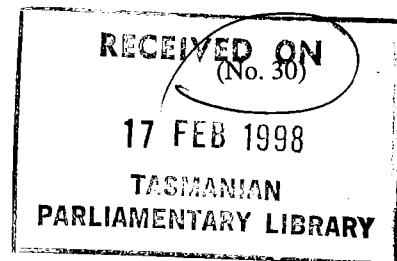


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JOINT SELECT COMMITTEE REPORT

PUBLIC SECTOR SUPERANNUATION IN TASMANIA

MEMBERS OF THE COMMITTEE

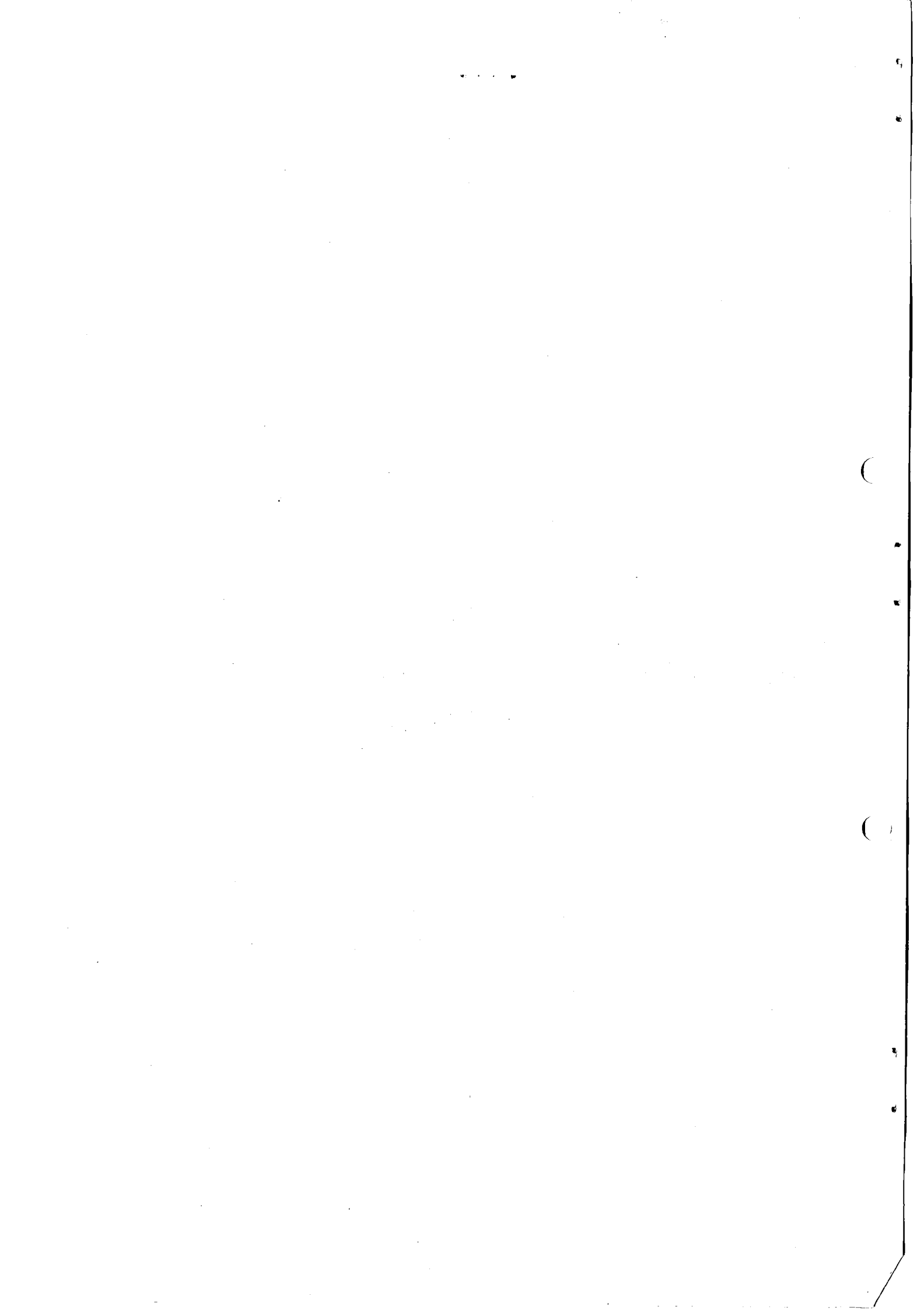
HOUSE OF ASSEMBLY

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Hon. D. Hiscutt

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FOREWORD

The Government's unfunded superannuation liability is a legacy of decisions taken by successive governments of all political persuasions over the past 60 years not to fund public sector superannuation on a pay-as-you-go basis. Rather, governments have deferred superannuation costs to later generations and elected to meet them as and when member benefits become due and payable.

The experience of a rapidly increasing unfunded liability in respect of public sector superannuation schemes in Tasmania, the focus of international credit rating agencies on this issue since they began rating the States independently from the Commonwealth in the early 1990s, the inequities between employees under current arrangements and the actions recently taken by many other State governments around Australia to address their superannuation funding difficulties were the main catalysts for this Committee's inquiry.

Superannuation should be regarded in much the same way as public sector debt - the Government has accepted an obligation to make payments in future years in respect of past commitments. In much the same way as the State began to actively manage its debt position since the late 1980s, there is now an urgent need for the State to reform public sector superannuation to ensure that the debt crisis is not simply replaced by a superannuation burden within the next few years. Other than debt servicing costs, superannuation outlays are the largest single expenditure item in the Tasmanian budget.

Unless superannuation reform occurs, the Committee believes that the financial gains made in Tasmania over the past seven years will largely have been wasted - the future taxpayers of this State will be forced to fund an emerging superannuation cost that will very quickly remove any budgetary flexibility that has been gained under the responsible fiscal strategies of successive Tasmanian Governments.

It is fair to say that the Committee has not found the task referred by Parliament to be an easy one - its deliberations have involved careful consideration of financial, industrial relations, retirement incomes and social justice issues. The Committee believes, however, that the package of reforms it has developed appropriately balances the many competing objectives and represents a unique opportunity to ensure that necessary change is made without disadvantaging any existing public sector employee, while at the same time providing a superannuation framework that will be an advantage to a very large number of new public sector employees in their future retirement.

The Committee expresses its gratitude to each person and organisation who prepared a submission for the benefit of the Committee. Most of those persons or organisations also gave oral evidence before the Committee, in an attempt to ensure that the

Committee fully understood the range of complex issues involved with superannuation in today's environment.

Finally, the Committee would like to extend its appreciation to Mr Mark Kerslake, Mr Greg Philp and Ms Jodi Booth from the Department of Treasury and Finance for their thorough and invaluable technical assistance to all members throughout the course of the inquiry and to Mr Charles Casimaty from the House of Assembly for his work in acting as Secretary to the Committee.



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(Chairman)

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3 December 1997

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ABBREVIATIONS

AEU	Australian Education Union (Tasmanian Branch)
ASFA	Association of Superannuation Funds of Australia
ATO	Australian Taxation Office
AWOTE	Average Weekly Ordinary Time Earnings
BMF	Benefit Multiple Factor
CPI	Consumer Price Index
CPSU	Community and Public Sector Union
FALs	Financial Assets and Liabilities
FSS	First State Superannuation (New South Wales)
GBE	Government Business Enterprise
GESB	Government Employees Superannuation Board (Western Australia)
GSP	Gross State Product
IAA	Institute of Actuaries of Australia
ISC	Insurance and Superannuation Commission
JSC	Joint Select Committee on Superannuation
PJFCs	Pre-1 July 1988 Funding Credits
PPF	Police Provident Fund
PRBF	Parliamentary Retiring Benefits Fund (Tasmania)
PSF	Parliamentary Superannuation Fund (Tasmania)

- f) limited growth in the provisions made by GBEs for their superannuation liability (given the levels that existed in 1992); and
 - g) lower investment returns than were assumed by the Actuary.
- 4) The reforms introduced by the Government in 1994 reduced the State's unfunded superannuation liability compared with what it would have been in the absence of any change. They did not go far enough, however, as they were not designed specifically for this purpose. Rather, they were designed to comply with Commonwealth changes in the area of vesting and to establish a modern superannuation scheme for public sector employees.
 - 5) The unfunded liability of the RBF scheme in real (1996-97 dollar) terms will, on the basis of actuarial projections, increase to \$4.9 billion by the year 2026 in the absence of any reform action.
 - 6) There is actually little or no opportunity for the Government to address the unfunded superannuation liability in respect of past (or accrued) service without reducing member entitlements.
 - 7) Tasmania is now in the position that most of the other States found themselves in some years back and in which the Commonwealth Government now finds itself - namely, of having burgeoning growth in unfunded superannuation liabilities. This position was the catalyst for the reforms that have been implemented (or, in the case of the Commonwealth, have been announced) on the mainland.
 - 8) To take no reform action will impose a severe financial burden on future generations of Tasmanian taxpayers if, as is expected on the basis of actuarial projections, the emerging cost of benefit payments increases dramatically over time.
 - 9) Failure to introduce reforms designed to address the unfunded superannuation liability problem will result in Tasmania falling considerably behind the other States in relation to overall fiscal capacity, as the required level of superannuation expenditure over future years will significantly reduce budgetary flexibility in this State. This will occur at the same time as budgetary flexibility will be increasing dramatically in other States, as they are consciously and transparently moving to eliminate their unfunded superannuation liabilities over set time periods.
 - 10) The progressive lack of fiscal capacity in Tasmania relative to that of the other States that will result from the failure to reform public sector superannuation arrangements to eliminate the unfunded liability over time will place added pressure on the Tasmanian Government's ability to foster economic growth and employment.

CHAPTER 3

- 1) Although the reforms introduced by other States are not identical, they were largely designed to address the same issues that currently confront Tasmania in relation to the management of its unfunded superannuation liabilities.
- 2) Other State governments have introduced reforms in response to:
 - a) concerns by the international credit rating agencies over the growth in unfunded liabilities and their role in overall State financial management;
 - b) cost pressures that exist within State budgets;
 - c) the desire to place public sector superannuation arrangements on the same footing as private sector superannuation arrangements and to thereby introduce greater flexibility for employees;
 - d) the desire to cap the growth in unfunded liabilities and to eliminate them over time through a targeted funding program;
 - e) the deficiencies associated with defined benefit schemes;
 - f) the desire to impose financial discipline, as a full funding approach ensures that changes to superannuation are properly factored into decision making (rather than the associated costs being able to be deferred); and
 - g) the desire to improve inter-generational equity, such that the burden of funding superannuation costs is spread more evenly between current and future taxpayers.
- 3) The reasons outlined above largely also represent the rationale for both the Queensland Government actively considering the introduction of similar reforms and for the Commonwealth Government recently announcing major reforms to public sector superannuation arrangements.
- 4) The key features of the superannuation reforms introduced in the other States in recent years include:
 - a) existing defined benefit schemes have been closed off to new entrants from a particular date;
 - b) fully funded accumulation schemes have been established for new public sector employees;
 - c) with the exception of the changes made in Victoria, the rights and entitlements of existing members of the defined benefit schemes at the time of closure have been preserved;

- d) additional contributions have been made by the respective Governments in order to address the growth in past service unfunded liabilities - with either 30 or 50 year targets being set for their elimination over time;
 - e) the level of employer contribution to the new accumulation schemes is that required under the Commonwealth's SGC requirements (although in the optional South Australian Triple S scheme, members will be able to receive up to 10 per cent from the employer after 2002 if they contribute at the rate of 4.5 per cent or more);
 - f) member contributions to the accumulation schemes are optional rather than compulsory; and
 - g) allocated pensions are provided as an alternative to straight lump sum benefits in the new accumulation schemes.
- 5) The actions taken (or under consideration) by mainland jurisdictions are directly relevant to the issues the Committee is required to address under the Terms of Reference for the current Inquiry. Tasmania is part of a Federation of States which directly compete with each other for investment, for funds from the Commonwealth Government, for population and the like. It would therefore be irresponsible to completely ignore the reforms introduced to public sector superannuation elsewhere throughout Australia and the reasons that prompted respective governments to announce or introduce (or consider introducing) those reforms.

CHAPTER 4

- 1) There have been significant changes to the environment in which public sector superannuation is being provided since the 1993 Joint Review of Public Sector Superannuation Arrangements, with the following developments having an impact on the decision in relation to scheme design and suggesting that some re-examination of the issue is necessary:
- a) major reforms being implemented in many mainland States, under consideration by the Queensland Government and recently announced by the Commonwealth Government;
 - b) the advent of enterprise bargaining;
 - c) greater worker mobility (and a consequent desire for fully funded and portable benefits);
 - d) more flexible working arrangements;
 - e) an increasing focus on issues of equity between members;

- f) increasing trends towards salary packaging;
 - g) increased Commonwealth regulatory and taxation complexity; and
 - h) the introduction of the Commonwealth superannuation surcharge.
- 2) The complexities, risks to employers, costs and inequities associated with defined benefit schemes have resulted in the vast majority of new superannuation funds created in the past decade being accumulation and not defined benefit schemes.
- 3) Virtually all the growth in scheme membership in both the public sector (consequent on the closure of most defined benefit schemes in other States) and the private sector has been in accumulation schemes.
- 4) In general terms, defined benefit schemes:
- a) advantage those employees with good promotional prospects and long periods of service with the one employer, but are less advantageous for employees with relatively stable salary profiles, short periods of service and high mobility;
 - b) are inherently discriminatory and inequitable as between members of the scheme;
 - c) are generally difficult for members to understand;
 - d) are difficult, complex and costly to administer due, in part, to their reliance on technical and professional expertise;
 - e) result in the employer underwriting investment risk and, therefore, involve an employer contribution that is uncertain, variable and difficult to predict;
 - f) leave the employer exposed to the risk associated with non-standard salary growth (through the impact on both past and future service costs), which is of major concern in an enterprise bargaining industrial relations context;
 - g) are not flexible enough to cater for total remuneration packaging and mobile workforces;
 - h) do not involve any close link between member contributions made and the end benefits received; and
 - i) cannot cater in any way for member investment choice.
- 5) In general terms, accumulation schemes are more appropriate in today's superannuation environment than defined benefit schemes, as they better balance the overall needs of both employers and employees. Accumulation schemes:

- a) maximise equity between members of the scheme, as each member receives the same effective level of employer superannuation support;
- b) are simple for members to understand, as they are based on a "bank account" concept and end benefits are directly related to the contributions made by both the employer and the member (if any);
- c) result in the employee benefiting from solid investment performance, as well as them bearing the result of poor investment performance;
- d) are relatively easy and cheap to administer;
- e) prevent rapid salary growth affecting any accrued entitlements; and
- f) more easily cater for broken work patterns, employee mobility and investment choice.

CHAPTER 5

- 1) The option of the Government making no changes to scheme design and continuing to meet superannuation costs on an emerging basis (that is, as and when member benefits become due and payable) is not a feasible approach to adopt, when responsible financial management dictates that reforms to public sector superannuation arrangements in this State are urgently required.
- 2) Reform is largely required to address the significant increase in unfunded superannuation liabilities that has occurred in recent times, to ensure that Tasmania remains fiscally competitive with other States over time (as nearly all mainland States have closed their defined benefit schemes and are embarking on funding programs to eliminate their unfunded liabilities over fixed periods) and to ensure that Tasmania provides appropriate superannuation arrangements for its new employees, having regard to issues such as the advent of enterprise bargaining, greater worker mobility, more flexible working arrangements and the increasing trend towards salary packaging.
- 3) Having regard to the situation throughout the rest of Australia, it is no longer financially feasible to keep the unfunded and costly RBF defined benefit contributory scheme open to new employees.
- 4) There are significant legal and industrial relations difficulties associated with the reform options of either reducing the accrued benefits (that relate to past, or worked, service) of existing RBF contributory scheme members or reducing the future (or unworked) service benefits for existing employees (with these reduced benefit arrangements also applying to all new public sector employees).

- 5) Notwithstanding any such difficulties, the Committee does not believe that any reform action should be adopted that impacts on the past or future benefit rights and entitlements of existing RBF scheme members - that is, the Committee very strongly holds the view that any compulsory changes made to current arrangements should be prospective and relate only to the superannuation arrangements established for new employees.
- 6) The option of leaving the RBF defined benefit scheme open to new members but fully funding their superannuation from commencement will result in an increased overall superannuation cost to the State.
- 7) An open defined benefit scheme leaves the State financially exposed to both non-standard salary growth (which impacts adversely on both the past and future service liabilities of defined benefit scheme members) and increased pension liabilities (in the face of increasing life expectancy).
- 8) Even if a defined benefit scheme had an employer cost exactly equal to that in an alternative accumulation scheme (that is, if there was no financial exposure or cost dimension associated with the decision whether or not to close the defined benefit scheme), the optimal approach would be to close the defined benefit scheme for new employees.
- 9) The preferred approach that achieves a number of the overall reform objectives concurrently is to close the defined benefit scheme and introduce a fully funded accumulation arrangement for new members. This will both ensure that new members will receive portable superannuation benefits that better suit their increased mobility and improve equity amongst all public sector employees over time.
- 10) While such a reform will not reduce the unfunded liability *per se*, it will ensure that the real liability is capped and that, provided new employees receive fully funded benefits from day one, the liability will gradually decline over a period of 60 or so years (consistent with the time taken for the existing liability to accrue).
- 11) Attempts to eliminate the unfunded liability through the Government making additional funding effort over and above that required to meet emerging benefits and to fund the accruing benefits of new entrants is not feasible in Tasmania, given the State's overall budgetary position.
- 12) Such attempts would also call into question issues relating to inter-generational equity, as current Tasmanian taxpayers would effectively be required to part fund the past service liability as well as fully fund the accruing liability of new employees.
- 13) Rather than reducing equity amongst public sector employees, the preferred reform option will ensure that an ever increasing number of public sector

employees will receive exactly the same level of employer superannuation support as part of their overall remuneration (as discussed in some detail elsewhere in this Report).

- 14) There would be some merit in the Government "back-funding" the RBF non-contributory scheme under this reform scenario. This could occur (for on-budget employees) through the transfer of an amount (estimated to be in the order of \$50 million as at 30 June 1996) from the Superannuation Provision Account in the Special Deposits and Trust Fund to the RBF Board.
- 15) If this was also to be required of those GBEs and other organisations with employees in the RBF non-contributory scheme, the Government would be in a position of having an unfunded past service liability for State Servants only in respect of the closed RBF contributory scheme (which would decline gradually over time). Further, both existing and new members of the non-contributory scheme would then be in a position of having fully funded superannuation support.

CHAPTER 6

- 1) The issue of the adequacy of end benefits for members is fundamentally a matter for Commonwealth Government retirement incomes policy and given that it has recently abandoned proposals to impose compulsory employee contributions and matching Commonwealth co-contributions, it would be possible to conclude that the minimum SGC employer obligations are regarded by the Commonwealth as being sufficient.
- 2) Private sector employers are generally not concerned with providing their employees with a benefit that is "adequate" in a retirement incomes sense. They have acted in such a manner as to suggest that contributions at the SGC rate are now the community and industrial standard, believing that the Commonwealth will concern itself with the issue of adequacy, having regard to overall national saving and the likely drain on welfare payments from an ageing population.
- 3) These aspects notwithstanding, it is appropriate for the Government to consider whether the level of superannuation support provided to its employees is capable of providing reasonable retirement benefits, so long as members are prepared to make some funding effort on their own behalf.
- 4) The benchmark for assessing the adequacy of benefits appears to be a level of total contributions from both employer and employee of between 12-15 per cent of a member's salary per year over their working life.

- 5) Adequacy of benefits can alternatively be expressed as a member retiring with a pension of 2/3 rds of pre-retirement income or a lump sum of 7-8 times salary at age 65 after 40 years service.
- 6) In all of the States which have introduced accumulation funds for new employees in recent years, SGC employer benefits have been provided everywhere except in one South Australian scheme (which is optional) and which will provide a 10 per cent employer contribution after 2002 provided the employee contributes 4.5 per cent of salary or more.
- 7) Employer contributions at the rate of the SGC minimum will, at 9 per cent beyond 2002, not be too dissimilar from the new entrant contribution rate of in the range of 9.5 per cent that has been calculated for the existing RBF contributory scheme.
- 8) The SGC level of employer contribution is currently provided in respect of 23 638 accounts (as at 30 June 1997) in the RBF non-contributory scheme, which implies that nearly 60 per cent of all existing public sector employees in Tasmania are already in receipt of SGC superannuation support only.
- 9) Actuarial advice suggests that, in the majority of cases, an accumulation scheme with an SGC level of employer contribution will, assuming the member makes the same funding effort as RBF contributors (5 per cent employee contributions), provide higher end benefits to members who join at relatively young ages (under 45 years of age) than the existing RBF defined benefit scheme.
- 10) Members who join at age 45 years or older will receive a higher after tax benefit under the RBF contributory scheme than under an accumulation scheme providing SGC benefits, although the Government has little obligation to provide an "adequate" retirement benefit for this category of new entrants (given that they will already have accrued a significant benefit in former employment).
- 11) An SGC employer contribution rate is sufficient to provide members with an adequate retirement benefit, as 40 years service with the member contributing 5 per cent of salary and the Government contributing 9 per cent after 2002 will produce an after tax end benefit in the order of 7.5 times final salary.
- 12) The provision of SGC employer superannuation support to new permanent employees would release additional funds already allocated in the Budget for use in reducing the Government's unfunded past service liability (which is a key issue of focus in the current Inquiry).
- 13) While employer contributions greater than the SGC rate would obviously result in higher end benefits for members, they would impose further financial obligations on the State which, given the Committee's findings on the magnitude

and the importance of the unfunded liability problem currently facing Tasmania, should be avoided.

- 14) Logic and equity suggests that the provision of a higher employer contribution rate than SGC to new entrants would also require that the higher rate also be paid to existing non-contributory scheme members.
- 15) Agreement to provide employer contributions at the rate of 9 per cent of salary in the new accumulation scheme from 1 July 1998 would, for example, impose additional costs on the State and its GBEs in respect of current non-contributory scheme members in the order of \$5.94 million (in today's dollar terms) during 1998-99. Over the period 1998-99 to 2001-02 (when the SGC rate reaches 9 per cent of salary), the total additional cost of providing 9 per cent superannuation from 1 July 1998 for non-contributory scheme members would be \$17.76 million (in today's dollar terms).
- 16) There would also be an additional cost associated with new permanent employees if, rather than being provided with the SGC rate from 1 July 1998, they were to be provided with superannuation support at 9 per cent of salary. Based on certain assumptions about the number of new entrants into the RBF contributory scheme over the period from 1998-99 to 2001-02 and their average salary levels, this additional cost is estimated to be in the order of \$5.47 million (in today's dollar terms).
- 17) In total, therefore, adopting an employer contribution rate of, say, 9 per cent of salary from 1 July 1998 rather than the SGC rate would impose total additional superannuation costs on the State in the order of \$23.2 million (in today's dollars). Arguably Tasmania cannot afford such an impost.
- 18) To the extent that employer contributions are made at a rate above the SGC for new permanent employees after 1 July 1998, the "gap saving" in respect to new permanent employees would be lower - that is, to the extent that the State is required to fund the benefits of new permanent employees at, say, 9 per cent rather than the SGC rate, there would be less funds available to be paid into the Superannuation Provision Account by Agencies to be used to fund the past service unfunded liability.
- 19) An employer contribution rate higher than the SGC minimum would send the wrong signals to:
 - a) Tasmanian taxpayers, as it would perpetuate the widespread view that employees in the public sector are treated more generously relative to employees in the private sector;
 - b) the business community, who would eventually have to bear part of the additional financial burden through higher taxation; and

- c) the international credit rating agencies, who would have difficulty in understanding how a State with the budgetary difficulties and unfunded superannuation liability problems of Tasmania could afford, in a sustainable sense, to provide superannuation at that level.
- 20) To the extent that Tasmania continues to provide more generous superannuation benefits for its employees than is the norm in the private sector, the move towards the outsourcing of Government activities will accelerate.
- 21) Based on actuarial advice, the arrangements associated with the proposed new accumulation scheme should not involve the provision of a real guarantee on the earning rate of the fund, as it fundamentally destroys the rationale for moving to an accumulation scheme design.
- 22) Historical investment experience in accumulation schemes suggests that even a guarantee of CPI + 2 per cent would expose the State to the prospect of being required to make significant additional employer contributions to the fund in order to ensure that the guarantee was honoured at certain times.
- 23) An alternative approach is possible to provide a degree of insulation to members of the accumulation scheme against fluctuations in investment returns, namely through the RBF Board offering some form of real return portfolio in the context of the implementation of investment choice arrangements.
- 24) Tasmania arguably has the least financial capacity of all the Australian States and, in light of the developments in public sector superannuation in the other States which were discussed in Chapter 3, it cannot realistically afford to be paying superannuation benefits to new public sector employees that are out of line with both private sector standards and those that exist in most other public sector schemes around Australia.

CHAPTER 7

- 1) The Commonwealth Government confirmed in the recent 1997-98 Budget that it would not proceed with any proposal for compulsory employee contributions or Commonwealth co-contributions, preferring to deliver a savings rebate to all Australians.
- 2) Accordingly, there are not any Commonwealth requirements for members of superannuation schemes to compulsorily contribute into those funds.
- 3) The Commonwealth Government is shaping its superannuation policy around a "choice" philosophy for members and clearly regards compulsion for members to contribute as being paternalistic.

- 4) The policy announced by the Commonwealth in relation to low income earners "opting out" of superannuation in favour of salary increases provides evidence that the Commonwealth recognises that superannuation is not the best financial option for all employees all of the time - that some employees might be better off at certain stages during their working life receiving higher salaries than contributing and having the employer contribute to superannuation on their behalf.
- 5) Attitudes to compulsory or voluntary employee contributions are largely ones of fundamental philosophy - views of all parties will differ as to whether the member always knows what is in his or her best interests and, if not, whether it is reasonable to assume that the Government should make that judgment.
- 6) Compulsion is supported by the view that employees have a responsibility to provide for their own retirement - that is, that superannuation is, in some sense, a partnership arrangement between the member and the employer.
- 7) There are many circumstances, however, in which it will not be in the financial interests of a member in today's regulatory and taxation environment to actually make employee contributions to superannuation over all of their working life at a uniform rate:
 - a) the recent Commonwealth announcement that, from 1 July 1999, all future superannuation contributions (including member contributions), and earnings on those contributions, will be preserved until preservation age, suggests that any compulsion upon members to contribute will effectively require them to "lock away" those funds for a very significant period of time (in excess of 40 years, for employees commencing work under the age of 20 years);
 - b) a member who has a young family, a non-working spouse, an average mortgage and receives an average salary is arguably better off eliminating his or her mortgage than making compulsory employee contributions at young ages. The member will then be able to contribute a much more significant percentage of salary at a later stage in life (say from age 40 years onwards) when other financial commitments are less significant;
 - c) the introduction by the Commonwealth of the 15 per cent superannuation surcharge on high income earners (and other employees who do not provide their tax file numbers to superannuation funds) on and from 20 August 1996 will mean that for many members, continuing to contribute to superannuation under a compulsory arrangement will no longer represent the most tax effective form of saving;
 - d) compulsory employee contributions may cause certain high income members to exceed the Commonwealth's Reasonable Benefit Limits. A

requirement to continue contributing in this circumstance would again result in the member being unable to benefit to the maximum possible extent from available tax concessions and tax effective investment strategies through the course of their working life; and

- e) if compulsory employee contributions were introduced for new public sector employees joining a revised RBF non-contributory scheme, logic and equity suggests that the same requirement would need to be placed on existing non-contributory members, which would result in a decrease in the take-home pay of those members.
- 8) The introduction of compulsory member contributions is not a feature of any of the new accumulation schemes recently introduced in the other States and Territories to address their unfunded superannuation liability problems.
- 9) If compulsory contributions were required from existing non-contributory scheme members, for example, at the rate of 3 per cent of salary, there would be a withdrawal of some \$8.9 million from circulation in the Tasmanian economy during 1998-99 (in today's dollar terms) which, given the economic circumstances prevailing in Tasmania at present, is a strong argument for leaving member contributions voluntary in any new scheme.
- 10) The fundamental obligation on employers is to ensure that the superannuation arrangements established for members permit them, with voluntary employee contributions, to accumulate an adequate retirement benefit over their working life. Whether individuals avail themselves of that opportunity is a decision that is best made on an individual basis.
- 11) There are many good reasons why an existing RBF contributor might wish to transfer to the new accumulation scheme being proposed if such an option was permitted.
- 12) Offering a transfer right to existing RBF contributors will have a positive impact on the unfunded superannuation liability associated with the RBF scheme over time, as the future service of the transferring member will be fully funded and, for pre 1 July 1994 members, the generous "anti-detriment" pension conversion factor will not apply in relation to future service.
- 13) The ability of each member of the current contributory scheme to effectively exercise some choice over the manner in which he or she receives superannuation support from the employer is increased under a transfer right.
- 14) The provision of choice is an essential component of the direction in which Commonwealth regulation of superannuation is taking the industry and concerns about some individuals making poor decisions should not prevent an option

being provided that also has the potential to significantly advantage a large number of individuals.

- 15) A compelling argument in favour of the provision of a transfer right is the announcement by the Commonwealth Government in the 1997-98 Budget that fund choice will require defined benefit funds to offer members the capacity to opt out.
- 16) Actuarial advice suggests that the provision of a transfer right that involves a carefully specified transfer benefit has the potential to produce savings in the future growth in the State's unfunded liability, provide many members with an advantage in terms of flexibility and choice and result in no change to the past service unfunded liability that currently exists.

CHAPTER 8

- 1) While the level of superannuation benefits provided to Parliamentarians, Judges and new legal office holders is largely a political issue, the level of employer superannuation support implicit in the current open Parliamentary scheme and the Judges' superannuation arrangement is very high by all community standards.
- 2) However, reasons for the high levels of superannuation support provided to Parliamentarians and Judges do exist. For example, members of Parliament generally have a shorter and more uncertain working life than State Servants and employees in the private sector and they do not enjoy all the forms of on-cost benefits that other employees receive (such as workers' compensation, redundancy benefits upon termination, protection from "unfair dismissal" and sick or long service leave). Judges, on the other hand, argue that such support is necessary to preserve the independence of the judiciary.
- 3) Both the Parliamentary superannuation schemes and the Judges' scheme are defined benefit superannuation arrangements and therefore suffer from the same disadvantages identified in respect of such schemes in Chapter 4. Furthermore, the 1973 Parliamentary scheme and the Judges' scheme both have significant unfunded liabilities attached to them.
- 4) The current Parliamentary scheme that applies in Tasmania was developed in a superannuation environment quite different to that which presently prevails. There are now minimum superannuation requirements under Commonwealth law, which means that members will enter Parliament with previous superannuation support and will leave in the knowledge that they will receive superannuation support in relation to their future employment.
- 5) Likewise, the environment in which superannuation is currently provided to Judges and other senior legal officers holders is different to that in which current

superannuation arrangements were established. With the certainty that Judges will commence employment with substantial prior superannuation, it is arguable as to whether there remains such a strong need for full lifetime benefits to be provided after relatively short periods of service.

- 6) There is a number of possible reform options available in relation to the Parliamentary and Judges' superannuation arrangements, namely:
 - a) make no changes to the current Parliamentary and Judges' superannuation schemes;
 - b) close off the existing Parliamentary and Judges' superannuation schemes and require new members to join an accumulation scheme in which they would receive employer superannuation support equivalent to that which is implicit in the current schemes;
 - c) close off the existing Parliamentary and Judges' superannuation schemes and require new members to join an accumulation scheme in which they would receive employer superannuation support at the same rate (the Commonwealth SGC level) as all other new public sector employees; and
 - d) close off the existing Parliamentary and Judges' superannuation schemes and provide that new members should be employed on the basis of a total remuneration package that includes the grossed up value of the existing salary component, a superannuation component, a car (if currently received) and any other benefits (if any).
- 7) The Committee does not believe that it is able to make specific reform recommendations to the Government in relation to the superannuation arrangements to be implemented for new members of Parliament. Members of the Committee are very conscious of the difficulties associated with current Parliamentarians reviewing the superannuation arrangements to apply to both themselves (through the possible provision of transfer rights) and to new Parliamentarians.
- 8) Notwithstanding the Terms of Reference for the current Inquiry, it is inappropriate for the Committee to make reform recommendations when the members of the Committee will be affected. Were it to do so, inevitably charges of conflict of interest would arise.
- 9) It would be more appropriate for a special independent panel to be constituted to conduct a review into the Parliamentary superannuation arrangements to apply to new members (including possible transfer options for members of the existing schemes) and to make recommendations to the Government in light of its independence, experience with superannuation matters and its ability to evaluate the totality of the current schemes and their objectives.

- 10) The independent panel established to make recommendations to the Government in relation to the reform of Parliamentary superannuation for new members should also be charged with the task of making recommendations in relation to the future superannuation arrangements to apply to new Judges and new Masters of the Supreme Court. New Solicitors-General and Directors of Public Prosecutions are more in the nature of career public servants than members of the judiciary and should therefore not be members of the Judges' Contributory Pensions scheme. Superannuation should be provided to these individuals on exactly the same basis as it currently is to Heads of Agency - that is, via a total remuneration package concept.
- 11) The Government, in providing such an independent panel with appropriate terms of reference, should require it to undertake a review having regard, *inter alia*, to particular reform principles. These should be based on the broad nature of the reforms being recommended by the Committee in relation to superannuation arrangements for new public sector employees.
- 12) Given that Heads of Agency are already employed on "package" basis in relation to salary and superannuation, no changes are required to the superannuation arrangements for this category of public sector employee.
- 13) New senior contract employees in the State Service should be covered by the same superannuation arrangements as the Committee is recommending for all new public sector employees. The only difference relates to the ability to salary sacrifice into superannuation. This option is not available to award employees but, given the contract nature of their employment, should remain open to new members of the Senior Executive Service. The Committee notes that the ability to make such arrangements is at no cost to the State Government.

CHAPTER 9

- 1) The current Commonwealth Government superannuation policy is progressively being focussed on the provision of "choice" to individuals.
- 2) In the 1997-98 Budget, the Commonwealth Government announced its intention to introduce legislation requiring the introduction of fund choice for new employees on and from 1 July 1998 and for members of existing superannuation funds on and from 1 July 2000.
- 3) In addition to the Budget announcements, the Commonwealth has also recently announced that it will give effect to its policy direction in relation to its own superannuation scheme, namely the Public Sector Superannuation (PSS) scheme. This scheme is to be closed to new entrants on and from 1 July 1998, with all new Commonwealth employees being required to nominate a private sector

superannuation fund into which their employer superannuation contributions are to be paid.

- 4) Member fund choice was also a key recommendation of the Wallis Inquiry into Australia's Financial System. The Committee felt that fund choice would assist in increasing the level of industry competition and in improving the efficiency of the superannuation industry. Outcomes along these lines were expected by the Wallis Committee to, over time, drive down the cost of investment for superannuation funds.
- 5) While it is not well known, nor actively marketed by the RBF Board or the Government, the *Retirement Benefits Regulations 1994* already allow employees, with the consent of their employing Agency, to opt out of the contributory scheme. Further, State Authorities can, with the consent of the Minister, elect not to participate in the RBF contributory scheme or in any of the superannuation arrangements established under the *Retirement Benefits Act 1993*.
- 6) The following advantages are generally advanced in relation to fund choice:
 - a) by being able to select the superannuation fund of their preference, employees will have increased flexibility to access a greater range of services and superannuation products and to ensure that the scheme they join best reflects their particular personal preferences and best addresses their personal circumstances;
 - b) employees with fund choice have a greater sense of ownership and control over their future superannuation savings;
 - c) control over the superannuation scheme they join provides members with the opportunity to consolidate their superannuation savings, which will provide greater opportunities to maximise their retirement benefit. With greater workforce mobility, it is now increasingly common for employees joining an employer to already have a "superannuation history" - in every case except an employee joining straight from school or university, individuals will have established superannuation arrangements in place and, in many instances, will have a preference for these to be continued; and
 - d) fund choice will produce greater competition amongst superannuation providers which, in a similar fashion to the increased competition being generated in a range of other markets in recent times, can be expected to produce efficiency benefits that will advantage members over time. It is contended that more emphasis on the achievement of competitive returns on investments, lower administration costs, higher quality of services and increased product differentiation (as schemes will now effectively be required to review the nature of all benefits provided and the manner in which these are packaged and presented) can only benefit employees.

- 7) There is a range of perceived disadvantages associated with the policy direction of the Commonwealth in relation to fund choice. These can be summarised as follows:
- a) the requirements to be placed on an individual under the proposed Commonwealth legislation to make a choice will present difficulties for many, as they will not be in a position to make a decision between the range of options available. While 'Key Feature Statements' will certainly assist members to make their election, there will still be a number of individuals that will not be able to understand exactly how alternatives compare and might, in the face of aggressive and unconscionable marketing conduct, ultimately make poor fund decisions;
 - b) the fund choice legislation will, in all likelihood, impose additional administrative costs on employers and superannuation funds. For example, employers will need to determine which funds are to be offered as choices to their employees, will need to gather together the Key Feature Statements associated with these and perhaps prepare other information that is sufficient to enable employees to make an informed choice. While most private sector funds would already have Key Feature Statements, public sector funds such as the RBF will also be required to develop these in order to compete for members in the fund choice environment;
 - c) employers might well end up exposed to liability where a fund selected by them fails to perform as indicated in the Key Features Statement. There is a degree of concern that the employer will not be able to completely absolve itself from responsibility in this circumstance, with members being able to take legal action at some point in the future on the basis that they received incorrect or misleading advice;
 - d) as individuals become increasingly aware of their superannuation investments, there may be a tendency for members to regularly "chase" the best returns and to transfer to funds that are performing well in the short term. This short term focus might well lead to lower returns over the medium-to-long term and have an impact on overall national savings. Further, this might have implications for the liquidity positions of superannuation funds;
 - e) choice of fund requires schemes to be fully funded, in order to enable members to elect out and to transfer their accrued benefit entitlement to a new fund of their choice; and
 - f) given the proposed requirement for employees to exercise a choice of fund within 28 days of commencing employment, an issue exists as to how an employee is to be treated in the event that they either die or are injured during that time. If no election has been made and either of these events

occurs, an issue to be addressed in the proposed Commonwealth legislation will be the obligations on employers to adequately provide for such employees.

- 8) While there is some merit associated with the possible difficulties surrounding the provision of fund choice to employees outlined above, the Committee believes that these are capable of being adequately addressed.
- 9) The matter of the onerous obligations imposed on employees to make a choice of superannuation fund can be accommodated through the provision of a 'default' choice in such cases. In those circumstances where an employee does not exercise an election, the Government, in conjunction with public sector unions, should be able to determine the appropriate arrangements to apply in the 'default' situation.
- 10) Most private sector funds are already experienced in competing for business and certainly have Key Feature Statements in relation to their schemes. Public sector schemes will need to develop these Statements under the Commonwealth choice model, but the Committee does not believe that this would require a great deal of effort.
- 11) In addition, the costs to employers of choosing which five, or more, funds will be offered as choices need to be offset against the savings that will accrue once an election has been made. In many instances, employees will elect to join private sector arrangements, which will result in Agencies no longer being required, from that point onwards, to provide a first-stop advisory service in relation to the operation of public sector schemes.
- 12) The Committee does not accept that the administrative costs associated with the payment of employer superannuation contributions by Agencies to a range of private sector funds (rather than to the Superannuation Provision Account, as is currently the case) is a real issue. For example, the Committee understands that the Department of Treasury and Finance already has the capacity to make salary payments to in excess of 40 financial institutions and currently makes deductions to a wide range of organisations in relation to health insurance and salary sacrifice contributions.
- 13) Not limiting the choice of fund in line with the Commonwealth proposals would result in the employer not being required to act as a de facto superannuation adviser. Rather than choosing a set number of superannuation funds which members have the option of joining and for which the employer must provide Key Feature Statements, a more workable solution would be for the choice of fund to be unlimited.
- 14) An employee should have the right to elect to have their employer superannuation contribution paid into any complying fund and if an employee is

not prepared to, or does not, make such an election, then the default arrangement will apply. This type of arrangement has minimal legal liability implications for the employer.

- 15) In most cases in the public sector, there is a period in the order of one month between a person being informed that they have been successful in gaining State Service employment and when they actually commence. This period should be used to request the potential employee to consider which superannuation fund he or she wishes to join, such that he or she is in a position to make an election from the first day of their employment.
- 16) Investment choice is, to a large extent, a different issue to that of fund choice. The reason for the difference is that the provision of investment choice to members of particular funds has been a feature of many superannuation funds for some time - many private sector superannuation schemes have allowed individuals to choose from a range of different investment portfolios to suit their risk preferences and particular financial circumstances.
- 17) The provision of investment choice to scheme members is generally seen to have the following advantages:
 - a) within every scheme there is a divergence between members in respect of age, the level of account balances held and risk profiles. The provision of investment choice, in theory, allows members to select the most appropriate mix of investments for their particular requirements;
 - b) member investment choice is entirely consistent with the broad direction in which Commonwealth Government superannuation policy is heading; and
 - c) investment choice is consistent with the underlying philosophy of accumulation schemes, whereby the member's end benefit is dependent, to a significant extent, on the investment returns received. Choice passes some of the responsibility for investment decisions to the individual (within the context of information to be provided to that member by the trustee of the fund, to ensure that decisions are made on a sound basis).
- 18) In much the same way as fund choice has some disadvantages, so does the provision of investment choice. Largely, however, these difficulties relate to issues of education and information and the need for trustees to make sure that members exercising investment choice do so on the basis of a solid understanding of the consequences of their decisions.
- 19) Perhaps the largest problem is an implementation issue - that of the trustees determining the level of choice to be offered. Decisions will be required by trustees on how often that choice should be available and what types of different

investment portfolios should be provided (as there are theoretically an infinite number of different investment options that could be made available).

- 20) The trustees of superannuation funds are best placed to make decisions about the nature of the investment choices to be provided, timing issues (such as how often a member can switch between alternatives) and whether a minimum account balance is required before investment choice can be accessed.
- 21) Likewise, the trustees should be responsible for determining the nature of the 'default' investment arrangement - what will apply in those instances where no election is made in relation to specific investment options.
- 22) Those members who avail themselves of the investment options provided should bear the full costs of those options. There should be no cross subsidies between those members who wish to have some input into the investment of their funds and those members who are happy to accept the default investment strategies adopted by the trustees. The charging of fully cost-reflective fees should therefore be a requirement in relation to public sector superannuation arrangements.

CHAPTER 10

- 1) There are no budgetary implications associated with the recommendation made by the Committee earlier in this Report that all new entrants after 1 July 1998 should be provided with a fully funded Superannuation Guarantee Charge (SGC) benefit. The reason for this is that Agencies and Authorities are currently funding these benefits from their budget allocations and will continue to do so from the monies included in the forward budget estimates.
- 2) There will, however, be less money going into the Superannuation Provision Account (SPA) during any financial year from which emerging RBF contributory scheme benefit payments can be met. It is this shortfall in SPA receipts which will impose some financial strain on the State in future years.
- 3) The advice from the Actuary suggests that the Government will need to consciously make additional Budget contributions into the SPA in order to ensure that there are sufficient funds available to meet all the RBF scheme benefits that emerge over time. The extent of these additional payments depends, however, on the nature of the funding approach adopted by the Government.
- 4) There is an infinite number of different funding scenarios which could be adopted by the Government to meet the emerging costs of the closed RBF contributory scheme - all of which have an impact on the remaining unfunded superannuation liability.

- 5) The "passive" funding scenario is based on the Government deciding to maintain current budgetary funding for superannuation over the next 8 years. The shortfall between total budgetary funds available to the Government and total superannuation outflows during this period which will result from the fact that the SGC benefits for both existing non-contributory scheme members and new employees will be fully funded (rather than being paid into the SPA) will be met through the Government running down the accrued balance in the Superannuation Provision Account (SPA) until it is exhausted (which is estimated to be in about 2003).
- 6) Beyond the year 2003, significant additional funding will then be required from the Budget for about 17 years to make sure that all RBF outflows continue to be met. This period therefore represents the period of financial pain for the State, as the effect of the "baby boomers" coming through to benefit age begins to be felt.
- 7) The extra funding required reaches about \$35 million (in today's dollar terms) by the year 2007-08, remains around this level for four or five years then gradually reduces to nothing by the year 2020. In summary, an additional \$430 million in aggregate (in today's dollars) will be required to be allocated from the State Budget under the passive funding scenario between the years 2003-04 and 2020 to ensure that all emerging benefits are paid.
- 8) This "passive" funding approach therefore involves minimising the short run budget impact of closing off the RBF contributory scheme to new members to prevent there being additions to the State's unfunded liability. It minimises the extra budget impact by making use of the SPA balance until it is exhausted and results in a gradual elimination of the overall unfunded liability over some 67 years.
- 9) An "aggressive" funding approach would involve much higher budget outlays on superannuation by the Government than is currently the case over the next 7-8 years - but would produce a very much faster decline in the unfunded liability over time. A similar funding approach is being pursued to varying degrees in Victoria, New South Wales and South Australia (see Chapter 3).
- 10) Given Tasmania's overall budgetary position, however, the full adoption by the Government of this "aggressive" approach to addressing its unfunded superannuation liability is not one which can be considered. The period of financial pain between 2003 and 2020, which will not be able to be avoided (given the profile of existing RBF scheme members), will be difficult enough for the Government to manage, without trying to eliminate the unfunded liability any quicker.
- 11) Rather than cutting existing expenditure levels in important areas, increasing taxes or increasing debt to try and address the unfunded superannuation liability problem, consideration should be given by the Government to taking every

available financial opportunity that presents itself to make extra contributions in this regard. For example, the Government should consider altering its current financial strategy to provide that some component of the interest cost savings associated with early debt retirement from major asset sales be used for superannuation purposes.

- 12) The cash flow analysis conducted by the Committee vividly demonstrate that unless Tasmania takes action of this sort, the costs of public sector superannuation will produce a budgetary burden much like the debt servicing crisis Tasmania experienced in the late 1980s and early 1990s. While the State has taken some action to address the debt crisis in an attempt to give some budgetary flexibility back to the Government, the costs of public sector superannuation will very quickly take any flexibility generated away for a period of some 17-18 years if the issue is not managed responsibly.
- 13) Leaving the RBF contributory scheme open to new entrants and fully funding their benefits on and from the commencement of their employment will be more costly for the State relative to the preferred approach of closing the scheme off and providing new employees with a fully funded SGC accumulation benefit. The Actuary has estimated that this extra cost to the State has a present value in the order of \$71.4 million.

RECOMMENDATIONS

CHAPTER 5

Recommendation 1:

No reforms should adversely impact on the past or future benefit rights and entitlements of existing RBF scheme members - that is, any changes made to current arrangements should be prospective and relate only to the superannuation arrangements established for new employees.

Recommendation 2:

The RBF contributory scheme should be closed off to new members on and from 1 July 1998.

Recommendation 3:

Employer superannuation support for new public sector employees in Tasmania should be provided through an accumulation scheme.

Recommendation 4:

Members of the RBF non-contributory scheme as at the date of closure should retain their current right to elect to join the RBF defined benefit scheme at the end of the two year qualifying period. At the end of that qualifying period, members of the RBF non-contributory scheme must make a binding and non-reversible election to either join the RBF contributory scheme or remain a non-contributory member.

Recommendation 5:

Married women who are currently exempt from joining the RBF contributory scheme, or who exempted themselves under existing or past legislation, should retain their present right to elect to join the closed RBF contributory scheme at any time during the remainder of their public service career.

Recommendation 6:

The current RBF non-contributory scheme should be the public sector scheme (with necessary modifications relating to funding and taxation treatment) through which accumulation-based benefits should be provided to new entrants.

Recommendation 7:

From 1 July 1998, the Government should be required by law to fully fund the accruing superannuation liabilities for all new employees and for all existing members of the RBF non-contributory scheme.

Recommendation 8:

The RBF non-contributory scheme should be a fully taxed scheme for the purposes of Commonwealth law.

Recommendation 9:

Such funds standing to the credit of the Superannuation Provision Account that are required (estimated to be in the order of \$50 million as at 30 June 1996), should be paid by the Government to the RBF Board to eliminate the current unfunded liability associated with the RBF non-contributory scheme.

Recommendation 10:

The same principle as outlined in Recommendation 9 should also apply to Government Business Enterprises and other off-budget employers who have provisions within their accounts relating to non-contributory employees.

CHAPTER 6**Recommendation 11:**

The appropriate employer contribution rate for the new accumulation scheme should be the level of support specified in the Commonwealth's *Superannuation Guarantee (Administration) Act 1992*.

Recommendation 12:

The Government should investigate the feasibility of legislating to ensure that the financial savings consequent upon the new employer contribution rate being below that for which Agencies are currently funded for new permanent employees are applied to reducing the State's past service unfunded superannuation liability.

Recommendation 13:

In the context of the implementation of investment choice arrangements in the proposed new accumulation scheme, the Retirement Benefits Fund Board should investigate the feasibility of establishing at least one investment portfolio that provides a real return each year.

Recommendation 14:

If such a portfolio is feasible to establish, the margin over the CPI provided in the investment portfolio should be set by the Board, having regard to its consideration of what an appropriate and responsible investment strategy is capable of delivering.

Recommendation 15:

If such an investment portfolio is offered as a choice, the Board should apply smoothing techniques in determining the annual crediting rate for the portfolio and establish a fluctuation reserve fund to ensure that the benefits of those members who elect to place their funds in this portfolio do not require any additional employer contribution or any cross-subsidies from other members of the scheme.

CHAPTER 7**Recommendation 16:**

Existing members of the RBF non-contributory scheme and new public sector employees commencing after the date of closure of the RBF contributory scheme should not be compulsorily required to contribute to the new accumulation scheme.

Recommendation 17:

The RBF Board should actively encourage all scheme members to make voluntary contributions by including suitable material in all their promotional and informational brochures that demonstrates, in broad terms, the benefits that flow from such a course of action.

Recommendation 18:

These members should have the right to make any level of voluntary employee contributions they desire into the Fund at any time.

Recommendation 19:

Current RBF contributory members should be permitted to cease contributing at any time and exit the scheme in favour of participating in the new fully funded accumulation scheme.

Recommendation 20:

Upon transfer, these members should have their accrued past service benefit multiple calculated and compulsorily preserved in the Fund.

Recommendation 21:

Prior to any member electing to transfer out of the RBF contributory scheme, the Board should be statutorily required to provide that member with information relating to the level of employer superannuation support received by them in the contributory scheme.

Upon electing to transfer out, each member should sign a "deed of release" that indicates that they have taken the advice provided by the Board into account in reaching their decision and indemnifies the Board against any future claims as to the quality of the advice and education provided. The election should specify that the decision to transfer has been made in full knowledge and understanding of the implications.

CHAPTER 8**Recommendation 22:**

Given the potential for conflicts of interest to arise, it is inappropriate for members of Parliament to make recommendations to the Government in relation to the reform of Parliamentary superannuation arrangements.

Recommendation 23:

The Government should appoint an independent panel with expertise in superannuation to conduct a review into the Parliamentary superannuation arrangements to apply to new members (including possible transfer options for existing scheme members) and to make recommendations to the Government.

Recommendation 24:

The independent panel established to make recommendations to the Government in relation to the reform of Parliamentary superannuation for new members should also be charged with the task of making recommendations in relation to the future superannuation arrangements to apply to new Judges and new Masters of the Supreme Court.

Recommendation 25:

The independent panel should be required to undertake the review having regard, *inter alia*, to the following reform principles:

- accumulation schemes are more appropriate than defined benefit schemes in today's economic, regulatory, taxation and workplace environments;
- equity should be achieved both between the superannuation arrangements to be provided for new Parliamentarians, new Judges, new Masters of the Supreme Court and new State Servants, and with employees in the private sector, subject to appropriate consideration being given to the range of issues that are peculiar to parliamentary and judicial service;
- any member contributions should be voluntary;
- new Parliamentarians, new Judges and new Masters of the Supreme Court should have the same degree of choice over the superannuation scheme they join as new members of the State Service; and
- existing Parliamentarians, Judges and the Master of the Supreme Court should have the same option of transferring out of the existing schemes into the proposed new arrangements as will existing members of the RBF contributory scheme.

Recommendation 26:

No change should be made in relation to the superannuation arrangements applicable to new Heads of Agency, as they are already employed on a "package" basis in relation to salary and superannuation.

Recommendation 27:

The *Solicitor-General Act 1983* and the *Director of Public Prosecutions Act 1973* should be amended to provide that new Solicitors-General and new Directors of Public Prosecutions appointed on and after 1 July 1998 are not eligible to join the Judges' Contributory Pension scheme. Rather, these persons should be employed on a "package" basis in the same manner as are Heads of Agency.

Recommendation 28:

New senior contract employees in the State Service should be provided with the same superannuation arrangements as are recommended to apply in relation to new public sector employees. They should, however, retain the ability to salary sacrifice (which is an option not available to award employees).

CHAPTER 9**Recommendation 29:**

New public sector employees on and after 1 July 1998 should be required to make an election prior to commencing employment as to which complying superannuation scheme they wish to join. There should be no limit on the scheme options available to these employees, although the ability to join the new RBF accumulation scheme should exist.

Recommendation 30:

Where a new employee fails to make an election prior to commencing employment, that employee is to automatically become a member of the new RBF accumulation scheme (the default scheme).

Recommendation 31:

The trustees of the new RBF accumulation scheme should determine the nature of the member investment choices to be made available to members, timing issues (such as how often a member can switch between alternatives) and whether a minimum account balance is required before investment choice can be accessed.

Recommendation 32:

The trustees of the new RBF accumulation scheme should determine the nature of the 'default' investment arrangements to apply - what investment arrangements will apply in those instances where no election is made in relation to specific investment options.

Recommendation 33:

The trustees of the new RBF accumulation scheme should ensure that full cost-reflective fees are charged relating to the exercise of member investment choice. Those members who avail themselves of the investment options provided should bear the full costs of accessing those options and there should be no cross subsidies between those members who wish to have some input into the investment of their funds and those members who are happy to accept the default investment strategies adopted by the trustees.

CHAPTER 10

Recommendation 34:

The Government should give consideration to altering its fiscal strategy to provide that some component of the interest cost savings associated with early debt retirement from major asset sales be applied to reducing the State's unfunded superannuation liability.

CHAPTER 11

Recommendation 35:

The Government and the RBF Board should, as a matter of priority, complete the full review that is presently underway into the merits or otherwise of altering the status of the RBF scheme to a taxed arrangement and reducing the gross benefits to be paid to scheme members in order to ensure that their end benefit net of tax remains unaffected (that is, to ensure that the impact on existing individual fund members is neutral). The Committee endorses the fact that the current review is also considering mechanisms for making maximum usage of the RBF's Pre 1 July 1988 Funding Credits to offset any additional tax liability arising from such a course.

Recommendation 36:

In order to provide greater flexibility to members in the proposed new accumulation scheme, the current option that the RBF Board has to enter into agreements with private sector providers in relation to the purchase of allocated pensions should be extended to enable the Board to offer allocated pensions in its own right.

Recommendation 37:

Prior to formally endorsing the major strategic recommendations contained in this Report, the Government should seek further actuarial advice in relation to the broad reform direction being proposed.

1. INTRODUCTION

1.1. FORMATION OF THE COMMITTEE

- 1.1.1. In the 1996-97 Budget Speech delivered in the House of Assembly on Thursday 15 August 1996, the Treasurer, the Hon Tony Rundle, MHA, announced the Government's intention to establish a Parliamentary Inquiry into public sector superannuation arrangements in Tasmania. Specifically, the Treasurer indicated that:

"The State needs to be more realistic about the superannuation benefits it provides to its politicians and employees.

Most other States have now closed their old public sector schemes to new members and are contributing for new government employees in line with the Superannuation Guarantee requirements put in place by the Keating Government.

Were such arrangements put in place in Tasmania it would be done on a no detriment basis for existing employees. It would only apply to future employees.

Such a move would provide increased portability and more choice about the amount employees contribute to their own superannuation.

*The Government believes these options need to be considered in Tasmania and will move to establish a Parliamentary Committee to do so."*¹

1.2. TERMS OF REFERENCE

- 1.2.1. Terms of Reference for the Inquiry were approved by the House of Assembly on Wednesday 23 October 1996 and by the Legislative Council on Tuesday 5 November 1996. These Terms of Reference are reproduced in full in Appendix 1.
- 1.2.2. In large part, the Government requested that Parliament consider establishing a Committee to review the issue of reforming public sector superannuation arrangements in Tasmania following a 47 per cent increase in the unfunded liability of the main public sector superannuation scheme in Tasmania, the

¹ 1996-97 Budget Speech, page 11

Retirement Benefits Fund (RBF) scheme, between 1992 and 1995 (the dates for successive triennial actuarial valuations of the Fund).

- 1.2.3. The Committee is required to consider whether or not the current Retirement Benefits Fund scheme and the two Parliamentary superannuation schemes should be closed to new entrants, with such persons receiving employer superannuation support in line with the requirements of the Commonwealth's *Superannuation Guarantee (Administration) Act 1992*. The review is also to examine whether or not similar principles should apply to the Judges' Contributory Pension scheme.
- 1.2.4. The reasons for the increase in the unfunded superannuation liability have been noted in past Budget papers, and a further outline of the reasons (as detailed by the Actuary in his Report into the state and sufficiency of the Retirement Benefits Fund as at 30 June 1995) are detailed in Chapter 2 of this Report.
- 1.2.5. In accordance with the Terms of Reference, the Minister for Finance prepared a Background Paper detailing the issues required by the Terms of Reference to be discussed during the course of the Inquiry. The Background Paper was made publicly available in an attempt to provide some guidance for interested parties wishing to make a submission to the Committee.

1.3. CALL FOR SUBMISSIONS

- 1.3.1. The Committee advertised its Terms of Reference on 7 December 1996 in the three major Tasmanian newspapers and invited submissions to the Inquiry. The Committee received 20 submissions from various persons or organisations, as detailed in Appendix 2.
- 1.3.2. Following receipt of the submissions, the Committee offered those individuals and organisations who made a submission the opportunity to appear before the Committee to give oral evidence. A full list of witnesses who appeared before the Committee is included as Appendix 3.
- 1.3.3. In some instances, the Committee asked those who appeared to provide further information, which in all cases was duly tendered.

1.4. ADDITIONAL INFORMATION

- 1.4.1. In addition to the above, the Committee requested the officers seconded to the Committee to obtain reports, or extracts from reports, from the other States which had also recently examined their public sector superannuation

arrangements. A full list of documents received and taken into evidence is included as Appendix 4.

- 1.4.2. Following receipt of these reports, the Committee visited Victoria, South Australia and New South Wales in mid-February 1997, as these States had taken similar action to that contemplated in the Terms of Reference.
- 1.4.3. The Committee sought the views of both State Treasuries and representatives of public sector unions in each of the jurisdictions. Those who appeared before the Committee are outlined in Appendix 3.
- 1.4.4. At the conclusion of the trip, all members of the Committee agreed that it had been very informative and of considerably greater value than simply examining the various reports that had been prepared. The Committee had an opportunity to pursue issues of concern with those directly involved in the policy decision making in the States visited and to get a feel for the impact the reforms had in those jurisdictions.

1.5. PROROGUING OF PARLIAMENT

- 1.5.1. With the proroguing of Parliament in March 1997, the Committee ceased to exist and, if it was to continue with its task, needed to be formally reconstituted. This occurred during the first week of the resumption of Parliament later that month. However, given that the Committee could not then meet the initially agreed reporting date of the end of March 1997, Parliament agreed that the reporting date for the Committee should be extended until 12 August 1997.
- 1.5.2. Given the complexity of the issues required to be considered by the Committee, a further extension of time was granted by Parliament at the commencement of the 1997 Budget Session and in November 1997. The Committee had a final reporting date of 12 December 1997.

1.6. OTHER DEVELOPMENTS

- 1.6.1. Given the range of complex and technical issues put before the Committee during the course of their public hearings, the Committee requested that the Secretary of the Department of Treasury and Finance, Mr Don Challen, make a presentation at the meeting held on 9 May 1997.
- 1.6.2. Following the presentation to the Committee by Mr Challen, the Committee requested the officers seconded to the Committee to prepare an additional paper outlining the superannuation changes announced by the Commonwealth Treasurer, the Hon Peter Costello, MHR in the 1997-98

Commonwealth Budget, together with the implications of these announcements (if any) for the Committee's deliberations. This paper was discussed by the Committee at the meeting held on 3 July 1997.

- 1.6.3. In mid-July 1997, the Committee also agreed to take into evidence a further paper prepared jointly by the Department of Treasury and Finance and the RBF Board. The Committee was very appreciative of this work, as it provided additional information in relation to a number of key areas upon which both parties had previously submitted. This joint paper greatly assisted the Committee in reaching its conclusions in a number of difficult reform areas.
- 1.6.4. The Minutes of each Committee meeting held are included as Appendix 5 to this Report.

1.7. STRUCTURE OF THE REPORT

- 1.7.1. The Committee's Report is structured to address the key issues required to be considered by the Terms of Reference. Chapter 2 provides background information in relation to the relevant public sector superannuation schemes and defines the unfunded liability problem confronting Tasmania.
- 1.7.2. Chapter 3 of the Report then summarises the reforms that have been undertaken in mainland jurisdictions in response to the same problem that exists in this State and outlines the rationale for those reforms. Chapter 4 discusses the advantages and disadvantages of both defined benefit and accumulation schemes.
- 1.7.3. Chapter 5 considers the various options that Tasmania has to effectively address the unfunded superannuation liability, while Chapter 6 considers the issue of what level of employer superannuation support should be provided to new entrants in an accumulation scheme. Chapter 7 discusses the issues associated with the level of employee contributions that might be required in a new scheme.
- 1.7.4. Chapter 8 considers whether the same reform action as is recommended for public sector employees should also apply to new members of Parliament, new Judges, new legal office holders and new senior contract employees in the State Service, while Chapter 9 deals with the matters of both fund and investment choice. Chapter 10 then presents detailed actuarial advice in relation to the likely cash-flows associated with the recommended reform option.
- 1.7.5. Finally, Chapter 11 deals with a range of other issues that have arisen throughout the Inquiry on which the Committee wishes to make recommendations to the Parliament.

2. CURRENT SUPERANNUATION ARRANGEMENTS AND THE UNFUNDED LIABILITY PROBLEM

2.1. PUBLIC SECTOR SUPERANNUATION IN TASMANIA

- 2.1.1. In Tasmania the major public sector superannuation schemes which impact upon the Consolidated Fund (and thus the taxpayer) are the Retirement Benefits Fund (RBF) scheme, the Parliamentary Superannuation Fund (PSF) scheme, the Parliamentary Retiring Benefits Fund (PRBF) scheme and the Judges' Contributory Pension scheme. The following legislation relates to these four schemes:
- *Retirement Benefits Act 1993;*
 - *Parliamentary Superannuation Act 1973;*
 - *Parliamentary Retiring Benefits Act 1985;*
 - *Judges' Contributory Pensions Act 1968;*
 - *Solicitor-General Act 1983;* and the
 - *Director of Public Prosecutions Act 1973.*
- 2.1.2. In addition to these schemes, certain senior public sector employees (including Heads of Agency) are employed on contracts which permit the payment of employer superannuation support into private sector superannuation funds nominated by the employee. The Committee's Terms of Reference require it to consider what superannuation arrangements should be provided to new State servants (including contract employees of all kinds), members of Parliament, Judges, Solicitors-General, Directors of Public Prosecutions and Masters of the Supreme Court.
- 2.1.3. The defining characteristics of the four main schemes outlined above are summarised in Table 2.1, together with details of the numbers of contributors and pensioners where appropriate. For the purposes of this Table, a scheme is characterised as an "open" scheme if new entrants are able to join that scheme. Conversely, a "closed" scheme is one which is no longer open to new entrants.
- 2.1.4. It should be noted that the figures detailed in Table 2.1 with respect to the RBF represent the number of particular accounts that are in existence. In some cases one person may have more than one account. It should also be noted that it is possible for certain non-contributory members to transfer to the contributory scheme after a defined period of service.

2.1.5. Further, the Table does not include the superannuation support arrangements provided by the Government to many employees such as Heads of Agency, members of the Senior Executive Service and other contract staff who are members of private superannuation funds.

Table 2.1 : Tasmanian Public Sector Superannuation Schemes

Scheme Name	Benefit design	Type of funding	Status of fund	Contributors 30 June 1997	Pensioners 30 June 1997
<i>Retirement Benefits Act 1993:-</i>					
• Contributory scheme	defined benefit	partially	open	18 113	7 180
• Non-Contributory scheme	defined contribution	partially	open	23 638	na ¹
• Amalgamated scheme	defined benefit	partially	closed	52	na ²
• Police Provident Fund	defined contribution	partially	closed	7	na ¹
<i>Parliamentary Superannuation Act 1973</i>	defined benefit	partially	closed	15 ⁴	27 ⁵
<i>Parliamentary Retiring Benefits Act 1985</i>	defined benefit	funded	open	38 ⁴	na ³
<i>Judges' Contributory Pensions Act 1968</i>	defined benefit	unfunded	open	9	8 ⁶

Notes:

1. Benefit expressed as a lump sum, but may be converted to a pension based on actuarially determined factors. In such cases, pensioners are included in the figures for the contributory scheme.
2. Pension beneficiaries are included in the figures for the contributory scheme.
3. Benefit provided as a lump sum only.
4. With the resignation of two Parliamentarians in early July 1997, these numbers became 13 and 40 respectively.
5. For the same reason, the number of pensioners increased to 29.
6. Benefit provided as a pension only.

Source: *Budget Overview 1997-98*, Budget Paper No 1, page 106.

2.1.6. The RBF was first established in accordance with the *Retirement Benefits Act 1970* and is the major scheme for public servants in Tasmania (both on-budget employees and those of Government Business Enterprises and State Authorities). There were major amendments to the scheme in 1982, 1987 and in 1993. The *Retirement Benefits Act 1993* provided a framework for new superannuation arrangements, the details of which are set out in the *Retirement Benefits Regulations 1994* and the *Retirement Benefits (Transitional) Regulations 1994*. The new scheme comprises both a contributory and a non-contributory element.

- 2.1.7. The RBF contributory scheme is a defined benefit scheme. Those eligible contribute between 5 per cent and 11 per cent of salary and voluntary contributions may be made. The basic benefit is a lump sum based on the length of contributory service, the average salary of the contributor over their last three years and a benefit multiple factor (BMF). The BMF for a person contributing at the basic rate of 5 per cent of salary is 0.2. For those who elect to contribute at a higher rate, the BMF increases by 0.0125 for each additional one per cent of employee contributions.
- 2.1.8. Where a contributor resigns prior to age 55, he or she is entitled to a benefit calculated on the same basis as the age retirement benefit (although a five year phased-in qualifying or "vesting" period exists). However, in accordance with Commonwealth legislation, the employer share of the end benefit (approximately 70 per cent of the total benefit) must be preserved until retirement after age 55.
- 2.1.9. Benefits are also payable in the event that the contributor dies, retires on the grounds of ill health, or is made redundant. Anti-detriment provisions also exist to protect certain entitlements of those contributors who joined the scheme prior to 1 July 1994. Such contributors can elect to take a benefit under the 1982 Act in the event that it is superior to that available under the 1993 Act.
- 2.1.10. The RBF non-contributory scheme is a defined contribution scheme for those employees not eligible to join the contributory scheme. The employer contribution in respect of non-contributory employees matches the rate required by the Commonwealth's Superannuation Guarantee Charge (SGC) legislation, currently 6 per cent of salary. Interest at the Commonwealth long term bond rate is credited to each non-contributory employee's superannuation account.
- 2.1.11. Non-contributory employees are entitled to a lump sum accumulation benefit (which may be converted to a pension) on retirement. Benefits are also payable in the event of resignation, death, ill-health or redundancy. If a non-contributor resigns from his or her position prior to age 55 or is made redundant, the accrued benefit must generally be compulsorily preserved in the RBF scheme until retirement from the workforce after age 55 years.
- 2.1.12. Those who formerly contributed to the superannuation scheme under the now repealed *Superannuation Act 1938* and who have not transferred to the RBF scheme, contribute and receive benefits under the new scheme arrangements as "amalgamated contributors". The contributions and benefits for amalgamated contributors reflect the arrangements pertaining under the old unit based scheme.

- 2.1.13. The Police Provident Fund (PPF) now operates under the framework of the RBF scheme. The PPF became a closed scheme on 31 December 1963 and there are very few contributors remaining in this scheme. Contributors pay 7.5 per cent of salary and this amount is matched by the employer. The accumulation benefit payable is the aggregate of the employer and employee contributions together with interest credited.
- 2.1.14. The RBF scheme has traditionally been an unfunded scheme. The employer makes no contributions into the Fund on an on-going basis and meets its share of the cost of benefits as and when they are paid to members. However, with effect from 1 July 1994, a Superannuation Provision Account (SPA) within the Special Deposits and Trust Fund (T780) has been maintained by successive Governments.
- 2.1.15. While there is no statutory requirement to do so, in accordance with Government policy agencies pay to the SPA each fortnight 11 per cent of salary in respect of contributory members, the appropriate SGC rate in respect of non-contributors and 7.5 per cent of salary in respect of PPF contributors. All benefit payments relating to on-budget agencies are then met from this source.
- 2.1.16. It should be noted that the T780 account is not invested or subject to actuarial control in the traditional sense and, accordingly, the account may not fully benefit from the receipt of investment earnings. Further, given that agency contributions to the SPA are dictated by Government policy, there is the potential for this money to be diverted to an alternative use at some future point. It should also be noted that the funds standing to the credit of the SPA that are not immediately required for benefit payment purposes are used to assist the Government with the management of its cash flows on a day-to-day basis, which reduces the amount of short term borrowings that would otherwise be required.
- 2.1.17. Agency contributions to the SPA subsequent to 1 July 1994 relate to the currently accruing liability. An additional payment is being made from the Consolidated Fund to the SPA each financial year as a contribution in respect of the accrued unfunded past service liability. In 1996-97, the additional contribution to the SPA in relation to the past service liability was \$31.9 million, as estimated in the Budget papers. As at 30 June 1997, the balance accumulated in the SPA was \$161.4 million.
- 2.1.18. With respect to Government Business Enterprises (GBEs) and State Authorities, provision for superannuation liabilities are included in the accounts of those organisations, with the level of employer contribution to those provisions being determined on actuarial advice. In much the same way as the SPA balance assists the Government in its day-to-day operations,

so do the funds held by way of superannuation provisions by GBEs and State Authorities.

- 2.1.19. The Parliamentary Superannuation Fund is a defined benefit pension scheme established under the provisions of the *Parliamentary Superannuation Act 1973*. The scheme was effectively closed to new members in 1985. As at 30 June 1997, there were 15 Parliamentarians covered by the provisions of this legislation and 27 pension beneficiaries.
- 2.1.20. Members contribute at the rate of 12 per cent of their Parliamentary salary. Under the scheme there is an entitlement to a pension benefit on retirement provided the person:
- retires after contributing for at least 15 years; or
 - has completed more than 8 years, but less than 15 years, of contributory service and satisfies criteria specified in section 16 of the Act.
- 2.1.21. In any other circumstances the member is entitled, on termination, to a refund of contributions plus interest and, if appropriate, an SGC payment. In the event of the death of a member, the spouse is entitled to a pension representing five-eighths of the pension to which the member would have been entitled, or 40 per cent of the basic salary (which is that received by a backbench member), whichever is the greater.
- 2.1.22. A member who has contributed for 20 years is entitled to the maximum pension benefit of 70 per cent times the basic salary for a Parliamentarian, times the ratio of the total Parliamentary salary received to the total basic salary that would have been received during the member's Parliamentary service if he or she had been a backbench member for all of their service. Members who have contributed in excess of 20 years may be entitled to a supplementary benefit payment determined by the Trustees on the advice of the Actuary.
- 2.1.23. Either 50 per cent or 100 per cent of a contributor's or spouse's pension may be commuted to a lump sum in accordance with conversion factors detailed in schedules to the Act.
- 2.1.24. The Parliamentary Retiring Benefits Fund is a defined benefit lump sum scheme established under the provisions of the *Parliamentary Retiring Benefits Act 1985*. The scheme covers those members of Parliament first elected after the scheme came into effect on 12 November 1985. As at 30 June 1997, there were 38 Parliamentarians covered by the provisions of this legislation.

- 2.1.25. Members contribute at the rate of 9 per cent of their Parliamentary salary during the first 20 years of service and thereafter at 9 per cent of the amount by which the member's Parliamentary salary exceeds the basic Parliamentary salary. The benefit upon retirement after 15 years service depends upon the years of contributory service. The maximum entitlement for those with 20 or more years of service is seven times final salary (as defined in the Act).
- 2.1.26. Superannuation arrangements for Judges are specified in the *Judges' Contributory Pensions Act 1968*. There is no Judges' Superannuation Fund as such, with the contributions made by Judges (5 per cent of salary) being deposited in, and all benefits being met from, the Consolidated Fund.
- 2.1.27. As at 30 June 1997 there were nine members of the scheme, including the Chief Justice, the five Puisne Judges, the Solicitor-General, the Director of Public Prosecutions and the Master of the Supreme Court. Office holders are covered by the Judges' scheme in accordance with the provisions of the legislation establishing their respective positions, or the Principal Act itself. Currently there are eight pension beneficiaries under the scheme arrangements.
- 2.1.28. The scheme provides for a pension of 50 per cent of salary following:
- retirement after 15 years service;
 - retirement on the grounds of ill-health; or
 - attainment of the statutory retirement age of 70 years.
- 2.1.29. Pensions are increased once a year in accordance with the movements in judicial salaries.
- 2.1.30. The Commonwealth Government's *Superannuation Guarantee (Administration) Act 1992* requires employers to provide all employees with a prescribed minimum level of employer superannuation support.
- 2.1.31. In accordance with the legislation, the SGC for large employers such as the State Government is currently 6 per cent of salary. Table 2.2 below shows the SGC schedule.

Table 2.2 : Superannuation Guarantee Charge - Employer Contributions

Period	Prescribed rate of contribution as a % of salary (large employers)
1 July 1992 to 31 Dec 1992	4
1 Jan 1993 to 30 June 1995	5
1 July 1995 to 30 June 1998	6
1 July 1998 to 30 June 2000	7
1 July 2000 to 30 June 2002	8
1 July 2002 onwards	9

Source: *Superannuation Guarantee (Administration) Act 1992*, Section 21(4).

2.1.32. In addition to the schemes outlined above, there is also an Agreement in place between the Treasurer and the RBF Board to ensure that any person leaving the employ of the State receives a payment sufficient to ensure that the State fulfils its obligations in respect of the SGC legislation. Under the Agreement, the Board is indemnified to the extent that it is required to make payments not otherwise provided for in State legislation.

2.2. THE INCREASING FOCUS ON UNFUNDED SUPERANNUATION LIABILITIES

2.2.1. Traditionally, public sector superannuation schemes have been unfunded. This reflects a policy position that has consistently been adopted by successive governments around the country over the past 100 years. Since the establishment of the first public sector superannuation arrangement in Tasmania in the early 1900s, there has therefore always been an unfunded superannuation liability in this State.

2.2.2. Until recent times, having an unfunded superannuation liability was not considered to be an issue requiring detailed attention. It was assumed that because State governments were everlasting, that they would have an ever-expanding role in the economy and that they had recourse to taxation powers, there was no difficulty in having an unfunded superannuation arrangement. It was considered that money which would otherwise be set aside in order to meet the superannuation entitlements of retiring public servants could best be used to provide other government services. Under this scenario, benefits

were simply met on an emerging cost basis - that is, as and when public sector employees retired.

- 2.2.3. It was not until the 1980s that the Tasmanian Government started to consider the funding of superannuation benefits for its employees. The first evidence of this is to be found in the Parliamentary Retiring Benefits Fund (PRBF) scheme. This scheme applies to those Parliamentarians first elected after 12 November 1985 and currently applies to 38 of the State's 54 politicians.
- 2.2.4. At the time of its creation, the scheme design provided for the employer benefit to be fully funded at a rate equivalent to 2.5 times the employee contribution rate of 9 per cent of salary, an effective employer contribution rate of 22.5 per cent. For reasons detailed elsewhere in this Report, this rate has recently increased to 25.2 per cent of salary. Under this arrangement, the appropriate employer contribution is paid from the Consolidated Fund each fortnight to the Parliamentary Superannuation and Retiring Benefits Trust (PSRBT) to be invested. This being the case, the PRBF can be regarded as a fully funded scheme, without any unfunded liabilities.
- 2.2.5. There were a number of further developments in relation to the debate over the funding of superannuation benefits in the late 1980s and early 1990s.
- 2.2.6. With effect from 1 January 1989, the Superannuation Accumulation Fund (SAF) scheme was introduced. This scheme provided that the 3 per cent productivity benefit which was introduced by the June 1986 National Wage Case decision would flow on to Tasmanian public sector workers in the form of superannuation and, in this sense, was regarded as a 'deferred pay rise'. Initially this arrangement was unfunded. However, with effect from 1 July 1990 the then Government decided to fund the benefit, on the basis that had the then Conciliation and Arbitration Commission awarded a wage increase rather than a superannuation benefit, the increase would had to have been met by the Government.
- 2.2.7. It should be noted that the SAF scheme was wound up with effect from 1 July 1994, with the introduction of revised public sector superannuation arrangements at that time.
- 2.2.8. The next major development concerning unfunded superannuation liabilities came about following the agreement reached at the May 1991 Premiers' Conference between all States, Territories and the Commonwealth to adopt a consistent reporting format for all Financial Assets and Liabilities (FALs). Under this agreement, all jurisdictions agreed that FALs are to be prepared on the basis of common concepts and classifications to facilitate inter-jurisdictional comparisons.

- 2.2.9. While reporting on a FALs basis does enable such comparisons, the figures reported in the FALs documents, prepared in accordance with the requirements of the *Financial Management and Audit Act 1990*, differ from those outlined in this Report as the classification of Agencies in the FALs Report and the treatment of provisions differ from the Consolidated Fund requirements.
- 2.2.10. As a consequence of the uniform reporting agreement, unfunded superannuation liabilities were first estimated by officers of the Department of Treasury and Finance in the 1990-91 Budget papers. At that time, it was estimated that the unfunded superannuation liability for on-budget Agencies as at 30 June 1989 was \$1.3 billion. However, in the 1991-92 Budget Papers it was indicated that, in calculating this estimate, the multiple applied to the present value of the RBF's share of both future benefits to existing contributors and future payments to existing pensioners in order to determine the extent of future contributions required by the State was too high.
- 2.2.11. The estimate for the unfunded superannuation liability of the RBF scheme as at 30 June 1989 had therefore been overstated. The Budget Papers for 1991-92 estimated the present value of the current and future liabilities of the State as at 30 June 1991 to be in the order of \$1.037 billion.
- 2.2.12. By the time of the 30 June 1992 report into the state and sufficiency of the RBF, the Actuary had been requested to estimate the size of the State's unfunded past service superannuation liability only (as it was completely unreasonable to expect the State to be fully funded at a point in time in relation to the future, unworked service of its employees). A figure of \$815 million with respect to the RBF scheme was outlined in the Actuary's report.
- 2.2.13. To ensure consistency in the use of estimates, the Committee has used the Actuary's estimate of the unfunded past service liability as at 30 June 1992 as the appropriate starting point.
- 2.2.14. The fact that international credit rating agencies have also focussed on the extent of the unfunded superannuation liabilities of the States and Territories is another development which has led to increasing attention being given to the superannuation circumstances of all the Australian States. Prior to 1990, the States were not rated separately from the Commonwealth Government, leading to the fact that the level of financial scrutiny of the States was relatively low.
- 2.2.15. This changed in 1990 and the continuing public commentary and scrutiny associated with the size of the unfunded liabilities of the public sector in Australia that has occurred since that time has been a major catalyst for the

superannuation reform action that has been seen around the country in recent years (see Chapter 3 for a discussion of these reforms).

- 2.2.16. In their final report in 1993, the NSW Legislative Assembly Select Committee Upon Public Sector Superannuation Schemes made the following comments in this regard:

"It was submitted by NSW Treasury that one of the principal financial reasons for the Government policy decision to address unfunded superannuation liabilities, apart from an overall shift by the current Government to adopt a more business-like approach in running its budget sector, was the concern expressed by the credit rating agencies Standard & Poors and Moodys towards these liabilities.

*This was particularly important as NSW had recently been put on "credit watch" and a downgrading in the State's AAA rating would have resulted in an estimated additional \$100 million per annum to meet increased debt-servicing costs."*²

- 2.2.17. In a recent publication by credit rating agency Standard and Poors, the focus on superannuation liabilities as a ratings issue was obvious. For example, one of the seven indicators reported for each State for fiscal year 1996 related to superannuation - namely, the ratio of unfunded superannuation liabilities to Gross State Product (GSP). Standard and Poors made the following comments:

*"... the ratings differences between the States reflect factors other than the position of their finances and debt levels. For example, the structure of the economies of the various States, their economic prospects, the flexibility of a State Government to deal with potential fiscal shocks, the varying demands on each State for government services and infrastructure and the level of contingent liabilities are all important factors in the ratings. These factors tend not to change to the same extent as the financial indicators and thus act as a restraint on ratings changes."*³

"For all States, with the exception of Queensland, the unfunded superannuation liability is their largest off-balance sheet liability ... New South Wales and South Australia... [are]... tackling the task of reducing their unfunded superannuation liability arising from the

² Select Committee Upon Public Sector Superannuation Schemes, Legislative Assembly, November 1993, page 33

³ Standard and Poors, *Credit Focus*, June 1997, page 5

past service of public sector employees, but progress will be slow, with both these States having a target date of about 2040 for the elimination of the liability."⁴

- 2.2.18. The other major credit rating agency, Moody's, made the following comment in relation to Tasmania in their recent report on the Australian States:

*"The State has additional liabilities relating to unfunded superannuation benefits...A number of reforms to increase provisions for superannuation have been introduced, however recent actuarial evaluations indicate that the unfunded liability will remain of significant size over the medium to long term."*⁵

- 2.2.19. The next major development in relation to this issue was the introduction of the *Retirement Benefits Regulations 1994*. Regulation 15 requires the Actuary to provide:

*"...a statement as to any liability for benefit payments not expected to be financed out of the assets of the Fund or any future contributions."*⁶

- 2.2.20. This was the first occasion that there was a legislative requirement for the Actuary to report on the extent of the unfunded superannuation liability in the RBF scheme.

- 2.2.21. A further development, prior to the establishment of this Committee, was the creation of the Superannuation Provision Account (SPA) within the Special Deposits and Trust Fund. As indicated earlier, with effect from 1 July 1994 on-budget Agencies were required, in accordance with Government policy, to pay to the SPA a percentage of salary with respect to RBF contributory members and the appropriate SGC rate in respect of non-contributory members. Some smaller off-budget Agencies also use the SPA.

- 2.2.22. While in theory these contributions relate to the currently accruing liability, as detailed in the 1994-95 Budget papers the Government is required, of necessity, to meet from the SPA the full emerging cost of superannuation, not simply the proportion of benefits which relate to service post 1 July 1994. The effect of this decision means that, despite the Government's best intentions, the RBF scheme remains a scheme which, in reality, is funded solely on an emerging cost basis.

⁴ Standard and Poors, *Credit Focus*, June 1997, page 7

⁵ Moody's Investors Service, *Moody's Analysis*, April 1997, page 17

⁶ *Retirement Benefits Regulations 1994*

- 2.2.23. Finally, there has been an increasing focus on unfunded superannuation liabilities as a result of governments taking the decision to move towards accrual accounting, which automatically raises the issue of governments providing for their liabilities as they accrue. That is, the move to accrual accounting raises the question as to why governments should behave any differently from private sector organisations in this regard.
- 2.2.24. There has also been heightened community focus on the matter of inter-generational equity in recent times - if benefits are received today, the community is now more conscious of the fact that it is fair and reasonable to expect today's generation of taxpayers to pay for them (rather than moving the costs on to future generations).

2.3. THE EXTENT OF THE PROBLEM

- 2.3.1. The Committee heard evidence, based on actuarial advice, that there has been very significant growth in the unfunded superannuation liability associated with public sector superannuation schemes in Tasmania over the past four years (particularly in relation to the RBF scheme, where the increase has been in excess of 69 per cent). As outlined earlier in this Report, it was this growth that was, in large part, the catalyst for the establishment of the Committee by the Parliament.
- 2.3.2. Actuarial reviews were undertaken of the RBF scheme, each of the Parliamentary schemes and the Judges' scheme as at 30 June 1995. The outcome of these reviews provides an estimate of the aggregate unfunded liability of the State in respect of public sector superannuation. The results as at 30 June 1995 are outlined in Table 2.3.

**Table 2.3 : Unfunded Superannuation Liability as at
30 June 1995 ¹**

	\$'000
<i>Retirements Benefits Scheme</i>	
Liabilities (contributory and non-contributory)	2 281 319
Assets (contributory and provision accounts)	1 081 674
	<u>1 199 645</u>
<i>Parliamentary Superannuation Scheme ²</i>	
Liabilities	21 483
Assets ³	7 511
	<u>13 972</u>
<i>Judges' Scheme</i>	
Liabilities	10 113
Assets	0
	<u>10 113</u>
TOTAL	<u>1 223 731</u>

Notes:

1. These figures are as published in the Actuary's valuation reports of the various schemes as at 30 June 1995.
2. The Parliamentary Retiring Benefits Scheme is excluded, on the basis that it is fully funded.
3. This includes the net deficit in the Fund and the net present value of future member contributions.

Source: *Budget Overview 1997-98*, Budget Paper No 1, page 158.

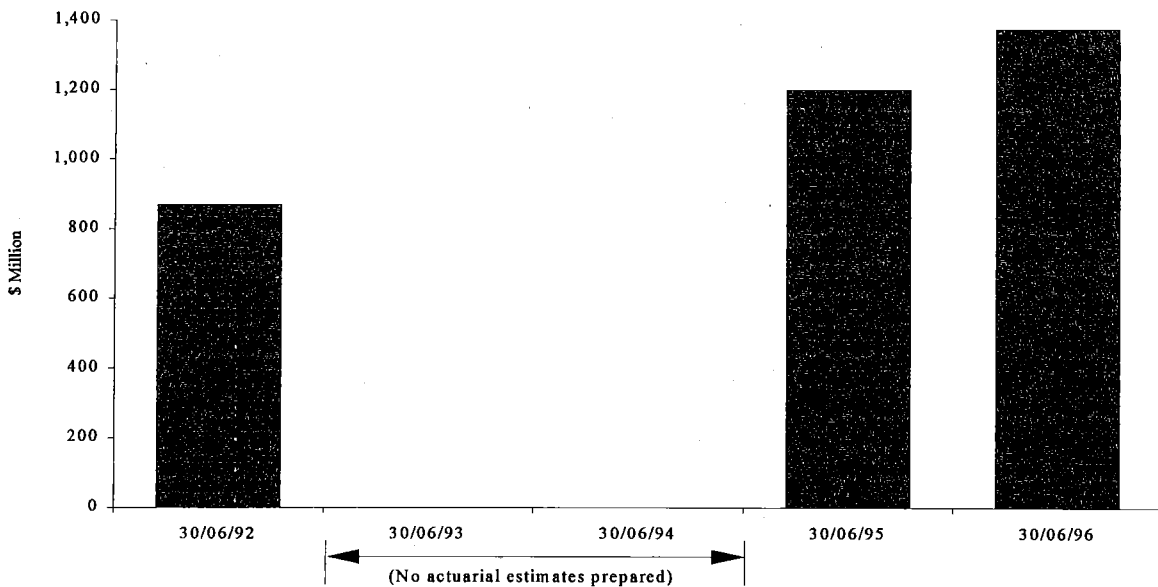
- 2.3.3. In relation to the RBF scheme, the Actuary has provided an updated valuation as at 30 June 1996. In this Report, the Actuary estimated that the unfunded liability associated with the RBF scheme at that point in time was \$1.374 billion.
- 2.3.4. Chart 2.1 below shows the nominal growth in the unfunded superannuation liability associated with the RBF scheme over a four year period, as outlined in various Actuarial Reports into the state and sufficiency of the Fund.
- 2.3.5. It should be noted that these figures only represent accrued (or past) service liabilities as at each date - they do not include the unfunded future service component for existing members of the RBF scheme.

- 2.3.6. In addition to the significant nominal growth in unfunded superannuation liabilities evident in Chart 2.1, the Committee felt that it was illustrative to also consider the profile of superannuation expenditures from the Consolidated Fund over the recent past.
- 2.3.7. The extent of these superannuation outlays, including outlays on Parliamentary and judicial superannuation, for the past thirteen years are shown in Chart 2.2 below. In this respect, the Department of Treasury and Finance advised the Committee that superannuation outlays are now only second to debt servicing costs in the State Budget in terms of size and may shortly exceed debt servicing costs.
- 2.3.8. It is evident from Chart 2.2 that superannuation outlays from the Budget have increased significantly over the past 13 years - from \$17.8 million in 1983-84 to \$108.4 million in 1996-97. The increase of 509 per cent over this period compares with a 130 per cent increase in total current outlays. As a result, superannuation outlays have increased from 2.08 per cent of current outlays in 1983-84 to 5.52 per cent in 1996-97.
- 2.3.9. In Chapter 10 of this Report, the Committee presents evidence to suggest that superannuation expenditure will become a much larger burden on Tasmanian finances over the next 25 years and is likely to constrain future Government spending in other areas if appropriate reform action is not taken now. In this regard, the Department of Treasury and Finance has indicated that in respect of the period from about 2003 to 2020:
- “...the projections illustrate that...this is the period of financial pain for the State, as the effect of the “baby boomers” coming through starts to be felt. Nearly 60 per cent of the existing RBF contributory membership is aged 40 years and over.”*
- 2.3.10. The Committee did note, however, that approximately one half of the current superannuation expenditure goes to persons who are receiving a pension from the RBF Board. The Department of Treasury and Finance was able to advise the Committee that during 1996-97 the Government paid out just over \$1 million per week in pension payments. Given that most RBF pensioners are resident in Tasmania, this represents a significant injection of funds into the State's economy.
- 2.3.11. Another measure that is illustrative is the size of the unfunded superannuation liability as a proportion of Gross State Product (GSP). Table 2.4 below outlines this ratio with respect to the State's total unfunded liability - that is, including the Parliamentary Superannuation Fund and the

⁷ Department of Treasury and Finance Submission, page 39

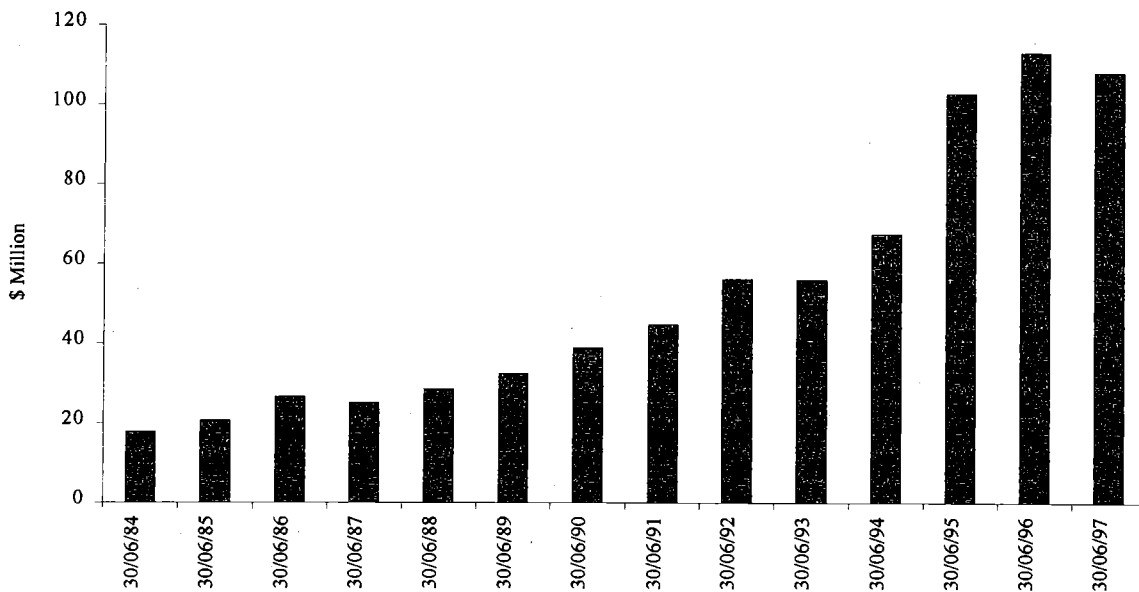
Contributory Pension scheme. As outlined above, although this is a measure which is used by the credit rating agencies, the figures in this table differ from those used by the ratings agencies as the non-FALs definition of the unfunded superannuation liability is used.

Chart 2.1 : Growth in Total RBF Unfunded Liability: 1992-96



Source: Department of Treasury and Finance Submission, Chart 1.

Chart 2.2 : Total Superannuation Expenditure: 1983-84 to 1996-97



Source: Budget Overview 1997-98, Budget Paper No 1, page 115.

- 2.3.12. It is evident from Table 2.4 that the State's unfunded superannuation liability as a proportion of Tasmanian GSP is estimated to have increased from 10.3 per cent as at 30 June 1992 to nearly 13.5 per cent as at 30 June 1996. The Committee notes that this is a very rapid rate of growth for such a short period and believes that it represents strong evidence in support of the argument that superannuation funding will reach crisis point in Tasmania in the very near future.

Table 2.4 : Unfunded Superannuation Liabilities as a Proportion of GSP

Year ended	Unfunded liability	GSP	Ratio
	Nominal (\$'000)	Nominal (\$'000)	
30-Jun-92	\$885,966	\$8,609,000	10.29%
30-Jun-93	\$998,561	\$8,924,000	11.19%
30-Jun-94	\$1,111,154	\$9,182,000	12.10%
30-Jun-95	\$1,223,749	\$9,800,000	12.49%
30-Jun-96	\$1,400,841	\$10,396,000	13.47%

Notes:

1. The total unfunded liability figure for 30 June 1992 is as detailed on page 154 of the 1995-96 Budget Paper No.1.
2. Unfunded liability figures for 30 June 1993 and 30 June 1994 are estimates only, with the annual increase being one-third of the difference between the two actuarially determined figures (1992 and 1995) for each of the schemes.
3. The total unfunded liability figure for 30 June 1996 includes an estimate prepared by the Actuary for the RBF scheme, with the estimates for the other schemes having been prepared within the Department of Treasury and Finance.

Source: *Budget Overview 1997-98*, Budget Paper No 1, page 113.

2.4. REASONS FOR THE INCREASE IN UNFUNDED LIABILITIES

- 2.4.1. The reasons for the large increase in the unfunded superannuation liability of the RBF scheme from 1992 to 1996 are many and varied. The main issues in this regard that have been brought to the attention of the Committee through the course of the Inquiry are summarised below.
- 2.4.2. There has been a significant increase in the liabilities associated with RBF pensioners (in the order of 62 per cent) over the four year period, due to:

- an increase in the number of pensioners (in part, as a result of the redundancy and early retirement programs that have been successively introduced);
- improved life expectancy;
- permitting spouses to retain their pensions upon remarriage (in line with Commonwealth Government requirements); and
- the inclusion of “anti-detriment” provisions for pre 1 July 1994 members of the RBF contributory scheme.

2.4.3. The RBF Board’s Submission to the Inquiry makes the following comments in relation to the increased liability associated with pensions:

“Over the last few years, the State Government has implemented a number of redundancy programs. The increase in the number of exits from the Fund, either taking a lump sum or pension, can in part be attributed to the restructuring of the State Government workforce over this period. Retrenchments and early retirements have resulted in a substantial transfer of liabilities from the active member provisions to the pension provisions.”⁸

“The liability of pensions has also increased during the review period because beneficiaries are living longer. The mortality experienced has improved over and above the experience used in the 1992 valuation. This, when combined with full indexation of pensions utilising the Consumer Price index, has substantially increased the liability of the Fund in pensions.”⁹

2.4.4. A significant increase in resignation benefits (471 per cent over the four year period) had a significant impact on the growth in unfunded liabilities in the RBF scheme, largely due to the changes in the benefit structure made in 1994. The Department of Treasury and Finance indicated to the Committee that these changes included:

“... the introduction of retrospective employer vesting, the abolition of early retirement penalties and granting those contributing at the old 2.75 per cent rate the option to upgrade past service at concessional cost”¹⁰

⁸ Retirement Benefits Fund Board Submission, page 87

⁹ *ibid*, page 88

¹⁰ Department of Treasury and Finance Submission, page 4

- 2.4.5. The increase in the liabilities associated with the non-contributory scheme (47 per cent between 1992 and 1996) has added to the overall unfunded liability, largely reflecting the increase in the minimum SGC rate from 4 per cent to 6 per cent over the four year period. Further, there has been a large increase in the number of transfers from the non-contributory scheme to the contributory scheme, as a result of the improved vesting provisions introduced in 1994 and the ability to purchase past non-contributory service for benefit purposes at concessional rates.
- 2.4.6. The fact that the investment returns achieved by the Fund on employee contributions have been below those assumed by the Actuary in earlier valuations has impacted on the estimated unfunded liability.
- 2.4.7. Limited growth in the superannuation provisions maintained by Government Business Enterprises has had a negative impact on the unfunded liability position (which is a net concept, with assets being deducted from gross liabilities). In the 1995 valuation report, the Actuary suggested that:

“The growth in the Authorities’ superannuation provisions has been insufficient to cover the growth in their superannuation liability. The level of accumulated superannuation provisions for Statutory Authorities is far lower than would have been expected given the 1992 provisions. This appears to indicate that the Authorities have run down their provisions to protect their operational account results.”¹¹

- 2.4.8. Finally, general increases in member salaries and wages (resulting from award and classification adjustments) at a rate greater than that assumed by the Actuary in his valuation reports has increased the unfunded liabilities of the RBF scheme during the period 1992 to 1996 (as is always the case in defined benefit schemes). In addition, changes to the definition of salary in the legislation has had a similar effect. In this respect, the RBF Board suggested to the Committee that:

“With the defined benefit RBF contributory scheme utilising Final Average Salary over three years for the current scheme and one year for the previous scheme, as a primary determinant in calculating a member’s benefit, changes in the salary definition and the ability of contract employees to manipulate salary in the final contributory years prior to receiving a benefit has substantially increased the benefits being paid.

¹¹ 1995 Actuarial Report, page 3

*These issues are affecting not only the employer liability, but also the member liability of the Fund in that higher employer provisions and member contributions to the Fund are not being paid over the members' full period of service."*¹²

2.4.9. While there has been a large increase in the unfunded liability associated with the RBF scheme in recent times, the Committee's attention was also drawn to the fact that the measures taken by the Government in the 1994 reforms will have the effect, in the long term, of reducing the unfunded superannuation liability relative to what it otherwise would have been.

2.4.10. These measures included:

- the closure of the Superannuation Accumulation Fund (SAF) scheme and the transfer of the accumulated provisions that had been made (some \$84 million) to the Superannuation Provision Account established within the Public Account;
- allowing retiring contributors to take all of their benefits as a lump sum if they wish (thus ensuring a long term gain to the Government in exchange for short term cash flow increases);
- less generous pension conversion factors being available to scheme members who joined after 1 July 1994; and
- the change in the definition of benefit salary from final average salary over one year to final average salary over three years.

2.4.11. The Committee noted that although there has been a dramatic increase in the State's unfunded superannuation liability since 1992, the Actuary has indicated that the unfunded liability is now lower (by around \$90 million) than what it would have been had the Government not taken the measures outlined above in the course of the 1994 reforms.

2.4.12. In its presentation to the Committee, the Department of Treasury and Finance argued that this demonstrated that the reforms introduced in 1994 did not go far enough in managing the State's unfunded superannuation liability. The Department also suggested that the environment in which superannuation is being provided had changed dramatically in recent years.

2.4.13. The Department of Treasury and Finance suggested to the Committee that:

"The following factors have had a bearing on the superannuation costs to the Government in recent years:

¹² Retirement Benefits Fund Board Submission, page 86

- *trend towards enterprise bargaining;*
- *the reductions in the number of public servants (with those remaining being paid higher salaries than previously); and*
- *the increased general awareness of superannuation in the community (which has resulted in, for example, more temporary employees electing to join the contributory scheme than previously)."*¹³

2.4.14. In many submissions to the Committee, it was noted that there is actually little or no opportunity for the Government to address the unfunded superannuation liability in respect of past (or accrued) service without reducing member entitlements - other than at the margin through, for example, making allocated pensions available to existing pensioners or providing existing pensioners with a once off lump sum commutation right.

2.4.15. The 1993 Report of the Victorian Commission of Audit made reference to this fact (which is explored in more detail in Chapter 5 of this Report):

*"The existing unfunded liabilities are the present value of accrued benefits, which relate to the cost of benefits in respect of service which has already been completed, minus the assets available to meet these liabilities. Therefore, apart from increasing assets by increasing contributions, existing unfunded liabilities can only be reduced by decreasing accrued benefits."*¹⁴

2.4.16. The Department of Treasury and Finance put to the Committee that the real issue facing it was to ensure that the employment of new public servants did not add to the existing unfunded liability. It suggested that Tasmania is now in the position that most of the other States found themselves in some years back and that the reforms that have been implemented on the mainland (which are discussed in detail in Chapter 3 of this Report) are now appropriate for this State.

2.5. UNFUNDED LIABILITY PROJECTIONS FOR THE RBF SCHEME

2.5.1. In order to get a better feel for the reform action that might be appropriate in the face of the unfunded liability problem discussed above, the Committee requested the Actuary to provide projections as to how the unfunded past

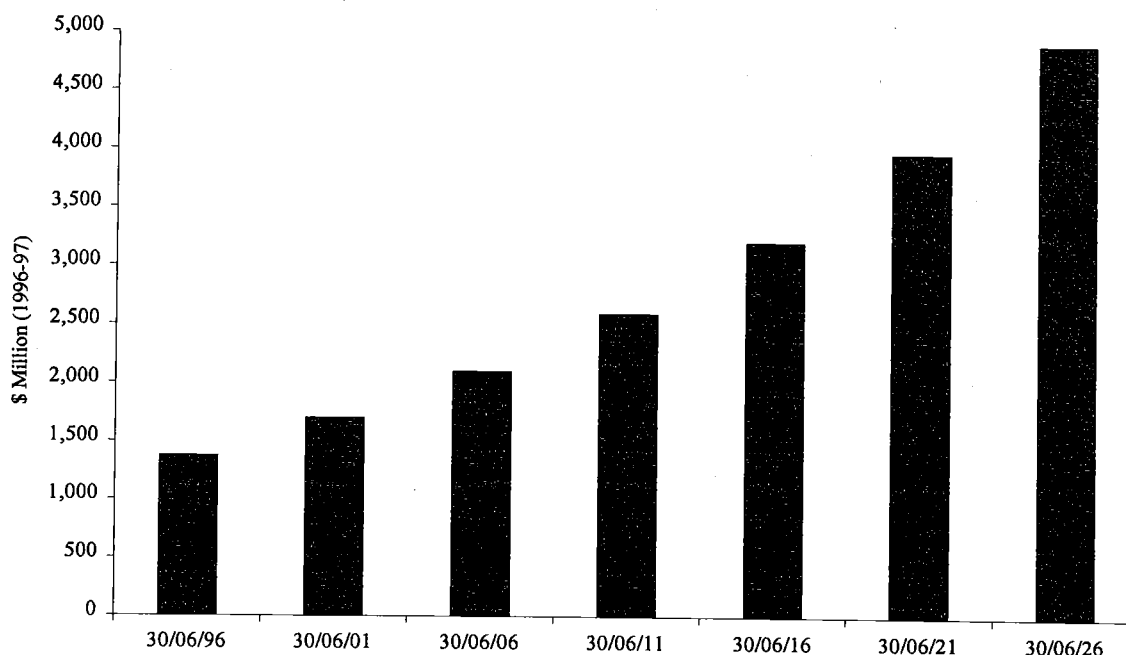
¹³ Department of Treasury and Finance Submission, page 6

¹⁴ *Report of the Victorian Commission of Audit*, page 237

service superannuation liability of the RBF scheme will trend over time should there be no change in the existing superannuation arrangements in the Tasmanian public sector.

- 2.5.2. Chart 2.3 shows the estimated growth in the unfunded liability of the RBF scheme in real terms (or today's dollars) over the same period.

Chart 2.3 : Projected Unfunded Liability Assuming No Change to the RBF Scheme



Source: Department of Treasury and Finance Submission, Chart 3.

- 2.5.3. In real terms, the Actuary's figures suggest that the RBF unfunded liability is expected to grow from \$1.37 billion in 1996 to \$1.70 billion by the year 2001, \$2.60 billion by the year 2011 and \$4.9 billion by the year 2026.
- 2.5.4. The graph does not show, however, that by the year 2046, the unfunded superannuation liability associated with the RBF scheme will be \$11.42 billion in today's dollar terms - assuming no reform action is taken by the Government during this period. That is, these figures assume that the State allows new entrants to join the defined benefit scheme and continues to meet its on-going superannuation liability as it emerges (without making any additional funding effort from the Budget).

2.6. SUMMARY OF EVIDENCE

- 2.6.1. The following evidence was presented to the Committee during the course of the Inquiry suggesting that Tasmania has a serious unfunded superannuation liability problem:

Department of Treasury and Finance

“Treasury would argue that the magnitude of the problem confronting Tasmania is...self-evident...In the absence of any reform action, by the year 2046 Tasmania will be the only State to have a massive unfunded superannuation liability. This poor financial management of a large contingent liability would see action taken by the international credit rating agencies to “mark Tasmania down” thereby further increasing the premium we will have to pay on borrowings in the capital markets.”¹⁵

RBF Board

“The need to concentrate on the Fund’s liabilities is evident from the movement in liabilities between 1992 and 1996, which movement is based on actuarial investigations into the state and sufficiency of the Fund...urgent attention is required in a number of areas of the scheme currently not under active management and supervision, particularly in the area of the State’s unfunded liabilities.”¹⁶

Tasmanian Chamber of Commerce and Industry (TCCI)

“The unfunded liability currently exceeds \$1.2 billion and despite certain funding initiatives in 1994, the liability has increased by 38 per cent in the past three years. The haemorrhaging must stop before it becomes an intolerable burden on future generations of taxpayers...affordable funding arrangements should be put in place to ensure the progressive abolition of the unfunded liability over time.”¹⁷

- 2.6.2. The following evidence was presented to the Committee expressing a contrary opinion, namely that Tasmania is not facing an unfunded superannuation liability crisis:

¹⁵ Department of Treasury and Finance Submission, page 7-8

¹⁶ Retirement Benefits Fund Board Submission, page 97-98

¹⁷ Tasmanian Chamber of Commerce and Industry (TCCI) Submission, pages 1-2

Australian Education Union (Tasmanian Branch) (AEU)

“Hideously large figures quoted as the “unfunded liability” of the State’s superannuation schemes causes great concern among people without a detailed understanding of the funding arrangements for defined benefit schemes. Quotation of such figures also reinforces existing prejudice about the favoured treatment given to public sector employees.”¹⁸

“In fact, however, the concept of “unfunded liability” is often misused if not deliberately abused... The AEU believes that caution should be exercised in making decisions based on any assertion that there is an “unfunded liability crisis.”¹⁹

Community and Public Sector Union (CPSU)

“There are many contributing factors to the level of and growth in the unfunded liability. None of these are of employees’ making. The unfunded liability is due solely to the fact that until recently the employer has not made its employer contributions to the RBF. In most cases it has not even made provision for them. This poor practice together with the poor investment performance on provisions managed by Treasury relative to RBF, has exacerbated the problem. It is not equitable to penalise employees for the mismanagement by Government.”²⁰

Tasmanian Council of Social Services (TasCOSS)

“TasCOSS does not believe that the current State Government’s superannuation liabilities are such as to warrant any radical change in policy direction.”²¹

2.7. COMMITTEE FINDINGS

- 2.7.1. Having regard to the discussion contained in this Chapter and the weight of evidence presented during the course of the Inquiry in relation to the unfunded superannuation liability associated with public sector superannuation arrangements in Tasmania, the Committee finds that:

¹⁸ Australian Education Union (Tasmanian Branch) (AEU) Submission, page 4

¹⁹ Australian Education Union (Tasmanian Branch) (AEU) Submission, page 17

²⁰ Community and Public Sector Union Submission, page 2

²¹ Tasmanian Council of Social Services (TasCOSS) Submission, page 2

- 1) International credit rating agencies have focussed on the extent of the unfunded superannuation liabilities of the States and Territories since 1990 and the continuing public commentary and scrutiny associated with the size of the unfunded liabilities of the public sector in Australia that has occurred since that time have been major catalysts for the superannuation reform action that has been seen around the country in recent years.
- 2) Tasmania's unfunded superannuation liabilities have grown very significantly over the period 1992 to 1996 (in absolute terms, as a proportion of total budgetary outlays and as a proportion of Tasmanian GSP), such that responsible financial management dictates that reforms are put in place now that are designed to ensure that further short term real growth is constrained and that over the long term, the unfunded liability is eliminated completely.
- 3) The reasons for the estimated growth in the unfunded liability in recent times are many and varied, including:
 - a) increases in salaries and wages at a greater rate than assumed by the Actuary in 1992;
 - b) a continuation by the Government of the policy of only meeting superannuation liabilities on an emerging cost basis;
 - c) a significant increase in the liabilities associated with RBF pensioners, due to an increasing number of pensioners, improved life expectancy, allowing spouses to retain their pensions on re-marriage (in compliance with Commonwealth changes), the inclusion of anti-detriment provisions for pre 1 July 1994 members of the RBF contributory scheme and the increasing number of exits from the scheme resulting from the redundancy and early retirement programs that have been implemented by successive Tasmanian Governments;
 - d) a significant increase in resignation benefits flowing from the scheme design changes made in 1994 (largely in order to ensure compliance with Commonwealth requirements);
 - e) increases in the minimum SGC contribution rate required under Commonwealth law (from 4 per cent to 6 per cent during the period from 1992 to 1996);
 - f) limited growth in the provisions made by GBEs for their superannuation liability (given the levels that existed in 1992); and

- g) lower investment returns than were assumed by the Actuary.
- 4) The reforms introduced by the Government in 1994 reduced the State's unfunded superannuation liability compared with what it would have been in the absence of any change. They did not go far enough, however, as they were not designed specifically for this purpose. Rather, they were designed to comply with Commonwealth changes in the area of vesting and to establish a modern superannuation scheme for public sector employees.
 - 5) The unfunded liability of the RBF scheme in real (1996-97 dollar) terms will, on the basis of actuarial projections, increase to \$4.9 billion by the year 2026 in the absence of any reform action.
 - 6) There is actually little or no opportunity for the Government to address the unfunded superannuation liability in respect of past (or accrued) service without reducing member entitlements.
 - 7) Tasmania is now in the position that most of the other States found themselves in some years back and in which the Commonwealth Government now finds itself - namely, of having burgeoning growth in unfunded superannuation liabilities. This position was the catalyst for the reforms that have been implemented (or, in the case of the Commonwealth, have been announced) on the mainland.
 - 8) To take no reform action will impose a severe financial burden on future generations of Tasmanian taxpayers if, as is expected on the basis of actuarial projections, the emerging cost of benefit payments increases dramatically over time.
 - 9) Failure to introduce reforms designed to address the unfunded superannuation liability problem will result in Tasmania falling considerably behind the other States in relation to overall fiscal capacity, as the required level of superannuation expenditure over future years will significantly reduce budgetary flexibility in this State. This will occur at the same time as budgetary flexibility will be increasing dramatically in other States, as they are consciously and transparently moving to eliminate their unfunded superannuation liabilities over set time periods.
 - 10) The progressive lack of fiscal capacity in Tasmania relative to that of the other States that will result from the failure to reform public sector superannuation arrangements to eliminate the unfunded liability over time will place added pressure on the Tasmanian Government's ability to foster economic growth and employment.

- 2.7.2. Before considering the relative advantages and disadvantages of defined benefit and accumulation schemes, Chapter 3 examines the reform action taken in the other States (and announced by the Commonwealth Government) in recent years in more detail.

3. INTERSTATE DEVELOPMENTS

3.1. INTRODUCTION

- 3.1.1. As indicated in Chapter 2, the Committee heard considerable evidence that most of the mainland States had closed their defined benefit superannuation schemes and replaced them with accumulation funds for new entrants. As often occurs, none of these developments took place at the same time, nor for precisely the same reasons. Furthermore, each State introduced slightly different arrangements.
- 3.1.2. As the Committee wished to establish a general understanding of these arrangements, it obtained copies of the reports which related to these developments.
- 3.1.3. As previously discussed, the Committee also decided to visit New South Wales, Victoria and South Australia to gain first hand knowledge of the developments in those jurisdictions. The Committee wished to assess the impacts of the moves to close the defined benefit arrangements in these States and to see whether or not the relevant decision makers had had any regrets about the actions which had been taken.
- 3.1.4. The remainder of this Chapter outlines in more detail the reform actions taken by other State governments in relation to public sector superannuation in recent years and the announcement by the Commonwealth Government in late September 1997 to reform its public sector superannuation arrangements. The Committee understands that while some reform action is currently being considered by the Queensland Government, to date no public announcements have been made in this jurisdiction.

3.2. NEW SOUTH WALES

- 3.2.1. New South Wales was the first State to institute reform of public sector superannuation arrangements. The State Superannuation Scheme was closed in 1985.
- 3.2.2. The closure of the remaining major public sector defined benefit schemes was undertaken partially in response to the Commonwealth Government's decision to introduce the Superannuation Guarantee Charge (SGC)

legislation with effect from 1 July 1992, although the Government indicated that such a decision may have been unavoidable even in the short term.²²

- 3.2.3. In introducing the legislation to close the unfunded defined benefit State Authorities Superannuation Scheme (SASS) to new members, the then NSW Minister for Finance, the Hon Mr Souris, indicated that the Government had been concerned with the growing unfunded liability in the State's public sector superannuation schemes.
- 3.2.4. The SASS scheme had become the universal scheme for all public sector employees in 1988, at a time when the total unfunded superannuation liability was estimated to be around \$12 billion. The SASS scheme had replaced the partly funded State Superannuation Fund (SSF). By 1992 the total unfunded superannuation liability had been estimated to be over \$15 billion and growing at the rate of \$1.2 billion per year.²³ Of this amount, around \$2 billion represented the unfunded liability of the SASS scheme.
- 3.2.5. The then Minister for Finance indicated that the situation with respect to the SASS scheme represented a significant element of the State's total unfunded liability position. Mr Souris outlined that if the unfunded superannuation liabilities were not addressed, it could threaten NSW's AAA credit rating.
- 3.2.6. In November 1993, the NSW Legislative Assembly Select Committee upon Public Sector Superannuation Schemes presented its Report on the actions taken earlier that year by the NSW Government to close the defined benefit public sector superannuation schemes and to introduce a fully funded accumulation scheme called First State Superannuation (FSS). This Report was undertaken to confirm or otherwise the decision of the Government to close the SASS scheme.
- 3.2.7. In NSW, the *First State Superannuation Act 1992* provides superannuation coverage for employees who commenced employment with NSW Government Departments, Statutory Authorities and other public sector Agencies after 1 July 1992. This legislation does not apply to Parliamentarians or Judges, as well as other employees detailed in schedule 2 of the Act.

²² *Hansard*, Legislative Assembly (NSW), 29 October 1992, page 8356

²³ *ibid*, page 8357

3.2.8. The key features of the scheme are outlined below.

Employer contribution rate	SGC rate (currently 6%). Optional additional employer contributions may be made up to age 65.
Employer funding	Fully funded.
Crediting rate on employer contributions	Fund earning rate.
Retirement Benefit	Accrued benefit at date of retirement.
Employee contributions	Optional, employer "top up" contributions may be made up to age 65. Upon cessation of employment, entitled to receive refund of contributions plus interest.
Resignation Benefit	Accrued benefit at date of resignation (to be preserved in accordance with Commonwealth legislation). May be preserved within Fund, in which case credited with Fund earning rate.
Redundancy	Accrued benefit at date of retirement.
Death Benefit	Cost is \$5 per month - no medical entry. Cover is \$50 000 until age 34, then decreasing. Members may opt out of cover.
Ill-health benefit	As for death benefit, provided trustees agree employee is unable to work in any paid employment.

Portability

Benefits are portable. Can transfer within NSW Public Sector without affecting contributions. If leaving public sector, can transfer accrued savings to another complying scheme or leave them with First State Super.

Fund choice

Employer benefit may be made to any complying fund of employees choice - open choice.

Investment choice

Choice of 5 investment strategies is available, with default option depending upon age, ie

=> Diversified (ages 18 - 45)

=> Balanced (ages 46 - 55)

=> Capital Guaranteed (ages 56 and over)

=> High growth and 'cash plus' strategies must be specially selected.

Ability to convert lump sum

Fund can provide an allocated pension.

Administrative Costs

\$2.40 per month administrative fee.

\$20.00 for a benefit payment.

Tax status of fund

Fully taxed.

3.2.9. In introducing the revised FSS accumulation arrangements in 1992, the NSW Government basically had two objectives:

*"The Government had twin objectives: one was basically to neutralise the substantial cost of the Commonwealth's initiatives in the Superannuation Guarantee scheme which would have increased our liability by \$2.4 billion (nominal dollars) by the year 2002. That is separate and distinct from the second objective, which was basically to move to full funding over time in a manageable way within the budget context."*²⁴

3.2.10. Perhaps the key conclusion reached by the NSW Select Committee that is directly relevant to the work of this Committee is outlined below:

"In this regard, the policy option adopted by the NSW Government to close SASS and create a new fully funded scheme such as FSS appeared to the Committee to validly represent a way for the NSW Government to realistically address several major issues:

- *it met the Commonwealth mandated SG level of contributions;*
- *it fully protected the rights and benefit expectations of employees belonging to the older schemes;*
- *it curtailed the growth in unfunded liabilities in SASS;*
- *it created a mechanism whereby the overall unfunded liabilities of NSW public sector schemes would eventually be extinguished; and*
- *it provided a simple, flexible and portable scheme for new employees and those employees who had not joined SASS."*²⁵

3.2.11. In addition to setting up the FSS accumulation scheme and funding this on a pay-as-you-go basis, the NSW Government has also embarked on a funding program to make further inroads into the existing unfunded liability of public sector schemes in that State.

²⁴ *Select Committee Upon Public Sector Superannuation Schemes*, Legislative Assembly, November 1993, page 32

²⁵ *ibid*, page 32

- 3.2.12. In particular, the Committee heard evidence from NSW Treasury officers that the Government is now making additional budget contributions (over and above those required to meet benefit payments for members of the closed defined benefit schemes as and when they emerge) in order to bring forward the day upon which all schemes will be fully funded.
- 3.2.13. The Committee was told that the NSW Government is making extra contributions with a view to ensuring that the unfunded liability relating to past service disappears to zero over a 50 year period.

3.3. VICTORIA

- 3.3.1. Victoria was the next State to take reform action in relation to public sector superannuation reform. On 30 April 1993, the Report of the Victorian Commission of Audit was handed to the Victorian Premier, the Hon Jeff Kennett, MP.²⁶
- 3.3.2. In that Report the Commission found that the total unfunded liabilities of Victorian public sector superannuation schemes amounted to \$17.7 billion as at 30 June 1992. Of this amount, \$15.4 billion (or 87 per cent) related to the unfunded liabilities of the State Superannuation Fund (SSF). The Commission found that on unchanged policies, the unfunded liabilities would grow to \$27.4 billion (in 1992 prices) by the year 2013, as annual Government contributions to the SSF would rise from \$650 million in 1991-92 to \$1 600 million (in 1991-92 prices) in thirty years - an increase of 146 per cent:

"Unfunded liabilities have increased rapidly for two reasons:

- *in past years, annual superannuation outlays have been too low to pay for the benefits earned by members during the year... ; and*
- *unfunded liabilities increase, in an analogous manner, to a non-accruing loan, with the interest that should have been earned. Current high real interest rates mean that unfunded liabilities are likely to continue to increase faster than the Government's capacity to pay."*²⁷

- 3.3.3. The Commission noted that superannuation outlays had risen by 170 per cent in real terms over the decade to 1991-92, compared with a 47 per cent

²⁶ Report of the Victorian Commission of Audit, May 1993, page 227

²⁷ *ibid*, page 227

increase in total current outlays and a 35 per cent increase in current revenue and grants. As a result, superannuation outlays have increased from 3.8 per cent of current outlays in 1981-82 to 7.0 per cent in 1991-92 and from 3.7 per cent to 7.3 per cent of current revenue and grants over the same period. This led the Commission to conclude that:

*"This rapid increase in superannuation outlays is likely to constrain future Government spending in other areas...the size of the existing unfunded liabilities and the difficulty involved in funding them needs to be appreciated."*²⁸

3.3.4. In the same way as New South Wales, Victoria was crucially concerned with the likely impact of the unfunded liability growth on its credit rating. The Commission stated:

*"The Commission regards this as the fundamental superannuation problem. Victoria must be seen to be managing its unfunded liabilities as well as its debt if its credit rating is to be improved."*²⁹

3.3.5. The Commission's Report outlined the fact that to eliminate the existing unfunded past service superannuation liabilities over a 40 year period would require an annual Government contribution of \$655 million, which would need to increase each year in line with the movement in average salaries.³⁰

3.3.6. The Commission further noted that to fully fund all benefits accruing after 30 June 1992 would require an annual Government contribution of a further \$395 million (and rising in line with average salaries) if no changes were made to the benefit structure. This suggested a total annual funding requirement from the Victorian Government of \$1.050 billion to eliminating the unfunded liability over 40 years.³¹

3.3.7. The Commission made a number of key recommendations in relation to superannuation.³² These were as follows:

- the Victorian Government should aim to eliminate the existing unfunded superannuation liabilities over a period of about 40 years by making specific contributions directly from the Consolidated Fund;

²⁸ *ibid*, page 229 and 234

²⁹ *ibid*, page 235

³⁰ *ibid*, page 240

³¹ *ibid*, page 240

³² *ibid*, page 216

- existing schemes should be closed to new members, who should be provided with SGC legislation benefits as a minimum;
- the Victorian Government should explore the cash-flow implications and the net effect of any required borrowings on reducing long-term costs, by allowing both members and pensioners to exchange their pensions for lump sum payments;
- if the previous recommendation produces insufficient savings, the Government should explore reducing future service benefits for all members to the minimum required under SGC legislation; and
- Departments should meet the employer share of future service benefits directly. Superannuation costs should be reflected in program costs.

3.3.8. In response to this Report all public sector defined benefit schemes, barring the defined benefit pension schemes applicable to Parliamentarians and Judges and the defined benefit lump sum scheme for operational emergency services employees, were closed to new entrants in 1993. From 1 January 1994, the employer superannuation support for new employees was the minimum established under the Commonwealth's SGC legislation.

3.3.9. The key features of the superannuation arrangements currently applicable to the majority of new Victorian public sector employees are outlined below.

Employer contribution rate	SGC rate (currently 6%).
Employer funding	Fully funded.
Crediting rate on employer contributions	Fund earning rate.
Employee contributions	Optional.
Retirement Benefit	Accrued benefit at date of retirement.
Resignation Benefit	Accrued benefit at date of resignation (to be preserved in accordance with Commonwealth legislation).
	May be preserved within Fund, in which case

credited with Fund earning rate.

Redundancy	Accrued benefit at date of retirement.
Death Benefit	Accrued benefit at date of retirement, however, member may opt for additional death cover.
Ill-health benefit	Accrued benefit at date of retirement, however, member may opt for additional disability cover.
Fund choice	Employer benefit may be made to complying fund of employee's choice.
Investment choice	Available to all members.
Ability to convert lump sum	Fund can provide an allocated pension.
Administrative costs	Borne by members.
Tax status of fund	Fully taxed

3.3.10. The Committee heard evidence from officers of the Victorian Treasury to the effect that the Victorian Government is making additional budget contributions over and above those required to meet benefit payments in respect of the schemes for hospital and emergency services. At this point the Government is not making additional budget contributions to the principal scheme, the State Superannuation Fund.

3.3.11. The Committee was told that on the basis of current policy, the Victorian Government expects the unfunded liability of its principal scheme, the State Superannuation Fund to be reduced to zero by the year 2047 - a 50 year period.

3.3.12. The Victorian Government has executed a number of other reforms designed to address its unfunded superannuation liabilities and believes it now has those liabilities under control.

- 3.3.13. In 1997 a project was commenced to strategically review the operation of public sector superannuation in Victoria. This review will include future management of unfunded liabilities.

3.4. SOUTH AUSTRALIA

- 3.4.1. The Report of the South Australian Commission of Audit, entitled "*Charting the Way Forward*", was completed in April 1994. The unfunded superannuation liability of the South Australian Government was one of the issues covered in that Report.
- 3.4.2. The Report indicated that as at 30 June 1993 the South Australian Government's unfunded superannuation liability was estimated to be \$4.406 billion. Furthermore, the Commission found that this liability was projected to more than double in real terms by the year 2021 should no reform action be taken by the Government.³³

*"These projections are presented to illustrate the potential increase in the Government's liability. The first assumption made in analysing these schemes is that no funding is provided by the Government to match the liability other than meeting benefit costs as they emerge... The reasons for producing the projections in this way is to demonstrate the need to develop and implement strategies to fund the Government's superannuation liability to prevent the liability growing in the way shown."*³⁴

- 3.4.3. The Commission went on to make the following important observation:

*"It must of course be understood that the increase in the Government's liability over the years to 2021 is not an amount which must be paid immediately by the Government but rather will be required to be met over a period of many years. If this liability were not funded, it would result in future taxpayers having to bear an inequitable share of the burden for this liability compared to current taxpayers."*³⁵

- 3.4.4. The Commission made a number of general recommendations.³⁶ These were:

³³ *Charting the Way Forward*, Report of the South Australian Commission of Audit, April 1994, page 2

³⁴ *ibid*, page 118

³⁵ *ibid*, page 120

³⁶ *ibid*, page 120

- the Government should develop a strategy to reduce and eventually eliminate the unfunded superannuation liability. Annual contributions of \$444 million from 1994-95, maintained in real value, are required to finance the unfunded liability (\$113 million more than is currently included in the Department of Treasury and Finance forward estimates);
- all existing defined benefit schemes should be closed to new members. New entrants to the Government sector should be provided with membership of the existing SGC accumulation schemes under which the minimum benefits required under Commonwealth law are provided;
- some scheme members who are entitled to a pension benefit do not currently make contributions at the rates required in the design of this benefit. Contribution rates for these employees should be increased;
- proposals should be developed by the Government to provide offers to members of the pension scheme to voluntarily transfer to the lump sum or SGC schemes. In addition, members should immediately be given the right to commute 100 per cent of their pension benefit to a lump sum. Actuarial evaluation of the effects of these structural changes on the Government's projected superannuation liability will be required;
- the retrenchment benefit for pension scheme members should be removed from the Superannuation Act. A person who is retrenched (at any age) should be entitled to benefits based on those accrued; and
- the Government should review the current superannuation administration and investment arrangements with a view to determining whether there would be benefits in creating a single superannuation board with responsibility for scheme administration and investment; and to remove legislative restrictions on the powers of investment of the South Australian Superannuation Fund Investment Trust (SASFIT).

3.4.5. Arising from this Report the South Australian Government accepted that all new employees would join their Superannuation Guarantee arrangement, established under the *Superannuation (Benefit Scheme) Act 1992*, unless they elect to join the voluntary South Australian Superannuation Scheme, called the Triple S Scheme, which was established under the *Southern State Superannuation Act 1994*.

3.4.6. The former scheme was introduced on 1 July 1992 to coincide with the introduction of the Commonwealth's Superannuation Guarantee scheme. The Triple S scheme was introduced for those employees who wish to make their own superannuation contributions. Under this scheme, the level of employer superannuation support, although based on the SG arrangements,

varies according to the level of employee contributions. The situation with regard to the scheme established under the *Superannuation (Benefit Scheme) Act 1992* is as follows:

Employer contribution rate	SGC rate (currently 6%).
Employer funding	Fully funded.
Crediting rate on employer contributions	10 year bond rate of the SA Government Financing Authority.
Employee contributions	Not applicable (must join Triple S scheme).
Retirement Benefit	Accrued benefit at date of retirement.
Resignation Benefit	Accrued benefit at date of resignation (to be preserved in accordance with Commonwealth legislation) May be preserved within Fund, in which case credited with Fund earning rate.
Redundancy	Accrued benefit at date of redundancy.
Death Benefit	Balance of account, plus the full insured benefit up to age 60 (at applicable SGC rate). Cost of 0.3% deducted from account. Insurance benefit in respect of future service not available if a workers' compensation benefit is being received. Insurance not available if over the age of 60 years.
Ill-health benefit	Balance of account, plus the full insured benefit up to age 60 (at applicable SGC rate). No medical required. Cost of 0.3% deducted from account. Insurance benefit in respect of future service not available if a workers' compensation benefit is being received. Insurance not available if over the age of 55 years.

Fund choice	Not presently available.
Investment choice	Not presently available.
Ability to convert lump sum	No options available.
Administrative costs	Deducted annually from account. For active members the maximum charge is \$26 per annum, and for members with an accrued benefit less than \$1 000, the lesser of \$25 or half the interest earnings.
Tax status of fund	Untaxed fund.
<p>3.4.7. The situation with regard to the Triple S scheme is a little different, as highlighted below.</p>	
Employer contribution rate	<p>If employee contributes at 4% or below: SGC.</p> <p>If employee contributes at 4.5% or more: 9% till 2002 then 10%.</p> <p>Executives on contracts can salary sacrifice amounts greater than 10% of salary.</p>
Employer funding	Fully funded.
Crediting rate on employer contributions	Earning rate of fund. Guaranteed to be at least CPI + 4% over membership of fund.
Employee contributions	May contribute between 1% and 10% (may change contribution rate annually).
Retirement Benefit	Accrued benefit at date of retirement.

Resignation Benefit	Accrued benefit at date of resignation (to be preserved in accordance with Commonwealth legislation). May be preserved within Fund, in which case credited with Fund earning rate.
Redundancy	Accrued benefit at date of redundancy.
Death Benefit	Balance of account, plus 5% of salary for years up to age 60. Minimum benefit is \$20,000. Cost of 0.3% deducted from employer component of account. Future service component not available if receive a workers' compensation benefit. Not available if over the age of 60 years. Increased Death cover available, but must undertake medical.
Ill-health benefit	Balance of account, plus the 5% of salary for years up to age 60. Minimum benefit is \$20,000. No medical required. Cost of 0.3% deducted from employer component of account. Future service component not available if receive a workers' compensation benefit. Not available if over the age of 55 years. Increased Disability Cover available, but must undertake medical.
Fund choice	Not presently available.
Investment choice	Not presently available.
Ability to convert lump sum	No options available.
Administrative costs	Deducted annually from account. For active members the maximum charge is \$40 per annum, and for members with an accrued benefit less than \$1 000, the lesser of \$40 or half the interest earnings.
Tax status of fund	Untaxed fund.

- 3.4.8. The Committee heard evidence from officers of the South Australian Department of Treasury and Finance to the effect that the South Australian Government is now making additional budget contributions (over and above those required to meet benefit payments for members of the closed defined benefit schemes as and when they emerge) in order to bring forward the day upon which all schemes will be fully funded.
- 3.4.9. The Committee was told that the South Australian Government is making extra contributions with a view to ensuring that the unfunded liability relating to past service disappears to zero over a 30 year period. At present, the two new schemes described above are fully funded.

3.5. WESTERN AUSTRALIA

- 3.5.1. The issue of public sector superannuation reform was addressed by the Report of the Independent Commission to Review Public Sector Finances, which published its "*Agenda for Reform*" in August 1993.
- 3.5.2. In that Report, the Commission found that as at 30 June 1992 the State had unfunded superannuation liabilities of \$4.4 billion. The Report noted that this figure had increased from \$3.7 billion over the four years to 1 July 1992. This represented a 19 per cent increase, or an annual average growth of around \$175 million.³⁷
- 3.5.3. In its summary on superannuation, the Commission noted that there is a conflict between the Government Employees Superannuation Board's (GESB) role as an adviser to the government and its position as the sole provider of superannuation management services. The recommendations made by the Commission were as follows:³⁸
- full concurrent funding should begin when the State's financial position permits contributions to be made without recourse to borrowings;
 - further actuarial assessments be undertaken to confirm the emerging obligations and the scope for progressive implementation of full concurrent funding;
 - the Government explore the savings that could be achieved by providing a lump sum alternative to existing pension entitlements;

³⁷ *Report of the Independent Commission to Review Public Sector Finances, Western Australia, August 1993, Volume 2, pages xvii*

³⁸ *ibid*, pages xvii-xviii

- the lump sum contributory scheme be closed to new members and the non-contributory lump sum scheme be continued to provide the benefits required by SGC legislation;
- opportunities for savings by contracting out all or part of the GESB's fund administration functions be investigated;
- the establishment of a consultative board of investment advice should be investigated;
- the proportion of funds under external management should be significantly increased;
- the State's superannuation arrangements should be subject to periodic independent review and independent advice should be obtained before implementing changes which affect the costs to the State; and
- if superannuation benefits are provided on a concurrently funded accumulation basis, private sector competition with the GESB should be allowed.

3.5.4. In the Commission's Report it also detailed the gross superannuation payments from the Consolidated Fund since 1985.³⁹ At that time superannuation represented 1.8 per cent of Consolidated Fund expenditure. By the year ended 30 June 1992 this figure had grown to 5.1 per cent of Consolidated Fund expenditure. These figures are comparable with the Tasmanian situation (see Chapter 2).

3.5.5. The Commission also noted that the international credit rating agency Standard and Poors had compared the unfunded liabilities of the various States by showing the unfunded superannuation liabilities on a per capita basis as well as on a percentage of GSP basis. The figures, as outlined in the Commission's Report, as at 30 June 1992 were as follows:⁴⁰

³⁹ *ibid*, page 103

⁴⁰ *ibid*, page 104

**Table 3.1 : Unfunded Superannuation Liabilities:
Ratio Measures - Interstate Comparisons at 30 June 1992**

State	Per capita (\$)	% of GSP
Queensland	0	0.0
New South Wales	2,348	10.3
Western Australia	2,694	11.3
Tasmania	2,208	12.7
South Australia	2,398	12.3
Victoria	4,054	17.7

Source: Report of the Independent Commission to Review Public Sector Finances, Western Australia, August 1993, page 104.

- 3.5.6. This table is illustrative, as it provides a basis of comparison between the States. It also demonstrates that Queensland is in the fortunate situation of having no public sector superannuation liabilities, a legacy of having fully funded superannuation schemes.
- 3.5.7. In examining the Report from Western Australia, the Committee noted that in Tasmania's case the ratio of unfunded superannuation liabilities to Gross State Product as at 30 June 1996 is estimated to have increased to 13.47 per cent (see Chapter 2).
- 3.5.8. The contributory defined benefit lump sum scheme was closed to new entrants at the end of December 1995. As a consequence, all new public sector employees in Western Australia automatically become members of West State Super.
- 3.5.9. West State Super is the scheme established under the provisions of the *Government Employees Superannuation Act 1987*. It is this scheme into which compulsory SGC employer superannuation contributions are made.
- 3.5.10. Membership of West State Super is automatic for all Government employees, except those who are members of either of the Pension scheme or the Contributory (lump sum) scheme or have the SG obligation paid to another fund. The Pension scheme was closed to new members in August 1986. The defined benefit lump sum scheme was established in 1987, with most members transferring into that scheme from the Pension scheme. That scheme was closed to new entrants in 1995.

3.5.11. West State Super is an accumulation scheme, the main features of which are as follows.

Employer contribution rate	SGC rate (currently 6%).
Employer funding	Partially funded (Statutory authorities).
Crediting rate on employer contributions	CPI + 2%.
Employee contributions	Optional.
Retirement Benefit	Accrued benefit at date of retirement.
Resignation Benefit	Accrued benefit at date of resignation (to be preserved in accordance with Commonwealth legislation). May be preserved within Fund, in which case credited with Fund earning rate.
Redundancy	Accrued benefit preserved at date of redundancy.
Death Benefit	Balance of account, plus the full insured benefit up to age 60.
Ill-health benefit	<u>Total and permanent incapacity:</u> Balance of account, plus the full insured benefit up to age 60 (at applicable SGC rate). No medical required. Actuarially determined cost deducted from account. <u>Partial and permanent incapacity:</u>

As above, except insurance benefit will be lower and based upon employee's future earning capacity.

Fund choice	For voluntary employee contributions only.
Investment choice	Not available.
Ability to convert lump sum	Not available (no provision for an allocated pension).
Administrative costs	Monthly administrative fee and benefit payment fee.
Tax status of fund	Untaxed fund.

3.6. QUEENSLAND

- 3.6.1. The Queensland Government is currently undertaking a review of superannuation arrangements for Queensland State public sector employees. The Queensland Government has no unfunded superannuation liabilities and, as such, is considering the appropriateness of the current structure of superannuation arrangements offered.
- 3.6.2. The co-ordinating Review Committee includes the Under Treasurer, the Public Service Commissioner and the Executive Director of the Queensland Government Superannuation Office. The aims of the Committee are to:
- address the needs and expectations of members and employers;
 - advance equity between employees in terms of superannuation; and
 - provide flexible superannuation arrangements which enhance enterprise bargaining outcomes.
- 3.6.3. The Review Committee is suggesting that from 1 July 1998 all permanent Budget-funded employees will be offered a choice of:
- superannuation guarantee contributions (currently 6%) in an accumulation fund; or

- 3% member contribution matched by a 12% employer contribution; or
- QSuper (existing defined benefit plan) with current contribution levels as follows -

Member Contribution	Defined Benefit
2%	10.5%
3%	14%
4%	17.5%
5%	21%

- 3.6.4. The Review Committee is also suggesting that investment choice be offered in the accumulation scheme.

3.7. COMMONWEALTH GOVERNMENT

- 3.7.1. On 25 September 1997, the Commonwealth Government announced reforms to its Public Sector Superannuation (PSS) scheme along the same lines as those discussed above. In particular, the Commonwealth Government announced the following changes:

- a) from 1 July 1998 all new Commonwealth employees will have their employer superannuation paid into their chosen complying superannuation fund or Retirement Savings Account (RSA) instead of the PSS scheme;
- b) the PSS scheme will be closed to new members from that date;
- c) from 1 July 2000 members of the PSS scheme and the closed Commonwealth Superannuation Scheme (the CSS) will have the choice of remaining in their scheme, with no change to existing arrangements, or to cease membership and have future employer superannuation paid to a complying superannuation fund or RSA of their choice;
- d) there will be no change to superannuation funding provided to agencies but employer contributions for new employees and employees who leave the CSS or PSS will be able to be negotiated with the employer (to either provide the same level of funding as currently exists or to

direct part of this funding to increased remuneration) subject to a safety net (minimum) of the Superannuation Guarantee rate; and

- e) employees will be able to choose superannuation arrangements that have regard to their own circumstances and risk preferences. For example, an employee close to retirement might wish to safeguard their superannuation savings by choosing to have superannuation contributions paid to a RSA in order to have a low risk investment but with low returns.

3.7.2. Indications are that the reasons why the Commonwealth announced such reforms are exactly those that prompted both the current Inquiry and, as discussed above, the reforms already introduced in other States. These reasons include:

- a) attempting to bring under control the Government's massive unfunded liability problem;
- b) providing members with fully funded and, therefore, fully portable superannuation benefits;
- c) providing increased flexibility and choice in remuneration, in order to recognise that the traditional public sector career-for-life is rapidly disappearing and employees have a much more mobile career path (including stints in the private sector); and
- d) bringing public sector arrangements more into line with those that represent the accepted community standard in the private sector.

3.7.3. The precise detail associated with the Commonwealth announcements is being developed by the Commonwealth Department of Finance, which will report to the Government with recommendations later in 1997. Implementation details will be available once the Government has considered the report, although it has been indicated that legislation to give effect to the announced reforms will be introduced into Parliament later in the year.

3.8. SUMMARY OF EVIDENCE

3.8.1. In relation to the issue of whether Tasmania should necessarily take the same action as that which has been introduced in four other jurisdictions (and under consideration by the Queensland Government and recently announced by the Commonwealth Government), the Community and Public Sector Union (CPSU) presented the following evidence to the Committee:

*"...[the action already taken in a number of other jurisdictions to close off their defined benefit schemes to new entrants]... is largely irrelevant to this Committee's considerations. Each scheme stands alone and the actions of one do not impact on the others. Such action in other jurisdictions has been taken largely for ideological reasons which is not the basis for this review."*⁴¹

- 3.8.2. By way of a contrary opinion, the Tasmanian Chamber of Commerce and Industry (TCCI) made the following observation to the Committee during the Inquiry:

*"The fact that virtually all other States have already moved in the direction we are advocating is a compelling argument as to why Tasmania should make a similar move without delay."*⁴²

3.9. COMMITTEE FINDINGS

- 3.9.1. Having regard to the discussion contained in this Chapter and the evidence presented during the course of the Inquiry in relation to the recent reforms introduced to public sector superannuation arrangements (or under consideration) in other jurisdictions, the Committee finds that:

- 1) Although the reforms introduced by other States are not identical, they were largely designed to address the same issues that currently confront Tasmania in relation to the management of its unfunded superannuation liabilities.
- 2) Other State governments have introduced reforms in response to:
 - a) concerns by the international credit rating agencies over the growth in unfunded liabilities and their role in overall State financial management;
 - b) cost pressures that exist within State budgets;
 - c) the desire to place public sector superannuation arrangements on the same footing as private sector superannuation arrangements and to thereby introduce greater flexibility for employees;

⁴¹ Community and Public Sector Union Submission, page 3

⁴² Tasmanian Chamber of Commerce and Industry Submission, page 2

- d) the desire to cap the growth in unfunded liabilities and to eliminate them over time through a targeted funding program;
 - e) the deficiencies associated with defined benefit schemes;
 - f) the desire to impose financial discipline, as a full funding approach ensures that changes to superannuation are properly factored into decision making (rather than the associated costs being able to be deferred); and
 - g) the desire to improve inter-generational equity, such that the burden of funding superannuation costs is spread more evenly between current and future taxpayers.
- 3) The reasons outlined above largely also represent the rationale for both the Queensland Government actively considering the introduction of similar reforms and for the Commonwealth Government recently announcing major reforms to public sector superannuation arrangements.
- 4) The key features of the superannuation reforms introduced in the other States in recent years include:
- a) existing defined benefit schemes have been closed off to new entrants from a particular date;
 - b) fully funded accumulation schemes have been established for new public sector employees;
 - c) with the exception of the changes made in Victoria, the rights and entitlements of existing members of the defined benefit schemes at the time of closure have been preserved;
 - d) additional contributions have been made by the respective Governments in order to address the growth in past service unfunded liabilities - with either 30 or 50 year targets being set for their elimination over time;
 - e) the level of employer contribution to the new accumulation schemes is that required under the Commonwealth's SGC requirements (although in the optional South Australian Triple S scheme, members will be able to receive up to 10 per cent from the employer after 2002 if they contribute at the rate of 4.5 per cent or more);
 - f) member contributions to the accumulation schemes are optional rather than compulsory; and

- g) allocated pensions are provided as an alternative to straight lump sum benefits in the new accumulation schemes.
- 5) The actions taken (or under consideration) by mainland jurisdictions are directly relevant to the issues the Committee is required to address under the Terms of Reference for the current Inquiry. Tasmania is part of a Federation of States which directly compete with each other for investment, for funds from the Commonwealth Government, for population and the like. It would therefore be irresponsible to completely ignore the reforms introduced to public sector superannuation elsewhere throughout Australia and the reasons that prompted respective governments to announce or introduce (or consider introducing) those reforms.
- 3.9.2. The Committee is conscious that in most other jurisdictions, defined benefit superannuation schemes have either been closed in recent years, or careful consideration is being given to closing them, in favour of accumulation schemes. Chapter 4 therefore considers the relative advantages and disadvantages of these two main forms of scheme design.

4. DEFINED BENEFIT AND ACCUMULATION SCHEMES

4.1. BACKGROUND

- 4.1.1. The issue of scheme design was considered in the 1993 Review of Superannuation Arrangements in the Tasmanian Public Sector. At that time it was decided that a defined benefit scheme was the most appropriate mechanism to provide superannuation coverage to permanent employees of the Tasmanian public sector:

*"In summary... the Review Group believes that the advantages to employees which derive from defined benefit plans are of considerable significance and should not be readily discarded... the Review Group recommends that any new scheme introduced in the Tasmanian public sector should at least provide for retirement benefits to be defined rather than accumulated entitlements."*⁴³

- 4.1.2. The 1993 Review Group recommended, however, that an accumulation style scheme be established for non-contributory employees. The following observations were made in relation to the application of defined benefit arrangements to temporary and casual employees:

"... the full defining of benefits would inevitably produce a number of practical problems in respect of certain classes of employees that will need to be addressed. For example, there would be difficulties associated with operating a fully defined benefit scheme in respect of non-salaried employees due to the fact that their work patterns and salary levels are traditionally less stable than those of permanent employees..."

*The State Government's Consulting Actuary indicated that to effectively provide defined benefits, the membership of a fund needed to have stability in weekly hours worked, salary structures, longer term employment prospects and so on..."*⁴⁴

- 4.1.3. The 1993 Review Group therefore recognised that there were necessary pre-conditions for defined benefit schemes to operate effectively. In this regard, the Committee notes that the environment in which superannuation is provided

⁴³ Review of Superannuation Arrangements in the Tasmanian Public Sector, 1993, page 161

⁴⁴ *ibid*, page 162

has changed dramatically over the years since 1992 (when the decisions were taken by the 1993 Review Group and the Report was actually written).

- 4.1.4. The advent of major reforms in mainland States (and active consideration of these in other jurisdictions), enterprise bargaining, greater worker mobility, more flexible working arrangements, issues of equity between members, salary packaging, increased Commonwealth regulatory and taxation complexity and the introduction of the Commonwealth's superannuation surcharge are all developments that impact on the decision in relation to scheme design and suggest that some re-examination of the issue is necessary.
- 4.1.5. Currently, permanent employees of the Tasmanian public sector are required to join the RBF defined benefit contributory scheme pursuant to the *Retirement Benefits Act 1993* and the *Retirement Benefits Regulations 1994*. Temporary and casual employees become members of the RBF non-contributory accumulation scheme. As at 30 June 1997, the contributory scheme had 18 113 member accounts while the non-contributory scheme had 23 638 member accounts.
- 4.1.6. Scheme design is a fundamental issue requiring consideration by the Committee in addressing the Terms of Reference. While Chapter 3 discussed the strong recent trend in other jurisdictions away from defined benefit schemes toward accumulation arrangements, the majority of submissions received by the Committee addressed, either directly or indirectly, the Terms of Reference in relation to accumulation and defined benefit schemes. In general, the submissions presented consistent views regarding the characteristics of defined benefit and accumulation schemes and the inherent advantages and disadvantages of both types of schemes.
- 4.1.7. This Chapter outlines the attributes of both defined benefit and accumulation schemes and evaluates the advantages and disadvantages of both types of scheme. The Committee then considers which alternative represents the most appropriate arrangement for future employees in the Tasmanian public sector, having regard to the superannuation needs of both employees and employers, and makes a number of recommendations in this regard.

4.2. DEFINED BENEFIT SCHEMES

- 4.2.1. The benefits accruing on resignation, retirement or death in a defined benefit scheme are predetermined according to a formula established in the scheme rules or regulations. The end benefit is usually determined with regard to the member's length of contributory service, level of contribution and average salary preceding retirement, resignation or death.

- 4.2.2. As end benefits are guaranteed under such a scheme, the employer's contribution will vary over time depending on such factors as the earning rate on investments, interest rates, salary growth and manipulation, the actuarial assumptions adopted for valuation purposes, inflation, the level of administration costs and the life expectancy of pensioners.
- 4.2.3. Employer contributions in a defined benefit scheme are therefore uncertain and are determined by actuarial investigation at regular intervals. The employer contribution, determined by the Actuary, is dependent on a number of exogenous factors (as outlined earlier).
- 4.2.4. Accordingly, it is always very difficult for an employer to know with any certainty the exact funding position of a defined benefit scheme - the outcome at a particular point in time is always a 'best guess' by the Actuary, based on assumptions that are made in a wide range of areas. In this regard, the Committee refers to the discussion in Chapter 5 in relation to just what the new entrant contribution rate actually is for the RBF defined benefit scheme.
- 4.2.5. Defined benefit schemes produce relatively secure benefits for members. Members are able to confidently plan for retirement, as the end benefit can be estimated with some certainty and produces a standard of living in retirement that is commensurate with that applying during the later stages of the member's working life. This results from the fact that the end benefit received is directly related to the member's salary prior to retirement.
- 4.2.6. The real value of members' end benefits are also protected in a defined benefit scheme during periods of high inflation. Again, this results from the direct link between end benefit and salary growth (which should be higher in inflationary periods).
- 4.2.7. Defined benefit schemes are particularly attractive to employees with good promotional prospects, long periods of service with the one employer and relatively consistent full time permanent employment. These schemes are not necessarily as attractive, however, for employees who maintain relatively stable salary profiles during their working lives, who have relatively short periods of service and who move between full and part time and permanent and temporary employment.
- 4.2.8. Defined benefit schemes are very complex to administer and, as such, require expert advice from professionals such as actuaries, lawyers and taxation specialists. According to the ISC, defined benefit schemes are up to

40 per cent more costly to administer than accumulation schemes.⁴⁵ Similarly, defined benefit arrangements are difficult for members to understand.

4.2.9. As the employee benefit is guaranteed in a defined benefit scheme and is not dependent on investment returns achieved by the Fund, the employer effectively underwrites periods of poor investment returns through making higher employer contributions than would otherwise be the case. However, the employer benefits (through a reduction in the contribution rate) if higher than expected investment returns are achieved.

4.2.10. The real issue is whether, in an environment of rapidly increasing unfunded liabilities and in an environment in which "salary" for benefit purposes is becoming increasingly blurred, the Government has the financial ability to continue with this underwriting any longer. The Committee notes the comments made by the Department of Treasury and Finance in this regard:

*"Employers wishing to decrease their exposure to defined benefit funds have tended to do this by closing them to new members and then arranging for new employees to join accumulation funds. The Insurance and Superannuation Commission notes that the membership of defined benefit funds will therefore eventually wind down."*⁴⁶

"In a defined benefit fund, the investment risk (both upside and downside) lies with the employer, whereas in a defined contribution or accumulation scheme the risk lies with the employee. This transfer of risk to employees is the main reason why, in Treasury's view, action taken to close the RBF defined benefit scheme should be accompanied by the introduction of fund and investment choice..."

*Tasmania no longer has the financial capacity to bear the investment risk of a defined benefit scheme, at the same time as providing a benefit to new entrants that is more generous than that provided by nearly all other public sector superannuation schemes around the country... the salary exposure inherent in defined benefit schemes is something that the Government can no longer afford to accept."*⁴⁷

4.2.11. The employer is exposed to salary movement in a defined benefit scheme and bears the risk that the actual rate of salary growth may exceed that

⁴⁵ *Superfunds*, ASFA, July 1996, page 18

⁴⁶ *ISC Bulletin*, June Quarter 1996, page 24

⁴⁷ Department of Treasury and Finance Submission, page 11

assumed by the Actuary over the period for which an employer contribution rate is determined. The extent of this exposure is significant, as the end benefit relates directly to final salary and is completely unrelated to the contributions made by a member during his or her membership of the scheme.

- 4.2.12. The Actuary prepared a detailed example for the Committee to illustrate the effect of a 10 per cent salary increase (over that assumed in the normal valuation exercise) on both the employee and the employer in a defined benefit scheme. For illustration purposes it was assumed that the member was 45 years of age, with an initial salary of \$40 000 and 20 years past service. The following table outlines the effect that this salary increase would have on the vested and accrued benefit of the employee under both a defined benefit and an accumulation scheme.
- 4.2.13. The vested benefit is the resignation or early retirement benefit and the accrued benefit is the amount of money that is notionally held to cover the accrued liability.

Table 4.1 : Impact of Salary Increases

Defined Benefit	\$	Accumulation Benefit	\$
Vested benefit pre pay rise	105 848	Vested benefit pre pay rise	110 428
Vested benefit post pay rise	116 433	Vested benefit post pay rise	110 428
Increase in vested benefit	10%	Increase in vested benefit	0%
Accrued benefit pre pay rise	96 465	Accrued benefit pre pay rise	110 428
Accrued benefit post pay rise	106 112	Accrued benefit post pay rise	110 428
Increase in accrued benefit	10%	Increase in accrued benefit	0%

Source: Actuarial Report Prepared for the Joint Select Committee on Superannuation, Financial Synergy, February 1997, page 18.

- 4.2.14. As can be seen in the example above, both the vested benefit and the accrued benefit increased by the same amount as the salary increase under a defined benefit arrangement. There is a one-to-one relationship in a defined benefit scheme, given that a pay rise affects all past service as well as future service. This results in a once-off increase in the past service unfunded liability of 10 per cent for the relevant employee.
- 4.2.15. Importantly, the salary increase has no impact on either the vested or accrued benefit under an accumulation scheme. If a member receives a non-standard

salary increase in an accumulation scheme, the additional superannuation cost relates only to future service - there is absolutely no impact on the past service unfunded liability whatsoever. This factor is one of the reasons why other States have moved to close their defined benefit schemes.

4.2.16. The RBF Board, in its submission to the Committee, cites this as a major reason in favour of closing the RBF defined benefit scheme:

“The recent experience with respect to the exploitation of superannuation funds through salary manipulation supports the introduction of accumulation fund schemes.”⁴⁸

4.2.17. Defined benefit schemes were largely designed when individuals worked for one employer for the majority of their working life and are inherently inflexible. The Committee believes that they are no longer appropriate in today’s industrial relations environment, as they do not adequately cater for:

- salary packaging (including the salary sacrifice of employee benefits for tax purposes);
- broken work patterns (with employees moving in and out of the workforce for a variety of reasons);
- casual and part time employment (which now generally comprises about 25 per cent of the workforce); or
- mobile workforces.

4.2.18. The RBF Board has suggested that:

“Because defined benefit schemes lack the simplicity and flexibility of accumulation fund schemes, the modern work patterns of employees and the workplace environment of employers generally favour accumulation fund scheme design.”⁴⁹

4.2.19. The Committee heard a good deal of evidence to suggest that defined benefit schemes are inherently inequitable as between members. Each and every employee in a defined benefit scheme effectively receives a different level of effective employer support, depending on factors such as:

- gender;
- marital status;

⁴⁸ Retirement Benefits Fund Board Submission, page 46 ...

⁴⁹ *ibid*, page 43

- the age of the member at entry;
- the age of the member at exit;
- the type of benefit taken (that is, a lump sum or a pension); and
- in relation to the RBF contributory scheme, whether the member joined the fund before or after 1 July 1994 (that is, whether they benefit from the anti-detriment pension conversion factors or not).

4.2.20. The Actuary has prepared some examples for the Committee in order to highlight how the level of employer support varies in the RBF defined benefit scheme.

**Table 4.2 : Employer Support in the RBF Contributory Scheme
(Percentage of Salary)**

MODEL WITH NO ANTI-DETRIMENT (POST 1 JULY 1994 MEMBER)

Age at entry	Number of years as a contributory member				
	5	10	15	20	40
20	4.14	4.29	4.54	4.88	5.71
30	6.04	6.48	7.05	7.77	
50	13.41	12.12	10.89		

MODEL WITH ANTI-DETRIMENT 50% PENSION

Male Single

Age at entry	Number of years as a contributory member				
	5	10	15	20	40
20	8.01	7.96	7.94	7.97	6.33
30	9.99	10.07	10.18	10.3	
50	15.81	13.12	10.89		

Male Reversionary

Age at entry	Number of years as a contributory member				
	5	10	15	20	40
20	8.5	8.51	8.59	8.75	7.68
30	10.74	10.97	11.27	11.61	
50	17.94	15.27	12.73		

Female Single

Age at entry	Number of years as a contributory member				
	5	10	15	20	40
20	8.41	8.4	8.46	8.58	7.41
30	10.58	10.78	11.03	11.34	
50	17.51	14.85	12.29		

Female Reversionary

Age at entry	Number of years as a contributory member				
	5	10	15	20	40
20	8.56	8.57	8.66	8.82	7.77
30	10.82	11.05	11.36	11.72	
50	18.10	15.41	12.83		

MODEL WITH ANTI-DETRIMENT 100% PENSION**Male Single**

Age at entry	Number of years as a contributory member				
	5	10	15	20	40
20	11.89	11.62	11.35	11.06	6.96
30	13.94	13.66	13.3	12.83	
50	18.22	14.12	10.89		

Male Reversionary

Age at entry	Number of years as a contributory member				
	5	10	15	20	40
20	12.86	12.73	12.65	12.61	9.65
30	15.44	15.46	15.48	15.46	
50	22.47	18.42	14.57		

Female Single

Age at entry	Number of years as a contributory member				
	5	10	15	20	40
20	12.68	12.5	12.37	12.27	9.12
30	15.12	15.07	15.01	14.92	
50	21.62	17.57	13.69		

Female Reversionary

Age at entry	Number of years as a contributory member				
	5	10	15	20	40
20	12.98	12.85	12.78	12.75	9.82
30	15.59	15.62	15.66	15.67	
50	22.79	18.7	14.76		

Source: Actuarial Report Prepared for the Joint Select Committee on Superannuation, Financial Synergy, February 1997, Appendix C.

4.2.21. As can be seen from the examples above, the level of employer superannuation support inherent in the RBF defined benefit scheme varies from 4.14 per cent of salary to 22.79 per cent of salary. In a defined benefit scheme all members effectively receive a different level of employer superannuation support. It is clearly not appropriate that the level of employer support received by public servants should be dependent on factors such as age at entry, age at exit, gender, marital status and the type of benefit taken.

4.2.22. Public sector employees who are appointed as temporary or casual automatically become members of the RBF non-contributory scheme and receive employer support at the SGC rate. This is a further element of inequity that exists in the current scheme arrangement - these employees receive a different level of employer support than permanent employees and are prevented from joining the RBF contributory scheme until satisfying certain requirements. The RBF Board has suggested that:

*"At the present time about 45 per cent of the public sector workforce enjoy 10.8 per cent of salary employer support under the RBF contributory scheme, with the remainder enjoying the minimum 6 per cent of salary SGC contribution."*⁵⁰

4.2.23. Defined benefit schemes are difficult and expensive to administer in today's regulatory environment. The Commonwealth's *Superannuation Industry (Supervision) Act 1993* (SIS Act) is the primary instrument of regulation for Australian superannuation funds. The SIS Act is a set of minimum standards aimed at improving the prudent management of certain regulated superannuation funds. The Insurance and Superannuation Commission (ISC) is responsible for the supervision and administration of the SIS Act.

⁵⁰ *ibid*, page 44

- 4.2.24. The RBF scheme is an "exempt public sector superannuation scheme" for the purposes of the SIS Act and, as such, is not subject to the strict requirements of the legislation. However, a Heads of Government Agreement operates between the Commonwealth and the States and Territories which requires exempt public sector superannuation schemes to comply with the broad principles and spirit of the Commonwealth's retirement incomes policy.
- 4.2.25. In recent times there has been a dramatically increasing trend away from defined benefit schemes in favour of accumulation schemes. The Insurance and Superannuation Commission (ISC) indicated in the November 1996 edition of the ASFA publication *Superfunds* that just 5 per cent of private sector superannuation scheme members (an all time low figure) are in defined benefit schemes. There has been a similar shift away from defined benefit arrangements in the public sector (see Chapter 3 for evidence in this regard). Most mainland States have closed their defined benefit schemes and introduced accumulation schemes, while other jurisdictions are actively considering such changes.
- 4.2.26. The regulatory rules governing superannuation are therefore normally drafted having regard to accumulation schemes. As a result, compliance with Commonwealth legislation is becoming increasingly demanding and complex for defined benefit schemes.
- 4.2.27. The 15 per cent surcharge announced by the Commonwealth Government in the 1996-97 Budget is one example of a Commonwealth initiative that has been formulated with accumulation schemes in mind. The surcharge legislation, which has now been passed by the Commonwealth Parliament, will be extremely complex for defined benefit schemes to implement and administer. This is evidenced by the difficulties the Commonwealth had in drafting the legislation to apply to defined benefit schemes - a significant error was made that requires correction through the Parliament before the surcharge applies to defined benefit schemes.
- 4.2.28. Mr Geoff Burgess, president of the Institute of Actuaries of Australia (IAA), recently made the following comment regarding the 15 per cent surcharge:

"While defined benefit numbers have been declining for years, the final nail in the coffin appears to have been hammered in with the budget announcement of a new 15 per cent surcharge on superannuation contributions. Many in the industry believe this charge will now force employers to seriously rethink their approach to employee superannuation."

⁵¹ *Superfunds*, ASFA, November 1996, page 16

- 4.2.29. Other relevant evidence in this regard is presented below:

Department of Treasury and Finance

*"The RBF has estimated that the cost of implementing the surcharge in the first year could be as high as \$1.5 million - which will flow through to higher contributions by the Government rather than being passed on to members... which would not have occurred under a funded accumulation scheme."*⁵²

RBF Board

*"...it will be much more difficult for unfunded defined benefit schemes to administer the surcharge arrangements than for accumulation funds."*⁵³

- 4.2.30. A final issue that has been drawn to the Committee's attention is the announced Commonwealth Government policy on fund and investment choice (which is discussed in greater detail in Chapter 9). In an unfunded defined benefit scheme such as the RBF contributory scheme, it is not possible to provide members with investment choice - as the end benefits are not related to investment performance. Likewise, a fund choice policy is difficult to administer, because it is so hard for a member to know exactly what level of employer support he or she is receiving in a defined benefit scheme. This makes comparisons with alternative schemes virtually impossible for the average fund member.

4.3. ACCUMULATION SCHEMES

- 4.3.1. Accumulation schemes normally involve both the employer contributions and the member contributions (if any) being pre-determined, often as a percentage of the member's salary. Benefits are not defined - members simply receive the accumulation over time of their own (if any) and their employer's contributions, together with interest at a rate that reflects the earnings on fund assets.
- 4.3.2. Accumulation schemes are typically funded with regard to both the employer and employee contributions (if any). However, the RBF non-contributory scheme is currently an unfunded accumulation scheme - the earnings rate is therefore not that achieved on fund assets (as these do not exist), but is defined as the Commonwealth Long Term Bond Rate.

⁵² Department of Treasury and Finance Submission, page 14

⁵³ Retirement Benefits Fund Board Submission, page 47

- 4.3.3. The end benefit to employees is not guaranteed in an accumulation scheme and, in contrast to defined benefit schemes, this will vary with the earning rate on investments achieved over the period of membership of the scheme. On the basis that investment performance is paramount, any move to introduce an accumulation scheme for new public sector employees may therefore need to be accompanied by the introduction of fund choice, investment choice or both. This will ensure that the member, through the appropriate exercise of choice, is able to properly manage this issue (having regard to the individual financial circumstances of the member). This matter is discussed in greater detail in Chapter 9.
- 4.3.4. Chapter 6 of this Report also details some actuarial examples that compare the end benefit of a member of the RBF defined benefit scheme with that of a member of an accumulation scheme who makes the same personal funding effort. It is demonstrated through these examples that in the majority of instances, an accumulation scheme will provide higher end benefits for members.
- 4.3.5. The employer contribution rate is fixed and completely certain in an accumulation scheme, which is an advantage to employers. Employers are not exposed to underwriting poor investment returns and accrued (or past service) liabilities being adversely affected by rapid salary growth. This also enables the employer to accurately estimate the amount of annual contributions required and budget accordingly.
- 4.3.6. The increasing popularity of accumulation schemes can, in part, be attributed to the flexibility they offer both employees and employers. According to the ISC⁵⁴, the majority of new superannuation funds established in the last decade have been accumulation and not defined benefit schemes.
- 4.3.7. Accumulation schemes more easily accommodate modern work practices. In a funded accumulation scheme, the portability of benefits (which is particularly important having regard to the mobile nature of today's work force), is guaranteed. In addition, salary packaging is able to be achieved under accumulation schemes much more easily.
- 4.3.8. Accumulation schemes are simple to administer. For example, it is not necessary to determine what constitutes 'service' and what constitutes 'salary' for benefit calculation purposes, as is the case with defined benefit schemes. As a result, the administration costs associated with accumulation schemes are relatively cheap in comparison with defined benefit arrangements. Similarly, accumulation schemes are therefore much simpler for members to understand, as they operate on a 'bank account' concept and

⁵⁴ *Insurance and Superannuation Commission Bulletin*, June 1996, page 24

the end benefit received is directly related to the contributions made by the employer and the employee (if any) during a member's working life.

- 4.3.9. Accumulation schemes which do not mandate employee contributions allow members the flexibility to make decisions appropriate to their financial circumstances. For example, a young member may choose to channel additional payments to eliminate a mortgage and increase contributions to superannuation at a later date when financial commitments are less significant. This issue is discussed in more detail in Chapter 7.
- 4.3.10. Accumulation schemes do ensure that all employees receive exactly the same level of employer superannuation support. In this respect, the Actuary made the following comment in the work he undertook for the Committee:

*"If a uniform level of yearly employer superannuation support is desired, the accumulation design is far better placed to deliver this than a defined benefit design."*⁵⁵

- 4.3.11. Evidence has been presented to suggest that the trustees of defined benefit schemes generally pursue a more aggressive investment strategy than those of accumulation schemes. With the advent of investment and fund choice, however, there is absolutely no reason why an individual cannot actively seek higher returns in an accumulation scheme by exercising appropriate investment choices, having regard to his or her own risk profile.

4.4. SUMMARY OF EVIDENCE

- 4.4.1. The following evidence was received by the Committee on the matter of whether defined benefit or accumulation schemes are more appropriate for both employers and employees. It should be noted that the majority of the evidence favours the introduction of accumulation arrangements:

Department of Treasury and Finance

*"For all the above reasons, Treasury strongly believes that it is now appropriate that a fully funded accumulation scheme be introduced for all new employees in the public sector."*⁵⁶

⁵⁵ Actuarial Report Prepared for the Joint Select Committee on Superannuation, Financial Synergy, February 1997, page 12

⁵⁶ Department of Treasury and Finance Submission, page 15

RBF Board

*"In stable economic and employment conditions, a defined benefit scheme design is better and more appropriate both for employees and employers, particularly public sector employers. However, the present economic, regulatory, tax and workplace environments currently support the consideration by Government of the issue that the current defined benefit arrangements should be closed and that a new accumulation scheme be introduced."*⁵⁷

Tasmanian Chamber of Commerce and Industry (TCCI)

*"Defined benefit schemes have few redeeming features. Compared with accumulation schemes they are complex, inflexible and relatively expensive to administer. These shortcomings will become increasingly significant in the light of recent... (Commonwealth)... legislative changes."*⁵⁸

Jacques Martin

*"There would need to be some compelling extraordinary circumstances unique to Tasmania for it to be inappropriate for the Tasmanian Government to follow the trend established elsewhere in closing its defined benefit schemes for its employees and that the funding level be the prevailing SGC rate."*⁵⁹

SUNCORP

*"A change to an accumulation fund with a common employer contribution rate for all staff will overcome all of the above... [concerns associated with defined benefit schemes]... and should produce a significant reduction in employer costs."*⁶⁰

The Senate Select Committee (in its 21st Report)

*"The Committee is persuaded that accumulation funds are increasingly the more appropriate vehicle to receive the super guarantee"*⁶¹

⁵⁷ Retirement Benefits Fund Board Submission, page 14

⁵⁸ Tasmanian Chamber of Commerce and Industry Submission, page 1

⁵⁹ Jacques Martin Submission, page 1

⁶⁰ Suncorp Submission, page 4

⁶¹ 21st Report of the Senate Select Committee on Superannuation, *Investment of Australia's Superannuation Savings*, December 1996, paragraph 6.21

4.4.2. Again, however, contrary views were put to the Committee:

Australian Education Union (AEU)

*"The AEU believes that a defined benefit superannuation scheme is the most appropriate type of superannuation scheme for those employees whom we represent."*⁶²

Community and Public Sector Union (CPSU)

*"The extensive review of RBF undertaken in 1990-93 found no reason to change to an accumulation scheme. One style of scheme is not necessarily better or worse than the other. There is on-going debate on the merits of both. Nothing has changed since 1993 that warrants a change to the decision taken at that time."*⁶³

Tasmanian Trades and Labor Council (TTLC)

*"The TTLC considers that both defined benefit schemes and accumulation style schemes have disadvantages and advantages. We believe that the scheme for public sector employees should be the scheme that is best suited to their needs and employment patterns. The Joint Review of Public Sector Superannuation Arrangements determined that a defined benefit scheme was most suitable."*⁶⁴

4.5. COMMITTEE FINDINGS

4.5.1. Having regard to the discussion contained in this Chapter and the evidence presented during the course of the Inquiry in relation to the relative advantages and disadvantages of defined benefit and accumulation superannuation schemes, the Committee finds that:

- 1) There have been significant changes to the environment in which public sector superannuation is being provided since the 1993 Joint Review of Public Sector Superannuation Arrangements, with the following developments having an impact on the decision in relation to scheme design and suggesting that some re-examination of the issue is necessary:

⁶² Australian Education Union (Tasmanian Branch) (AEU) Submission, page 2

⁶³ Community and Public Sector Union Submission, page 2

⁶⁴ Tasmanian Trades and Labor Council (TTLC) Submission, page 2

- a) major reforms being implemented in many mainland States, under consideration by the Queensland Government and recently announced by the Commonwealth Government;
 - b) the advent of enterprise bargaining;
 - c) greater worker mobility (and a consequent desire for fully funded and portable benefits);
 - d) more flexible working arrangements;
 - e) an increasing focus on issues of equity between members;
 - f) increasing trends towards salary packaging;
 - g) increased Commonwealth regulatory and taxation complexity; and
 - h) the introduction of the Commonwealth superannuation surcharge.
- 2) The complexities, risks to employers, costs and inequities associated with defined benefit schemes have resulted in the vast majority of new superannuation funds created in the past decade being accumulation and not defined benefit schemes.
- 3) Virtually all the growth in scheme membership in both the public sector (consequent on the closure of most defined benefit schemes in other States) and the private sector has been in accumulation schemes.
- 4) In general terms, defined benefit schemes:
- a) advantage those employees with good promotional prospects and long periods of service with the one employer, but are less advantageous for employees with relatively stable salary profiles, short periods of service and high mobility;
 - b) are inherently discriminatory and inequitable as between members of the scheme;
 - c) are generally difficult for members to understand;
 - d) are difficult, complex and costly to administer due, in part, to their reliance on technical and professional expertise;
 - e) result in the employer underwriting investment risk and, therefore, involve an employer contribution that is uncertain, variable and difficult to predict;

- f) leave the employer exposed to the risk associated with non-standard salary growth (through the impact on both past and future service costs), which is of major concern in an enterprise bargaining industrial relations context;
 - g) are not flexible enough to cater for total remuneration packaging and mobile workforces;
 - h) do not involve any close link between member contributions made and the end benefits received; and
 - i) cannot cater in any way for member investment choice.
- 5) In general terms, accumulation schemes are more appropriate in today's superannuation environment than defined benefit schemes, as they better balance the overall needs of both employers and employees. Accumulation schemes:
- a) maximise equity between members of the scheme, as each member receives the same effective level of employer superannuation support;
 - b) are simple for members to understand, as they are based on a "bank account" concept and end benefits are directly related to the contributions made by both the employer and the member (if any);
 - c) result in the employee benefiting from solid investment performance, as well as them bearing the result of poor investment performance;
 - d) are relatively easy and cheap to administer;
 - e) prevent rapid salary growth affecting any accrued entitlements; and
 - f) more easily cater for broken work patterns, employee mobility and investment choice.

5. OPTIONS FOR REFORM

5.1. POSSIBLE OPTIONS

- 5.1.1. In previous Chapters, it has been demonstrated that there has been a substantial increase in the unfunded superannuation liability of Tasmanian public sector superannuation schemes in recent years. In addition, there have been significant changes in the environment in which superannuation is now delivered - for example, employees are now much more mobile than ever was the case in the past, working arrangements are increasingly flexible, there is an increasing trend towards salary packaging and there is a greater focus on issues associated with equity amongst employees.
- 5.1.2. All these factors suggest that some form of reform is required to public sector superannuation arrangements in Tasmania. In this light, the Committee examined the range of possible options for reform that were seen to exist.
- 5.1.3. After considerable discussion and debate, the Committee considered that there are five possible reform approaches. These are as follows:
- 1) do nothing, with the Government making no changes to scheme design and continuing to meet superannuation costs on an emerging basis (that is, as and when member benefits become due and payable);
 - 2) alter the existing superannuation arrangements for both current and new public sector employees;
 - 3) close off the existing RBF defined benefit contributory scheme from a nominated date (leaving current scheme members unaffected) and introduce a fully funded accumulation scheme for new entrants;
 - 4) leave the existing RBF defined benefit contributory scheme open to new members (leaving current scheme members unaffected) but ensure that each new entrant is fully funded from commencement; and
 - 5) leave the existing RBF defined benefit contributory scheme open, but provide new members with the choice of either joining that scheme or joining a fully funded accumulation scheme providing an equivalent level of employer superannuation support.
- 5.1.4. Each of these options is discussed in turn in the remainder of this Chapter.

5.2. TAKE NO REFORM ACTION

5.2.1. The Committee has already considered the nature of the unfunded superannuation liability problem in Tasmania (see Chapter 2) and concluded that, having regard to the action taken in a number of other mainland States in recent years, under consideration in Queensland and recently announced by the Commonwealth Government (see Chapter 3), it is imperative that some amendments to the current arrangements be introduced if:

- a) the cost of superannuation is to be responsibly managed over time;
- b) new employees are to be provided with access to modern superannuation arrangements which better cater for their needs in the current labour market environment; and
- c) the inequities in the level of employer superannuation support provided to different categories of employees that currently exists in the Tasmanian public sector are addressed over time.

5.2.2. In relation to costs, the Committee has already found that Tasmania's unfunded superannuation liabilities have grown very significantly over the period 1992 to 1996 (in absolute terms, as a proportion of total budgetary outlays and as a proportion of Tasmanian GSP), such that responsible financial management dictates that reforms are put in place now that are designed to ensure that further short term real growth is constrained and that over the long term the unfunded liability is eliminated completely.

5.2.3. Further, the Committee has recognised that Tasmania arguably has the least financial capacity of all the Australian States and it is crucial to consider whether, in light of the developments in public sector superannuation in the other States, it can realistically afford to be paying superannuation benefits to public sector employees that are very nearly the most generous in the country.

5.2.4. In view of both the above and the arguments already considered by the Committee in earlier Chapters concerning the relative merits of accumulation schemes and defined benefit schemes, this reform approach is not preferred by the Committee and was largely only included for the sake of completeness.

5.3. AMENDING EXISTING BENEFIT STRUCTURES

5.3.1. The second broad reform option considered by the Committee involves taking action to reduce the benefits provided in the existing RBF contributory scheme. This approach could theoretically take two forms -

either reduce the accrued benefits (that relate to past, or worked, service) of existing RBF contributory scheme members or reduce the future (or unworked) service benefits for existing employees (with these reduced benefit arrangements also applying to all new public sector employees).

- 5.3.2. In relation to the option of reducing accrued benefits for existing members, the Committee notes that while theoretically possible, such action would constitute a breach of the Heads of Government Agreement that exists which effectively binds the States and Territories to complying with the spirit of the Commonwealth's *Superannuation Industry (Supervision) Act 1993* (the SIS Act).
- 5.3.3. Recognising that unfunded public sector superannuation schemes established under State law are fundamentally different to fully funded private sector schemes established under a Trust Deed, the Commonwealth has declared certain public sector schemes to be "Exempt Public Sector Superannuation Schemes" (EPSSS) under the SIS legislation. In substitution, each State government has entered into an agreement with the Commonwealth that it will comply with the broad principles of the Commonwealth's retirement incomes policy in relation to the provision of superannuation to its employees.
- 5.3.4. The SIS Act prohibits any reduction in a member's accrued benefit unless certain specified conditions are met - including, among other things, that the member has consented to the benefit reduction, that the reduction is required for tax purposes (as will occur in relation to the new Commonwealth surcharge on high income earners) or that the Insurance and Superannuation Commissioner has consented to the reduction. A possible reduction in the benefits of existing members is discussed in Chapter 11, but the net effect of such a change (relating to altering the tax status of the RBF scheme) would be no change in a member's net of tax end benefit.
- 5.3.5. Given that none of these conditions will exist in the context of any reduction in accrued benefits for the purposes of reducing the State's unfunded superannuation liability, the Committee notes that there would be significant practical difficulties associated with the implementation of this reform approach. In any event, the Committee believes that were such a reduction to be made, notwithstanding the SIS provisions, this would fundamentally represent a breach of the employment contract between the Government and all existing public sector employees.
- 5.3.6. Current members of the RBF contributory scheme would not, under such a scenario, receive the level of superannuation support from the State which they believed they would receive upon commencing employment. This would constitute a retrospective removal of a right and entitlement and

would equate to an adverse amendment being made to the contract of employment that the Government implicitly has with all existing employees.

- 5.3.7. This issue was raised with the Committee at various stages during the inquiry. For example, the CPSU suggested that:

*"Superannuation is a core condition of employment and a component of an employee's remuneration package. Any reduction in superannuation for existing... employees is therefore a reduction in the terms and conditions of employment applicable to their position."*⁶⁵

- 5.3.8. The Auditor-General went further to suggest that with any superannuation reforms:

*"... the Government will be taking a calculated risk that employees will be unable to obtain compensating salary increases to offset the reduction in employer contributions."*⁶⁶

- 5.3.9. In relation to the possible option of reducing future benefit accrual rates in the RBF contributory scheme for existing (and therefore new) employees, the Committee notes that the circumstances that make it difficult to reduce accrued benefits do not apply. Neither the SIS Act nor the Heads of Government Agreement would in any way prevent the reduction of future accruals, nor would such action have the associated industrial relations difficulties (as there is obviously no employment contract between the Government and a new employee who is yet to commence employment).

- 5.3.10. The 1993 Report of the Victorian Commission of Audit suggested that:

*"There is no impediment to reducing future service benefits for new employees. For existing employees, such action is not disallowed by any superannuation legislation..."*⁶⁷

- 5.3.11. For example, it would be possible for the Government to guarantee the accrued benefits of members up until a changeover date (say 1 July 1998) and from that point in time simply provide benefits in line with the Commonwealth's SGC minimum requirements. Such an option would have the attraction of providing all employees with the same level of employer superannuation support from the same point in time. This option was, in part, canvassed by the Police Association of Tasmania:

⁶⁵ Community and Public Sector Union Submission, page 1

⁶⁶ Auditor General's Submission, page 3

⁶⁷ Report of the Victorian Commission of Audit, May 1993, page 238

*"Once a scheme design has been agreed for new entrants, consideration can be given to the desirability of modifying the accruing benefits of existing employees to make them more compatible with those for new employees."*⁶⁸

- 5.3.12. The Committee notes that the Retirement Benefits Fund Board submission actually recommended that there be changes made to the future benefit accruals of current employees. In this regard, it argued that a sunset clause be introduced in the RBF legislation to abolish the anti-detriment pension conversion factor of 12, which is available to persons who were RBF contributors prior to 30 June 1994, at some point in the future:

*"This growth is capable of being capped by the introduction of sunset clauses in the RBF legislation with respect to the continuation of anti-detriment clauses for... [pre]... 1 July 1994 contributors into the future."*⁶⁹

- 5.3.13. While such action is certainly possible, the Committee notes that the Terms of Reference effectively only require the Committee to consider what the superannuation arrangements should be for new employees, new Parliamentarians, new Judges, new legal office holders and new senior contract employees in the State Service. The announcement by the Premier, the Hon Tony Rundle, in the 1996-97 Budget Speech is also relevant in this regard. In particular, the Premier indicated that:

*"Were such arrangements put in place in Tasmania... [similar to those introduced in Victoria some years back]... it would be done on a no detriment basis for existing employees. It would only apply to future employees."*⁷⁰

- 5.3.14. In similar fashion to reducing the accrued benefits of existing members, it is likely to be regarded as unreasonable to fundamentally alter the superannuation arrangements of public sector employees who have commenced their employment in a defined benefit scheme with a reasonably predictable resignation or retirement benefit.
- 5.3.15. The Committee noted that this does not imply that the scheme design rules can never be altered, just that the fundamental principles should remain reasonably static. This was also the view put to the Committee in a number of submissions. For example, the Tasmanian Chamber of Commerce and Industry (TCCI) suggested that:

⁶⁸ Police Association of Tasmania Submission, page 1

⁶⁹ Retirement Benefits Fund Board Submission, page 99 ...

⁷⁰ 1996-97 Tasmanian Budget Speech, page 11

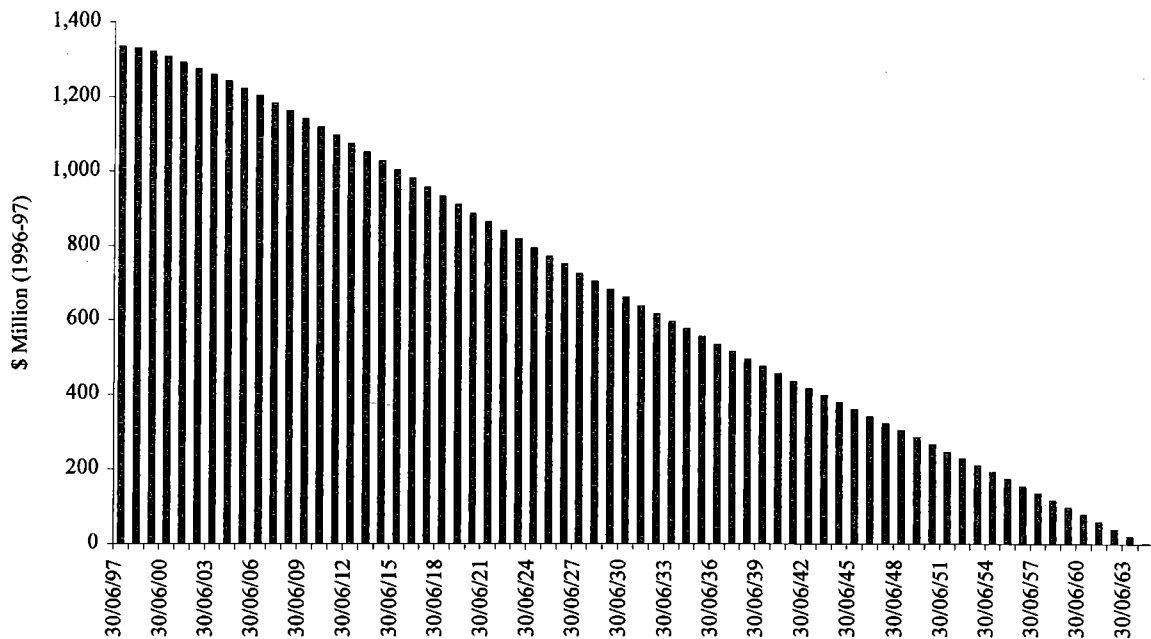
“Entitlements for existing employees must be protected or alternative arrangements put in place so that existing members are not disadvantaged.”⁷¹

5.4. CLOSE OFF THE RBF DEFINED BENEFIT SCHEME AND INTRODUCE NEW ARRANGEMENTS FOR NEW EMPLOYEES

- 5.4.1. The third reform option considered by the Committee is that which the Terms of Reference require the Committee to specifically address - in particular, whether the RBF contributory scheme should be closed off to new entrants, with them being provided with a fully funded SGC benefit via a new accumulation scheme.
- 5.4.2. In Chapter 4 the Committee considered issues associated with both defined benefit and accumulation schemes and concluded that an accumulation scheme design best addresses the needs of both employers and employees in the current superannuation environment. The fundamental issue to be addressed in this section of the Report, therefore, is whether closing the defined benefit RBF contributory scheme to new entrants and providing them with fully funded benefits is a desirable reform approach in light of the State's unfunded liability problem.
- 5.4.3. The Committee has already noted in Chapter 3 the evidence suggesting that this reform approach has been adopted in most other Australian States in recent years (and is under consideration by the Queensland Government and has recently been announced by the Commonwealth Government). In order to assess the impact on the unfunded superannuation liability over time of closing the RBF contributory scheme off to new members and providing them with a fully funded benefit, the Committee requested the Actuary to prepare projections of how the unfunded liability associated with the RBF scheme would move over time under this scenario.
- 5.4.4. Chart 5.1 below demonstrates the results of the Actuary's projections.

⁷¹ Tasmanian Chamber of Commerce and Industry Submission, page 2

Chart 5.1 : Projected Unfunded Liability With the RBF Scheme Closed to New Members



Source: Department of Treasury and Finance Submission, Chart 4.

5.4.5. The unfunded liability will continue to increase in nominal terms for many years, as:

- existing scheme members actually work their future service;
- they benefit from continued salary growth;
- they move onto pension benefits (many of which will be at a heavily subsidised rate, due to the anti-detriment provisions that apply to pre-1 July 1994 members);
- existing pensioners receive indexation increases over time; and
- many of the currently unfunded preserved benefits will continue to grow in line with the scheme's indexation arrangements.

5.4.6. The Committee notes, however, that it is evident from Chart 5.1 above that the unfunded liability associated with a closed RBF scheme reduces in real terms as the stock of existing members and pensioners diminishes over time. According to the Department of Treasury and Finance:

"The Actuary has projected that by the year 2019, the liability will have reduced to \$885 million (in today's dollars) and will disappear completely by the year 2064. This would leave Tasmania

in a similar financial position to all other States - no contingent superannuation liability on the balance sheet after about 67 years."⁷²

- 5.4.7. The Committee felt that it was illustrative to compare the unfunded liability in the year 2046 under both an open and closed scheme arrangement. In Chapter 2 it was demonstrated that with no change to current arrangements, the unfunded superannuation liability associated with the RBF scheme will, based on actuarial projections, be \$11.42 billion (in today's dollar terms) in that year. Under the closed scheme scenario presented above, the liability will be under \$500 million in the year 2046 (in 1996-97 prices).
- 5.4.8. While adopting a reform approach of closing the RBF contributory scheme off to new entrants and fully funding the benefits of these employees will obviously involve additional contributory effort from the Government in future years, the comparisons presented above clearly demonstrate that there are significant financial gains for the State from the making of those additional contributions over the short term. The cash flow implications of this reform approach are discussed in greater detail in Chapter 10 of this Report.
- 5.4.9. The Committee notes that closing the RBF defined benefit scheme off to new entrants will not reduce the unfunded liability *per se*. Rather, it represents a reform approach that is designed to ensure that future Governments do not add to the unfunded liability by not funding the accruing superannuation benefits of new public sector employees. Provided the liability is effectively capped in real terms from a particular date through closure of the scheme to new entrants and the benefits of these employees are fully funded from commencement in an alternative scheme, the passage of time will ensure that the liability disappears gradually.
- 5.4.10. Evidence was presented in Chapter 3 that, in addition to taking this reform approach, other States have also embarked upon a funding program over and above that required to meet both emerging unfunded benefits and the full superannuation cost of new employees. This is designed to accelerate the abolition of the liability - to bring forward the ultimate day on which the unfunded liability reaches zero.
- 5.4.11. The Committee's view is that given the significant economic and financial difficulties confronting the State, such an approach is currently not feasible in Tasmania. While clearly desirable, eliminating the unfunded liability associated with the RBF scheme as quickly as possible is less important in the context of the Committee's deliberations than recommending reform

⁷² Department of Treasury and Finance Submission, page 16

action that effectively prevents Governments from adding to the unfunded liability through the failure to fund the accruing benefits of new employees.

- 5.4.12. The Committee's strong view is that the Government's first priority should be to implement reforms to ensure that the benefits of new employees are fully funded. The Committee believes that only when this has been achieved should the Government consider, in the context of its economic and financial circumstances, taking action to more proactively eliminate the past service unfunded liability that exists. The Department of Treasury and Finance made the following observation in this regard:

*"Given Tasmania's overall budgetary position, any attempt to wipe off the unfunded past service liability proactively through additional budget allocations (that is, other than letting it decline naturally over time) would involve considerable financial pain... and it is arguable that there are more important budgetary imperatives in this State than eliminating the unfunded liability quickly."*⁷³

- 5.4.13. In the event that the RBF contributory scheme was to be closed off to new entrants and new employees were to receive fully funded benefits through the RBF non-contributory scheme, the Committee saw that there would be some merit in the Government "back-funding" that scheme. This could occur (for on-budget employees) through the transfer of an amount (estimated to be in the order of \$50 million as at 30 June 1996) from the Superannuation Provision Account in the Special Deposits and Trust Fund to the RBF Board.
- 5.4.14. If this was also to be required of those GBEs and other organisations with employees in the RBF non-contributory scheme, the Government would be in a position of having an unfunded past service liability for State Servants only in respect of the closed RBF contributory scheme (which would decline gradually over time). Further, both existing and new members of the non-contributory scheme would then be in a position of having fully funded superannuation support.
- 5.4.15. Based on the most recent actuarial reports in relation to GBEs and other off-budget Agencies and organisations (as at 30 June 1995), those bodies could be expected to have to contribute an amount in the order of \$6.5 million into the Fund. The Committee did not believe that this would impose a significant financial burden, as the amount would be spread over some 20 GBEs and 13 other statutory authorities and organisations.

⁷³ *ibid*, page 17

5.5. LEAVE THE RBF SCHEME OPEN AND FULLY FUND THE BENEFITS OF NEW MEMBERS

5.5.1. The fourth reform option considered by the Committee is to keep the RBF contributory scheme open under the current arrangements and increase funding levels to ensure that all new entrants into that scheme are fully funded from the commencement of their employment.

5.5.2. The Committee spent some considerable time debating the merits of this type of reform approach relative to option 3 outlined in section 5.4 above. In essence, the assessment of this proposal has both a cost dimension and a scheme design dimension.

5.5.3. In relation to the cost issue, the real difference between this approach and option 3 is the relative cost of providing superannuation benefits to a new entrant. To be in a position to assess this issue, actuaries generally calculate what is called the "new entrant contribution rate" for a defined benefit scheme. The Department of Treasury and Finance has suggested that this cost:

*"... is the amount of employer contribution each year which, if set aside and invested, would accumulate to an amount sufficient to exactly fund the end benefit of that new entrant."*⁷⁴

5.5.4. This is very much an "average" concept, which is based on a very wide range of assumptions about future salary growth, future investment returns of the fund, administration costs, taxation liabilities and inflation. It will only represent the actual cost of a new entrant to the employer as a percentage of salary in the event that every one of the Actuary's assumptions are actually borne out by experience over the working life of the new entrant. This clearly never happens which, to some extent, calls into question the usefulness of focussing attention on what is, in effect, a theoretical concept.

5.5.5. The analysis presented in Chapter 4 in relation to new entrant costs for the RBF contributory scheme illustrates the point that focussing on a single "average" new entrant contribution rate for a defined benefit scheme is misleading - the issue of just what each employee costs the Government is a much more complex one that is impossible to capture in a single per cent of salary contribution rate.

5.5.6. This aspect notwithstanding, the Committee received evidence from the RBF Board that the new entrant cost in the RBF contributory scheme is in the order of 10.8 per cent of salary for a member that joined the scheme prior to

⁷⁴ Department of Treasury and Finance Submission, page 18

1 July 1994 (and who therefore benefits from the anti-detriment pension conversion factor)⁷⁵. In respect of a post 1 July 1994 member (who will not benefit from the expensive anti-detriment arrangements), the Committee has heard evidence that the new entrant cost is somewhere in the range of 8.6 to 9.5 per cent of salary - with the actual figure depending on the assumptions made about the cost structures of the RBF scheme.

5.5.7. The RBF Board's initial submission suggested that the new entrant cost was 8.6 per cent of salary, based on administration costs equal to 0.5 per cent of salaries (which broadly represents the industry average, involving a majority of relatively cheaper accumulation schemes).

5.5.8. However, the Department of Treasury and Finance submitted to the Committee that the administration costs for the RBF contributory scheme are much higher as a percentage of salaries:

"The Actuary has estimated that if the actual costs of administration incurred by the RBF Board are included, the figure is actually 1.2 per cent of salary per member... the Committee has already heard evidence that the RBF Board has a high administration charge - particularly from SUNCORP, whose offer to take over the administration of the scheme must lie in their belief that they could administer the scheme more efficiently and therefore make a profit.

*If the actual costs of running the RBF scheme are included in the actuarial calculations, the cost to the employer of a new entrant into the RBF defined benefit scheme becomes 9.5 per cent of salary."*⁷⁶

5.5.9. In a supplementary submission to the Committee, the RBF Board re-visited the issue of its cost structure and suggested that the administration costs associated with the contributory scheme are actually in the range of 0.54 - 0.92 per cent of salary:

"The Board maintains that administration costs for the RBF defined benefit scheme are approximately 0.54 per cent of salary per member, when trustee and investment management costs are excluded (which is normal industry practice). When the additional

⁷⁵ Retirement Benefits Fund Board Submission, page 44

⁷⁶ *ibid*, page 20

trustee costs and investment management costs are included, the approximate costs are 0.92 per cent of salary per member.”⁷⁷

- 5.5.10. The Committee is aware, however, that in generating these figures, the Board has excluded certain costs on the basis that they represent financial subsidies being provided by the Board to the Government. In particular, the Board has excluded the following costs from the 1996-97 estimate of administration costs:
- \$600 000, representing the full cost of administering the compulsory preservation requirements (with no recovery being made from emerging benefits);
 - \$340 000, representing the cost of providing life time pensions on a fortnightly basis without an administration charge; and
 - \$354 000, representing the cost of the non-contributory scheme, with no recovery other than the potential for a future increase in employer contributions to the contributory scheme.
- 5.5.11. The Committee believes, however, that while there might be arguments to suggest that the RBF Board should not properly bear these costs, the fact of the matter is that the RBF Board is currently meeting these costs. While these cross-subsidies will be required to be removed (under the National Competition Policy principles) once the RBF Board commences competing with private sector funds under the Commonwealth’s announced policy on fund choice, these costs currently form part of the costs of operation for the RBF Board.
- 5.5.12. On this basis, the Committee accepts that the administration costs associated with the current RBF defined benefit contributory scheme are significantly higher than 0.5 per cent of salary per member.
- 5.5.13. In light of the above, the impact on the Government’s unfunded liability of keeping the RBF defined benefit scheme open to new entrants can be determined. A new entrant in a fully funded SGC scheme will have a cost to the employer of 9 per cent of salary once the SGC is fully implemented in the year 2002. The Committee notes that on the basis that the cost of a new entrant into the contributory scheme is greater than 9 per cent of salary, leaving the RBF contributory scheme open will impose additional superannuation costs on the State relative to option 3 above - closing the scheme off . This option is therefore contrary to the focus of the current

⁷⁷ RBF Board, Supplementary Submission to the Parliamentary Joint Select Committee on Superannuation, page 7

inquiry, which is to recommend reform which will contain the growth in the State's unfunded liability and to reduce it to zero over time.

- 5.5.14. In addition, the State would forego the short term savings associated with the progression of the SGC from the current level of 6 per cent of salary to 9 per cent over the next five years.
- 5.5.15. As indicated earlier, the new entrant contribution rate in defined benefit schemes is based on a series of assumptions. In particular, it assumes a standard salary and promotional scale. The Committee understands that if public servants, either in total or in specific groups (such as teachers, police or nurses) receive pay rises in excess of those assumed due to successful moves to national parity or from enterprise bargaining agreements, then the State's unfunded liability under an open RBF contributory scheme scenario will increase proportionally.
- 5.5.16. The Actuary has indicated to the Committee in the various reports prepared during the course of the inquiry that if, for example, a group of public sector employees are successful with a bid for a 15 per cent salary increase, this will add something in the order of 9.5 per cent (15 per cent less the standard assumption of 5.5 per cent salary growth) directly onto the past service unfunded liability in respect of those scheme members. The Department of Treasury and Finance made the following comment in this respect:

"There is a one-to-one relationship in a defined benefit scheme, given that a pay rise affects all past service as well as future service. This outcome does not occur in an accumulation scheme. If a member receives a non-standard salary increase in these schemes, the additional superannuation cost only relates to future service - which is, in Treasury's view, one of the reasons why other States have moved to close their defined benefit schemes.

*There is simply too great an exposure for the employer in a defined benefit scheme, where the end benefit relates to final salary and is completely unrelated to the contributions made by a member during his or her membership of the scheme."*⁷⁸

- 5.5.17. The other cost element relevant to this reform option is that by leaving the RBF defined benefit scheme open to new entrants, the State remains exposed to increasing future unfunded pension liabilities. As individuals are living longer, the employer will bear any costs associated with the payment of pensions from a defined benefit scheme for periods beyond those assumed in the determination of the actuarial pension conversion factors.

⁷⁸ *ibid*, page 8

- 5.5.18. It was suggested earlier in this section that the assessment of this reform proposal has both a cost dimension and a scheme design dimension. In relation to the scheme design dimension, even if the cost of providing superannuation support to new employees was identical under the RBF defined benefit scheme and any new arrangement (that is, if the cost was equivalent to 9 per cent of salary, or the mid-point between the Treasury and the initial RBF Board estimates) there are many other reasons why option 3 might be preferable to the current option.
- 5.5.19. The Committee found in Chapter 4 that defined benefit schemes, such as the RBF contributory scheme, are no longer appropriate in the current economic, regulatory, tax and workplace environments. They are inflexible in the manner that they cater for member needs (such as salary packaging), there is no portability of benefits due to their generally unfunded nature (which is nearly a mandatory requirement, given the increased mobility of the workforce in today's environment), they principally benefit those employees with strong career prospects, they are inherently inequitable as between members, they are costly to administer and they are difficult for the average member to comprehend.
- 5.5.20. Further, evidence is presented in Chapter 6 that demonstrates that in many instances, public sector employees will be significantly advantaged from receiving an SGC employer superannuation benefit under an accumulation scheme than the current employer contribution implicit under the RBF defined benefit contributory scheme.
- 5.5.21. The evidence presented in Chapter 3 that Queensland is considering closing their defined benefit arrangement is compelling. The cost of providing superannuation is not an issue for that State, given that its unfunded superannuation liability is zero. This suggests that there must be significant non-financial advantages from closing defined benefit arrangements and substituting alternative accumulation arrangements.
- 5.5.22. In summary, while leaving the RBF contributory scheme open to new members and fully funding their superannuation from their time of commencement would represent a step forward relative to current arrangements, the overall cost and residual financial exposure to the State would be higher under such a reform approach and members would remain covered by superannuation scheme arrangements that are anachronistic.
- 5.5.23. In Chapter 10 of this Report, more detailed cash flow information is presented in relation to both option 3 and option 4. In that Chapter, the Committee presents actuarial advice on the additional cash costs to the State associated with proceeding with option 4.

5.6. LEAVE THE RBF SCHEME OPEN, BUT ALLOW NEW MEMBERS TO EITHER JOIN THAT SCHEME OR A FUNDED ACCUMULATION SCHEME PROVIDING AN EQUIVALENT LEVEL OF EMPLOYER SUPPORT

- 5.6.1. The final reform approach considered by the Committee is to leave the existing RBF defined benefit contributory scheme open, but provide new members with the choice of either joining that scheme or joining a fully funded accumulation scheme that provides an equivalent level of employer superannuation support.
- 5.6.2. Many of the arguments against this particular alternative approach have been covered earlier in this Report. In summary, this option involves continuing the choice of joining a defined benefit scheme, although the Committee has already determined that defined benefit schemes are less appropriate in the current labour market environment than accumulation schemes (see Chapter 4). For those new members that do elect to join the RBF scheme, they would also cost the State more than would be the case if they joined an accumulation scheme that involved an employer contribution equivalent to the maximum SGC rate.
- 5.6.3. Leaving the RBF defined benefit scheme open would expose the State to:
- a) the impact of salary increases in excess of that assumed by the Actuary (as past service, as well as future service, is adversely affected by salary growth in a defined benefit scheme); and
 - b) the impact of increasing future unfunded pension liabilities, in an environment where people are living longer.
- 5.6.4. A further undesirable feature of this particular option is that it would be possible for members to “select against the State”. That is, new employees would be able to exercise the choice of either joining the RBF scheme or joining an accumulation scheme, whichever is assessed as providing the highest benefit to the individual (having regard to their particular circumstances).
- 5.6.5. For example, actuarial evidence is presented in Chapter 6 suggesting that those new employees who join prior to about age 45 years will receive a superior benefit under an accumulation scheme design (even with an employer contribution equal to the SGC rate), while those joining later on in their working life will receive a higher end benefit under the defined benefit arrangements. This is because of the reduced ability of older new entrants to benefit from the compounding of employer contributions and interest.

- 5.6.6. The Committee felt that providing new employees with the choice envisaged under this reform option would therefore result in the highest overall superannuation cost to the State. Having regard to this fact, and the additional reasons outlined above, the Committee did not favour this approach.

5.7. SUMMARY OF EVIDENCE

- 5.7.1. The reform approach embodied in option 3 (closing the RBF scheme off to new entrants and providing new entrants with fully funded accumulation benefits) was favoured by the Department of Treasury and Finance, the RBF Board, the Tasmanian Chamber of Commerce and Industry, Jacques Martin and SUNCORP. The following evidence is referenced in this regard:

Department of Treasury and Finance

*"Treasury strongly believes that the Committee should recommend that the existing RBF defined benefit scheme should be closed to new entrants on and from a nominated date (probably 30 June 1998)... The current past service unfunded liability has accrued over the past 60 years and Treasury believes that eliminating it over a further 60 or so years is not unreasonable."*⁷⁹

RBF Board

*"In stable economic and employment conditions, a defined benefit scheme design is better and more appropriate both for employees and employers, particularly public sector employers. However, the present economic, regulatory, tax and workplace environments currently support the consideration by Government of the issue that the current defined benefit arrangements should be closed and that a new accumulation scheme be introduced."*⁸⁰

Tasmanian Chamber of Commerce and Industry (TCCI)

"Recommendation 1:

*All existing defined benefit schemes for public servants, politicians and judges be closed to new entrants immediately."*⁸¹

⁷⁹ *ibid*, pages 10 and 17

⁸⁰ Retirement Benefits Fund Board Submission, page 14

⁸¹ Tasmanian Chamber of Commerce and Industry Submission, page 1

“Recommendation 3:

Affordable funding arrangements should be put in place to ensure the progressive abolition of the unfunded liability over time.”⁸²

Jacques Martin

“There would need to be some compelling extraordinary circumstances unique to Tasmania for it to be inappropriate for the Tasmanian Government to follow the trend established elsewhere in closing its defined benefit schemes for its employees and that the funding level be the prevailing SGC rate.”⁸³

“The question of containing the growth of unfunded liabilities is a complex one, but it can be said with certainty that by introducing arrangements paralleling those in other jurisdictions such an outcome will be achieved.”⁸⁴

SUNCORP

“A change to an accumulation fund with a common employer contribution rate for all staff will overcome all of the above... [concerns associated with defined benefit schemes]... and should produce a significant reduction in employer costs.”⁸⁵

- 5.7.2. Employee organisations that presented evidence to the Committee do not accept that closing the RBF scheme off and fully funding the benefits of new entrants is necessary. In particular, the Community and Public Sector Union (CPSU) suggested that:

“The CPSU does not support the closure of the defined benefits schemes, nor does it believe there is sufficient justification to take such action... The CPSU supports a review of the other schemes to bring them into line with RBF... The closure of the RBF would have a significant detrimental impact in the Tasmanian economy and the incomes and standard of living of employees in their retirement.”⁸⁶

- 5.7.3. The Tasmanian Trades and Labor Council (TTLC) opposed this particular course, with the TTLC also actually suggesting that the Committee should

⁸² *ibid*, page 2

⁸³ Jacques Martin Submission, page 1

⁸⁴ *ibid*, page 2

⁸⁵ Suncorp Submission, page 4

⁸⁶ Community and Public Sector Union (CPSU) Submission, page 1

make recommendations to provide greater access to the RBF contributory scheme for temporary and casual employees:

"We believe that the RBF contributory scheme should not be closed to new entrants and that it should be more accessible to temporary and casual employees..."⁸⁷

5.7.4. Likewise, the Australian Education Union (Tasmania Branch) has suggested that:

"The AEU believes that the RBF contributory scheme should not be closed to new entrants. While the scheme has its faults, it is a sophisticated and creative solution to the superannuation question confronting State governments."⁸⁸

5.8. COMMITTEE FINDINGS

5.8.1. Having regard to the discussion contained in this Chapter and the weight of evidence presented during the course of the Inquiry in relation to the issue of the most appropriate reform option to be pursued in addressing the State's unfunded liability problem, the Committee finds that:

- 1) The option of the Government making no changes to scheme design and continuing to meet superannuation costs on an emerging basis (that is, as and when member benefits become due and payable) is not a feasible approach to adopt, when responsible financial management dictates that reforms to public sector superannuation arrangements in this State are urgently required.
- 2) Reform is largely required to address the significant increase in unfunded superannuation liabilities that has occurred in recent times, to ensure that Tasmania remains fiscally competitive with other States over time (as nearly all mainland States have closed their defined benefit schemes and are embarking on funding programs to eliminate their unfunded liabilities over fixed periods) and to ensure that Tasmania provides appropriate superannuation arrangements for its new employees, having regard to issues such as the advent of enterprise bargaining, greater worker mobility, more flexible working arrangements and the increasing trend towards salary packaging.

⁸⁷ Tasmanian Trades and Labor Council (TTLC) Submission, page 1

⁸⁸ Australian Education Union (Tasmania Branch) (AEU) Submission, page 12

- 3) Having regard to the situation throughout the rest of Australia, it is no longer financially feasible to keep the unfunded and costly RBF defined benefit contributory scheme open to new employees.
- 4) There are significant legal and industrial relations difficulties associated with the reform options of either reducing the accrued benefits (that relate to past, or worked, service) of existing RBF contributory scheme members or reducing the future (or unworked) service benefits for existing employees (with these reduced benefit arrangements also applying to all new public sector employees).
- 5) Notwithstanding any such difficulties, the Committee does not believe that any reform action should be adopted that impacts on the past or future benefit rights and entitlements of existing RBF scheme members - that is, the Committee very strongly holds the view that any compulsory changes made to current arrangements should be prospective and relate only to the superannuation arrangements established for new employees.
- 6) The option of leaving the RBF defined benefit scheme open to new members but fully funding their superannuation from commencement will result in an increased overall superannuation cost to the State.
- 7) An open defined benefit scheme leaves the State financially exposed to both non-standard salary growth (which impacts adversely on both the past and future service liabilities of defined benefit scheme members) and increased pension liabilities (in the face of increasing life expectancy).
- 8) Even if a defined benefit scheme had an employer cost exactly equal to that in an alternative accumulation scheme (that is, if there was no financial exposure or cost dimension associated with the decision whether or not to close the defined benefit scheme), the optimal approach would be to close the defined benefit scheme for new employees.
- 9) The preferred approach that achieves a number of the overall reform objectives concurrently is to close the defined benefit scheme and introduce a fully funded accumulation arrangement for new members. This will both ensure that new members will receive portable superannuation benefits that better suit their increased mobility and improve equity amongst all public sector employees over time.
- 10) While such a reform will not reduce the unfunded liability *per se*, it will ensure that the real liability is capped and that, provided new employees receive fully funded benefits from day one, the liability will

gradually decline over a period of 60 or so years (consistent with the time taken for the existing liability to accrue).

- 11) Attempts to eliminate the unfunded liability through the Government making additional funding effort over and above that required to meet emerging benefits and to fund the accruing benefits of new entrants is not feasible in Tasmania, given the State's overall budgetary position.
- 12) Such attempts would also call into question issues relating to inter-generational equity, as current Tasmanian taxpayers would effectively be required to part fund the past service liability as well as fully fund the accruing liability of new employees.
- 13) Rather than reducing equity amongst public sector employees, the preferred reform option will ensure that an ever increasing number of public sector employees will receive exactly the same level of employer superannuation support as part of their overall remuneration (as discussed in some detail elsewhere in this Report).
- 14) There would be some merit in the Government "back-funding" the RBF non-contributory scheme under this reform scenario. This could occur (for on-budget employees) through the transfer of an amount (estimated to be in the order of \$50 million as at 30 June 1996) from the Superannuation Provision Account in the Special Deposits and Trust Fund to the RBF Board.
- 15) If this was also to be required of those GBEs and other organisations with employees in the RBF non-contributory scheme, the Government would be in a position of having an unfunded past service liability for State Servants only in respect of the closed RBF contributory scheme (which would decline gradually over time). Further, both existing and new members of the non-contributory scheme would then be in a position of having fully funded superannuation support.

5.9. COMMITTEE RECOMMENDATIONS

- 5.9.1. In light of the Committee's findings in relation to the appropriate superannuation reform option to pursue in this State, the Committee makes the following recommendations:

Recommendation 1:

No reforms should adversely impact on the past or future benefit rights and entitlements of existing RBF scheme members - that is, any changes made to current arrangements should be prospective and relate only to the superannuation arrangements established for new employees.

Recommendation 2:

The RBF contributory scheme should be closed off to new members on and from 1 July 1998.

Recommendation 3:

Employer superannuation support for new public sector employees in Tasmania should be provided through an accumulation scheme.

Recommendation 4:

Members of the RBF non-contributory scheme as at the date of closure should retain their current right to elect to join the RBF defined benefit scheme at the end of the two year qualifying period. At the end of that qualifying period, members of the RBF non-contributory scheme must make a binding and non-reversible election to either join the RBF contributory scheme or remain a non-contributory member.

Recommendation 5:

Married women who are currently exempt from joining the RBF contributory scheme, or who exempted themselves under existing or past legislation, should retain their present right to elect to join the closed RBF contributory scheme at any time during the remainder of their public service career.

Recommendation 6:

The current RBF non-contributory scheme should be the public sector scheme (with necessary modifications relating to funding and taxation treatment) through which accumulation-based benefits should be provided to new entrants.

Recommendation 7:

From 1 July 1998, the Government should be required by law to fully fund the accruing superannuation liabilities for all new employees and for all existing members of the RBF non-contributory scheme.

Recommendation 8:

The RBF non-contributory scheme should be a fully taxed scheme for the purposes of Commonwealth law.

Recommendation 9:

Such funds standing to the credit of the Superannuation Provision Account that are required (estimated to be in the order of \$50 million as at 30 June 1996), should be paid by the Government to the RBF Board to eliminate the current unfunded liability associated with the RBF non-contributory scheme.

Recommendation 10:

The same principle as outlined in Recommendation 9 should also apply to Government Business Enterprises and other off-budget employers who have provisions within their accounts relating to non-contributory employees.

- 5.9.2. The following Chapter looks at the issue of what level of employer superannuation support should be provided to new entrants in the proposed fully funded and fully taxed accumulation scheme.

6. EMPLOYER SUPERANNUATION CONTRIBUTIONS

6.1. BACKGROUND

6.1.1. In previous Chapters, the Committee has, *inter alia*, recommended that:

- the RBF contributory defined benefit scheme be closed to new entrants from 1 July 1998;
- a fully funded accumulation scheme is the most appropriate scheme to establish for new public sector employees in Tasmania, be they employed on a permanent, temporary or casual basis; and
- the RBF non-contributory scheme should be the vehicle for providing newly appointed public sector employees with an accumulation benefit.

6.1.2. These recommendations address a number of key aspects of the Committee's Terms of Reference. The issue to be considered in this Chapter is whether new public sector employees should, in the revised RBF non-contributory accumulation scheme, receive:

*"... employer funded superannuation support in line with the requirements of the Commonwealth Superannuation Guarantee (Administration) Act 1992."*⁸⁹

6.1.3. Prior to considering the various options for the level of employer contributions for new employees, the following section outlines very briefly what the Commonwealth's minimum superannuation requirements are.

6.2. THE COMMONWEALTH'S SUPERANNUATION GUARANTEE CHARGE

6.2.1. The Commonwealth's *Superannuation Guarantee (Administration) Act 1992* (the SG Act) governs the payment of employer superannuation contributions. The SG Act provides the minimum level of superannuation contributions an employer is required to make in respect of an employee, expressed as a percentage of an employee's salary. The current requirement is for large employers to contribute 6 per cent of salary, with this level of support increasing over time in accordance with the following table.

⁸⁹ Joint Select Committee on Superannuation, Terms of Reference, (b)

Table 6.1 : SGC Employer Contribution Rates

Period	Prescribed rate of contribution as a % of salary (large employers)
1 July 1992 to 31 Dec 1992	4
1 Jan 1993 to 30 June 1995	5
1 July 1995 to 30 June 1998	6
1 July 1998 to 30 June 2000	7
1 July 2000 to 30 June 2002	8
1 July 2002 onwards	9

Source: *Superannuation Guarantee (Administration) Act 1992*, Section 21(4).

6.3. ADEQUACY OF END BENEFITS

6.3.1. The Committee believes that there are three options for an appropriate level of employer contribution rate, namely:

- employer contributions at the minimum SGC rate which, given that the Committee has recommended in Chapter 5 that the RBF contributory scheme be closed from 1 July 1998, should be regarded as being 7 per cent, with this increasing to 8 per cent after two years and to 9 per cent from 1 July 2002;
- employer contributions at the maximum SGC rate (9 per cent) from 1 July 1998 onwards; or
- employer contributions at some rate higher than the maximum SGC rate from 1 July 1998.

6.3.2. Each of those options was extensively considered by the Committee. The key issues for the Committee in making a decision on the appropriate level of employer contributions were:

- the cost to Government (which flows from the Terms of Reference, as the main focus of the Inquiry is concerned with recommendations to enable the State to manage its unfunded superannuation liability in a responsible manner); and
- the adequacy of end benefits to members.

- 6.3.3. In relation to the cost to Government, this issue is explored in more detail later in this Chapter when the options are discussed.
- 6.3.4. With respect to the adequacy of end benefits for members, the Committee recognises that this is fundamentally a matter for Commonwealth Government retirement incomes policy. The Committee noted that a number of recent Commonwealth Government superannuation initiatives are relevant to interpreting the direction of retirement incomes policy in this regard.
- 6.3.5. Firstly, in the 1997-98 Budget the Commonwealth Government abandoned previous proposals to require compulsory member contributions (timed to start at 1 per cent of salary in 1997-98 and increasing to 3 per cent by the year 1999-2000) which would then attract Commonwealth co-contributions by way of further superannuation support (subject to an incomes test).
- 6.3.6. Secondly, the Commonwealth Government also announced an increase in the salary threshold under which employees will be permitted, with the approval of the employer, to elect to receive no employer superannuation support at all, but rather receive the SGC contribution in the form of higher salary. These elections will be possible at the commencement of employment or once annually thereafter. An employee who has opted out of receiving employer SGC contributions may opt back into superannuation at any time.
- 6.3.7. The Committee also noted that employers in the private sector generally are not concerned with providing their wages employees with a benefit that is "adequate" in a retirement incomes sense. Private sector employers have acted in such a manner as to suggest that contributions at the SGC rate are now the community and industrial standard and believe that the Commonwealth will concern itself with the issue of adequacy, having regard to overall national saving and the likely drain on welfare payments from an ageing population.
- 6.3.8. Notwithstanding the above, the issue of benefit adequacy should be considered and the Committee heard a deal of evidence in this regard. The issue is a complicated one, as exactly what is an adequate benefit depends on individual circumstances. For example, a member on a lower salary may have less scope to cut discretionary income in retirement while, on the other hand, he or she might also receive "top up" social security entitlements. As the Actuary has noted:

*"Sex, marital status, dependants, other financial resources etc all contribute to the requirements for post retirement income."*⁹⁰

⁹⁰ Actuarial Advice Report Prepared for the Joint Select Committee on Superannuation, Financial Synergy, February 1997, page 17

- 6.3.9. Many organisations that presented evidence to the Committee suggested that, in percentage-of-member-salary terms, the level of superannuation contributions required to provide an adequate income for a member in retirement was in the order of 12-15 per cent over the member's working life.
- 6.3.10. This evidence, which is outlined below, is used as a benchmark for assessing the adequacy of benefits under each of the employer contribution rate options outlined in paragraph 6.3.1.

6.4. EMPLOYER CONTRIBUTIONS AT THE SGC RATE

- 6.4.1. In relation to the issue of employer contribution rates, the Committee noted the actuarial advice detailed in Chapter 5 that a new entrant into the RBF contributory scheme receives employer support in excess of 9 per cent of salary (and closer to 9.5 per cent of salary, depending on the assumptions made about the administration costs associated with the RBF scheme). This is not markedly dissimilar to the maximum SGC benefit of 9 per cent of salary.
- 6.4.2. Further, as indicated in Chapter 2, the SGC level of employer contribution is currently provided in respect of 23 638 accounts (as at 30 June 1997) in the RBF non-contributory scheme. The Committee notes that this implies that nearly 60 per cent of all existing public sector employees in Tasmania are already in receipt of SGC superannuation support only. This is important, as it sets the 'benchmark' level for the debate over an appropriate amount of employer superannuation support for new entrants.
- 6.4.3. As indicated earlier, this is the employer contribution rate level that the Committee's Terms of Reference require it to assess. In undertaking this assessment, the Committee was mindful of the fact (outlined in Chapter 3) that in all of the States which have introduced accumulation funds for new employees in recent years, only South Australia provides a higher level of employer superannuation support than that required under the SG Act (and only in an optional scheme which has, since its introduction in 1992, attracted only about 2 000 members because of the requirement for employees to make contributions of their own)⁹¹.
- 6.4.4. As discussed in Chapter 3, new employees in South Australia have the choice of either joining the State Superannuation Benefit Scheme (SSBS), receiving SGC employer contributions and making no employee

⁹¹ *Hansard*, Joint Select Committee discussions with South Australian Treasury officials, February 1997, page

contributions, or joining the "Triple S" scheme and receiving employer superannuation support equal to the SGC up until 2002, and 10 per cent of salary thereafter, in exchange for making employee contributions of 4.5 per cent of salary or more.

- 6.4.5. Against this background, the Committee accepts that if employer superannuation support was fixed at 6 per cent of salary, then the accumulated end benefit (without employee contributions) would be inadequate. However, the SGC minimum is scheduled to reach 9 per cent of salary over the next five years. In the context of the working life of a post 1 July 1998 public sector employee, the fact that the level of support will be 2 percentage points below 9 per cent for two years and 1 percentage point below it for two years will, on the actuarial advice presented below, be insignificant in terms of the end benefit received.
- 6.4.6. The Committee believes that the employee should properly play a role in the generation of an "adequate" retirement benefit. For example, all members of the RBF contributory defined benefit scheme do contribute towards their ultimate benefit to the tune of a minimum of 5 per cent of salary (with many voluntarily contributing in excess of this amount). While this is compulsory, any comparison of end benefits involving the existing RBF contributory scheme and a scheme providing SGC employer benefits needs to take this fact into account.
- 6.4.7. In order to provide a basis for assessing the adequacy of employer contributions at the SGC rate, the Committee requested the Actuary to provide quantitative advice. The Actuary compared the benefit of a new entrant to the RBF contributory scheme with a new employee who commences in an accumulation scheme and receives the SGC benefit (commencing at 6 per cent of salary and rising to 9 per cent in accordance with the Commonwealth timetable).
- 6.4.8. It should be noted that as any new entrant will not, in effect, ever receive a 6 per cent employer contribution, as the new arrangements will not be in place until after 1 July 1998 when the SGC minimum increases to 7 per cent, the figures shown below actually understate the end benefit in the proposed accumulation scheme.
- 6.4.9. To ensure that an equitable comparison was made, the Actuary used consistent salary, inflation and earnings assumptions and had regard to the tax differences between the two funds. That is, account was taken of the fact that the RBF scheme is unfunded and 'untaxed', whereas the accumulation scheme would be fully funded and, therefore, a 'taxed' scheme under Commonwealth legislation. The general approach adopted by the Actuary is outlined below:

“The defined benefit arrangement is assumed to be as currently applies - that is, no contribution tax applies, the end benefit has a tax free component for member’s undeducted contributions and benefit tax applies on the residual at the rate of 16.7 per cent on the first \$86,495 and 31.7 per cent of the balance.

All service is assumed to be post 1 July 1983 and no pre 1 July 1988 funding credits have been applied. For the accumulation arrangement the contribution tax has been taken at 15 per cent while the end benefit tax is zero percent on the first \$86,495 plus 16.7 per cent of the balance.

The defined benefit results for exit ages before the age of 55 years have been reduced by the net effect of the lower crediting rate on the compulsorily preserved component in order to present a fairer comparison to the accumulation design. No after tax benefit has been shown for exits before the age of 55 because a large component/all the benefit needs to be preserved until a date of retirement after the age of 55.”⁹²

- 6.4.10. Consistent with the Committee’s view that the adequacy of end benefits should be assessed on the basis that the new employee in the accumulation scheme makes the same contribution to his or her end benefit as the new member in the RBF contributory scheme, a member contribution of 5 per cent of salary is included in both cases. In the accumulation scheme, the total contribution from both employer and employee, once the SGC reaches 9 per cent in 2002, would therefore be 14 per cent of salary.
- 6.4.11. The figures in the following tables provide a comparison of end benefits payable, at various exit ages, for members aged 25 years at entry, 35 years at entry and 45 years at entry. The benefits are calculated gross and net of taxation in real (1996-97) dollars and as a multiple of FAS(3). When comparing the end benefits payable it is necessary to have regard to the end benefit net of tax, due to the taxation differences to which the Actuary alludes above.
- 6.4.12. It should be noted that the figures presented below abstract from the costs of death and disability insurance. Advice provided by the Retirement Benefits Fund Board in its supplementary submission to the Committee suggests, however, that while insurance costs impact marginally on the dollar figures, their inclusion in the analysis does not affect the conclusions which can be

⁹² Actuarial Advice Report Prepared for the Joint Select Committee on Superannuation, Financial Synergy, February 1997, page 14

drawn regarding the relative size of the RBF defined benefit and the accumulation scheme benefit.⁹³

Table 6.2 : Adequacy of Benefits

AGE 25 ENTRY - 1996-97 DOLLARS

Exit Age	Accumulation Benefit Gross of Tax	Accumulation Benefit Net of Tax	Defined Benefit Gross of Tax	Defined Benefit Net of Tax
35	46 779	n.a.	41 232	n.a.
40	76 743	n.a.	69 986	n.a.
45	110 428	n.a.	105 848	n.a.
50	148 299	n.a.	150 331	n.a.
55	190 874	172 651	205 137	156 985
60	238 739	212 169	239 327	180 292
65	292 550	256 621	273 516	203 516

AGE 25 ENTRY - MULTIPLE OF FAS(3)

Exit Age	Accumulation Benefit Gross of Tax	Accumulation Benefit Net of Tax	Defined Benefit Gross of Tax	Defined Benefit Net of Tax
35	1.36	n.a.	1.21	n.a.
40	2.24	n.a.	2.05	n.a.
45	3.23	n.a.	3.10	n.a.
50	4.34	n.a.	4.40	n.a.
55	5.58	5.05	6.00	4.59
60	6.98	6.21	7.00	5.27
65	8.56	7.51	8.00	5.95

AGE 35 ENTRY - 1996-97 DOLLARS

Exit Age	Accumulation Benefit Gross of Tax	Accumulation Benefit Net of Tax	Defined Benefit Gross of Tax	Defined Benefit Net of Tax
45	46 779	n.a.	51 979	n.a.
50	76 743	n.a.	89 344	n.a.
55	110 428	106 211	136 758	109 976
60	148 299	137 501	170 948	133 561
65	190 874	172 651	205 137	156 985

⁹³ RBF Board, Supplementary Submission, page 7.

AGE 35 ENTRY - MULTIPLE OF FAS(3)

Exit Age	Accumulation Benefit Gross of Tax	Accumulation Benefit Net of Tax	Defined Benefit Gross of Tax	Defined Benefit Net of Tax
45	1.37	n.a.	1.52	n.a.
50	2.24	n.a.	2.61	n.a.
55	3.23	3.11	4.00	3.22
60	4.34	4.02	5.00	3.91
65	5.58	5.05	6.00	4.59

AGE 45 ENTRY - 1996-97 DOLLARS

Exit Age	Accumulation Benefit Gross of Tax	Accumulation Benefit Net of Tax	Defined Benefit Gross of Tax	Defined Benefit Net of Tax
55	46 779	46 779	68 379	62 056
60	76 743	76 743	102 568	86 166
65	110 428	106 211	136 758	109 976

AGE 45 ENTRY - MULTIPLE OF FAS(3)

Exit Age	Accumulation Benefit Gross of Tax	Accumulation Benefit Net of Tax	Defined Benefit Gross of Tax	Defined Benefit Net of Tax
55	1.36	1.36	2.00	1.82
60	2.24	2.24	3.00	2.52
65	3.23	3.11	4.00	3.22

Source: Actuarial Report Prepared for the Joint Select Committee on Superannuation, Financial Synergy, February 1997, pages 14-17.

6.4.13. It is evident from the tables above that, in the majority of cases, the accumulation scheme with an SGC level of employer contribution will, assuming the member makes the same funding effort as RBF contributors, provide higher end benefits to members who join at relatively young ages than the existing RBF defined benefit scheme.

6.4.14. For example, an accumulation scheme will provide an after tax benefit superior to the RBF contributory scheme for a member joining at age 25 years, regardless whether he or she works until age 55, 60 or 65. This result holds for a member who joins at age 35 years and exits after age 60, however for a member who exits at age 55 the RBF contributory scheme will provide a greater benefit.

- 6.4.15. A member who joins at age 45 years or older will receive a higher after tax benefit under the RBF contributory scheme than under an accumulation scheme. The Committee notes, however, that the Government has little obligation to provide an 'adequate' retirement benefit for these new entrants. In the current environment of compulsory employer superannuation support, new public sector employees joining at later ages can be expected to have already accrued significant superannuation in their earlier employment.
- 6.4.16. In relation to these calculations, the Secretary of the Department of Treasury and Finance made the following comment:

*"... older new entrants receive a more generous benefit under the RBF scheme as the member is not able to benefit to the same extent in an accumulation scheme from compounding as a member who starts early and has more years of service."*⁹⁴

- 6.4.17. In addition to the real dollar values shown above, the tables also demonstrate that in multiple of salary terms, a member joining an accumulation fund that provides SGC benefits (from 6 per cent through to 9 per cent) at 25 years of age and makes member contributions at the rate of 5 per cent of salary for 40 years, will receive an end benefit approximately 7.5 times final salary in net of tax terms (compared with only 5.95 times in the RBF contributory scheme).
- 6.4.18. On the basis of the actuarial evidence provided above, an SGC employer contribution rate is more than sufficient to provide members with an adequate retirement benefit. The Committee notes the conclusion of the Actuary in this regard:

*"An SGC employer contribution rate, supplemented by a 5 per cent member contribution, can be expected to achieve over a full 40 year funding period a benefit of 8 times final average salary. This should be an adequate superannuation benefit."*⁹⁵

- 6.4.19. The Committee noted that with respect to the general situation in the private sector, National Mutual gave the following evidence:

*"In our experience the higher end of the range for most employers has been 7-8... [times]... salary..."*⁹⁶

⁹⁴ Department of Treasury and Finance Submission, page 23

⁹⁵ Actuarial Advice Report Prepared for the Joint Select Committee on Superannuation, Financial Synergy, February 1997, page 17

⁹⁶ National Mutual Submission, page 7

- 6.4.20. This analysis involving member contributions of 5 per cent of salary in the new accumulation arrangement should not to be interpreted as suggesting that member contributions should be compulsory. This issue is discussed in detail in Chapter 7. The Committee's obligation in recommending reforms to existing superannuation arrangements is to provide an alternative scheme that allows, with some funding effort on behalf of the member (which is not unreasonable), the accumulation of an "adequate" retirement benefit over the member's working life.
- 6.4.21. Whether new employees take advantage of this opportunity to contribute themselves (should member contributions be voluntary) is largely a decision that is best made on an individual basis, having regard to the particular financial circumstances of each new employee.
- 6.4.22. There are other benefits associated with the provision of SGC employer superannuation support to new employees. In particular, this would release additional funds already allocated in the Budget for use in reducing the Government's unfunded past service liability (which is an issue of focus for the current Inquiry).
- 6.4.23. The State currently funds its Agencies to provide an 11 per cent contribution into the Superannuation Provision Account for new permanent employees. On this basis, moving to an SGC benefit for new permanent employees would produce savings to Agencies of 4 per cent of salary for those employees for two years (11 per cent less 7 per cent), 3 per cent for two years (11 per cent less 8 per cent) and 2 per cent thereafter (11 per cent less 9 per cent). These savings could be appropriated by Government and applied to the superannuation funding task confronting the State.

6.5. EMPLOYER CONTRIBUTIONS HIGHER THAN THE SGC RATE

- 6.5.1. The Committee previously identified two other options for the appropriate level of employer superannuation support, namely:
- a) employer contributions at the maximum SGC rate (9 per cent) from 1 July 1998 onwards; or
 - b) employer contributions at some rate higher than the maximum SGC rate from 1 July 1998.
- 6.5.2. Given that both these possible alternative arrangements involve employer contributions in excess of those considered in the previous section, the Committee will address them effectively as a single option (as all the comments that apply to option (a) apply equally to option (b)).

- 6.5.3. The main advantage associated with employer contributions greater than the SGC rate is that either:
- end benefits for new members will be higher (for a given level of member contributions); or
 - members will be able to accrue the same end benefit through a reduced level of member contribution (if any was being made).
- 6.5.4. The disadvantages associated with levels of employer support above the SGC minimum are numerous. From a cost perspective, for example, any employer contribution above the SGC rate would impose further financial obligations on the State. This is not a viable or sustainable outcome, given the conclusions reached in earlier Chapters concerning the magnitude and importance of the unfunded liability problem currently facing Tasmania.
- 6.5.5. Clearly the higher the employer contribution rate, the higher the end benefit for the employee. Equally, however, the greater the level of employer support, the less financial resources will be available to the Government to assist it in meeting its cash flow requirements (and thereby helping to reduce its past service unfunded superannuation liability). For example, the 'gap saving' between the 11 per cent provided in Agency budgets for new permanent employees and the SGC employer contribution rate would decrease or, were the level set at 11 per cent, this gap saving would disappear completely.
- 6.5.6. A second financial disadvantage from providing employer superannuation support above the SGC rate results from the fact that there are currently 23 638 accounts in the RBF non-contributory scheme receiving SGC support. Equity considerations would suggest that whatever higher rate was paid in respect of new entrants would also be required to be paid to existing non-contributory scheme members.
- 6.5.7. As Agencies are currently only funded to provide SGC benefits in respect of existing non-contributors, a higher rate would require an immediate increase in Agency global allocations and add straight on to the State's Net Financing Requirement. Similarly, GBEs would be required to provide additional amounts within their accounts for any employer contribution rate greater than the SGC rate.
- 6.5.8. Given that the cost of funding SGC contributions in respect of existing RBF non-contributors is estimated to be in the order of \$20.78 million (in today's dollar terms) for an SGC rate of 7 per cent during 1998-99, the impact of, say, increasing the level of support to 9 per cent of salary from 1 July 1998 would impose an extra cost for current non-contributors (not new employees) of \$5.94 million (in today's dollars) during the year.

- 6.5.9. An extra \$2.97 million would be required for every one per cent by which the contribution rate exceeded the SGC rate. Over the four year period from 1998-99 to 2001-02 (when the SGC rate reaches 9 per cent of salary in any case), the additional cost to the State of providing 9 per cent superannuation support to all current members of the non-contributory scheme would total \$17.76 million (in today's dollar terms).
- 6.5.10. There would also be an additional cost associated with new permanent employees if, rather than being provided with the SGC rate from 1 July 1998, they were to be provided with superannuation support at 9 per cent of salary. Based on certain assumptions about the number of new entrants into the RBF contributory scheme over the period from 1998-99 to 2001-02 and their average salary levels, this additional cost is estimated to be in the order of \$5.47 million (in today's dollar terms).
- 6.5.11. In total, therefore, adopting an employer contribution rate of, say, 9 per cent of salary from 1 July 1998 rather than the SGC rate would impose total additional superannuation costs on the State in the order of \$23.2 million (in today's dollars). Arguably Tasmania cannot afford such an impost.
- 6.5.12. It should be noted that to the extent that employer contributions are made at a rate above the SGC for new permanent employees after 1 July 1998, the "gap saving" referred to above would be lower - that is, to the extent that the State is required to fund the benefits of new permanent employees at, say, 9 per cent rather than the SGC rate, there would be less funds available to be paid into the Superannuation Provision Account by Agencies to be used to fund the past service unfunded liability.
- 6.5.13. The Committee notes that the issue of the appropriate level of employer contribution rate for new employees after 1 July 1998 needs to be considered in light of evidence presented earlier in this Chapter suggesting that higher employer contribution rates are not required to provide 'adequate' benefits to new entrants. As indicated previously, provided a new member is prepared to make the same individual funding effort as he or she would have been required to make had the RBF contributory scheme remained open (namely, contribute 5 per cent by way of employee contributions), then the accumulation scheme will deliver adequate and superior end benefits to many employees.
- 6.5.14. The Committee also noted that if it were to recommend an employer contribution rate higher than the SGC minimum, it would send the wrong signals to Tasmanian taxpayers (as it would perpetuate the widespread view that employees in the public sector are treated more generously relative to employees in the private sector), the business community (who would eventually have to bear part of the additional financial burden through higher taxation) and the international credit rating agencies (who would have

difficulty in understanding how a State with the budgetary difficulties of Tasmania could afford, in a sustainable sense, to provide superannuation at that level).

- 6.5.15. If the Government were to provide more than what is required under the SGC arrangements (given the level and expected growth in the unfunded superannuation liability), it would suggest to the various stakeholders that the Government was not serious about attempting to reduce its unfunded superannuation liability and to manage the emerging problem in a responsible manner.
- 6.5.16. If the State Government were to provide superannuation support to new employees above the SGC requirements, any cost-benefit assessments in relation to the competitive tendering and contracting out of Government services to the private sector would continue to systematically bias the results against in-house provision. To the extent that Tasmania continues to provide more generous superannuation than is the norm in the private sector, the move towards the outsourcing of Government activities will accelerate.
- 6.5.17. The Department of Treasury and Finance has suggested as follows:

*"In any cost-benefit analysis done to support outsourcing, the superannuation component for staff is a significant factor. Higher superannuation costs will always bias the calculation towards there being a benefit from outsourcing - public sector employment will look less attractive, which is likely to accelerate the loss of public sector jobs at a faster rate than would otherwise be the case."*⁹⁷

6.6. GUARANTEE ON FUND EARNINGS

- 6.6.1. A further issue that has been raised with the Committee that has a bearing on member benefits in an accumulation scheme is the prospect of a guarantee on the earning rates credited to member accounts. This is one possible mechanism that could possibly offset the perceived difficulty with moving to an SGC level of employer superannuation support in an accumulation arrangement.
- 6.6.2. As indicated in Chapter 4, a perceived disadvantage associated with accumulation schemes is that the fluctuations in investment returns associated with superannuation is effectively transferred from the employer (who effectively underwrites this in a defined benefit scheme) to the employee (who both benefits from superior investment performance and

⁹⁷ Department of Treasury and Finance Submission, page 18

bears the burden of under performance). While the linking of the establishment of an accumulation scheme for all new entrants with the introduction of fund and investment choice can address this issue, the granting of a legislative guarantee on earnings rates is another possible solution.

- 6.6.3. The Committee notes that this is not an issue with respect to the current RBF non-contributory scheme, as this is unfunded and the crediting rate on member accounts is effectively defined - as indicated earlier, the legislation provides that members earn the Commonwealth Long Term Bond Rate on their "notional" employer contributions.
- 6.6.4. The approach of having a guarantee on investment earnings is adopted in the South Australian "Triple S" superannuation scheme. This is the optional scheme for new entrants wishing to make employee contributions and the employer contribution rate is the SGC minimum until 2002 and then 10 per cent thereafter (provided the member contributes 4.5 per cent of salary or more). The guarantee is that the crediting rate will not be less than 4 per cent real (or CPI + 4 per cent) over the period of membership in the fund - that is, it is not a year-by-year guarantee but a working life one.
- 6.6.5. The Committee requested the Actuary to provide advice on the feasibility of such an arrangement being adopted in this State. The Actuary has advised as follows:

*"This scenario involves either moving some of the investment risk to the employer or to the other members. It destroys one of the main reasons for moving to an accumulation fund. The trend in superannuation design in Australia is towards member's control over fund choice and investment choice. This suggestion does not fit in with that trend."*⁹⁸

- 6.6.6. In reaching the conclusion that the provision of a guaranteed real rate of return in an accumulation scheme is undesirable, the Actuary evaluated the investment performance of accumulation funds over the past 30 years and determined what would have been the actual account outcome for a particular member.
- 6.6.7. The Actuary based actual investment returns over the past 30 years firstly on the arithmetic average of the results published in the Mercer earnings survey. Secondly, where historical data was not available through this avenue, the Actuary determined an investment return by constructing a "proxy" typical

⁹⁸ Actuarial Advice Report Prepared for the Joint Select Committee on Superannuation, Financial Synergy, 18 July 1997, page 5

investment portfolio that consisted of 55 per cent shares, 10 per cent property and the balance in fixed interest bonds.

- 6.6.8. The actual member account outcome using past investment performance was then compared with the account balance that would have existed under the 4 per cent real guarantee arrangement, in order to determine the percentage of time that the guaranteed account balance would have exceeded the balance based on actual crediting rates of the fund.
- 6.6.9. Table 6.3 below summarises the results of the Actuary's investigation of this issue.

Table 6.3 : Percentage of Time the Guarantee Account Balance Would Exceed the Actual Investment Account Balance

Guarantee	1-5 years	6-10 years	11-15 years	> 15 years
CPI + 4 per cent	41.4 %	27.8 %	26.7 %	4.2 %
CPI + 3 per cent	35.7 %	25.2 %	15.6%	1.7 %
CPI + 2 per cent	32.1 %	25.2 %	11.1%	0.0 %

Source: Actuarial Report Prepared for the Joint Select Committee on Superannuation, Financial Synergy, 18 July 1997, page 5.

- 6.6.10. It is evident from the above table that the higher is the guarantee margin over the Consumer Price Index (CPI), the more likely is the real guarantee to be required. For example, with a CPI + 4 per cent guarantee, the likelihood of the guarantee being required for a member leaving in the first five years is 41.4 per cent. With a guarantee of CPI + 2 per cent, however, the likelihood reduces to 32.1 per cent. This result holds across all periods of scheme membership shown in the table.
- 6.6.11. Further, the longer a member remains in a scheme, the less likely is the real guarantee to be required. For example, with a CPI + 4 per cent guarantee, the 41.4 per cent chance of the guarantee being required for a member leaving in the first five years compares with a 4.2 per cent chance for a member leaving after more than 15 years service. This result holds across all guarantee margins over the CPI.
- 6.6.12. Based on this analysis, the Committee accepts that the risks of any guarantee provided on earning rates in the new accumulation scheme being called upon are high. The Committee notes the Actuary's comments in this regard:

*"This design could require significant additional ... [employer] ... contributions or cross subsidies via an investment fluctuation reserve."*⁹⁹

- 6.6.13. The Actuary has advised the Committee that while "...the past few years of good real rates of returns and modest inflation gives a false sense of security" (page 6), Australia would only need to experience a repeat of the financial market conditions that existed in the early-to-mid 1970s for a guaranteed real rate of return provision to result in a requirement for very significant additional employer contributions to be made to the accumulation scheme to ensure that the guarantee can be honoured by the fund.
- 6.6.14. A guaranteed real rate of return effectively transfers all the upside investment risks to employees (as they will benefit directly from strong investment performance of the fund above the real rate guaranteed), but leaves either:
- the employer exposed to the downside investment risks (as further employer contributions over and above the SGC rate will be required in the event that the balance of a member's actual account at exit is less than the balance in the guaranteed account); or
 - other fund members exposed to the downside investment risks (as the need to operate, and call upon, an investment fluctuation reserve designed to smooth the fund's actual earning rates over time would require all other scheme members to have to accept a lower crediting rate at certain times).
- 6.6.15. It would also be impossible to offer investment choice in the same scheme as one which carries a guarantee on real rates of return. If both a real guarantee was in place and members could elect different investment portfolios (ranging, for example, from capital guaranteed to speculative equities), the Committee feels that members would choose the most risky investment portfolio in full knowledge that a guaranteed floor was in place. That is, members would effectively be able to gamble against the fund (to the detriment of either the employer, other members or both).
- 6.6.16. The mandating of a guaranteed real rate of return in the new accumulation scheme therefore has potential cost implications. Any further financial exposure for the State should be avoided, in view of the fact that the State already has a large unfunded superannuation liability problem which requires urgent attention. The Committee's recommendations are designed to address, rather than exacerbate, this situation.

⁹⁹ *ibid*, page 6

- 6.6.17. There is an alternative approach to providing some member certainty within the accumulation scheme, however, that warrants consideration. One possible mechanism to address the issue of investment risk for employees in an accumulation scheme would be for the RBF Board to consider, as part of the implementation of the investment choice arrangements (which are discussed in greater detail in Chapter 9), offering one particular portfolio that involved some real return on the earning rate of the fund.
- 6.6.18. Members who wished to ensure that they received some protection against investment earning fluctuations could select this option (which would involve a margin over the CPI that the Board felt it could deliver through the adoption of appropriate strategic and tactical asset allocation strategies).
- 6.6.19. Under this proposal, the Board would endeavour to invest the funds in this portfolio to effectively cover the requirement for the real return that was provided. The consequence of the Board adopting such an investment strategy for this portfolio, however, would be that much of the possible upside on investment returns would need to be sacrificed.
- 6.6.20. That is, the investment strategy that the real rate of return portfolio would require would almost certainly preclude the achievement of very high real rates of return - which would obviously not be consistent with every member's investment preference. Given that participation in this portfolio would be optional, however, the sacrificing of higher real returns for a more certain minimum earning rate would only occur for those members who made the required election.

6.7. SUMMARY OF EVIDENCE

- 6.7.1. The following evidence was presented to the Committee in relation to the appropriate level of employer contribution in any new accumulation scheme:

RBF Board

"Based on actuarial advice, a minimum level of superannuation support which will provide an adequate retirement income at age 65 years (after 40 years service) is a 12 per cent contribution rate. From an actuarial point of view, it is not important where the contributions come from and some alternatives include :-

- *for permanent employees, 9 per cent from the employer and 3 per cent from the employee;*
- *for temporary employees, 6 per cent from the employer with the balance coming from an optional voluntary 3 per cent*

employee contribution with a matching employer contribution to a maximum of 12 per cent."¹⁰⁰

Mr David Benbow, Business Superannuation Consultant, National Mutual

'We believe that to provide a meaningful end benefit for a normal member... we require somewhere between 12 per cent and 15 per cent of salary and that meaningful retirement, we believe, translates... [into]... the member not suffering a loss of a standard of living on retirement.'"¹⁰¹

Department of Treasury and Finance

*"In relation to the matter of "adequate" retirement benefits, the RBF Board, in its submission to the Committee, presented actuarial evidence that the superannuation industry generally regards 2/3 rds of pre-retirement income as being "adequate" and that an end benefit of 7-8 times salary is necessary to provide this at age 65 years after 40 years service."*¹⁰²

Mr Julian Sawicki, Financial Controller, Public Service Association, South Australia

*"Certainly in the 50-65... [per cent of salary]... bracket, I think, would be a reasonable retirement income for the majority of people - certainly children should be off hands at that stage, the home should be paid off at that stage. But people still need to have a reasonable amount of money to enjoy their retirement years."*¹⁰³

RBF Board

*"... the proposed level of SGC contribution (6 per cent of salary) will not provide an adequate retirement income benefit."*¹⁰⁴

¹⁰⁰ Retirement Benefits Fund Board Submission, page 50

¹⁰¹ *Hansard*, 30 January 1997, page 4 - Mr David Benbow, Business Superannuation Consultant, National Mutual

¹⁰² Department of Treasury and Finance Submission, page 26

¹⁰³ *Hansard*, Joint Select Committee discussions with South Australian union representatives, February 1997, page 33

¹⁰⁴ Retirement Benefits Fund Board Submission, page 47

"... the current level of SGC contribution of 6 per cent of salary is not an appropriate superannuation substitute to the current RBF contributory scheme..."¹⁰⁵

- 6.7.2. The public sector unions shared this view, although the Committee noted that it appeared to be based on anecdotal evidence rather than detailed actuarial analysis:

"The SGC is grossly inadequate in providing security and dignity in retirement for employees. The SGC was introduced to provide superannuation benefits for employees who previously did not enjoy superannuation benefits. It was not intended as a replacement for existing superannuation schemes. The SGC is the legal minimum employer contribution and is inadequate in providing for a reasonable standard of living in retirement."¹⁰⁶

6.8. COMMITTEE FINDINGS

- 6.8.1. Having regard to the above and the weight of evidence presented to it in relation to the most appropriate level of employer contributions in the proposed new accumulation scheme, the Committee finds that:

- 1) The issue of the adequacy of end benefits for members is fundamentally a matter for Commonwealth Government retirement incomes policy and given that it has recently abandoned proposals to impose compulsory employee contributions and matching Commonwealth co-contributions, it would be possible to conclude that the minimum SGC employer obligations are regarded by the Commonwealth as being sufficient.
- 2) Private sector employers are generally not concerned with providing their employees with a benefit that is "adequate" in a retirement incomes sense. They have acted in such a manner as to suggest that contributions at the SGC rate are now the community and industrial standard, believing that the Commonwealth will concern itself with the issue of adequacy, having regard to overall national saving and the likely drain on welfare payments from an ageing population.
- 3) These aspects notwithstanding, it is appropriate for the Government to consider whether the level of superannuation support provided to its

¹⁰⁵ *ibid*, page 50

¹⁰⁶ Community and Public Sector Union (CPSU) Submission, page 1

employees is capable of providing reasonable retirement benefits, so long as members are prepared to make some funding effort on their own behalf.

- 4) The benchmark for assessing the adequacy of benefits appears to be a level of total contributions from both employer and employee of between 12-15 per cent of a member's salary per year over their working life.
- 5) Adequacy of benefits can alternatively be expressed as a member retiring with a pension of 2/3 rds of pre-retirement income or a lump sum of 7-8 times salary at age 65 after 40 years service.
- 6) In all of the States which have introduced accumulation funds for new employees in recent years, SGC employer benefits have been provided everywhere except in one South Australian scheme (which is optional) and which will provide a 10 per cent employer contribution after 2002 provided the employee contributes 4.5 per cent of salary or more.
- 7) Employer contributions at the rate of the SGC minimum will, at 9 per cent beyond 2002, not be too dissimilar from the new entrant contribution rate of in the range of 9.5 per cent that has been calculated for the existing RBF contributory scheme.
- 8) The SGC level of employer contribution is currently provided in respect of 23 638 accounts (as at 30 June 1997) in the RBF non-contributory scheme, which implies that nearly 60 per cent of all existing public sector employees in Tasmania are already in receipt of SGC superannuation support only.
- 9) Actuarial advice suggests that, in the majority of cases, an accumulation scheme with an SGC level of employer contribution will, assuming the member makes the same funding effort as RBF contributors (5 per cent employee contributions), provide higher end benefits to members who join at relatively young ages (under 45 years of age) than the existing RBF defined benefit scheme.
- 10) Members who join at age 45 years or older will receive a higher after tax benefit under the RBF contributory scheme than under an accumulation scheme providing SGC benefits, although the Government has little obligation to provide an "adequate" retirement benefit for this category of new entrants (given that they will already have accrued a significant benefit in former employment).
- 11) An SGC employer contribution rate is sufficient to provide members with an adequate retirement benefit, as 40 years service with the

member contributing 5 per cent of salary and the Government contributing 9 per cent after 2002 will produce an after tax end benefit in the order of 7.5 times final salary.

- 12) The provision of SGC employer superannuation support to new permanent employees would release additional funds already allocated in the Budget for use in reducing the Government's unfunded past service liability (which is a key issue of focus in the current Inquiry).
- 13) While employer contributions greater than the SGC rate would obviously result in higher end benefits for members, they would impose further financial obligations on the State which, given the Committee's findings on the magnitude and the importance of the unfunded liability problem currently facing Tasmania, should be avoided.
- 14) Logic and equity suggests that the provision of a higher employer contribution rate than SGC to new entrants would also require that the higher rate also be paid to existing non-contributory scheme members.
- 15) Agreement to provide employer contributions at the rate of 9 per cent of salary in the new accumulation scheme from 1 July 1998 would, for example, impose additional costs on the State and its GBEs in respect of current non-contributory scheme members in the order of \$5.94 million (in today's dollar terms) during 1998-99. Over the period 1998-99 to 2001-02 (when the SGC rate reaches 9 per cent of salary), the total additional cost of providing 9 per cent superannuation from 1 July 1998 for non-contributory scheme members would be \$17.76 million (in today's dollar terms).
- 16) There would also be an additional cost associated with new permanent employees if, rather than being provided with the SGC rate from 1 July 1998, they were to be provided with superannuation support at 9 per cent of salary. Based on certain assumptions about the number of new entrants into the RBF contributory scheme over the period from 1998-99 to 2001-02 and their average salary levels, this additional cost is estimated to be in the order of \$5.47 million (in today's dollar terms).
- 17) In total, therefore, adopting an employer contribution rate of, say, 9 per cent of salary from 1 July 1998 rather than the SGC rate would impose total additional superannuation costs on the State in the order of \$23.2 million (in today's dollars). Arguably Tasmania cannot afford such an impost.
- 18) To the extent that employer contributions are made at a rate above the SGC for new permanent employees after 1 July 1998, the "gap saving" in respect to new permanent employees would be lower - that is, to the

extent that the State is required to fund the benefits of new permanent employees at, say, 9 per cent rather than the SGC rate, there would be less funds available to be paid into the Superannuation Provision Account by Agencies to be used to fund the past service unfunded liability.

- 19) An employer contribution rate higher than the SGC minimum would send the wrong signals to:
 - a) Tasmanian taxpayers, as it would perpetuate the widespread view that employees in the public sector are treated more generously relative to employees in the private sector;
 - b) the business community, who would eventually have to bear part of the additional financial burden through higher taxation; and
 - c) the international credit rating agencies, who would have difficulty in understanding how a State with the budgetary difficulties and unfunded superannuation liability problems of Tasmania could afford, in a sustainable sense, to provide superannuation at that level.
- 20) To the extent that Tasmania continues to provide more generous superannuation benefits for its employees than is the norm in the private sector, the move towards the outsourcing of Government activities will accelerate.
- 21) Based on actuarial advice, the arrangements associated with the proposed new accumulation scheme should not involve the provision of a real guarantee on the earning rate of the fund, as it fundamentally destroys the rationale for moving to an accumulation scheme design.
- 22) Historical investment experience in accumulation schemes suggests that even a guarantee of CPI + 2 per cent would expose the State to the prospect of being required to make significant additional employer contributions to the fund in order to ensure that the guarantee was honoured at certain times.
- 23) An alternative approach is possible to provide a degree of insulation to members of the accumulation scheme against fluctuations in investment returns, namely through the RBF Board offering some form of real return portfolio in the context of the implementation of investment choice arrangements.
- 24) Tasmania arguably has the least financial capacity of all the Australian States and, in light of the developments in public sector superannuation

in the other States which were discussed in Chapter 3, it cannot realistically afford to be paying superannuation benefits to new public sector employees that are out of line with both private sector standards and those that exist in most other public sector schemes around Australia.

6.9. COMMITTEE RECOMMENDATIONS

- 6.9.1. In light of the findings of the Committee in relation to the issue of an appropriate level of employer superannuation support for new entrants in the proposed accumulation scheme, the Committee makes the following recommendations:

Recommendation 11:

The appropriate employer contribution rate for the new accumulation scheme should be the level of support specified in the Commonwealth's *Superannuation Guarantee (Administration) Act 1992*.

Recommendation 12:

The Government should investigate the feasibility of legislating to ensure that the financial savings consequent upon the new employer contribution rate being below that for which Agencies are currently funded for new permanent employees are applied to reducing the State's past service unfunded superannuation liability.

Recommendation 13:

In the context of the implementation of investment choice arrangements in the proposed new accumulation scheme, the Retirement Benefits Fund Board should investigate the feasibility of establishing at least one investment portfolio that provides a real return each year.

Recommendation 14:

If such a portfolio is feasible to establish, the margin over the CPI provided in the investment portfolio should be set by the Board, having regard to its consideration of what an appropriate and responsible investment strategy is capable of delivering.

Recommendation 15:

If such an investment portfolio is offered as a choice, the Board should apply smoothing techniques in determining the annual crediting rate for the portfolio and establish a fluctuation reserve fund to ensure that the benefits of those members who elect to place their funds in this portfolio do not require any additional employer contribution or any cross-subsidies from other members of the scheme.

- 6.9.2. The following Chapter considers the issue of whether, having regard to the discussion above, employees should be required to compulsorily contribute to the new SGC accumulation scheme.

7. EMPLOYEE CONTRIBUTIONS AND TRANSFER ARRANGEMENTS

7.1. BACKGROUND

- 7.1.1. Chapter 6 discussed the issue of the adequacy of benefits in a new accumulation scheme that provides employer superannuation support at the Commonwealth SGC rate. The Committee accepted evidence that demonstrated that the provision of SGC contributions by the employer is sufficient to provide what the superannuation industry regards as an 'adequate' retirement benefit for scheme members, provided that the member is prepared to make some funding effort on his or her own behalf.
- 7.1.2. Against this background, it is necessary to consider whether employees in the new accumulation scheme should be compulsorily required to contribute (and, if so, at what rate) or whether they should be left to make this decision voluntarily, having regard to their own personal circumstances.
- 7.1.3. The Terms of Reference effectively require the Committee to make a recommendation in this regard, as they provide as follows:

"To inquire into and report on whether or not to...

*(5) Provide existing members of the schemes detailed in (1) above with the option of ceasing to contribute (subject to any Commonwealth requirements in relation to compulsory employee contributions) and participating in the non-contributory arrangements outlined in (3) and (4) above."*¹⁰⁷

- 7.1.4. As previously indicated, currently members of the RBF contributory scheme are required under the Act to contribute a minimum of 5 per cent of salary. Members may make additional contributions up to 11 per cent of salary to the contributory scheme or they may make voluntary contributions to the Investment Account. Members of the RBF non-contributory scheme are not required to make employee contributions, however they may also make voluntary contributions to the Investment Account.

¹⁰⁷ Joint Select Committee on Superannuation, Terms of Reference

7.2. COMMONWEALTH POLICY ANNOUNCEMENTS - 1997-98 BUDGET

- 7.2.1. In the 1995-96 Budget, the former Commonwealth Government announced its intention to introduce compulsory employee contributions (timed to start at 1 per cent of salary in 1997-98 and increasing to 3 per cent by the year 1999-2000) which would then attract Commonwealth co-contributions by way of further superannuation support (subject to an incomes test). The current Commonwealth Government confirmed in the recent 1997-98 Budget, however, that it would not proceed with any proposal for compulsory employee contributions or Commonwealth co-contributions, preferring to deliver a savings rebate to all Australians. Accordingly, there are not any Commonwealth requirements for members of superannuation schemes to make employee contributions into those funds.
- 7.2.2. The Commonwealth Government also announced its policy on fund and investment choice in the 1997-98 Budget, which is discussed in greater detail in Chapter 9. Clearly, therefore, the Commonwealth Government is shaping its superannuation policy around a "choice" philosophy for members and regards compulsion for members to contribute as being paternalistic.
- 7.2.3. The 1997-98 Commonwealth Budget is centred around "*...promoting equity and individual choice...*"¹⁰⁸ and the Budget Paper entitled "*Savings: Choice and Incentive*", which was issued jointly by the Commonwealth Treasurer and the Minister for Social Security on Budget night, sets down the savings and retirement incomes policy measures announced in the 1997-98 Budget. The Commonwealth indicated that it will achieve its retirement incomes policy objectives by:
- "...encouraging people who are able to save for their retirement to do so, particularly through superannuation."*¹⁰⁹
- 7.2.4. The retirement incomes system in place under the current Commonwealth Government therefore provides incentives for voluntary superannuation and other private savings by employees (through appropriate rebates and taxation measures), but does not require members to make compulsory employee contributions.
- 7.2.5. The Commonwealth Government also announced an increase in the salary threshold under which employees will be permitted, with the approval of the employer, to elect to receive no employer superannuation support at all, but

¹⁰⁸ *Savings: Choice and Incentive*, Ministerial Statement, 13 May 1997, page 15

¹⁰⁹ *ibid*, page 2

rather receive the SGC contribution in the form of higher salary. These elections will be possible at the commencement of employment or once annually thereafter. An employee who has opted out of receiving employer SGC contributions may opt back into superannuation at any time.

7.2.6. The Committee considers that these announcements by the Commonwealth Government represent an important indication of the overall environment in which employees will receive superannuation coverage into the future. The "opting out" policy referenced above is strong evidence to suggest that the Commonwealth recognises that superannuation is not the best financial option for all employees all of the time - that some employees might be better off receiving higher salaries than contributing, and having the employer contribute, to superannuation on their behalf.

7.2.7. The 1997-98 Commonwealth Budget also included announcements in relation to revised preservation rules. In particular, the Commonwealth announced that from 1 July 1999, all future superannuation contributions (including member contributions), and earnings on those contributions, will be preserved until preservation age, except in very limited circumstances. Benefits that are not required to be preserved at that date will remain as non-preserved benefits, but the quantum of these will not be indexed over time.

7.2.8. The Committee notes that this announcement has implications for the decision as to whether employee superannuation contributions should be mandated or not. Currently, members can gain access to their own contributions and interest upon resignation or redundancy prior to reaching the preservation age. Under the rules from 1 July 1999 onwards, this will no longer be possible in respect of contributions made after that date.

7.2.9. This suggests that any compulsion upon members to contribute will effectively require members to "lock away" those funds for a very significant period of time (in excess of 40 years, for employees commencing work under the age of 20 years). The Committee recognises that this is arguably a very different situation to that which exists under current preservation arrangements (which largely relate to employer contributions).

7.3. VOLUNTARY OR COMPULSORY MEMBER CONTRIBUTIONS

7.3.1. Attitudes to compulsory or voluntary employee contributions are largely ones of fundamental philosophy - does the member always know what is in his or her best interests and, if not, is it reasonable to assume that either the Government or the unions are in a position to make that judgment?

- 7.3.2. Clearly, much of the argument in favour of compulsion is based around the view that employees will make poor decisions if contributions are optional. The Australian Education Union (Tasmania Branch) discusses, for example, the danger of employees taking "...*unwise decisions*..." (page 16 of their submission). Further, compulsion is supported by the view that employees have a responsibility to provide for their own retirement - that is, that superannuation is, in some sense, a partnership arrangement between the member and the employer.
- 7.3.3. Employee contributions are necessary if an individual wishes to ensure sufficient superannuation to have a reasonable standard of living in retirement. The Committee notes that the evidence presented in Chapter 6 suggests that with voluntary member contributions of 5 per cent of salary, an SGC employer contribution will produce an end benefit that is "adequate" (in a sense that is acceptable in the superannuation industry). There are many circumstances, however, in which it will not be in the financial interests of a member to actually make employee contributions to superannuation over all of their working life at a uniform rate.
- 7.3.4. For example, a member who has a young family, a non-working spouse, an average mortgage and receives an average salary would arguably be better off eliminating his or her mortgage than making compulsory employee contributions at young ages. The member may then be able to contribute a much more significant percentage of salary at a later stage in life (say from age 40 years onwards) when other financial commitments are less significant. Optional employee contributions would produce this sort of flexibility for members.
- 7.3.5. The Senate Select Committee, in its 21st Report, expressed a similar view, stating that:
- "...there is a great need to encourage voluntary contributions by members so that people, at times in their life when they actually have got some surplus money ...can actually contribute into their fund."*¹¹⁰
- 7.3.6. The view of the Senate Select Committee and the Commonwealth Government (which was discussed earlier) is that the real obligation on employers is to ensure that the superannuation arrangements for members permit them, with voluntary employee contributions, to accumulate an adequate retirement benefit over their working life. Whether individuals

¹¹⁰ 21st Report of the Senate Select Committee on Superannuation, *Investment of Australia's Superannuation Savings*, December 1996, paragraph 6.21

avail themselves of that opportunity is a decision that is best made on an individual basis.

7.3.7. Other considerations are relevant to the issue of compulsory or voluntary member contributions. For example, the introduction by the Commonwealth of the 15 per cent superannuation surcharge on high income earners (and other employees who do not provide their tax file numbers to superannuation funds) on and from 20 August 1996 will mean that for many members, continuing to contribute to superannuation under a compulsory arrangement will no longer represent the most tax effective form of saving.

7.3.8. Similarly, compulsory employee contributions may cause certain high income members to exceed the Commonwealth's Reasonable Benefit Limits (RBLs). The requirement to continue contributing in this circumstance would again result in the member being unable to benefit to the maximum possible extent from available tax concessions and tax effective investment strategies through the course of their working life. SUNCORP, in their evidence to the Committee, made the following comment in this regard:

*"The introduction of the contribution surcharge by the Federal Government, as well as Reasonable Benefit Limits, will mean that some employees may not wish to continue paying their own contributions, as it will not be tax effective."*¹¹¹

7.3.9. It is evident that under many circumstances it would be inequitable for the State Government to mandate employee superannuation contributions for new employees in the proposed accumulation scheme. The Committee also notes that, just as any employer contribution rate above the SGC level for new employees would, on the basis of logic and equity, be required to be provided to the 23 638 existing members of the RBF non-contributory scheme, so would any requirement for members to compulsorily contribute.

7.3.10. These employees are not required to contribute a percentage of their salary to superannuation. If compulsory employee contributions were introduced for new public sector employees joining the same scheme, it follows that the same requirement would need to be placed on existing non-contributory members. Failure to do so would be inequitable and create yet another class of members, which should clearly be avoided.

7.3.11. Requiring existing employees to contribute a percentage of their salary to superannuation would result in a decrease in the take-home pay of those members. As the Department of Treasury and Finance has suggested:

¹¹¹ Suncorp Submission, page 5

“This would effectively require the Government to force a reduction in take-home pay for these members, which might be difficult to justify (other than saying the Government believes its in their best interests).”¹¹²

- 7.3.12. The Committee notes that were it to recommend the introduction of compulsory member contributions for all members of the new accumulation fund, it might be necessary to seek written guarantees from the relevant public sector unions that they would not seek compensatory wage increases for those employees who receive a reduction in their take-home pay as a result of such a reform.
- 7.3.13. The introduction of compulsory member contributions is not a feature of any of the new accumulation schemes recently introduced in the other States and Territories to address their unfunded superannuation liability problems. Only one new scheme in South Australia requires compulsory member contributions, but the Committee notes from Chapter 3 that members can elect to either join this scheme (the “Triple S” scheme) or join a non-contributory SGC superannuation scheme (the State Superannuation Benefit Scheme).
- 7.3.14. A further consideration that is relevant to the issue of compulsory or voluntary member contributions is the investment strategy adopted by the RBF Board. As it is required to do under the Heads of Government Agreement relating to the applicability of the Commonwealth’s *Superannuation Industry (Supervision) Act 1993* principles to the States, the Board makes prudent investment decisions based on a thorough analysis of the likely returns to be achieved and the levels of risk involved. Currently, however, the Board does little investing in Tasmania.
- 7.3.15. Any requirement placed on members to contribute to superannuation would therefore result in substantial funds being effectively withdrawn from the economy of Tasmania and invested by the Board in either cash, fixed interest bonds, Australian equities, international equities, direct property or listed property trusts outside of the State. If compulsory contributions were required from existing non-contributory scheme members, for example, at the rate of 3 per cent of salary, there would be a withdrawal of some \$8.9 million from circulation in the Tasmanian economy during 1998-99 (in today’s dollar terms).
- 7.3.16. Given the economic circumstances prevailing in Tasmania at present, the Committee notes that this is a strong argument for leaving member contributions as voluntary in any new scheme.

¹¹² Department of Treasury and Finance Submission, page 25

7.4. TRANSFER ARRANGEMENTS

7.4.1. As outlined earlier in this Chapter, the Terms of Reference for the Committee's Inquiry require it to address whether a transfer right should be offered to existing RBF contributors in the event that a new, fully funded SGC accumulation scheme is established for new public sector employees. Given that the Committee has recommended that this occur, the issue of transfer rights needs consideration.

7.4.2. There are many good reasons why an existing RBF contributor might wish to transfer to the new accumulation scheme being proposed if such an option was permitted:

- to ensure that they are members of a fully funded scheme in relation to future service, which results in benefit portability between different employers;
- disenchantment about the preservation arrangements in the RBF defined benefit scheme, under which preserved benefits are indexed by the greater of movements in either the Consumer Price Index (CPI) or Average Weekly Ordinary Time Earnings (AWOTE). Members may feel that these indexation arrangements are such that they are better off receiving superannuation support in a scheme which is fully funded and to which fund earning rates apply to preserved benefits;
- because they have a preference for accumulation arrangements. This might well be the case for many, as future salary growth might be expected to be below future investment earnings;
- in the situation where member contributions required in the accumulation scheme are either below those required in the defined benefit scheme or completely optional, to take advantage of a reduction in employee contributions and effectively increase their take-home pay;
- to take advantage of any fund or investment choice options that might be provided to accumulation scheme members (which are discussed in more detail in Chapter 9); and
- to be able to improve the tax effectiveness of the sum of money that represents their member contributions into the defined benefit scheme, in the face of the Commonwealth's 15 per cent surcharge on high income earners and the Reasonable Benefit Limits.

7.4.3. The offering of a transfer right to existing RBF contributors will have a positive impact on the unfunded superannuation liability associated with the RBF scheme over time, as the future service of the transferring member will

be fully funded and, for pre 1 July 1994 members, the generous "anti-detriment" pension conversion factor will not apply in relation to future service.

- 7.4.4. Further, the ability of each member of the current contributory scheme to effectively exercise some choice over the manner in which he or she receives superannuation support from the employer is increased under a transfer right. That is, the provision of such an option sits comfortably within the overall 'choice' philosophy that the Commonwealth Government is pursuing in respect of the superannuation industry.
- 7.4.5. The Committee heard evidence from the public sector unions suggesting that they did not favour the provision of a transfer right to existing RBF contributors. It is noted, however, that the reasons provided are essentially the same as those outlined above in relation to whether employee contributions should be compulsory or optional - the unions believe that members, when faced with this transfer opportunity, will invariably make decisions that are "bad" for them financially and which will not be, in the view of the unions rather than that of the particular employee, in the long term interests of that member:

Australian Education Union (AEU)

*"The AEU, as an organisation representing employees, is concerned that employees may be seduced by the prospect of immediate money available through an opt-out arrangement which has the effect of reducing their retirement benefit... We are naturally concerned that many employees will opt-out of the contributory scheme and later regret their actions."*¹¹³

CPSU

*"The CPSU does not support this proposal. Such a provision may have a serious impact on the social and economic well being of employees and potentially lead to a further deterioration in the level of unfunded liability of the fund."*¹¹⁴

- 7.4.6. Similarly, the RBF Board indicated to the Committee that it held concerns over the proposal to offer existing RBF contributors the ability to opt out into an alternative scheme. The Board submitted that:

¹¹³ Australian Education Union (Tasmanian Branch) (AEU) Submission, page 16

¹¹⁴ Community and Public Sector Union Submission, page 2

*"...if the Terms of Reference are implemented with respect to allowing existing RBF contributors to opt out of the scheme and transfer to the new arrangement, then there is the real possibility that both the cost of employer sponsored superannuation and the State's unfunded liability will increase."*¹¹⁵

- 7.4.7. As indicated in the previous section, the opposition of the public sector unions to choice (based on the perceived need to protect members from the possibility of them making supposedly "adverse" choices against their own better interests) is essentially one of basic philosophy. The provision of choice is an essential component of the direction in which Commonwealth regulation of superannuation is taking the industry and concern about some individuals making poor decisions should not necessarily prevent an option being provided that also has the potential to significantly advantage a large number of individuals.
- 7.4.8. In this respect, the Committee notes that a compelling argument in favour of the provision of a transfer right is the announcement by the Commonwealth Government in the 1997-98 Budget that fund choice will require defined benefit funds to offer members the capacity to opt out. The Commonwealth Budget publication entitled *"Savings: Choice and Incentive"* clearly recognises the possibility that employees who exercise their choice to leave a defined benefit fund may receive reduced employer superannuation contributions for future service.¹¹⁶
- 7.4.9. The Commonwealth has announced, however, that despite this possibility, this is a clear choice for the individual to make and the only obligation on employers is to ensure that employees are informed of the consequences of their choice prior to it being exercised.
- 7.4.10. In relation to the issue raised by the public sector unions and the RBF Board concerning the impact on the accrued past service unfunded liability of the provision of a transfer right, actuarial advice provided to the Committee suggests that this issue is a complex one, with the answer depending on the exact nature of the transfer benefit to be given to transferring employees. There is a number of options in relation to the form of any transfer benefit:
- a) provide a benefit equal to the normal resignation benefit (that does not involve the preservation of employee contributions and interest);
 - b) provide a transfer value equal to the resignation benefit, with preservation requirements until retirement age; and

¹¹⁵ Retirement Benefits Fund Board Submission, page 50

¹¹⁶ *Savings: Choice and Incentive*, Ministerial Statement, 13 May 1997, page 19

- c) allow a transferring employee to leave a frozen accrued benefit multiple in the fund to be paid at retirement.

7.4.11. In relation to option (a) above, the Actuary has indeed suggested that this would have a serious adverse impact on the past service unfunded liability:

*"While this may have savings with regard to future levels of employer support, it will have a significant detrimental impact on the accrued liabilities."*¹¹⁷

7.4.12. Further, it is possible that compliance with the spirit of the Commonwealth SIS Act would prevent such a transfer benefit being offered - there will be no separation from the employer occurring if a member transfers out of the RBF defined benefit scheme and it is therefore arguable that a "defined event" has occurred (within the meaning of the SIS Act) to enable the member to receive, in cash, that component of the resignation benefit that reflects his or her member contributions and interest.

7.4.13. The Committee understands from the Actuary that option (b) above also contains an unacceptable risk that the past service unfunded liability would increase. For particular members that might transfer out of the RBF scheme there would be a reduction in the past service unfunded liability, while for others there would be an increase:

*"Offering a transfer value equal to the resignation benefit, with preservation requirements, will result in gains in some circumstances and losses in others. The net aggregate position will depend on the profile of the members taking up the offer."*¹¹⁸

7.4.14. In relation to the third option identified above, however, the Actuary has indicated to the Committee that this would be totally cost neutral:

*"...cost neutrality can be achieved by allowing the transferring member to leave a frozen accrued benefit multiple in the fund to be paid at the ultimate date of exit from service."*¹¹⁹

7.4.15. On the basis of the work undertaken by the Actuary to clarify this cost issue, therefore, the provision of a transfer right that involves a carefully specified transfer benefit has the potential to produce savings in the future growth in the State's unfunded liability (for the reasons outlined above), provide many

¹¹⁷ Actuarial Information for the RBF Board Submission, page 17

¹¹⁸ Actuarial Advice Report Prepared for the Joint Select Committee on Superannuation, Financial Synergy, February 1997, page 21

¹¹⁹ *ibid*, page 21

members with an advantage in terms of flexibility and choice and result in no change to the past service unfunded liability that currently exists. Moreover, it is entirely consistent with the announced changes in Commonwealth superannuation policy contained in the 1997-98 Budget.

7.5. SUMMARY OF EVIDENCE

7.5.1. Evidence was put to the Committee by a number of parties suggesting that compulsory employee superannuation contributions should be prescribed in any new superannuation scheme arrangements. For example:

RBF Board

“Based on actuarial advice, a minimum level of superannuation support which will provide an adequate retirement income at age 65 years (after 40 years service) is a 12 per cent contribution rate. From an actuarial point of view, it is not important where the contributions come from and some alternatives include:

- *for permanent employees, 9 per cent from the employer and 3 per cent from the employee... ”¹²⁰*

“... the provision of superannuation cover at... a minimum of 12 per cent of salary... [9 per cent SGC from the employer and 3 per cent from the employee]... is a sustainable policy option towards providing an adequate retirement income at age 65 years (after 40 years service). ”¹²¹

National Mutual

“In an accumulation plan it has been quite common for the employer to pay in a certain contribution and require their employee to also contribute at a similar rate... It is also common for plans to allow members to choose their own contribution rate within set limits. ”¹²²

Police Association of Tasmania (PAT)

“Mandatory employee contributions can be regarded as somewhat paternalistic, however are consistent with designing

¹²⁰ Retirement Benefits Fund Board Submission, page 14

¹²¹ *ibid*, page 22

¹²² National Mutual Submission, page 7

superannuation schemes to meet the needs of employees rather than just regarding them as deferred pay arrangements."¹²³

Mr Tom Adams, Vice President, South Australian Superannuation Federation

*"To me I would retain compulsion. Just do not let the genie out of the bottle."*¹²⁴

- 7.5.2. Similarly, evidence was presented suggesting that member contributions should be voluntary:

Jacques Martin

*"Existing members should be given the choice to continue in the present arrangement or opt for any other made available...All members should be free to contribute from their own resources in excess of the Government's funding arrangements."*¹²⁵

Tasmanian Chamber of Commerce and Industry (TCCI)

*"Employee contributions should be a matter of choice for the member."*¹²⁶

Department of Treasury and Finance

*"Treasury very strongly believes that employee contributions should not be compulsory, with members being free to determine, within the context of their own financial circumstances, whether to contribute or not. Treasury believes that it is paternalistic in the extreme and against a "choice" philosophy for the Committee to suggest that it is always in the best interests of members to contribute to superannuation all of the time."*¹²⁷

Mrs Beryl Ashe, Employee Representative, SAS Trustee Corporation Board, NSW

"Certainly I would be reluctant to come out in favour of compulsory payments or contributions in the current

¹²³ Police Association of Tasmania Submission, page 14

¹²⁴ *Hansard*, Joint Select Committee discussions with South Australian officials, February 1997, page 36

¹²⁵ Jacques Martin Submission, page 2

¹²⁶ Tasmanian Chamber of Commerce and Industry Submission, page 2

¹²⁷ Department of Treasury and Finance Submission, page 24

setup... Frankly, I think most of us would say that the prudent thing to do is to help provide for your retirement, but it is how far you go in this climate - the social and industrial climate in which we are now operating - to pursue that. It is encouragement rather than force."¹²⁸

7.6. COMMITTEE FINDINGS

7.6.1. Having regard to the above, and the weight of evidence presented to it in relation to the issue of whether member contributions should be optional or compulsory and whether existing RBF contributors should be provided with a right to opt out of the scheme and move to the new accumulation scheme, the Committee finds that:

- 1) The Commonwealth Government confirmed in the recent 1997-98 Budget that it would not proceed with any proposal for compulsory employee contributions or Commonwealth co-contributions, preferring to deliver a savings rebate to all Australians.
- 2) Accordingly, there are not any Commonwealth requirements for members of superannuation schemes to compulsorily contribute into those funds.
- 3) The Commonwealth Government is shaping its superannuation policy around a "choice" philosophy for members and clearly regards compulsion for members to contribute as being paternalistic.
- 4) The policy announced by the Commonwealth in relation to low income earners "opting out" of superannuation in favour of salary increases provides evidence that the Commonwealth recognises that superannuation is not the best financial option for all employees all of the time - that some employees might be better off at certain stages during their working life receiving higher salaries than contributing and having the employer contribute to superannuation on their behalf.
- 5) Attitudes to compulsory or voluntary employee contributions are largely ones of fundamental philosophy - views of all parties will differ as to whether the member always knows what is in his or her best interests and, if not, whether it is reasonable to assume that the Government should make that judgment.

¹²⁸ *Hansard*, Joint Select Committee discussions with union representatives in NSW, February 1997, page 18

- 6) Compulsion is supported by the view that employees have a responsibility to provide for their own retirement - that is, that superannuation is, in some sense, a partnership arrangement between the member and the employer.
- 7) There are many circumstances, however, in which it will not be in the financial interests of a member in today's regulatory and taxation environment to actually make employee contributions to superannuation over all of their working life at a uniform rate:
 - a) the recent Commonwealth announcement that, from 1 July 1999, all future superannuation contributions (including member contributions), and earnings on those contributions, will be preserved until preservation age, suggests that any compulsion upon members to contribute will effectively require them to "lock away" those funds for a very significant period of time (in excess of 40 years, for employees commencing work under the age of 20 years);
 - b) a member who has a young family, a non-working spouse, an average mortgage and receives an average salary is arguably better off eliminating his or her mortgage than making compulsory employee contributions at young ages. The member will then be able to contribute a much more significant percentage of salary at a later stage in life (say from age 40 years onwards) when other financial commitments are less significant;
 - c) the introduction by the Commonwealth of the 15 per cent superannuation surcharge on high income earners (and other employees who do not provide their tax file numbers to superannuation funds) on and from 20 August 1996 will mean that for many members, continuing to contribute to superannuation under a compulsory arrangement will no longer represent the most tax effective form of saving;
 - d) compulsory employee contributions may cause certain high income members to exceed the Commonwealth's Reasonable Benefit Limits. A requirement to continue contributing in this circumstance would again result in the member being unable to benefit to the maximum possible extent from available tax concessions and tax effective investment strategies through the course of their working life; and
 - e) if compulsory employee contributions were introduced for new public sector employees joining a revised RBF non-contributory scheme, logic and equity suggests that the same requirement

would need to be placed on existing non-contributory members, which would result in a decrease in the take-home pay of those members.

- 8) The introduction of compulsory member contributions is not a feature of any of the new accumulation schemes recently introduced in the other States and Territories to address their unfunded superannuation liability problems.
- 9) If compulsory contributions were required from existing non-contributory scheme members, for example, at the rate of 3 per cent of salary, there would be a withdrawal of some \$8.9 million from circulation in the Tasmanian economy during 1998-99 (in today's dollar terms) which, given the economic circumstances prevailing in Tasmania at present, is a strong argument for leaving member contributions voluntary in any new scheme.
- 10) The fundamental obligation on employers is to ensure that the superannuation arrangements established for members permit them, with voluntary employee contributions, to accumulate an adequate retirement benefit over their working life. Whether individuals avail themselves of that opportunity is a decision that is best made on an individual basis.
- 11) There are many good reasons why an existing RBF contributor might wish to transfer to the new accumulation scheme being proposed if such an option was permitted.
- 12) Offering a transfer right to existing RBF contributors will have a positive impact on the unfunded superannuation liability associated with the RBF scheme over time, as the future service of the transferring member will be fully funded and, for pre 1 July 1994 members, the generous "anti-detriment" pension conversion factor will not apply in relation to future service.
- 13) The ability of each member of the current contributory scheme to effectively exercise some choice over the manner in which he or she receives superannuation support from the employer is increased under a transfer right.
- 14) The provision of choice is an essential component of the direction in which Commonwealth regulation of superannuation is taking the industry and concerns about some individuals making poor decisions should not prevent an option being provided that also has the potential to significantly advantage a large number of individuals.

- 15) A compelling argument in favour of the provision of a transfer right is the announcement by the Commonwealth Government in the 1997-98 Budget that fund choice will require defined benefit funds to offer members the capacity to opt out.
- 16) Actuarial advice suggests that the provision of a transfer right that involves a carefully specified transfer benefit has the potential to produce savings in the future growth in the State's unfunded liability, provide many members with an advantage in terms of flexibility and choice and result in no change to the past service unfunded liability that currently exists.

7.7. COMMITTEE RECOMMENDATIONS

- 7.7.1. In light of the findings of the Committee in relation to the issues of compulsory or voluntary employee contributions and the provision of a transfer option for existing members of the RBF contributory scheme, the Committee makes the following recommendations:

Recommendation 16:

Existing members of the RBF non-contributory scheme and new public sector employees commencing after the date of closure of the RBF contributory scheme should not be compulsorily required to contribute to the new accumulation scheme.

Recommendation 17:

The RBF Board should actively encourage all scheme members to make voluntary contributions by including suitable material in all their promotional and informational brochures that demonstrates, in broad terms, the benefits that flow from such a course of action.

Recommendation 18:

These members should have the right to make any level of voluntary employee contributions they desire into the Fund at any time.

Recommendation 19:

Current RBF contributory members should be permitted to cease contributing at any time and exit the scheme in favour of participating in the new fully funded accumulation scheme.

Recommendation 20:

Upon transfer, these members should have their accrued past service benefit multiple calculated and compulsorily preserved in the Fund.

Recommendation 21:

Prior to any member electing to transfer out of the RBF contributory scheme, the Board should be statutorily required to provide that member with information relating to the level of employer superannuation support received by them in the contributory scheme.

Upon electing to transfer out, each member should sign a "deed of release" that indicates that they have taken the advice provided by the Board into account in reaching their decision and indemnifies the Board against any future claims as to the quality of the advice and education provided. The election should specify that the decision to transfer has been made in full knowledge and understanding of the implications.

- 7.7.2. The following Chapter considers whether the same arrangements as have been proposed in the previous Chapters should apply to new members of Parliament, new Judges, new legal office holders and new senior contract employees in the State Service.

8. PARLIAMENTARIANS, JUDGES, LEGAL OFFICE HOLDERS AND SENIOR CONTRACT EMPLOYEES

8.1. INTRODUCTION

8.1.1. The Committee's Terms of Reference specifically require it to consider whether the existing Parliamentary Retiring Benefits Fund (PRBF) and Judges' Contributory Pension Fund schemes should be closed to new entrants at some future point, with new members of these schemes being provided with employer funded superannuation support in line with the requirements of the Commonwealth's Superannuation Guarantee Charge legislation. Further, the Committee is required to report on the most appropriate future superannuation arrangements for those senior State Service employees on contract.

8.1.2. That is, the Committee is required to consider whether, having come to a number of conclusions in relation to future superannuation arrangements for State Servants, these are equally applicable to Parliamentarians, Judges, legal office holders and senior contract employees in the State Service.

8.1.3. The Terms of Reference require the Committee to have regard to:

"...the desirability of revising public sector superannuation arrangements to ensure equity in relation to the level of employer superannuation support between...[all]...classes of persons outlined..."¹²⁹

8.1.4. As outlined earlier, there are currently two superannuation schemes applicable to Parliamentarians. The first is a closed scheme established under the provisions of the *Parliamentary Superannuation Act 1973*. The second arrangement, established under the provisions of the *Parliamentary Retiring Benefits Act 1985*, applies to Parliamentarians first elected after 12 November 1985.

8.1.5. The Chief Justice, the five Puisne Judges and the Master of the Supreme Court are all covered by the provisions of the *Judges' Contributory Pensions Act 1968*. In addition, the *Solicitor-General Act 1983* and the *Director of Public Prosecutions Act 1973* provide that those statutory office holders have superannuation arrangements which are identical to those applicable to

¹²⁹ Joint Select Committee on Superannuation, Terms of Reference

Judges. In this Chapter, references to the Judges scheme or Fund therefore apply to the nine office holders covered by these three pieces of legislation.

- 8.1.6. Prior to considering issues associated with superannuation for new Parliamentarians, Judges, legal office holders and senior contract employees, the following sections provide some background to the existing arrangements that are in place.

8.2. THE PARLIAMENTARY SUPERANNUATION FUND (PSF)

- 8.2.1. The Parliamentary Superannuation Fund is a defined benefit pension scheme established under the provisions of the *Parliamentary Superannuation Act 1973*. The scheme was closed to new members in 1985. As at 30 June 1997, there were 15 Parliamentarians covered by the provisions of this legislation and 27 pension beneficiaries. Two retirements early in the 1997-98 financial year has altered these numbers to 13 active members and 29 pensioners.
- 8.2.2. Members contribute at the rate of 12 per cent of their Parliamentary salary. Under the scheme there is an entitlement to a pension benefit on retirement provided the person:
- retires after contributing for at least 15 years; or
 - has completed more than 8 years, but less than 15 years, of contributory service and satisfies criteria specified in section 16 of the Act.
- 8.2.3. In any other circumstances the member is entitled, on termination, to a refund of contributions plus interest and, if appropriate, a Superannuation Guarantee Charge (SGC) payment. In the event of the death of a member, the spouse is entitled to a pension representing five-eighths of the pension to which the member would have been entitled, or 40 per cent of the basic salary, whichever is the greater. In certain cases a benefit is simply paid to the deceased member's estate.
- 8.2.4. A member who has contributed for 20 years is entitled to the maximum pension benefit of 70 per cent times the basic salary of a Parliamentarian, times the ratio of the total Parliamentary salary received to the total basic salary that would have been received during the member's Parliamentary service if he or she had been a backbench member for all of their service.
- 8.2.5. Either 50 per cent or 100 per cent of a contributor's or spouse's pension may be commuted to a lump sum in accordance with conversion factors detailed in schedules to the Act.

- 8.2.6. The State's share of benefits is met on an emerging cost basis. An actuarial valuation of the scheme was undertaken as at 30 June 1995. This report estimated that the State's share of existing liabilities as at that time (or the unfunded liability) was \$14 million.
- 8.2.7. Were there to be any new entrants to the scheme (which, given that it is a closed scheme, is impossible unless a former member happens to again be elected to Parliament), the "new entrant" cost would be in the order of 30 per cent of salary per annum. This compares with a new entrant cost for members of the RBF contributory scheme of approximately 9.5 per cent of salary per annum.

8.3. THE PARLIAMENTARY RETIRING BENEFITS FUND (PRBF)

- 8.3.1. The Parliamentary Retiring Benefits Fund is a defined benefit lump sum scheme established under the provisions of the *Parliamentary Retiring Benefits Act 1985*. The scheme covers those members of Parliament first elected after the scheme came into effect on 12 November 1985. As at 30 June 1997, there were 38 Parliamentarians covered by the provisions of this legislation.
- 8.3.2. Members contribute at the rate of 9 per cent of their Parliamentary salary during the first 20 years of service and thereafter at 9 per cent of the amount by which the member's Parliamentary salary exceeds the basic Parliamentary salary. The benefit upon retirement after 15 years service depends upon the years of contributory service. The maximum entitlement for those with 20 or more years of service is seven times final salary (as defined in the Act).
- 8.3.3. This scheme is fully funded, with the Government currently contributing 25.2 per cent of salary per annum for each member of the scheme. This is an increase from the scheme design level of 22.5 per cent of salary, and arises from the Actuary's recommendation at the time of the 30 June 1995 review that the Government's contribution needed be increased to 2.8 times member contributions to ensure that the scheme remained fully funded, at least until the time of the next actuarial review due as at 30 June 1998.
- 8.3.4. As this is a fully funded scheme, there is no unfunded superannuation liability associated with this scheme.

8.4. THE JUDGES' CONTRIBUTORY PENSION SCHEME

- 8.4.1. Superannuation arrangements for Judges are specified in the *Judges' Contributory Pensions Act 1968*. There is no Judges' Superannuation Fund as such, with the contributions made by Judges (5 per cent of salary) being deposited in, and all benefits being met from, the Consolidated Fund.
- 8.4.2. As at 30 June 1997 there were nine members of the scheme including the Chief Justice, the five Puisne Judges, the Solicitor-General, the Director of Public Prosecutions and the Master of the Supreme Court. Office holders are covered by the Judges' scheme in accordance with the provisions of the legislation establishing their respective positions, or the Principal Act itself. Currently there are eight pension beneficiaries under the scheme arrangements.
- 8.4.3. The scheme provides for a pension of 50 per cent of salary following:
- retirement after 15 years service;
 - retirement on the grounds of ill-health; or
 - attainment of the statutory retirement age of 70 years.
- 8.4.4. Pensions are increased once a year in accordance with the movements in judicial salaries.
- 8.4.5. The Judges' scheme is an unfunded scheme. The State Government Actuary has estimated the extent of the unfunded liability as at 30 June 1995 as being \$10.113 million.
- 8.4.6. Actuarial advice obtained in 1995 by the Department of Treasury and Finance suggested that the required level of funding by the State for future service liabilities only is in the order of 44.5 per cent of salaries per annum over the remaining expected life of current members. The Actuary commented that should the Government wish to achieve a fully funded status over the same period, a contribution of 149.2 per cent of salary would be required.

8.5. SENIOR CONTRACT EMPLOYEES IN THE STATE SERVICE

- 8.5.1. Senior contract employees in the State Service currently have the option of either joining (or remaining in) the Retirement Benefits Fund scheme or having their employer superannuation support paid into a private fund of their choice. It should be noted that such employees already have the option

of salary sacrificing part of their salary remuneration in the form of further superannuation.

- 8.5.2. Heads of Agency are already generally employed on a "package" basis in relation to salary and superannuation. That is, a level of remuneration is established for a position and the individual is able to determine the mix between superannuation and salary (subject to the State continuing to meet its SGC obligations in relation to a minimum level of employer superannuation support).

8.6. REFORM IN OTHER JURISDICTIONS

- 8.6.1. To date, the Committee is unaware of any reforms being made to superannuation arrangements for members of Parliament and the judiciary in other Australian States and Territories. In relation to Commonwealth Parliamentarians and Judges, however, the Committee is aware of two significant developments that have some bearing.

- 8.6.2. The first of these was the release of the Report of the National Commission of Audit. That Commission made recommendations to the Commonwealth Government in a Report presented on 21 June 1996. The Commission recommended that the Government move away from defined benefit funds for Parliamentarians and Judges and introduce accumulation arrangements. The recommendations were as follows:

Recommendation 5.6:

The Government should initiate further work to examine the replacement of its current defined benefit superannuation schemes with accumulation schemes. The objective of this change is to increase remuneration flexibility rather than to reduce the total value of overall remuneration packages.¹³⁰

Recommendation 5.7:

Superannuation for Parliamentarians and Judges should be structured in a similar way to arrangements for senior executives in the rest of the workforce. That is, superannuation should be paid through accumulation benefit arrangements and the amount of superannuation should be determined by individuals as part of a fixed overall remuneration package.¹³¹

¹³⁰ National Commission of Audit, Report to the Commonwealth Government, June 1996, page 98

¹³¹ *ibid*, page 99

- 8.6.3. The Committee also noted that following a motion moved by the then Leader of the Democrats in the Senate, Senator Kernot, the Senate Select Committee on Superannuation was given a reference to investigate the appropriateness of the current unfunded defined benefit superannuation schemes for Judges and Parliamentarians. The Terms of Reference of that Committee are detailed in Appendix 6 and they are remarkably similar to those under which the current Inquiry is being conducted.
- 8.6.4. The Senate Select Committee's Report was recently released. The Committee was so divided over the issues, however, that the Report is not that useful a guide to the future direction that the Commonwealth Government might take in relation to superannuation for Parliamentarians.
- 8.6.5. The Committee split three ways - namely, along party lines. The Coalition members, the Australian Labor Party members and the member representing the Australian Democrats all presented dissenting views, with the only main issues of agreement being that the existing Parliamentary superannuation scheme needs to be changed and that the Remuneration Tribunal should be given the matter to resolve.
- 8.6.6. In relation to Judges' superannuation, the parties reached agreement that Judges' pensions are a cornerstone of judicial independence and that the scheme should be retained, with minor amendments relating to pension determination and rights of commutation.
- 8.6.7. The relevant conclusions and recommendations of the Senate Select Committee are summarised below:

"PART A: PARLIAMENTARIANS

- 3.84 The Committee considers that change to the Parliamentary Contributory Superannuation Scheme (PCSS) is desirable. The scheme is now out of step with superannuation practice in the wider community. There is convincing evidence that it is excessively generous to a small group of retiring parliamentarians.
- 3.85 The Committee is also conscious of the difficulties associated with a Parliamentary Committee reviewing their own entitlements. Inevitably, charges of conflict of interest will arise.
- 3.86 The Committee believes there is a lack of transparency in parliamentary superannuation and that this lack of transparency gives rise to much of the criticism of the PCSS.
- 3.87 The divergent views of Coalition and Australian Labor Party Senators are expressed in the following section. The Australian

Democrat member, Senator Lyn Allison, has appended a separate dissent to this report.

Coalition Senators' view - Superannuation and Parliamentary remuneration

3.88 Coalition members of the Committee conclude that the issue of superannuation must be considered as part of parliamentary remuneration determined by the Remuneration Tribunal.

3.89 The Coalition Senators consider that the framework and the terms of remuneration should be determined by the Government of the day, who should give guidance to the Remuneration Tribunal taking account of the following principles:

- Separation of retirement income and redundancy functions

Coalition Senators concur with the view put by several witnesses that the PCSS attempts to fulfil too many functions and considers that the scheme should operate solely as a method of providing income for retirement.

- Choice and opting out

Coalition Senators consider that new parliamentarians should be offered the choice of opting out of the PCSS in favour of a fully funded accumulation scheme or retirement savings account of their choice. This could become part of the establishment of a fully funded parliamentary scheme.

- Early vesting of benefits

Coalition Senators consider that the current disparity in benefits between short and longer term members needs to be addressed. The benefit, as far as practicable, should be proportional to years of service. The development of the concept of notional employer contributions for Superannuation Surcharge Tax purposes may be useful for this purpose.

- Optional and variable contributions

Coalition Senators are of the view that the scheme should be made more responsive to the personal circumstances and needs of members. However, if parliamentarians elect not to contribute to the scheme or to contribute at a lower rate, the value of their final benefits should be discounted accordingly.

- 3.90 At present the parliamentary scheme provides for the taking of pensions prior to retirement age. Under the changes to the preservation rules announced in the 1997-98 Budget, early access to benefits will still be possible '...where the benefits are taken as a non-commutable life pension or lifetime annuity'. While a case may be made for allowing early access to pensions, this is not consistent with current community standards. Coalition Senators recommend that future members of parliament should not receive any pension benefit until age 55.
- 3.91 For current members, Coalition Senators consider that there is a case for introducing actuarially discounted benefits if they are taken before age 55. The Australian Government Actuary should determine the appropriate discount to be applied. However, introduction of this provision should coincide with the new preservation rules announced in the 1997-98 Budget, that is, to commence from 1 July 1999.

Australian Labor Party Senators' view - Superannuation and parliamentary remuneration

- 3.92 The report refers to the independent Remuneration Tribunal setting the employment conditions of members of parliament.
- 3.93 Labor Senators have chosen not to recommend specific changes to the Parliamentary Contributory Superannuation Scheme but see the Remuneration Tribunal as the appropriate body to make necessary recommendations for reform in light of its independence, experience with remuneration matters and its ability to evaluate the totality of the scheme and its objectives.
- 3.94 Labor Senators believe there is a case for reviewing the Parliamentary Contributory Superannuation Scheme and recognise the potential conflict of interest in current parliamentarians determining changes to the superannuation scheme which affect the entitlements of current and future parliamentarians.
- 3.95 Labor Senators recommend that any review of the Parliamentary Contributory Superannuation Scheme be conducted independently by the Remuneration Tribunal.

Funding

- 3.96 The Committee has considered whether there is any advantage to be gained through fully funding the PCSS. The Committee notes the evidence of the Australian Government Actuary that such a proposal would not produce any savings for many years.

- 3.97 In the long term the Committee believes that the PCSS should move toward becoming a fully funded scheme. This would provide for greater transparency of superannuation with other parliamentary entitlements.

Controls on costs to the Commonwealth

- 3.98 The Committee notes the evidence that it received that the provision of survivor and invalidity benefits represent a significant and uncontrolled extra cost. While accepting that there may be a need to review these provisions, the Committee notes that survivor benefits are provided in many superannuation arrangements. The Committee considers that such arrangements are entirely reasonable.
- 3.99 The Committee recommends that survivor and invalidity benefits continue to be paid. However, the rules under which these benefits are paid should be reviewed by the Remuneration Tribunal, in accordance with standards adopted in other private and public sector superannuation schemes.

Interest on contributions

- 3.100 The new preservation rules announced by the Government apply to contributions by parliamentarians to the PCSS. Unless a mechanism is developed for paying interest on these contributions, the real value of these contributions may be eroded over time.
- 3.101 The Committee therefore recommends that contributions made by parliamentarians attract interest in accordance with normal superannuation practice.

PART B: JUDGES

Conclusion 5.7

The Committee concludes that the judges' pension scheme should be retained, with minor amendments as recommended below.

Conclusion 1.43

The Committee takes the view, on the evidence it has received, that the judicial pension scheme does indeed have a greater role than just being part of a remuneration package. The Committee recognises that judicial independence is a guarantee of the impartiality of the judiciary, which underpins the federal nature of the Commonwealth, and the protection of individual rights. The Committee shares the widespread view that secure and adequate judicial remuneration,

during retirement as well as during service, is essential to judicial independence.

Recommendation 3.1

The Committee recommends that the *Judges' Pensions Act 1968* be amended to provide for an actuarially reduced pension to be paid to a judge who retires under age 60 after ten or more years service, but who has attained the age of 55.

Recommendation 4.1

The Committee recommends that survivor and invalidity benefits continue to be paid to beneficiaries of the judges' pension scheme. However, as in the case of the parliamentary scheme, the Committee considers that the rules under which these benefits are paid should be reviewed to ensure they are in accordance with community standards.

Recommendation 4.2

The Committee recommends that the *Judges' Pensions Act 1968* be amended to provide for an option for a judge to elect to have his or her pension commuted on retirement, or on death before or after retirement, to the extent that would provide a lump sum equal to one year of the yearly pension to which the judge was entitled at the date of the retirement or death.

If such an election is made, any pension subsequently payable to the judge, spouse or dependant, is actuarially reduced by the value of the commutation so that the total value of benefits paid is the same as if there had been no election.

MINORITY REPORT

Senator Lyn Allison, representing the Australian Democrats, submitted a minority report. In her report Senator Allison made a number of recommendations, detailed below:

PART A: LEVEL OF PUBLIC SUBSIDY TO THE PARLIAMENTARY SCHEME

Recommendation No. 1

That the level of public subsidy to the PCSS is excessive and needs to be substantially reduced.

Recommendation No. 2

That the Remuneration Tribunal should be asked to determine an appropriate, reduced level of superannuation benefits for parliamentarians, taking into account standards prevailing in the community at large and the unusual nature of parliamentary life.

PART B: SHOULD PARLIAMENTARIANS BE COMPENSATED FOR A REDUCTION IN SUPERANNUATION

Recommendation No. 3

That salary packaging and total remuneration packaging approaches be rejected for parliamentarians' remuneration, with each element of remuneration being separately assessed as being appropriate and fair for its relevant purpose.

Recommendation No. 4

That the PCSS be confined in scope to providing an adequate post age 55 retirement income for former parliamentarians, taking into account the unusual nature of parliamentary life.

Recommendation No. 5

That in restricting the PCSS to retirement income purposes and reducing the level of public subsidy, there should be introduced a separate and additional dislocation allowance to assist former parliamentarians in transition from office to the workforce. Such an allowance should be set by the Remuneration Tribunal taking into account community standards in the area and the unusual nature of parliamentary life.

PART C: OTHER DESIGN ISSUES IN RELATION TO THE PCSS**Recommendation No. 6**

That, in redesigning the PCSS, the Remuneration Tribunal be asked to:

- a) Restructure the scheme as a fully vested accumulation scheme with the level of public subsidy being substantially reduced, and with the Government contribution becoming an appropriate multiple of the parliamentarians' 11.5 per cent contribution;
- b) That the redundancy function be separated from the retirement function;
- c) That, the Government contribution should cease after 18 years, and parliamentarians be permitted to reduce their contributions to 5.75 per cent after 18 years service as at present;
- d) That membership of the scheme remain compulsory, but where a member can satisfy the trustees that they have adequate retirement savings already, they may opt out of the scheme, thereby forfeiting the benefit of the Government contribution;
- e) That the rules for survivor and invalidity benefits be reviewed;
- f) That parliamentarians be able to make additional contributions if they so opt and be paid interest on those contributions; and
- g) That benefits under the scheme be paid as a pension, actuarially determined based on the value of the accumulated benefit when the parliamentarian retires or turns 55 (which ever is later), with the parliamentarian able to commute up to 50 per cent of their pension to a lump sum as at present.

Recommendation No. 7

That the new scheme apply equally to new and current parliamentarians in respect of future service. The entitlements of existing members should be determined under the current scheme as at the date of the closure of the existing scheme, with the Remuneration Tribunal determining appropriate transitional arrangements.

PART D: JUDGES SCHEME

The Australian Democrats generally support the analysis, conclusions and recommendations of the Majority Report in respect of the Judges' scheme."

- 8.6.8. The Committee noted the various recommendations made by the Senate Select on Superannuation. The Committee noted that it was not aware of any reaction from the Commonwealth Government to the Committee's Report. Clearly, the Commonwealth Government may decide to accept all, some or none of the Senate Select Committee's recommendations.
- 8.6.9. The Committee also concluded that while the report and the recommendations were of some assistance in helping members formulate their own views on the Tasmanian situation, the Senate Committee's Report deals with Commonwealth superannuation arrangements, which although similar to those prevailing in Tasmania, are somewhat different.
- 8.6.10. While the Commonwealth arrangements are, in the main, more generous than those prevailing in Tasmania, it must be noted that Tasmania simply does not have the same financial capacity as the Commonwealth.

8.7. DISCUSSION

- 8.7.1. In relation to Parliamentary superannuation, both the existing schemes in Tasmania are defined benefit schemes and therefore suffer from the disadvantages identified in respect of such schemes in Chapter 4. The experience of the Parliamentary Retiring Benefits Fund represents a good example of the difficulties that exist.
- 8.7.2. While this scheme is fully funded, the effect of the Parliamentary salary increases over recent years led the Actuary to recommend in his 1995 review into the state and sufficiency of the scheme that the employer contribution rate be increased from 2.5 times member contributions to 2.8 times. In short, because salary increases have a retrospective effect in defined benefit schemes, the enhanced past service benefits of members led to a need for the Government to increase its level of employer superannuation contributions to maintain a fully funded situation. As discussed in Chapter 4, such a situation does not occur in accumulation funds, where wage increases only impact prospectively.
- 8.7.3. The current Parliamentary schemes that apply in Tasmania were developed in a superannuation environment quite different to that which currently prevails. For example, there was no minimum superannuation requirement

under Commonwealth law and a large proportion of the working population received no superannuation support from their employer.

- 8.7.4. The levels of employer superannuation support built into the design of the PSF and PRBF schemes are large relative to those which relate to other public sector and private sector employees. One reason for this is that Parliamentary service is inherently variable - it may occur at relatively young ages as well as just prior to what would otherwise have been normal retirement age. Further, Parliamentary service is also highly uncertain and can end following an election at any time. Members who do not get re-elected might also experience some difficulty in resuming previous careers, due to significant time away from particular professions or occupations.
- 8.7.5. The Committee notes, however, that with the advent of the Commonwealth's SGC legislation, a person entering Parliament will have accrued some superannuation in previous employment. Similarly, a member losing his or her seat following an election will receive superannuation support in alternative employment. On this basis, it is possible to conclude that the environment in which past superannuation arrangements for Parliamentarians in Tasmania were developed is different to that which currently prevails.
- 8.7.6. In their submission to the Committee, the Police Association of Tasmania made the following point in this regard:

*"Superannuation schemes were traditionally developed on the basis of need at a time when resignation benefits tended to be minimal. Thus a politician who started at age 40 was assumed to have no previous superannuation and the scheme was designed to cope with this."*¹³²

- 8.7.7. In relation to the superannuation arrangements applicable to members of the Judges' scheme, the issue outlined above is also relevant. Judges have traditionally received very high levels of superannuation support in recognition that, in the absence of any other superannuation, they effectively needed to be provided with full lifetime benefits after relatively short periods of service. Again, the observation made by the Police Association of Tasmania in their submission to the Committee is pertinent:

*"The introduction of SG benefits, the availability of superannuation more generally and preservation arrangements greatly reduces the rationale for providing full benefits after short periods of service."*¹³³

¹³² Police Association of Tasmania Submission, page 11

¹³³ *ibid*, page 18

- 8.7.8. The Chief Justice of Tasmania, the Hon W J Cox, raised the issue of the independence of the judiciary in his submission to the Committee. He indicated that it was his view that:

*"Security of tenure, adequacy of remuneration while in office and adequacy of a pension in retirement are traditionally regarded as essential to the independence of the judiciary."*¹³⁴

- 8.7.9. The Committee considered this to be a very important issue to consider. On the one hand, the Committee did not want to recommend any reforms which could threaten, or potentially threaten, the independence of the judiciary. On the other hand, the Committee was conscious of the fact that the level of employer superannuation support implicit in the Judges Pension scheme is very high and, by all community standards, excessive.

- 8.7.10. The Committee noted the comments made by Professor Winterton in a paper he wrote on judicial remuneration for the Australian Institute of Judicial Administration Incorporated. In that paper, Professor Winterton noted that:

*"The question of judicial remuneration essentially involves the reconciliation and balance between two fundamental, but potentially conflicting, principles of constitutional government: judicial independence and Parliamentary control over appropriation"*¹³⁵

- 8.7.11. It is difficult to support the argument that providing new Judges and legal office holders with a lower level of employer superannuation support than for current incumbents could threaten the concept of judicial independence. In this regard, the Committee noted that the recently released "Statement of Judicial Independence" did not make reference to the superannuation entitlements of Judges.

- 8.7.12. The Committee noted that Professor Winterton also suggested that:

*"It is unnecessary for present purposes to examine the full implications of judicial independence. As critics have noted, it has occasionally been deployed by the judiciary as a rhetorical weapon in defence of the status quo and to ward off reform and accountability."*¹³⁶

¹³⁴ Submission by the Chief Justice of Tasmania, page 1

¹³⁵ George Winterton, *Judicial Remuneration in Australia*, The Australian Institute of Judicial Administration Incorporated, Melbourne, 1995, page 2

¹³⁶ *ibid*, page 13

- 8.7.13. Although there were very few persons or organisations who made specific comments in relation to Judges and legal office holders, the Committee did note that at least one national commentator has raised the issue, albeit in the context of Commonwealth Judges. Mr Brian Toohey, a writer for the *Australian Financial Review*, recently suggested that:

"The extraordinary generosity of the existing superannuation scheme ignores the income of Judges before and after life on the Bench. If most had been doing as well as they claim at the Bar, then they should have built up a significant level of superannuation before becoming a Judge. If they retire at 60, many can look forward to additional earnings from a new career in consulting, heading commissions of inquiry, private arbitration, or at the Bar.

*Switching to a normal employer contribution of 6-9 per cent should be possible without any diminution in the quality of candidates for either the Court or the Parliament."*¹³⁷

- 8.7.14. In considering the introduction of the "surcharge" on high income earners, it is interesting to note that the Commonwealth Government recently indicated, for constitutional reasons, that the surcharge would not apply to current Judges in the various Commonwealth and State Courts. However, the Commonwealth also indicated that the same protection would not apply to newly appointed Judges, presumably on the basis that such persons would be aware of the terms and conditions pertaining to their employment prior to accepting a judicial appointment.

8.8. OPTIONS FOR REFORM

- 8.8.1. The Committee is aware that there is a general feeling within the wider Tasmanian community that the superannuation benefits of Parliamentarians, Judges and legal office holders are excessive in comparison with those of other groups of public and private sector employees. On this basis, it is difficult to accept the argument advanced by the Chief Justice that:

*"It is unfortunate that some sections of the media tend to highlight the ratio of contribution by Judges to the level of their potential benefits as compared with public servants. The comparison is irrelevant and proves nothing."*¹³⁸

¹³⁷ Brian Toohey, *Australian Financial Review*, 8 April 1997

¹³⁸ Submission by the Chief Justice of Tasmania, page 2

8.8.2. Accordingly, the Committee believes that there is a number of possible reform options. Some of these are outlined below:

- a) make no changes to the current Parliamentary and Judges' superannuation schemes, on the basis that the levels of employer superannuation support implicit in those schemes is recognition for a range of factors that are peculiar to service in those particular occupations;
- b) close off the existing Parliamentary and Judges' superannuation schemes and require new members to join an accumulation scheme in which they would receive employer superannuation support equivalent to that which is implicit in the current schemes. While not altering the overall level of support, this option would ensure that new Parliamentarians and new Judges would receive superannuation through a vehicle that was more appropriate in today's workplace environment;
- c) close off the existing Parliamentary and Judges' superannuation schemes and require new members to join an accumulation scheme in which they would receive employer superannuation support at the same rate (the Commonwealth SGC level) as all other new public sector employees. This would maximise equity as between all classes of employees and recognise that differences in skills, experience and responsibility as between Judges, Parliamentarians, legal office holders and State Servants will be adequately reflected in different salary levels; and
- d) close off the existing Parliamentary and Judges' superannuation schemes and provide that new members should be employed on the basis of a total remuneration package that includes the grossed up value of the existing salary component, a superannuation component, a car (if currently received) and any other benefits (if any). New Parliamentarians and new Judges would therefore be free to determine their own superannuation arrangements, subject to a requirement that they must salary sacrifice from the total remuneration package an amount that is sufficient to ensure that the State's SGC obligations under Commonwealth law are met.

8.8.3. Consistent with the view expressed by the Senate Select Committee in relation to the reform of Commonwealth Parliamentary superannuation arrangements, however, the Committee did not believe that it was able to make specific reform recommendations to the Government in relation to the superannuation arrangements to be implemented for new members of Parliament.

- 8.8.4. Members of the Committee were very conscious of the difficulties associated with current Parliamentarians reviewing the superannuation arrangements to apply to both themselves (through the possible suggestion that, similar to the recommendations made earlier in relation to State Servants, transfer rights be provided to members of the existing schemes to elect to move into the new arrangements) and to new Parliamentarians. The Committee felt that notwithstanding the Terms of Reference for the current Inquiry, it was inappropriate for this to occur and agreed with the unanimous view of the Senate Select Committee that were it to make such reform recommendations, inevitably charges of conflict of interest would arise.
- 8.8.5. The Committee believes that it would be more appropriate for a special independent panel to be constituted to conduct a review into the Parliamentary superannuation arrangements to apply to new members (including possible transfer options being provided for members of the existing schemes) and to make recommendations to the Government in light of its independence, experience with superannuation matters and its ability to evaluate the totality of the current schemes and their objectives.
- 8.8.6. In relation to new Judges and new Masters of the Supreme Court, the Committee felt that the independent panel established to make recommendations to the Government in relation to the reform of Parliamentary superannuation for new members should also be charged with the task of making recommendations in relation to the future superannuation arrangements to apply to these categories of persons.
- 8.8.7. The Committee did not feel, however, that new Solicitors-General and Directors of Public Prosecutions should be able to join the Judges' Contributory Pensions scheme. These employees are more in the nature of career public servants than members of the judiciary and should therefore be treated in the same manner as Heads of Agency in relation to superannuation - that is, superannuation should be provided through a "package" concept.
- 8.8.8. The Government, in providing such an independent panel with appropriate terms of reference, should require it to undertake a review having regard, *inter alia*, to the following principles, namely that:
- a) accumulation schemes are more appropriate than defined benefit schemes in today's economic, regulatory, taxation and workplace environments;
 - b) equity should be achieved both between the superannuation arrangements to be provided for new Parliamentarians, new Judges, new Masters of the Supreme Court and new State Servants, and with employees in the private sector, subject to appropriate consideration being given to the range of issues that are peculiar to parliamentary and

judicial service (such as the fact that Parliamentarians, for example, generally have a shorter and more uncertain working life, they receive no workers' compensation cover that extends beyond their term of office, they do not receive redundancy benefits in the event that their employment is terminated, they have no protection from "unfair dismissal" and they have no sick or long service leave);

- c) any member contributions should be voluntary;
- d) new Parliamentarians, Judges and Masters of the Supreme Court should have the same degree of choice over the superannuation scheme they join as new members of the State Service; and
- e) existing Parliamentarians, Judges and Master of the Supreme Court should have the same option of transferring out of the existing schemes into the proposed new arrangements as will existing members of the RBF contributory scheme.

8.9. SUMMARY OF EVIDENCE

- 8.9.1. Few of the organisations which made a submission to the Committee commented upon the Parliamentarian and Judges aspects of the Terms of Reference. An extract of relevant evidence is, however, reproduced below.

The Tasmanian Chamber of Commerce and Industry (TCCI)

*"... arrangements for new employees (including politicians) must be based on the accumulation model."*¹³⁹

"The Parliamentary scheme (and probably the Judges' scheme) are in a special category. In our view politicians should be paid a loading on their salary, and subject to meeting SGC requirements, they would be free to make whatever arrangements they like in the private market place.

*The level of salary loading is a separate matter on which we do not have a fixed view, other than to observe that the existing required contribution of 25% appears excessive."*¹⁴⁰

¹³⁹ Tasmanian Chamber of Commerce and Industry Submission, page 2

¹⁴⁰ *ibid*, page 3

National Mutual

"If the Government wishes to attract quality appointees... it is important to provide competitive salary packaging arrangements in line with market trends and expectations.

For newly appointed Parliamentarians a similar approach could be adopted. The length of "tenure" of Parliamentarians is on average shortening as it is in the general workforce.

The major issues of concern therefore shift to portability, asset accumulation and protection for many of the incumbents.

By providing a "total employment cost" package it provides Parliamentarians with flexibility to build on existing superannuation assets at their discretion, as well as providing portability of benefits at the completion of their Parliamentary careers."¹⁴¹

Tasmanian Trades and Labor Council (TTLC)

"We believe that, in principle, parliamentarians and judges should receive the same level of superannuation support as permanent public servants."¹⁴²

Department of Treasury and Finance

"Treasury believes that from an equity perspective, the Committee would find it very difficult to take a particular decision for public sector employees and another for Parliamentarians, Judges and other legal officers...It is recognised that the superannuation benefits to be provided to Parliamentarians and Judges will largely be a political issue. However, Treasury is of the view that the current level of employer support which is implicit in the relevant schemes cannot be justified and needs to be substantially reduced."¹⁴³

"There is clearly a long held view that public sector employees (including Parliamentarians, Judges and senior public servants) benefit from more generous superannuation arrangements than are

¹⁴¹ National Mutual Submission, pages 16 and 17

¹⁴² Tasmanian Trades and Labor Council Submission, page 1

¹⁴³ Department of Treasury and Finance Submission, pages 30 and 31

generally available in the private sector...Committee recommendations along these lines... would go a long way towards addressing this perception."¹⁴⁴

Chief Justice of Tasmania (Hon W Cox)

*"The considerations which apply to the terms and conditions of appointment and service of Judges are quite different from those applicable elsewhere in the public sector...security of tenure, adequacy of remuneration while in office and adequacy of a pension on retirement are traditionally regarded as essential to the independence of the judiciary. Unless all three are guaranteed, independence is undermined and the recruitment of suitable persons to serve the community as Judges is jeopardised."*¹⁴⁵

8.10. COMMITTEE FINDINGS

8.10.1. Having regard to the above and the evidence presented to it in relation to the most appropriate superannuation arrangements for new Parliamentarians, members of the judiciary, legal office holders and senior contract employees, the Committee finds that:

- 1) While the level of superannuation benefits provided to Parliamentarians, Judges and new legal office holders is largely a political issue, the level of employer superannuation support implicit in the current open Parliamentary scheme and the Judges' superannuation arrangement is very high by all community standards.
- 2) However, reasons for the high levels of superannuation support provided to Parliamentarians and Judges do exist. For example, members of Parliament generally have a shorter and more uncertain working life than State Servants and employees in the private sector and they do not enjoy all the forms of on-cost benefits that other employees receive (such as workers' compensation, redundancy benefits upon termination, protection from "unfair dismissal" and sick or long service leave). Judges, on the other hand, argue that such support is necessary to preserve the independence of the judiciary.
- 3) Both the Parliamentary superannuation schemes and the Judges' scheme are defined benefit superannuation arrangements and therefore suffer from the same disadvantages identified in respect of such

¹⁴⁴ *ibid*, page 36

¹⁴⁵ Submission by the Chief Justice of Tasmania, page 1

schemes in Chapter 4. Furthermore, the 1973 Parliamentary scheme and the Judges' scheme both have significant unfunded liabilities attached to them.

- 4) The current Parliamentary scheme that applies in Tasmania was developed in a superannuation environment quite different to that which presently prevails. There are now minimum superannuation requirements under Commonwealth law, which means that members will enter Parliament with previous superannuation support and will leave in the knowledge that they will receive superannuation support in relation to their future employment.
- 5) Likewise, the environment in which superannuation is currently provided to Judges and other senior legal officers holders is different to that in which current superannuation arrangements were established. With the certainty that Judges will commence employment with substantial prior superannuation, it is arguable as to whether there remains such a strong need for full lifetime benefits to be provided after relatively short periods of service.
- 6) There is a number of possible reform options available in relation to the Parliamentary and Judges' superannuation arrangements, namely:
 - a) make no changes to the current Parliamentary and Judges' superannuation schemes;
 - b) close off the existing Parliamentary and Judges' superannuation schemes and require new members to join an accumulation scheme in which they would receive employer superannuation support equivalent to that which is implicit in the current schemes;
 - c) close off the existing Parliamentary and Judges' superannuation schemes and require new members to join an accumulation scheme in which they would receive employer superannuation support at the same rate (the Commonwealth SGC level) as all other new public sector employees; and
 - d) close off the existing Parliamentary and Judges' superannuation schemes and provide that new members should be employed on the basis of a total remuneration package that includes the grossed up value of the existing salary component, a superannuation component, a car (if currently received) and any other benefits (if any).
- 7) The Committee does not believe that it is able to make specific reform recommendations to the Government in relation to the superannuation

arrangements to be implemented for new members of Parliament. Members of the Committee are very conscious of the difficulties associated with current Parliamentarians reviewing the superannuation arrangements to apply to both themselves (through the possible provision of transfer rights) and to new Parliamentarians.

- 8) Notwithstanding the Terms of Reference for the current Inquiry, it is inappropriate for the Committee to make reform recommendations when the members of the Committee will be affected. Were it to do so, inevitably charges of conflict of interest would arise.
- 9) It would be more appropriate for a special independent panel to be constituted to conduct a review into the Parliamentary superannuation arrangements to apply to new members (including possible transfer options for members of the existing schemes) and to make recommendations to the Government in light of its independence, experience with superannuation matters and its ability to evaluate the totality of the current schemes and their objectives.
- 10) The independent panel established to make recommendations to the Government in relation to the reform of Parliamentary superannuation for new members should also be charged with the task of making recommendations in relation to the future superannuation arrangements to apply to new Judges and new Masters of the Supreme Court. New Solicitors-General and Directors of Public Prosecutions are more in the nature of career public servants than members of the judiciary and should therefore not be members of the Judges' Contributory Pensions scheme. Superannuation should be provided to these individuals on exactly the same basis as it currently is to Heads of Agency - that is, via a total remuneration package concept.
- 11) The Government, in providing such an independent panel with appropriate terms of reference, should require it to undertake a review having regard, *inter alia*, to particular reform principles. These should be based on the broad nature of the reforms being recommended by the Committee in relation to superannuation arrangements for new public sector employees.
- 12) Given that Heads of Agency are already employed on "package" basis in relation to salary and superannuation, no changes are required to the superannuation arrangements for this category of public sector employee.
- 13) New senior contract employees in the State Service should be covered by the same superannuation arrangements as the Committee is recommending for all new public sector employees. The only

difference relates to the ability to salary sacrifice into superannuation. This option is not available to award employees but, given the contract nature of their employment, should remain open to new members of the Senior Executive Service. The Committee notes that the ability to make such arrangements is at no cost to the State Government.

8.11. COMMITTEE RECOMMENDATIONS

- 8.11.1. In light of the findings of the Committee in relation to the issue of the appropriate superannuation arrangements to apply to new Parliamentarians, new Judges, new legal office holders and new senior contract employees in the State Service, the Committee makes the following recommendations:

Recommendation 22:

Given the potential for conflicts of interest to arise, it is inappropriate for members of Parliament to make recommendations to the Government in relation to the reform of Parliamentary superannuation arrangements.

Recommendation 23:

The Government should appoint an independent panel with expertise in superannuation to conduct a review into the Parliamentary superannuation arrangements to apply to new members (including possible transfer options for existing scheme members) and to make recommendations to the Government.

Recommendation 24:

The independent panel established to make recommendations to the Government in relation to the reform of Parliamentary superannuation for new members should also be charged with the task of making recommendations in relation to the future superannuation arrangements to apply to new Judges and new Masters of the Supreme Court.

Recommendation 25:

The independent panel should be required to undertake the review having regard, *inter alia*, to the following reform principles:

- accumulation schemes are more appropriate than defined benefit schemes in today's economic, regulatory, taxation and workplace environments;
- equity should be achieved both between the superannuation arrangements to be provided for new Parliamentarians, new Judges, new Masters of the Supreme Court and new State Servants, and with employees in the private sector, subject to appropriate consideration being given to the range of issues that are peculiar to parliamentary and judicial service;
- any member contributions should be voluntary;
- new Parliamentarians, new Judges and new Masters of the Supreme Court should have the same degree of choice over the superannuation scheme they join as new members of the State Service; and
- existing Parliamentarians, Judges and the Master of the Supreme Court should have the same option of transferring out of the existing schemes into the proposed new arrangements as will existing members of the RBF contributory scheme.

Recommendation 26:

No change should be made in relation to the superannuation arrangements applicable to new Heads of Agency, as they are already employed on a "package" basis in relation to salary and superannuation.

Recommendation 27:

The *Solicitor-General Act 1983* and the *Director of Public Prosecutions Act 1973* should be amended to provide that new Solicitors-General and new Directors of Public Prosecutions appointed on and after 1 July 1998 are not eligible to join the Judges' Contributory Pension scheme. Rather, these persons should be employed on a "package" basis in the same manner as are Heads of Agency.

Recommendation 28:

New senior contract employees in the State Service should be provided with the same superannuation arrangements as are recommended to apply in relation to new public sector employees. They should, however, retain the ability to salary sacrifice (which is an option not available to award employees).

- 8.11.2. The following Chapter considers issues associated with the provision of fund and investment choice within public sector superannuation arrangements.

9. FUND AND INVESTMENT CHOICE

9.1. BACKGROUND

- 9.1.1. As indicated in earlier Chapters, current Commonwealth Government superannuation policy is progressively being focussed on the provision of choice to individuals. It was against this "choice" philosophy background that in the 1997-98 Budget, the Commonwealth abandoned the proposal of the former Government for compulsory member contributions to be introduced (which were to attract Commonwealth co-contributions).
- 9.1.2. In that same Budget the Commonwealth Government also announced its intention to legislate in relation to member fund choice. This Chapter will outline the key elements of that announcement and then consider a range of issues associated with both fund choice and investment choice.
- 9.1.3. Given that there is the possibility of some confusion in relation to these concepts, the Committee felt that it would be useful to clearly distinguish between fund choice and investment choice at the outset. Fund choice involves individual employees being able to elect (either in a limited or unlimited manner) which superannuation scheme they wish to belong to. Once that election is made and the person joins a particular scheme, the provision of investment choice involves a number of options being made available to members in relation to the precise manner in which their funds are invested.
- 9.1.4. It is therefore possible to have both fund and investment choice under any revised public sector superannuation arrangements, or to have just one of them. The Committee is aware, however, that investment choice within a particular fund is now commonplace in the private sector - most schemes now offer members a choice of possible investment vehicles (with some of the more common options being labelled as capital stable, capital guaranteed, balanced, managed and growth). The concept of members of superannuation funds having some control over the manner in which their vested benefit is invested by the fund trustees has already been raised, in a limited fashion, in Chapter 6.
- 9.1.5. The Committee notes that its Terms of Reference specifically require that the matter of fund choice be considered during the course of the Inquiry. In particular, the Committee was requested by Parliament to report on whether or not new employees should be provided with the option of either joining a public sector arrangement (however that might be structured) or nominating one of a number of complying private sector superannuation funds into which the employer superannuation support should be paid.

9.2. THE 1997-98 COMMONWEALTH BUDGET AND FUND CHOICE

- 9.2.1. The Commonwealth Government announced in the 1997-98 Budget that it intends to legislate to provide that on and from 1 July 1998, new employees must be able to choose which superannuation fund, public offer fund or Retirement Savings Account (RSA) their Superannuation Guarantee (SG) and award superannuation contributions are to be paid into.
- 9.2.2. Employers will be required to give employees 28 days in which to make a choice from among five or more complying superannuation funds or RSAs nominated by the employer. If they exist, the choices offered by the employer to each new employee must include a relevant industry fund or funds, an in-house fund and the RSA provided by the institution receiving the employee's pay.
- 9.2.3. Further, in respect of the choices offered by an employer to an individual employee, the employer will be required to provide a 'Key Features Statement', which is prepared by each fund or RSA, and supply any relevant application forms to that employee. Where a nomination is not made by the employee within the required time frame, the employer superannuation contributions are to be made to the fund or RSA specified by the employer.
- 9.2.4. Existing employees must be provided with the same fund choice options within two years of the date of effect of the proposed legislation. Given the announced commencement of fund choice for new employees from 1 July 1998, this suggests that existing scheme members will need to be offered a choice of fund in line with the above arrangements on and from 1 July 2000.
- 9.2.5. In the associated 1997-98 Budget Paper entitled *Savings: Choice and Initiative*, the Commonwealth announced that for constitutional reasons the proposed choice of funds legislation will not apply to employees working under State industrial awards. However, the Commonwealth indicated that it will request all State Governments to consider introducing complementary legislation to achieve choice of fund for individuals employed under State awards, where they have not already done so.
- 9.2.6. The Committee notes that the proposed application of the fund choice legislation to employees covered by federal industrial awards but not to those covered by State industrial awards will produce some difficulty in relation to the RBF scheme. This will arise due to the fact that there are many employees covered by the *Retirement Benefits Act 1993* that are employed under a federal award (such as teachers, for example), while others are obviously employed under State awards. As such, the Government will be

legislatively required to provide a choice of fund for some employees, but not others.

- 9.2.7. The Committee notes that it would be inequitable to provide flexibility and choice to some scheme members but not others. Further, the introduction of differential arrangements for employees in the same scheme, based on the nature of the award under which they are employed, would be administratively cumbersome and, arguably, discriminatory.
- 9.2.8. The Commonwealth Budget documents also indicate that the proposed choice of fund legislation will not apply to public sector arrangements to the extent that employer Superannuation Guarantee (SG) and award contributions are unfunded. Nevertheless, the Commonwealth has announced that the choice of fund legislation will apply to defined benefit funds, in the sense that contributors to such schemes will need to be provided, on and from 1 July 2000, with the ability to exercise a choice and to leave their current fund in favour of an alternative arrangement.
- 9.2.9. In this respect, the Commonwealth document acknowledges that employees who exercise their choice to leave a defined benefit fund may receive reduced employer superannuation support in relation to future service. It is noted that employees leaving a defined benefit scheme might only receive SGC minimum employer contributions in future, rather than contributions at a rate consistent with the defined benefit scheme that they left. In such circumstances, the Commonwealth has indicated that employees will need to be informed by their employers of the full consequences of their choice.
- 9.2.10. The proposed choice of fund legislation will also not override the provisions of workplace agreements, as the Commonwealth Government noted that were it to do so, it would be inconsistent with the intention of the industrial relations legislative framework.
- 9.2.11. In light of the above summary, it is clear to the Committee that the announcements by the Commonwealth Government will have considerable implications for both employers and the trustees of superannuation funds. Many issues will need to be addressed before employee fund choice comes into effect, a number of which are discussed in section 9.5 below.

9.3. THE WALLIS INQUIRY AND FUND CHOICE

- 9.3.1. Member fund choice was also a key recommendation of the Wallis Inquiry into Australia's Financial System. The Inquiry's objective in making recommendations in this area was to assist in increasing the level of industry competition and in improving the efficiency of the superannuation industry. Outcomes along these lines were expected by the Wallis Committee to, over

time, drive down the cost of investment for both superannuation funds and managed funds in general.

9.3.2. In particular, the Wallis Inquiry suggested that:

“Allowing member choice could increase competition between funds and should, other things being equal, enhance efficiency in the industry. However, member choice raises several concerns:

- *administrative costs for employers and funds are likely to be greater if freedom of choice is unfettered and can be exercised at will. If members exercise choice frequently, additional exit/entry fees may offset any increase in investment returns;*
- *choice also raises issues for fund liquidity. Investment strategies may need to be adjusted to hold more liquid assets and may result in greater focus on short-term investment performance. United States’ experience suggests that investor choice has not led to higher volatility in fund liquidity.*

These problems may be partly addressed by imposing some limitations on exit, such as a suitable notice period or limits on the frequency of change. Subject to these constraints, the additional competition engendered by choice is likely to put downward pressure on costs and to encourage rationalisation of the industry.”¹⁴⁶

9.3.3. A number of the implementation issues raised by the Wallis Committee are discussed in further detail in section 9.5 below.

9.4. THE EXTENT OF FUND CHOICE CURRENTLY AVAILABLE IN THE RBF SCHEME

9.4.1. While it is not well known, nor actively marketed by the RBF Board or the Government, the *Retirement Benefits Regulations 1994* already allow employees, with the consent of their employing Agency, to opt out of the contributory scheme. In particular, regulation 4 provides as follows:

“These regulations do not apply to...

¹⁴⁶ *Financial System Inquiry, Final Report by the Wallis Committee, March 1997, page 488*

(d) *a person in respect of whom an Agency has certified:*

- * *that alternative arrangements have been made for that employee by the Agency; and*
- * *that those arrangements satisfy the requirements of the Superannuation Guarantee (Administration) Act 1992 of the Commonwealth.*¹⁴⁷

9.4.2. Although this provision does exist, the Committee is aware that there is only a very small number of employees who have exercised the option of not joining the RBF scheme through this mechanism. The RBF Board has indicated, for example, that only 220 contract and permanent employees have exercised the right to opt into alternative superannuation arrangements - just over 1 per cent of the contributory scheme membership.¹⁴⁸

9.4.3. In addition to the above provision relating to employees of Agencies in the public sector, employees of certain State Authorities are not automatically members of the RBF contributory scheme. Regulation 23 is relevant in this regard:

“(4A) A contributor who is employed by a State Authority which, with the approval of the Minister, has elected to participate in the non-contributory scheme established under Part 5 by notice in writing to the Board, may elect to exempt himself or herself from contributing to the Fund.

*(4B) A contributor who is employed by a State Authority which, with the approval of the Minister, has elected to participate in a scheme other than a scheme established under these regulations by notice in writing to the Board, may elect to exempt himself or herself from contributing to the Fund.”*¹⁴⁹

9.4.4. The Committee notes that while these “choice” options do exist, they are of a completely different nature to the type of choice arrangements envisaged by the Commonwealth in its 1997-98 Budget announcements. The key difference is that the employees covered by the above provisions are not free to make choices themselves.

¹⁴⁷ *Retirement Benefits Regulations 1994, regulation 4*

¹⁴⁸ RBF Board Submission, page 60

¹⁴⁹ *Retirement Benefits Regulations 1994, regulation 23*

- 9.4.5. In respect of employees employed by an Agency, the ability to opt out is determined by the willingness of the Agency to make alternative arrangements while, in relation to employees employed by State Authorities, the approval of the Minister is required for either the Authority to only participate in the non-contributory scheme or to participate in a scheme that is not established under the Retirement Benefit Regulations.

9.5. DISCUSSION RELATING TO THE PROVISION OF FUND CHOICE

- 9.5.1. The Commonwealth Government, the Wallis Committee of Inquiry and the Governments of those other States who have already introduced fund choice (see Chapter 3) clearly believe that there are significant benefits associated with the provision of such flexibility to employees. In addition to the 1997-98 Budget announcements in relation to fund choice, the Commonwealth has recently also announced that it will give effect to its policy direction in relation to its own superannuation scheme, namely the Public Sector Superannuation (PSS) scheme.

- 9.5.2. As outlined in Chapter 3, new Commonwealth public sector employees on and after 1 July 1998 will have their employer superannuation paid into their chosen private sector complying superannuation fund or Retirement Savings Account (RSA) instead of the PSS scheme. In particular;

- a) the PSS scheme will be closed to new members from that date;
- b) from 1 July 2000 members of the PSS scheme and the closed Commonwealth Superannuation Scheme (the CSS) will have the choice of remaining in their scheme, with no change to existing arrangements, or to cease membership and have future employer superannuation paid to a complying private sector superannuation fund or RSA of their choice.

- 9.5.3. The following advantages are generally advanced in relation to fund choice:

- a) by being able to select the superannuation fund of their preference, employees will have increased flexibility to access a greater range of services and superannuation products and to ensure that the scheme they join best reflects their particular personal preferences and best addresses their personal circumstances;
- b) employees with fund choice have a greater sense of ownership and control over their future superannuation savings;

- c) control over the superannuation scheme they join provides members with the opportunity to consolidate their superannuation savings, which will provide greater opportunities to maximise their retirement benefit. With greater workforce mobility, it is now increasingly common for employees joining an employer to already have a "superannuation history" - in every case except an employee joining straight from school or university, individuals will have established superannuation arrangements in place and, in many instances, will have a preference for these to be continued; and
- d) fund choice will produce greater competition amongst superannuation providers which, in a similar fashion to the increased competition being generated in a range of other markets in recent times, can be expected to produce efficiency benefits that will advantage members over time. It is contended that more emphasis on the achievement of competitive returns on investments, lower administration costs, higher quality of services and increased product differentiation (as schemes will now effectively be required to review the nature of all benefits provided and the manner in which these are packaged and presented) can only benefit employees.

9.5.4. Notwithstanding the benefits expected to flow from the implementation of fund choice, it is fair to suggest that there is a range of perceived disadvantages associated with this Commonwealth policy direction. These can be summarised as follows:

- a) the requirements to be placed on an individual under the proposed Commonwealth legislation to make a choice will present difficulties for many, as they will not be in a position to make a decision between the range of options available. While 'Key Feature Statements' will certainly assist members to make their election, there will still be a number of individuals that will not be able to understand exactly how alternatives compare and might, in the face of aggressive and unconscionable marketing conduct, ultimately make poor fund decisions;
- b) the fund choice legislation will, in all likelihood, impose additional administrative costs on employers and superannuation funds. For example, employers will need to determine which funds are to be offered as choices to their employees, will need to gather together the Key Feature Statements associated with these and perhaps prepare other information that is sufficient to enable employees to make an informed choice. While most private sector funds would already have Key Feature Statements, public sector funds such as the RBF will also be

required to develop these in order to compete for members in the fund choice environment;

- c) employers might well end up exposed to liability where a fund selected by them fails to perform as indicated in the Key Features Statement. There is a degree of concern that the employer will not be able to completely absolve itself from responsibility in this circumstance, with members being able to take legal action at some point in the future on the basis that they received incorrect or misleading advice;
- d) as individuals become increasingly aware of their superannuation investments, there may be a tendency for members to regularly "chase" the best returns and to transfer to funds that are performing well in the short term. This short term focus might well lead to lower returns over the medium-to-long term and have an impact on overall national savings. Further, this might have implications for the liquidity positions of superannuation funds;
- e) choice of fund requires schemes to be fully funded, in order to enable members to elect out and to transfer their accrued benefit entitlement to a new fund of their choice; and
- f) given the proposed requirement for employees to exercise a choice of fund within 28 days of commencing employment, an issue exists as to how an employee is to be treated in the event that they either die or are injured during that time. If no election has been made and either of these events occurs, an issue to be addressed in the proposed Commonwealth legislation will be the obligations on employers to adequately provide for such employees.

9.5.5. While there is some merit associated with the possible difficulties surrounding the provision of fund choice to employees outlined above, after careful consideration the Committee believes that these are capable of being adequately addressed.

9.5.6. In relation to the matter of the onerous obligations imposed on employees to make a choice of superannuation fund, despite not fully understanding the issues associated with, and the impact of, their choice, the Committee believes that this can be accommodated through the provision of a 'default' choice in such cases. In this regard, in those circumstances where an employee does not exercise an election, the Commonwealth announcements envisage that the employer will make the choice on their behalf.

9.5.7. The Committee holds the view that the State Government, in conjunction with public sector unions, should be able to determine the appropriate arrangements to apply in the 'default' situation. This would ensure that those

employees who simply do not get around to making an election, and those employees who might find the making of an election too difficult, receive adequate superannuation coverage.

- 9.5.8. The Committee accepts that the implementation of fund choice will not be costless and that there will be administrative expense associated with the initiative. However, most private sector funds are already experienced in competing for business and certainly have Key Feature Statements in relation to their schemes. Public sector schemes will need to develop these Statements, but the Committee does not believe that this would require a great deal of effort (given the scheme summaries that are already in existence for the purposes of advising new members of what the scheme arrangements entail).
- 9.5.9. In addition, the costs to employers of choosing which five, or more, funds will be offered as choices need to be offset against the savings that will accrue once an election has been made. In many instances, employees will elect to join private sector arrangements where accounts already exist from previous employment. This will result in Agencies no longer being required, from that point onwards, to provide a first-stop advisory service in relation to the operation of public sector schemes. Any superannuation concerns from then on (other than one relating to the payment of employer superannuation contributions) would be a matter between the employee and the private sector scheme of which they are a member.
- 9.5.10. In addition, the Committee does not accept that the administrative costs associated with the payment of employer superannuation contributions by Agencies to a range of private sector funds (rather than to the Superannuation Provision Account, as is currently the case) is a real issue. For example, the Committee received evidence to suggest that the Department of Treasury and Finance already has the capacity to make salary payments to in excess of 40 financial institutions¹⁵⁰ and currently makes deductions to a wide range of organisations in relation to health insurance and salary sacrifice contributions.
- 9.5.11. With regard to the prospect of increased employer liability under a fund choice scenario, the proposed Commonwealth legislation is likely to address this issue (as it is one which has been raised with the Commonwealth Government by the superannuation industry and private and public sector employers in the period since the 1997-98 Budget announcement). The Committee notes the evidence presented by the Department of Treasury and Finance in this regard:

¹⁵⁰ Paper prepared by the Department of Treasury and Finance for the Committee in relation to the superannuation announcements of the Commonwealth in the 1997-98 Budget, page 6

“Employees electing not to join the RBF scheme, or electing to opt out at some future point, should be compelled to sign a “release” form that indemnifies either the employer or the RBF Board for any advice or education they might have provided to the member in relation to scheme choices. This release form should specify that the decision has been made in full knowledge and understanding of all the implications.”¹⁵¹

- 9.5.12. While the Committee accepts that there are some legal issues associated with such a proposal (relating, for example, to whether liability can be extinguished through the use of the mechanism suggested by the Department of Treasury and Finance), it is convinced that some arrangement should be able to be devised that adequately addresses these types of issues.
- 9.5.13. In this regard, it might well be that not limiting the choice of fund in line with the Commonwealth proposals would result in the employer not being required to act as a de facto superannuation adviser. That is, rather than choosing a set number of superannuation funds which members have the option of joining and for which the employer must provide Key Feature Statements, a more workable solution might be for the choice of fund to be unlimited. An employee would have the right to elect to have their employer superannuation contribution paid into any complying fund and if an employee was not prepared to, or did not, make such an election, then the default arrangement would apply. This type of arrangement has completely different legal liability implications for the employer.
- 9.5.14. The Committee finds it difficult to see why, once the concept of fund choice is accepted, there should be a defined number of schemes offered to employees. Mr Bill Kelty, Secretary of the Australian Council of Trade Unions (ACTU), has expressed similar views in this regard. The following summary of his comments to a recent Sydney Conference on Superannuation and Human Resource Management was included in the October 1997 edition of the ASFA publication *Superfunds*:

“While he believes choice-of-fund to be inevitable, Kelty said the five-fund structure is too simplistic and unsustainable: ‘It is a political compromise that will have a very short life - you either have choice or you don’t’”¹⁵²

- 9.5.15. Likewise, the Committee holds the view that there are arrangements that should be established within the RBF scheme to ensure that employees do

¹⁵¹ Department of Treasury and Finance Submission, page 29

¹⁵² ASFA publication, *Superfunds*, October 1997, pages 32-33

not "chase" investment returns and switch funds regularly, thereby imposing possible administrative and financial difficulties. For example, the legislation should specifically provide that certain limitations apply to elections to exit the fund. A specified period of notice might well be required in order to ensure that the fund does not experience any liquidity problems in providing a transfer benefit (in a fully funded scheme).

- 9.5.16. The Committee accepts that there are problems associated with the provision of fund choice in relation to unfunded defined benefit schemes. It should be noted that given the recommendations previously made by the Committee in relation to the establishment of a new fully funded accumulation scheme for new entrants, fund choice should not cause any difficulties for employees who commence on and after 1 July 1998. The provision of fund choice to existing RBF defined benefit scheme members has effectively already been addressed in Chapter 7, in the context of the provision of a 'right of transfer' to any new scheme that might be established.
- 9.5.17. Finally, it was suggested above that a potential difficulty with fund choice under the proposed Commonwealth model will be where a member takes the full 28 day period to choose a fund. In order to ensure that new employees have death and disability insurance on and from the commencement of their employment, however, the Committee believes that it would be possible to implement arrangements that require employees to have made their choice prior to starting work.
- 9.5.18. In most cases in the public sector, there is a period in the order of one month between a person being informed that they have been successful in gaining State Service employment and when they actually commence. This period could be used to provide potential employees with the time to make an election from the first day of their employment.

9.6. INVESTMENT CHOICE

- 9.6.1. Investment choice is, to a large extent, a different issue to that of fund choice. The reason for the difference is that the provision of investment choice to members of particular funds has been a feature of many superannuation funds for some time - many private sector superannuation schemes have allowed individuals to choose from a range of different investment portfolios to suit their risk preferences and particular financial circumstances.
- 9.6.2. As indicated in earlier Chapters, the provision of investment choice is not possible in respect of unfunded defined benefit schemes. This is because there are no employer funds to be invested. While there are employee

contributions, the member has little interest in overall investment performance (given that the end benefit that they will receive is defined in the scheme rules). Investment choice is therefore a more significant issue in funded accumulation schemes where the end benefit is not guaranteed.

9.6.3. The provision of investment choice to scheme members is generally seen to have the following advantages:

- a) within every scheme there is a divergence between members in respect of age, the level of account balances held and risk profiles. The provision of investment choice, in theory, allows members to select the most appropriate mix of investments for their particular requirements. For example, members with a long term horizon can benefit from a growth investment strategy without suffering from the overall effects of a more conservative investment strategy designed to address the needs of all members;
- b) member investment choice is entirely consistent with the broad direction in which Commonwealth Government superannuation policy is heading; and
- c) investment choice is consistent with the underlying philosophy of accumulation schemes, whereby the member's end benefit is dependent, to a significant extent, on the investment returns received. Choice passes some of the responsibility for investment decisions to the individual (within the context of information to be provided to that member by the trustee of the fund, to ensure that decisions are made on a sound basis).

9.6.4. In much the same way as fund choice has some disadvantages, so does the provision of investment choice. Largely, however, these difficulties relate to issues of education and information and the need for trustees to make sure that members exercising investment choice do so on the basis of a solid understanding of the consequences of their decisions. There is a risk that members will make inappropriate investment choices or poorly judge the switching of portfolios to the detriment of their retirement incomes.

9.6.5. Perhaps the largest problem is an implementation issue - that of the trustees determining the level of choice to be offered. Decisions will be required by trustees on how often that choice should be available and what types of different investment portfolios should be provided (as there are theoretically an infinite number of different investment options that could be made available). Members could be offered portfolio choice ranging from growth portfolios through to cash (which is the most common arrangement), asset class selection (where members select the percentage of their funds that are

to be invested in particular classes such as property, shares, fixed interest and so on) or the choice of investment managers within particular asset classes.

- 9.6.6. The results of these decisions will, in all likelihood, produce significant changes in the investment structure of the fund and trustees will need to ensure that flexibility over the management of the fund's assets is not inappropriately reduced and that the complexity of the arrangements is not too great.
- 9.6.7. Again, there will obviously be higher administration costs associated with the implementation of member investment choice. The decisions taken in relation to the matters of detail referred to above will ultimately determine the extent to which investment choice will impact on costs - for example, the more complex the options, the higher the costs of communicating the implications to members.
- 9.6.8. The Committee believes that the trustees of superannuation funds are best placed to make decisions about the nature of the investment choices to be provided, timing issues (such as how often a member can switch between alternatives) and whether a minimum account balance is required before investment choice can be accessed. Likewise, the trustees should be responsible for determining the nature of the 'default' investment arrangement - what will apply in those instances where no election is made in relation to specific investment options.
- 9.6.9. The Committee noted that when combined with the implementation of fund choice, any member who is dissatisfied with the range of investment choices made available by a particular fund would be able to exercise their right and change superannuation fund such that their particular requirements were better addressed.
- 9.6.10. In the opinion of the Committee, however, a fundamental principle should apply in relation to the costs of implementing member investment choice - those members who avail themselves of the options provided should bear the full costs of those options. There should be no cross subsidies between those members who wish to have some input into the investment of their funds and those members who are happy to accept the default investment strategies adopted by the trustees. The charging of fully cost-reflective fees should therefore be a requirement in relation to public sector superannuation arrangements.

9.7. SUMMARY OF EVIDENCE

- 9.7.1. The following represents a summary of the evidence the Committee received during the course of the Inquiry in relation to both fund and investment

choice. It should be noted that with the exception of the evidence submitted by the RBF Board (which was included in a supplementary submission to the Committee), all the other evidence presented below pre-dates the 1997-98 Budget announcement by the Commonwealth Government in relation to fund choice. Accordingly, it needs to be interpreted as being submitted in an environment where no decision had been taken about compulsory fund choice:

Department of Treasury and Finance

"In relation to fund choice, Treasury believes that the Committee should recommend that all new employees should be able to choose which scheme they want their employer contributions paid into:

- * *all employees should be compelled to make an election as to the fund they wish to join prior to commencing employment;*
- * *this would avoid any difficulties with time delays taken to make choices, which might affect the State's SGC compliance and result in some members being without death and disability cover for a period;*
- * *if they elect to join the RBF accumulation scheme, there is no reason why they should not be able to elect to opt out at any time in the future."*¹⁵³

*"In addition to new employees having the choice of superannuation fund, Treasury suggests that the new RBF scheme should also offer investment choice as part of its operation."*¹⁵⁴

RBF Board

"The RBF Board, while supporting a choice philosophy, believes that as an interim measure pending Commonwealth legislation, all members should automatically become members of the RBF scheme (however designed) and then be permitted to exercise their right to opt out if they so desire... [it is appreciated]... however, that the recently announced Commonwealth policies in this area will dictate the arrangements that Tasmania will be required to establish in due course..."

¹⁵³ Department of Treasury and Finance Submission, pages 28-29

¹⁵⁴ *ibid*, page 29

Treasury and the RBF Board agree that the arrangements should be that where a member does not make a choice, the appropriate nominated fund should be the Fund managed by the RBF Board."¹⁵⁵

*"... [It is agreed by the RBF Board and Treasury that investment choice be offered in RBF accumulation schemes]... The RBF Board should determine the range of investment options to be given to accumulation scheme members and the specific rules that are to attach to the exercising of investment choice. Both parties acknowledge that member investment choice is not an issue for defined benefit schemes."*¹⁵⁶

Auditor-General

*"The objective of the Committee should be to recommend amendments so that superannuation arrangements for the public sector in Tasmania move to provide greater equity and portability and to permit greater freedom of choice for individual contributors, subject to the constraint that the cost of any new or amended scheme is not increased... Investment choice should be limited to larger balances to simplify administration."*¹⁵⁷

AEU

"The AEU recognises that broadening fund choice will mean more complicated administration for the employer payroll sections.

The AEU believes that if it is made compulsory for employees to have a choice of at least five funds, the RBF defined benefit scheme should be one of those choices...

The AEU also believes that if choice is to be encouraged and members given access to other superannuation funds, then industry funds should be included in the range of choices.

The AEU endorses in principle proposals for limited member investment choice for members of accumulation schemes... The AEU believes that members of accumulation schemes should have a choice between investment portfolios such as capital stable, equities, property, Tasmanian portfolios etc. However, restrictions

¹⁵⁵ Joint RBF Board - Treasury Position Paper on Superannuation Reform, page 4

¹⁵⁶ *ibid*, page 3

¹⁵⁷ Submission by the Auditor-General, pages 1-2

through fee structures or charging schedules will probably limit the number of transactions that can be made."¹⁵⁸

CPSU

"RBF legislation currently provides for limited 'fund choice' and this provision should be maintained. The issue of fund choice is extremely complex and its implementation would lead to widespread confusion.

There is little evidence of demand from employees for 'fund choice' and where it has been provided the uptake rate has been negligible. It is clear that this will become an issue of more significance in the future and from a Tasmanian Public Sector perspective requires much greater consideration.

In any event the current RBF administrative arrangements should continue the controlling and co-ordinating body for public sector superannuation."¹⁵⁹

Jacques Martin

"It is Federal Government policy that fund and investment choice at member level be introduced - that would seem to dictate that members of the Tasmanian public sector be provided those options. It would follow that:

- * existing members should be given the choice to continue in the present arrangement or opt for any other made available.*
- * that all members be free to contribute from their own resources in excess of the Government's funding arrangement.*"¹⁶⁰

National Mutual

"Most superannuation products available in today's marketplace offer a range of investment portfolio structures (eg varying weightings in asset classes) and a range of investment managers

¹⁵⁸ Australian Education Union (Tasmanian Branch) (AEU) Submission, page 10

¹⁵⁹ Community and Public Sector Union (CPSU) Submission, pages 1-2

¹⁶⁰ Submission by Jacques Martin, pages 1-2

from whom members can choose. Most products provide for switching of assets between portfolios at a reasonable cost.

It would be administratively impractical for the State Government to allow total freedom of choice with respect to payment of employer and employee contributions... We believe it would be sufficient for the Government to provide employees with the option of 3-4 superannuation plans together with the RBF scheme as a default should employees not elect to choose an alternative plan provider.”¹⁶¹

TCCI

“Fund choice and investment choice will become an increasingly live issue as the Commonwealth Government firms up its policy position. We do not have a firm position on what preferred arrangements should be other than to say that:

- * a degree of choice in terms of both fund and investment is both inevitable and desirable; and*
- * totally unfettered choice may impose unreasonable administrative costs on the employer.”¹⁶²*

TTLC

“The TTLC does not oppose the introduction of fund choice but notes that the current Regulations provide for some flexibility. Were such choice to be promoted and encouraged the TTLC believes that employees should have access to industry style funds but that they should also have access to the defined benefit contributory scheme as one of the options.

Investment choice is irrelevant to defined benefit schemes. However, the TTLC does not oppose the introduction of investment choice for accumulation style schemes such as the RBF non-contributory scheme.”¹⁶³

¹⁶¹ Submission by National Mutual, pages 24-25

¹⁶² Tasmanian Chamber of Commerce and Industry (TCCI) Submission, pages 2-3

¹⁶³ Tasmanian Trades and Labor Council (TTLC) Submission, page 2

9.8. COMMITTEE FINDINGS

9.8.1. Having regard to the above and the evidence presented to it in relation to the issues of fund and investment choice, the Committee finds that:

- 1) The current Commonwealth Government superannuation policy is progressively being focussed on the provision of "choice" to individuals.
- 2) In the 1997-98 Budget, the Commonwealth Government announced its intention to introduce legislation requiring the introduction of fund choice for new employees on and from 1 July 1998 and for members of existing superannuation funds on and from 1 July 2000.
- 3) In addition to the Budget announcements, the Commonwealth has also recently announced that it will give effect to its policy direction in relation to its own superannuation scheme, namely the Public Sector Superannuation (PSS) scheme. This scheme is to be closed to new entrants on and from 1 July 1998, with all new Commonwealth employees being required to nominate a private sector superannuation fund into which their employer superannuation contributions are to be paid.
- 4) Member fund choice was also a key recommendation of the Wallis Inquiry into Australia's Financial System. The Committee felt that fund choice would assist in increasing the level of industry competition and in improving the efficiency of the superannuation industry. Outcomes along these lines were expected by the Wallis Committee to, over time, drive down the cost of investment for superannuation funds.
- 5) While it is not well known, nor actively marketed by the RBF Board or the Government, the *Retirement Benefits Regulations 1994* already allow employees, with the consent of their employing Agency, to opt out of the contributory scheme. Further, State Authorities can, with the consent of the Minister, elect not to participate in the RBF contributory scheme or in any of the superannuation arrangements established under the *Retirement Benefits Act 1993*.
- 6) The following advantages are generally advanced in relation to fund choice:
 - a) by being able to select the superannuation fund of their preference, employees will have increased flexibility to access a greater range of services and superannuation products and to ensure that the scheme they join best reflects their particular

personal preferences and best addresses their personal circumstances;

- b) employees with fund choice have a greater sense of ownership and control over their future superannuation savings;
 - c) control over the superannuation scheme they join provides members with the opportunity to consolidate their superannuation savings, which will provide greater opportunities to maximise their retirement benefit. With greater workforce mobility, it is now increasingly common for employees joining an employer to already have a "superannuation history" - in every case except an employee joining straight from school or university, individuals will have established superannuation arrangements in place and, in many instances, will have a preference for these to be continued; and
 - d) fund choice will produce greater competition amongst superannuation providers which, in a similar fashion to the increased competition being generated in a range of other markets in recent times, can be expected to produce efficiency benefits that will advantage members over time. It is contended that more emphasis on the achievement of competitive returns on investments, lower administration costs, higher quality of services and increased product differentiation (as schemes will now effectively be required to review the nature of all benefits provided and the manner in which these are packaged and presented) can only benefit employees.
- 7) There is a range of perceived disadvantages associated with the policy direction of the Commonwealth in relation to fund choice. These can be summarised as follows:
- a) the requirements to be placed on an individual under the proposed Commonwealth legislation to make a choice will present difficulties for many, as they will not be in a position to make a decision between the range of options available. While 'Key Feature Statements' will certainly assist members to make their election, there will still be a number of individuals that will not be able to understand exactly how alternatives compare and might, in the face of aggressive and unconscionable marketing conduct, ultimately make poor fund decisions;
 - b) the fund choice legislation will, in all likelihood, impose additional administrative costs on employers and superannuation funds. For example, employers will need to determine which

funds are to be offered as choices to their employees, will need to gather together the Key Feature Statements associated with these and perhaps prepare other information that is sufficient to enable employees to make an informed choice. While most private sector funds would already have Key Feature Statements, public sector funds such as the RBF will also be required to develop these in order to compete for members in the fund choice environment;

- c) employers might well end up exposed to liability where a fund selected by them fails to perform as indicated in the Key Features Statement. There is a degree of concern that the employer will not be able to completely absolve itself from responsibility in this circumstance, with members being able to take legal action at some point in the future on the basis that they received incorrect or misleading advice;
 - d) as individuals become increasingly aware of their superannuation investments, there may be a tendency for members to regularly "chase" the best returns and to transfer to funds that are performing well in the short term. This short term focus might well lead to lower returns over the medium-to-long term and have an impact on overall national savings. Further, this might have implications for the liquidity positions of superannuation funds;
 - e) choice of fund requires schemes to be fully funded, in order to enable members to elect out and to transfer their accrued benefit entitlement to a new fund of their choice; and
 - f) given the proposed requirement for employees to exercise a choice of fund within 28 days of commencing employment, an issue exists as to how an employee is to be treated in the event that they either die or are injured during that time. If no election has been made and either of these events occurs, an issue to be addressed in the proposed Commonwealth legislation will be the obligations on employers to adequately provide for such employees.
- 8) While there is some merit associated with the possible difficulties surrounding the provision of fund choice to employees outlined above, the Committee believes that these are capable of being adequately addressed.
- 9) The matter of the onerous obligations imposed on employees to make a choice of superannuation fund can be accommodated through the provision of a 'default' choice in such cases. In those circumstances

where an employee does not exercise an election, the Government, in conjunction with public sector unions, should be able to determine the appropriate arrangements to apply in the 'default' situation.

- 10) Most private sector funds are already experienced in competing for business and certainly have Key Feature Statements in relation to their schemes. Public sector schemes will need to develop these Statements under the Commonwealth choice model, but the Committee does not believe that this would require a great deal of effort.
- 11) In addition, the costs to employers of choosing which five, or more, funds will be offered as choices need to be offset against the savings that will accrue once an election has been made. In many instances, employees will elect to join private sector arrangements, which will result in Agencies no longer being required, from that point onwards, to provide a first-stop advisory service in relation to the operation of public sector schemes.
- 12) The Committee does not accept that the administrative costs associated with the payment of employer superannuation contributions by Agencies to a range of private sector funds (rather than to the Superannuation Provision Account, as is currently the case) is a real issue. For example, the Committee understands that the Department of Treasury and Finance already has the capacity to make salary payments to in excess of 40 financial institutions and currently makes deductions to a wide range of organisations in relation to health insurance and salary sacrifice contributions.
- 13) Not limiting the choice of fund in line with the Commonwealth proposals would result in the employer not being required to act as a de facto superannuation adviser. Rather than choosing a set number of superannuation funds which members have the option of joining and for which the employer must provide Key Feature Statements, a more workable solution would be for the choice of fund to be unlimited.
- 14) An employee should have the right to elect to have their employer superannuation contribution paid into any complying fund and if an employee is not prepared to, or does not, make such an election, then the default arrangement will apply. This type of arrangement has minimal legal liability implications for the employer.
- 15) In most cases in the public sector, there is a period in the order of one month between a person being informed that they have been successful in gaining State Service employment and when they actually commence. This period should be used to request the potential employee to consider which superannuation fund he or she wishes to

join, such that he or she is in a position to make an election from the first day of their employment.

- 16) Investment choice is, to a large extent, a different issue to that of fund choice. The reason for the difference is that the provision of investment choice to members of particular funds has been a feature of many superannuation funds for some time - many private sector superannuation schemes have allowed individuals to choose from a range of different investment portfolios to suit their risk preferences and particular financial circumstances.
- 17) The provision of investment choice to scheme members is generally seen to have the following advantages:
 - a) within every scheme there is a divergence between members in respect of age, the level of account balances held and risk profiles. The provision of investment choice, in theory, allows members to select the most appropriate mix of investments for their particular requirements;
 - b) member investment choice is entirely consistent with the broad direction in which Commonwealth Government superannuation policy is heading; and
 - c) investment choice is consistent with the underlying philosophy of accumulation schemes, whereby the member's end benefit is dependent, to a significant extent, on the investment returns received. Choice passes some of the responsibility for investment decisions to the individual (within the context of information to be provided to that member by the trustee of the fund, to ensure that decisions are made on a sound basis).
- 18) In much the same way as fund choice has some disadvantages, so does the provision of investment choice. Largely, however, these difficulties relate to issues of education and information and the need for trustees to make sure that members exercising investment choice do so on the basis of a solid understanding of the consequences of their decisions.
- 19) Perhaps the largest problem is an implementation issue - that of the trustees determining the level of choice to be offered. Decisions will be required by trustees on how often that choice should be available and what types of different investment portfolios should be provided (as there are theoretically an infinite number of different investment options that could be made available).

- 20) The trustees of superannuation funds are best placed to make decisions about the nature of the investment choices to be provided, timing issues (such as how often a member can switch between alternatives) and whether a minimum account balance is required before investment choice can be accessed.
- 21) Likewise, the trustees should be responsible for determining the nature of the 'default' investment arrangement - what will apply in those instances where no election is made in relation to specific investment options.
- 22) Those members who avail themselves of the investment options provided should bear the full costs of those options. There should be no cross subsidies between those members who wish to have some input into the investment of their funds and those members who are happy to accept the default investment strategies adopted by the trustees. The charging of fully cost-reflective fees should therefore be a requirement in relation to public sector superannuation arrangements.

9.9. COMMITTEE RECOMMENDATIONS

- 9.9.1. In light of the findings of the Committee in relation to the issues of fund and investment choice, the Committee makes the following recommendations:

Recommendation 29:

New public sector employees on and after 1 July 1998 should be required to make an election prior to commencing employment as to which complying superannuation scheme they wish to join. There should be no limit on the scheme options available to these employees, although the ability to join the new RBF accumulation scheme should exist.

Recommendation 30:

Where a new employee fails to make an election prior to commencing employment, that employee is to automatically become a member of the new RBF accumulation scheme (the default scheme).

Recommendation 31:

The trustees of the new RBF accumulation scheme should determine the nature of the member investment choices to be made available to members, timing issues (such as how often a member can switch between alternatives) and whether a minimum account balance is required before investment choice can be accessed.

Recommendation 32:

The trustees of the new RBF accumulation scheme should determine the nature of the 'default' investment arrangements to apply - what investment arrangements will apply in those instances where no election is made in relation to specific investment options.

Recommendation 33:

The trustees of the new RBF accumulation scheme should ensure that full cost-reflective fees are charged relating to the exercise of member investment choice. Those members who avail themselves of the investment options provided should bear the full costs of accessing those options and there should be no cross subsidies between those members who wish to have some input into the investment of their funds and those members who are happy to accept the default investment strategies adopted by the trustees.

- 9.9.2. The following Chapter considers the cash flow implications for the State associated with the implementation of the recommendations made by the Committee in this Report.

10. CASH FLOW IMPLICATIONS

10.1. INTRODUCTION

10.1.1. As indicated earlier in this Report, the purpose of this Chapter is to provide cash flow analyses associated with both the proposed reform approach for the RBF scheme (closing the contributory defined benefit scheme to new entrants and fully funding the benefits of these employees via an accumulation scheme) and one of the alternative RBF reform options considered in Chapter 5 (namely, leaving the contributory scheme open to new members but fully funding the benefits of these employees from the commencement of their employment).

10.1.2. The information presented in this Chapter illustrates:

- a) the future direction for the State's emerging superannuation outlays over the next 70 or so years;
- b) how this profile of future expenditures might alter if the Government was to make additional financial contributions towards the funding of the superannuation liability (with both "passive" and "aggressive" funding scenarios being shown); and
- c) the additional costs that would be borne by the Government from leaving the RBF scheme open to new entrants (but fully funding their benefits), relative to the preferred approach of closing the scheme off and providing new employees with a fully funded accumulation benefit.

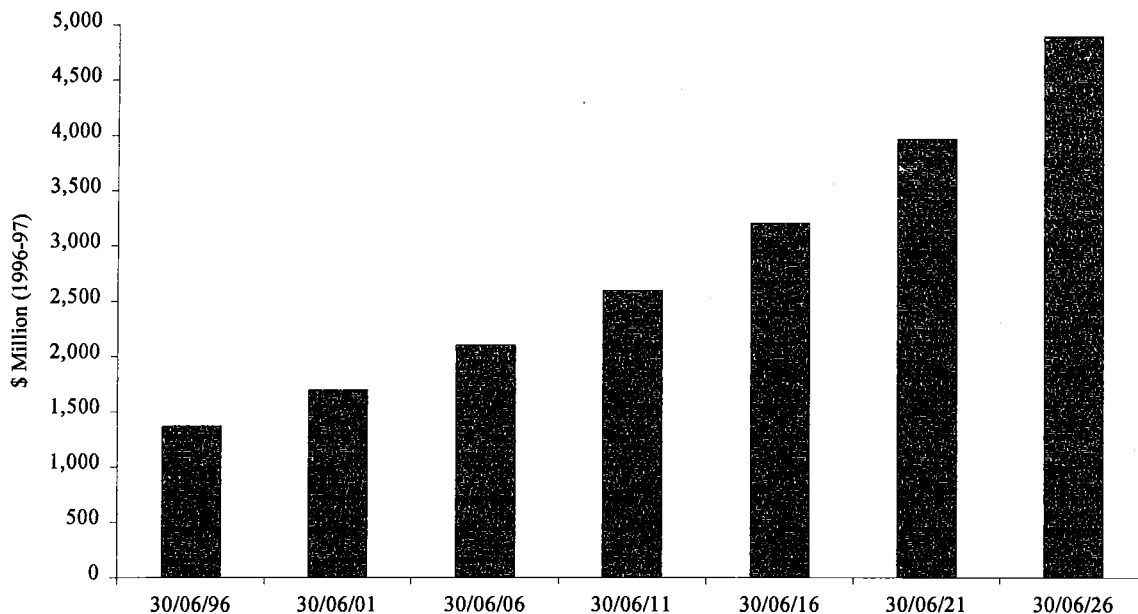
10.1.3. Prior to discussing the cash flow material, the following section briefly summarises the overall unfunded liability situation to which the cash flow data relates.

10.2. SUMMARY OF UNFUNDED LIABILITY POSITION

10.2.1. In Chapter 2, actuarial evidence was presented indicating how the unfunded liability associated with the RBF contributory scheme would move over time in the event that the scheme remained open to new entrants. Chart 10.1 illustrates this projected movement in real (today's dollar) terms.

10.2.2. The Chart, again based on actuarial estimates, shows that the unfunded liability is expected to rise from \$1.37 billion as at 30 June 1996 to \$4.9 billion by the year 2026.

Chart 10.1 : Projected Real Unfunded Liability - Assuming No Change to the RBF Scheme



Source: Department of Treasury and Finance Submission, Chart 3.

10.2.3. What this Chart does not show is that by the year 2046, the figure will be \$11.42 billion in today's dollar terms - assuming no reform action is taken by the Government in relation to the RBF scheme during this period.

10.2.4. The Committee argued in earlier Chapters that the magnitude of the problem confronting Tasmania is, from this Chart, self-evident. After discussing issues in relation to:

- a) the relative advantages and disadvantages of defined benefit and accumulation schemes;
- b) the costs of superannuation to the employer under the RBF contributory scheme and an SGC accumulation-based alternative; and
- c) the level of end benefits members could expect to receive under both scenarios,

a number of recommendations have been made relating to public sector superannuation reform.

10.2.5. The main recommendations made by the Committee in earlier Chapters are as follows:

- a) that the RBF contributory scheme should be closed to new entrants on and from 1 July 1998; and

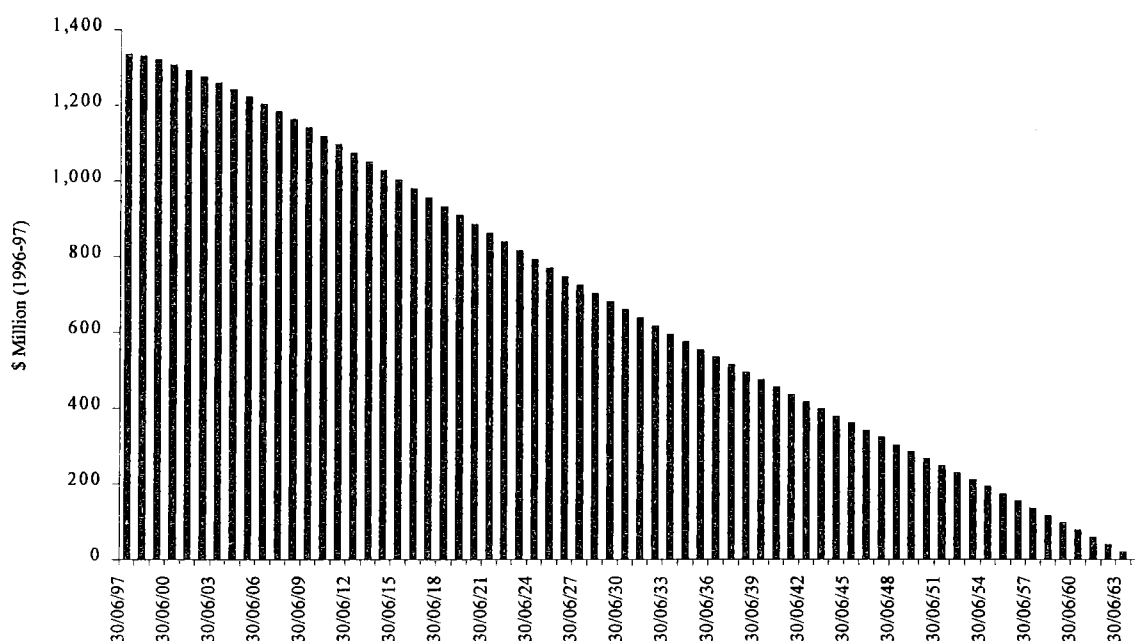
- b) that all new entrants should be provided with a fully funded SGC employer benefit through either the RBF non-contributory accumulation scheme or a private sector fund of the member's choice.

10.2.6. Chart 10.2 below shows how the unfunded liability for the RBF scheme is expected, based on actuarial advice, to move over time if it is closed to new entrants in this manner.

10.2.7. The unfunded liability associated with the RBF scheme will continue to increase in nominal terms for a number of years, as:

- a) existing scheme members actually work their future service;
- b) they benefit from continued salary growth;
- c) they move onto pension benefits (many of which will be at a heavily subsidised rate, due to the anti-detriment provisions that apply to pre-1 July 1994 members);
- d) existing pensioners receive indexation increases; and
- e) many of the currently unfunded preserved benefits will continue to grow in line with the scheme's indexation arrangements.

Chart 10.2 : Projected Unfunded Liability - With the RBF Scheme Closed to New Entrants

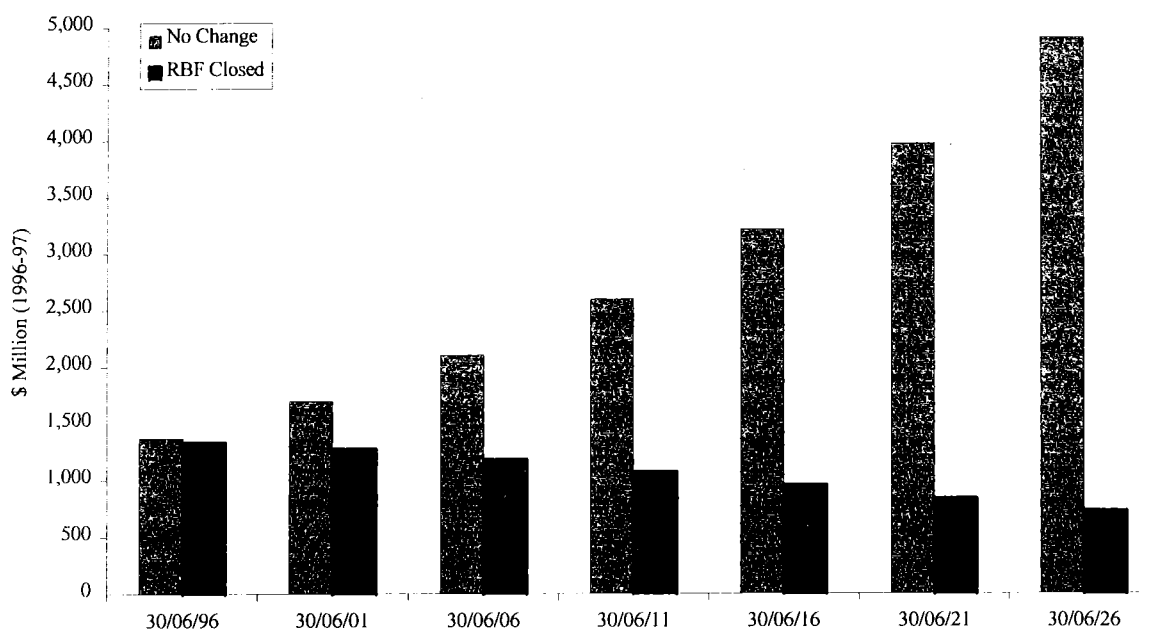


Source: Department of Treasury and Finance Submission, Chart 4.

10.2.8. It can be seen that the unfunded liability associated with a closed RBF scheme reduces in real terms as the number of existing members and pensioners diminishes over time. The Actuary has projected that by the year 2019, the liability will have reduced to \$885 million (in today's dollars) and will disappear completely by the year 2064. This would leave Tasmania in a similar financial position to all other States - no contingent superannuation liability on the balance sheet after about 67 years.

10.2.9. Chart 10.3 below shows the projected unfunded liability under both scenarios - leaving the RBF scheme open to new members with no change in current arrangements and closing the scheme off to new employees and fully funding their benefit. It is apparent that by the year 2026, there is a very significant difference in the State's unfunded liability in relation to the RBF contributory scheme.

Chart 10.3 : Projected Unfunded Liability - No Change and with the RBF Scheme Closed



Source: Combination of Charts 3 and 4 in the Department of Treasury and Finance Submission.

10.2.10. As indicated in Chapter 5, however, closing the RBF contributory scheme off to new entrants, providing these employees with a fully funded accumulation benefit and therefore eliminating the unfunded liability over 67 years is not without its budgetary complexities. Before discussing these complexities, the following section overviews the mechanics of the Superannuation Provision Account in slightly more detail than was provided in Chapter 2.

10.3. THE SUPERANNUATION PROVISION ACCOUNT

10.3.1. In conjunction with the introduction of the new public sector superannuation arrangements with effect from 1 July 1994, the Superannuation Provision Account (SPA) was established in the Special Deposits and Trust Fund (SDTF). The established purpose of the Account is to:

- a) receive contributions from Agencies and certain Authorities (at such rates as are determined by the Government from time to time) to make appropriate provision to meet employee superannuation liabilities accruing after 1 July 1994 under the provisions of the *Retirement Benefits Act 1993*;
- b) receive contributions from the Consolidated Fund in respect of the superannuation liability accrued prior to the establishment of the SPA (that is, the liability accrued prior to 1 July 1994); and
- c) pay employer contributions (both lump sums and pensions) to the RBF Board for employees of contributing Agencies and Authorities who have separated from the Tasmanian public sector.

10.3.2. The balance of the SPA as at 30 June 1997 was \$161.4 million and, at the time of the 1997-98 Budget, this balance was expected to increase (on the basis of no reform action being taken) as follows:

30 June 1998	\$183.6 million
30 June 1999	\$209.1 million
30 June 2000	\$236.8 million
30 June 2001	\$269.5 million
30 June 2002	\$304.1 million

10.3.3. All Agency and Authority contributions to the SPA are made on a fortnightly basis and the rate of contribution is based on actuarial assessment. In general, the rates currently used are:

- a) 11 per cent of salary for those employees who contribute to the RBF; and
- b) 6 per cent of salary for those employees who are members of the non-contributory RBF scheme.

- 10.3.4. While the Actuary suggested in his 1995 valuation Report that the employer share of RBF scheme benefits could be marginally reduced below 11 per cent of salary for contributory members, the Committee understands that the Government decided to leave the rate at 11 per cent in order to build up the balance in the Provision Account at a faster rate than otherwise would have been the case.
- 10.3.5. The additional contribution made each year from the Consolidated Fund to the SPA in respect of the accrued superannuation liability prior to 1 July 1994 is made through the Reserved-by-Law item R069 and the payments made to date, and those which were projected to occur over the next four years at the time of the 1997-98 Budget, are as follows:

Year	\$m
1994-95 (actual)	24.2
1995-96 (actual)	57.4
1996-97 (actual)	31.9
1997-98 (est)	38.3
1998-99 (est)	41.9
1999-00 (est)	47.1
2000-01 (est)	52.5
2001-02 (est)	57.7

Source: *1997-98 Budget Papers*, Chapter 6.

- 10.3.6. The Committee notes that the extraordinary payment made in 1995-96 reflected the fact that amounts previously paid from this account in relation to the pre 1 July 1994 superannuation share of employer redundancy payments were reimbursed to the account.
- 10.3.7. Payments are made, on a regular basis, out of the SPA to the RBF Board for reimbursement of lump sums and pensions paid to former employees of contributing Agencies and Authorities who have taken a superannuation benefit.
- 10.3.8. Interest is credited to the balance of the SPA quarterly (although the first interest instalment was not made until near the end of the 1994-95 financial year) and the rate of interest is based on the rate obtained by the Government from the investment of surplus funds with Tascorp.
- 10.3.9. Details of interest credited are outlined in Table 10.1.

Table 10.1 : Interest Credited to the SPA

Period	Rate of Interest	Amount
	(%)	(\$'000)
1994-95	6.07	2 373
1995-96		
September Qtr	7.46	1 970
December Qtr	7.40	1 897
March Qtr	7.40	2 236
June Qtr	7.40	2 183
Total		8 286
1996-97		
September Qtr	7.34	3 486
December Qtr	6.73	2 512
March Qtr	5.92	2 490
June Qtr	5.73	1 254
Total		9 742

Notes

1. Includes \$0.677 million paid that related to the June quarter 1996.

10.3.10. The magnitude of the actual inflows into the SPA from the various funding sources for 1996-97 is outlined below:

	\$m
11 per cent from Agencies for RBF contributors	62.2
6 per cent from Agencies for non-contributors	14.4
R069 (Consolidated Fund)	31.9
Interest	9.7
Other (adjustments, late payments from 1994-95 etc)	2.4
Total	120.6

- 10.3.11. For the purposes of illustration, approximately \$105.4 million was spent from the SPA during the 1996-97 financial year on reimbursing the RBF Board for benefit payments under the Retirement Benefits Act. This left an excess of receipts over expenditure of some \$15.2 million (which explains the increase in the balance of the SPA from about \$146.2 million at 30 June 1996 to \$161.4 million as at 30 June 1997).
- 10.3.12. The crucial matter to appreciate from the above discussion in relation to the operation of the SPA is that while there is an impression that the Government is fully providing, on an on-going basis, for its accruing superannuation liability, this is not actually the case.
- 10.3.13. The Government is certainly requiring Agencies and Authorities with employees in the RBF scheme to make regular contributions into the SPA in respect of accruing liabilities (which has been the case since 1994), but is using the vast majority of those funds to meet benefit payments as they emerge - and many of these obviously have a large pre 1 July 1994 employer component, which is completely unfunded and unprovided for.
- 10.3.14. The Government is effectively setting funds aside for one purpose (namely, for the future funding of benefits accruing after 1 July 1994) but is immediately using most of those funds for a different purpose (namely, for funding benefits that have a large pre 1 July 1994 employer component). The Committee notes that this process was outlined in detail in the 1994-95 Budget Papers, following the creation of the SPA.

10.4. CASH FLOW ANALYSIS - CLOSING OFF THE RBF SCHEME

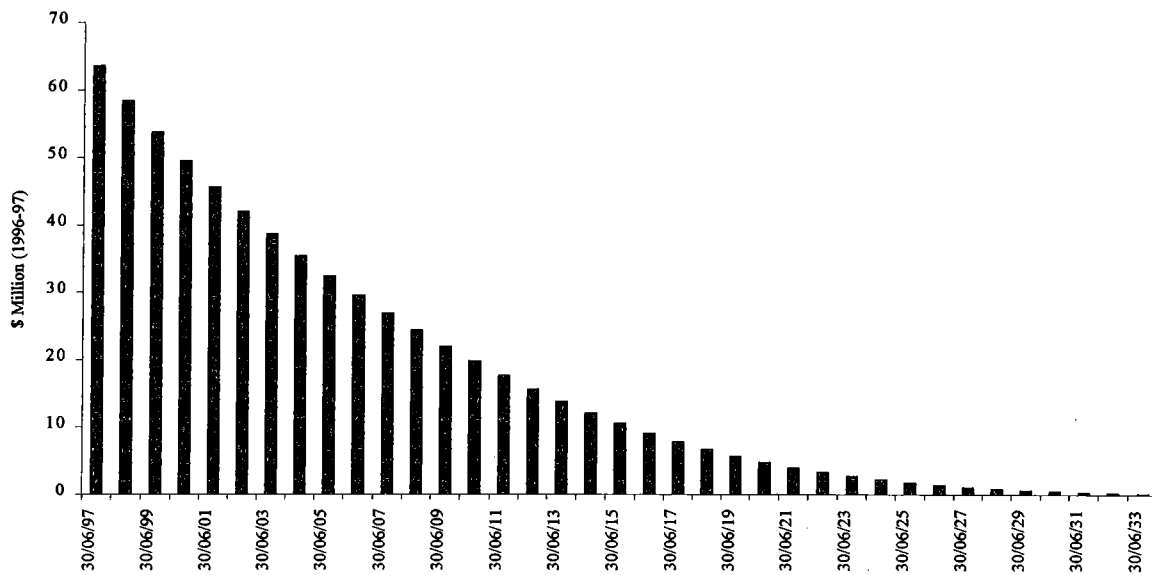
- 10.4.1. The Committee sought cash flow projections from the Actuary in relation to closing off the RBF contributory scheme to new members and continuing to meet benefit payments for existing RBF members and pensioners as and when they emerge.
- 10.4.2. There are no cash flow implications associated with the recommendation made by the Committee that all new entrants should be provided with a fully funded Superannuation Guarantee Charge (SGC) benefit in an accumulation scheme (either the RBF non-contributory scheme or a private fund of the member's choice). The reason for this is that Agencies and Authorities are currently funding these benefits from their budget allocations and will continue to do so from the monies included in the forward budget estimates.

- 10.4.3. Under such a reform outcome, what would occur is that Agencies and Authorities would simply pay, each fortnight, the required SGC contribution for all new members into either the RBF scheme or a private sector fund chosen by the employee - rather than paying those contributions into the SPA (as is presently the case).
- 10.4.4. The consequence of this is that there will be less money going into the SPA during any financial year from which benefit payments can be met. The Committee notes that it is this shortfall in SPA receipts which will impose some financial strain on the State in future years in relation to the meeting of emerging costs.
- 10.4.5. The advice from the Actuary suggests that the Government will need to consciously make additional Budget contributions into the SPA in order to ensure that there are sufficient funds available to meet all the RBF scheme benefits that emerge over time.
- 10.4.6. As indicated earlier, there are basically three sources of funds available to meet the emerging cost of future benefits payable to pensioners and existing RBF contributors under the Committee's reform recommendations:
- a) the 11 per cent contributions made by Agencies and Authorities into the SPA in respect of existing permanent employees (funding for which was built into Agency base budgets from the start of 1994-95);
 - b) the Reserved-by-Law contribution from the Budget (item R069) which is required to help the State meet its emerging RBF costs; and
 - c) the difference between the 11 per cent for new permanent employees which Agencies currently pay into the SPA and the SGC contribution that they will be required to make to the RBF non-contributory scheme (or a private fund chosen by the member) under the proposed reforms.
- 10.4.7. That is, the Government has funded Agencies and required them to pay 11 per cent for new permanent employees but Agencies will only be required to pay 7 per cent for new members from 1 July 1998 (a saving of 4 per cent), 8 per cent from 1 July 2000 (a saving of 3 per cent) and 9 per cent from 1 July 2002 (a saving of 2 per cent). These savings will be available to the Government to fund the benefits of RBF pensioners and existing scheme members over time.
- 10.4.8. The Actuary has prepared projections for each of these components over time. Chart 10.4 below shows the expected amount available from the 11 per

cent contributions by Agencies for existing permanent employees. The Committee notes that there are some minor discrepancies between the numbers shown in the following Charts and those outlined earlier in relation to the SPA components for 1996-97.

10.4.9. While actual figures for the inflows into, and outflows from, the SPA during 1996-97 are now available, at the time the Committee had its actuarial advice prepared this was not the case. Accordingly, the cash flow estimates presented in the remainder of this Chapter are based on estimated outcomes for the 1996-97 financial year and data for future years is based on that contained in the 1996-97 Budget Papers.

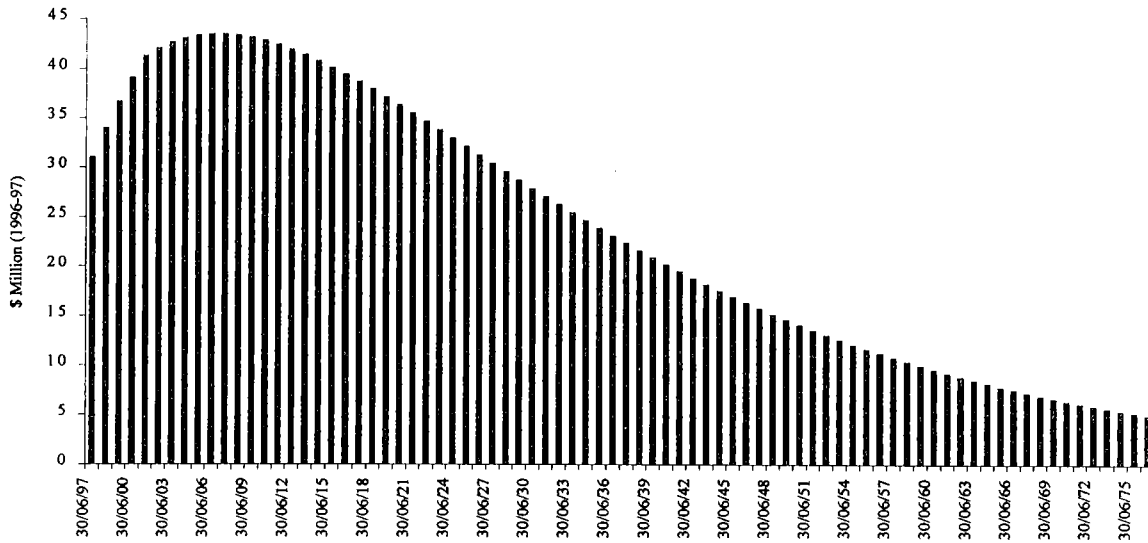
Chart 10.4 : Inflows - 11% Agency Contributions for Existing Employees



Source: Department of Treasury and Finance Cash Flow Analysis, 27 June 1997, Chart 4, page 11.

10.4.10. Chart 10.5 below shows the expected amount available from the R069 item - based on no changes to the amount shown in the Government's forward estimates at the time of the 1996-97 Budget.

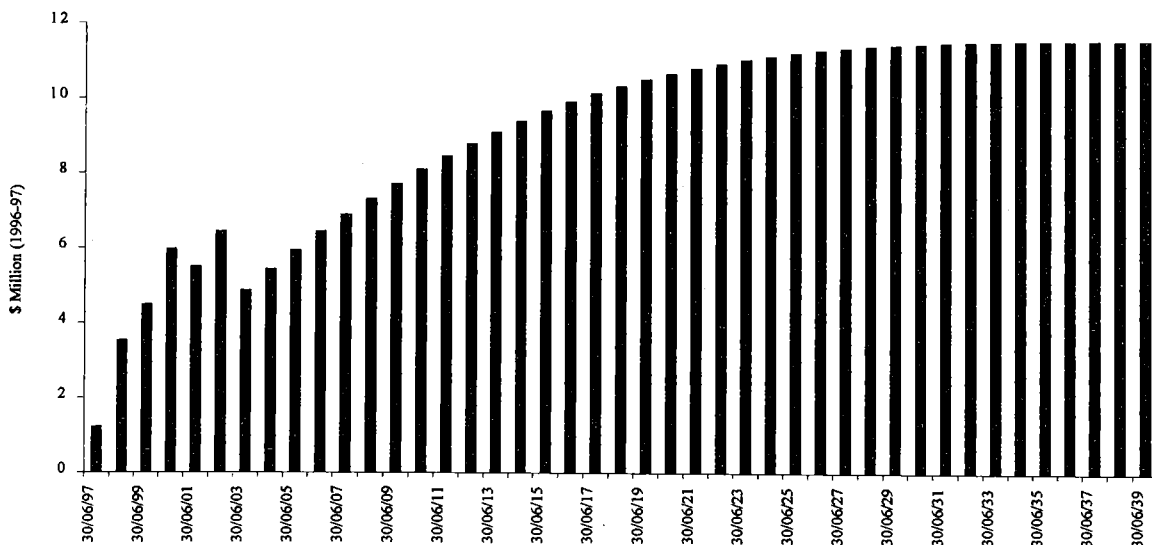
Chart 10.5 : Inflows - R069 Contributions



Source: Department of Treasury and Finance Cash Flow Analysis, 27 June 1997, Chart 5, page 11.

10.4.11. Chart 10.6 below shows the expected amount available from the “savings” that will be made as a result of the difference between the 11 per cent for which Agencies are currently funded and the SGC contribution they will be required to make for new permanent employees in the future. It should be noted that in Chapter 6, the Committee has recommended that the Government should investigate the feasibility of legislating to ensure that these “savings” are applied to reducing the State’s past service unfunded superannuation liability.

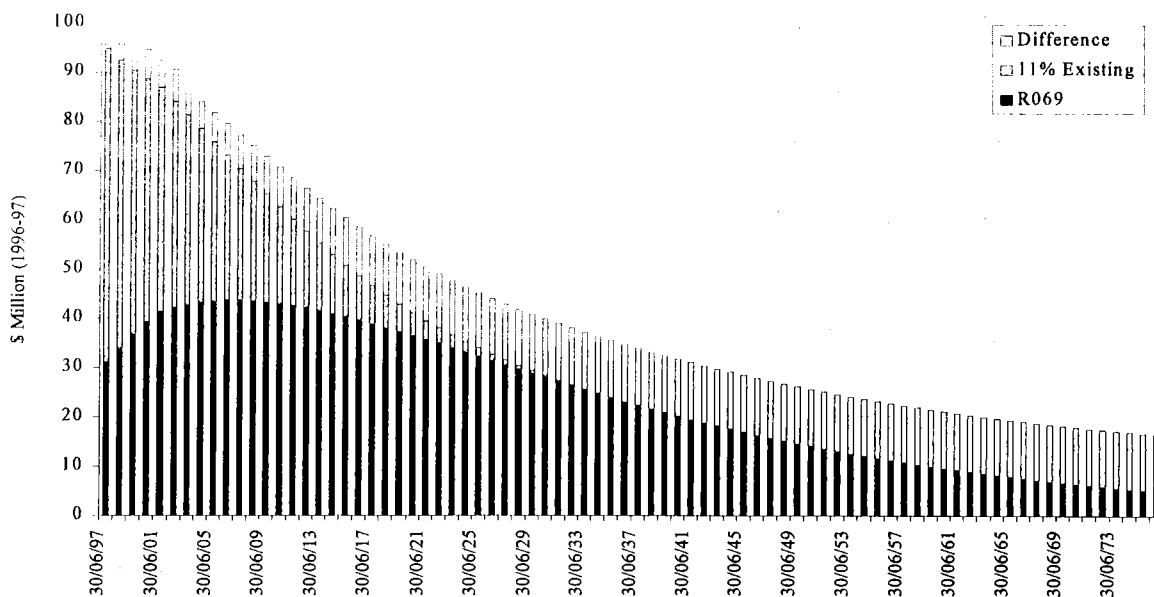
Chart 10.6 : Inflows - Difference Between 11% Employer Contributions for New Permanent Employees and the SGC Rate



Source: Department of Treasury and Finance Cash Flow Analysis, 27 June 1997, Chart 6, page 12.

10.4.12. These available funds are shown in Chart 10.7 in an aggregated way - and it is evident that the total available funding to meet emerging RBF benefits for existing members and pensioners (without any additional Budget contribution) is in the order of \$96 million in 1997-98 (in today's dollar terms).

Chart 10.7 : Total Inflows



Source: Department of Treasury and Finance Cash Flow Analysis, 27 June 1997, Chart 7, page 12.

10.4.13. It is evident from Chart 10.7 that the amount of funds available to meet future RBF benefit payments decreases in real terms over time.

10.4.14. In relation to the expenditure (or outflows) side, the Actuary has modelled three sources of "outflows" in respect of a closed RBF contributory scheme:

- a) those required to fund existing pension payments;
- b) those required to fund the emerging benefit payments of existing RBF contributors over time; and
- c) those required to fund payments out of the existing preservation account to those RBF contributors who have already exited the Fund and whose benefits require full funding once the former employee reaches the age of 55 years.

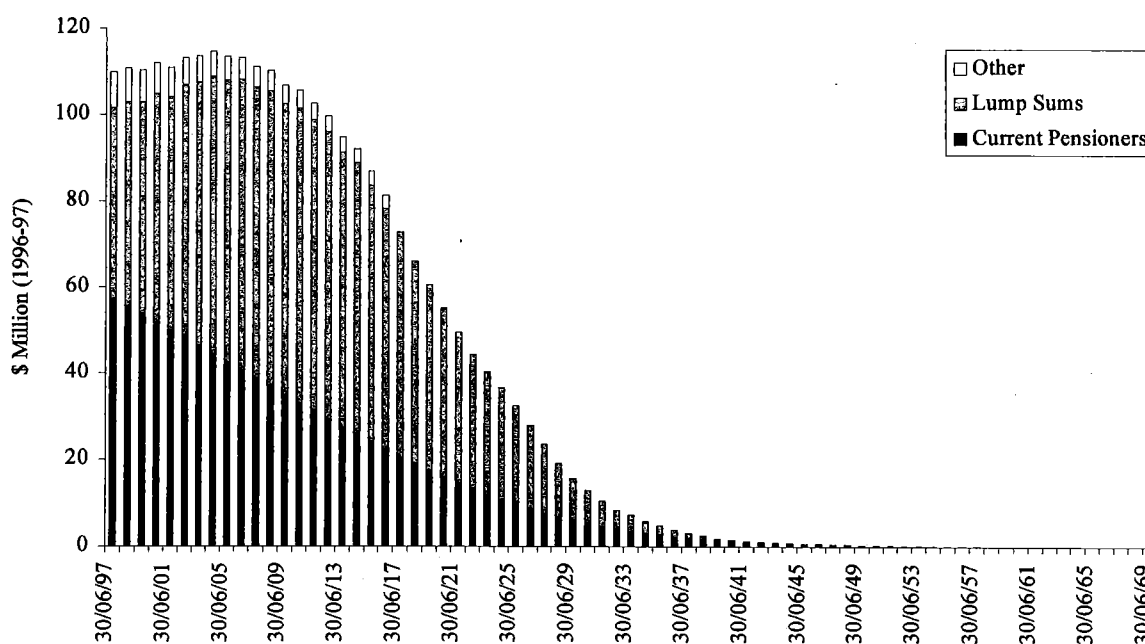
10.4.15. These outflows are shown in aggregate terms in Chart 10.8 below.

10.4.16. Chart 10.9 below shows both total inflows and total outflows over time (in 1996-97 dollars) under a closed RBF contributory scheme scenario. It is evident that total real outflows required to meet RBF contributory scheme benefit payments are projected by the Actuary to exceed total real inflows (or the amount of currently budgeted funds available) for the next 25 years. This shortfall in funds is represented by the hatched area in Chart 10.9.

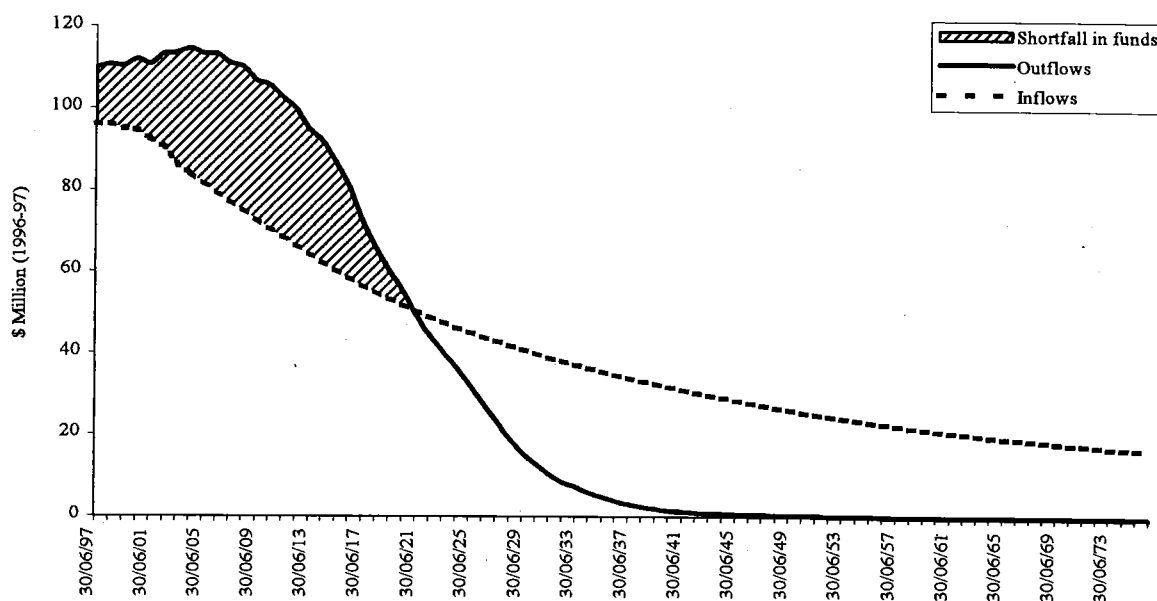
10.4.17. Beyond the next 25 years, the current budgetary effort will be more than sufficient to meet emerging benefit payments, as member numbers decline in the closed scheme. The budgetary effort could actually be scaled back, with the budget savings then being available for other purposes.

10.4.18. The Committee notes that there will still exist an unfunded liability until beyond the year 2060.

Chart 10.8 : Total Outflows



Source: Department of Treasury and Finance Cash Flow Analysis, 27 June 1997, Chart 8, page 13.

Chart 10.9 : Cash Flows - Current Budgetary Funding

Source: Department of Treasury and Finance Cash Flow Analysis, 27 June 1997, Chart 9, page 14.

10.4.19. The Actuary has advised that there is an infinite number of different funding scenarios which could be adopted by the Government to meet the emerging costs of the closed RBF contributory scheme - all of which have an impact on the remaining unfunded superannuation liability.

10.4.20. Two possible funding approaches were developed by the Actuary in detail for illustrative purposes and are presented below:

- a) a "passive" scenario that involves the least amount of financial pain for the State; and
- b) an "aggressive" scenario that would involve substantial additional Government funding over the next few years - but which would produce significant longer term savings, as the unfunded liability would be extinguished around the year 2020.

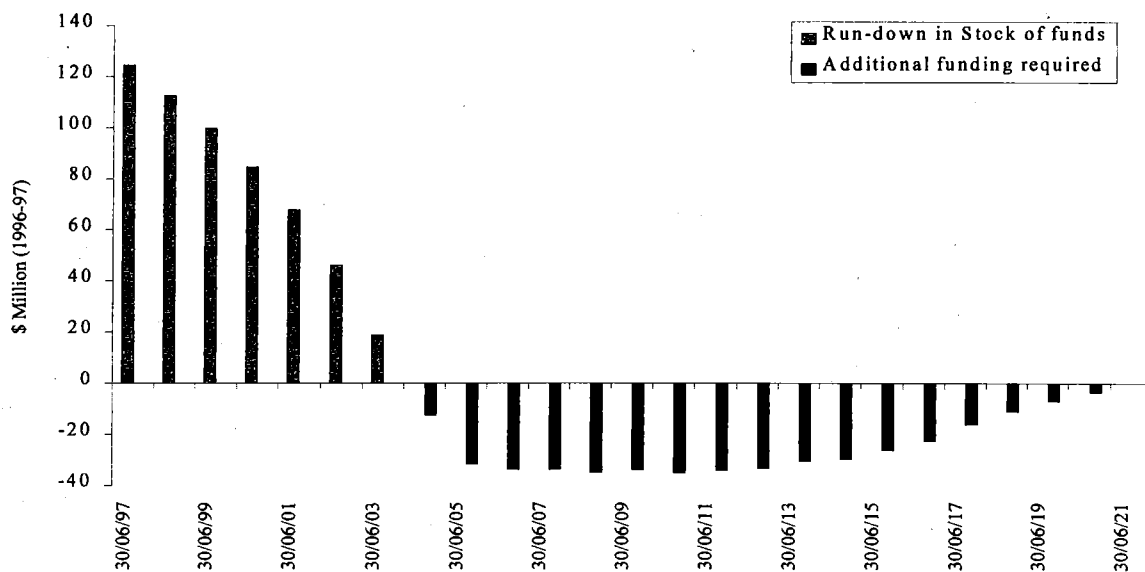
10.4.21. The "passive" funding scenario is based on the Government deciding to maintain current budgetary funding (that is, the level of funding shown as "total inflows" in Charts 10.7 and 10.9 above) over the next 8 years. Under this scenario, the shortfall between total inflows and total outflows during this period (the hatched area in Chart 10.9) will be met through the Government running down the accrued balance in the Superannuation Provision Account (SPA) until it is exhausted.

10.4.22. As indicated earlier, the balance of the SPA as at 30 June 1996 was \$146.2 million. The Committee has recommended in Chapter 5, however, that a proportion of this balance (estimated to be in the order of \$50 million as at 30 June 1996) should be paid to the RBF Board to wipe-off the unfunded

liability relating to the existing service of those members of the RBF non-contributory accumulation scheme.

- 10.4.23. After adjusting for this amount and the small notional actuarial surplus that currently exists in the RBF scheme, this leaves a “starting kitty” of some \$131.6 million that, together with interest earnings, can be run down over the next 8 years to offset the shortfall in inflows that has been identified and to ensure that all current pensions and emerging RBF contributory scheme benefits get paid.
- 10.4.24. Chart 10.10 below shows the run down in the “stock” of funds in the SPA over the next 8 years (the columns above the line) that occurs under this passive funding scenario - and it is evident that the SPA balance is exhausted by the year 2003.
- 10.4.25. Beyond the year 2003, Chart 10.10 shows that additional funding will then be required from the Budget for about 17 years (the columns below the line) to make sure that all RBF outflows continue to be met. Chart 10.9 above demonstrated that total outflows exceeded total inflows under this funding approach up until the year 2020.
- 10.4.26. This additional funding would probably need to take the form of higher contributions from the Budget to the Reserved-by-Law item R069. The Committee has been advised that under this funding approach, this item will need to be “topped up” by the Government for about 17 years to ensure that all RBF contributory scheme benefits continue to be met.

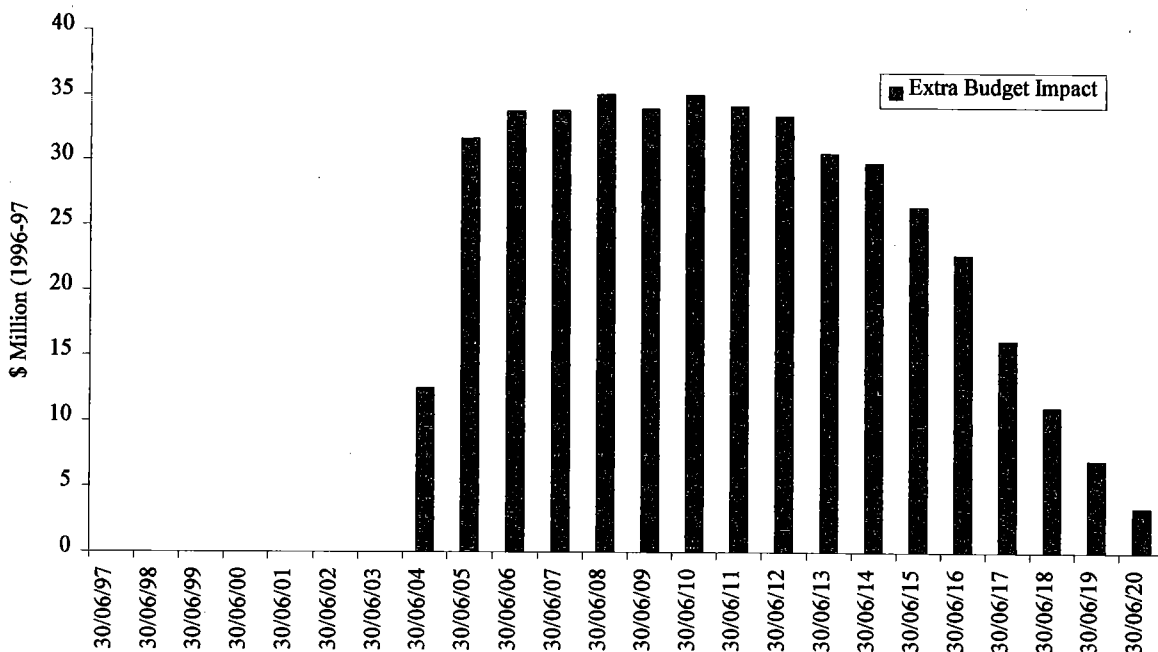
Chart 10.10 : Impact on the Superannuation Provision Account - Current Funding Basis



Source: Department of Treasury and Finance Cash Flow Analysis, 27 June 1997, Chart 10, page 16.

- 10.4.27. Under this passive funding approach (involving the using up of the SPA balance in the first instance), the period between 2003-04 and 2020 represents the period of financial pain for the State, as the effect of the “baby boomers” coming through to benefit age begins to be felt. The Committee understands from information provided by the RBF Board¹⁶⁴ that nearly 60 per cent of the existing RBF contributory scheme membership is aged 40 years and over.
- 10.4.28. Chart 10.11 below shows the level of the additional funding from the Budget that would be required, under this passive approach, between the years 2003-04 and 2020.
- 10.4.29. The columns above the line in this Chart represent a mirror image of those below the line on Chart 10.10. It can be seen that the extra funding required reaches about \$35 million (in today’s dollar terms) by the year 2007-08, remains around this level for four or five years then gradually reduces to nothing by the year 2020. In summary, an additional \$430 million in aggregate (in today’s dollars) will be required to be allocated from the State Budget under this passive funding scenario between the years 2003-04 and 2020 to ensure that all emerging benefits are paid.

Chart 10.11 : Extra Budget Impact - Current Funding Basis

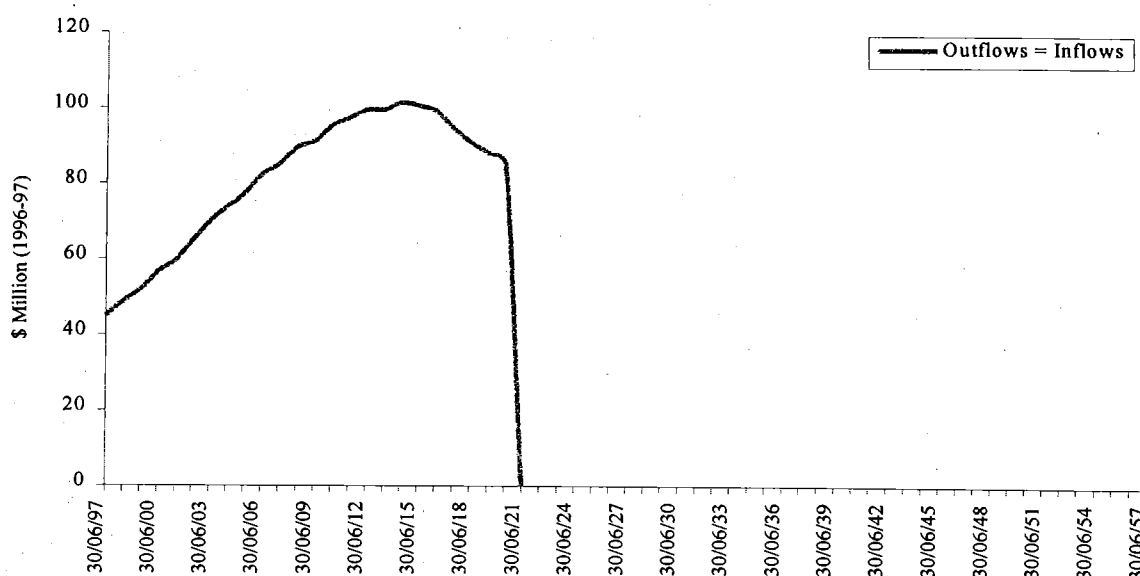


Source: Department of Treasury and Finance Cash Flow Analysis, 27 June 1997, Chart 11, page 17.

¹⁶⁴ Retirement Benefits Fund Board Submission, page 44

- 10.4.30. The Committee notes that this “passive” funding approach therefore involves minimising the short run budget impact of closing off the RBF contributory scheme to new members to prevent there being additions to the State’s unfunded liability. It minimises the extra budget impact by making use of the SPA balance until it is exhausted and results in a gradual elimination of the overall unfunded liability over some 67 years.
- 10.4.31. The alternative funding scenario developed by the Actuary (which, as indicated earlier, simply represents one of an infinite number of possible alternative funding programs) has been labelled by the Committee as an “aggressive” approach. This involves much higher budget outlays on superannuation by the Government than is currently the case over the next 7-8 years - but produces a very much faster decline in the unfunded liability over time. A similar funding approach is being pursued to varying degrees in Victoria, New South Wales and South Australia (see Chapter 3).
- 10.4.32. This alternative approach involves keeping total funding inflows from the Budget equal to total superannuation outflows in each year from now on. That is, extra contributions are made from the Consolidated Fund through R069 in each year beyond 1996-97 to ensure that the amount of money paid into the SPA in any one year exactly equals the amount paid out in pensions or benefits for existing and former scheme members.
- 10.4.33. In contrast to the passive approach outlined above, this involves not using the balance in the SPA in any form - the \$131.6 million “starting kitty” is simply left to accumulate with interest over time. Chart 10.12 shows the result that this approach would produce.

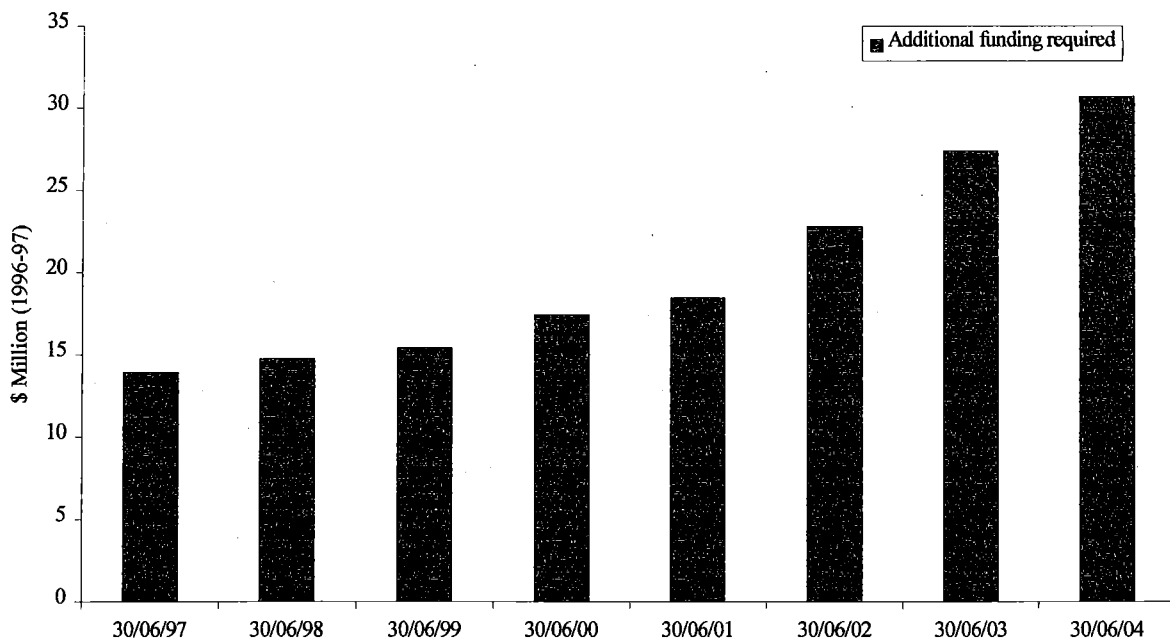
Chart 10.12 : Total Funding Required From the Budget to Keep Superannuation Outflows Equal to Inflows



Source: Department of Treasury and Finance Cash Flow Analysis, 27 June 1997, Chart 12, page 18.

- 10.4.34. Through putting in additional money early to avoid drawing down on the Superannuation Provision Account, the result generated under this funding scenario is that the State's unfunded liability disappears by the year 2020 - no extra superannuation outlays would be required from the Budget beyond that time, as the accumulated balance in the SPA would be sufficient (in the face of a rapidly declining number of members in the closed RBF scheme) to fund all future benefit payments over time.
- 10.4.35. The significant financial benefits from making extra funding effort early can therefore be seen - and the Committee notes that a good analogy is paying off a personal mortgage quicker. The more money an individual pays off his or her mortgage in the early years, then the quicker the person owns their home and the cheaper has been the overall cost.
- 10.4.36. Chart 10.13 below shows the amount of the additional funding effort that would be required over the next 7-8 years to produce this "aggressive" result. In summary, the Actuary has advised that the Government would need to allocate from the Budget an additional \$160 million in aggregate (in today's dollar terms) between 1997 and 2002-03, in addition to the \$430 million (in today's dollar terms) that will still be required between 2003-04 and 2020.

Chart 10.13 : Additional Funding Required from the Budget to Maintain the SPA Balance



Source: Department of Treasury and Finance Cash Flow Analysis, 27 June 1997, Chart 13, page 19.

- 10.4.37. Clearly this “aggressive” funding scenario produces a superior overall financial result for Tasmania, but involves considerable extra budget contributions from now on for a 7-8 year period.
- 10.4.38. Given Tasmania’s overall budgetary position, however, it is arguable whether the State should consider the full adoption of this “aggressive” approach to addressing its unfunded superannuation liability. The period of financial pain between 2003 and 2020 which will not be able to be avoided (given the profile of existing RBF scheme members) will be difficult enough for the Government to manage. As suggested by the Department of Treasury and Finance:

“... while eliminating the past service liability as quickly as possible is clearly desirable, such an approach is less important in the context of the Committee’s Terms of Reference than recommending reform that effectively prevents new employees adding to the unfunded liability from here on in.

Given Tasmania’s overall budgetary position, any attempt to wipe off the unfunded past service liability proactively through additional budget allocations (that is, other than letting it decline naturally over time) would involve considerable financial pain and it is arguable that there are more important budgetary imperatives in this State than eliminating the unfunded liability quickly.

The current past service unfunded liability has accrued over the past 60 years and Treasury believes that eliminating it over a further 60 years is not unreasonable:

- *to attempt to wipe the liability off quicker (like some other States) by making additional contributions, calls into question issues relating to inter-generational equity;*
- *that is, equity issues associated with current Tasmanian taxpayers being required to part fund the past service liability as well as funding current benefit payments.*

It is felt that the credit rating agencies would be relaxed with a strategy of capping the liability and eliminating it over the life of the members of the closed scheme.”¹⁶⁵

¹⁶⁵ Department of Treasury and Finance Submission, pages 17 and 18

- 10.4.39. The Committee notes that rather than cutting existing expenditure levels in important areas, increasing taxes or increasing debt to try and address the unfunded superannuation liability problem, the Government should give consideration to taking every available financial opportunity that presents itself to make extra contributions in this regard.
- 10.4.40. For example, the Government could consider altering its current financial strategy to provide that some component of the interest cost savings associated with early debt retirement from major asset sales be used for superannuation purposes.
- 10.4.41. The cash flow analysis presented above does vividly demonstrate that unless Tasmania takes action of this sort, the costs of public sector superannuation will produce a budgetary crisis much like the debt servicing crisis Tasmania experienced in the late 1980s and early 1990s. While the State has taken some action to address the debt crisis in an attempt to give some budgetary flexibility back to the Government, the costs of public sector superannuation will very quickly take any flexibility generated away for a period of some 17-18 years if the issue is not managed responsibly.
- 10.4.42. The Committee holds the view that the actuarially based analysis presented above demonstrates that by taking certain reform decisions, it is possible for the Tasmanian Government to prevent this occurring. The solution is certainly greater funding effort by the Government, but this is within manageable limits over the next two decades provided action is taken earlier enough.

10.5. CASH FLOW IMPLICATIONS - LEAVING THE RBF SCHEME OPEN TO NEW MEMBERS

- 10.5.1. As indicated in Chapter 5, one possible superannuation reform option open to the Government would be to leave the RBF contributory scheme open to new entrants but fully fund their benefits on and from the commencement of their employment. It was suggested in Chapter 5 that this option would be more costly for the State, relative to the preferred approach of closing the scheme off and providing new employees with a fully funded SGC accumulation benefit.
- 10.5.2. The reason for the higher cost associated with leaving the RBF defined benefit scheme open to new entrants is that these employees receive an average employer contribution certainly greater than 9 per cent (the maximum SGC employer contribution rate) and probably closer to 9.5 per cent (see Chapter 5 for a discussion of this matter). In this light, a new entrant in a fully funded SGC scheme will have a cost to the employer of 9

per cent of salary (once the SGC is fully implemented in the year 2002), compared with a cost in an open RBF contributory scheme in the order of 9.5 per cent of salary.

- 10.5.3. The Committee notes that it is therefore obvious that leaving the RBF contributory scheme open to new entrants and fully funding their benefits on and from the commencement of their employment will be more costly for the State relative to the preferred approach of closing the scheme off and providing new employees with a fully funded SGC accumulation benefit.
- 10.5.4. To support this contention, the Actuary has provided the Committee with quantitative advice. The Actuary has estimated that this extra cost to the State has a present value in the order of \$71.4 million.¹⁶⁶ It should be noted that this is a cost to the Government in addition to the future costs that the State will be required to bear in order to ensure that it is able to continue to pay the emerging benefits of existing RBF scheme members.
- 10.5.5. It has already been demonstrated in section 10.4 above that these costs, even under the so-called "passive" funding approach, are likely to be significant for a period of some 17 years (between 2003 and 2020). The extent of these costs are expected to be such that imposing an extra \$71.4 million on the State would make the overall funding task that much more difficult to manage.
- 10.5.6. The Committee notes that the option of leaving the RBF defined benefit scheme open to new entrants but fully funding these from commencement is not inconsistent with the overall objective of the current Inquiry, which is to recommend reform that will contain the growth in the State's unfunded liability and reduce it to zero over time. That is, this particular reform approach would still see the unfunded past service liability disappear at about the same time as under the recommended approach of closing off the RBF contributory scheme and providing SGC benefits to new members.
- 10.5.7. Again, the Committee believes that this point is obvious - the past service unfunded liability should be unaffected by the exact manner in which the Government decides to deal with future employees. Provided their benefits are fully funded from commencement, the unfunded past service liability should reduce to zero over roughly the same period (which is estimated to be in the order of 67 years under the "passive" funding approach outlined earlier in this Chapter). What the Actuary's figures have demonstrated, however, is that the alternative approach of leaving the RBF defined benefit scheme open to new entrants will actually cost the State more to achieve this desired outcome.

¹⁶⁶ Actuarial advice prepared for the Committee by Financial Synergy, July 1997, page 1

10.6. COMMITTEE FINDINGS

10.6.1. Having regard to the above, the Committee finds that:

- 1) There are no budgetary implications associated with the recommendation made by the Committee earlier in this Report that all new entrants after 1 July 1998 should be provided with a fully funded Superannuation Guarantee Charge (SGC) benefit. The reason for this is that Agencies and Authorities are currently funding these benefits from their budget allocations and will continue to do so from the monies included in the forward budget estimates.
- 2) There will, however, be less money going into the Superannuation Provision Account (SPA) during any financial year from which emerging RBF contributory scheme benefit payments can be met. It is this shortfall in SPA receipts which will impose some financial strain on the State in future years.
- 3) The advice from the Actuary suggests that the Government will need to consciously make additional Budget contributions into the SPA in order to ensure that there are sufficient funds available to meet all the RBF scheme benefits that emerge over time. The extent of these additional payments depends, however, on the nature of the funding approach adopted by the Government.
- 4) There is an infinite number of different funding scenarios which could be adopted by the Government to meet the emerging costs of the closed RBF contributory scheme - all of which have an impact on the remaining unfunded superannuation liability.
- 5) The "passive" funding scenario is based on the Government deciding to maintain current budgetary funding for superannuation over the next 8 years. The shortfall between total budgetary funds available to the Government and total superannuation outflows during this period which will result from the fact that the SGC benefits for both existing non-contributory scheme members and new employees will be fully funded (rather than being paid into the SPA) will be met through the Government running down the accrued balance in the Superannuation Provision Account (SPA) until it is exhausted (which is estimated to be in about 2003).
- 6) Beyond the year 2003, significant additional funding will then be required from the Budget for about 17 years to make sure that all RBF outflows continue to be met. This period therefore represents the period of financial pain for the State, as the effect of the "baby boomers" coming through to benefit age begins to be felt.

- 7) The extra funding required reaches about \$35 million (in today's dollar terms) by the year 2007-08, remains around this level for four or five years then gradually reduces to nothing by the year 2020. In summary, an additional \$430 million in aggregate (in today's dollars) will be required to be allocated from the State Budget under the passive funding scenario between the years 2003-04 and 2020 to ensure that all emerging benefits are paid.
- 8) This "passive" funding approach therefore involves minimising the short run budget impact of closing off the RBF contributory scheme to new members to prevent there being additions to the State's unfunded liability. It minimises the extra budget impact by making use of the SPA balance until it is exhausted and results in a gradual elimination of the overall unfunded liability over some 67 years.
- 9) An "aggressive" funding approach would involve much higher budget outlays on superannuation by the Government than is currently the case over the next 7-8 years - but would produce a very much faster decline in the unfunded liability over time. A similar funding approach is being pursued to varying degrees in Victoria, New South Wales and South Australia (see Chapter 3).
- 10) Given Tasmania's overall budgetary position, however, the full adoption by the Government of this "aggressive" approach to addressing its unfunded superannuation liability is not one which can be considered. The period of financial pain between 2003 and 2020, which will not be able to be avoided (given the profile of existing RBF scheme members), will be difficult enough for the Government to manage, without trying to eliminate the unfunded liability any quicker.
- 11) Rather than cutting existing expenditure levels in important areas, increasing taxes or increasing debt to try and address the unfunded superannuation liability problem, consideration should be given by the Government to taking every available financial opportunity that presents itself to make extra contributions in this regard. For example, the Government should consider altering its current financial strategy to provide that some component of the interest cost savings associated with early debt retirement from major asset sales be used for superannuation purposes.
- 12) The cash flow analysis conducted by the Committee vividly demonstrate that unless Tasmania takes action of this sort, the costs of public sector superannuation will produce a budgetary burden much like the debt servicing crisis Tasmania experienced in the late 1980s and early 1990s. While the State has taken some action to address the debt crisis in an attempt to give some budgetary flexibility back to the

Government, the costs of public sector superannuation will very quickly take any flexibility generated away for a period of some 17-18 years if the issue is not managed responsibly.

- 13) Leaving the RBF contributory scheme open to new entrants and fully funding their benefits on and from the commencement of their employment will be more costly for the State relative to the preferred approach of closing the scheme off and providing new employees with a fully funded SGC accumulation benefit. The Actuary has estimated that this extra cost to the State has a present value in the order of \$71.4 million.

10.7. COMMITTEE RECOMMENDATIONS

- 10.7.1. In light of the findings of the Committee in relation to issues associated with the cash flow implications of reform to public sector superannuation in Tasmania, the Committee makes the following recommendation:

Recommendation 34:

The Government should give consideration to altering its fiscal strategy to provide that some component of the interest cost savings associated with early debt retirement from major asset sales be applied to reducing the State's unfunded superannuation liability.

- 10.7.2. The following Chapter considers a number of further issues that have been drawn to the Committee's attention during the course of the Inquiry that need addressing.

11. OTHER ISSUES

11.1. INTRODUCTION

11.1.1. In addition to the matters discussed in previous Chapters, a number of further issues have either been raised, or otherwise drawn to the Committee's attention, during the course of the Inquiry that require addressing. While these issues are not specifically covered by the Terms of Reference for the Inquiry, the Terms of Reference do generally provide that the Committee:

"...should also consider alternative mechanisms for reducing the level of, and the rate of growth in, the State's unfunded superannuation liability..."¹⁶⁷

11.1.2. The additional issues upon which the Committee wishes to provide advice to the Parliament are as follows:

- a) the tax status of the Retirement Benefits Fund (including the issue of the use of Pre 1 July 1988 Funding Credits);
- b) the availability of allocated pensions; and
- c) the desirability of the Government seeking a second actuarial opinion on the broad reform direction recommended in this Report.

11.2. TAX STATUS OF THE RBF SCHEME

11.2.1. The Retirement Benefits Fund Board presented evidence to the Committee in relation to the tax status of the RBF scheme. The issue was also raised with the Committee by the Department of Treasury and Finance.

11.2.2. Prior to 1988, the Commonwealth's *Income Tax Assessment Act 1936* (ITAA) conferred exemption from income tax on private sector superannuation funds (provided, after 1987, they complied with the requirements of the Commonwealth's *Occupational Superannuation Standards Act 1987* (OSSA) that were monitored by the Insurance and Superannuation Commission). Prior to 1988, public sector superannuation funds were unconditionally exempt from income tax under section 23(jaa) of the ITAA.

¹⁶⁷ Joint Select Committee on Superannuation, Terms of Reference

- 11.2.3. In 1988, the Commonwealth introduced changes to the taxation of income of superannuation funds, whether private or public. From 1 July 1988, the net investment income of superannuation funds which complied with OSSA was subject to tax at the rate of 15 per cent (with the rate of tax for non-complying superannuation funds being 47 per cent), and employer and other deductible contributions were taxed at 15 per cent for complying funds and 47 per cent for non-complying funds.
- 11.2.4. After 1 July 1988, all superannuation funds are nominally "taxed" funds, unless they are constitutionally protected under section 114 of the Australian Constitution. The RBF scheme is not constitutionally protected and so therefore is nominally a "taxed" fund.
- 11.2.5. To date, however, the RBF Board has paid only minimal tax to the Commonwealth because, under the provisions of the ITAA, it has been able to exempt from tax investment income required to fund current pensions. In addition, it has elected under the ITAA to exempt employer contributions from tax.
- 11.2.6. The decision by the Board to exempt employer contributions from tax effectively means that the lump sum and pension benefits paid by the Fund are "untaxed" (or more correctly, are paid from an "untaxed" source). Because benefits are received by members from an "untaxed" source, however, they attract a higher tax rate than otherwise applies. Ignoring the myriad complexities in superannuation tax arrangements relating to matters such as periods of service, age and the Medicare levy, a simplified summary of the tax arrangements applying to end benefits is outlined below:

	Taxed (rate of tax)	Untaxed (rate of tax)
First \$90,474 (which is indexed)	0 %	15 %
Excess over \$90,474	15 %	30 %

- 11.2.7. The difference in the tax paid on end benefits relates to the manner in which employer contributions are taxed in the Fund during membership. In the "taxed" situation, employer contributions are taxed at 15 per cent as and when they are paid into the Fund, which means that the tax on end benefits is reduced. In an "untaxed" situation, no tax is paid on employer contributions as and when they are paid into the Fund, which means that the tax on end benefits is commensurately higher.

11.2.8. The following example illustrates some of the issues associated with possibly altering the tax status of the RBF scheme. Again, simplifying assumptions have been used (such as the member is over 55 years of age, the highest lump sum tax rate is relevant and the Medicare levy is ignored).

	<u>Untaxed</u>	<u>Taxed</u> ¹	<u>Taxed</u> ²
	(\$)	(\$)	(\$)
Employer contributions	1 000	1 176	969
Tax paid by Fund	0	176	145
Benefit paid to member	1 000	1 000	824
Tax paid by member	300	150	124
Net benefit received	700	850	700
Total tax payable by both the Fund and the member	300	326	269

Notes

1. Without a reduction in benefits.
2. With a reduction in benefits.

11.2.9. It can be seen from the above that simply moving to become a "taxed" fund would increase the costs of the RBF scheme to the Government in the order of 17.6 per cent - it would be required to contribute an extra \$176 in order to give the member the same defined benefit of \$1 000. Because the member would benefit from a lower tax regime on end benefits, however, the net benefit in the hands of the member would be \$850 compared with \$700 under the untaxed arrangement. That is, there would be a windfall gain to members at the expense of the employer. Further, there would be an increase in Commonwealth tax revenue in the order of 8.7 per cent.

11.2.10. The table also reveals that it is possible to reduce the gross benefits of members at the same time as moving to become a "taxed" fund to leave them in exactly the same after tax position as they were in the "untaxed" arrangement - that is, gross benefits can be reduced to ensure that the member continues to receive a net benefit of \$700. In the above example, the level of employer contribution required to fund the identical net benefit of \$700 falls from \$1 000 to \$969.

- 11.2.11. It can be seen that a consequence of moving to a "taxed" arrangement is that the liability of the RBF to pay tax increases. In 1988 when contributions tax was first introduced, however, the Commonwealth granted those funds with an unfunded liability a "pre 1 July 1988 funding credit" (PJFC). This allows such funds to reduce their taxable income in respect of contributions made after 1988 (when tax was first introduced) that relate to benefits accrued prior to that date (when tax did not apply).
- 11.2.12. There are certain limits on how much of the RBF's PJFC can be used in any one year. Together with the fact that the PJFC is indexed each year, the result since 1988 has been a steady increase in the available PJFC. The following table illustrates this fact.

<i>FINANCIAL YEAR</i>	<i>TOTAL PJFC - 1 JULY</i>	<i>PJFC DEBIT</i>	<i>INDEXATION FACTOR</i>	<i>PJFC CREDIT 30 JUNE</i>
	\$	\$		\$
1988/89	1,164,604,879	27,148,952	1.073	1,220,490,210
1989/90	1,220,490,210	42,525,006	1.066	1,255,710,907
1990/91	1,255,710,907	27,578,092	1.075	1,320,242,776
1991/92	1,320,242,776	23,736,537	1.044	1,353,552,514
1992/93	1,353,552,514	19,249,372	1.008	1,344,977,567
1993/94	1,344,977,567	34,962,598	1.028	1,356,866,828
1994/95	1,356,866,828	0	1.045	1,417,925,835
1995/96	1,417,925,835	0	1.042	1,477,478,720

Source: RBF Board Submission, page 92

- 11.2.13. As at 30 June 1996, the Retirement Benefits Fund had a PJFC balance of \$1,477,478,720. Interestingly, this amount is in excess of the estimated unfunded liability associated with the RBF scheme as at 30 June 1996 (\$1.374 billion).
- 11.2.14. It is possible that the increased tax liability of the RBF scheme in moving to a "taxed" arrangement can be offset to some extent by the Board making greater use of the available PJFC. The Committee is aware that the Victorian Superannuation Board took action along these lines some years ago.

11.2.15. The possibility of reducing the costs of superannuation to the Government without any detriment to members was precisely the reason why both the RBF Board and the Department of Treasury and Finance raised the issue of tax status with the Committee. The RBF suggested that the Government should:

“... undertake a detailed investigation of the costs and associated benefits of the RBF scheme becoming a taxed Fund, including:

- *the usage of the Fund's pre 1 July 1988 funding credit;*
- *the reduction of gross benefits to members so as to provide an increase in the after-tax taxed benefit to members over the current after-tax untaxed benefit”¹⁶⁸*

11.2.16. In its submission to the Committee, the Department of Treasury and Finance suggested that:

“A review into possibly making the RBF scheme a taxed fund and offsetting the increased tax liability by higher usage of the PJFC should be investigated.”¹⁶⁹

11.2.17. Since the Committee received the RBF Board and Department of Treasury and Finance submissions in relation to the desirability of a review being undertaken into the tax status of the RBF scheme, the Committee understands that these two parties have already taken action to commence such a review, in conjunction with expert taxation specialists and the State Government's Consulting Actuary.

11.2.18. The Committee is conscious of the fact that the issues associated with changing tax status are extremely complex, inter-related with other fund design and management issues and difficult to understand. The matters that require consideration are not as simple as portrayed above. For example, it might well be difficult to demonstrate to members that there is no detriment from a reduction in their gross benefit.

11.2.19. Further, some members of the RBF scheme may well be disadvantaged from a change in tax status - such as RBF pensioners living overseas who are not subject to Australian income tax laws, pensioners who receive an annual pension below the tax-free threshold (as they would not be able to claim a rebate against their pension) and so on. In the event that the tax status of the

¹⁶⁸ Retirement Benefits Fund Board Submission, page 18

¹⁶⁹ Department of Treasury and Finance Submission, page 43

RBF scheme is altered, specific arrangements will be required to ensure that this does not occur.

- 11.2.20. Notwithstanding the complexities, the Committee believes that the whole issue is worthy of more detailed investigation and analysis by the RBF Board and the Government and endorses the review that is currently in train in this respect.

11.3. ALLOCATED PENSIONS

- 11.3.1. Another issue raised during the course of the Inquiry by both the RBF Board and the Department of Treasury and Finance related to the availability of allocated pensions in any new accumulation scheme. The RBF Board provided the following definition of an allocated pension:

“Allocated pensions are pension arrangements where a person has his or her own account and regularly draws down an amount from the account, within certain legislated limits. The pension continues until death or until the money runs out. On death, any balance is paid to the estate or is available to buy a pension for a surviving spouse.”¹⁷⁰

- 11.3.2. The Committee notes that under regulation 65 of the *Retirement Benefits Regulations 1994*, the RBF Board has the power to enter into an agreement with a registered life office to provide former eligible employees (that is, former members of the non-contributory scheme) and former contributors with an option to purchase an allocated pension. The Committee understands, however, that to date this has not occurred.
- 11.3.3. As indicated earlier in this Report, the Committee has recommended that the benefit to be provided to members of the proposed new accumulation scheme be a lump sum benefit only - that is, there will be no normal life time pension option. This is because it is not possible to offer normal life-indexed pensions as part of an accumulation scheme design. The assets of accumulation schemes, unlike defined benefit schemes, are fully vested in the members and the trustees have both no access to additional assets and no ability to guarantee life pensions which, over time, might cost more than the available assets and income of a particular individual.
- 11.3.4. In light of the above, the Committee believes that, in order to provide greater flexibility to members in the proposed new accumulation scheme, the current option that the RBF Board has to enter into agreements with private sector

¹⁷⁰ Retirement Benefits Fund Board Submission, page 37

providers in relation to the purchase of allocated pensions should be extended to enable the Board to offer allocated pensions in its own right.

- 11.3.5. The greater accessibility of allocated pensions to members of the RBF scheme (both contributory and non-contributory) will attract those individuals who want an income stream but who also wish to have continual access to their lump sum capital invested. There is the prospect that the offering of allocated pensions will therefore assist in arresting, to some extent, the significant growth in the current pension liability associated with the RBF scheme (which was outlined in Chapter 2).

11.4. SECOND ACTUARIAL OPINION

- 11.4.1. The Committee recognises that the recommendations made in this Report represent very major reform to existing public sector superannuation arrangements in Tasmania. The unfunded liability problem that the recommendations are designed to address represents a significant financial exposure for the State and, in making any changes to current arrangements, the Government will need to be certain that the broad direction chosen will produce the benefits that the Committee has suggested.
- 11.4.2. Accordingly, the Committee believes that prior to formally endorsing the major strategic recommendations contained in this Report, it would be desirable for the Government to seek further actuarial advice in relation to the broad reform direction being suggested.
- 11.4.3. The Auditor-General raised this issue in his submission to the Committee:

*"Given the long term significance of this issue to Government and employees alike, the Committee should consider whether it would be desirable to obtain a second actuarial opinion on some aspects."*¹⁷¹

11.5. COMMITTEE RECOMMENDATIONS

- 11.5.1. In light of the above, the Committee makes the following additional recommendations:

¹⁷¹ Submission by the Auditor-General, page 3

Recommendation 35:

The Government and the RBF Board should, as a matter of priority, complete the full review that is presently underway into the merits or otherwise of altering the status of the RBF scheme to a taxed arrangement and reducing the gross benefits to be paid to scheme members in order to ensure that their end benefit net of tax remains unaffected (that is, to ensure that the impact on existing individual fund members is neutral). The Committee endorses the fact that the current review is also considering mechanisms for making maximum usage of the RBF's Pre 1 July 1988 Funding Credits to offset any additional tax liability arising from such a course.

Recommendation 36:

In order to provide greater flexibility to members in the proposed new accumulation scheme, the current option that the RBF Board has to enter into agreements with private sector providers in relation to the purchase of allocated pensions should be extended to enable the Board to offer allocated pensions in its own right.

Recommendation 37:

Prior to formally endorsing the major strategic recommendations contained in this Report, the Government should seek further actuarial advice in relation to the broad reform direction being proposed.

APPENDIX 1 - TERMS OF REFERENCE

To inquire into and report upon whether or not to:

- (a) Close off from some future date the following defined benefit superannuation schemes to new entrants:
- the Retirement Benefits Fund contributory scheme;
 - the Parliamentary Retirement Benefits Scheme; and
 - the Judges' Contributory Pensions Scheme.
- (b) Provide newly appointed:
- State Servants, including contract employees of all kinds;
 - Parliamentarians;
 - Judges;
 - Solicitors-General;
 - Directors of Public Prosecutions; and
 - Masters of the Supreme Court
- with employer funded superannuation support in line with the requirements of the Commonwealth Government's *Superannuation Guarantee (Administration) Act 1992*.
- (c) Provide those new employees detailed in (b) above with the option of nominating one of a number of "complying" private sector superannuation funds into which the employer contribution is to be paid.
- (d) Provide that the Retirement Benefits Fund (RBF) non contributory scheme be the "default" scheme where no election is made under (c) above.
- (e) Provide existing members of the schemes detailed in (a) above with the option of ceasing to contribute (subject to any future Commonwealth requirements in relation to compulsory employee contributions) and participating in the non-contributory arrangements outlined in (c) and (d) above.

And that the Joint Select Committee should also consider alternative mechanisms for reducing the level of, and the rate of growth in, the State's unfunded superannuation liability and without limiting the range of factors to be taken into consideration the Committee should, in conducting its inquiry, have regard to:

- the advantages and disadvantages of defined benefit and accumulation schemes for employees and the employer;
- the level of and recent growth in the State's unfunded liability in respect of Public Sector Superannuation arrangements in Tasmania;

- the actions already taken in a number of other jurisdictions and trends in regard to defined benefits schemes to new entrants;
- the desirability of revising public sector superannuation arrangements to ensure equity in relation to the level of employer superannuation support between the classes of persons outlined in (2) above; and
- the regulatory environment associated with superannuation and changes in these arrangements expected to be made by the Commonwealth in the near future.

And that the Minister for Finance shall prepare a Background Paper for the consideration by the Committee, which will be available to all interested parties who will be given the opportunity to make submissions in relation to the matters outlined above.

And that the Committee, in undertaking this inquiry, shall have ready access to detailed expert superannuation advice from the Tasmanian Department of Treasury and Finance; and

That the number of members to be appointed be six and that the Committee finalise its report by 31 March 1997.

APPENDIX 2 - LIST OF SUBMISSIONS RECEIVED AND TAKEN INTO EVIDENCE

1. Suncorp - submission dated 19th December, 1996.
2. The Office of the Chief Justice - submissions dated 19th December, 1996 and 20th December, 1996.
3. Jacques Martin - submission dated 19th December, 1996.
4. Tasmanian Chamber of Commerce and Industry - submission dated 9th January, 1997.
5. Tasmanian Chamber of Commerce and Industry - dated 12th February, 1997. Further information offered at hearing Police Association of Tasmania submission dated 13th January, and attachment - The Northern Territory of Australia Public Sector Assets and Liabilities - Budget Paper No. 4 1993-94.
6. Retirement Benefits Fund Board - submission dated 10th January, 1997 - documents:
 - ⇒ *Retirement Benefits Act 1993* - volumes 1, 2 and 3;
 - ⇒ Retirement Benefits Fund Actuarial Review and Valuation as at 1 July 1995;
 - ⇒ The Dictionary of Superannuation;
 - ⇒ Report on Superannuation Cashflow projections prepared for the Retirement Benefits Fund Board dated 7th February, 1997. Further information offered at hearing;
 - ⇒ Letter dated 17 February, 1997 - containing further information in connection with Report dated 7th February, 1997.
7. National Mutual Insurance - submission dated January, 1997.
8. TasCOSS - submission dated 13th January, 1997.
9. Australian Education Union, Tasmanian Branch - submission dated 13th January, 1997.
10. Community and Public Sector Union - submission dated 14th January, 1997.
11. Tasmanian Trades and Labor Council - submission dated 14th January, 1997.
12. Report of the Victorian Commission of Audit - Volume 1 (supplied by Treasury).

13. Select Committee Upon Public Sector Superannuation Schemes (supplied by Treasury).
14. Auditor General, Tasmanian Audit Office, submission dated 30th January, 1997.
15. United Firefighters Union of Australia, Tasmanian Branch, submission dated 31st January, 1997.
16. Submission: From Ross Christie, General Manager, State Superannuation Office, Department of Treasury and Finance, South Australia - notes for meeting with Tasmanian Superannuation Joint Select Committee in Adelaide on Thursday 20th February, 1997.
17. Submission: From Community and Public Sector Union, S.A. Branch, SPSF Group, Public Service Association of SA Inc. submitted to hearing in Adelaide on Thursday 20th February, 1997 (Ms. Jan McMahon, General Secretary).
18. Department of Treasury and Finance Submission, 9 May 1997.
19. Joint RBF Board - Treasury Position Paper on Superannuation Reform, 29 July 1997.
20. Supplementary RBF Board Submission, 29 July 1997.

APPENDIX 3 - LIST OF WITNESSES

- Mr. Tom Adams, Vice President, South Australian Superannuation Federation
- Mr. Glenn Appleyard, Deputy Secretary, Department of Treasury and Finance
- Ms Beryl Ashe, Employee Representative on SAS Trustee Corporation Board and Part-time Board Member on the FSS Trustee Corporation Board
- Mr. Sonny Azzopardi, Manager, Administration and Research, Tasmanian Chamber of Commerce and Industry
- Mr. Kevin Beasley, Suncorp
- Mr. David Benbow, National Mutual Insurance
- Mr. John Burke, Trustee, State Fire Commission Superannuation Fund
- Mr. Don Challen, Secretary, Department of Treasury and Finance
- Mr. Ross Christie, General Manager, South Australian Superannuation Office, Department of Treasury and Finance
- Ms Penny Cocker, President, Australian Education Union (Tasmanian Branch)
- Mr. Martin Connolly, Acting Principal Policy Analyst, NSW Treasury
- Ms Helen Davison, Director, Finance and Liability Management, Department of Treasury and Finance, Victoria
- Ms. Lynne Fitzgerald, Secretary, Tasmanian Trades and Labor Council
- Mr. Garry Fletcher, Secretary, Retirement Benefits Fund
- Mr. Allen Griffin, Former Executive Director, Superannuation, Department of Treasury and Finance, Victoria
- Mr. Mike Hansen, Representative for CPSU-SPSF Group, Victorian Branch
- Mr. George Hluchaniuk, State Manager, National Mutual Insurance
- Mr. Rod Hunt, Information Officer, Australian Education Union (Tasmanian Branch)
- Mr. Mark Kadziolka, Assistant Secretary, The Police Association of Tasmania
- Dr. Arthur McHugh, Auditor-General (Tasmania)

- Ms Jan McMahon, General Secretary, Public Sector Association of South Australia Inc.
- Mr. Ian Neale, Acting Executive Director, Accounting and Financial Policy, NSW Treasury
- Mr. Deane Prior, Director, Superannuation Policy Unit, South Australian Department of Treasury and Finance
- Ms Melinda Savvides, Principal Policy Officer, State Super, SAS Trustee Corporation
- Mr. Julian Sawicki, Financial Controller, Public Sector Association of South Australia Inc.
- Ms. Sharon Smith, Assistant Secretary, Retirement Benefits Fund
- Mr. Greg Vines, General Secretary, Community and Public Sector Union
- Mr. Richard Warwick, Secretary, United Firefighters Union of Australia (Tasmanian Branch)
- Mr. Ian Weaving, State Manager, Suncorp
- Mr. Phil Wilkinson, Vice President, The Police Association of Tasmania

APPENDIX 4 - LIST OF DOCUMENTS RECEIVED AND TAKEN INTO EVIDENCE

- 'Joint Select Committee on Superannuation - Major Issues to be Discussed' - distributed by Mr. Philp.
- NSW Legislative Assembly, Select Committee Upon Public Sector Superannuation Schemes, November 1993.
- Report of the Victorian Commission of Audit, Volumes 1 and II, May 1993.
- 'Options for Employer Sponsored Superannuation in Commercial Government Authorities' prepared by Mr. Brian Bendzulla, 21 June, 1994 - distributed by Mr. Garry Fletcher, Secretary, RBF.
- State Authority Superannuation Board/State Superannuation Investment and Management Corporation, Annual Reports 1996, submitted to hearing in N.S.W. on Wednesday 19th February, 1997 (Ms. Beryl Ashe, Employee Representative on SAS Trustee Corporation Board).
- 'Financial Statement 1996-97' (South Australian financial paper No. 1) - Extract from paper titled 'Liability Management' pages 114-134 (Deane Prior).
- 'Prudential Statement - Victorian Public Sector Investments' 25/2/97 Submitted by Department of the Treasury Victoria to hearing in Melbourne on Friday 21st February, 1997 (Ms. Helen Davison).
- State Authority Superannuation Board/State Superannuation Investment and Management Corporation, Annual Reports 1996.
- "Contributory Superannuation for SA Public Sector Employees - Triple S - Southern State Superannuation Scheme -1 July, 1996. Submitted to hearing in Adelaide on Thursday 20th February, 1997 (Mr. Ross Christie).
- 'Public Sector Superannuation Arrangements in Victoria Following the Reform Programme 1993-96.' Submitted to hearing by Department of Treasury and Finance, Victoria in Melbourne on Friday 21st February, 1997 (Mr. Allen Griffin).
- 'Treasury Presentation - Parliamentary Joint Select Committee on Superannuation' - dated 9 May, 1997.
- Credit Focus, Standard and Poors, June 1997.
- Joint RBF Board - Treasury Position Paper on Superannuation Reform, dated 29 July, 1997.
- Moody's Analysis, Moody's Investors Service, April 1997.

- Budget Paper No.1 - Budget Overview 1997-98.
- Budget Speech 1997-98.
- Budget Paper No.1 - Budget Overview 1996-97.
- Budget Speech 1996-97.
- Superfunds, ASFA, July 1996 and November 1996.
- ISC Bulletin, June Quarter 1996.
- Savings: Choice and Incentive, Ministerial Statement, 13 December, 1996.
- Investment of Australia's Superannuation Savings, 21st Report of the Senate Select Committee on Superannuation, December 1996.
- Judicial Remuneration in Australia, by George Winterton, The Australian Institute of Judicial Administration Incorporated 1995.
- Newspaper article by Brian Toohey, Australian Financial Review, 8 April, 1997.
- Newspaper article by Louise Dodson, Australian Financial Review, 2 September, 1997.
- 'Fund choice headaches ahead, say experts' article by Rebecca Kennedy in October 1997 issue of SUPERFUNDS.
- 'Review of Superannuation Arrangements in the Tasmanian Public Sector', 1993.
- 'Charting the Way Forward', Report of the South Australian Commission of Audit', April 1994.
- 'Report of the Independent Commission to Review Public Sector Finances', Western Australia, August 1993.

APPENDIX 5 - MINUTES OF COMMITTEE MEETINGS

TUESDAY, 19 NOVEMBER 1996

The Committee met in the Committee Room 2, Parliament House, Hobart, at 12.00 noon.

Members Present

House of Assembly	Legislative Council.
Mr <i>Cornish</i> (Chair)	Mr <i>Bailey</i>
Mr <i>Foley</i>	Mr <i>Hiscutt</i>
Mr Lennon	Mr Wilson

The Secretary took the Chair and read the Order appointing the Committee.

The Secretary called for nominations for Chairman.

Mr *Cornish* was nominated by Mr *Foley* and being the only nomination was declared elected and took the Chair.

Usage

It was resolved to use the Standing Orders of the House of Assembly.

Conduct of Inquiry

(a) Advertising -

Advertisements are to be inserted in the three main newspapers, the closing date for submissions - 20 December, 1996.

(b) Submissions -

Submissions are to be sought from: Trusts involved, C.P.S.U., Secretaries of Government agencies, Judges and those under that scheme, Secretaries of Government Agencies and the Secretary is to be informed by Members of any other individual or organisation to be contacted.

(c) Hearings -

The Committee will meet in January to consider submissions and to decide which to invite to appear before the Committee for hearings in late January and February.

The Committee will meet on Tuesday 14 January, 1997 at 11.00 a.m. at Parliament House to consider submissions, and earlier if necessary.

Hearings are to be in public unless it is necessary to take evidence in private.

(d) Advisers -

The Chairman informed the Committee that the Department of Treasury and Finance personnel would be made available to assist the Committee. Mr Mark Kerslake will be seconded as an advisor to the Committee.

(e) Other matters -

The Chairman informed the Committee he would arrange for a background Paper to be prepared, in accordance with the Resolution appointing the Committee, and sent to Members of the Committee to consider. The Committee will meet on Thursday 28th November, 1996 at 1.00 p.m. and if necessary on Friday 29th November, 1996 at 9.30 a.m. to approve the Paper for release to interested parties.

Other relevant inquiries -

There have been inquiries at a Federal level and in most other States and these inquiries need to be obtained and analysed.

At 12.45 p.m. the Committee adjourned until a date to be fixed.

TUESDAY, 14 JANUARY 1997

The Committee met in Committee Room 2, Parliament House, Hobart, at 11.00 am.

Members Present

House of Assembly

Mr *Cornish* (Chair)Mr *Foley*Mr *Lennon*

Legislative Council.

Mr *Bailey*Mr *Hiscutt*Mr *Wilson***Committee Advisers**

Resolved, That unless otherwise ordered, the following advisers be admitted to the proceedings of the Committee whether in public or private session:

Mrs Vena Boman, Parliamentary Research Unit;

Mr Mark Kerslake, Director, Economic Financial Policy Division, Department of Treasury and Finance; and

Mr Greg Philp, Assistant Director - Superannuation Policy Division, Department of Treasury and Finance. (*Mr Cornish*)

Mrs Boman, Mr Kerslake and Mr Philp were admitted.

Mr *Wilson* took his seat.

Minutes

The Minutes of the meeting held on Tuesday, 19 November, 1996 were circulated, read and confirmed as a true and accurate record.

Superannuation arrangements of other States

Mr Kerslake undertook to obtain and provide the Committee with any information, particularly in the form of inquiry reports and/or papers, dealing with reviews of superannuation arrangements undertaken in other States.

Mr *Hiscutt* took his seat.

Submissions

Resolved,

(1) That the closing date for the receipt of submissions from those organisations previously invited to do so be extended until Friday, 31 January 1997; and

(2) The Education Union, Australian Nursing Federation (Tasmanian Branch) and the United Firefighters' Union of Australia (Tasmanian Branch) be invited to provide the Committee with a written submission, to be received by Friday, 31 January 1997. (Mr *Hiscutt*)

Evidence

Ordered, That the following submissions be received and taken into evidence:-

Suncorp - submission dated 19th December, 1996

The Office of the Chief Justice - submissions dated 19th December, 1996 and 20th December, 1996

Jacques Martin - submission dated 19th December, 1996

Tasmanian Chamber of Commerce and Industry - submission dated 9th January, 1997

Police Association of Tasmania submission dated 13th January, 1997 and attachment - The Northern Territory of Australia 1993-94 Public Sector Assets and Liabilities - Budget Paper No. 4 1993-94

Retirement Benefits Fund Board - submission dated 10th January, 1997 - documents - Retirement Benefits Act 1993 - volumes 1, 2 and 3; Retirement Benefits Fund Actuarial Review and Valuation as at 1 July 1995; The Dictionary of Superannuation

National Mutual Insurance - submission dated January, 1997

TasCOSS - submission dated 13th January, 1997 (Mr *Wilson*)

Evidence Paper

Mr Philp distributed the following paper:

“Joint Select Committee on Superannuation - Major Issues to be Discussed”.

Future Meetings`

The Committee resolved to meet on the following dates at Parliament House:

Wednesday, 29 January 1997 at 9.30 am

Thursday, 30 January 1997 at 11.30 am

Friday, 31 January 1997 at 9.30 am

Resolved, That the Committee investigate the superannuation arrangements existing in New South Wales, Victoria and South Australia and that the Committee travel to the

abovementioned destinations for the period 18 February to 21 February 1997 for that purpose. (Mr *Lennon*)

Interim Report

Mr *Wilson* suggested that given the time limitations an Interim Report be prepared addressing points 1 and 2 of the 'Major Issues' paper abovementioned.

The Committee deliberated.

The Acting Secretary undertook to advise the Committee of the purpose and content of Interim Reports.

Other Matters

Mr *Bailey* advised the Committee of correspondence he had received from Hon. Geoffrey Chisolm regarding the inquiry. It was decided that the matters addressed were outside the Committees Terms of Reference.

At 12.15 pm, the Committee adjourned until Wednesday, 29 January 1997 at 9.30 am, in Committee Room 2.

WEDNESDAY, 29 JANUARY 1997

The Committee met in Committee Room 2, Parliament House Hobart at 9.30 am.

Members Present

House of Assembly
Mr *Cornish* (Chair)
Mr *Foley*
Mr *Lennon*

Legislative Council.
Mr *Bailey*
Mr *Wilson*

Apology

Mr. *Hiscutt*

Mr Kerslake and Mr Philp were in attendance

Minutes

The minutes of the meeting held on Tuesday, 14 January 1997 were circulated, read and confirmed as a true and accurate record. (Mr. *Lennon*)

Evidence

Ordered, That the following submissions be received and taken into evidence:

- ⇒ Australian Education Union, Tasmanian Branch - submission dated 13 January 1997;
- ⇒ Community and Public Sector Union, - submission dated 14 January 1997;
- ⇒ Tasmanian Trades and Labor Council - submission dated 14 January 1997;
- ⇒ New South Wales Legislative Assembly, Select Committee Report on, Public Sector Superannuation Schemes, November 1993; and
- ⇒ Chapter 11 Superannuation, from Report of the Victorian Commission of Audit, Volume II, May 1993. (Mr. *Lennon*)

Interim Report

The Committee received advise from the Clerk of the House on the requisites for producing an interim report. The advise was noted and the issue may be again considered at an later date

Other Matters

Correspondence received from The Australian Education Union, Tasmanian Branch, advised the Committee of their inability to attend current hearings. The Committee will endeavour to accommodate the Union with a later hearing.

Witness

RETIREMENT BENEFITS FUND

Mr Garry Fletcher, Secretary and Ms Sharon Smith Asst. Secretary were called, made the statutory declaration and were examined by the Committee. Hansard transcript available.

The witnesses withdrew.

Suspension

At 1.00 pm. the meeting was suspended until 2.00 pm.

Witness

SUNCORP

Mr Ian Weaving State Manager and Mr Kevin Beasley were called, made the statutory declaration and were examined. Hansard transcript available.

The witnesses withdrew.

Witness

TASMANIAN TRADES AND LABOR COUNCIL

Ms Lynne Fitzgerald, Secretary was called, made the statutory declaration and was examined. Hansard transcript available.

The witness withdrew.

Adjournment

The Committee was adjourned at 3.46 pm until 11.30 am Friday 30 January 1997.

THURSDAY 30 JANUARY 1997

Members Present

House of Assembly

Mr *Cornish* (Chair)

Mr *Foley*

Mr *Lennon*

Legislative Council.

Mr *Bailey*

Mr *Wilson*

Apology

Mr *Hiscutt*

Mr Kerslake and Mr Philp were in attendance

Witnesses

The following witnesses were called.

NATIONAL MUTUAL INSURANCE

Mr George Hluchaniuk State Manager and Mr David Benbow, were called, made the statutory declaration and were examined. Hansard transcript available.

The witnesses withdrew.

Suspension

At 1.00 pm. the meeting was suspended until 2.00 pm.

Witness

COMMUNITY AND PUBLIC SECTOR UNION

Mr Greg Vines General Secretary was called, made the statutory declaration and was examined. Hansard transcript available.

The witness withdrew.

Witness

THE POLICE ASSOCIATION OF TASMANIA

Mr Phil Wilkinson Secretary and Mr Mark Kadziolka Asst. Secretary were called, made the statutory declaration and were examined. Hansard transcript available.

The witness withdrew.

Minutes

The minutes of the meeting held on Thursday, 14 January 1997 were circulated, read and confirmed as a true and accurate record. (Mr *Lennon*)

Adjournment

The Committee was adjourned at 4.17 pm. until Friday, 31 January 1997.

FRIDAY, 31 JANUARY 1997

The Committee met in Committee Room 2, Parliament House Hobart at 9.33 am.

Members Present

House of Assembly
Mr *Cornish* (Chair)
Mr *Foley*
Mr *Lennon*

Legislative Council.
Mr *Bailey*
Mr *Wilson*

Apology

Mr *Hiscutt*

Mr. Kerslake and Mr. Philp were in attendance.

Minutes

The minutes of the meeting held on Thursday, 30 January 1997 were circulated, read and confirmed as amended, to be a true and accurate record. (Mr *Lennon*)

Witnesses

The following witnesses were called.

UNITED FIREFIGHTERS UNION OF AUSTRALIA (Tasmanian Branch)

Mr Richard Warwick, Secretary and Mr John Burke Trustee, State Fire Commission Superannuation Fund, were called made the statutory and were examined. (Hansard transcript available.)

The witnesses withdrew.

Witness

TASMANIAN CHAMBER OF COMMERCE AND INDUSTRY

Mr Sonny Azzopardi, Manager, Administration and Research, was called made the statutory and was examined. (Hansard transcript available)

The witness withdrew.

Suspension

At 11.35 am. the meeting was suspended until 2.00 pm.

Witness

RETIREMENT BENEFITS FUND

Mr Garry Fletcher, Secretary was recalled and re-examined. Hansard transcript available.

The witness withdrew.

Evidence

Ordered; That the following submissions be taken into evidence:

Auditor-General - submission dated 30, January 1997

United Fire Fighters Union of Australia Tasmanian Branch - dated 31, January 1997

Paper

Mr. Garry Fletcher, Secretary, Retirement Benefits Fund, distributed a report titled 'Options for Employer Sponsored Superannuation in Commercial Government Authorities' prepared by Mr. Brian Bendzulla, 21, June 1994.

Other Matters

Resolved, That the Auditor-General be called to give evidence before the Committee.
(Mr Lennon)

Adjournment

At 3.35 pm. the Committee adjourned until 9.30 am. Wednesday, 19 February 1997 at Parliament House, Sydney, New South Wales.

WEDNESDAY, 19 FEBRUARY 1997

The Committee met at 9.35 am in the Jubilee Room, Parliament House, Sydney, New South Wales.

Members Present

House of Assembly
Mr *Cornish* (Chair)
Mr *Foley*
Mr *Lennon*

Legislative Council.
Mr *Bailey*
Mr *Hiscutt*
Mr *Wilson*

Mr Kerslake was in attendance.

Witnesses

The Committee met and examined the following witnesses.

Ms Beryl Ashe, Employee representative on SAS Trustee Corporation Board and Part time Board Member on the FSS Trustee Corporation Board, and Ms. Melinda Savvides, Principal Policy Officer State Super SAS Trustee Corporation, were called, made a submission and were examined by the Committee. Hansard transcript available.

Document Tabled

State Authority Superannuation Board/State Superannuation Investment and management Corporation, Annual Reports 1996.

The witnesses withdrew.

Witness

Mr. Ian Neale, Acting Executive Director Accounting and Financial Policy NSW Treasury and Mr. Martin Connolly, Acting Principal Policy Analyst, were called, made a submission and were examined by the Committee. Hansard transcript available.

The witnesses withdrew.

Adjournment

At 1.45 pm the Committee adjourned until 9.30 am on Thursday, 20 February at Parliament House, Adelaide, South Australia.

THURSDAY, 20 FEBRUARY 1997

The Committee met at 9.30 am in the Old Chamber, Parliament House, Adelaide, South Australia.

Members Present:

House of Assembly	Legislative Council.
Mr <i>Cornish</i> (Chair)	Mr <i>Bailey</i>
Mr <i>Foley</i>	Mr <i>Hiscutt</i>
Mr <i>Lennon</i>	Mr <i>Wilson</i>

Mr Kerslake was in attendance.

Witnesses

The following witnesses were called and examined by the Committee.

MR ROSS CHRISTIE, General Manager, South Australian Superannuation Office, Department of Treasury and Finance, was called, made a submission and was examined by the Committee. (Hansard transcript available.)

Paper

Submission tabled dated, Thursday 20 February, 1997

The witness withdrew.

Witnesses

MS JAN McMAHON, General Secretary, and MR. JULIAN SAWICKI, Financial Controller, Public Sector Association of South Australia Inc. and

MR TOM ADAMS, Vice President South Australian Superannuation Federation, were called, made a submission and were examined by the Committee. (Hansard transcript available.)

Paper

Submission tabled.

The witnesses withdrew.

Suspension

At 12.45 pm the meeting was suspended until 2.10 pm.

Witness

MR DEANE PRIOR, Director Superannuation Policy Unit, Department of Treasury and Finance, was called, made a submission and was examined by the Committee. Hansard transcript available.

Documents Tabled

'Financial Statement 1996-97' (South Australian financial paper No.1) Extract from paper titled ' Liability Management' pages 114-134.

The witness withdrew.

Adjournment

At 3.16 pm the meeting was adjourned until 10.30 am on Friday, 21 February 1997 at Parliament House, Melbourne, Victoria.

FRIDAY, 21 FEBRUARY 1997

The Committee met 10.25 am in Media Room No. 2 Legislative Council, Parliament House, Melbourne, Victoria.

Members Present

House of Assembly
 Mr *Cornish* (Chair)
 Mr *Foley*
 Mr *Lennon*

Legislative Council.
 Mr *Bailey*
 Mr *Hiscutt*
 Mr *Wilson*

Mr Kerslake was in attendance.

Witnesses

The Committee met and examined the following witnesses.

MS HELEN DAVISON, Director Finance and Liability Management, Department of Treasury and Finance, Victoria, and MR ALLEN GRIFFIN, Former Executive Director Superannuation, Department Treasury and Finance, Victoria, were called, made a submission and were examined by the Committee. (Hansard transcript available.)

Documents Tabled

‘Prudential Statement Victorian Public Sector Investments’

‘Public Sector Superannuation Arrangements in Victoria following the Reform Programme 1993 - 96’

The witnesses withdrew.

Suspension

At 12.25 pm the meeting was suspended until 1.00 pm.

Witness

MR MIKE HANSEN, Representative for CPSU-SPSF Group Victorian Branch, was called, made a submission and was examined by the Committee. Hansard transcript available.

Mr *Lennon* and Mr *Bailey* withdrew.

The witness withdrew.

Adjournment

At 2.10 pm the meeting was adjourned until 4.30 pm on Tuesday, 25 February 1997 at Henty House, Launceston.

TUESDAY, 25 FEBRUARY, 1997

The Committee met at 4.30 pm at Henty House, 4th floor Conference Room, Launceston.

Members Present:

House of Assembly
Mr *Cornish* (Chair)
Mr *Lennon*

Legislative Council.
Mr *Bailey*
Mr *Hiscutt*
Mr *Wilson*

Apology

Mr *Foley*

Mr. Mark Kerslake and Mr. Greg Philp were in attendance.

Minutes

The minutes of meetings held on Friday 31 January 1997, Wednesday, 19 February 1997, Thursday 20 February 1997, and Friday 21 February 1997, were circulated, read and confirmed as a true and accurate record. (Mr. *Lennon*)

Business

The Committee met and considered the evidence presented thus far.

Discussion ensued.

The merits of closing the defined benefit scheme in favour of an accumulative fund were debated, as well as the suitability of similar changes to the Parliamentary and Judicial schemes.

Evidence

Ordered, That the following submissions and documents be taken into evidence:

Document entitled: State Authority Superannuation Board /

State Superannuation Investment and Management Corporation,

Annual Reports 1996, submitted in Sydney on Wednesday 19th February, 1997, by Ms. Beryl Ashe, Employee Representative on SAS Trustee Corporation Board.

Document entitled: 'Financial Statement 1996-97' (South Australian financial paper No.1) and Extract from paper titled 'Liability Management' pages 114 - 134. Submitted in Adelaide on Thursday 20th February, 1997 by Deane Prior, Director Superannuation Policy Unit, Department of Treasury and Finance.

Pamphlet titled: 'Contributory Superannuation for SA Public Sector Employees - Triple S - Southern State Superannuation Scheme' - 1 July, 1996: and Submission: From Mr. Ross Christie, General Manager, State Superannuation Office, Department of Treasury and Finance.

Submission: Community and Public Sector Union, S.A. Branch, SPSF Group, Public Service Association of SA Inc. - submitted in Adelaide on Thursday 20th February, 1997, by Ms. Jan McMahon, General Secretary. Document entitled:

'Prudential Statement - Victorian Public Sector Investments', and 'Public Sector Superannuation Arrangements in Victoria Following the Reform Programme 1993-96. Submitted in Melbourne on Friday 21st February, 1997 by Ms. Helen Davison and Mr. Allen Griffin, from the Department of Treasury and Finance. (Mr. Lennon)

Adjournment

At 6.00 pm the meeting was adjourned until 9.15 am on Wednesday, 26 February 1997, at Henty House 4th floor Conference Room.

WEDNESDAY, 26 FEBRUARY 1997

At 9.15 am the Committee met at Henty House, 4th floor Conference Room, Launceston.

Members Present:

House of Assembly

Mr *Cornish* (Chair)

Mr *Lennon*

Legislative Council.

Mr *Bailey*

Mr *Hiscutt*

Mr *Wilson*

Apology

Mr *Foley*

Mr Mark Kerslake and Mr Greg Philp in attendance.

Business

The Committee met to hear evidence from the following witnesses.

Witness

The Auditor-General, Dr Arthur McHugh, was called, made the statutory declaration and was examined. Hansard transcript available.

The witness withdrew.

Witness

Ms Penny Cocker, President and Mr Rod Hunt, Information Officer

Representing the Australian Education Union - Tasmanian Branch, were called, made the statutory declaration and were examined. Hansard transcript available.

Mr *Lennon* withdrew.

The witnesses withdrew.

Adjournment

At 12.09 pm the meeting was adjourned *sine die*.

FRIDAY 9 MAY 1997

At 2.00 o'clock pm the Committee met in Committee Room 1, Parliament House Hobart.

Members Present:

House of Assembly
Mr *Cornish* (Chair)
Mr *Foley*

Legislative Council.
Mr *Bailey*
Mr *Hiscutt*
Mr *Wilson*

Apology

Mr *Lennon*

Witnesses

The Committee met to hear evidence from the following witnesses.

Mr Don Challen, Secretary and Mr. Glenn Appleyard, Deputy Secretary, Department of Treasury and Finance, were called, made the statutory declaration and were examined. (Hansard transcript available)

Paper:

A copy of 'Treasury Presentation - Parliamentary Joint Select Committee on Superannuation' dated, 9 May 1997, was tabled and taken into evidence. (Mr *Wilson*)

It was agreed Treasury would provide.

The witnesses withdrew.

Minutes

The minutes from the meeting held on Tuesday, 18 March 1997 were circulated, read and confirmed as a true and accurate record. (Mr *Wilson*)

Adjournment

At 4.43 pm the meeting was adjourned *sine die*.

THURSDAY 3 JULY 1997

At 10.00 o'clock am the Committee met in Committee Room 2, Parliament House Hobart.

Members Present

House of Assembly

Legislative Council

House of Assembly

Legislative Council.

Mr *Cornish* (Chair)

Mr *Bailey*

Mr *Foley*

Mr *Hiscutt*

Mr *Lennon*

Mr *Wilson*

Mr Mark Kerslake and Mr Greg Philp were in attendance.

Committee Research Assistant

Resolved; That unless otherwise ordered, Department of Treasury and Finance, Research Assistant, Ms Jodi Booth be admitted to the proceedings of the Committee whether in public or private session. (Mr *Lennon*)

Ms Booth was admitted.

Minutes

The minutes from the meeting held on Friday 9 May 1997 were circulated, read and confirmed as a true and accurate record. (Mr *Wilson*)

Briefing on Treasury Submission

Mr Kerslake briefed the Committee on the Treasury's submission outlining possible approaches for funding the superannuation unfunded liability.

Mr *Lennon* withdrew.

Mr *Lennon* resumed his seat.

Suspension

The meeting was suspended at 11.30 am until 11.40 am.

Draft Report Format

Mr Kerslake distributed a paper outlining the structure and possible content of a draft report.

Discussion ensued.

Members agreed that more substantial alternatives should be provided as a basis for debate, prior to taking decisions on the Terms of Reference

The Chair agreed to provide the Committee with a more comprehensive draft report prior to the next meeting.

Adjournment

At 12.25 pm the meeting was adjourned until Tuesday 22 July 1997 at 10.00 am in Committee Room 1 Parliament House Hobart.

TUESDAY 22 JULY 1997

At 10.08 o'clock am the Committee met in Committee Room 1, Parliament House Hobart.

Members Present:

House of Assembly

Legislative Council

House of Assembly

Legislative Council.

Mr *Cornish* (Chair)Mr *Bailey*Mr *Foley*Mr *Hiscutt*Mr *Lennon*Mr *Wilson*

Mr Mark Kerslake, Mr Greg Philp and Ms Jodi Booth were in attendance.

Apologies

Mr *Wilson* late arrival.

Minutes

The minutes from the meeting held on Thursday 3 July 1997 were circulated, read and confirmed as a true and accurate record. (Mr *Hiscutt*)

Mr *Wilson* took his seat.

Consideration of draft report

Resolved, that the Committee adjourn until 12.00 pm to allow all members to finish reading the discussion draft report (Mr *Foley*).

Suspension

The Committee adjourned until 12.00 pm.

The Committee resumed at 12.00 pm.

Members Present

House of Assembly

Legislative Council.

Mr *Cornish* (Chair)Mr *Bailey*Mr *Foley*Mr *Hiscutt*Mr *Lennon***Consideration of draft report**

The Committee considered the discussion draft report and discussed amendments to be prepared by the officers seconded from the Department of Treasury and Finance.

Mr. *Wilson* took his seat.

Suspension

The meeting was suspended at 1.00 pm until 2.00 pm.

The meeting resumed at 2.10 pm.

Members Present

House of Assembly

Mr *Cornish* (Chair)

Mr *Foley*

Mr *Lennon*

Legislative Council.

Mr *Bailey*

Consideration of draft report

The Committee continued consideration of the discussion draft report and discussion of amendments to be prepared by the officers seconded from the Department of Treasury and Finance.

Mr. *Hiscutt* took his seat.

Mr. *Wilson* took his seat.

The Committee agreed to seek confirmation from other jurisdictions about the details of their superannuation schemes.

Extension of reporting deadline

The Committee agreed that it would be necessary to obtain an extension to the reporting deadline when Parliament resumes.

Next meeting

The Committee agreed to meet on 10 and 11 September from 10.00 am until 4.30 pm.

Adjournment

At 4.20 pm the Committee adjourned until 10.00 am on Wednesday 10 September 1997.

WEDNESDAY 10 SEPTEMBER 1997

At 10.00 o'clock am the Committee met in Committee Room 2, Parliament House Hobart.

Members Present:

House of Assembly
Mr *Cornish* (Chair)
Mr *Foley*
Mr *Lennon*

Legislative Council.
Mr *Bailey*
Mr *Hiscutt*

Mr Mark Kerslake and Ms Jodi Booth were in attendance.

Minutes

The minutes from the meeting held on Tuesday 22 July 1997 were circulated, read and confirmed as a true and accurate record. (Mr *Bailey*)

Mr *Wilson* took his seat.

Consideration of draft report

The Committee resumed consideration of the draft report.

Reviewing the changes made as a result of the last meeting. Then recommenced consideration on a paragraph by paragraph basis starting at chapter 5.

Mr *Lennon* withdrew.

Mr *Lennon* resumed his seat.

Suspension

The meeting was suspended at 11.36 am until 11.49 am resuming with all members present.

Consideration of draft report

The Committee resumed consideration of the draft report.

Suspension

The meeting was suspended at 1.00 pm until 2.17 pm.

The meeting resumed at 2.17 pm.

Members Present:

House of Assembly

Mr *Cornish* (Chair)

Mr *Foley*

Mr *Lennon*

Legislative Council.

Mr *Bailey*

Consideration of draft report

The Committee continued consideration of the draft report and approved all of chapter 5 with the exception of paragraphs, 5.4.8 and 5.5.10 and the recommendations. It was agreed that these sections should be dealt with later.

Mr *Bailey* withdrew

The Committee proceeded to examine chapter 6 and had approved all paragraphs up to and including 6.4.22 at the time of adjournment.

Adjournment

At 4.28 pm the Committee adjourned until 10.00 am on Thursday 11 September 1997.

THURSDAY 11 SEPTEMBER 1997

At 10.05 o'clock am the Committee met in Committee Room 2, Parliament House, Hobart.

Members Present:

House of Assembly
Mr *Cornish* (Chair)
Mr *Foley*
Mr *Lennon*

Legislative Council.
Mr *Bailey*
Mr *Hiscutt*
Mr *Wilson*

Mr Mark Kerslake and Ms Jodi Booth were in attendance.

Consideration of draft report

The Committee resumed consideration of the draft report.

The Committee proceeded with the consideration of the recommendations.

CHAPTER 4

Recommendation 1 –The following amendment was proposed, That the word 'be', be left out and that the word 'include', be inserted (Mr *Foley*)

The question was put and resolved in the negative.

The Chair put the question that recommendation 1 stand as part of the report.

The question was resolved in the affirmative.

CHAPTER 5

The Committee approved recommendations 2 and 3.

Recommendations 4 and 5 were amalgamated and approved.

Recommendation 6 was approved.

Consideration of recommendations 7 and 8 were deferred.

Recommendation 9 was approved.

Recommendation 10 was deleted as it was agreed that recommendation 8 adequately covered this point.

Recommendation 11 was approved.

The Committee agreed to defer consideration of recommendation 12.

Suspension

The meeting was suspended at 11.17 am until 11.35 am resuming with all members present.

Draft report

The Committee resumed consideration of the draft report.

CHAPTER 6

Recommendation 13 was considered.

The following amendment was moved; That all the words after -'be' - be left out and that the words, -'9% from 1 July 1998 or the minimum SGC rate should it be greater than 9%' - be inserted. (*Mr Lennon*)

The Chair put the question, That recommendation 13 be so amended.

The Committee divided;

Division

AYES	NOES
<i>Mr Lennon</i>	<i>Mr Cornish</i>
<i>Mr Foley</i>	<i>Mr Hiscutt</i>
<i>Mr Wilson</i>	<i>Mr Bailey</i>

The result of the division being equal, the question passed in the negative.

The Chair then put the question, that recommendation 13 stand as part of the report.

The Committee divided;

Division

AYES	NOES
<i>Mr Cornish</i>	<i>Mr Lennon</i>
<i>Mr Hiscutt</i>	<i>Mr Foley</i>
<i>Mr Bailey</i>	<i>Mr Wilson</i>

The result of the division being equal the question passed in the negative.

The Chair put the question that recommendation 14 stand as part of the report.

The Committee divided;

Division

AYES	NOES
Mr <i>Cornish</i>	Mr <i>Lennon</i>
Mr <i>Hiscutt</i>	Mr <i>Foley</i>
Mr <i>Bailey</i>	Mr <i>Wilson</i>

The result of the division being equal, the question passed in the negative.

The Chair put the question that recommendation 15 be deleted.

The Committee divided.

Division

AYES	NOES
Mr <i>Cornish</i>	Mr <i>Wilson</i>
Mr <i>Foley</i>	Mr <i>Hiscutt</i>
Mr <i>Bailey</i>	Mr <i>Lennon</i>

The result of the division being equal the question passed in the negative.

Recommendations 16 and 17 were approved.

Suspension

The meeting was suspended at 1.00 pm and resumed at 2.24 pm. with all members present.

Consideration of draft report

The Committee resumed consideration of the draft report.

It was agreed to defer consideration of recommendation 18 until the next meeting.

CHAPTER 7

The Committee approved recommendations, 19, 20, 21, 22, 23, and 24.

Evidence

The following documents were taken into evidence:

(Mr *Bailey*)

- Credit Focus, Standard and Poors, June 1997

- Joint RBF Board – Treasury Position Paper on Superannuation Reform, dated 29 July 1997
- Moody's Analysis, Moody's Investors Service, April 1997
- Budget Overview 1997-98, Budget Paper No.1,
- Budget Speech, 1997-98
- Superfunds, ASFA, July 1996 and November 1996
- ISC Bulletin, June Quarter 1996
- Savings: Choice and Incentive, Ministerial Statement, 13 May 1997
- Investment of Australia's Superannuation Savings, 21st Report of the Senate Select Committee on Superannuation, December 1996
- Judicial Remuneration in Australia, by George Winterton, The Australian Institute of Judicial Administration Incorporated, 1995
- Newspaper article by Brian Toohey, Australian Financial Review, 8 April 1997
- Australian Financial Review, 2 September 1997

Adjournment

At 3.25 pm the Committee adjourned *sine die*.

FRIDAY 24 OCTOBER 1997

At 10.07 am the Committee met in Committee Room 2, Parliament House, Hobart.

Members Present:

House of Assembly
Mr *Cornish* (Chair)
Mr *Foley*
Mr *Lennon*

Legislative Council.
Mr *Hiscutt*
Mr *Wilson*

Mr Mark Kerslake, Mr Greg Philp and Ms Jodi Booth were in attendance.

Apology

Mr *Bailey*

Minutes

The minutes from the meeting held on Thursday 11 September 1997 were circulated, read and confirmed as a true and accurate record. (Mr *Lennon*)

Consideration of draft report

The Chair summarised progress thus far, recapping the chapters and recommendations approved by the Committee.

The Committee resumed the consideration of the draft report with Chapter 8 - Parliamentarians, Judges, Legal Officer Holders and Senior Contract Employees.

The Committee considered the appropriateness of members of Parliament to making recommendations to the Government in relation to the reform of Parliamentary Superannuation arrangements.

The Committee considered the appointment of independent panels to review the Parliamentary and Judges Superannuation arrangements.

Suspension

At 11.20 am the meeting was suspended and resumed at 11.35 am with all members present.

Consideration of draft report

The Committee resumed consideration of the draft report, turning to the recommendations of Chapter 9.

Recommendations 34, 35, 36, 37 and 38 were approved and adopted as part of the report.

The Committee then worked through the content of the chapter and adopted it as part of the report.

Suspension

At 1.37 pm the meeting was suspended and resumed at 2.15 pm with all members present.

Consideration of draft report

The Committee resumed its deliberations with the consideration of the recommendations of chapter 11 of the report.

Recommendations 39, 40, and 41 were approved and adopted as part of the report.

The Committee then approved the content of chapter 11 as part of the report.

Paper

The following paper was tabled and taken into evidence. (Mr Cornish)

'Fund choice headaches ahead, say experts' article by Rebecca Kennedy in October 1997 issue of SUPERFUNDS.

Adjournment

At 2.56 pm the Committee adjourned until 10.00 am on Friday 7 November 1997.

FRIDAY 7 NOVEMBER 1997

At 10.03 am the Committee met in Committee Room 2, Parliament House, Hobart.

Members Present:

House of Assembly

Legislative Council

Mr *Cornish* (Chair)

Mr *Bailey*

Mr *Foley*

Mr *Hiscutt*

Mr *Lennon*

Mr *Wilson*

Mr Mark Kerslake and Ms Jodi Booth were in attendance.

Minutes

The minutes from the meeting held on Friday 24 October 1997 were circulated, read and confirmed as a true and accurate record. (Mr *Hiscutt*)

Actuarial Advice

Ordered; That it be noted, that the Joint Select Committee on Superannuation requested actuarial advice from Benzulla Tasmania Pty. Ltd., and that the account of \$4,725 for this service should be forthcoming from both Houses of Parliament.

Consideration of draft report

The Chair summarised progress thus far, recapping the chapters and recommendations approved by the Committee.

The Committee resumed the consideration of the draft report with Chapter 8

Recommendations 25, 26, and 27 were approved and adopted as part of the report.

Recommendations 27 and 28 to be reconsidered.

Recommendation 29 was approved and adopted as part of the report.

Recommendation 30 to be reworded.

CHAPTER 6

Recommendation 11

The following amendment was moved;

That the Committee notes the level of employer support specified in the Commonwealth's Superannuation Guarantee (Administration) Act 1992.

Notwithstanding, this the Committee recommends that the level of employer contribution rate for the new accumulation scheme should be the subject of negotiation between the Government and their employees. (Mr *Lennon*)

The Chair put the question that the amendment be adopted.

The Committee divided.

Division

AYES

Mr *Foley*

Mr *Lennon*

NOES

Mr *Cornish*

Mr *Bailey*

Mr *Hiscutt*

Mr *Wilson*

The question was passed in the negative.

The Chair then put the question that recommendation 11 as originally stated be adopted as part of the report.

The Committee divided

Division

AYES

Mr *Cornish*

Mr *Bailey*

Mr *Hiscutt*

Mr *Wilson*

NOES

Mr *Foley*

Mr *Lennon*

The question was passed in the affirmative.

Mr *Lennon* withdrew

Mr *Wilson* withdrew

CHAPTER 6

Recommendation 17

The following amendment was moved;

That, all accumulation scheme members making voluntary employee contributions of not less than 4 per cent of salary receive a guarantee under the scheme rules that the crediting rate will not be less than 4 per cent real (that is, CPI plus 4) over their period of scheme membership. (Mr *Foley*)

The Chair put the question that the amendment be adopted.

The Committee divided.

Division

AYES

Mr *Foley*

NOES

Mr *Cornish*

Mr *Bailey*

Mr *Hiscutt*

The question past in the negative.

The Chair then put the question that recommendation 17 stand as part of the report.

The Committee approved and recommendation 17 was adopted.

Mr *Wilson* resumed his seat

CHAPTERS 3 and 10 were approved and adopted as part of the report.

Mr *Hiscutt* withdrew

CHAPTER 5 - recommendation 6 was reconsidered and adopted as part of the report.

Adjournment

At 12.22 pm the Committee adjourned until Thursday 13 November 1997.

MONDAY 1 DECEMBER 1997

At 6.07 the Committee met in Committee Room 2 Parliament House Hobart.

Members Present:

House of Assembly
Mr *Cornish* (Chair)
Mr *Foley*
Mr *Lennon*

Legislative Council
Mr *Hiscutt*
Mr *Wilson*

Apology

Mr *Bailey*

Mr Kerslake, Mr Philp and Ms Booth were in attendance.

Minutes

The minutes of the meeting held on Thursday 13 November 1997 were circulated, read and confirmed as a true and accurate record. (Mr *Hiscutt*)

Time of Meeting

The meeting originally scheduled 7.30 pm was brought forward to 6.00 pm, Mr *Lennon* noted his objection to this change.

Consideration Final draft report

A final draft containing all amendments and corrections was considered.

A motion was moved that the draft report be adopted as the Report of the Joint Select Committee on Superannuation. (Mr *Hiscutt*)

The Chair put the question.

The question was resolved in the affirmative.

Mr. Lennon abstained.

Acknowledgment

The Committee acknowledged the major contribution of time and expertise that the Treasury Officers seconded to the Committee invested in this report.

Adjournment

At 6.30 pm the Committee adjourned *sine die*.