effect of the change in investment strategy, we have not revised our assumed investment return because we recommend that the Trustee consider further de-risking.

1.15 The COM plan's assets cover vested benefits at the review date and therefore the COM plan was in a satisfactory financial position at that date as defined in SPS 160.

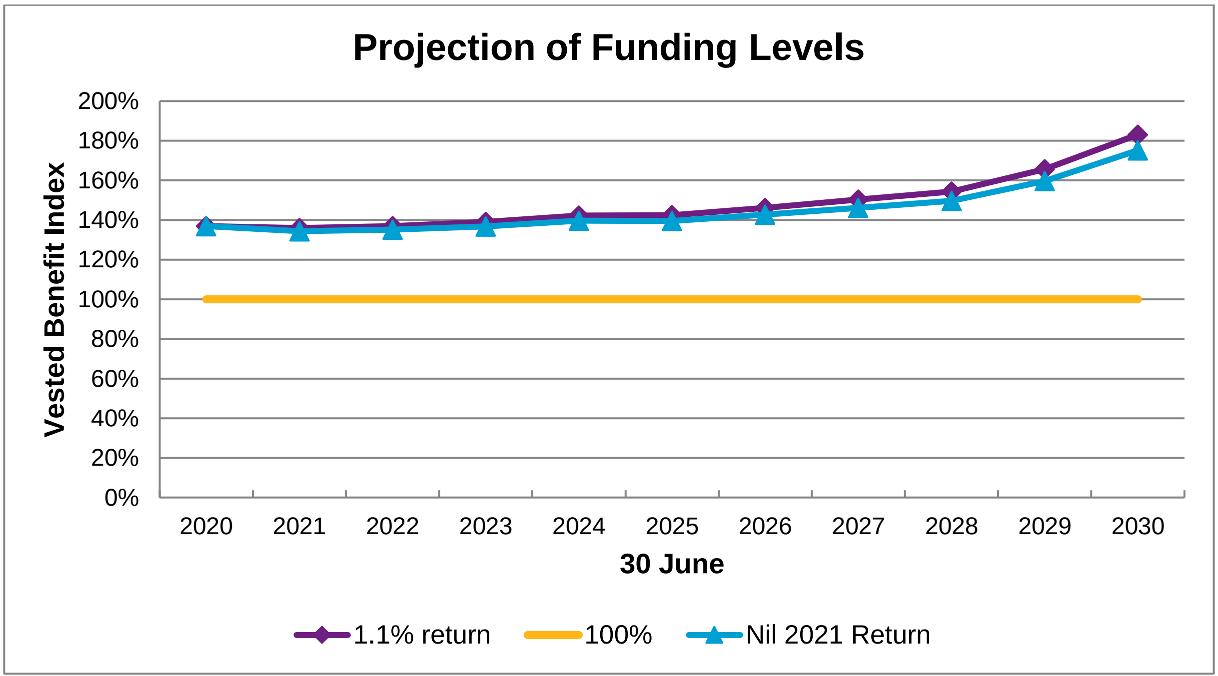
1.16 Our projection below shows that, on the basis of the assumptions made in this actuarial investigation and assuming that City of Melbourne ceases to contribute in line with the recommendations set out below, the COM plan is expected to remain in a satisfactory financial position.

1.17 If City of Melbourne continue to contribute, and experience is as expected, the actuarial surplus is $9.2 million. If City of Melbourne ceased contributions from 1 July 2020 this would reduce to $4.6 million. Even if the expected investment return reduced from 1.1% p.a. to 0.1% p.a. (an estimated cash rate), a surplus is expected to remain.

1.18 If experience is as expected, City of Melbourne is not expected to be required to make any further contributions because of the actuarial surplus that exists. We recommend a contribution holiday commence as soon as convenient, but no later than from 1 July 2021.

1.19 We also recommend Vision Super consider reducing the investment risk in the COM plan assets when appropriate, assuming its preference and the preference of the City of Melbourne continues to be to reduce risk rather than build surplus. We note this has minimal immediate impact on the current Vested Benefits and a reduction in the investment risk could be made immediately if the Trustee considered it appropriate. For example, if the investment strategy was set to target a net investment return of 0.1% p.a. the proposed contribution holiday is still expected to be viable. If de-risking does not occur then the expectation is that the surplus will continue to increase leaving material excess assets when the last member is paid.

1.20 The future funding position, and the potential for additional contributions to be required from City of Melbourne, is dependent upon future experience and particularly future investment returns. The following chart compares the expected Vested Benefit Index (VBI) in the best estimate "base case" and if there is a nil return in the year to 30 June 2021 (and expected returns thereafter). In both cases no City of Melbourne contributions are assumed from 1 July 2020. It should be noted that a nil return is not the worst outcome that could occur. Other areas of future experience that may affect the future funding position include salary increases.



1.21 If the 2021 investment return is zero before reverting to 1.1% p.a., no contributions would be expected to be required. The expected increase in VBI shown on the chart confirms that the surplus is expected to continue to increase, even with the recommended contribution holiday, indicating a reduction in underlying risk within the investment strategy is an important consideration.

Recommendations

1.22 We recommend that City of Melbourne adopt the following funding plan:

a From 1 July 2020 a contribution rate of 13% (inclusive of 1% salary continuance cover) of salaries for Division D members;

b From a convenient date agreed between Vision Super and City of Melbourne, but no later than 1 July 2021:

- A nil contribution rate for Division D members.

c If the VBI is below 100% (which is unlikely), top-up amounts for exiting members equal to the following amount increased for contribution tax:

Benefit Payment less (Vested Benefit x VBI)

Top-up payments are to be calculated and invoiced quarterly in arrears. Benefit payments exclude the amount of any insurance proceeds.

d City of Melbourne also needs to contribute the amount of members' salary sacrifice contributions.

1.23 If experience is as assumed then City of Melbourne would never need to contribute again. However, because experience could be worse than assumed we also recommend that if the VBI reduces to 125% further actuarial advice be obtained to review the contribution holiday and determine whether contributions should recommence.

1.24 We recommend that Vision Super consider reducing risk within the current investment strategy. The analysis is Section 7 shows that a very low (positive) investment return is expected to leave a reduced surplus.

1.25 The current and projected liquidity should continue to be regularly reviewed, and stress tested.

1.26 We also recommend that Vision Super update the insurance policy to remove remaining self-insurance, as it considers appropriate.

1.27 As required under SPS 160, the Trustee has set the Shortfall Limit for the COM plan at 100%. We consider this Shortfall Limit to be reasonable given the strong financial position of the COM plan and our recommendation to consider further de-risking. Based on the current investment strategy it would also be reasonable to reduce the Shortfall Limit to 99% but this is not our recommendation.

1.28 The next triennial actuarial review should be carried out as at a date no later than 30 June 2023.

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18 December 2020

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Section 2: Introduction

2.1 This report was commissioned by Vision Super Pty Ltd, the Trustee of the Local Authorities Superannuation Fund (the Fund).

2.2 The Local Authorities Superannuation Act (1988) (the Act) was proclaimed on 25 May 1988. The Act has been replaced and since 1 July 1998, the Fund has been governed by a Trust Deed.

2.3 The Fund is a “regulated fund” under the provisions of the Superannuation Industry (Supervision) Act 1993 (“SIS”). We understand that the Fund is treated as a complying superannuation fund for taxation purposes and is a taxed superannuation fund.

2.4 In accordance with Superannuation Prudential Standard 160 (SPS 160), “triennial” actuarial investigations are required at intervals of not more than three years. The last triennial actuarial investigation was completed for the COM plan as at 30 June 2017 and our report was dated 1 November 2017.

2.5 This actuarial investigation report covers the COM plan within the Fund, which is a sub-fund as defined in SPS 160. The divisions of the Fund that pay only accumulation benefits are not considered in this report. The actuarial investigations for the Parks Plan and the main Defined Benefit plan, which are also sub-funds as defined in SPS 160, are covered in separate reports.

2.6 The purpose of this report is to:

- examine the sufficiency of the assets in relation to members’ accrued benefit entitlements;
- determine the contribution rates required to so that the COM plan is expected to maintain a satisfactory financial position;
- satisfy requirements of the Trust Deed; and
- meet legislative requirements.

This actuarial review has been conducted in order to meet the Trustee’s obligations in accordance with SPS160 issued under section 34C of the Superannuation Industry (Supervision) Act (SIS Act) which came into effect from 1 July 2013.

2.7 This report satisfies the requirements of the following Professional Standards and Guidance of the Institute of Actuaries of Australia:

- Practice Guideline 1
- Professional Standard 400
- Professional Standard 402
- Professional Standard 404.

Actuarial Investigation as at 30 June 2017 and subsequent events

2.8 The report on the actuarial investigation as at 30 June 2017 concluded that the experience of the COM plan over the three years to 30 June 2017 had been favourable. During the three years to 30 June 2017 investment returns were higher than expected. The COM plan was in a satisfactory financial position.

2.9 We understand that City of Melbourne has contributed in accordance with our recommendations (refer Section 7).

2.10 Under the assumptions adopted in the last actuarial investigation the employer contributions were expected to be more than required to meet funding requirements, and following discussions with Vision Super we recommended they consider whether a lower risk investment strategy was appropriate. We also recommended a possible contribution holiday be considered. Subsequent to the actuarial investigation a lower risk investment strategy was adopted (refer Section 4).

2.11 We also recommended that the Board consider a plan to reduce the exposure to illiquid assets in the COM plan to zero over time given the maturity of the plan and the possibility of large benefit payments. The illiquid assets have reduced over the three years to 30 June 2020. Nonetheless, this continues to remain a consideration of this actuarial investigation.

2.12 We also recommended that Vision Super review the insurance policies to ensure it is satisfied that any self-insurance is not material. There is still an element of self-insurance within the COM plan. Please refer to Section 8.

2.13 There have been no amendments to the COM plan benefits since 30 June 2017.

2.14 There have been no legislative changes or changes to benefits that have materially impacted on the funding of the COM plan.

2.15 Experience has been favourable since 30 June 2017 as shown by improved funding indices (refer to Section 6).

Reliance Statement and Data

2.16 This report is provided subject to our agreed Terms and Conditions of Engagement dated 8 May 2020. This report is provided solely for the Trustee's use and for the specific purposes indicated above. It may not be suitable for use in any other context or for any other purpose.

2.17 Except where we expressly agree in writing, this report should not be relied on by any third party. In the absence of such consent and an express assumption of responsibility, no responsibility whatsoever is accepted by us for any consequences arising from any third party relying on this report or any advice relating to its contents.

2.18 The Trustee may make a copy of this report available to its auditors, Authorities and to any person to whom the Trustee may be required to provide a copy under relevant legislation, but we make no representation as to the suitability of this report for any purpose other than that for which it was originally provided and accept no responsibility or liability to the Trustee's auditors, Authorities or any third party in this regard. The Trustee should draw the provisions of this paragraph to the attention of its third parties when passing this report to them.

2.19 In conducting this review, we have relied upon information and data provided to us orally and in writing by the Trustee and other persons or organisations designated by the Trustee. We have relied on all the data and information provided, including plan provisions, membership data and asset information, as being complete and accurate. We have not independently verified the accuracy or completeness of the data or information provided, but we have performed limited checks for consistency.

2.20 The results presented in this report are directly dependent upon the accuracy and completeness of the underlying data and information. Any material inaccuracy in the data, assets, plan provisions or other information provided to us may have produced results that are not suitable for the purposes of this letter and such inaccuracies may produce materially different results that could require that a revised letter be issued.

Content of this Report

2.21 The remainder of this report is structured in the following manner:

- Sections 3 to 5 consider the data, assets, assumptions and methodology;
- Section 6 considers the financial position of the COM plan at 30 June 2020.
- Section 7 considers the adequacy of funding of the COM plan.
- Section 8 considers insurance.
- Section 9 considers material risks.
- Appendices A to F include supporting details of benefits, membership, accounts, actuarial assumptions, assets and actuarial surplus;
- Appendix G contains the statements required under SPS 160.

Section 3: Data and Experience

3.1 This section deals with the data used in the investigation and comments on the more significant factors bearing upon the experience of the COM plan.

Membership

3.2 For the purposes of this investigation, we were supplied with information on active members of the COM plan as at 30 June 2020 together with details of exits during the period from 1 July 2017 to 30 June 2020. While we have relied upon the data provided, from our checking processes we believe that the data is sufficiently accurate for the purposes of this investigation.

3.3 In summary, the active membership of the COM plan has decreased by 26 (or 25%) from 104 at 30 June 2017 to 78 at 30 June 2020.

Summary of COM Plan Membership as at 30 June 2020

	Number	Average Age (years)	Average Service (years)	Average Salaries
Active	78	57.3	32.5	102,704

3.4 Retained members have accumulation benefits within the Fund but a defined benefit top-up may apply and any such amount must be paid from COM plan assets. As at 30 June 2020, there were 31 retained members with account balances totalling $8.1 million. A summary of the movement in active membership is set out in Appendix B.

Salaries

3.5 We have examined the salary experience of COM plan members over the three year period ending 30 June 2020. The data showed that the full time equivalent salary of COM plan members who remained members as at 30 June 2020 grew by 2.5% p.a. over the period. This compares to growth of 1.7% p.a. over the three year period to 30 June 2017 in the last actuarial investigation.

3.6 The actual increase over the three years ending 30 June 2020 was lower than the assumed rates of 3.5% p.a. in the 30 June 2017 actuarial investigation. The lower than expected salary increases would have resulted in an improvement in the COM plan financial position.

3.7 It is of interest to compare the average rate of salary increase with the increase in Australian Average Weekly Ordinary Time Earnings (AWOTE). Over the three years period ending 30 June 2020, AWOTE increased by 3.6% p.a. On average, members received salary increases which are lower than those of the wider community.

Demographic Experience of Active Members

3.8 Given the small size in membership, it is difficult to develop statistically reliable decrement assumptions based on plan experience.

3.9 We have decided to continue to apply the same resignation and retirement rates as are used for the main Defined Benefit plan. These are the same rates that were adopted in the last triennial actuarial investigation as at 30 June 2017.

3.10 For death and disablement we have decided to retain the same assumptions adopted for the 30 June 2017 actuarial investigation that were based on the external insurance premium rates.

Administration Expenses

3.11 In the 30 June 2017 investigation, the administration expense was assumed to be set as 4.5% of salaries for active members.

3.12 Actual expenses over the three years ending 30 June 2020 have been higher than expected. Based on experience we have increased the assumed level of expenses to 6% of salaries for active members.

Investment Returns

3.13 Vision Super has advised that the rate of return (net of tax and investment expenses) earned by the COM plan for the three years ending 30 June 2020 was 6.0% p.a.

Investment Return	
Year ended	**% p.a.**
30 June 2018	6.0
30 June 2019	8.3
30 June 2020	3.9
Average	6.0

3.14 Comparison of the 6.0% p.a. return for the intervaluation period with the average salary increase rate (from paragraph 3.5) of 2.5% p.a. shows a real return of approximately 3.5% p.a. which is higher than the 2.0% p.a. real return assumed in the 2017 investigation.

3.15 The real returns over the valuation period have had a positive effect on the COM plan's financial position.

Section 4: Assets and Investments

Assets

4.1 Copies of the Fund's audited financial statements as at 30 June 2020 were supplied by Vision Super for the investigation together with details of the investment strategy at 30 June 2020. Vision Super subsequently provided the investment strategy dated 17 July 2020. We were also provided a breakdown of the market value of assets by sub-plan. A summary of cash flows over the period 1 July 2017 to 30 June 2020 is set out in Appendix C.

4.2 The fair value of the COM assets as at 30 June 2020 used in the valuation was $54.6 million. This asset value excludes $8.1 in respect of retained benefits accounts. The financial statements include the fair value of assets for the three defined benefit sub-plans and this value is consistent with that amount.

4.3 Vision Super has excluded the Operational Risk Financial Requirement from the COM plan assets in the financial statements.

4.4 We believe that the most suitable approach for this investigation is to adopt the fair value of assets for all purposes. In our opinion the use of fair market value is reasonable as the COM plan is expected to be ongoing.

Asset Allocation

4.5 As at 30 June 2020 the COM plan invested in a primarily defensive range of asset classes such as fixed interest and cash investments. As at 17 July 2020 a decision was made to shift away from fixed interest towards alternative debt and a small allocation to equities. Appendix E shows the Strategic Asset Allocation, the Actual Asset Allocation as at 30 June 2020 and the Strategic Asset Allocation resulting from an amendment to the investment strategy on 17 July 2020.

4.6 The Strategic Allocation to Growth Assets as at 30 June 2020 was 0% (which is a material reduction from 41.9% as at 30 June 2017), while the actual growth allocation was slightly higher at 1.2%. As at 17 July 2020 the Strategic Allocation to Growth Assets was 15% (which is still a material reduction from the growth allocation at 30 June 2017, but an increase from 30 June 2020).

4.7 In our opinion the allocation to growth assets is among a range of allocations that could reasonably be used by the COM plan, subject to our view that the Trustee should consider further de-risking the COM plan assets.

4.8 Setting the Strategic Asset Allocation is a balance between:

a A high allocation to growth assets, which is expected to produce relatively high but more variable investment returns and therefore lower but more variable employer contributions; and

b A low allocation to growth assets, which is expected to produce relatively low but less variable investment returns and therefore higher but less variable employer contributions.

4.9 The COM plan has been closed to new members for many years. Therefore, its liabilities will reduce significantly over the next five years in real terms. If future investment returns are higher or lower than expected it is possible that a significant "actuarial surplus" or "actuarial shortfall" will again result. Therefore, it is recommended that the funding position of the COM plan continues to be considered when setting investment policy.

Liquidity

4.10 As at 30 June 2020, 1.2% of the investments are in illiquid asset classes. Since 30 June 2020, this has increased a little.

4.11 We understand the illiquid strategic asset allocation at 30 June 2020 was 0% (which was reduced materially from 24.1% at 30 June 2017). As at 17 July 2020 the Strategic Allocation to illiquid assets increased to 5% (which is still a material reduction from the growth allocation at 30 June 2017, but a slight increase from 30 June 2020).

4.12 In the long term, the defined benefit plans will require full liquidity. Therefore, we believe the currently low exposure levels to illiquid assets are consistent with our previous recommendations. That said, we continue to strongly express our view that illiquid asset exposure in the defined benefit plans should trend to zero unless the rest of the Vision Super assets are used to support the liquidity.

Unit Pricing

4.13 Within the Fund there are defined contribution members as well as defined benefit members. The assets and liabilities of the defined contribution members are equal, subject to timing differences, with daily unit pricing being used. There is no investment reserving. We have been advised that the assets of the defined contribution members are segregated from the defined benefit assets and Vision Super has in place processes to limit cross subsidies between defined contribution and defined benefit members.

4.14 The Fund’s Investment Governance Framework states that defined benefit investment options are considered separately from the Accumulation Investment options. This means that the COM plan’s asset allocation should not be materially impacted by the experience of the defined contribution plans.

Shortfall Limit

4.15 The Trustee has set a Shortfall Limit in accordance with SPS 160 of 100% for the COM plan. This means that between actuarial investigations, a restoration plan to restore the VBI to 100% is required if the COM plan’s VBI reduces to below 100%.

4.16 A Shortfall Limit is defined in paragraph 10 of SPS 160 as:

“the extent to which an RSE licensee considers that a fund can be in an unsatisfactory financial position with the RSE licensee still being able to reasonably expect that, because of corrections in the temporary negative market fluctuations in the value of fund assets, the fund can be restored to a satisfactory financial position within one year.”

4.17 We believe that the current Shortfall Limit was appropriate at 30 June 2020 and we recommend it remain at 100%.

4.18 However, consideration could be given to reducing it to 99% following the increase to growth assets on 17 July 2020. We have considered that:

a The actual asset allocation to growth assets of about 1.2% at 30 June 2020 is consistent with the current Shortfall Limit of 100% based on the Actuaries Institute’s guidance. However, the recent change in the COM plan growth asset allocation to 15% on 17 July 2020 is consistent with a Shortfall Limit of 99% based on the Actuaries Institute’s guidance;

b Vested benefits are higher than Minimum Requisite Benefits; and

c The employer has a contractual obligation to pay contributions determined by the Trustee.

4.19 In Section 7 of this report we recommend the Trustee consider further reducing the COM plan's allocation to growth assets. If this were to occur and Vision Super were to continue their commitment to reducing the allocation towards growth assets, then the current Shortfall Limit of 100% is likely to remain appropriate and this is why we suggest retaining the 100% Shortfall Limit

Section 5: Valuation Assumptions and Funding Method

5.1 An appropriate set of both financial and demographic assumptions must be determined before values can be placed on the COM plan's liabilities and assets. The assumptions relating to benefit liabilities and assets are discussed under separate headings below.

Valuation of Benefit Liabilities

5.2 The assumptions for this actuarial investigation have been determined on a "best estimate" basis.

5.3 "Best estimate" describes assumptions which reflect "mean" estimates for the various factors, rather than choosing assumptions with explicit margins to cope with uncertainty about future experience. These "best estimate" assumptions might be described as being realistic. They are equally likely to prove to be conservative or to be optimistic and are less likely to be able to absorb fluctuations in future experience.

5.4 As the COM plan is closed to new members and as a result has declining membership, "best estimate" assumptions continue to be relevant because using conservative assumptions would be expected to eventually result in excess assets. Best estimate assumptions are also required by the Actuaries Institute's Professional Standards.

5.5 Appendix D contains a summary of the assumptions used.

Key Financial Assumptions

5.6 Financial assumptions for investment earnings, salary inflation and pension increases are required to value the liabilities.

5.7 The factor of major significance in the investigation of the COM plan's active member benefit liabilities is the differential between the assumed future rate of investment earnings and the assumed rate of salary growth due to inflation. (These factors are almost exactly compensating in their effect upon the present value of the employed members' COM plan's future benefit liabilities - hence, the difference between the rates is important, rather than their absolute values.)

5.8 The "best estimate" financial assumptions adopted at the 30 June 2017 actuarial investigation were:

- 3.5% p.a. salary inflation.
- 5.5% p.a. investment return.

Investment Return

5.9 In order to determine the best estimate assumptions for this investigation, we have considered the capital market assumptions of Willis Towers Watson and the Fund's asset consultants, Frontier. A best estimate net investment return of 1.1% p.a. has been adopted for this investigation based on the asset allocation at 30 June 2020. The reduction since 2017 reflects the material reduction in growth assets in the asset allocation and lower asset class return expectations.

We have been advised by Vision Super that there was a revision to the investment strategy of the COM plan effective 17 July 2020. Accordingly, some of the COM plans allocation towards fixed interest has shifted towards alternative debt and equities. The Fund's asset consultants, Frontier, have advised the net investment return of this investment strategy is 1.9% p.a..

Our intention is to continue adopting the best estimate net investment return of 1.1% p.a. for the purpose of this investigation. This is consistent with our recommendation for the Trustee to consider further de-risking of the investment strategy. However, we also consider the effect of adopting this "alternate" investment return within the relevant sections of this investigation.

5.10 The assumptions are net of investment management fees.

CPI Increases

5.11 The Reserve Bank's target CPI range is 2.0% p.a. to 3.0% p.a.. We have reduced the assumption from 2.5% p.a. at 30 June 2017 to 2.0% p.a. at 30 June 2020 after considering the price inflation expectations of the asset consultants and the need to be consistent with the assumed investment return.

Salary Inflation

5.12 The actual salary increases of the COM plan members have been lower than AWOTE (refer 3.7). As the average age of COM plan members is now over 55 years, significant benefit payments are expected in the next few years and the short term salary inflation assumption is important. A salary inflation assumption of 2.0% p.a. for two years and 2.75% p.a. thereafter has been adopted in this investigation and is considered best estimate.

5.13 A salary increase assumption of 2.0% p.a. for two years and 2.75% p.a. thereafter is between 0% p.a. and 0.75% p.a. above the assumed 2.0% p.a. CPI, which is within the historical long term 0% to 2% p.a. differential. Given recent experience and the maturity of the COM plan, we believe that this is appropriate. No promotional salary increases are being assumed.

5.14 Therefore, the "best estimate" financial assumptions adopted for the 30 June 2020 investigation are a -0.9% p.a. real investment return over salary inflation for two years and -1.65% p.a. thereafter.

This comprised a 1.1% p.a. net of tax investment return assumption and a 2.0% p.a. salary inflation assumption for two years followed by 2.75% p.a. thereafter. This is lower than assumed as at 30 June 2017 and will mean a relative deterioration in the expected long term funding position.

Demographic Assumptions

5.15 The demographic assumptions that affect the COM plan have been discussed in Section 3. Appendix D summarises the demographic assumptions adopted for this investigation.

Benefits

5.16 The benefits which have been valued are summarised in Appendix A.

Valuation of Assets

5.17 The fair value of assets has been adopted consistently with the last actuarial investigation.

Actuarial Funding Method

5.18 In recommending a funding plan which aims to be sufficient to fund the members' benefits in the long-term, it is necessary to project the operation of the COM plan into the future, using the actuarial assumptions set out above.

5.19 Briefly the projection operates in the following manner:

a project total benefits and expenses expected to emerge in all future years in respect of current members. The projection is based on the long-term actuarial assumptions including allowance for the contingencies under which benefits can be paid (retirement, death, disablement and resignation), salary and pension increases;

b discount these projected benefits to a present value at the assumed long-term investment return;

c in a similar manner to (a) and (b), project the ongoing employer contribution and member contributions over all future years for current members, and discount them to present values; and

d determine the additional funding required by the employer by comparing (b) with (c) plus the appropriate value of the assets at the investigation date.

5.20 This projection is known as the aggregate funding method, which is considered to be appropriate for a closed fund. The purpose of the calculation is to assess if the existing contribution rates and assets are sufficient to provide all future benefits on current assumptions.

5.21 Under SPS 160, APRA requires superannuation funds to put in place a plan that is expected to fully fund their vested benefits within three years if the fund's assets are less than the vested benefits at an actuarial investigation, also known as being in an "Unsatisfactory Financial Position". A funding plan is also required when the VBI reduces to below the shortfall limit, currently 100%, between actuarial investigations.

5.22 The shortfall or surplus relative to vested benefits is likely to vary from the actuarial shortfall or surplus calculated using the method set out in 5.19. It is possible that the recommended funding amount under this funding method may not be sufficient to be expected to maintain the COM plan's Vested Benefits Index (VBI) to 100% within the timeframe required by APRA if it is below 100%. In this situation additional contributions would be recommended as required by APRA.

5.23 Additional contributions can be made to target a VBI of 100% but where these contributions are higher than any actuarial shortfall calculated using the aggregate funding method described above a surplus would be expected to result in the long term if experience is as expected. Vision Super may also be able to manage any such shortfalls or surpluses through a combination of changes to funding and investment strategy.

5.24 In the next section we review the financial position as at 30 June 2020 and in Section 7 we discuss the adequacy of the long term funding arrangements.

Section 6: Financial Position of the COM Plan

6.1 The financial position of the COM plan at the investigation date provides some insight into the progress towards fully funding members' benefits in the long-term.

6.2 A convenient means of assessing the financial position of the COM plan involves the calculation of various indices of benefits compared to assets.

Vested Benefits Index

6.3 The first of the indices is the "Vested Benefits Index" (VBI). Vested Benefits are defined as the benefits that would be due and payable if all the members voluntarily terminated their service with their employers at the investigation date. For active members, the Vested Benefits are the resignation benefit or the early retirement benefit (if aged 55 or more). For retained members, the vested benefit included in this index is the defined benefit top-up amount (i.e. the excess of the Accrued Retirement at the date of exit adjusted with CPI indexation over their account balance) which is also the amount included for these members in the other indices.

6.4 The Vested Benefits Index is calculated as follows:

$$\text{VBI} = \frac{\text{fair value of assets}}{\text{total of vested benefits}}$$

6.5 The Vested Benefit Index as at 30 June 2020 is:

VBI as at 30 June 2020	
COM plan assets ($m)	54.6
Vested Benefits ($m)	39.9
Vested Benefit Index	136.9%

6.6 The calculated VBI for the COM plan at 30 June 2020 is 136.9%. This compares with a VBI of 123.5% at the 30 June 2017 investigation. The COM plan was not in an unsatisfactory financial position as at 30 June 2020.

6.7 The VBI for the COM plan has increased since 30 June 2017 mainly due to the higher than expected real investment returns during the year and also the contributions being made expected to be more than required.

6.8 The VBI of the COM plan at 30 June 2020 is not materially affected by any changes to the assumed net investment return.

Discounted Accrued Benefits Index

6.9 Discounted Accrued Benefits mean the present value of the benefit payable in the future (based on the assumptions) accrued in respect of service to the investigation date. The method of apportioning active members' benefits to past service for the COM plan is as follows, effectively recognising the portion of future benefits arising due to service to date:

a Retirement– the past service benefit (based on accrued lump sum multiples) at the calculation date, with allowance for future salary growth to the assumed exit date.

b Death and Disablement benefits – the total projected death/disablement benefit at the assumed exit date multiplied by the ratio of service to the calculation date divided by service to the retirement date.

c Immediate Resignation Benefit – the past service benefit at the calculation date (based on the multiples at the calculation date) with allowance for future salary growth up to the assumed resignation date.

6.10 The Discounted Accrued Benefits are not subject to a minimum of the Vested Benefits.

6.11 The index is a measure of the COM plan's on-going capacity to meet Accrued Benefits in the long run.

6.12 The "Discounted Accrued Benefits Index" (DABI) is calculated as follows:

$$\text{DABI} = \frac{\text{fair value of assets}}{\text{total of discounted accrued benefits}}$$

6.13 The Discounted Accrued Benefit Index as at 30 June 2020 is:

DABI as at 30 June 2020	
COM plan assets ($m)	54.6
Discounted Accrued Benefits ($m)	43.5
Discounted Accrued Benefit Index	125.4%

6.14 The calculated DABI for the COM plan at 30 June 2020, based on the "best estimate" assumptions, used in this investigation, is 125.4%. The DABI was estimated to be 131% at the 30 June 2017 investigation. The reduction in DABI was mainly due to the better than expected real investment return over the period being materially offset by the sizeable impact of the changes in financial assumptions.

6.15 Because the DABI is more than 100%, it means current assets are expected to be sufficient to provide the benefits of members' accrued benefits based on service to 30 June 2020.

6.16 As detailed in Section 5.9, there was a change to the COM plans growth allocation on 17 July 2020. Under the alternate assumed net investment return of 1.9% p.a., which is consistent with the asset allocation at 17 July 2020 the DABI for the COM plan increases to 130% at 30 June 2020. The DABI improved with the increase in expected long-term net investment return.

Minimum Requisite Benefits Index

6.17 We have also considered the asset coverage of members' Minimum Requisite Benefits.

6.18 The Minimum Requisite Benefits (MRBs) are the minimum amount of benefit that must be provided to enable City of Melbourne to satisfy its Superannuation Guarantee obligations. The method to calculate the amount of MRBs for the active members is specified in my Benefit Certificate dated 23 October 2018.

6.19 The MRBs have been configured on the administration system. We have therefore used the MRB data provided by the administrator for the purposes of this valuation.

6.20 The Minimum Requisite Benefit Index is calculated as follows:

$$\text{MRBI} = \frac{\text{fair value of assets}}{\text{total of Minimum Requisite Benefits}}$$

6.21 The Minimum Requisite Benefit Index as at 30 June 2020 is:

MRBI as at 30 June 2020	
COM plan assets ($m)	54.6
Minimum Requisite Benefits ($m)	29.5
Minimum Requisite Benefit Index	185.1%

6.22 As at 30 June 2020 we estimate that the ratio of the market value of assets to the amount of Minimum Requisite Benefits was approximately 185.1%. This compares with a MRBI of 169% at the 30 June 2017 investigation. The increase in MRBI was mainly due to the better than expected real investment return during the period.

6.23 The MRBI of the COM plan at 30 June 2020 is not materially affected by any changes to the assumed net investment return.

6.24 If this ratio for the entire Fund falls to below 100%, it becomes Technically Insolvent as defined in the SIS Regulations. If this occurs the Trustee must take certain steps to restore solvency. The Trustee needs to continue to monitor the "Notifiable Events" defined in the Funding and Solvency Certificate to identify if the Fund is at risk of becoming, or becomes, Technically Insolvent so appropriate action can be taken.

Other Measures of Financial Position

6.25 In accordance with Clause A.21.1(a) of the Trust Deed, an Employer requires the approval of the Board to terminate its contributions to the COM plan. We assume this approval would not be provided unless any future funding risk is adequately managed.

6.26 However, if an Authority does terminate its contributions, Clause A.21 of the Trust Deed states that:

> *"the Trustee, after obtaining the advice of the Actuary and subject to A.21.5, may adjust any benefit which is or may become payable to or in respect of any person whom the Trustee may consider is affected by that termination to the extent and in the manner the Trustee considers appropriate and equitable"*

6.27 Further it states in Clause A.21.5 that:

> *"…Unless otherwise agreed between the Trustee and the Employer, an adjustment made …must not increase the amount of any benefit which, in the opinion of the Trustee after obtaining the advice of the Actuary, has accrued in respect of a person immediately prior to the effective date of that adjustment in respect of the period up to that date or improve the basis upon which benefits accrue during or in respect of any period after that date."*

6.28 Therefore, in the case of the termination of contributions the Trustee has some flexibility in respect of the benefits provided, subject to superannuation law, and there is no alternative measure of financial position that needs to be calculated in respect of this situation.

6.29 On retrenchment, members are entitled to an accrued retirement lump sum. This benefit may also be payable on partial disablement. For active members, the ratio of retrenchments benefits as at 30 June 2020 to assets was 134.3%. At the 30 June 2017 investigation, the retrenchment benefit index was 120%. The increase in the index is mainly due to better than expected real investment return during the period. This index is not materially affected by any changes to the assumed net investment return.

6.30 At the date of this report, an additional contribution is required from City of Melbourne in respect of each retrenchment, and each exit if the VBI is below 100%, so that there is no additional financial strain on the COM plan. However, given the strong financial position of the COM plan in this report we recommend that this no longer occur.

6.31 In certain situations, some members can elect a pension, subject to the approval of Vision Super. While there are no current pensioners, a member electing a pension may cause a strain on funding.

6.32 In Appendix E the COM plan's asset allocation is shown and there is currently a low allocation to illiquid assets. The funding indices have been calculated based on the valuation of these assets at fair market value from the 30 June 2020 draft financial statements (excluding disposal costs). Given the low level of illiquid assets, we do not consider there to be a material risk of significant discounted asset values (and reduction to funding indices) occurring in the unlikely event that these assets had to be quickly liquidated.

6.33 There was no material deferred tax asset in the Fund as at 30 June 2020. Therefore, the funding is not significantly dependent upon being able to utilize such an amount.

Section 7: Assessing the adequacy of the Funding Arrangements

The Present Funding Arrangements

7.1 The funding arrangements for the COM plan currently comprise the following components:

a A contribution rate of 13% (inclusive of 1% salary continuance cover) of salaries for Division D members;

b If the VBI is below 100% and in any event upon retrenchment, top-up amounts for exiting members equal to the following amount increased for contribution tax:

Benefit Payment less (Vested Benefit x VBI)

Top-up payments were to be calculated and invoiced quarterly in arrears. Top-up payments are required for all retrenchments (VBI capped at 100%), but for other exits only when the VBI is below 100%. Benefit payments exclude the amount of any insurance proceeds.

c City of Melbourne also needs to contribute the amount of members' salary sacrifice contributions.

Total Service Liability Surplus/ Deficit as at 30 June 2020

7.2 As at 30 June 2020 and adopting an assumed net investment return of 1.1%p.a. there was a total service liability surplus of $9.2 million. This means that the current value of assets plus expected future contributions is more than the value of expected future benefits and expenses by $9.2 million, assuming that City of Melbourne continues to contribute at current rates.

As detailed in Section 5.9, there was a change to the COM plans growth allocation on 17 July 2020. Under the alternate assumed net investment return of 1.9% p.a., which is consistent with the asset allocation at 17 July 2020 the total liability surplus increases to $11 million. This is due to the increase in assumed future net investment return. The current value of assets plus expected future contributions continue to be more than the value of expected future benefits and expenses, assuming that City of Melbourne continues to contribute at current rates.

Full details of calculations under both net investment returns are set out in Appendix F.

7.3 The total service liability surplus as at 30 June 2017 was $12.2 million. The actuarial surplus has reduced over the intervaluation period mainly due to favourable financial experience (excess of investment return above salary increase) being more than offset by a change in assumptions. The de-risking reduced the actuarial surplus by an order of $10 million dollars, but favourable real returns for the three years ending 30 June 2020 increased the actuarial surplus to be significantly more than expected given the de-risking that occurred.

7.4 The existing funding arrangements are expected to be more than adequate if the current assumptions are borne out in practice. In fact, the total service liability surplus of $9.2 million is higher than the expected value of all future City of Melbourne contributions (less tax) of $4.6 million (refer to Appendix F). This means that if experience is as expected from 30 June 2020, City of Melbourne would not need to make any further contributions to the COM plan. If City of Melbourne ceased contributions a surplus of $4.6 million is expected to remain if no further action is taken.

7.5 Nevertheless, it needs to be recognised that the ultimate cost of benefits for members of the COM plan will depend on the actual future experience of all the relevant factors (investment earnings, salary growth, mortality rates, turnover rates, etc.). Therefore, the contribution arrangements will need to be varied as the actual experience unfolds.

7.6 If experience is as expected in future, to avoid being left with a significant surplus in the long term, the Trustee will need to materially:

a reduce City of Melbourne contributions (eg. to zero); and

b reduce the expected investment return by reducing investment risk. This step is expected to be required even if City of Melbourne ceased to contribute.

Sensitivity of Funding Arrangements to Future Assumptions

7.7 As outlined in Section 5, factors that affect the future experience of the COM plan are split into two broad categories. They are the financial assumptions and the demographic assumptions. The results are more sensitive to changes in the financial assumptions and the sensitivity of the “actuarial surplus” to the financial assumptions is considered below.

7.8 To quantify the potential impact of variations in financial experience the following table shows the impact of changing some of the assumptions on the “actuarial surplus” as at 30 June 2020.The “gap” is the excess of the assumed investment return above the assumed salary inflation, because it is the difference between the assumptions that is important as they offset each other.

Impact of Changes in Key Assumptions

	Actuarial Surplus $ Million
Best estimate assumptions (i.e. 1.1% p.a. net investment return)	9.2
Higher gap (+1% pa)	11.4
Lower gap (-1% pa)	6.8

7.9 The table shows that a variation in the financial assumptions has a significant impact on the actuarial surplus or shortfall.

Note that the variations selected in the sensitivity analysis do not indicate upper or lower bounds of all possible outcomes.

7.10 There is also a risk that the demographic experience may differ from our assumption which would lead to a lower or higher funding cost.

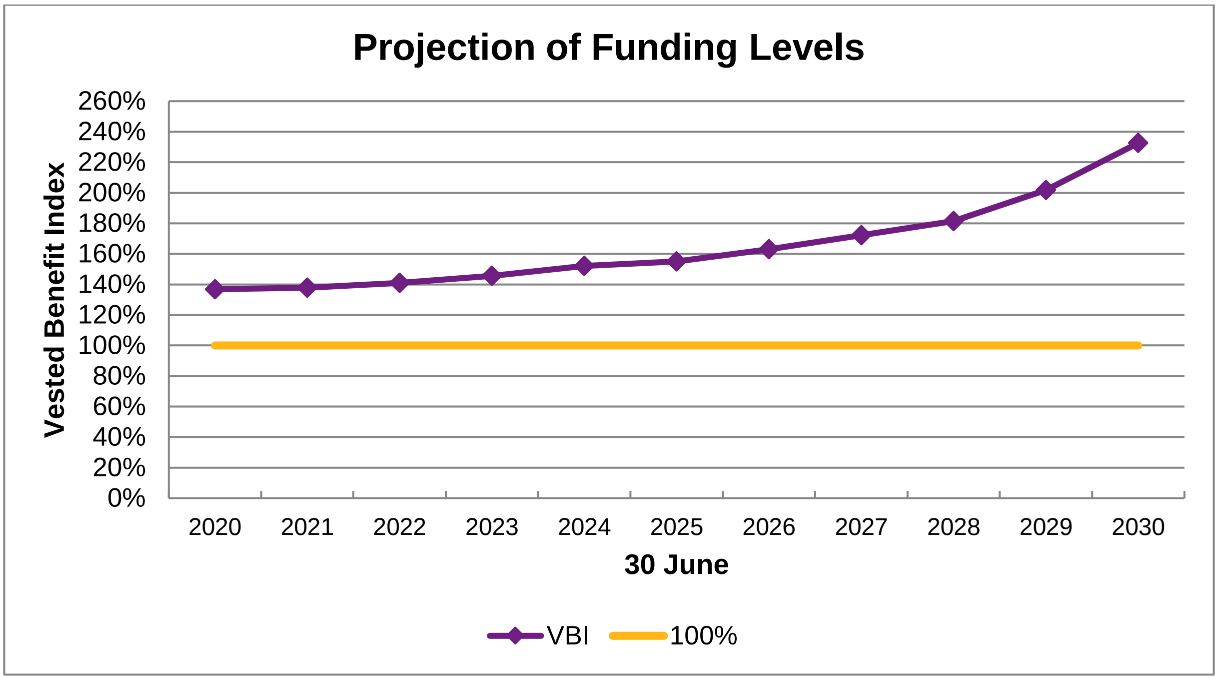
7.11 This table also shows that with the $9.2 million total service liability surplus as at 30 June 2020, an assumed net of tax investment return of 0.1% p.a. rather than 1.1% p.a. was expected to be more than sufficient to fund all liabilities. The remaining surplus of $6.8 million is higher than the present value of expected future employer contributions. This further confirms that there is opportunity for the City of Melbourne to have a contribution holiday.

7.12 Note that any change in the investment strategy so that the expected net return changed from the 1.1% p.a. is not expected to affect the VBI as at 30 June 2020 because currently all of the Vested Benefits are lump sums and independent of assumptions.

Projection of Funding Levels

7.13 This section considers the adequacy of the funding by projecting the COM plan's future funding level. This projection is based on the "best estimate" funding assumptions set out in Appendix D.

7.14 The graph below shows the projected Vested Benefits (VBI) of the COM plan for the next ten years. For clarity, we note an assumed net investment return of 1.1% p.a. is used in this projection and the current contribution rates are expected to be retained over the next ten years. City of Melbourne is also assumed to continue to contribute.



7.15 The chart shows the VBI is expected to stay well above 100% over the next ten years and no additional contribution is expected to be required from City of Melbourne to meet the funding requirement under SPS 160. However, in practice actual experience will be different to what is expected and the VBI may decrease or increase more quickly than expected.

7.16 The above chart shows that the VBI is expected to increase materially over time. This is consistent with a total service liability surplus of $9.2 million at 30 June 2020. The expected growth in VBI would be even higher if an assumed investment return of 1.9% p.a. was assumed.

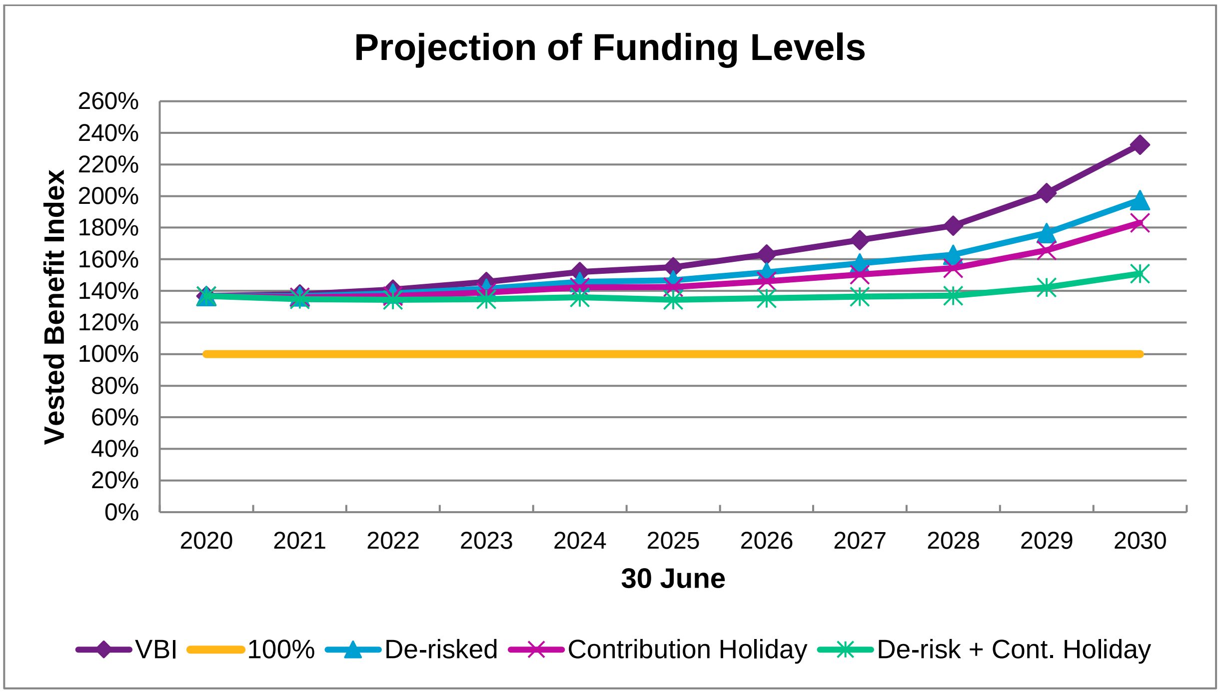
7.17 If the future investment return was lower at 0.1% p.a. the VBI would still be expected to increase, but much more slowly. Nonetheless, the overarching result of an improving VBI is expected to remain under the current contribution schedule and current investment strategy.

7.18 We recommend Vision Super considers a more defensive investment strategy and introduce a contribution holiday. The graph below shows the projected Vested Benefits (VBI) of the COM plan for the next ten years if Vision Super adopts the recommended funding and investment strategy scenarios:

a De-risk towards a 100% cash portfolio, with an expected future net investment return of 0.25% p.a. whilst retaining the current contribution schedule remaining;

b Contribution holiday from 1 July 2021, whilst retaining an expected net investment return of 1.1% p.a.

c The combination of a contribution holiday from 1 July 2021 and a de-risked investment strategy with an expected future net investment return of 0.25% p.a.. The rate of 0.25% p.a. was chosen because it was the official cash rate at the time. The same conclusion is reached with the new cash rate of 0.1% p.a..



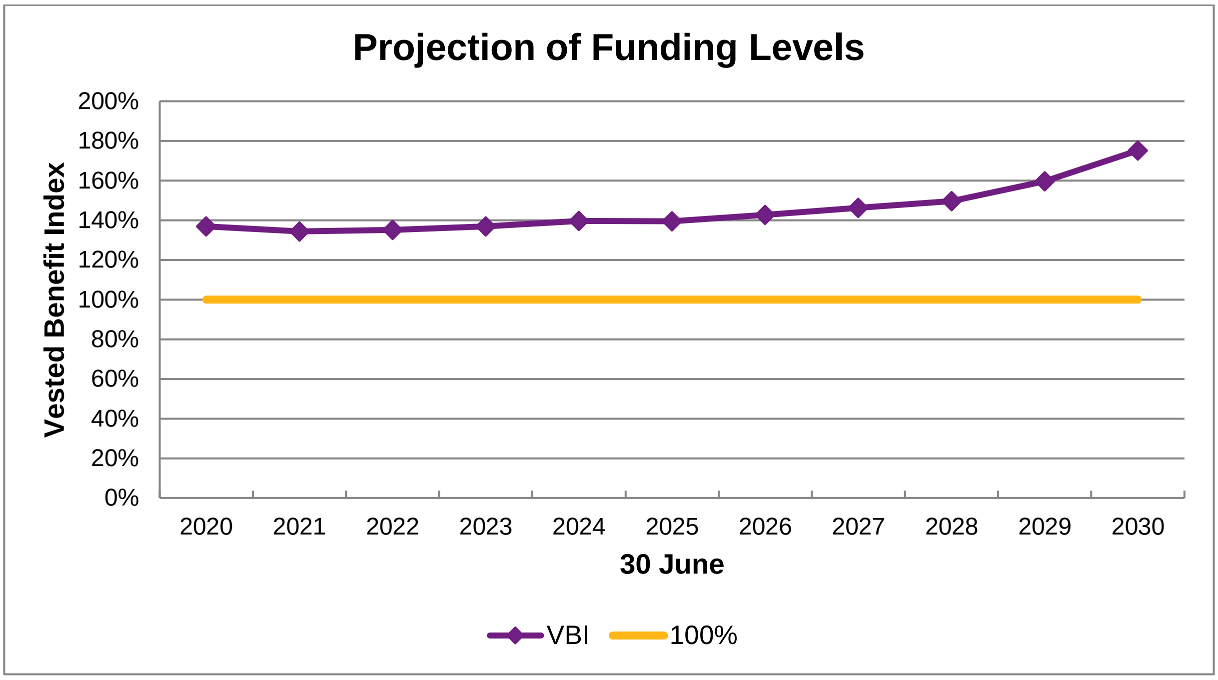
7.19 The chart shows the VBI is expected to stay well above 100% over the next ten years in the recommended funding and investment strategy scenarios, meaning that in all projected scenarios the City of Melbourne is expected to meet the funding requirements under SPS 160.

In practice actual experience will be different to what is expected and the VBI may decrease or increase more quickly than expected.

Other Funding Issues

7.20 The COM plan is mature and its funding is very sensitive to future experience. As shown in Section 7.8 a lower than expected investment return would reduce the “actuarial surplus”.

7.21 The chart below shows the impact on the VBI in an adverse scenario where the return is 0% for the year to 30 June 2021 and all other experience is as expected. For clarity, a best estimate return of 1.1% p.a. is assumed from 1 July 2021 and contributions are assumed to remain the same as current to 30 June 2021, after which it is assumed the COM plan will go on a contribution holiday.



7.22 If the return is 0% in 2020/21, the VBI is expected to fall very slightly, before increasing over time. As the COM plan now contains a low level of growth assets, we note the likelihood and severity of negative returns are reduced. This further strengthens the argument for both initiating a contribution holiday and reducing investment risk.

7.23 On the other hand, if experience is favourable an even larger “actuarial surplus” could result. Vision Super would need to consider how to treat such an “actuarial surplus”.

Events since 30 June 2020

7.24 Vision Super has advised that the investment return for the five months ending 30 November 2020 for the COM plan was 1.38% (equivalent to 3.3% p.a.). This is greater than the best estimate expected return of 1.1% p.a. and therefore will have had a positive impact on the financial position. This does not change our recommendations.

7.25 As detailed in Section 5.9, there was a change to the COM plans growth allocation on 17 July 2020. We maintain our view there is an opportunity to de-risk the investment strategy further and target a lower expected investment return if reducing risk remains the preference of City of Melbourne and the Trustee. The effect of the change of investment strategy has been addressed throughout this investigation. Overall the change in asset allocation does not materially affect the key funding recommendations of this investigation.

7.26 We are not aware of any other events subsequent to 30 June 2020 that would materially impact upon the results of the actuarial investigation of the COM plan.

Recommendation

7.27 Section A.20.1 of the Trust Deed states:

> *"each Employer must contribute to the Fund in respect of a particular Employee at any particular time the amount or rate of contributions determined by the Trustee after obtaining the advice of the Actuary, including the Unfunded Liability Amount…."*

7.28 Based on the results we recommend that the Trustee:

a Reduce City of Melbourne's contributions to zero; and

b Consider further reducing investment risk to target a lower expected investment return, based on the Trustee and City of Melbourne's stated preference to reduce risk where practical.

7.29 If a contribution holiday is not initiated or investment risk is not reduced, and City of Melbourne continues to contribute at the current rates, the already material surplus is expected to continue to grow. The treatment of the surplus would need to be considered now. Even with our recommendations there is an expectation of some remaining surplus. However, this is dependent upon future experience. While the City of Melbourne would never be expected to contribute again, there remains the possibility that contributions could be necessary.

7.30 We recommend that the contribution holiday commence as soon as convenient for Vision Super and the City of Melbourne, but no later than 1 July 2021.

7.31 In summary, we recommend that City of Melbourne adopt the following funding plan:

a From 1 July 2020, a contribution rate of 13% (inclusive of 1% of salary continuance cover) of salaries for Division D members;

b From a convenient date agreed between Vision Super and City of Melbourne, but no later than 1 July 2021, a nil contribution rate for Division D;

c If the VBI is below 100% (which is unlikely to occur), top-up amounts for exiting members equal to the following amount increased for contribution tax:

Benefit Payment less (Vested Benefit x VBI)

Top-up payments are to be calculated and invoiced quarterly in arrears Benefit payments exclude the amount of any insurance proceeds.

d City of Melbourne also needs to contribute the amount of members' salary sacrifice contributions.

7.32 We also recommend that if the VBI reduces to 125% further actuarial advice be obtained to review the contribution holiday and determine whether contributions should recommence.

7.33 It is very important to understand that each of the components of the funding arrangements is very dependent on the actual future experience of the COM plan. Consequently all contribution components are subject to regular review by the Trustee using actuarial advice and could vary from the current recommendations at any time in the future. The next actuarial investigation is due as at 30 June 2023.

Section 8: Insurance

8.1 The COM plan provides death and disablement benefits that are significantly higher than the resignation/retirement benefits.

8.2 As at the 31 December 2011 valuation, the COM plan was self-insured. Therefore, at that time it was City of Melbourne that ultimately bore the financial risk if the amount of death and disablement benefits paid was significantly higher than expected. Variation in the claims experience could also have a large impact on the COM plan's funding position and increase the likelihood of more variable contributions.

8.3 We recommended in the triennial actuarial investigation as at 31 December 2011 that the Trustee externally insure the death and disablement benefits in the COM plan in order to mitigate the various risks involved. The COM plan has been externally insured with MLC, having changed from CommInsure .

8.4 Given the small number of COM plan members and the progression of time, the risk of a self-insured claim emerging from prior to 1 October 2012 is small. If this were to occur, City of Melbourne would currently be required to make top-up contributions in respect of the self-insured component of the benefit if the VBI was below 100%, on the basis that it makes top-up contributions for the unfunded element of all benefits on exit in this circumstance. Therefore, if the VBI was below 100% there would not be expected to be a financial strain on the funding if such a claim was made. If the VBI is above 100% then the self-insured component of the benefit is likely to be able to be funded from surplus.

8.5 Vision Super has externally insured lump sum amounts in some situations where pensions could be paid if a claim occurs. Actuarial advice has been provided on the appropriate amount of the lump sums. If such a claim occurs, City of Melbourne would retain the ongoing risk in respect of the pension.

8.6 The insurance policy has been updated over time to better reflect the underlying sum insured components. However, there is still a variance between the administered sum insured (determined as the difference between the administered death benefit ad vested benefit) and the insured benefit as stated in the MLC policy. This difference is largely due to the death benefit being determined using pre 30 June 1993 accrual rates, whilst the vested benefit makes allowance for both pre and post 30 June 1993 accrual rates. Therefore, there is still some self-insurance totalling approximately $5 million in respect of death. Self-insurance is negligible for TPD. These differences are not material for funding. However, we recommend Vision Super consider updating insurance policies to remove self insurance.

Section 9: Material Risks

9.1 The funding of the COM plan is dependent upon future experience. We have briefly considered below the material risks in respect of funding. If experience is materially adverse City of Melbourne may be required to recommence contributions.

Investment Risk

9.2 The most significant risk facing the COM plan is that investment returns will not be as high as expected. There is also a risk that the surplus could be difficult to utilize if not managed carefully. These risks occur because the income generated from the existing assets are not matched to the expected future benefit payments. If investment markets are negative, there is also the risk that the minimum benefits of retained members would apply more often increasing the cost to City of Melbourne.

9.3 A change to the assumed investment return could also have a material impact on City of Melbourne contribution requirements in the short term, but would not be expected to impact the ultimate cost of funding benefits unless the change in assumption was because of a change in investment strategy. This also applies for other assumptions.

9.4 As per current practice, the Trustee should continue to consider the liabilities and the funding position when determining the COM plans' investment strategy.

Salary Inflation Risk

9.5 Salary increases exceeding expectations will have a negative impact on funding.

9.6 It is the excess of the investment return above the rates of salary increases that is most important because the assets increase with the investment return and the liabilities with salary.

Pensioner Longevity Risk

9.7 At 30 June 2020 there were no life time pensioners in the COM plan, but some members can elect pensions in prescribed circumstances. If this should occur, there is a risk that the liability will increase, particularly if pensioners live longer than expected. This would have a negative impact on the funding position.

Retrenchments Risk

9.8 The retrenchment benefit is larger than the resignation benefit for some members. A significant number of retrenchments would have a negative impact on liquidity and funding. This risk is reducing over time because the number of members under age 55 is reducing.

9.9 The current funding plan includes top-up contributions by City of Melbourne to manage this risk if the VBI is below 100%, although there could be a timing issue with additional contributions to fund the retrenchment benefits only being made after the retrenchments.

9.10 Furthermore, a large number of exits would temporarily reduce the funding position, when the VBI is below 100%, until the additional contributions to fund the deficiency with respect to the exits are made.

Legislation Risk

9.11 There is a risk that legislation changes could impact on funding. For example:

a Changes to legislation may impact investment returns or other aspects of experience; and

b Changes to tax may impact funding.

Other

9.12 Operational risks (e.g. unit pricing and administration) are not considered in this report.

9.13 There are many other risks in respect of the funding of the COM plans but we have not included those that we do not consider to be currently material.

Appendix A: Summary of Benefits and Conditions

The benefits are set out in the Fund's Trust Deed. The Fund has been governed by the Trust Deed originally dated 26 June 1998 on and from 1 July 1998. The Trust Deed has subsequently been amended numerous times. This report is based on a copy of the Trust Deed including amendments up to 1 July 2014.

Membership

The City of Melbourne Plan was established in 1995 following the transfer of the City of Melbourne Superannuation Fund into Vision Super. The benefits are set out in the City of Melbourne Fund Trust Deed, and now incorporated in the Fund's Trust Deed in Division D. This plan is closed to new members.

Contributions and Accrual Rate

Members are allowed to contribute at a rate between 0% and 9% of salary. The accrual of member's benefit multiple is dependent on member contribution rate, as follows:

Contribution Rate (%)	Accrual Rate Post 30 June 1993 (%)	Accrual Rate Pre 30 June 1993 (%)
0	7.7	9.00
1	9.50	11.00
2	11.25	13.00
3	13.00	15.00
4	14.75	17.00
5	16.50	19.00
6	18.25	21.00
7	20.00	23.00
8	21.75	25.00
9	23.50	27.00
6.5%*	19.00	22.00

* Ex-officer only

Accrued Benefit Multiple (ABM)

The sum of accrual rate for each year of membership in accordance with the table above.

Retirement Benefit

The accrued retirement benefit calculated as Accrued Benefit Multiple x Final Average Pay (FAP).

Death Benefit

The lump sum benefit is calculated as the sum of:

i. ABM based on pre 30 June 1993 accrual rate x FAP; and

ii. 21% x Prospective Service to age 60 x FAP

Total and Permanent Disablement Benefit

The lump sum benefit is calculated as the sum of:

i. ABM x FAP; and

ii. 21% x Prospective Service to age 60 x FAP

Retrenchment Benefit

The accrued retirement benefit.

Resignation Benefit

The lump sum benefit of either:

a. Immediate benefit equal to:

- If member resigns before reaching age 50:

  ABM_5 x FAP + C_5

- If member resigns between age 50 and 55:

$$\frac{[\ (ABM_5 \times FAP + C_5\ ) \times (55 - age) + (ABM \times FAP) \times (Age - 50)\ ]}{5}$$

Where

ABM5 – Accrued Benefit Multiple five years ago
C5 – contributions over the last five years plus credited investment returns

b. Retained Benefit

Members can elect to retain their benefit within the fund and upon reaching age 55 members are entitled to the greater of the two benefits below:

- Resignation Benefit adjusted with investment earnings; or
- Accrued Retirement Benefit at the date of exit adjusted with CPI indexation

Salary Continuance Benefit

On temporary disablement or illness, members may receive 70% of salary payable up to two years after a 90-day waiting period.

Superannuation Guarantee

The benefits are subject to a superannuation guarantee minimum. Like all defined benefit members, the minimum is based on salary as defined in the Trust Deed. If Ordinary Time Earnings is higher than salary then top-up contributions are made to an accumulation account within the Fund and do not need to be considered from a funding perspective.

Other Benefits

Other benefit provisions exist, including the ability to request a pension in specified circumstances.

Appendix B: Membership Movements

COM plan

Membership as at 1 July 2017[1]	104
Exits	26
Membership as at 30 June 2020	78

[1] In addition there were 31 COM plan retained beneficiaries as at 30 June 2020.

Appendix C: Summary of Income and Expenditure for the Fund

	($'000)
Market Value at 1 July 2017	**8,597,435**
Plus	
Net Investment Revenue	1,380,771
Contribution Revenue	2,015,634
Other Revenue	492,340
	3,888,745
Less	
Benefits paid	1,779,665
Administration Expenses	70,183
Superannuation Contribution Surcharge	0
Insurance Premium	62,802
Taxation Provision	208,874
	2,121,524
Market Value at 30 June 2020	**10,364,656**
Comprised of:	
Defined Benefit Plan	2,330,138
City of Melbourne	56,681
Parks Victoria including Ports	34,332
Accumulation Accounts & Reserves	6,176,284

Appendix D: Summary of Valuation Assumptions

Financial Assumptions

The most significant financial assumptions are:

- Active members:
  - investment returns (net of tax; expenses) — 1.1% p.a.
  - salary inflation growth — 2.0% p.a. for two years, 2.75% p.a. thereafter
  - CPI increases — 2.0% p.a.
- administration expenses: — 6.0% of salaries

Demographic Assumptions

Active Members

The table below illustrates the decrement rates assumed for active members. The decrement rates represent the percentage of members leaving the plan each year by each cause.

Year of Age	Deaths %	Disablements %	Resignations %	Retirements %
20	0.10	0.02	13.42	-
30	0.09	0.06	6.48	-
40	0.12	0.13	3.77	-
50	0.27	0.40	2.44	-
60	0.76	1.43	-	15.0
64	-	-	-	15.0

Appendix E: Asset Allocation

Asset Allocation at 30 June 2020

Asset Class	Actual Asset Allocation 30 June 2020 (%)	Strategic Asset Allocation (SAA) 30 June 2020 (%)
Australian Equity	0.0	0.0
International Equity	0.0	0.0
Private Equity	1.2	0.0
Infrastructure	0.0	0.0
Absolute Return Multi Strategies	0.0	0.0
Property	0.0	0.0
Opportunistic Investments	0.0	0.0
Alternative Debt	0.0	0.0
Fixed Interest	73.8	75.0
Cash	25.0	25.0
Total	**100.0**	**100.0**
Allocation to Illiquid Assets	1.2%	0%
Allocation to Growth Assets	1.2%	0%

Asset Allocation post 30 June 2020

Asset Class	Strategic Asset Allocation Post 30 June 2020 (%)
Australian Equity	5.0
International Equity	5.0
Private Equity	0
Infrastructure	0
Property	0
Opportunistic Investments	0
Alternative Debt	10.0
Fixed Interest	20.0
Cash	60.0
Total	**100.0**
Allocation to Illiquid Assets	5%
Allocation to Growth Assets	15%

Appendix F: Total Service Liability Surplus/(Deficit)

Total Service Liability Surplus / (Deficit), using assumed net investment return of 1.1% p.a.

		($million)
Present Value of Active Member Liabilities		49.6
Retirement	46.5	
Death	0.7	
Disablement	0.9	
Resignation	1.5	
plus Present Value of Additional Retained Liability		0.1
less Family Offset and Surcharge Account balances		(0.5)
plus Value of Salary Continuance Cover		0.4
plus Present Value of Future Expenses		2.2
plus Allowance for tax on Contributions		0.3
Total Benefit Liability		**52.1**
Compared to:		
Assets		54.6
plus Value of ongoing member contributions		1.8
plus Value of ongoing Authority contributions (13% of salaries)		4.9
Total Assets		**61.3**
Surplus of Total Assets over Total Benefit Liability as at 30 June 2020		9.2

Total Service Liability Surplus / (Deficit), using assumed net investment return of 1.9% p.a.

		($million)
Present Value of Active Member Liabilities		47.7
Retirement	44.7	
Death	0.7	
Disablement	0.9	
Resignation	1.5	
plus Present Value of Additional Retained Liability		0.1
less Family Offset and Surcharge Account balances		(0.5)
plus Value of Salary Continuance Cover		0.4
plus Present Value of Future Expenses		2.2
plus Allowance for tax on Contributions		0.3
Total Benefit Liability		**50.1**

Compared to:	($million)
Assets	54.6
plus Value of ongoing member contributions	1.8
plus Value of ongoing Authority contributions (13% of salaries)	4.7
Total Assets	**61.1**
Surplus of Total Assets over Total Benefit Liability as at 30 June 2020	11.0

Appendix G: Actuarial Statements required under SPS 160 Paragraph 23(a) – (h)

COM plan

The following statements are prepared for the purposes of actuarial statements and Paragraphs 23(a) to (h) of SPS160.

Background

The effective date of the most recent actuarial review of the COM plan is 30 June 2020. The actuarial investigation was undertaken by Matthew Burgess, Fellow of The Institute of Actuaries of Australia, on behalf of Towers Watson Australia Pty Ltd (AFSL 229921).

This statement has been prepared for the Trustee of Vision Super as part of the actuarial investigation in accordance with the Professional Standards issued by The Institute of Actuaries of Australia.

Assets (SPS160 23(a))

The fair value of the COM plan assets at 30 June 2020 was $54.6 million.

This value of assets at 30 June 2020 excludes amounts held to meet the Operational Risk Financial Requirement (ORFR) and was used to determine the required contributions.

Financial Condition SPS160 23(b)

The projected likely future financial position of the COM plan during the three years following the valuation date and based on my best estimate assumptions is as follows.

Date	Vested Benefits Index (%)
30 June 2020	136.9%
30 June 2021	136%
30 June 2022	137%
30 June 2023	139%

The projected financial position is shown only for the defined benefit members and the additional liability for retained members.

Accrued Benefits (SPS160 23(c))

Accrued Benefits have been determined as the present value of expected future payments arising from membership completed as at the review date plus any additional accumulation benefits at face value. Accrued Benefits have not been subjected to a minimum of vested benefits.

In determining Accrued Benefits, the major assumptions adopted were a -0.9% p.a. real investment return over salary inflation for two years, followed by -1.65%% p.a. real investment return over salary inflation thereafter. This comprised a 1.1% p.a. net of tax investment return assumption and a 2.0% p.a. salary inflation assumption for two years, followed by 2.75% p.a. thereafter.

The future rate of investment return used to determine the accrued benefits is the anticipated rate of return on the COM plan assets.

Assumptions were also made about rates members would withdraw from service because of death, total and permanent disablement and resignation.

The past membership component of all benefits payable in future from the COM plan in respect of the current membership are projected forward allowing for future salary increases and then discounted back to the valuation date at the assumed rate of investment return.

Using the above method, the total value of accrued benefits and the actuarial value of the COM plan assets at 30 June 2020 were:

Value of accrued benefits:	$43.5 million
Fair Value of Assets:	$54.6 million. The ratio of the actuarial value of the assets to the value of the total accrued benefits was 125.4% which indicates an adequate coverage of the value of the accrued benefits as at the date of the actuarial investigation.

In our opinion, the value of the assets of the COM plan at 30 June 2020 was adequate to meet the liabilities of the COM plan in respect of accrued benefits in the COM plan. The assets are considered adequate in the longer term based on the contributions recommended below, and assumptions as to the future experience which we regard as appropriate.

Vested Benefits (SPS160 23(d))

Vested benefits are the benefits to which members would be entitled if they voluntarily left service.

At the date of the actuarial investigation, the total vested benefits and net market value of the COM plan total assets were:

Total Vested Benefits:	$39.9 million
Fair Value of Assets:	$54.6 million

The ratio of the net market value of the COM plan assets to total vested benefits was 136.9%, which indicates a satisfactory coverage of Vested Benefits as at the date of the actuarial investigation.

In our opinion, the Fund's financial position is satisfactory.

The Trustee has determined the short fall limit to be 100%. In my opinion this can reasonably be left unchanged, although the Trustee could revise it to 99% following the change in investment strategy effective 17 July 2020.

Minimum Benefits and Funding and Solvency Certificates (SPS160 23(e) and (f))

Funding and Solvency Certificates (FSC) for the Fund covering the period from 1 July 2017 to 30 June 2020 as required by the Superannuation Industry (Supervision) Act have been provided.

In our opinion, the solvency of the Fund will be able to be certified in any Funding and Solvency Certificate required under the Superannuation Industry (Supervision) Regulations during the three year period to 30 June 2023 if experience is as assumed.

We note that for the purpose of issuing an FSC, the appropriate funding measure is in respect of coverage of minimum benefits (MRBs), which in this fund are considerably less than vested benefits, and are covered sufficiently by COM plan assets. At 30 June 2020, the ratio of assets to MRBs is 185.1%. The total Minimum Requisite Benefits as at 30 June 2020 was $29.5 million.

Recommended Contributions (SPS160 23(g))

We recommend that City of Melbourne contribute the following amounts:

- From 1 July 2020 a contribution rate of 13% (inclusive of 1% salary continuance cover) of salaries for Division D members;
- From a convenient date agreed between Vision Super and City of Melbourne, but no later than 1 July 2021:
  - A nil contribution rate for Division D;

- If the VBI is below 100% top-up payments for exiting members equal to the following amount increased for contribution tax:

  Benefit Payment less (Vested Benefit x VBI)

  Top-up payments are to be calculated and invoiced quarterly in arrears. Benefit payments exclude the amount of any insurance proceeds; plus

- Any salary sacrifice contributions should be made in respect of members in accordance with the Trust Deed.

The amounts of required contributions will be reviewed in the next triennial actuarial review of the COM plan to be conducted with an effective date no later than 30 June 2023. However, an earlier actuarial review should be undertaken if there are any significant changes in the COM plan.

Matthew Burgess

Matthew Burgess FIAA
RSE Actuary

Surath Fernando FIAA

18 December 2020

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