

Treasurer

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Hon Craig Farrell MLC
Chair
Sessional Committee Government Administration A
Parliament House
HOBART TAS 7000

Attention: Ms Gabrielle Woods

Dear Mr Farrell

Committee inquiry into increasing employer contributions as part of the RBF Defined Benefit Scheme

Thank you for the opportunity to provide a submission to the Committee's inquiry into the Retirement Benefits Fund's Defined Benefit Scheme. In my submission, I provide detailed information about the RBF Defined Benefit Scheme, the findings of the State Actuary and the Government's funding strategy for this significant liability.

The RBF Defined Benefit Scheme was established under the *Retirement Benefit Act 1970*, and was continued under the *Retirement Benefits Act 1982* and the *Retirement Benefits Act 1993*. The Scheme's administrative details are contained in the *Retirement Benefits Regulations 2005*.

The RBF Defined Benefit Scheme is an unfunded scheme, where the unfunded liability represents members entitlements that are not supported by the assets of the Scheme. The unfunded liability is an estimate based on the accrued past service and expected future service benefits of current and former members of the RBF Defined Benefit Scheme. It is the unfunded proportion of the Scheme which presents a financial risk to the Government.

The main schemes currently operating in the General Government Sector that have an unfunded liability are those established under the *Retirement Benefits Act*, the former *Parliamentary Superannuation Act 1973*, the former *Parliamentary Retiring Benefits Act 1985* and the *Judges' Contributory Pensions Act 1968*.

In Australia, superannuation funds are usually classified as either accumulation funds or defined benefit funds. The main difference between the two types of funds relates to who bears the investment performance risk. In the case of the RBF Defined Benefit Scheme, the Government bears all of the investment performance risk of the Scheme and, as a consequence, may have to increase its contributions if the Scheme's assets are insufficient to cover member benefits.

Unlike accumulation funds, the RBF Defined Benefit Scheme makes payments to eligible members at a set rate, with the level of payment determined by a number of factors including the member's Final Average Salary over the three years before retirement and the level of funds they contributed during their membership.

Despite the Scheme being closed to new entrants on 15 May 1999, the management of the defined benefit superannuation liability continues to be a key budgetary priority for the Government. In the *Revised Estimates Report 2015-16*, the General Government Superannuation liability as at 30 June 2016 is estimated to be \$5 514.7 million.

The General Government Superannuation liability is projected to continue to grow over the next 10 to 15 years, as the “baby boomer” generation retires from the workforce, with the liability not being extinguished until around 2083.

Each year the Government makes employer contribution payments from the Consolidated Fund to the RBF to cover the Government’s share of the unfunded pensioner and lump sum benefits paid to members during the year. This is known as an emerging cost funding arrangement, where the contributions being made each year are based on the contribution rate recommended by the Actuary. In the 2015-16 Budget, it was estimated that the Government will make employer contributions of \$260 million during 2015-16 as its share of benefit payments.

The current funding arrangements were introduced in response to difficult financial and economic conditions created in the wake of the Global Financial Crisis. The funding arrangements ensure that the annual cost of defined benefit superannuation is manageable and does not hamper the Government’s ability to provide services to the community. The model also spreads the burden gradually and equitably across generations and realigns the timing of cash inflows and outflows associated with the defined benefit schemes.

Each year, the State Actuary provides an updated estimate of the superannuation liability as at 30 June.

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

As well as undertaking an annual actuarial assessment of the defined benefit schemes, the State Actuary is also required to provide a more in depth assessment of those schemes every three years.

Regulation 23 of the Retirement Benefits Regulations requires an actuarial investigation into the state and sufficiency of the RBF Defined Benefit Scheme every three years, starting from 30 June 2007.

The most recent actuarial 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.

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.

Table I outlines the level of Government contributions for all new benefits paid from 1 July 2014, that was recommended by the State Actuary in the 2013 Triennial Review.

Table I: Recommended Government Contribution Rates

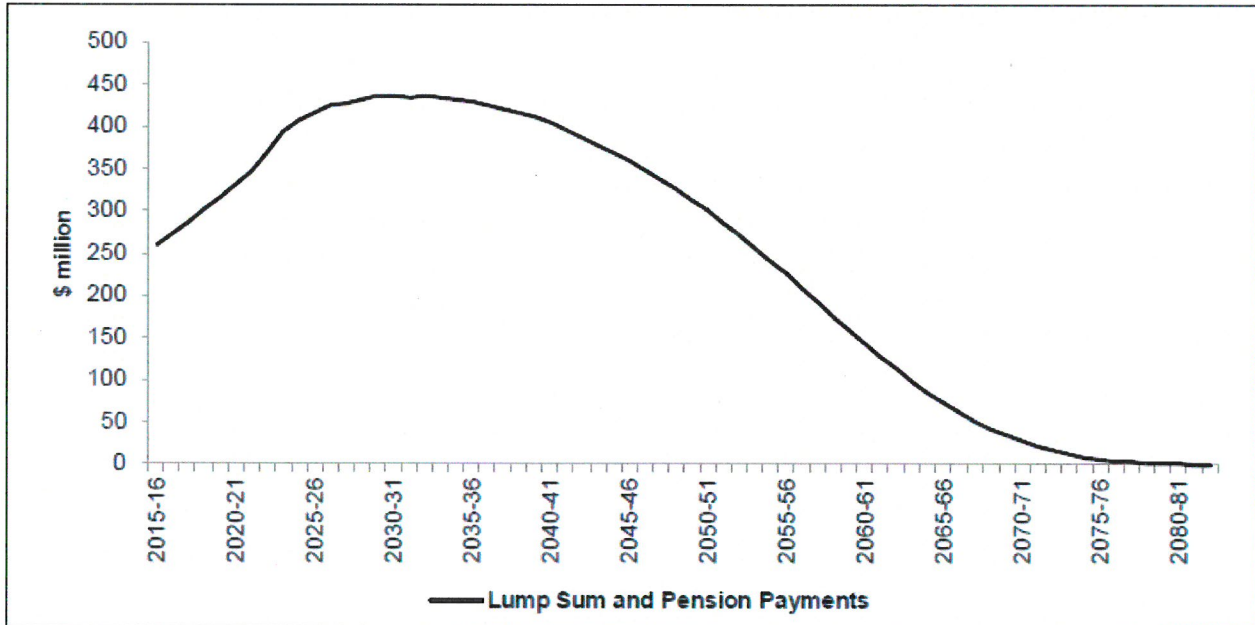
Effective date (starting 1 July)	Government contribution rate (% of basic benefits)	Estimated annual Government contributions, as at 30 June 2013 (\$'000)
2014	78.5	264 000
2015	80.5	284 000
2016	82.5	299 000
2017	84.5	314 000
2018	86.5	335 000
2019	88.5	358 000

In December 2013, the Treasurer approved the increases in Government contributions for new members that were recommended by the State Actuary.

Since 2014-15, the Budget and Forward Estimates have incorporated the full cost of the approved increases in employer contributions, with the Budget fully funding the Government's share of benefits into the future.

Based on the actuarial projections provided for the 2015-16 Budget, the annual Government contribution is estimated to grow quickly over the next 10 to 15 years, as members retire from the workforce.

Chart I: Defined Benefit Superannuation Costs, 2015-16 to 2082-83



Source: *The Budget 2015-16, Budget Paper No. 1, page 134.*

Based on the most recent actuarial assessment provided by the State Actuary, the Government's contribution is projected to peak in 2029-30, at approximately \$437 million. The required Government contribution is then projected to gradually decrease over the coming decades, with the contribution in 2040-41 projected to be approximately \$404 million.

The 2015-16 Budget estimates that the defined benefit superannuation costs will be 4.7 per cent of GGS cash receipts from operating activities in 2015-16. It is estimated that these costs will continue to grow and peak (as a percentage of GGS cash receipts) at 5.4 per cent in 2023-24.

The increasing defined benefit superannuation liability has been a key budget risk for the State for a number of years and without prudent fiscal management, it would place significant strain on the Government's financial position and its ability to provide an adequate level of services to the community.

The Government has responded to this key budget risk by incorporating the management of the defined benefit superannuation liability in its Fiscal Strategy.

As part of its 2014-15 Budget, the Government established a Strategic Action item in its Fiscal Strategy to recognise the increasing service costs associated with defined benefit superannuation.

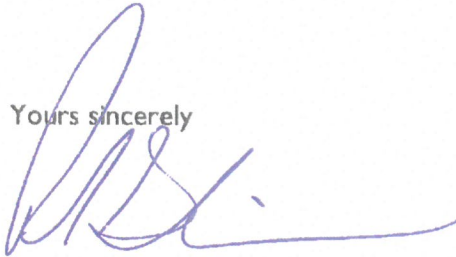
As noted above, the employer contributions included in the Budget and Forward Estimates are based on the recommendations of the State Actuary. There is sufficient Budget funding to meet the Government's employer share of costs at the levels recommended by the State Actuary. The Government will continue to ensure that it manages this critical ongoing funding task in the most prudent way and in accordance with the recommendations of the State Actuary.

The 2016-17 Budget will include revised actuarial projections for the defined benefit superannuation liability and, if it will assist, I am happy to provide an update to the Committee after the release of the 2016-17 Budget.

The next triennial actuarial review is due in late 2016, for the year ending 30 June 2016. The review will evaluate the outcomes of the Government's increased employer contributions and may recommend changes to the current level of Government contributions for member benefits.

The findings of the review will be considered as part of the development of the 2017-18 Budget. I will make arrangements for a copy of the State Actuary's report to be provided to the Committee when it is finalised.

Yours sincerely

A handwritten signature in blue ink, appearing to read 'Peter Gutwein', with a long horizontal flourish extending to the right.

Hon Peter Gutwein MP
Treasurer

