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21 December 2020

Merck Superannuation Plan:
Actuarial Investigation as at 30 June 2020

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1 Executive summary and recommendations

1.1 Introduction

I have carried out an actuarial investigation of the Merck Superannuation Plan (the Plan) a defined benefit plan within the Retirement Portfolio Service (RPS) as at 30 June 2020 (valuation date).

This report has been prepared for the Plan's Trustee, OnePath Custodians Pty Limited.

The main purposes of the investigation are to:

- Examine the financial condition of the Plan at the valuation date.
- Recommend the employer contributions required by Merck to meet its continuing benefit obligations, and to maintain the Plan in a sound financial condition.
- Consider the appropriateness of the Plan's investment and insurance arrangements.
- Satisfy the actuarial investigation requirements of the Superannuation Industry (Supervision) Act 1993 (SIS).

Neekhil Shah of Mercer Consulting carried out the previous actuarial investigation of the Plan, as at 1 July 2017. His report was dated 8 December 2017.

This report complies with the Actuaries Institute's *Professional Standard 400 Investigations of the financial condition of defined benefit superannuation funds.*

1.2 Financial position

My actuarial investigation of the Plan focuses on the financial condition of the closed defined benefit section of the Plan.

At the valuation date, there were [redacted] defined benefit members. Total vested benefits (i.e. the benefits immediately available to members on resignation or retirement) were $[redacted], backed by Plan assets of $[redacted].

The Plan was in a satisfactory financial position (as defined under SIS) at the valuation date, with the Plan's defined benefit section assets providing 111% coverage of members' vested benefits.

1.3 Valuation of Plan liabilities

I have valued the Plan's defined benefit liabilities at 30 June 2020 using the following financial assumptions:

Assumption	Rate (% p.a.)
Discount rate / investment return (net of investment tax and expenses)	5.0%
Salary growth	[redacted]%

The results of the valuation as at 30 June 2020 can be summarised as follows:

Valuation balance sheet	$'000
Defined benefit assets	[redacted]
Employer liabilities:	
Past service liabilities	[redacted]
Future service liabilities	[redacted]
Less: future member contributions	([redacted])
Total employer liabilities	[redacted]
Deficit	([redacted])

On the assumptions adopted, employer contributions at the rate of 6.5% of defined benefit member salaries would be required to fund the Plan's past and future accruing defined benefit liabilities. Therefore the total employer contribution rate required, i.e. inclusive of member pre-tax contributions of 5.9% of salary, is 12.4% of salaries. This rate excludes any allowance for Plan expenses and insurance premiums.

1.4 COVID-19 and other material risks

The COVID-19 pandemic introduces additional uncertainty to liability valuations, and its impact is difficult to predict.

The most likely COVID-19 related risk impacting the Plan is lower than expected investment returns. This may be due to volatility, e.g. as seen during the share market falls of February and March 2020, or to sustained periods of low investment returns in the current ultra-low interest rate environment.

1.5 Investment objectives

The Plan's defined benefit section assets are invested in the Optimix Balanced fund, whose investment objective is to achieve returns (before investment fees and taxes) that on average exceed inflation by at least 5.0% p.a., over periods of ten years or more.

In my view, the Plan's investment objectives are appropriate.

However, my report notes that Merck is more exposed to downside risk (reduced surplus if investment returns are poor relative to salary growth) than upside (additional surplus if investment returns are strong). Merck could mitigate the downside risk by requesting the Trustee to adopt a more conservative investment strategy.

1.6 [redacted]

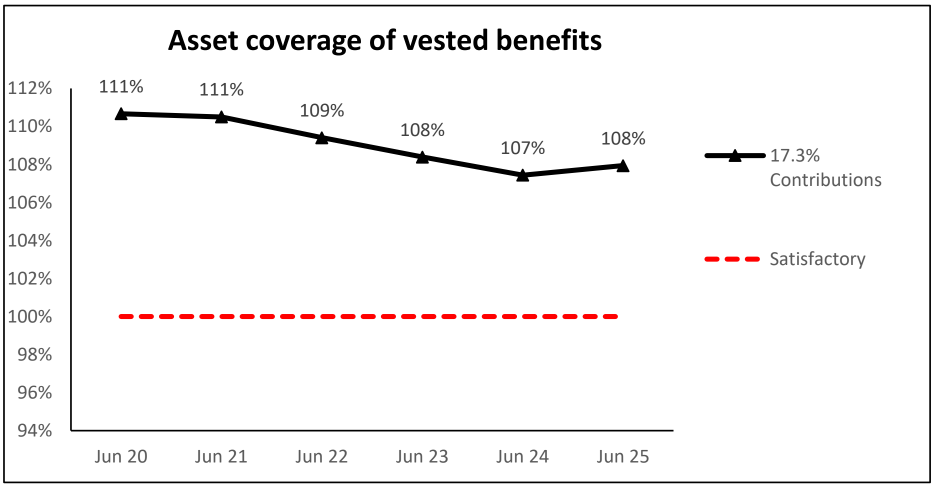
[redacted]

1.7 Recommendations

I recommend that:

- Merck should continue to contribute to the Plan at the rate of 17.3% of defined benefit member salaries.
- Future administration and consulting expenses, including the cost of this actuarial investigation, can be met from Plan surplus, i.e. rather than Merck paying direct or reimbursing the Plan.

On the valuation assumptions adopted, a continuation of the current Merck contribution rate will provide sufficient margin for the Plan to meet administration expenses and insurance premiums over the next few years. Plan assets are also expected to provide a reasonable buffer over and above members' vested benefits. [redacted]



1.8 Next actuarial review

The next actuarial investigation of the Plan for SIS purposes will be due as at 30 June 2023.

[redacted]

I also understand that the Trustee monitors the Plan's defined benefit asset coverage of vested benefits on a monthly basis, and will notify me if this measure falls below 110%.

John Newman
Fellow of the Institute of Actuaries of Australia
21 December 2020

2 The Plan

2.1 Overview

The Plan is a defined benefit sub-plan within the RPS.

OnePath Custodians Pty Limited is the RPS Trustee. ANZ Wealth provides administration services.

The Plan is regulated by the Australian Prudential Regulation Authority (APRA) under the Superannuation Industry (Supervision) Act 1993 (SIS). As a regulated and complying plan, employer contributions are tax deductible to Merck, but subject to tax in the hands of the Trustee, and the Plan's investment income is subject to concessional rates of tax.

The Plan contains a closed defined benefit section, and an accumulation section open to new members. Although the Plan is administered as two separate sections, the Trustee has confirmed that the RPS's structure allows cross-subsidies between these sections so that employer costs, and shortfalls or surpluses, can be taken together across the Plan as a whole.

Merck uses the Plan to meet its Superannuation Guarantee (SG) obligations under the Superannuation Guarantee Administration Act 1992.

2.2 Trust Deed

The Plan is governed by the provisions of the RPS Trust Deed, and the Plan's Employer Application Form and Benefit Specification Schedule, and any subsequent deeds of amendment.

For ease of reference, the Plan's governing provisions are referred to collectively in this report as the Trust Deed.

The benefit provisions relating to the Plan's defined benefit members are summarised in Appendix 1 to this report.

3 Data

3.1 Reliance on data provided

My actuarial investigation of the Plan focuses on the financial condition of the closed defined benefit section, and is based on 30 June 2020 membership and investment data provided by the Plan's administrators, ANZ Wealth.

I have checked the data for reasonableness and consistency with the Trust Deed. However, I have not independently verified the data, hence my report necessarily relies on the accuracy and completeness of the data provided.

3.2 Membership

At the valuation date, the Plan contained [redacted] defined benefit members.

My valuation makes no allowance in either the assets or the liabilities for any rollover or voluntary account balances these members may have in the accumulation section of the Plan.

3.3 Vested benefits

At the valuation date, total vested benefits for the Plan's defined benefit members were $[redacted].

3.4 Asset value

I have taken the defined benefit section asset value as $[redacted] at the valuation date, based on the Plan's Statement of Account for the 2019-20 financial year.

This was the value of the Plan's investment holding in Optimix Balanced at the valuation date. Based on the information provide by the Plan's administrators, I am not aware of any amounts payable to or from the Plan that would require adjustment to this asset value.

At the valuation date, the Plan's defined benefit section assets provided 111% coverage of members' vested benefits, i.e. a surplus margin of $[redacted].

4 Plan's experience since previous investigation

4.1 Benefit changes

Since the previous actuarial valuation of the Plan, there have been no changes to the Trust Deed relating to the calculation of members' benefit entitlements.

4.2 Membership changes

At the 30 June 2017 valuation date, the Plan had [redacted] defined benefit members. Three members have exited the Plan between 30 June 2017 and 30 June 2020.

4.3 Employer contributions

The previous valuation report recommended that Merck:

- Continue contributing to the Plan at the rate of 17.3% of defined benefit member salaries (inclusive of member pre-tax contributions of 5.9% of salary).
- Pay top-up contributions, as advised by the actuary, for any early retirement benefits provided with employer consent.
- Either reimburse the Plan, or pay direct, all administration and insurance premium deductions from defined benefit section assets.

I understand that Merck's regular contributions over the three year period have been in accordance with the 17.3% of salary recommendation.

Merck also paid an additional contribution of $[redacted] into the Plan on 30 April 2020. This was in accordance with a recommendation made by Mercer Consulting in their letter of 24 March 2020, because of COVID-19 related investment losses in February and March 2020.

4.4 Expenses and insurance premiums

The Plan's Statements of Account for the three years to 30 June 2020 show total deductions of approximately $[redacted] for expenses and insurance premiums, and $[redacted] reimbursed to the Plan by Merck. Therefore the Plan's financial experience will be correspondingly worse than was projected based on the 30 June 2017 valuation.

ANZ Wealth have also advised that there are additional consulting fees still to be paid in respect of the three year period. I understand that these have been invoiced direct to

Merck, and hence that no allowance need be made in this valuation for additional fees previously incurred.

4.5 Investment returns

In the previous valuation it was assumed that the Plan's investment return would be 5.5% p.a. Based on movements in unit prices for the Plan's Optimix Balanced investment, I estimate the Plan's actual investment return as 2.8% p.a., after investment fees and tax, over the three year period to 30 June 2020.

4.6 Member salary growth

The previous valuation assumed defined benefit member salary growth of [redacted]% p.a. Based on the data available, I estimate that defined benefit salaries have increased by an average [redacted]% p.a. over the three year period to 30 June 2020.

4.7 Real rate of investment return

The key measure impacting the Plan's financial position is the real rate of investment return, i.e. the investment return over and above the rate of member salary growth. The Plan's real rate of return over the period was expected to be 2% p.a. (i.e. 5.5% p.a. - 3.5% p.a.) but in practice was close to nil (estimated 2.8% p.a. – 2.8% p.a.) This will have had a negative impact on the Plan's financial position at 30 June 2020, relative to that previously expected.

4.8 Overall financial impact

Based on the assumptions adopted for the previous valuation, Plan assets were expected to provide 107% coverage of defined benefit members' vested benefits at 30 June 2020. In practice, the Plan's financial position is slightly stronger, with Plan assets providing 111% vested benefit coverage.

Merck's additional $[redacted] contribution has approximately offset the negative impacts of the lower than expected real rate of investment return, and the Plan expenses not fully reimbursed. The Plan's membership changes over the period may also have had a positive impact (the Plan's asset coverage of vested benefits will improve as member numbers dwindle) but there is insufficient historical membership data to confirm the impact.

5 Investments

5.1 Optimix Balanced fund

The Plan's defined benefit section assets are invested in the Optimix Balanced fund.

This fund's investment objective is to achieve returns (before investment fees and taxes) that on average exceed inflation by at least 5.0% p.a., over periods of ten years or more.

The fund has an 80% benchmark exposure to growth and alternative asset classes, and 20% to fixed interest and cash.

5.2 Investment objectives

For a Plan paying benefits linked to members' salary growth, it is appropriate to maintain some exposure to growth assets, as the Plan's investment returns will then be expected to outperform measures such as AWOTE or CPI over reasonably long periods.

I am satisfied that the Plan's investment objective is appropriate.

However, the corollary of any material exposure to growth assets is that the Plan's investment returns can be expected to be more volatile, and quite possibly negative, in the short term. The Plan's investment horizon is becoming shorter (two members are within ten years of the Plan's normal retirement date) reducing the likelihood of the Plan recouping any material investment losses that might occur.

Merck could if it wished, mitigate the investment downside risk by requesting the Trustee to adopt a more conservative investment strategy.

5.3 Crediting rate policy

The Plan's crediting rates for defined benefit member balances are based on movements in unit prices for the Plan's Optimix Balanced investment holding, with investment management fees added back, i.e. effectively these costs are met by Merck.

I consider that this crediting rate policy is appropriate for the Plan.

5.4 Shortfall limit

For the purpose of APRA's Superannuation Prudential Standard 160, the Trustee is required to set a shortfall limit. This is the extent to which the Trustee considers that the Plan can be in an unsatisfactory financial position, with the Trustee still being able to reasonably expect that, because of corrections to temporary negative market fluctuations in the value of fund assets, the Plan can be restored to a satisfactory financial position within one year.

I have been advised that the Trustee has set a shortfall limit of 100%, i.e. for the Plan not to be in breach of its shortfall limit, Plan assets need to provide at least 100% coverage of defined benefit members' vested benefits.

In my opinion, currently there is no need to review this shortfall limit.

6 Insurance

6.1 Death and TPD benefits

For members of the defined benefit section, death and total and permanent disablement (TPD) benefits are fully insured under a group life arrangement. The insured portion of each member's death and TPD benefit is the excess above the member's vested benefit.

In my view, this fully insured approach is appropriate, given the small size of the defined benefit section and the potential variability of claims experience.

6.2 Temporary disablement benefits

The Plan's temporary disablement benefits are also fully insured which in my view is appropriate.

7 Valuation of liabilities

7.1 Methodology

For the purpose of this valuation, I have used the aggregate funding method, which I consider appropriate for a small defined benefit plan closed to new entrants.

This method calculates the employer contribution rate required to fund members' future benefit payments, in respect of both past and future service, taking into account the Plan assets held at the valuation date.

The liabilities for projected future benefit payments are split into a component in respect of service prior to the valuation date (the past service liability) and a component in respect of service after the valuation date (the future service liability). The past service liability for each member at the valuation date has been assessed subject to a minimum of that member's vested benefit.

7.2 Financial assumptions

The financial assumptions used in the valuation are:

Assumption	Rate (% p..a)
Discount rate / investment return (net of investment expenses and tax)	5.0%
Salary growth	[redacted]%

I have reduced the previous discount rate assumption from 5.5% p.a. to 5.0% p.a., based on the current more subdued outlook for investment returns generally.

I have also reduced the salary growth assumption from [redacted]% p.a. to [redacted]% p.a., based on the current low inflation and wage growth environment.

As the real rate of return assumption (i.e. investment return in excess of salary growth) remains at 2.0% p.a., the impact of the change in assumptions is not material.

7.3 Demographic assumptions

Given the Plan has only four defined benefit members, I have adopted a simple nil decrements basis for valuing members' benefits, and assumed that members will remain in the Plan until retirement age 65.

7.4 Superannuation Guarantee

The SG rate currently is 9.5% of Ordinary Time Earnings (OTE). The rate is scheduled to increase to 12% of OTE as follows:

Financial year	Rate (% of OTE)
Up to 2020-21	9.5%
2021-22	10.0%
2022-23	10.5%
2023-24	11.0%
2024-25	11.5%
2025-26 and subsequent	12.0%

For the purpose of the actuarial valuation, it has been assumed that the SG rate will increase as shown.

Currently, there is some uncertainty whether the SG will be increased as scheduled. If the increases are delayed or do not eventuate, the Plan's projected financial position will be slightly stronger than is shown below in this report.

8 Funding Status

8.1 Introduction

This section examines the Plan's ability to meet defined benefit members' benefits at the valuation date. I have measured the Plan's asset coverage of the following benefits:

a) SG minimum benefits.

b) Vested benefits.

c) Actuarial value of accrued benefits.

d) Retrenchment benefits.

e) Benefits on termination of the Plan.

8.2 Asset coverage of member benefits

At the valuation date, defined benefit section assets amounted to $[redacted], and provided the following coverage of member benefit entitlements:

Benefits	Amount ($)	Asset coverage	Note
SG minimum	[redacted]	125%	
Vested benefits	[redacted]	111%	
Actuarial value of accrued benefits	[redacted]	110%	Using the assumptions adopted for the valuation
Retrenchment benefits	[redacted]	109%	Basis used historically: early retirement benefit discounted by 1.5% p.a. before age 60.

In the event that Merck terminates its participation in the Plan, the Trust Deed requires any arrears of contributions to be paid into the Plan, but does not impose any additional funding requirements.

9 Valuation Results

9.1 Valuation balance sheet

The results of the valuation as at 30 June 2020 can be summarised as follows:

Valuation balance sheet	$'000
Defined benefit assets	[redacted]
Employer liabilities:	
Past service liabilities	[redacted]
Future service liabilities	[redacted]
Less: future member contributions	([redacted])
Total employer liabilities	[redacted]
Deficit	([redacted])

On the assumptions adopted, an employer contribution rate of 6.5% of defined benefit salaries would be required to fund the deficit, i.e. a total employer contribution rate of 12.4% of salaries inclusive of member pre-tax contributions of 5.9% of salary.

This rate makes no allowance for the Plan's administration expenses and insurance premiums, which are currently averaging around $[redacted] p.a., or around 4.5% of defined benefit member salaries.

9.2 Impact of variation in assumptions

The key financial assumptions for the liability valuation are the Plan investment return of 5.0% p.a. net of tax and investment expenses, and the salary growth rate of [redacted]% p.a., i.e. a real rate of return of 2.0% p.a.

The table below illustrates the sensitivity of the valuation results to variations in these two assumptions:

Investment return	Deficit $'000	Contribution rate
3%	[redacted]	20.4%
4%	[redacted]	16.0%
5%	[redacted]	**12.4%**
6%	[redacted]	10.7%
7%	[redacted]	9.9%

Salary growth	Deficit $'000	Contribution rate
1%	[redacted]	9.9%
2%	[redacted]	10.7%
3%	[redacted]	**12.4%**
4%	[redacted]	15.0%
5%	[redacted]	20.5%

The tables illustrate that Merck's investment risk is asymmetric. Merck is more exposed to downside risk (i.e. increased contribution rates due to poor real rates of investment return) than upside (reduced contribution rates if real investment returns are strong). This is because if real investment returns are high, the Plan's minimum accumulation benefits are more likely to apply, and the employer contribution rate will tend towards the SG rate.

Merck could if it wished, mitigate the downside risk by requesting the Trustee to adopt a more conservative investment strategy.

The valuation results also depend on the lifetime of the defined benefit section.
If members retire earlier than the maximum defined benefit accrual age of 65, the valuation results would improve as follows:

Retirement age	Deficit $'000	Contribution rate
60	[redacted]	11.2%
62.5	[redacted]	11.7%
65	[redacted]	**12.4%**

The tables do not indicate the bounds of all possible outcomes. In practice, the Plan's experience may lie outside the ranges illustrated.

10 Material risks

10.1 Introduction

Professional Standard PS 400 issued by the Institute of Actuaries of Australia requires the actuary to consider and document any material risks to the Plan associated with the actuarial assumptions, or related to the ongoing actuarial management.

10.2 Investment return

The key assumptions made in this report are the investment return assumption of 5.0% p.a., and the salary growth assumption of [redacted]% p.a., i.e. an assumption that the Plan's real investment return will be 2.0% p.a.

The Plan's financial position may be impacted adversely by greater than expected salary increases and/or investment underperformance.

10.3 COVID-19

The COVID-19 pandemic introduces additional uncertainty to liability valuations, and its impact is difficult to predict.

The most likely COVID-19 related risk impacting the Plan is lower than expected investment returns. This may be due to volatility, e.g. as seen during the share market falls of February and March 2020, or to sustained periods of low investment returns in the current ultra-low interest rate environment.

11 Recommendations

11.1 Plan's financial position

The Plan was in a satisfactory financial position at 30 June 2020 (as defined in SIS) with Plan assets for defined benefit members providing 111% coverage of members' vested benefits.

I estimate, based on movements in Optimix Balanced unit prices, that the defined benefit section assets have earned approximately 7.5% between 30 June 2020 and 30 November 2020, i.e. well in excess of the valuation assumption of 5.0% p.a. Therefore the Plan's financial position is likely to have improved further since 30 June 2020.

11.2 [redacted]

[redacted]

11.3 Employer contribution recommendations

I recommend that:

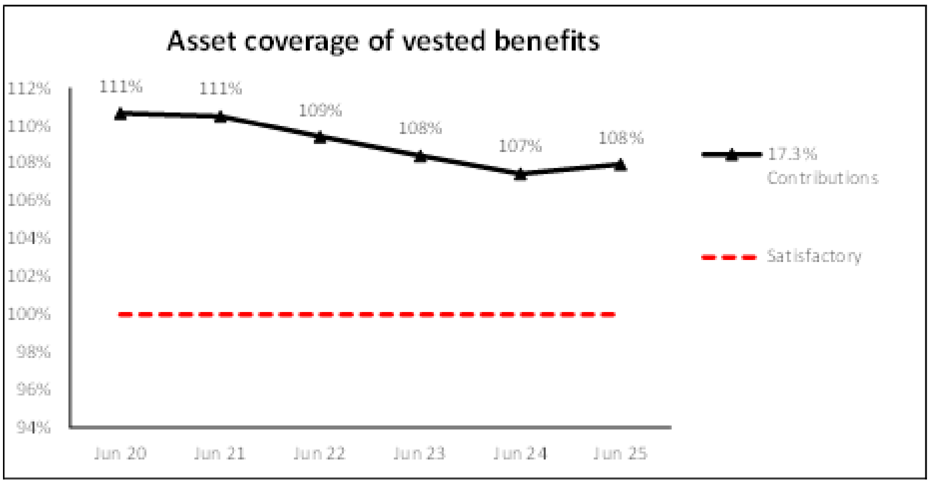
- Merck should continue to contribute to the Plan at the rate of 17.3% of defined benefit member salaries.
- Future administration and consulting expenses, including the cost of this actuarial investigation, can be met from Plan surplus (i.e. rather than Merck paying direct or reimbursing the Plan).

11.4 Vested benefit projections

On the valuation assumptions adopted, a continuation of the current Merck contribution rate will provide sufficient margin for the Plan to meet administration expenses and insurance premiums over the next few years. For the purposes of the projections below, we have allowed for administration expenses and insurance premiums of $25,000 p.a., increasing at 3% p.a. in future years.

Plan assets are also expected to provide a reasonable buffer over and above members' vested benefits. [redacted]

The graph below summarises the Plan's projected asset coverage of member vested benefits over the five-year period following the valuation date.



11.5 Next actuarial review

The next actuarial investigation of the Plan for SIS purposes will be due as at 30 June 2023.

[redacted].

I also understand that the Trustee monitors the Plan's defined benefit asset coverage of vested benefits on a monthly basis, and will notify me if this measure falls below 100%.

Appendix 1. Benefit Summary

Benefits and definitions	
Final average salary (FAS)	Average of the five highest review date salaries over the 10-year period prior to exit
Member contributions	5% of salary (paid as 5.9% pre-tax contributions)
Normal retirement age	65
Retirement benefit	A multiple of FAS, currently accruing at the rate of 15% of FAS for each year of service. Payable after age 60 with employer consent, or on exit due to ill-health at any time.
Resignation benefit	The member contribution account, plus vesting of up to 150% depending on the member's length of service.
Retrenchment benefit	A benefit equal to equal to *the Member's equitable share of the Plan if the DB Member remained in Service.* Historically this has been calculated as the early retirement benefit discounted by 1.5% p.a. before age 60.
Minimum Requisite Benefit (MRB)	All Plan benefits are subject to a minimum of the MRB, calculated in accordance with the Plan's Benefit Certificate to satisfy SG requirements.
Death and Total and Permanent Disablement (TPD) benefits	The projected normal retirement benefit based on the member's current salary.
Temporary disablement benefits	An income benefit equal to 75% of salary.

Appendix 2. AASB1056 disclosures

This statement is provided to assist the Trustee in preparing its AASB1056 disclosures. It has been prepared in accordance with Institute of Actuaries Professional Standard 402, and Practice Guideline PG499.06.

For the purposes of AASB1056, the following amounts have been determined as at 30 June 2019 in respect of members of the defined benefit section of the Plan:

	Amount
Fair value of assets	$[redacted]
Member liabilities	$[redacted]
Value of vested benefits	$[redacted]

The key assumptions used are investment returns of 5.0% p.a., and member salary growth of [redacted]% p.a. These are best estimate assumptions, and the investment return assumptions are based on the investment objectives of the Plan. I have also adopted a simple nil decrements basis for valuing member benefits, and assumed that members remain in the Plan until retirement age 65.

Member liabilities have been calculated as the actuarial value of accrued benefits, i.e. the total of the present values of expected future benefit payments attributable to service that accrued prior to the valuation date. A vested benefit minimum has not been applied.

The tables below illustrates the sensitivity of the member liabilities to variations in the key assumptions:

Investment return	Member liabilities
3%	$[redacted]
4%	$[redacted]
5%	**$[redacted]**
6%	$[redacted]
7%	$[redacted]

Salary growth	Member liabilities
1%	$[redacted]
2%	$[redacted]
3%	**$[redacted]**
4%	$[redacted]
5%	$[redacted]

Appendix 3. Short report for members

The following statement has been prepared for compliance with Regulation 9.31 of the Superannuation Industry (Supervision) Act 1993.

I have carried out an actuarial valuation of the Merck Superannuation Plan, a sub-plan of the Retirement Portfolio Service, at 30 June 2020 and certify the following:

a) The value of the Plan's defined benefit section assets at the valuation date was $[redacted].

b) The value of the Plan assets was sufficient to meet the value of the liabilities in respect of accrued benefits at the valuation date. I expect the Plan's assets to remain sufficient to cover the liabilities in respect of accrued benefits over the three year period following the valuation date.

c) For the three years following the valuation date, I recommend that:

- Merck should continue to contribute to the Plan at the rate of 17.3% of defined benefit member salaries (inclusive of member pre-tax contributions of 5.9% of salary).
- The Plan's defined benefit section assets may be used to meet the section's future administration and consulting expenses and insurance premiums.

d) All required Funding and Solvency Certificates have been issued for the Plan. I believe it is likely that an actuary will be able to certify the solvency of the Plan in any Funding and Solvency Certificate that may be required during the three year period following the valuation date.

e) At the valuation date the Plan was in a satisfactory financial position (as defined in SIS Regulation 9.04). I expect the Plan to remain in a satisfactory financial position during the three year period following the valuation date.

John Newman, FIAA
21 December 2020

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