



PARLIAMENT OF TASMANIA

**LEGISLATIVE COUNCIL
GOVERNMENT ADMINISTRATION COMMITTEE "A"**

REPORT

ON

**THE INCREASED EMPLOYER CONTRIBUTIONS BY
THE GOVERNMENT INTO RBF DEFINED BENEFIT
SCHEMES**

Members of the Committee

Hon Craig Farrell MLC (Chair)
Hon Robert Armstrong MLC
Hon Ruth Forrest MLC

Hon Mike Gaffney MLC
Hon Leonie Hiscutt MLC
Hon Tony Mulder MLC

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INTRODUCTION

1. Government Administration Committee A (the Committee) was established by resolution of the Legislative Council and its operation is governed by Sessional Orders agreed to by the Council.
2. The Committee met on 9 March 2016 and resolved that a Sub-Committee be formed to conduct an inquiry into the increased employer contributions by the Government into RBF defined benefit schemes.
3. On 9 March 2016, the Committee presented a Special Report on a Resolution to Commence an Inquiry (the Inquiry) in accordance with Sessional Order 4 (14).
4. The Inquiry adopted the following Terms of Reference:

To inquire into and report upon the increased employer contributions by the Government into RBF defined benefits schemes as set out in the RBF's 2015 Annual Report, in particular -

 1. Reasons for the increased funding shortfall;
 2. The risks and implications of the current and any future increases in employer contributions to the Government's budgetary position; and
 3. Any other matters incidental thereto.
5. The Membership of the Sub-Committee was:

Hon Ruth Forrest MLC (Inquiry Chair)
Hon Craig Farrell MLC
Hon Mike Gaffney MLC
Hon Leonie Hiscutt MLC
6. The Inquiry was advertised in Tasmania's three daily regional newspapers. The Inquiry also directly contacted a number of persons and organisations with specific knowledge or expertise and invited them to provide evidence to the Inquiry.

7. The Inquiry also established a dedicated web-page at http://www.parliament.tas.gov.au/ctee/Council/GovAdminA_RBF.htm.
8. All submissions and transcripts are included on the web-page and these should be read in conjunction with the Sub-Committee Report. A list of submissions is provided in Appendix 1 of the Report.
9. Eight submissions were received. The Inquiry conducted public hearings in Hobart on 2nd and 3rd May 2016 and seven groups or individuals provided verbal evidence.
10. The Committee reviewed the Report of the Sub-Committee and, on 13 October 2016, resolved to conclude the current inquiry and release a final report. The Committee intends that this Report be considered in its entirety as the final report of the Inquiry.
11. The Committee resolved that Members of the Sub-Committee be endorsed to speak publicly about the report in their capacity as Members of the Sub-Committee.

Signed this 13th day of October 2016

A handwritten signature in blue ink, consisting of several loops and a long horizontal stroke extending to the right.

Hon Craig Farrell MLC
Committee Chair



PARLIAMENT OF TASMANIA

**LEGISLATIVE COUNCIL
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FINAL REPORT

ON

**THE INCREASED EMPLOYER CONTRIBUTIONS BY
THE GOVERNMENT INTO RBF DEFINED BENEFIT
SCHEMES**

Members of the Sub-Committee

Hon Ruth Forrest MLC (Inquiry Chair)

Hon Craig Farrell MLC

Hon Mike Gaffney MLC

Hon Leonie Hiscutt MLC

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ABBREVIATIONS

ANMF	Australian Nursing and Midwifery Federation
APRA	Australian Prudential Regulation Authority
CPSU	Community and Public Sector Union
FAS	Final Average Salary
PAT	Police Association of Tasmania
PwC	PricewaterhouseCoopers
RBF	Retired Benefits Fund
TASS	Tasmanian Association of State Superannuants Inc.

EXECUTIVE SUMMARY

This Report summarises the facts regarding the Government's unfunded superannuation liability and discusses the concerns and common beliefs regarding the defined benefit schemes, in particular the Contributory Scheme. All defined benefit schemes are now closed.

The unfunded liability of the Contributory Scheme at a point in time reflects the difference between the plan assets available to pay benefits and the amount of accrued benefits at the date of valuation by the Actuary.

The Government's contribution to the unfunded superannuation liability is the State's fourth largest budget expense item. This liability will continue to grow until it peaks in 2023. The annual cost to the Government is expected to peak in 2031 at \$441 million per annum.

The liability has accrued over decades and the cost to Government is projected to continue for another six decades. Successive Governments have made policy decisions to fund the superannuation liability on an emerging cost basis.


The State Actuary, in his 2013 Triennial Review recommended that Government employer contribution rates increase from 76.5 per cent (2013-14) to 78.5 per cent (2014-15) and progressively increase to 88.5 per cent (2019-20). This Review projected that without Government intervention to improve the financial position of the fund, the Contributory Scheme will have no assets by approximately 2037.

The superannuation liability debt represents a key budget risk to Government. The Report presents the response of the Government as to the management of this liability.

The Government's current Fiscal Strategy requires the combined annual servicing costs of General Government debt and defined benefit superannuation liabilities to be less than six per cent of General Government cash receipts. The 2016-17 Budget projected that the combined annual servicing costs of the General Government debt and defined benefit superannuation liabilities will be 4.9 per cent (2016-17); 5.2 per cent (2017-18); 5.4 per cent (2018-19); and 5.6

per cent (2019-20). If these figures are achieved the requirements of the Fiscal Strategy will be met.

The Committee recommends that a further review and examination of the Government's ongoing management of this risk be undertaken in 2026.

A handwritten signature in black ink, appearing to read 'R Forrester', written in a cursive style.

Hon Ruth Forrester MLC
Inquiry Chair
13 October 2016

RECOMMENDATIONS

The Committee makes the following recommendations:

1. In 2026, the Government initiate a similar review process be undertaken to assess and report on the Government's ongoing financial management of the defined benefit schemes.
2. The review include, and not be limited to, the following:
 - a. The performance of Governments (2016-2026) in adhering to the State Budget Fiscal Strategy, requiring the combined annual servicing cost of General Government debt and defined benefit superannuation liabilities, to be less than six per cent of General Government cash receipts¹;
 - b. Whether the estimated employer contribution payments, comprising both pension and lump sum benefit costs, over the total life of the defined benefit schemes, fall within the projections detailed in the 2015-16 RBF Annual Report² and 2016-17 Budget³; and
 - c. The outcome of the transfer of responsibility for the RBF defined benefit schemes to the Superannuation Commission established under the *Public Sector Superannuation Reform Act 2016*.

¹ Introduced in the 2014-15 Budget Paper No. 1 Fiscal Strategy p. 3

² 2015-16 RBF Annual Report p. 73

³ 2016-17 Budget Paper No. 1 p. 135

SUMMARY OF FINDINGS

1. As at 30 June 2015 the Contributory Scheme (which has the largest unfunded liability) had:
 - a. plan assets of \$1.8 billion;
 - b. an accrued benefit liability of \$6.3 billion; and
 - c. an unfunded liability of \$4.5 billion.
2. The unfunded liability of the Contributory Scheme at a point in time reflects the difference between the plan assets available to pay benefits and the amount of accrued benefits at the date of valuation by the Actuary.
3. Successive Governments made policy decisions to only fund the emerging cost of the superannuation liability.
4. The Contributory Scheme is a hybrid scheme: the Government employer contribution is funded on an emerging cost basis when scheme members become entitled to a pension or lump sum benefit, with the remaining part of the benefit paid from the schemes' assets.
5. The projected nominal value of the annual expenses is estimated to peak in 2031 at \$441 million.
6. All defined benefit schemes are now closed:
 - a. Contributory Scheme closed 15 May 1999;
 - b. Parliamentary Superannuation Fund closed 1 July 1999;
 - c. Parliamentary Retiring Benefits Fund closed 1 July 1999;
 - d. State Fire Commission Superannuation Scheme closed 1 May 2006;
 - e. Tasmanian Ambulance Service Superannuation Scheme closed 30 June 2006.
7. RBF is both the Trustee and Administrator of the RBF defined benefit fund.
8. Since 2011 the administration of the RBF defined benefit funds has been outsourced to Mercer.
9. The Department of Treasury and Finance is responsible for the defined benefit fund scheme design.

10. The *Public Sector Superannuation Reform Act 2016*:

- a. provides responsibility for the RBF defined benefit schemes to be transferred to a Superannuation Commission established under the legislation; and
- b. makes no change to the entitlement of the members of the RBF defined benefit schemes.

11. Responsibility for the RBF defined benefits schemes will transfer to the Superannuation Commission from 1 April 2017.

12. The Government will retain responsibility for the funding of the RBF defined benefit schemes.

13. The Committee accepts that the following factors contributed to the increased funding shortfall:

- a. the addition of interest to the previous deficit;
- b. RBF administration and management expenses in excess of the assumed rate;
- c. a higher up-take of pensions than was assumed;
- d. the average member contribution rate increased during the period;
- e. investment earnings were lower than assumed.

14. The demographic profile of RBF defined benefit fund members means:

- a. more Contributory Scheme members are entering the pension phase; and
- b. since the establishment of the defined benefit fund improved rates of longevity have increased the years of pension payments.

15. The defined benefit unfunded superannuation liability is a “snapshot” of the Scheme’s financial condition at a particular point in time.

16. The State Actuary uses a range of economic and demographic assumptions to project benefit payments. The current value of the liability can vary significantly if there is a change in any of the underlying assumptions.

17. The Auditor-General independently reviews the data assumptions and methodology used by the State Actuary.

18. The State Actuary (2013 Triennial Review) recommended that Government employer contribution rates increase from 76.5 per cent (2013-14) to 78.5 per cent (2014-15) and progressively increase to 88.5 per cent (2019-20).
19. The increased level of Government employer contributions will not be applied to the employer contribution for pensioners prior to 2014-15.
20. The 2013 Actuarial Triennial Review projected that without Government intervention to improve the financial position of the fund, the Contributory Scheme will have no assets by approximately 2037.
21. If the Contributory Scheme has no assets the Government would be responsible for funding 100 per cent of the benefit payments.
22. The Government's contribution to the unfunded superannuation liability is the State's fourth largest budget expense item.
23. The Government's Fiscal Strategy requires the combined annual servicing costs of General Government debt and defined benefit superannuation liabilities to be less than six per cent of General Government cash receipts.
24. The 2016-17 Budget projected that the combined annual servicing costs of the General Government debt and defined benefit superannuation liabilities will be 4.9 per cent (2016-17); 5.2 per cent (2017-18); 5.4 per cent (2018-19); and 5.6 per cent (2019-20).
25. The Contributory Scheme has a greater number of retired members (pensioners) than active members.
26. The Government does not have any plans to change the design or legislated entitlements of members of the defined benefit schemes.
27. No evidence was received from the Government of inappropriate reclassification or "upscaling" of employees income prior to retirement.
28. The inflation (indexation) rate currently has the greatest impact on the quantum of the liability.
29. Since 2010 the requirement for employer contributions to be paid as and when they fall due, has been enforced by the Department of Treasury and Finance.

30. As at 20 April 2016 there were 9,261 members receiving a pension with an average annual gross pension of \$31,302.

31. Many members receiving a pension from the Contributory Scheme are also receiving a part pension from the Australian Government.

1. BACKGROUND

RBF Defined Benefit Fund

1.1 A defined benefit fund provides benefits to its members in accordance with a set formula and is not limited by the funds which have accumulated over time through contributions made by members whilst employed, or the employer during their employment.

1.2 Within the RBF defined benefit fund there are five defined benefit sub-funds:

- Contributory Scheme (closed 15 May 1999)
- Parliamentary Superannuation Fund (closed 11 November 1985)
- Parliamentary Retiring Benefits Fund (closed 1 July 1999)
- State Fire Commission Superannuation Scheme (closed 1 May 2006)
- Tasmanian Ambulance Service Superannuation Scheme (closed 30 June 2006).

1.3 Each of the defined benefit sub-funds has been closed to new members.

1.4 The net assets, calculated benefits and unfunded liability of the defined benefit sub-funds, at 30 June 2015, are detailed in the following table.

2015					
Sub-fund	Effective date of last actuarial review	Net assets for defined benefit members at valuation date \$'000	Actuarial value of accrued benefits for defined benefit members at valuation date \$'000	Vested benefits for defined benefit members at valuation date \$'000	Unfunded liability/ (surplus) \$'000
Contributory Scheme	30/06/2015	1766 260	6 225 596	6 578 746	4 459 336
Parliamentary Superannuation Fund	30/06/2015	4 563	14 661	14 661	10 098
Parliamentary Retiring Benefits Fund	30/06/2015	3 801	3 277	3 746	(524)
State Fire Commission Superannuation Scheme	30/06/2012	25 470	19 314	19 123	(6 156)
Tasmanian Ambulance Service Superannuation Scheme	30/06/2015	50 848	40 970	39 601	(9 878)
Total		1 850 942	6 303 818	6 655 877	4 452 876

Source: RBF Annual Report 2014-15⁴

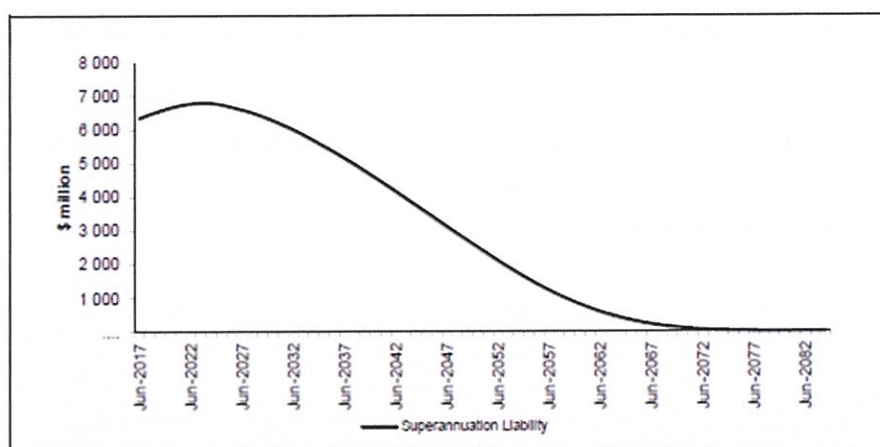
⁴ RBF Annual Report 2014-15, p.72

- 1.5 The 2015 unfunded liability reflects the difference between the net assets available to pay benefits and the amount of accrued benefits at 30 June 2015.
- 1.6 As at 30 June 2015 the Contributory Scheme had an unfunded liability of \$4.5 billion and the Parliamentary Superannuation Scheme had an unfunded liability of \$10.1 million.
- 1.7 The Contributory Scheme and the Parliamentary Superannuation Scheme do not have sufficient net assets to meet the value of accrued benefits payable to its members.
- 1.8 The remaining defined benefit sub-funds, the Parliamentary Retiring Benefits Fund, State Fire Commission Superannuation Scheme and Tasmanian Ambulance Service Superannuation Scheme, do have sufficient net assets available to meet the value of benefits due to members of those schemes.
- 1.9 The vested benefits of members of the defined benefit sub-funds are guaranteed under legislation and payment must be made to RBF by the State if an agency fails to make a payment called for by RBF.
- 1.10 The General Government superannuation liability as at 30 June is shown in the table below⁵:

	2017	2018	2019	2020
	Budget	Forward Estimate	Forward Estimate	Forward Estimate
	\$m	\$m	\$m	\$m
Present Value of Superannuation Liability	7 958.3	8 046.5	8 116.6	8 167.8
Fair Value of Plan Assets	(1 612.8)	(1 584.4)	(1 552.2)	(1 515.0)
Total	6 345.5	6 462.2	6 564.4	6 652.8

⁵ 2016-17 Budget Paper No. 1 p. 132

1.11 The General Government superannuation liability projection 30 June 2017 to 30 June 2084 is shown in the chart below.⁶ The chart projects the liability (net of plan assets) over the total life of the defined benefit schemes.



Source: 2016-17 Budget Paper No. 1

The Contributory Scheme

1.12 The State Actuary recommended, following the most recent actuarial triennial review (as at 30 June 2013), that the level of employer support for the Contributory Scheme be increased in accordance with the following table for all new benefits paid from 1 June 2014. The recommended contribution program is expected to ensure that the Contributory Scheme will have sufficient assets to meet its obligations over its projected lifetime.

Effective date	Employer contribution rate (% of basic benefits)	Estimate annual employer contributions (\$'000)
1 July 2014	78.5%	264 000
1 July 2015	80.5%	284 000
1 July 2016	82.5%	299 000
1 July 2017	84.5%	314 000
1 July 2018	86.5%	335 000
1 July 2019	88.5%	358 000

Source: RBF Annual Report 2014-15⁷

⁶ *Ibid*, p. 132

⁷ RBF Annual Report 2014-15, p.73

The Parliamentary Superannuation Fund

1.13 The State Actuary recommended, following the most recent actuarial triennial review, that the Government continues to contribute at the rate of 73% of pension benefits. The State Actuary also recommended that the Government make one or more additional ad hoc contributions to fund the deficit before 30 June 2016. As at 30 June 2013, the amount required to fully fund the deficit was estimated to be \$240,000 per annum.

Financial Risk to the Government

1.14 The Government acknowledges the budget risk that this increasing cost to the Budget represents.⁸ The Government's Fiscal Strategy includes a commitment to manage General Government debt and defined benefit superannuation liabilities to ensure the combined annual servicing cost is less than six per cent of General Government cash receipts, but there is the proviso that the strategic actions may change in the longer run in response to a changing budgetary and economic environment.⁹

1.15 The Government noted:

As the superannuation liability is calculated using assumptions about future events, which may or may not happen, the State Actuary's estimate of the liability does not represent the total cost to extinguish the liability.

The final cost of the defined benefit scheme will be influenced by many variables that will change over the life of the liability. Some of the variables include estimates of members' final salaries, employment turnover, mortality and marital status.¹⁰

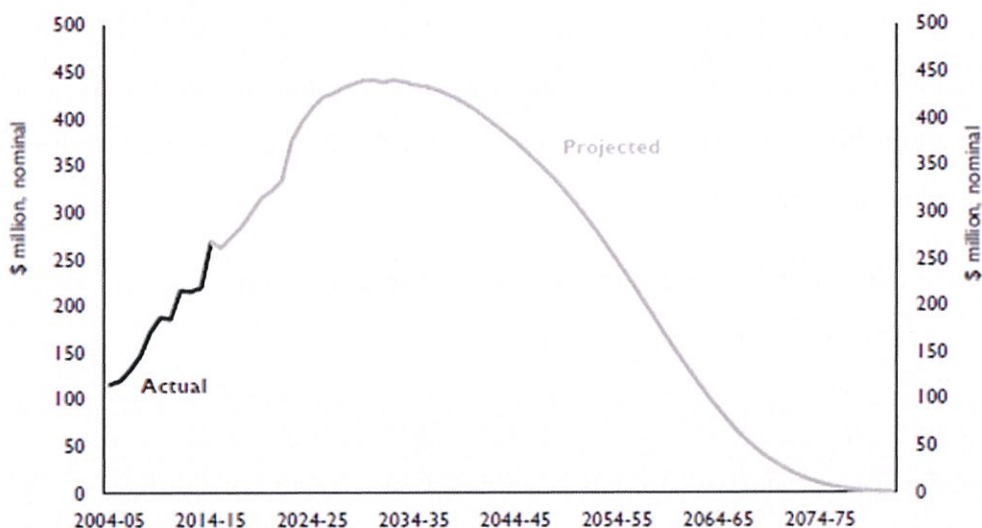
1.16 A recent Department of Treasury and Finance projection of the net annual cost of servicing the defined benefit superannuation liability, which reflects independent actuarial assessments prepared by the State Actuary of the estimated annual employer contribution payments, is depicted in the Chart below. In this projection the nominal value of the annual

⁸ 2016-17 State Budget Paper no.1 p. 135

⁹ *Ibid*, p. 36

¹⁰ Treasurer's Submission p. 2

expenses is estimated to peak in 2031 at \$441 million. These expenses are then estimated to decline as fewer persons become eligible for payments under the schemes primarily due to mortality.



Source: Tasmanian Government Fiscal Sustainability Report 2016

Consequence of Successive Government’s Policy Decisions

1.17 The unfunded liability status of the defined benefit schemes is a consequence of past and ongoing policy decisions of successive Governments. Due to pressures arising from a constrained Budget position, and in seeking to ensure intergenerational equity by spreading the funding burden over time, Governments have made the policy decision to fund the superannuation liability on an emerging cost basis.

1.18 The unfunded liabilities of the defined benefit schemes have accrued over many decades as benefits are funded on an emerging cost basis when scheme members become entitled to a pension or lump sum benefit.¹¹

1.19 Mr Philip Mussared, RBF CEO stated:

If the scheme was fully funded we would be investing it at, say, 7 per cent, producing \$500 million of income. It would be meeting that cost. Successive governments have chosen to do this on an emerging cost basis. I am sure the point has been made by others. The superannuation cost to the State

¹¹ 2016-17 Budget Paper No. 1 p. 131

Government is now the fourth largest item in the budget. These numbers say it will increase. That is Government policy.¹²

1.20 Submissions to the Inquiry made the point that Contributory Scheme members...plan their affairs and expectations based on their contractually agreed entitlements... [and] joined a superannuation fund that placed certain obligations on them for which, in return, they were guaranteed a certain outcome.¹³

1.21 Mr Chris Bevan, President of the Tasmanian Association of State Superannuants Inc. (TASS) stated:

I believe how it needs to be addressed is that this was not a thing that happened overnight, it is a creep. In the 1920s or 1930s when they designed it, a particular group of people on a particular salary with a particular life expectancy could afford to do it by putting the money away, if they did, or on an emerging basis because it was not a lot.

I remember when I started in 1972 and the fund was explained to me and why I had 5.5 per cent taken out of my salary at that stage with no question of do you want this taken out, I received my first pay cheque and asked, 'What is that?' and somebody explained it to me. I was 17 years of age. At 17 you do not think at 57 I will have done my 40 years and I am going to get a pension for life. It doesn't go through the mind of a 17 year-old but you have to pay it anyway.

As the years ticked by and I do one year, I do 10 years, I do 20 years, somebody in government should have been saying statistically there are a lot of him, and therefore our cost is getting greater, and we need to be active about it. They chose to be inactive.

That is not an issue that me, as an individual, or all of the 'me's' grouped together, ever had an opportunity to address. We had a meeting with Philip Mussared from RBF recently. He made a comment along the lines that had they invested the money and had RBF had the money instead of being held

¹² Mussared, P – RBF Inquiry Hansard Transcript 3 May 2016, p. 4

¹³ ANMF Tasmanian Branch Submission, p. 1 and Police Association of Tasmania Submission, p. 2

in Treasury under this smoke and mirrors...He said we would have been the largest fund in Tasmania that would have been part of the Quadrant TasPlan merger instead of being a secondary-type measure. The whole issue about the APRA regulations and whether RBF would be recognised as a fully APRA fund would not have been an issue, which has created an issue for the Government and the RBF...and they need to separate them now. What they have done, in my simplistic way of looking at it, is it is putting RBF back to where it was when I started in 1972, back into Treasury or back into a single body looking after the Contributory Scheme...The government missed a golden opportunity here. It should have addressed it on a creeping basis.¹⁴

Current parties to the operation of the Contributory Scheme

1.22 Mr Mussared sought to clarify the differentiation of roles in the operation of the scheme:

We have RBF which is both the trustee and the administrator of the Scheme. Since 2011 we have outsourced the administration of the scheme to Mercer... The Actuary is the person responsible for the assumptions that underlie the accounts of the scheme. David Knox [State Actuary, Mercer Consulting (Australia) Pty Ltd] has provided the advice to us about things like the unfunded liability, the requirement from contributions, the percentage of those contributions that the employer should pay, et cetera.

Finally, there is Treasury which advises the Treasurer, the Minister responsible for the legislation. Treasury is responsible for the scheme design.¹⁵

¹⁴ Bevan, C – RBF Inquiry Hansard Transcript 2 May 2016, p. 26

¹⁵ Mussared, P - RBF Inquiry Hansard Transcript 3 May 2016, p. 2

Legislative Change – formation of the Superannuation Commission

1.23 The *Public Sector Superannuation Reform Act 2016*:

- provides responsibility for the RBF defined benefit schemes to be transferred to a Superannuation Commission established under the legislation; and
- makes no change to the entitlement of the members of the RBF defined benefit schemes.

1.24 Responsibility for the RBF defined benefit schemes will transfer to the Superannuation Commission from 1 April 2017. Currently, the Department of Treasury and Finance is conducting tender processes for the provision of administration and investment management services for the defined benefit schemes.

1.25 The RBF Board will be responsible for the RBF defined benefit schemes until fiduciary responsibility is transferred to the Superannuation Commission. The Government has commenced a process to outsource the provision of defined benefit member administration and investment management services which will be delivered under contract with the Superannuation Commission.

1.26 The Government will retain responsibility for the funding of the RBF defined benefit schemes.

Findings:

1. As at 30 June 2015 the Contributory Scheme (which has the largest unfunded liability) had:
 - a. plan assets of \$1.8 billion;
 - b. an accrued benefit liability of \$6.3 billion; and
 - c. an unfunded liability of \$4.5 billion.
2. The unfunded liability of the Contributory Scheme at a point in time reflects the difference between the plan assets available to pay benefits and the amount of accrued benefits at the date of valuation by the Actuary.

3. Successive Governments made policy decisions to only fund the emerging cost of the superannuation liability.
4. The Contributory Scheme is a hybrid scheme: the Government employer contribution is funded on an emerging cost basis when scheme members become entitled to a pension or lump sum benefit, with the remaining part of the benefit paid from the schemes' assets.
5. The projected nominal value of the annual expenses is estimated to peak in 2031 at \$441 million.
6. All defined benefit schemes are now closed:
 - a. Contributory Scheme closed 15 May 1999;
 - b. Parliamentary Superannuation Fund closed 1 July 1999;
 - c. Parliamentary Retiring Benefits Fund closed 1 July 1999;
 - d. State Fire Commission Superannuation Scheme closed 1 May 2006;
 - e. Tasmanian Ambulance Service Superannuation Scheme closed 30 June 2006.
7. RBF is both the Trustee and Administrator of the RBF defined benefit fund.
8. Since 2011 the administration of the RBF defined benefit funds has been outsourced to Mercer.
9. The Department of Treasury and Finance is responsible for the defined benefit fund scheme design.
10. The *Public Sector Superannuation Reform Act 2016*:
 - a. provides responsibility for the RBF defined benefit schemes to be transferred to a Superannuation Commission established under the legislation; and
 - b. makes no change to the entitlement of the members of the RBF defined benefit schemes.
11. Responsibility for the RBF defined benefits schemes will transfer to the Superannuation Commission from 1 April 2017.
12. The Government will retain responsibility for the funding of the RBF defined benefit schemes.

2. EVIDENCE

Term of Reference 1: Reasons for the increased funding shortfall

2013 Actuarial Triennial review

2.1 The submission from the Hon Peter Gutwein, Treasurer, made reference to the 2013 actuarial triennial review to identify the reasons for the increased funding shortfall:

The most recent triennial review was completed for the year ending 30 June 2013. The review discussed the Scheme's growing deficit and changes in the Actuary's assumptions since the previous review in 2010.

The main concern identified by the State Actuary in the 2013 review was the increasing size of the deficit for the Scheme, which had grown from \$258 million as at the 30 June 2010 triennial review to \$344 million as at 30 June 2013. The deficit represents the difference between the net value of plan assets and the present value of contributions, less the present value of future benefits and Scheme costs. The major factor that contributed to the increase in the deficit was the addition of interest to the previous deficit. Other factors that contributed to the increase in the deficit included:

- *RBF administration and management expenses in excess of the assumed rate;*
- *a higher up-take of pensions than was assumed;*
- *the average member contribution rate increased during the period; and*
- *investment earnings were lower than assumed.*

2.2 In correspondence the Treasurer further noted:

The financial position of the defined benefit schemes is published every six months in the December Quarterly Report and the Treasurer's Annual Financial Report, in accordance with the Australian Accounting Standards. The Treasurer's Annual Financial Report is audited by the Tasmanian Audit Office and, every second year, the Auditor-General appoints an external actuarial expert to conduct a review of the actuarial assumptions used by the State Actuary. In addition, revised actuarial assessments are also

prepared by the State Actuary for the Budget and the Revised Estimates Report.¹⁶

2.3 The RBF submission confirmed the factors identified in the Treasurer's submission and added:

As a result of this experience, we have increased the future level of assumed expenses and increased the assumed level of pension take up in the future; both of these changes have had an adverse impact.

However, offsetting the above, the following factors had a favourable impact on the financial position:

- *The agreement to increase the employer share from 75.5% to 76.5% of the basic Benefit with effect from 1 July 2012;*
- *Salary increases during the period at less than the assumed rate; and*
- *A decrease in assumed future salary increases for five years, reflecting the current economic conditions.¹⁷*

2.4 Mr Mervin Reed, Tasmanian Wealth Advisors, disagreed with the assessment and assumptions made by Treasury and RBF, stated:

I disagree with the Treasury view... Because of the age and the gender spectrum of the existing public sector employees who are over 55 years old.

Your concern is whether the Treasury's figures are accurate. The answer is they are probably not because the Treasury cannot forecast who is going to retire any more than the Actuary can. That is the first thing. If you have a look at the overhang - there is 45 per cent of the state service that is over 55 years old. A large majority of those are women who, unfortunately, in the previous scheme were unable to access superannuation because it was not a condition of service. When it became a condition of service they all signed on to the deal. Most of these women joined the scheme between 1991 and 1995. They do not have the years of service, so they are staying in service to build the multiple for retirement. They will all retire within a five- or six-year

¹⁶ Treasurer's letter of 16 June 2016, p. 2

¹⁷ RBF submission, p. 2

*period. That is why the tsunami is going to whack the budget very hard, very deliberately, and there is nothing to stop it.*¹⁸

- 2.5 The Treasurer responded in writing to the question of whether the quantum and timing of the peak in unfunded liability will be worse than predicted and required urgent and significant reform. The Treasurer stated:

The Government disagrees with any such suggestion.

The Government's defined benefit superannuation liability is a snapshot of the Scheme's financial condition at a particular point in time, calculated using assumptions with a set value at that point in time.

Due to the nature of the calculations and the range of economic and demographic assumptions used by the State Actuary to project benefit payments, the current value of the liability can vary significantly if there is a change in any of the underlying assumptions.

*As the superannuation liability is calculated using assumptions about future events, which may or may not happen, the State Actuary's estimate of the liability does not represent the total cost to extinguish the liability...the Government will continue to rely on the expert advice that it receives from the State Actuary, which is independently reviewed by the Tasmanian Audit Office.*¹⁹

- 2.6 Mr Rod Whitehead, Auditor-General, commented on the unfunded liability and the role of and assessment undertaken by the State Actuary.

In regard to the gross liability, it should be recognised that the liability is determined by an actuarial assessment undertaken by the State Actuary. That includes a number of assumptions, some of which include the discount rate, the higher take-up of pensions relative to lump sums, and various other actuarial assumptions that are outlined in the State Actuary's report, which is attached as an attachment to the RBF financial statements.

¹⁸ Reed, M - RBF Inquiry Hansard Transcript 2 May 2016, p. 3

¹⁹ Treasurer's letter of 16 June 2106 pp. 1-2

In conducting our audit of the RBF, we also look at the actuarial assessments, and engage our own expert to review the assumptions of the State Actuary to ensure that those assumptions are appropriate.²⁰

2.7 Mr Jara Dean, Assistant Auditor-General added:

We do engage an expert to undertake a peer review of the State Actuary every three years. The last time this review took place was in 2015 and prior to that in 2012. The outcome of the review was that our expert was satisfied that the data assumptions and methodology used by the State Actuary were reasonable and concluded that the source data were relevant and appropriate for the purpose of the valuation. This is data as it relates to the members of the fund. The assumptions and methodology were consistent with the relevant accounting and professional standards and have been determined in a manner consistent with prior periods. Again the assumptions, for example, about mortality rates, when people will be retiring, decisions around whether people will be taking pension or lump sum payments, these are the type of assumptions we are talking about... The assumptions were consistent with industry practice and the method of calculations applied were appropriate. On that basis, we were satisfied that the work that the State Actuary performed was done in accordance with the relevant standards and the general practice is that actuaries would apply in determining the value of the liability²¹.

2.8 The State Actuary, Dr David Knox of Mercer Consulting (Australia) Pty Ltd provided the following background to the 2013 review:

RBF has five defined benefits schemes...the one that dominates ... is the contributory scheme with about 30 000 members, which is made up of active members, pensioners and preserved members. That scheme represents somewhere between 96 per cent and 98 per cent of the state's defined benefit liability.

It is helpful to go back a little. I am going to go back to before the global financial crisis to the Actuarial Review and these reviews are done every

²⁰ Whitehead, R - RBF Inquiry Hansard Transcript 2 May 2016, p. 43

²¹ Dean, J - RBF Inquiry Hansard Transcript 2 May 2016, p. 44

three years. In 2007 I was not the State Actuary and [PricewaterhouseCoopers] PwC did the work. At that point they found the scheme was reasonably well balanced. There was a net positive position of \$105 million, allowing for the Government, it was then planned to increase to 75 per cent of each member's benefit. However, the global financial crisis came along, as we all know. In the years from 2007 to 2010, the scheme, instead of earning a positive return over those three years, lost money at the rate of 3.5 per cent per annum. That represented a loss of about \$480 million. It meant that when we looked at June 2010, it had moved from a positive \$105 million to a negative \$258 million. That was caused by the investment losses with the global financial crisis.

In 2013, that loss net position worsened to a minus \$344 million and the major cause of that was the interest on the loss. If you are already in a loss position, it gets worse unless you do something about it. In 2013 we recommended that the Government had to increase the proportion of benefits it paid to new retirees, whether they were pensioners or those receiving a lump sum benefit. We will do another review as at June this year, 2016, and we will re-assess the position.

I thought I would make that opening comment that when we look at the position of the contributory scheme, the major defined benefit scheme, its net position dates back to the global financial crisis.²²

- 2.9 Mr Whitehead, Auditor-General, made comments related to employer contributions:

it should be noted that the employer contributions are based on advice from the actuaries and it is the Government's responsibility for the whole of the funding shortfall. Timing around when the government contributions will be made is really what determines the level of government contributions at any particular point of time.

We make reference to the whale graph, which I understand most people refer to it as, which is essentially the undiscounted payment cash flows from

²² Knox, D – RBF Inquiry Hansard Transcript 3 May 2016, p. 33

pensions and lump sums, representing the whole cost which is not split between the RBF and the Government - although in some cases I have seen versions of this particular graph which show the Government's contribution over the expected time that the liability will need to be extinguished.

The whole graph shows a significant build-up in the annual cost over the next three-year period, to 2021, which shows an increase of approximately 30 per cent in the annual contributions that will need to be made. Then there is a peak period covering a period of 15 to 20 years, during which the maximum contributions will need to be made, after which the level of contributions required to extinguish the liability will be reduced.²³

RBF administration and management expenses

2.10 Dr Knox commented on the claim in the RBF submission that expenses were in excess of the assumed rate and a factor that increased the deficit.

That comment was basically an assumption that we have to make on what is the level of expenses going forward. Those expenses we normally express as a percentage of either salaries or pensions. They were going through significant reform between 2007 and 2010 and we had to make a note that expenses were higher than previously had been assumed, so looking forward we made that comment. I would expect that those expenses have come down in the last three years. We have not done the numbers for the last three years yet but it will be done later this year. I think the RBF have kept a tight control on expenses but I haven't got the latest numbers. I should add even when we are talking about an increase in expenses, this might be only an increase, in broad terms for the whole scheme we are talking about the value of future benefits being worth something like \$7 billion, or \$7 000 million, in 2013. The value of the expenses in today's dollars compared to the \$7 million was around \$150 million. Yes, it is an important number but it is not a number which is going to blow everything out of the water.²⁴

²³ Whitehead, R - RBF Inquiry Hansard Transcript 2 May 2016, p. 43

²⁴ Knox, D - RBF Inquiry Hansard Transcript 3 May 2016, p. 39

Demographic change and a higher take up of pensions

2.11 A number of submissions noted the changing demographics of retirees since the retirement benefit schemes were established.

2.12 Mr Mussared stated:

In regard to the terms of reference of the inquiry, the first question was, what is the reason for the increased funding requirement? The short answer to that is demographics. More contributory scheme members are entering the pension phase. On an emerging cost basis those pensions need to be paid. The total call on the employers, both Treasury and the agencies which contribute directly, is increasing... I think demographics is what it is all about. If you are talking to David Knox he can take you through the hedge profile of the members. What we are seeing now is there are none in the 20s, a very small number in the 30s, it steps up into the 40s and peaks in the 50s and 60s. While we do not have age retirement in the State Service, the Actuary makes assumptions about when those people will retire. They will be retiring over the next 10 to 15 years. Both the number will increase and the expectation from the Government of its percentage, will increase.²⁵

2.13 Dr Knox confirmed that changing demographics is the biggest challenge. He said:

No, that is the biggest change. The other thing that is happening - if I just look at some comparison numbers - in 2007 we had 12 000 active members and 7 500 pensioners. In 2013 we had 7 500 active members and 8 500 pensioners. Come 2016, we are probably going to have somewhere between 5 000 and 6 000 active members and probably close to 10 000 pensioners. You can start to see the demography shifting. Yes, there are still active members who are approaching retirement, but it is the pensioners who are getting most of the payments. Of course, they cannot put any more money in. They have left employment. There is no salary effect there. The thing that is driving the liability for pensioners is purely the inflation rate.²⁶

²⁵ Mussared, P - RBF Inquiry Hansard Transcript 3 May 2016, p. 4

²⁶ Knox, D - RBF Inquiry Hansard Transcript 3 May 2016, p. 36

2.14 Mr Reed identified longevity as a contributing factor to increasing costs:

During the period of time since the start of RBF defined benefit scheme (the 1930's), diet, health care, and medical advances have meant that the statistical age of death across the community in Tasmania is around 84.5 years for males and about 85.7 years for females.

Hence the actuarial base of the defined benefits scheme, saw in 1930, a pension being paid for around 12 years, and in 1960 the pension being paid for 12.47 years this rose in 1990 to 15.41 years and in 2007 was 18.54 years.

Future Life expectancy from 2018 is estimated to see pensions being paid for around 21.6 years.

So from a design base of 12 years of pension payments, when the scheme first commenced, to a pension payment liability of 12 years, we now have a pension payment liability of 21.6 years...There will be more pensioners who will live much longer and at much higher aggregate FAS3 salary numbers²⁷

2.15 With regard to the higher take up of pensions Dr Knox stated :

It is true that over time a higher proportion of retirees are taking pensions as opposed to lump sums. Back in 2007, the assumption was that about 60 per cent of the benefits would be taken as a pension. In 2013, we had increased this to 75 per cent. It may even go up to 80 per cent this year. Why is that happening? I think it is happening for one very simple reason that people are becoming increasingly aware of longevity as they see their parents living into their 90s. They think, 'Oh, I could live a little bit longer too.' For those who joined the scheme in the earlier years and had the 12:1 pension commutation, these are very generous benefits and it is very good value to take the pension.

I think we will continue to see more and more the benefits taken in pension form as people become increasingly aware of the value of a defined benefits indexed pension from the State Government. They look at the lump sum and they say, 'What can I get from that? A term deposit is only giving me 3 per cent. The share market is risky. Hmm, what do I do with my money?'

²⁷ Reed, M Submission, p. 3

Alternatively, the Government is going to pay me an indexed pension until I die.' In one sense there is no choice, if you look at it from that perspective. Obviously, some people are in poorer health, so we would never expect a 100 per cent pension take-up. Some people will want lump sums to pay a debt off or to have some money to travel. I think that trend to take a pension is not only there in Tasmania, but it is in most public sector schemes around the country²⁸

2.16 The table below, from the RBF Annual Report 2014-15, sets out the number of pensioners per 1,000 assumed to die during each year at selected ages, along with the assumed rates of improvement.

Age	Retiree		Invalid		Spouse		Improvement per annum	
	Male	Female	Male	Female	Male	Female	Male	Female
55	1.8	1.7	5.4	3.3	4.5	2.7	3.21%	2.45%
60	3.0	2.4	8.7	5.2	7.2	4.4	3.34%	2.52%
65	4.2	2.9	14.4	8.1	12.0	6.8	3.29%	2.52%
70	9.0	5.5	23.0	13.4	19.2	11.2	3.08%	2.45%
75	14.6	11.6	39.7	23.8	33.1	19.8	2.73%	2.30%
80	38.6	27.1	69.1	43.9	57.6	36.6	2.21%	2.07%
85	64.5	55.9	118.9	85.1	99.1	70.9	1.61%	1.62%
90	156.0	89.9	195.4	157.1	162.9	130.9	1.07%	1.03%
95	237.7	229.2	277.3	250.7	231.1	209.0	0.78%	0.67%
100	392.9	283.6	338.5	339.4	282.1	282.8	0.51%	0.47%
105	469.1	335.0	384.8	404.3	320.7	336.9	0.24%	0.26%
110	1000.0	1000.0	1000.0	1000.0	1000.0	1000.0	0.00%	0.00%

Source: RBF Annual Report 2014-15²⁹

Rate of Contribution

2.17 With regard to the rate of higher contribution by members, Mr Mussared stated:

The third one is the fact there is a degree of choice for the members as to how much they want to put in and the more they put in the higher will be their pension. So they are recognising there are advantages in making higher contributions...³⁰

²⁸ Knox, D – RBF Inquiry Hansard Transcript 3 May 2016, p. 36

²⁹ RBF Annual Report 2014-15, Appendix B, p. 110

³⁰ Mussared, P – RBF Inquiry Hansard Transcript 3 May 2016, p. 10

2.18 Dr Knox confirmed:

The average member contribution rate in 2007 was 6.9 per cent. In 2010 it was 7.8 per cent. In 2013 it was 8.4 per cent. You are absolutely right. Members are putting more money in. At the same time, during those six-year periods the average age of members in the contributory scheme increased from 48.8 years to 52.0. What we are seeing there is, as members become older, and this is reasonably typical across the country, and they move into their 50s, they have more capacity to save. Maybe the mortgage is paid off, maybe the kids have left home - or not.³¹

Findings:

13. The Committee accepts that the following factors contributed to the increased funding shortfall:
 - a. the addition of interest to the previous deficit;
 - b. RBF administration and management expenses in excess of the assumed rate;
 - c. a higher up-take of pensions than was assumed;
 - d. the average member contribution rate increased during the period;
 - e. investment earnings were lower than assumed.
14. The demographic profile of RBF defined benefit fund members means:
 - a. more Contributory Scheme members are entering the pension phase; and
 - b. since the establishment of the defined benefit fund improved rates of longevity have increased the years of pension payments.
15. The defined benefit unfunded superannuation liability is a "snapshot" of the Scheme's financial condition at a particular point in time.
16. The State Actuary uses a range of economic and demographic assumptions to project benefit payments. The current value of the liability can vary significantly if there is a change in any of the underlying assumptions.
17. The Auditor-General independently reviews the data assumptions and methodology used by the State Actuary.

³¹ Knox, D – RBF Inquiry Hansard Transcript 3 May 2016, p. 35

Term of Reference 2: The risks and implications of the current and any future increases in employer contributions to the Government's budgetary position

2013 Actuarial Triennial review

- 2.19 The submission of the Treasurer detailed the actions recommended by the review to address the funding shortfall:

The review recommended that, in order to reduce the funding deficit, the Government should gradually increase its level of contributions for new member benefits from 76.5 per cent in 2013-14 to 78.5 per cent in 2014-15 and progressively increasing to 88.5 per cent by 2019-20. The recommended increases applied to new benefits only which means that, for a member retiring in 2014-15, the Government contributed 78.5 per cent of that member's benefit payment, with the remaining 21.5 per cent being funded by the assets of the Scheme. The increased level of Government contributions recommended by the State Actuary had no impact on the employer contribution for current pensioners.

In the review, the State Actuary noted, that without Government intervention to improve the financial position of the fund, it projected that the Scheme will have no assets by approximately 2037. In such a situation, the Government's funding share would immediately increase to 100 per cent of all benefit payments.³²

- 2.20 Mr Mussared stated:

The second part of your terms of reference was: what are the implications for current and future increases in employer contributions to the Government's budgetary position? ... I think we will see the actuary recommending steady increases in the employer's share ... If those percentages do not increase, the actuary has estimated that the \$1.8 billion will actually itself be exhausted by 2037³³

³² Treasurer's submission, pp 2-3

³³ Mussared P – RBF Inquiry Hansard Transcript 3 May 2016, p. 6

Payment of Emerging Cost Employer Contributions

2.21 Mr Mussared discussed his experience regarding the payment of employer contributions by entities when called by RBF, he stated:

As a CEO of a superannuation fund, RBF, administering the CON, [contributory fund] if we had no assets, I would be nervous from time to time because clearly if at any point the employer failed to make a contribution, the scheme would be in deficit. It would be out of money. As a combined accumulation and defined benefits scheme, we would probably be looking to borrow cash from the accumulation scheme. That would be a most uncomfortable situation to be in.

The situation I have experienced over the past six years is that the employer contributions are paid as and when they are called for. When I first arrived, a number of agencies were in the habit of using us as a bank and taking a little bit of time to pay their contributions when called. The Treasury meets the contributions for the inter-budget agencies, but a number of GBEs and SOCs we bill directly. Some of those, (a) were unhappy that they were being called upon to pay these monies, and (b) if they had a cash flow problem themselves, they were happy to pass it onto us. I think I have conveyed the message that that is not acceptable behaviour, and I do not think it has been an issue for a number of years now.³⁴

Impact on the Budget

2.22 The impact of the liability on the State budget was raised as an area of concern by a number of witnesses.

2.23 Ms Kathrine Morgan-Wicks, Deputy Secretary of the Department of Treasury and Finance, stated:

The unfunded superannuation liability is mentioned as a key risk, I think, in the last many budgets. It will sit there and it will sit there in probably every state's budget risks as a key one which is closely monitored. From a Treasury view, the emerging cash cost and our projections which would

³⁴ *Ibid*, p. 3

probably run out to 2083, are numbers that we closely manage to ensure that the emerging cash cost is included in budget estimates. It is a figure that is there as a mainstay. It is not something that is played with.

We take the State Actuary's expert opinion. We look at all of the assumptions that go into that opinion and the formulation of that. It is reviewed at various stages in the year. It is put there as one of the main budget items and factored in, in terms of expense. So from a Treasury position, the emerging cash cost can be met on the basis of our current estimates. In terms of comments like, 'spiralling out of control, et cetera,' that is certainly not our view. It is not the one that is projected in the information we include within budget papers every year to try to explain the policy setting we currently have and the approach we take to making sure it is funded but funded in a way which does not unfairly impact on a particular generation. This is a long-term cost to the budget. It is a significant one. Yes, it is a risk but it is one which is currently managed under the current policy settings.³⁵

2.24 Mr Mussared stated:

When I am asked to talk about RBF, I do make the point that superannuation is the fourth-largest item in the Government's budget. Health, education, state development, and then it is superannuation.³⁶

2.25 Mr Reed expressed concern in his submission of what he terms "the coming Tsunami of RBF Defined Fund retirements". He claims that once the 55-65 age group start retiring there will be a sustained impact upon the Consolidated Fund of the Tasmanian Government, with the cash required to fund the pensions rising at the rate of up to \$60m per annum.³⁷

2.26 Mr Reed noted in his submission:

A further generator of retirement funding growth is the concept built into the scheme called the final average salary or FAS... persons considering

³⁵ Morgan-Wicks, K - RBF Inquiry Hansard Transcript 3 May 2016, p. 29

³⁶ Mussared P -- RBF Inquiry Hansard Transcript 3 May 2016, p. 7

³⁷ Reed, M submission, p. 8

*retirement within organisations, are given favourable treatment in relation to additional salary by way of higher duties allowances and even promotion, in order to increase their final average salary, over the last three years of their public service working life.*³⁸

2.27 Mr Reed commented on the use of the final average salary to calculate the value of pensions. He said:

*... averaging is a rort. It generates rorts within the public sector.*³⁹

2.28 Ms Morgan-Wicks commented on the impact of higher salaries on the liability:

*... an increase in salary, yes obviously that will impact on the liability. Certainly over the last couple of years or since the 2014-15 Budget there has been an agreed 2 per cent wage increase policy. That is the wages policy for the Government, which is lower than in previous decades. But added together with classification changes that will obviously impact on the final salary for a member.*⁴⁰

2.29 With regard to the matter of overtime increasing the final average salary calculation, Ms Morgan-Wicks stated:

As we mentioned before, Treasury does not receive this kind of individual information. There may be anecdotal information about any working person who is approaching their retirement attempting to play within the rules. It might be termed rorting. However, if they are acting within the current scheme provisions and legitimately achieve either a promotion, legitimately undertake overtime which is not currently restricted according to age or whether or not you are a defined benefit member. Treasury has not received information to this extent nor have we undertaken any modelling to state it might be unduly or significantly influencing the level of liability or a contribution rate by employer... Overtime is a factor of awards. It is reviewed each time an award comes up and as a part of industrial negotiations per sector. It is a typical and usual part of employment... From

³⁸ *Ibid*, p. 6

³⁹ Reed, M - RBF Inquiry Hansard Transcript 2 May 2016, p. 4

⁴⁰ Morgan-Wicks, K - RBF Inquiry Hansard Transcript 3 May 2016, p. 23

*a global perspective, Treasury obviously receives information in relation to employee expenses. We are watching that very carefully and we have not seen any type of significant aberration at a global level. We are just not receiving that kind of information at the three years prior to retirement.*⁴¹

2.30 Mr Mussared stated:

*It is not a rort. It is an unintended consequence of the scheme design. We only administer the scheme. These are questions to put to Treasury and if there is a concern this is happening, Treasury needs to look at the regulations. We cannot change the regulations. We can only administer the regulations. Do we, for example, go back and look at someone's salary four years ago and compare it to what it is now? No, because there is no point.*⁴²

2.31 The Treasurer did not support the view that there are unintended consequences in the design of the Scheme, stating:

The view that there have been "unintended consequences" associated with the design of the Scheme is not a view of the Government or of the Department of Treasury and Finance.

*Factors such as reclassification, salary progression and additional overtime are taken into account by the State Actuary and are fully reflected in its final expense projections for the Scheme. As more and more members retire and enter pension phase, the proportion of active members in the Scheme will continue to decline and these salary factors will have a reduced impact on the liability.*⁴³

2.32 Dr Knox was asked about claims of reclassification or scaling up of incomes prior to retirement. He responded:

DR KNOX - We do look at some of the increases because it is driving the defined benefit. I can tell you in the last two financial years, 2013-14 and 2014-15, the average salary increase in the contributory scheme was 4.2 per cent and 3.2 per cent, respectively.

⁴¹ *Ibid*, p. 30

⁴² Mussared, P - RBF Inquiry Hansard Transcript 3 May 2016, p. 15

⁴³ Treasurer's letter of 16 June 2016, p. 3

CHAIR - Which is, interestingly, above the Government's range as policy of 2 per cent.

Dr KNOX - Correct. The fact it is above 2 per cent could mean that people have received promotions. It could mean that some individuals are doing what has been suggested. But for the scheme as a whole, it is not way out of our expectations.

CHAIR - So, even if people are doing it, it is not having a significant impact on the Government's requirements to fund?

Dr KNOX - That is correct. The other point I would make is that within the contributory scheme we actually now have more pensioners than we do active members. What that means is, once you start to receive a pension, your salary is having no impact. The pension has commenced. What is having an impact on the liability is the inflation rate, which is the indexation rate. If inflation is below our expectations, which it is in the last 12 months, it will help the scheme's financial position. The pension might only go up at 1.5 per cent or 2 per cent where we have expected long term the pension would increase by 2.5 per cent, which is the mid-point of the Reserve Bank range.⁴⁴

2.33 Mr Craig Jeffery, Branch Director (Department of Treasury and Finance) explained that the increased employer contribution is necessary as:

... there is a funding gap. If something is not done the asset pool will decline and so something needs to be done... The change would be very marginal. It is a pool of assets which was going to decline in 24 years from 2013 which will probably now decline in, I cannot remember the numbers, but 40 to 50 years or something like that.⁴⁵

⁴⁴ Knox, D - RBF Inquiry Hansard Transcript 3 May 2016, p. 35

⁴⁵ Jeffery, C - RBF Inquiry Hansard Transcript 3 May 2016, p. 25

2.34 Ms Morgan-Wicks, stated:

Without moving to a 100 per cent contribution from Government at a point in time which then disadvantages the general public in services which can then be afforded in the budget.⁴⁶

2.35 Mr Tom Lynch, General Secretary of the Community and Public Sector Union (CPSU) quoted the following from an RBF Communication to CPSU Members at the hearing:

“Why is the increase in employer share necessary? Increasing the employer's share of contribution scheme benefits is necessary for the following reasons: the ageing membership and the fact the contributory scheme is closed to new members means that the membership base will continue to age and decline over time whilst the accrued benefits of remaining members will continue to increase. This places pressure on the funding arrangements for the contributory scheme.”

We are seeing something here which should not be surprising us. There is a lot of people who are on pensions, there is a reducing number of people making contributions, therefore the liability for the scheme was always going to increase in this way.

“What is the unfunded component of the contributory scheme benefit? The unfunded component is the employee's share of your contributory scheme benefit which is funded by last minute employer contributions. In the case of the Contributory Scheme Life Pension, the employer share is paid fortnightly as the employer contributions for the duration of Contributory Scheme Life Pension. In the case of the contributory scheme retirement lump sum payment, the employer share is paid as an employee contribution in the form of one-off lump sum payment.”

The employer has made their decision as to how they are going to fund their component of this contractual arrangement. I think it is extremely unreasonable to think because the employer has decided not to do anything

⁴⁶ Morgan-Wicks, K – RBF Inquiry Hansard Transcript 3 May 2016, p. 25

in that part other than as described there - Fund the pension on a fortnightly basis.⁴⁷

2.36 Mr Whitehead, Auditor-General, noted:

In the contribution that the Government makes, it is directly related to the cash flows that need to be paid over the term of the remaining pension payments going out to 2083. But there is that peak period of time over the next 15 to 20 years when there is going to be significant drain on the state's financial resources to meet those pensioner benefit payments. The Government has set a benchmark as to what level it would like those payments to represent in percentage of gross receipts. It is a question of how achievable or how relevant that particular benchmark will be into the future.

Again, there may be changes in some of the actuarial assumptions that might require revisiting of that particular benchmark but the fact that the Government has set a benchmark that it wants to maintain that benefit level within, on an annualised basis, sets an expectation of the public as to how much of the Government receipts will be available to meet that liability.

... it sets that public expectation on what that level of contribution will need to be. This is, to some extent, a liability that is going to go across a number of generations and across a number of Governments. It is a matter of coming up with the contribution level that is fair across those generations.⁴⁸

2.37 The Government's Fiscal Strategy is committed to ensuring the combined annual servicing cost of General Government debt and defined benefit superannuation liabilities will be managed to be less than six per cent of General Government cash receipts. In light of evidence to the Inquiry, the Treasurer was asked to provide an indication of the impact that meeting the emerging costs of the Contributory Scheme will have on the ability of Government to fund the service needs (e.g., health, education, and police) of the State.

⁴⁷ Lynch, T – RBF Inquiry Hansard Transcript 2 May 2016, p. 36

⁴⁸ Whitehead, R - RBF Inquiry Hansard Transcript 2 May 2016, p. 50

2.38 The Treasurer's response noted:

The Government's Fiscal Strategy includes a Strategic Action that the combined annual servicing costs of General Government debt and defined benefit superannuation liabilities will be less than six per cent of General Government cash receipts. As noted in Budget Paper No. 1 of The Budget [2016-17], the increasing defined benefit superannuation liability has been a key risk for the State for a number of years and without continued prudent fiscal management, it will place a significant strain on the Government's financial position.

The 2016-17 Budget provides an update on the progress of the Government's Fiscal Strategy and shows that, over the 2016-17 Budget and Forward Estimates period, the combined annual servicing costs of the General Government debt and defined benefit superannuation liabilities will be 4.9 per cent in 2016-17; 5.2 per cent in 2017-18; 5.4 per cent 2018-19; and 5.6 per cent in 2019-20.⁴⁹

2.39 The Treasurer was asked what the impact would be if emerging costs rose to 7 per cent and 10 per cent of general government receipts. He did not specifically answer this question, instead stating:

As outlined in the Tasmanian Government Fiscal Sustainability Report 2016, the defined benefit superannuation expenses, as a share of General Government cash receipts, is projected to be less than six per cent in three of the four scenarios used to model the long-term sustainability of the Tasmanian Government's finance. The scenarios selected in the Report examine the extent to which the State's finances are sustainable under a range of different economic, demographic and fiscal assumptions.

Scenarios one, two and three assume revenue growth rates (excluding interest outcome) of 4.8 per cent, 3.5 per cent and 3.9 per cent respectively. Scenario four of the Report, which assumes the slowest growth (2.2 per cent) of General Government revenue (excluding interest income), indicates that the defined benefit superannuation expenses, as a share of General

⁴⁹ Treasurer's letter of 16 June 2016 p. 4

Government cash receipts, is only slightly higher than six per cent and will peak in 2024-25 and then decline.

The Government is confident that there is sufficient Budget capacity to meet the combined annual servicing costs of the General Government debt and defined benefit superannuation liability.⁵⁰

2.40 The Treasurer's response was also sought with regard to a number of strategies proposed during the Inquiry, as measures to reduce the impact on the State's Budget:

- a. the option of changing members entitlements such as altering indexation arrangements and/or capping benefits;
- b. facilitating the exit of members in the accumulation stage; and
- c. winding up the scheme, particularly the issues of members' agreement, legislative issues and conformance with Superannuation law.

2.41 The Treasurer's response was:

As I have stated publicly, on many occasions, the Government has no plans to change the design or legislated entitlements of members of the defined benefit schemes.

The decision taken to close the Scheme to new entrants on 15 May 1999 has, in effect, resulted in the slow "winding up" of the Scheme.

It is important to note that, if members were forced to move their entitlements out of the defined benefit schemes, then they would need to be compensated and that these compensation costs would erode any savings believed to eventuate as a result of the transfer⁵¹.

⁵⁰ *Ibid*, p. 4

⁵¹ *Ibid*, p. 2

Findings:

18. The State Actuary (2013 Triennial Review) recommended that Government employer contribution rates increase from 76.5 per cent (2013-14) to 78.5 per cent (2014-15) and progressively increase to 88.5 per cent (2019-20).
19. The increased level of Government employer contributions will not be applied to the employer contribution for pensioners prior to 2014-15.
20. The 2013 Actuarial Triennial Review projected that without Government intervention to improve the financial position of the fund, the Contributory Scheme will have no assets by approximately 2037.
21. If the Contributory Scheme has no assets the Government would be responsible for funding 100 per cent of the benefit payments.
22. The Government's contribution to the unfunded superannuation liability is the State's fourth largest budget expense item.
23. The Government's Fiscal Strategy requires the combined annual servicing costs of General Government debt and defined benefit superannuation liabilities to be less than six per cent of General Government cash receipts.
24. The 2016-17 Budget projected that the combined annual servicing costs of the General Government debt and defined benefit superannuation liabilities will be 4.9 per cent (2016-17); 5.2 per cent (2017-18); 5.4 per cent (2018-19); and 5.6 per cent (2019-20).
25. The Contributory Scheme has a greater number of retired members (pensioners) than active members.
26. The Government does not have any plans to change the design or legislated entitlements of members of the defined benefit schemes.
27. No evidence was received from the Government of inappropriate reclassification or "upscaling" of employees income prior to retirement.
28. The inflation (indexation) rate currently has the greatest impact on the quantum of the liability.

Term of Reference 3: Any other matters incidental thereto

Option of Borrowing to Fund the Superannuation Liability

2.42 A suggestion was made that Government could borrow funds to pay down the liability in a low interest rate environment.

2.43 Dr Knox was asked if such a decision be taken by Government whether it could improve the Net Operating Balance as a result of reduced interest and result in a poorer cash position. Dr Knox responded:

That is true. In the last actuarial review in 2013, we expected the funds earn 7.5 per cent a year going forward. We might adjust that in 2016. The last three years, we think that is probably going to be the earning rate in this three-year period. If the government were to borrow money - and I am not saying whether it should or should not - but hypothetically, should it borrow money and put more money into the scheme and the scheme earns 7.5 per cent, then the earning rate on that money would be higher than the government borrowing rate or the interest cost.

By putting money into the fund, it is borrowing at 3 per cent or 4 per cent and if the fund is able to earn 6 per cent or 7 per cent, then the fund is in a better position. That is looking at one government expenditure compared to many. I am not saying whether that is the right or the wrong decision but looking at it in isolation.⁵²

2.44 Mr Mussared also commented on the possibility of funding the superannuation liability through borrowings:

They could borrow \$5 billion and no worries. I have a somewhat tongue-in-cheek thought that if the government can borrow at, say, 4 per cent or 5 per cent and RBF is earning 7 per cent, why does it not go and borrow the \$5 billion, give it to us and pocket the difference? That is a matter for high policymakers to consider.⁵³

2.45 Mr Reed suggested the cost to wind up the Contributory Schemes could be borrowed by Government suggesting a figure of \$4 - 4.5 billion.

⁵² Knox, D - RBF Inquiry Hansard Transcript 3 May 2016, p. 34

⁵³ *Ibid*, p. 9

2.46 In light of this evidence, the Treasurer was asked to comment upon a strategy of borrowing funds to inflate the plan assets of the Contributory Scheme.

2.47 The Treasurer's response was:

The Government has not considered such an approach. There would be a number of significant risks the Government would need to consider if it decided to borrow to fund the unfunded defined benefit superannuation liability. Some of the potential issues include increased exposure to downside investment risk, possible tax impacts on member benefits, and the impact on the Government's Net Debt.

At present, the Government is committed to progressing the outcomes of the RBF Review, which was undertaken to identify ways to improve the administration of public sector superannuation; maintain the ongoing delivery of services to public sector employees; protect the interests of RBF members; and to ensure that any framework chosen will deliver the best possible financial outcomes for members.

As part of the RBF Review, the Government has introduced the Public Sector Superannuation Reform Bill 2016, which will create a new superannuation fund and will secure Tasmanian jobs and ensure that Tasmanians continue to benefit from the presence of a competitive and viable superannuation fund in their state.

As part of the Government's reforms to public sector superannuation, the RBF's defined benefit schemes will continue to remain the responsibility of the Tasmanian Government, administered through a Superannuation Commission that will be supported by an office within the Department of Treasury and Finance. The size of this office will be developed in tandem with the outcome of the defined benefits scheme tender process and in consultation with the RBF Board and other stakeholders. The administration and investment management services of the defined benefit

*schemes will be outsourced, and the final provider of these services will be chosen after the completion of a public tender process.*⁵⁴

- 2.48 A witness suggested that facilitating the exit of members from defined benefit schemes in the accumulation stage, or the winding up of defined benefit schemes, could be an option to limit the ongoing liability. Such a decision would be subject to legislative change and conformance with Superannuation Law, This proposal was not supported by the Treasurer.

*As I have stated publicly, on many occasions, the Government has no plans to change the design or legislated entitlements of members of the defined benefit schemes.*⁵⁵

- 2.49 The question was raised with Dr Knox regarding the potential need to fund the Superannuation Guarantee Levy amounts if a decision was to be taken to close the defined benefit schemes. Dr Knox was asked what portion of the estimated unfunded superannuation liability would relate to Superannuation Guarantee Levy commitments. He responded:

... that is an interesting question. We have to do some modelling on it and would be happy to do so if Treasury asked us for it. Your premise is correct. The benefits coming out of the contributory scheme are valued at more than 9.5 per cent. There is no need for the government to put any extra in. If the government had been paying, the tree had grown to 9 to 9.5 per cent, what would it look like? Yes, we could do some modelling to see what it would be. It would be extra costs to the government's budget in those years but it would be offset in future years.

CHAIR - It would be a not insignificant number, I would think.

Dr KNOX - Absolutely. Way back in 1992 you are probably talking about something like 20 000 active members of the contributory scheme. Even if you are putting in 9 per cent and the average Joe is, say, \$50 000 - I am going to make the maths a little easier - it might be \$5 000 to \$6 000 a year

⁵⁴ Treasurer's letter of 16 June 2016, p. 3

⁵⁵ Treasurer's letter of 16 June 2016 p. 2

times all your 20 000 members over 20 years. With investment earnings it is going to grow into a very significant fund.

CHAIR - So shutting it down and allowing people to be moved out of it, if this was to be called upon, your requirement to comply with the SGL Act, it could be an issue?

Dr KNOX - Well, you would still have significant costs. There are probably 6 000 to 7 000 members in the contributory scheme at the moment. If they were all on \$100 000 you have an extra cost of somewhere between \$60 million to \$100 million per year despite contributions. It is a really rough ball park figure, do not hold me to it. It is a significant sum.

CHAIR - It is academic in many ways. As I understand, the Government is not planning to do this or to change it. When it is being proposed by witnesses as an option to make it easier to fund hospitals or schools, if it was to be considered, these are calculations which would need to be done.

Dr KNOX - You are right. As I said before, you have to remember most of the liability is now with the pensioners. Those pensions, unless you offer them the lump sum option which we talked about earlier, still have to be paid. They are no longer in employment. As the pensioner population continues or starts to dominate and continues to increase, the options available to government become fewer and fewer.⁵⁶

2.50 The Department of Treasury and Finance was asked to arrange for the State Actuary to undertake modelling in relation to the notional amount of superannuation contributions that would have been paid into the defined benefit Contributory Scheme, had the Government been required to make contributions at the rate of the Superannuation Guarantee Levy.

2.51 The State Actuary calculated a total value of notional Government contributions of \$1.2 billion for the period 1993 to 2016. The accumulated value of the estimated Government contributions, including interest at the Fund's crediting rate and without any deduction of contributions tax was \$2.9 billion in 2016.

⁵⁶ Knox, D - RBF Inquiry Hansard Transcript 3 May 2016, pp.41-42

Options to reduce costs of the Contributory Schemes

- 2.52 Mr Reed suggested a number of options to reduce the ongoing costs to Government of meeting the unfunded liability.⁵⁷ Some proposed changes would require legislative change.
- 2.53 Suggestions to alter the schemes in these ways were not supported by Government or other key stakeholders.
- 2.54 As detailed above, at paragraph 2.47, the Government has declared it is committed to implementing the outcomes of the RBF review.
- 2.55 When queried regarding the potential cost efficiencies to be gained from the process, the response from the Secretary of the Department of Treasury and Finance was:

At this stage, it is not possible to provide any estimate of the extent to which the review will reduce the administrative costs. However, in the medium term, cost reductions may be expected from efficiencies gained by using Treasury's back office services, as the RBF defined benefit schemes are progressively integrated into Treasury. In the longer term, the overall cost of administering the defined benefit schemes is expected to reduce, as the majority of defined benefit members reach retirement age and transition to pensions.⁵⁸

Pension Payments

- 2.56 The perception that the majority of individuals receiving a pension from the defined benefits schemes are large figures was not supported by the evidence.

⁵⁷ Reed, M Submission pp.9-10

⁵⁸ Department of Treasury and Finance correspondence of 7 June 2016, p. 2

2.57 RBF provided the following data which details the number of RBF life pensioners and average gross annual RBF life pensions as at 20 April 2016.

Gross annual RBF life pension \$'000	No. of pensioners	Average gross annual RBF life pension \$
< 10	1 401	6 241
10 to 19.9	2 047	14 906
20 to 29.9	1 685	24 687
30 to 39.9	1 353	34 793
40 to 49.9	1 057	44 579
50 to 59.9	869	54 578
60 to 69.9	467	64 313
> 70	412	92 997
Total	9 291	31 302

Source: RBF correspondence⁵⁹

2.58 Overall a total of 9,261 pensioners average an annual gross pension of \$31,302. The majority of 7,543 pensioners, who receive a pension below \$50,000, average an annual gross pension of \$23,206.

2.59 Dr Knox stated:

...the average pension is quite modest. We did some work on this last year when the Federal Government changed the rules or the tax treatment of defined benefit pensions. Most pensioners from the contributory scheme are receiving a part pension from the Government which indicates they are not on a lot of money.⁶⁰

2.60 Mr Murray Harper, TASS stated:

...we believe that the annual pension is of the order of \$25 000, or so, per year. It may be a little higher, maybe \$27 000 - \$28 000 but it is around about that sort of figure.⁶¹

2.61 The Police Association of Tasmania (PAT) submission made the comment "disparaging discussion over the cost of government pensions has the risk of generating pension envy."⁶²

⁵⁹ RBF correspondence received 9 May 2016 in response to question on notice

⁶⁰ Knox, D - RBF Inquiry Hansard Transcript 3 May 2016, p. 37

⁶¹ Harper, M - RBF Inquiry Hansard Transcript 2 May 2016, p. 22

⁶² PAT Submission, p. 2

2.62 Mr Mussared discussed the growing number of individuals making the application for re-entry to the scheme:

The great thing about superannuation is nobody realises when they first join these schemes what the potential benefit will be in 40 years' time. One of the things we see is a lot of people who had the option of being in the contributory scheme in the 1970s and 1980s let it pass. Now they are reaching retirement age, they are sitting in an office with somebody who is planning their overseas holiday, their new car and everything else. They are asking how they are doing this, thinking I could have been in that scheme and somehow I let it slip away...they made the choice they did not want to make the contributions. Increasingly, they come to us and say, 'You did not give me the advice I needed', or 'I never got that letter, please open the door and let me back in'. We will be hearing a lot more of this in future.⁶³

Findings:

29. Since 2010 the requirement for employer contributions to be paid as and when they fall due, has been enforced by the Department of Treasury and Finance.
30. As at 20 April 2016 there were 9,261 members receiving a pension with an average annual gross pension of \$31,302. .
31. Many members receiving a pension from the Contributory Scheme are also receiving a part pension from the Australian Government.

⁶³ Mussared, P - RBF Inquiry Hansard Transcript 3 May 2016, p. 11

⁶³ Harper, M - RBF Inquiry Hansard Transcript 2 May 2016, p. 22

⁶³ Mussared, P - RBF Inquiry Hansard Transcript 3 May 2016, p. 11

3. APPENDICES

1. Submissions

1. Mr Mervin Reed, Tasmanian Private Wealth Advisers
2. Mr Glenn MacDonald
3. Retired Benefits Fund
4. Tasmanian Association of State Superannuants
5. Unions Tasmania
6. Police Association of Tasmania
7. Mr Peter Gutwein MP, Treasurer
8. Community and Public Sector Union
9. Australian Nursery and Midwifery Federation (Tasmanian Branch)

2. Hearings held in Parliament House, Hobart

1. Monday 2nd May 2016
2. Tuesday 3rd May 2016

3. Meetings held

1. Thursday 10th March 2016
2. Wednesday 27th April 2016
3. Monday 2nd May 2016
4. Tuesday 3rd May 2016
5. Friday 6th May 2016
6. Friday 10th June 2016
7. Monday 19th September 2016
8. Tuesday 20th September 2016
9. Monday 3rd October 2016
10. Tuesday 11th October 2016
11. Thursday 13th October 2016

