THE LEGISLATIVE COUNCIL GOVERENEMENT ADMINISTRATION COMMITTEE A MET IN COMMITTEE ROOM 2, PARLIAMENT HOUSE, HOBART ON TUESDAY 3 MAY 2016.

INQUIRY: RETIREMENT BENEFITS FUND INQUIRY

Mr PHILIP MUSSARED, CHIEF EXECUTIVE OFFICER, AND Ms CLAIRE BESSELL, RETIREMENT BENEFITS FUND, WERE CALLED, MADE THE STATUTORY DECLARATION AND WERE EXAMINED.

CHAIR (Ms Forrest) - Welcome, thank you for joining us. The proceedings of the committee are recorded on *Hansard* and it will be transcribed and form part of the public record which will be on our website and also inform our report. What you say here is covered by parliamentary privilege but if you speak to the media or someone outside about what you say in here, you are not, even just repeating what you have said, so you need to be aware of that.

It is a public hearing and the media may turn up, although I do not think this has a huge amount of interest, so that is okay. If you want to provide any information 'in camera' or in confidence to us, you can make that request to the committee and the committee will consider that. You were sent the information about presenting to a parliamentary committee.

Ms BESSELL - Yes.

CHAIR - Unless you have any questions we will start. If you would like to speak to your submission - it was fairly brief in its content - there are a few areas we would like to delve down into, particularly after having had some discussion with other witnesses yesterday. I assume you have probably taken time to read the submissions that were on the website or not?

Mr MUSSARED - No.

Ms BESSELL - No.

CHAIR - So you are not aware of others. Some of the questions may relate to what other witnesses have suggested and told us and things like that. We are aware of the restructure of RBF going on at the moment. If you would like to make some opening remarks and speak to your submission and then we will have some questions for you.

Mr MUSSARED - I am the chief executive officer of the RBF and this is Claire Bessell, the senior financial accountant. We are here to speak about the unfunded liability. Perhaps to contextualise my comments, I am sure I am saying things to the committee that the committee is fully aware of but it is important to remember there are a number of parties to the operation of the contributory scheme. I assume you are focusing on the contributory scheme.

CHAIR - We are.

Mr MUSSARED - There are other defined benefit schemes.

CHAIR - The others are included but the contributory one is the biggest one by far.

Mr MUSSARED - We have RBF which is both the trustee and the administrator of the scheme. Since 2011 we have outsourced the administration of the scheme to Mercer and this all gets complex because you will probably be talking to, or have already talked to, David Knox who is the Actuary. David is the State Actuary. He is from Mercer, the consultant that looks after the administration of the scheme for us. The Actuary is the person responsible for the assumptions that underlie the accounts of the scheme. David Knox has provided the advice to us about things like the unfunded liability, the requirement from contributions, the percentage of those contributions that the employer should pay, et cetera.

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

This all seems pretty self-evident but in the operation of the scheme most people do not understand those differentiation of roles, and we are continually subjected to criticisms in scheme design or we are being asked, 'Why is the unfunded liability what it is?'. That is a question to put to the Actuary who will state his assumptions and explain that reason. I wanted to start by saying that.

The second point is that any defined benefit scheme such as the contributory scheme can be either funded or unfunded. The choice as to which approach is adopted is one for the employer, in this case, the state. I guess RBF in the sense of the CON is in a sense a hybrid in that there is a significant balance of assets held by the contributory scheme, about $1.8 billion. If you think about, for example, the age pension, there are no assets supporting the age pension in Australia. It is completely funded on an emerging cost basis. That is one extreme. At the other extreme is, say, a corporate scheme administered or overseen by APRA where APRA would require that the scheme be at all times 100 per cent funded. So UniSuper, their DBD component, the expectation would be that they would be fully funded. To the extent that there was a shortfall in funding, APRA would expect the employer to make up that short fall.

CHAIR - If there was an excess, they could take it back?

Mr MUSSARED - If there was an excess, they would note the excess. It would be pretty rare to hand it back. That would be pretty rare.

CHAIR - It has happened, I think, has it not, occassionally?

Mr MUSSARED - It is tempting fate. We would have a surplus today. It all depends on what happens to markets tomorrow. Clearly, if it built up into a significant amount, it could be returned to the employer. The point I want to make is that there is nothing exceptional about the situation at the CON. The Government has made a clear decision, successive governments have made a clear decision, that they will meet the costs of the CON on an emerging costs basis.

That results in when we present our accounts that the estimated cost of the liabilities of the scheme is a very large number, the assets is quite a small number, and therefore the net unfunded liability is a significant number. The size of that number depends on who you ask. It depends what approach you use to valuing the liability. It can be simply based on using an interest rate, the Commonwealth Bond rate, or it can be much more granular in terms of looking at the individual members and their demographics and the expectations around them. That is why you see different numbers quoted.

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

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

CHAIR - Even with FT?

Mr MUSSARED - I do not think FT has been a problem, no.

CHAIR - They have a significant liability and poor cash flow.

Mr MUSSARED - Yes. At the moment we have no bad behaviours. With $1.8 billion of assets, even if the state government decided to take a complete contributions holiday, the crunch point would be probably four or five years off. It is not something we really think about within the business. We assume the contributions will come forward when called for, and that with the $1.8 billion there is a more than adequate reserve there to ensure that there is no prospect of a short-term crisis confronting our capacity to pay pensions.

CHAIR - I am sure members would not be happy to see you selling off assets to pay their entitlements, if the government was not meeting their obligation.

Mr MUSSARED - They would not be happy, no. I am saying from the point of view of would they receive their pension every fortnight. Yes, they would. For at least five years.

CHAIR - You mentioned the potentially uncomfortable approach to borrow from the accumulation fund. I would have thought the accumulation fund members would not have been too impressed about it either?

Mr MUSSARED - We would be in a very severe position. As I say, $1.8 billion provides a degree of comfort to the trustees and to the administration that short of five years on contribution we could continue to operate.

In regard to the terms of reference of the inquiry, the first question was, what is the reason for the increased funding requirement? The short answer to that is demographics. More contributory scheme members are entering the pension phase. On an emerging cost basis those pensions need to be paid. The total call on the employers, both Treasury and the agencies which contribute directly, is increasing.

CHAIR - Before you go on to the next point, the demographics is not something which would suddenly happen. We knew there would be a lot of baby boomers heading to that place. Why the sudden surprise? Why are we seeing the sudden increase? It is fairly sudden in the scale of it. The Actuary makes their assumptions; they would have known. Why this jump at this point?

Mr MUSSARED - No, the dollar amounts. The table shows it increasing from 2014-19. I do not think it is sudden. I do not think it is unexpected. It is simply a statement of what the demographics generate. It may not have appeared before but it is not sudden, new or unexpected.

CHAIR - I know things have changed since the scheme was originally designed but it was aimed at about 71 per cent. I know people did not live as long and retired earlier. You could expect this to change. It does seem the employer's contribution will be -

Mr MUSSARED - It will go to 100 per cent. This is because there is an unfunded liability. In a fully funded scheme -

CHAIR - Even with all the assets?

Mr MUSSARED - No, it is only $1.8 billion with a total liability of $6 billion. If the scheme was fully funded we would be investing it at, say, 7 per cent, producing $500 million of income. It would be meeting that cost. Successive governments have chosen to do this on an emerging cost basis. I am sure the point has been made by others. The superannuation cost to the state government is now the fourth largest item in the budget. These numbers say it will increase. That is government policy.

CHAIR - Yes, it is not for you to comment. So, the next reason beside demographics?

Mr MUSSARED - I think demographics is what it is all about. If you are talking to David Knox he can take you through the hedge profile of the members. What we are seeing now is there are none in the 20s, a very small number in the 30s, it steps up into the 40s and peaks in the 50s and 60s. While we do not have age retirement in the State Service, the Actuary makes assumptions about when those people will retire. They will be retiring over the next 10 to 15 years. Both the number will increase and the expectation from the government of its percentage, will increase.

CHAIR - On the usual demographics, women were not allowed to join initially and then they were not encouraged to join superannuation defined benefit schemes like this. Some were able to buy back in but it is not easy for a lot of women. They did not have the financial capacity to do it. It was suggested one of the issues here is there are a large number of women who will work longer to try to maximise their benefits. Has that been factored into these demographics? They are not going to be such big earners, I would not think, out of the scheme.

Mr MUSSARED - If they are not in the scheme.

CHAIR - They are in the scheme now - that is what he was suggesting.

Mr MUSSARED - Yes, so David would be looking at these as a very small cohort of people and let's assume they are just public servants, he is very much looking at the individual composition of the scheme.

CHAIR - Are you finding that, though, that there are more women working longer and retiring later? Later in age.

Mr MUSSARED - I do not think we could comment on what we see as members coming to us to retire but common sense would suggest that both in DB schemes and in accumulation schemes that everybody is going to work longer. In an accumulation scheme the only cost to the government or to the employer is the superannuation guarantee.

I am old enough that nobody worked beyond 54 and 11 months and now 54 is the new 65 or 70. In Sydney, before I took on this job I had somebody who was 73 and everyone has their personal circumstances that lead to that. The removal of compulsory age retirement gives people that choice. Ask any financial adviser and they will tell you the only way to reach your financial goal is to put more money in early or to work longer at the end.

CHAIR - The suggestion was that because women could not put money in earlier they are now being almost forced into a position where they need to work longer. It is all good if you are physically able to but a lot of nurses fall into this category and a lot of them cannot because back then we all damaged our backs. They are disadvantaged significantly.

Mr MUSSARED - The same arguments have been made for men working in labouring jobs, the tradies, et cetera. It is exactly the same issue. It is all very well for white collar workers to say I am going to stay on another five years but that is not a choice that is open to everyone.

Ms BESSELL - In the last training review of 2013, and David Knox will probably talk about this, you can see from the training review in 2010 they expected 51 females to retire at 61 and only 38 did but then as you get up in the higher ones, it has gone the other way.

CHAIR - Is that a public document because I was unable to find it?

Ms BESSELL - It is sent to Treasury and RBF and we put it up to our board. We do not release it publicly. Treasury has the contract with the state. We put it up to our board, we give it to our external auditors but that is as far as it goes from RBF's point of view. I am not sure whether Treasury -

CHAIR - I am better to ask Treasury for a copy rather than you.

Ms BESSELL - Yes.

Mr MUSSARED - Every three years the Actuary does a very detailed review of the state of the scheme and out of that comes those recommendations as to the employer contribution percentage.

Ms BESSELL - I can see what you said that they expected more women to retire earlier but it went the other way. David Knox would be able to explain.

CHAIR - Does that training review, or maybe it is information you can provide, give us a breakdown of the salary ranges and the number of people in those ranges that are currently on pensions? Those who are still working could change because some people claim, and I think you referred to this, it is not what is put out in the media, that it is a lucrative rort almost, the defined benefit scheme.

Mr MUSSARED - It is a scheme that has unintended consequences.

CHAIR - True. Representatives from TASS and some of the unions made the claim that the majority of people receiving DB pensions are in the lower end, $25 000 to $30 000 per annum. The ones you will see in the front page of the *Mercury* are the $200 000 pensions of which there are not many. We are interested to see that break-up because that is really important.

Mr MUSSARED - So a break-up of what people are receiving as pensions which is also influenced by the choice people make. Not everybody chooses to take the pension.

CHAIR - No, some people take the lump sum.

Mr MUSSARED - Some will take the lump sum or they take a part lump sum. We can certainly do a percentage breakdown of what people are receiving as pensions?

CHAIR - Yes.

Mr MUSSARED - It is also influenced by the choice people make. Not everybody chooses to have pensions. Some take the lump sum or they take a part. We can certainly do a percentage breakdown of what pensions we are paying at the moment.

CHAIR - Yes.

Mr MUSSARED - Sure. The second part of your terms of reference was: what are the implications for current and future increases in employer contributions to the Government's budgetary position? The budgetary position is really an issue for the Treasury to comment on, but I think we will see the actuary recommending steady increases in the employer's share. Really, again, it is in the triennial review. If those percentages do not increase, the actuary has estimated that the $1.8 billion will actually itself be exhausted by 2037, and at that point in the absence of -

CHAIR - That is when the barn is completely empty?

Mr MUSSARED - Yes. There is a - I can show you the whale graph, it's a form of whale graph. Really, what it is saying is, there are the assets without the employer percentage increasing. There it is increasing and basically there is still cash all the way through, but very clearly, if the percentages are not increased, then the cash disappears in 2037. If I was the CEO in 2037, to go back to my earlier comment -

CHAIR - Is that one in the triennial review?

Mr MUSSARED - Yes, it is. At that point I would be a nervous CEO.

Ms BESSELL - The next triennial review is due this balance date, 30 June 2016.

Mr MUSSARED - The other general comment I can make is, the assumption that people who had that defined benefit schemes were as safe as houses is increasingly being tested. Australia is quite unusual in that we basically gave away DB schemes and made that shift towards accumulation schemes in the 1980s and 1990s. A lot of Europe is still heavily wedded to defined benefit schemes. They are increasingly acknowledging that with the promises that have been made in terms of scheme design, the underlying assumptions are now increasingly being challenged. In particular, the rate of return that is required on the investments is becoming increasingly problematic, and therefore, probably within a decade we will see increasingly that the choice will be between reducing the promise or the employers and the governments having to tip in more funding.

CHAIR - The rate of return on your assets?

Mr MUSSARED - We have been averaging about 7 per cent on a rolling five-year basis, which is the target that we have been aiming for. That is the number that the actuary uses, but if you were to say to people today, 'I can guarantee you 7 per cent', I would be flocked with people. Past performance is no guarantee of future performance.

CHAIR - Europe is in a worse position than we are in that regard, as well as generally.

Mr MUSSARED - Yes.

CHAIR - We shouldn't be comparing ourselves with Europe, I don't think.

Mr MUSSARED -No, it is just that they have a much more -

CHAIR - Bigger challenge coming down the line.

Mr MUSSARED - Bigger challenge as a result of still being wedded to the DB approach, both -

CHAIR - The GFC hit them much harder.

Mr MUSSARED - Yes, and they have a lot of social issues to deal with at the moment.

CHAIR - They do. That second term of reference is really more a question for the Treasury, you are right.

Mr MUSSARED - Yes, how are they going to fund it?

CHAIR - Yes.

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

CHAIR - The unfunded liability is the only real liability on the -

Mr MUSSARED - It is not the liability, no. It is the actual payment that the state is making on an emergent -

CHAIR - On an annual basis, yes.

Ms BESSELL - The pension is every fortnight. The lump sums that people choose to take when they retire, we invoice the agencies and Treasury for that.

CHAIR - Yes. Just a couple of things. I am not sure whether we were talking about the same thing or not a while ago - you talked about the fund deficit. In 2010 it was $258 million and three years later it was $344 million. Have you made public the growing deficit that was first revealed in 2010? It must have been fairly obvious after the negative returns in 2008 and 2009.

Ms BESSELL - What number did you have for 2010?

CHAIR - $258 million - the fund deficit.

Ms BESSELL - That would be the unfunded liability?

Mr MUSSARED - No, it is the difference between - if you put a value on the promise by the government to pay the future contributions and call it an asset and offset it against the liabilities, you have a surplus or a deficit.

Ms BESSELL - I do not report that in the financial statements. It is not in the notes?

Mr MUSSARED - Where did I read that? Is it in the submissions?

CHAIR - Yes, it is from Dr Knox. This is from the triennial review. I assume that is where it is from?

Mr MUSSARED - Yes.

Ms BESSELL - Sorry, I thought because it says the 2015 annual report.

Mr MUSSARED - That is really an accounting number.

CHAIR - Is the triennial report into the contributory fund - it is not publicly available yet, sorry. Again, this is from your submission. Maybe it is not your words but Dr Knox's perhaps. You said the deficit was most affected by the addition of interest. Is it notional interest or on the deficit itself?

Mr MUSSARED - No, I would be making a stab if I tried to comment on that. You are speaking to Dr Knox? I would ask him to elaborate on that.

CHAIR - We are, yes. Maybe it is another question for him. If funding was increased, as the percentage of the government contribution is to increase, technically that should reduce the deficit faster than the notional interest would increase the deficit. Is that how it works, or is this something you cannot comment on?

Mr MUSSARED - Clearly, if the interest cost is going up faster than the additional contributions we are receiving then the deficit will increase.

CHAIR - The only way to reduce or remove the debt is for the government to fund it in one go, which is a decision they could make.

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

CHAIR - Yes, and pay interest on that. Once you have the defined benefit scheme people maybe it is a question you could ask them. Is it something the board would consider looking at or not?

Mr MUSSARED - It is a matter for government. There would be views within Treasury that owing money through your super is different to owing money to financial markets. They are different sorts of debt.

CHAIR - Again, this is from your submission and quoting Dr Knox, predominantly, here. Again, it may be a question for him. The four dot points you have - other factors that occurred during the three years to increase the deficit, because it is the deficit we are talking about here - 'expenses during the period in excess of the assumed rate' - what makes up those expenses?

Mr MUSSARED - That would be the share that is apportioned between the contributory scheme and the accumulation scheme of the administration costs of RBF. In 2011-12 we were going through a period when we had done the transfer of administration to Mercer. There are a number of, in effect, one-off projects taking place. We are really talking at the margin here in terms of the impact.

CHAIR - The higher take up of pensions are assumed.

Mr MUSSARED - That is what it is. An assumption is made people will take the cash or take a mixture of pension and cash. They are opting for the certainty of the pension.

CHAIR - The pension obviously adds additional cost over time.

Ms BESSELL - To administer it and it is for life. They could pass away tomorrow then it reverts to the spouse - 75 per cent if you have a spouse.

Mrs HISCUTT - For the life of the spouse?

Ms BESSELL - Yes. So if you take a lump sum you do not have that.

Mr MUSSARED - You can have more than one.

Ms BESSELL - Yes.

CHAIR - They do not get 75 per cent each do they?

Mr MUSSARED - No, you can be the spouse of more than one pensioner.

Ms BESSELL - If your first spouse dies and you marry someone else.

Mr GAFFNEY - Do you work out what return you get when people pass away? Do you have that factored in?

Ms BESSELL - No.

Mr GAFFNEY - I am wondering how you keep track of that by the government?

Ms BESSELL - The actuary assumes mortality rates and then each three year-period they compare the actual to what they factored in. Obviously, it is always different. That is how it is monitored.

Mr GAFFNEY - So as Australians' longevity changes.

Ms BESSELL - Exactly right.

CHAIR - On the point about spouse - and it is more likely to be this way and this is not being sexist - an older man marries a much younger woman and he was in a defined benefits scheme and he is on $200 000 a year, so 75 per cent of that continues to the spouse for her life?

Mr MUSSARED - It means the tail of the whale can be very long into the future.

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

CHAIR - Before you move off that point, is this also impacted by higher salary rates when people want to put their own contributions in?

Mr MUSSARED - Higher than assumed salary rates would impact. So one of the assumptions the Actuary would make is future salary increases in the public sector will b 'x'; if they are higher than 'x' then that will contribute to this.

CHAIR - There were reforms in past governments where, in education for example, a new model was put in place and a number of people who one assumes would be in defined benefit schemes because of their length of service with the education department, were elevated up pay scales and then once those reforms were unwound they stayed at that level. A lot of them were perhaps at a higher level anyway. Is this is the sort of thing that is being picked up here?

Mr MUSSARED - No, what you are talking about is an unintended consequence of the scheme which is if somebody can move into a higher salary rate position they can apply to have that maintained as their salary for pension contribution purposes even if they revert to a lower level position.

CHAIR - That is a scheme design issue?

Mr MUSSARED - This is more the situation of people saying I was contributing 5 per cent but now I am going to contribute 11 per cent and I will get a higher pension.

CHAIR - It is not unreasonable for people to do in planning for retirement.

Ms BESSELL - No.

CHAIR - People do it in private funds.

Mr MUSSARED - The great thing about superannuation is nobody realises when they first join these schemes what the potential benefit will be in 40 years' time. One of the things we see is a lot of people who had the option of being in the contributory scheme in the 1970s and 1980s let it pass. Now they are reaching retirement age, they are sitting in an office with somebody who is planning their overseas holiday, their new car and everything else. They are asking how they are doing this, thinking I could have been in that scheme and somehow I let it slip away.

CHAIR - Poor financial advice, perhaps, many years before.

Mr MUSSARED - I do not think they had financial advice. I think they made the choice they did not want to make the contributions. Increasingly, they come to us and say, 'You did not give me the advice I needed', or 'I never got that letter, please open the door and let me back in'. We will be hearing a lot more of this in future.

CHAIR - People can still buy their way back in?

Mr MUSSARED - No, they can apply for a lost right. If that lost right is approved they can then apply to come back in, which we do by giving them a loan.

Mrs HISCUTT - What is the likelihood of that? How many people do they expect might want to buy back in?

Mr MUSSARED - It happens in two ways. One is by individuals putting their circumstances before us and saying if they had received the letter I would have signed and returned it to you and I would have been in the scheme.

Mrs HISCUTT - Is there a lot of that happening?

Mr MUSSARED - Not a lot. We have one person who pretty much spends their whole time looking after these reviews. Then we have decisions of the judiciary, where the court interprets the legislation in a certain way and this has the effect of opening the doors to a new class of people.

CHAIR - So, the investment earnings were marginally lower than assumed?

Mr MUSSARED - I think we may have said seven and it might have been six point something as the actual. I think 2011 or 2012 was a dip down year. In 2011-12 the return was only 1.54 per cent. The year before it was 8.5 per cent, the year after it was 12 per cent and the assumption was 7.5 per cent. We had, on average, 7.36 per cent.

CHAIR - The low investment earnings in 2008-09 related to the Global Financial Crisis, I assume?

Mr MUSSARED - That is now washed out of the five-year rolling terms. Yes, it would have had its effect in its time.

CHAIR - In 2011 there was another decline as well?

Mr MUSSARED - In 2011-12 there was not a decline. We only earned 1.54 per cent.

CHAIR - Okay. Someone suggested yesterday it was because of the situation in Europe at the time?

Mr MUSSARED - 2011-12?

CHAIR - They went through another bit of a recession.

Mr MUSSARED - It was not a recession, it was not negative returns. They were very low compared to what we had assumed or what we had modelled.

CHAIR - You talked earlier about the assets of $1.9 billion or $1.8 billion?

Mr MUSSARED - $1.8 billion

CHAIR - How are they allocated between the defined benefits and the accumulation funds?

Mr MUSSARED - They are the DB assets.

CHAIR - So, they are completely separate?

Ms BESSELL - We account for them separately but it is a pool.

Mr MUSSARED - We pool it for investment purposes and in deciding how to invest it we consult very closely with Treasury. They indicate the risk profile they are comfortable with.

CHAIR - Who does?

Mr MUSSARED - Treasury, for those assets.

CHAIR - Okay, for those in the defined benefits? Are you able to talk about this, the risk strategy you use for the defined benefit scheme?

Mr MUSSARED - It is not so much a risk strategy. As with any bundle of assets you can choose to allocate them to particular investment classes. The traditional allocation for an accumulation scheme is 70 per cent into growth assets, 30 per cent into defensive assets. Defensive assets are fixed interest or bonds. The growth assets are things like equities. There are sub-sets within growth assets. There are sub-sets within growth assets, there is infrastructure or property or all those different other classes. We have a conversation with Treasury on a regular basis to ask how comfortable are you with risk and usually the answer would be, 'We would prefer more certainty at the expense of highest possible returns' but clearly we want -

CHAIR - In the defined benefits scheme?

Mr MUSSARED - For the contributory scheme. It is always a trade-off between high return and risk. Their risk profile is lower than the average investor and we seek to create a portfolio for them that affects that. There is a lot of consultation about that. On the accumulation side it is largely driven by what the members have indicated they want to invest their funds in when they choose their member options. It will just accumulate, but what we have to do is make the choices to where we invest. For example, if people said I want to be in Australian equities, we will then choose the fund manager that looks after that.

CHAIR - The loss on the Hobart Airport, for example, is not borne by the accumulation fund, that is all within the contributory scheme?

Mr MUSSARED - No, it is shared.

CHAIR - So they share the loss in that? How do you divide the assets and earnings between the contributory fund and the other defined benefits fund?

Ms BESSELL - Each scheme has a net asset.

Mr MUSSARED - It is a financial statement keeping track of every dollar that comes in and every dollar that goes out. They are not physically separated assets in that the airport can be owned partly by accumulation, partly by contributory scheme, partly by the parliamentary scheme but it is RBF that appears as the owner of that asset, not the actual scheme itself. It is an accounting treatment.

CHAIR - You would divide the assets and the earnings?

Mr MUSSARED - Yes. The earnings will flow from where the assets have been allocated.

Ms BESSELL - We have net assets that total RBF and that is broken into the six schemes, we have the one accumulation and five DB. If you think about it as a percentage basis and then you get a total interest amount but then it is also more complicated in that CON has this percentage in cash. It is a very complicated percentage.

Mr MUSSARED - It is a very big spread sheet.

CHAIR - That is why I would like to understand it and I do not think the other members do very well either.

Ms BESSELL - The statements are presented, consolidated up, so they just set a total.

CHAIR - Some years ago there used to be some segment reporting. You do not do that anymore?

Mr MUSSARED - It was the advice of the auditors.

CHAIR - It was their suggestion? They were saying that you used to do it. Now you say that they suggest that you did not. I do not recall them saying that.

Mr MUSSARED - Always try to keep the auditors happy.

Ms BESSELL - We still have that information because that is how I build it up, that is how I do it, but it is not in the annual report.

Mr MUSSARED - It is not published as such.

CHAIR - I am not sure why their advice was not to do segment reporting because segment reporting helps people like me understand what is happening in a scheme and others who have an interest in it. Is it possible to provide that segment reporting?

Mr MUSSARED - Statements for the individual funds?

Ms BESSELL - Yes, I do have this here. It is audited on a consolidated basis though. All the data is audited as part of that but the audit statement specifically says RBF on a consolidated basis, so yes you could.

Mr MUSSARED - But they would be unaudited statements.

CHAIR - Yes. Do you have a concern about providing the committee with a copy of that?

Ms BESSELL - I do not redo the notes but I do have the balance sheet and the profit and loss.

CHAIR - You can either table it now or you can provide it to us later whichever you prefer.

Mr MUSSARED - That is the statement of assets.

Ms BESSELL - You can see the total in the column will equal the total in the annual report and then you can see the split up there.

CHAIR - We said that it is unaudited.

Mr MUSSARED - The total is correct because it matches the consolidated number.

CHAIR - Yes, one would hope so. Do members have any other questions at this stage?

Mr FARRELL - Yesterday we heard about the average three-year final payment. Do you create figures on what it would be normally and what it is after the three years? There was some suggestion yesterday the scheme is being rorted and people are being promoted for a three-year period to increase their payout. I wonder if you have any figures or if anything rang alarm bells in regard to this.

CHAIR - On that point, there was some comment about FAS(1) and FAS(2) and the design around it. Is that what you are talking about, Craig?

Mr FARRELL - Yes.

Mr MUSSARED - The scheme is designed to pay people a pension which is driven by their length of service and their final average salary. There is FAS(3) which is the three-year average, FAS(1) which is the one-year average. To the extent FAS can be increased, as in the Final Average Salary can be increased, the pension will be increased.

The definition of salary within the regulations goes way beyond what you would expect salary to be. Therefore there is ample scope for arrangements to be made to boost FAS.

CHAIR - How is salary defined?

Mr MUSSARED - It is pretty much anything you want to call income. Overtime is the obvious kicker in it. If your employer is prepared to put you on 40 hours overtime a week for 12 months your salary can double in your last year and your pension will increase correspondingly. If you work for an inner budget agency, your agency will not pay the cost, Treasury will.

CHAIR - So that is the rort which was being talked about.

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

CHAIR - I accept there could be some creative use of this opportunity, but then there are people who are also genuinely promoted and earn the money they are promoted to.

Ms BESSEL - It just happens to be the last three years of work.

CHAIR - I put this to another witness about the issue of overtime. I am not sure how overtime is defined. I use an example of myself as a nurse, this was in the private sector but I imagine the principles would be the same. My contracted hours were two days a week but I inevitably worked at least 76 hours a fortnight, more at times. Over 76 hours a fortnight is overtime but between the two days and full time, is that classified as overtime?

Mr MUSSARED - For the purposes of the scheme it is income. It is whatever you are paid for it.

CHAIR - So it is how much you end up with in your pay packet, basically?

Mr MUSSARED - Yes, and there are challenges for us in administering the scheme. There can be situations, for example with nurses, where they work more than a full FTE in a week. Designing administration systems to account for this is challenging.

CHAIR - If you say overtime can no longer be counted in this salary, it should be excluded from the definition.

Mr MUSSARED - I am not saying that.

CHAIR - I am not saying you are saying it. There are some who may say it.

Mr MUSSARED - There are people who have always had two hours overtime a week all their life. The argument is the pension should reflect the fact their salary was 'x' plus some overtime. This is why the clause was put in there. What the scheme designers do not think about is people will always find a way to gain from these arrangements.

CHAIR - Yes. In defence of the nurses, they come in because there is no-one else and they are working shifts when they really do not want to and things like that.

Mr MUSSARED - I do not think I have ever heard it said about nurses.

CHAIR - No. When people talk about rorting the system, people like that get targeted -

Ms BESSELL - When they are the ones legitimately - my mum is a nurse.

CHAIR - She would know what it is like. Does that answer the question -

Mr FARRELL - Yes. I just thought it was really important to have on the record how the system works and it is your role just to administer it.

CHAIR - Those are questions really for the Treasury, I think.

Mr FARRELL - Yes, but it is good to cover it at this level.

Mr MUSSARED - The other comment that can be made in the same context is: when the contributory scheme was first implemented, and we are going back to when RBF was set up in 1904 - the concept of a state-owned corporation did not exist. Now you have state-owned corporations where staff are members of the contributory scheme and they are being paid not just commercial, but commercial incentivised remuneration.

CHAIR - Salary packages, that sort of thing?

Mr MUSSARED - Yes. So we end up paying some very sizeable pensions. That was never intended. The original background to a defined benefit scheme was that a public servant got three things: they got tenure, they got a guaranteed pension at the end, and if they had done really well, they got a CBE or an MBE or something. That was the trifecta of rewards. The contributory scheme has stayed there. It has not been reviewed - well, it has been tinkered with. You used to get a divisor of 12; now it is 20. In effect, the pension rate has gone from 8.5 per cent to 5 per cent, but that is probably the only significant change that has taken place with the scheme. For the rest of it, it is still very much a 1960s, 1970s scheme, and people have worked out ways to maximise their benefit.

CHAIR - Again, this may not be something that you can comment at length about, but in terms of trying to address some of these unintended consequences, humans being humans will do what they can do maximise their own benefit. We all do it. It is human nature.

Ms BESSELL - It is within the legislation.

CHAIR - That is right. It is not illegal to do it. It was recognised that this was going to create a problem, and the scheme was closed in 1999. It was subsequently suggested that there should be significant reform now, and we change the way that salaries are defined or other aspects -

Mr MUSSARED - No, I am not suggesting that at all.

CHAIR - No, I am not suggesting that you do. But to do that, do you think it is even necessary to have the discussion if we just accept this is the way this has been closed, there is going to be the tail. Treasury has said repeatedly, to previous governments and the current

Government, that the unfunded liability is less than 6 per cent of the total general government receives, not the whole state sector. So it is manageable. We are shining a light on it at the moment clearly, but does it need to have a significant change? That is probably a personal thing that I don't expect you to express.

Mr MUSSARED - It is a policy.

CHAIR - Yes. Unfortunately, the Treasurer is not available today. I might have to get him another time. He is the only one that can really talk about the policy. A few questions for the Treasury and more for the Treasurer. Is there anything else you wanted to say in closing or any other comments you would like to make?

Mr MUSSARED - No. Thank you for the opportunity to appear.

Ms BESSELL - Thank you.

CHAIR - I appreciate you coming. You do not directly report and are responsible to parliament. Thank you.

THE WITNESSES WITHDREW.

Mr CRAIG JEFFERY, DIRECTOR, GOVERNMENT FINANCE AND ACCOUNTING BRANCH, AND **Ms KATHRINE MORGAN-WICKS**, DEPUTY SECRETARY, BUDGET AND FINANCE, DEPARTMENT OF TREASURY AND FINANCE, WERE CALLED, MADE THE STATUTORY DECALARATION AND WERE EXAMINED.

CHAIR - Thank you both very much for coming.

You have presented for parliamentary committees before; you know it is sworn evidence, parliamentary privilege protects you while you are here, it is all recorded. I do not need to go through all of it for you, do I?

Mr JEFFERY - No.

CHAIR - That's fine. We have Treasury's submission. A number of the questions we will probably ask will be policy questions which we know you will refer to the Treasurer. We would like to pose some of them as we go. For those you can answer we would appreciate the answer, and those you refer to the Treasurer we will take up with him at a later time. I know that the submission is signed by the Treasurer but I expect to be able to speak to it in broad terms at least.

Ms MORGAN-WICKS - Yes.

CHAIR - Yes, that's fine. If you would like to do that initially, and then we will have some questions for you.

Ms MORGAN-WICKS - Thank you very much, Chair. If I may introduce ourselves, my name is Kathrine Morgan-Wicks, I am the Deputy Secretary responsible for Budget and Finance at Treasury. On my left we have Mr Craig Jeffery, who is Director of our Government Finance and Accounting branch and has been responsible for superannuation policy for a number of years - I will not mention how many - at Treasury. We are very pleased to attend the committee today.

We read the terms of reference with great interest, and the invitation to the Treasurer and the Secretary to provide a submission. The Treasurer was very pleased to make quite an extensive submission to try to address the terms of reference. We do apologise, Chair, for addressing our submission to the honourable Mr Craig Farrell as that was the information available on the website at that time.

CHAIR - I have forgiven you for that. I have not forgiven the Treasurer.

Ms MORGAN-WICKS - I am very pleased to answer any questions the committee has today, or will otherwise take it on notice if we are unable to do so.

CHAIR - Did you want to make any comment, Craig, about the history of all of this since you have been there a while?

Mr JEFFERY - Not really, unless the committee wants me to.

CHAIR - Okay. Have you had an opportunity to read the submissions which are on the website? There are some submissions there which question the structure and the policy framework around how the unfunded defined benefits contributory scheme have, perhaps, unintended consequences which is something RBF talked about when they were here.

Since its inception when times were quite different, what has driven the policy change we have seen? Is there room for more policy change to address some of those unintended consequences?

Ms MORGAN-WICKS - Perhaps if I start and if it suits the committee Craig might address more detailed questions. The Defined Benefit Scheme has always been unfunded in terms of employer contributions. Without going into the history of the Superannuation Provision Account the approach has been, since around 2011 - Craig, correct me if I am wrong - the employer contribution -

Mr JEFFERY - 2011-12.

Ms MORGAN-WICKS - Sorry, 2011-12. It again continues the premise. It is unfunded. The government takes full responsibility for the investment risk of the scheme and obtains expert advice from the State Actuary in evaluating or estimating projected employer contributions to the scheme and ensuring all approved contributions are included in Budget and forward Estimates.

CHAIR - Another thing which was raised with RBF was the opportunity to have a look at the last State Actuary's triennial report. They said the question was best directed to you, if you are able to provide it. The Treasurer has committed to providing a copy of the next one. It will be after we report, I imagine. It would be helpful for the committee to have a copy of the last report if it is possible for you to provide, either now or later?

Ms MORGAN-WICKS - The triennial review is quite aged at the moment. We are writing a new one for 30 June 2016. In providing it, I request it is kept private to the committee. It is not a public document at the moment and it is not contemplated in the regulations that it is a public document. However, we would be pleased to provide a copy to the committee for their use.

CHAIR - We will need to consider that in terms of this confidentiality. We might write to have it sent and it can be put to us so the committee can make a determination about that.

Ms MORGAN-WICKS - We would be pleased to respond to that. It is getting to be quite an old document at the moment. Extracts have been lifted from the triennial review and put into the RBF annual report, also into their submission and we also refer to it, for example, in budget papers to include certain numbers. It is close to three years old now with the new one to be commissioned.

CHAIR - In the Treasurer's comment at the end of the Treasury's submission, he talks about the triennial review being done by June 2016. He said he will provide a copy to the committee. He has not requested confidentiality around the current one. Is your concern the last one is dated and it should remain confidential?

Ms MORGAN-WICKS - I would have two concerns. The first being it is not a public document currently. It is quite a lengthy document and quite complicated so the concern about it being released without any kind of overview - we do refer to the pertinent parts of the report in various documents now - but for the provision of the 2016 review, I know the Treasurer has not requested confidentiality. I would request I discuss that with him.

CHAIR - Get him in order?

Ms MORGAN-WICKS - Yes.

CHAIR - All right, we will address that through correspondence to you.

Mr JEFFERY - That is the report for the year ending 30 June. It will not be available until around October-November, which is the usual timing.

CHAIR - Yes. We will have reported before then, hopefully. It would still be helpful to have the information provided later. Do other members have overarching questions?

I want to go into an area I raised with one of the witnesses who suggested the defined benefit scheme could be wound up, basically. Members could be paid out and they could make their own decisions about whether they rolled over into another accumulation fund or managed themselves or whatever they did. He made some claims about how that would be cheaper, or more cost efficient for the government to borrow the $5 billion to $6 billion and put it into a future fund type of arrangement to meet the liability.

I want to put something to you and hear your comment on it. As you would know with Paul Keating's Super Guarantee Levy, since 1992 employers have had to contribute super for employees, originally 3 per cent and now 9.5 per cent. It is my understanding that if a defined benefit scheme employer contributed more than the SGL amounts then they were exempted from the SGL.

RBF was a generous scheme as has been mentioned by some witnesses. Therefore, RBF was not required to put away any extra to satisfy the SGL requirements. The government was notionally contributing enough already, pursuant to fund rules, to satisfy the SGL even though it was completely unfunded. This means the SGL amounts notionally belong to defined benefit members and that they are unfunded.

Would you be able to provide for the committee what you believe the SGL contributions would otherwise have been? Have they been payable each year since 1992? Do you know what sort of figure we are talking about? I am trying to address some of these which have been put about how to manage this liability, in spite of the fact the Treasurer said it is manageable. It has been said by past and current Treasurer's.

Mr JEFFERY - Is that the superannuation guarantee rate contributions for members of the defined benefit scheme would have made?

CHAIR - Yes, would have paid had there been a requirement to do so.

Mr JEFFERY - We do not have that information.

CHAIR - Could you work out what the figure would be?

Mr JEFFERY - We would have to commission the Actuary to do it. It would be an actuarial calculation.

Ms MORGAN-WICKS - The Actuary may be able to provide it when he comes.

CHAIR - Not when he comes, he would have to work it out, possibly. It would be something best addressed to the Actuary rather than to you?

Mr JEFFERY - The Actuary would be looking for us to commission that particular piece of work. It might be something the committee might want to include when they write to us and ask for the Actuary to do the work.

CHAIR - When these things are in the public arena, there would be people out there who may agree with the view it should be wound up. My concern is this money would and should have been paid if the scheme was differently run. It is money which technically belongs to the defined benefit members now, if RBF would have had to pay that amount. It makes the argument simple; it is wrapping it up.

Mr JEFFERY - If different arrangements had been in place, yes.

CHAIR - Yes. Technically, if you wound it up would you not have to address those responsibilities to fund that? I would be interested to see what the figure would be. Do you know what I am aiming at? You are not being very clear.

Ms MORGAN-WICKS - In terms of applying a different policy setting, the one which was formulated at the moment, in meeting contributions on an emerging cost basis and budgeting for that.

CHAIR - Yes, under the Super Guarantee Levy.

Ms MORGAN-WICKS - So it would be asking the question to apply a different policy question. We can ask the Actuary to complete the calculation.

CHAIR - It is over a 24-year period. It is quite a lot.

Ms MORGAN-WICKS - Yes, but if there are any statements about what is due or what is owned by members, it would depend on the policy setting which is applied at that time. At the moment we have an unfunded superannuation defined benefit liability and one we are managing in a particular policy setting.

CHAIR - In policy settings, we have read and heard about the intent, which you roughly alluded to at the beginning, Kathy, of the scheme when it was first implemented. It was more aimed at the lower paid, blue collar-type workers, to enable them to have security of employment and a pension at the end. It was not aimed at the white collar and higher paid workers. We have asked RBF to provide us with some detail about the salary bands that people on pensions are on, where they fit, because the ones that hit the front of the *Mercury* are the ones with $200 000 per annum pensions, which other witnesses claim is a very small percentage of those getting that level of funding that flows through the spouse, and that adds a bit now as well. The majority of people who are on pensions and are likely to take pensions in the future, are not in that high salary band. We do not have that information yet, but I think that will be quite interesting.

In your view, and again this may be a policy question, but do you believe there is anything that can be done to perhaps not cause detriment to members, but that could actually make it easier to deal with some of those unintended consequences that people going into higher salary brackets or working a lot of overtime in those last one to three years, depending on how the final average salary is calculated, that would not necessarily disadvantage members, but would perhaps put a bit of a lid on the liability, I guess?

Ms MORGAN-WICKS - Craig may comment in a moment, but in terms of not just acting to the detriment of members, I would also be concerned about acting to the detriment of this generation that are living in Tasmania in terms of any kind of action that the Government may take to change a policy setting that puts an undue burden or pressure on this generation. At the moment, the policy setting is around meeting the emerging cash cost. It is manageable, it is budgeted. Certainly the budget papers will talk about the particular peaks in the employer contribution, and the impact on the budget. It has been formulated in a way to try to spread that burden across the generations of Tasmanians. I suppose the concern would also be that the current policy settings are not acting to the detriment of current defined-benefit members, but also for the current generations of Tasmanians that are enjoying the services that currently are provided to them by way of the budget and public services. Craig, you might wish to comment.

Mr JEFFERY - I think the issue of potential changes to the scheme design is a policy issue that is more appropriately dealt with by the Treasurer or the Government. Just in addition to what Kath has said, the budget environment is such at the moment that agencies are strictly controlling costs and looking carefully at costs. Whether in the past there have been opportunities to pay overtime or for promotions and things like that, I think the environment is probably a lot tighter at the moment and for the foreseeable future. Whether there is a big risk there or not, I do not know.

CHAIR - In terms of whether you and Treasury have noticed or observed what we are hearing anecdotally of job reclassification and upscaling in the few years before retirement, are you seeing that as an issue? Some witnesses have raised it, so I am just wondering, is it just some views expressed broadly in the community that may not be well-informed, or is it actually a reality, do you think?

Mr JEFFERY - I am guessing you asked a similar question of RBF this morning and I am not sure if they would have much of an idea, but the actuary makes assumptions, as part of their actuarial reviews, about salary increments and promotions and things like that, which is an important factor leading into their actuarial assessments. That is based on experience, as in the actuary's judgment of the broader community, but also in terms of the State Service and the actual experience within the scheme. We have certainly seen no significant changes at all in expectations of salary increases or promotions or anything like that.

Dr Knox may be able to expand a little bit more on how he goes about coming up with those assumptions, but I do not think there is any evidence in the scheme as a whole. In our accounting and our financial reporting, we are dealing with the big picture of the total scheme. We do not have a lot of exposure to individual member experience, apart from the people in Treasury who we know are members or anything like that. Those circumstances that you have alluded to have never been what I have observed within Treasury, where I have been quite a number of years. As I say, the assumptions made by the actuary are not showing that there are any significant changes.

CHAIR - Are you seeing more members increasing their voluntary contributions? Which then will increase their benefit at the end, which - I am not critical of people doing that, I think it is sensible in many ways because we all should try our best to fund our own retirement if we can.

Mr JEFFERY - We would not really have access to any of that information. That would be something the RBF would be more able to answer about voluntary contributions.

CHAIR - We did ask them about that but I want to ask.

Ms MORGAN-WICKS - Certainly the actuary commented on that as one of the factors that led to an increased deficit noted in the triennial review.

Mr JEFFERY - Within the broader community, over the past couple of decades there has been an increasing focus on superannuation and there is a lot of discussion about superannuation and planning, so to some extent that does encourage people to voluntarily contribute. Particularly in the global financial crisis, people were probably more likely to be putting money into superannuation rather than taking overseas holidays or buying new cars.

CHAIR - Or buying shares.

Mrs HISCUTT - I can see perhaps the line of questioning that is there at the minute. You do not feel comfortable in being qualified to answer? Is this what we are saying? We do not seem to be getting many answers to the Chair's questions.

CHAIR - They are answering them.

Mrs HISCUTT - Yes, but it is more like we are not qualified to answer such questions, so are you more qualified to answer the debt and how to address the debt as it comes?

Mr JEFFERY - Our area of expertise is the accounting and reporting. I am just a simple accountant so I just do accounting. Kath and I know about budgeting and accounting but in terms of individuals' behaviour and whether people are more or less likely to increase contributions -

Ms MORGAN-WICKS - It is not information that is available to Treasury.

Mr JEFFERY - That is not my professional expertise, all I am doing is basically saying what I have seen over the past.

CHAIR - He has talked about the submission and that is why I am not taking anything outside the submission.

Mrs HISCUTT - It is an interesting line of questions. Yes, it is in the submission.

CHAIR - The other thing that has been raised is the definition of salary in terms of the final average salary, a policy decision of many years ago. Again, people should not be criticised for maximising their salary for whatever reason, either for their immediate needs or their future needs. Do you think that has been an issue in terms of increasing the liability? Are there any emerging costs now that the Government is being required to pay?

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

CHAIR - It is not as much the policy around the 2 per cent wage increase policy, it is more about what else is included in that calculation of final average salary, all the overtime and other allowances and things like that. This could be a policy question and if it is, that is fine. Is that something that could be addressed without causing detriment to members too much by saying, your salary is your salary; if you work all this overtime then we do not count that, your salary is your salary - or your contracted wage or whatever it is, it depends whether they are on a salary or on a wage. Do you think that is something that should be looked at, or is that something outside your remit?

Mr JEFFERY - I think it is a question of policy outside our area of expertise. I imagine these are more questions of policy for the Treasurer or the Government but in the context of the current RBF review and the flow on of changes out of that it may well be these areas will be looked at in future.

CHAIR - With the current changes to RBF underway at the moment, one of the comments RBF made was that one of the reasons for the increase was the administrative costs. It was not a huge amount but administrative costs had increased. They said it was partly related to some one-off administrative tasks. Assuming it goes through our House - it is still there at the moment - that will reduce the administrative costs by how much? How much do you believe costs will reduce?

Mr JEFFERY - The RBF review and the legislation is being dealt with in a different area to Treasury. I have very limited knowledge of the assumptions under that or any of the information about that.

Ms MORGAN-WICKS - We would be happy to take the question on notice. In regard to the branch joining Treasury and assumptions around reducing administrative costs, Treasury would have a lot more visibility over those and the inclusion of the branch and we are able to apply our own policies to the sharing of staff resources, ICT, and so on.

CHAIR - We should see some cost savings occurring.

Ms MORGAN-WICKS -We would anticipate that occurring, from a usual group of people joining a larger Treasury department which runs its costs quite efficiently.

CHAIR - I will try to get to more accounting type things. As I understand it, we talk about the deficit in the fund. We talked to RBF about what has contributed to the increasing deficit. It seems to me the more the government contribute the less the fund deficit. It narrows the gap. The lowering of the unfunded liability would mean there is lower nominal superannuation interest in the general government's income statements. Is that a correct assumption? This is assuming the government have money to put into it.

Mr JEFFERY - The Actuary recommended in the triennial review a phased series of increases in the government's employer share. This is the share we pay for each person's pension every fortnight or each person who takes a lump sum for new benefits only. For existing benefits, that is people who prior to those increases to 2013 who were already on pensions, there was no change in the government's contribution. It is a going forward. It is an increase in our share. The reason for doing this is to protect. RBF are holding plan assets and the reason to increase the government's employer share was, whatever the government is not paying as its employer contribution RBF is paying as the plan assets contribution.

The Actuary was saying if no change was made the plan assets would decline by 2037. From that point there are no plan assets. The government would be paying everything. It is changing and making sure fund assets decline more slowly and remain for a lot longer. Its effect on the superannuation liability it is not changing the gross liability at all - the fact we are increasing our contributions. The liability is what the liability is. All it is doing is making the plan assets last longer and therefore the gap between the plan assets and the gross liability is the unfunded component.

It is not affecting the gross liability. It is making sure the unfunded liability, or the plan assets, stay in place for longer than the Actuary was saying.

CHAIR - Yes. If a government proportion increases that will reduce the nominal interest payment required?

Mr JEFFERY - We do not pay nominal interest, it is nominal so it is an expense. The nominal interest will change but only to the extent to what the plan assets are compared to what they would have been. It is only a change at the margin.

CHAIR - Will it result in an improvement to the net operating balance? You have a cash flow challenge but you have potentially an improvement in the net operating balance.

Mr JEFFERY - The liability would be the same. The fund assets may be slightly higher. There may be a slight impact on the nominal interest.

Ms MORGAN-WICKS - If you are increasing the contribution that is the expense as well.

CHAIR - It becomes a choice. I could be wrong, Craig, I am not the accountant here. The scenario I have put is that your net operating balance looks a bit better but your cash position is worse. It is a bit of a six of one, half a dozen of the other approach.

Mr JEFFERY - The cash payments is a cash cost in the cash flow statement whereas the nominal interest is a nominal cost in the income statement. The intention of the change which was made had nothing to do with the impact on nominal interest. It was, the Actuary has done the review, there is a funding gap. If something is not done the asset pool will decline and so something needs to be done.

It is nothing to do with trying to manage the nominal interest. The change would be very marginal. It is a pool of assets which was going to decline in 24 years from 2013 which will probably now decline in, I cannot remember the numbers, but 40 to 50 years or something like that.

Ms MORGAN-WICKS - Without moving to a 100 per cent contribution from government at a point in time which then disadvantages the general public in services which can then be afforded in the budget.

CHAIR - Yes, so according to the whale graph in Treasury's submission, it looked as if it starts to decline around 2040. It stays static for a while.

Mr JEFFERY - Yes. It peaks in 2029-30. That is not the liability. That is our costs we are paying out.

Ms MORGAN-WICKS - That is the cash contribution which peaks in 2030-31 at an estimate of $430 million. It is the cash cost.

CHAIR - The other thing RBF mentioned was Treasury is responsible for setting the investment risk strategy around this. Could you tell us more about this? This is for both the accumulation fund and the contributory fund. Could you talk to us about how they are different? I know the members in the accumulation fund basically determine where it is going to go. How is the investment risk strategy managed for the contributory fund?

Mr JEFFERY - RBF has external investment advisors called JANA, I think. Did they talk about how they obtain their investment advice? I assume they cover that. Each year RBF knows what its existing investment strategy is, discusses internally and discusses with their external advisors what the potential options are and then seeks guidance from Treasury about what a suitable risk based approach to those investments would be. For the past many years, that guidance has been that the budget situation and the cash cost and liability exposure is such, and the desire for the asset pool to grow good but not to decline more rapidly than what is in the actuary's calculations, means that the risk appetite is very risk-averse. You may well think that is a standard Treasury risk response.

CHAIR - I would be surprised if it was anything different, to be honest.

Mr JEFFERY - But my role has been for many years doing the accounting and the reporting and managing the relationship with the actuary. It was about four or five years ago we did some transfer of responsibilities. Because I was managing the relationship with the actuary, I took over responsibility for superannuation policy. I had my first discussions on this risk profile that we envisaged they should follow.

Prior to that time, it was being driven more by a focus on the liability side of things, whereas our focus, as you are aware, for a number of years, as the Treasurer has put in his submission, has been on making sure that we understand what the budget exposure is in superannuation payments coming out and making sure that curve of payments is manageable and that the increases are as - we know the line is going to go up, and we know there is going to be a peak - to try to make that transition from where we are now to the peak as incremental as we can, so that we do not have a situation where one year the budget is paying out $250 million, and then the next year the budget has to make $400 million. It is $250 million, $260 million - not smoothing it so much but just making sure that the profile is manageable and there is no big impact on the budget.

That was the context we gave to RBF - risk averse, but with a focus on making sure that the assets decline as slowly as possible and that we manage the profile of those costs going out the door. We know what the actuary is saying. We know what the expectations are, and for all intents and purposes, manage to keep within that and do better if possible, but do no worse. That is probably a long answer.

CHAIR - Basically, the answer is that you have a fairly risk-averse strategy?

Mr JEFFERY - Yes.

CHAIR - That is the strategy.

Mr JEFFERY - Both personally and professionally, I would say.

Ms MORGAN-WICKS - Risk averse and watching the proportion of GTS cash receipts - making sure that is manageable, which is featured in the Government's fiscal strategy of making sure that it remains under 6 per cent.

CHAIR - I notice in your fiscal sustainability report that was released last week or the week before that even when it peaks, the Treasury is still confident it will stay at or below 6 per cent of the total state receipts.

Mr MORGAN-WICKS - Yes, on the current modelling.

CHAIR - Yes. The reason I am asking you these questions about the risk strategy is, as we can tell from the payments and the unfunded liability whale graph, the peak and the big hits to budget are there because the majority of people are going to retire fairly soon, over the next five to 10 years. Most people would want to take a fairly risk-averse approach at that point in their lives as opposed to when they are 20 and going into some sort of scheme. I think most people who would benefit from this would also take that sort of approach. It was not a loaded question anyway. I was just trying to understand how the policy framework - and you did explain that quite well - is established around that. I was not aware that the Treasury had the final say in RBF's investment risk strategy.

Ms MORGAN-WICKS - I probably would qualify that. Certainly the Treasury is consulted about the investment strategy, but RBF is the day-to-day manager in investment decisions for the fund. They have that responsibility. Treasury is obviously responsible for budget estimates and for the actuals. We require that information. We are consulted and we will provide an input into that investment strategy. But I would not suggest that Treasury is overall ultimately responsible for that but we would contribute to it.

CHAIR - Assuming the legislation for the House passes and then we have the defined benefit schemes and the contributory fund being the biggest of those, they are going to be dealt with separately. In the approach that is taken there, is that part of the consideration in determining who actually manages this in the future? This is a concern that has been raised by some representative groups, what it will mean for them. I think when it first hit the deck there were a couple of people who were concerned that it was going to be wound up and it was not going to be the same focus on managing their retirement funds into the future. How will it work into the future, the management of this portion, this part of what is now in RBF but will be -

Ms MORGAN-WICKS - I can provide a very general comment because the other Deputy Secretary, Anton Voss, is responsible for what is going to be the transition of the RBF into Treasury. My last statement in relation to our involvement in investment decisions with the overall setting-up policy is within the current policy settings. Once there is that change and the transition of what remains to Treasury, obviously yes, the Secretary of Treasury will be responsible for that branch and for the policy decisions that are made by that branch in consultation with the Treasurer - a different operating environment. I would not like to go into any further detail because I would not like to mislead the committee on that.

CHAIR - My understanding, unless it is my misunderstanding of the content of a previous briefing in relation to the bill that is before the House at the moment, was that the administration and management of the defined benefits fund would be managed externally to Treasury. Or is it going to be remaining in Treasury, or is that just an interim measure?

Ms MORGAN-WICKS - My understanding is that there is a current proportion of the RBF team and staff that will still remain responsible for that fund so they will remain when there is a carve-up. It is not that we are suggesting our current seven or eight Treasury staff are going to come in and take that over. They will remain responsible and still continue to exercise their duties and bring that expertise to the management of the fund. It will occur as a branch within Treasury. I am very happy to take a question and provide further detail on notice in relation to that because I am not responsible for that.

Mr JEFFERY - At the moment the RBF has outsourced some of their back-office functions to an external entity and I think the intention is under the future model that those similar functions will be outsourced.

CHAIR - That is as I understood it.

Ms MORGAN-WICKS - It certainly was limited interruption and a very smooth passage for members.

CHAIR - In your submission, as with the RBF and some others, you have identified the main reasons for the increase in the government contribution or the employer contribution. The four dot points on page 3 of your submission, we have covered most of them anyway - the RBF administration management expenses in excess of the assumed rate, high take-up of pensions and it was assumed the average member contribution rate increased during the period and investment earnings were lower than assumed. Is that in your view as well? In Treasury's view, are they the key reasons why this happened? Is there nothing else we need to be aware of or any other potential issues that could occur that could see another significant jump above what has been predicted or forecast?

Ms MORGAN-WICKS - No. That and the addition of interest to the deficit I think is the major factor that was contributing.

Mr JEFFERY - Those reasons are a summary of the main reasons or the main explanations that were in the triennial review report, which the committee will have access to. You will see that there is a number of pages covering those areas, but they are the main areas. As we have already talked about, there is a triennial review this year and they will look at those factors, but it sounds like RBF had said there were some one-off costs in their administration that will not be in it in the next few years. My guess is that the uptake of pensions has been reasonably consistent over the past few years.

CHAIR - So the next review will probably adjust for that?

Mr JEFFERY - Yes, so the triennial review, the State Actuary will do exactly the same process as they have done for the last two or three triennial reviews and exactly what they have done in 2013. It may be the gap has disappeared, or there is a surplus or the gap is bigger, and they will recommend strategies to deal with that.

CHAIR - Craig, I think you mentioned the interest on the deficit. How much is that? That is the other point you have made. That is the other factor that has contributed. Do we have a figure for that cost? I go back to the point that if you increase the contribution, then the interest payment should reduce.

Mr JEFFERY - It is a notional deficit calculated by the Actuary, so they are comparing the difference between what their deficit was in 2010 compared to 2013. My guess would be in terms of interest they would be applying the earning rate of the scheme in those three years. We can find it in the report. That is probably a good question to ask Dr Knox when you talk to him. The Actuary has included interest at their assumed earning rate. So that is the assumed earning rate on the plan assets.

CHAIR - Just a final question, unless you want to add anything yourselves. When we read in the media and we hear members of parliament and others speaking about this challenge, we are told it is a railway out of control; it is a tsunami wanting to swamp us all; it is unmanageable; it is going to decimate the state budget, the unfunded liability and the emerging costs that we see - what is the Treasury's response to that? What is your response to that? I am sure the Treasurer will have a response of his own at a later time. From the Treasury's point of view, are we facing a devastating impact to the budget with meeting the requirements of this liability into the future?

Ms MORGAN-WICKS - The unfunded superannuation liability is mentioned as a key risk, I think, in the last many budgets. It will sit there and it will sit there in probably every state's budget risks as a key one which is closely monitored. From a Treasury view, the emerging cash cost and our projections which would probably run out to 2083, are numbers that we closely manage to ensure that the emerging cash cost is included in budget estimates. It is a figure that is there as a mainstay. It is not something that is played with. We take the State Actuary's expert opinion.

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

This is a long-term cost to the budget. It is a significant one. Yes, it is a risk but it is one which is currently managed under the current policy settings.

CHAIR - Did you want to add anything, Craig?

Mr JEFFERY - I agree to all of that. We take the superannuation liability and its accounting and reporting very seriously, as does the Auditor-General. Our Treasurer's Annual Financial Report and our Treasury financial statements include the unfunded superannuation liability each year. They are both audited. Every second year the Auditor-General appoints an external actuarial expert to review the work of our actuarial expert.

CHAIR - They told us that, yes.

Mr JEFFERY - PwC (PricewaterhouseCoopers), Catherine Nance, who was our former State Actuary did the review last year. The reason he alternates is the audit team looks at superannuation one year and risk management fund the alternate year. We are very confident the numbers we provide are based on the best possible information and assessment.

CHAIR - Another question I want to put to you. Again, it may be one you would prefer us to address to the Treasurer. One witness suggested it will come to the point or it is almost has come to the point, the meeting of these emerging cost cash requirements will mean either paying people their pensions or keeping a hospital or school open. When challenged on this, the Treasurer has clearly stated a number of times, past and current treasurers, it will not exceed 6 per cent of the total cash general government cash receipts. How do you respond to this?

Ms MORGAN-WICKS - It would be a question for the treasurer of the day. It is not a position currently under consideration or being put to the Treasurer. There is not that choice because it is not required. Keeping the emerging cash cost at under 6 per cent is a reasonable policy setting moving forward. It is not one which is impacting in terms of a decision to close a hospital or a school. It is simply not the balancing required when it is at that proportion of general government cash receipts.

CHAIR - Thank you. Any questions from other members?

Mr FARRELL - We heard from another witness who stated the scheme is open to rorting with the FAS system and the three year final salary review in making up the final payment. Are there any concerns within Treasury this is something affecting the amount of money paid? Are there any models on what it would be with or without the three-year final payment?

Ms MORGAN-WICKS - As we mentioned before, Treasury does not receive this kind of individual information. There may be anecdotal information about any working person who is approaching their retirement attempting to play within the rules. It might be termed rorting. However, if they are acting within the current scheme provisions and legitimately achieve either a promotion, legitimately undertake overtime which is not currently restricted according to age or whether or not you are a defined benefit member.

Treasury has not received information to this extent nor have we undertaken any modelling to state it might be unduly or significantly influencing the level of liability or a contribution rate by employer.

Mr FARRELL - So a lot of that would be, for example, as the Chair mentioned, with nurses and the normal amount of overtime to keep the hospital running. The same thing with teachers towards the end of their career, quite often they are moved up the chain.

Ms MORGAN-WICKS - Overtime is a factor of awards. It is reviewed each time an award comes up and as a part of industrial negotiations per sector. It is a typical and usual part of employment.

CHAIR - We did have claims that it being a rort, the final average salary calculations being used in such ways - but within the rules, there was no suggestion that it was not within the rules to maximise someone's pension entitlement at the end, and I would argue that most of us would do it.

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

CHAIR - A couple of years ago there was an inquiry by the Legislative Council into the overtime in the prison system. We know that there is a lot of overtime undertaken by nurses, not so much teachers, which make up a large portion of the public service employees. Has there been modelling done around the amount of overtime that is done and the impact on the budget in broad terms as well as potential impact on pension benefits into the future? Or is that something that has not really been looked at? I am sure the Treasurer would be keen to know if there are ways that we can minimise this impact because if overtime is blowing out as it was in the prison, then the question is, when do you employ a new staff member rather than keep paying so much overtime?

Ms MORGAN-WICKS - From a global position, we do not see at the general government sector level a proportion of overtime as part of the employee expense. Each head of agency is responsible for their employee expense line. They are responsible for the number of FTEs they employ and the use of those FTEs. As part of the budget we may receive submissions, for example, from the prisons a couple of years ago in terms of restructuring or changing the use of FTEs to try to hire more to avoid an overtime increase, but that is done within FTE levels that have been agreed between heads of agencies and their ministers as to the proper use of those resources.

We do closely watch and budget at Estimates the employee expense and the actuals that are coming through. We are tracking loans throughout the year because employee expenditure is such a significant proportion of the budget at close to 43 per cent or 44 per cent.

CHAIR - It is really up to the individual manager of that area, the secretary of the department?

Ms MORGAN-WICKS - Heads of agency will be responsible for their own resources and policy settings. Different areas will have different settings for overtime according to the sector in which they work: for nurses and medical, prison officers in Justice, Parks if there is particular overtime or peak seasons during fire-fighting, for example. That is a head of agency and subject to our general sector employment in our policy settings.

CHAIR - That is why they get paid big bucks I guess, the heads of agency.

Thank you very much, we appreciate your input. A lot of the questions were asked to respond to other submissions. It is really important we get it on record so it enables us to write a report that states the facts as they actually are. We appreciate your willingness to answer these questions and we will also get onto the Treasurer. We forgot that they were sitting this week because we are not. Did you want to make any closing comments or are you happy?

Ms MORGAN-WICKS - No thank you, but thank you for the opportunity.

CHAIR - Thank you.

Mr JEFFERY - Thank you.

CHAIR - We will see you soon when the Financial Management Bill finally is dealt with.

Mr JEFFERY - Looking forward to it.

THE WITNESSES WITHDREW.

Dr KNOX - Good afternoon.

CHAIR - I am Ruth Forrest, the Chair of the committee. We also have Mike Gaffney, Craig Farrell and Leonie Hiscutt, as well as the secretary. You are not required to swear to give this evidence because you are outside the state, but if you are happy to, we are quite happy to do so.

Dr KNOX - I am very happy to give a declaration.

Dr DAVID MONTGOMERY KNOX, WAS CALLED (BY TELECONFERENCE), MADE THE STATUTORY DECLARATION AND WAS EXAMINED.

CHAIR - Thank you, David. This hearing is being recorded on *Hansard* for the purposes of forming part of our report. It will be transcribed and published on our website and also inform our committee report. As far as parliamentary privilege goes, because you are outside the state I do not know that that applies. Since you are sworn you are effectively covered, but I don't imagine you would be talking to the media outside this meeting anyway.

Dr KNOX - That's correct.

CHAIR - Do you have any questions before we start?

Dr KNOX - No, please proceed.

CHAIR - You have seen the terms of reference of the committee and we have had submissions and some hearings with a range of witnesses, which you may have read on our parliament website, but also with Treasury and RBF. We thought it was important to talk to you as the State Actuary to inform us about the assumptions and the modelling of work that you do to determine the basis for the requirements for the employer, the state Government, to fund the emerging costs for people on pensions or taking lump sum payments as they retire. Did you want to make some overarching comments about your role and how you go about that? Then the committee will probably have questions for you following that.

Dr KNOX - Thank you very much for the opportunity to speak to you. It is probably worth making some opening comments and a brief background of myself and some of the roles that we do.

I am David Knox, a senior partner of Mercer and also Senior Actuary in Australia. As well as being the State Actuary for Tasmania and the Actuary for RBF I am also the Actuary to the West Australian Public Sector Schemes. I spent five years as a board member for the Australian Prudential Regulation Authority, and I was a former Professor of Actuarial Studies at the University of Melbourne. That is a little bit about me.

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

It is helpful to go back a little. I am going to go back to before the global financial crisis to the Actuarial Review and these reviews are done every three years. In 2007 I was not the State

Actuary and PwC did the work. At that point they found the scheme was reasonably well balanced. There was a net positive position of $105 million, allowing for the government, it was then planned to increase to 75 per cent of each member's benefit. However, the global financial crisis came along, as we all know. In the years from 2007 to 2010, the scheme, instead of earning a positive return over those three years, lost money at the rate of 3.5 per cent per annum. That represented a loss of about $480 million. It meant that when we looked at June 2010, it had moved from a positive $105 million to a negative $258 million. That was caused by the investment losses with the global financial crisis.

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

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

CHAIR - Thanks for that, David. It provides a succinct summary of the reason for where we are now.

I asked a question of Treasury and RBF about the funding of the deficit and the notional interest payments on that deficit. That was one of the things that became apparent between the global financial crisis and where we are now. If increasing the Government percentage, the employer percentage required to pay toward the new pensions and lump sum payments that are made, will that reduce the deficit and thus the interest payment required?

Dr KNOX - Yes, it will gradually do that. We look at this as the scheme that is going to continue for the next 30, 40 or 50 years. We put in today's dollars, the value of those contributions and the value of the benefits. If the value of the contributions from the employees and the government gradually increase, then the deficit reduces. As the deficit reduces, the interest on that deficit also reduces.

CHAIR - Potentially you could get into a more favourable position more quickly if more was put in to reduce the deficit?

Dr KNOX - Correct.

CHAIR - I do not know whether you are able to comment on this or not, and say if you do not feel you can. In some respects it becomes a decision about whether you have better net operating balance with your reduced interest and a poorer cash position as a result of that.

Dr KNOX - That is true. In the last actuarial review in 2013, we expected the funds earn 7.5 per cent a year going forward. We might adjust that in 2016. The last three years, we think that is probably going to be the earning rate in this three-year period. If the government were to borrow money - and I am not saying whether it should or should not - but hypothetically, should it borrow money and put more money into the scheme and the scheme earns 7.5 per cent, then the earning rate on that money would be higher than the government borrowing rate or the interest cost. By putting money into the fund, it is borrowing at 3 per cent or 4 per cent and if the fund is able to earn 6 per cent or 7 per cent, then the fund is in a better position.

That is looking at one government expenditure compared to many. I am not saying whether that is the right or the wrong decision but looking at it in isolation.

CHAIR - In undertaking some of your assessments you do in your triennial review, the committee has heard from other witnesses of anecdotal evidence of job reclassification or scaling up of income, whether through salary increases or a lot of overtime or other financial benefits before retirement. Do you look at this sort of thing in your assessment, whether this is a reality? Or is it simply some people saying it appears to be what is happening?

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

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

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

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

Dr KNOX - That is correct. The other point I would make is that within the contributory scheme we actually now have more pensioners than we do active members. What that means is, once you start to receive a pension, your salary is having no impact. The pension has commenced. What is having an impact on the liability is the inflation rate, which is the indexation rate.

If inflation is below our expectations, which it is in the last 12 months, it will help the scheme's financial position. The pension might only go up at 1.5 per cent or 2 per cent where we have expected long term the pension would increase by 2.5 per cent, which is the mid-point of the Reserve Bank range.

CHAIR - The other comment made by Treasury and RBF was that the average member contribution rate increased during the periods. I do not know if we would begrudge anyone putting their money into super rather than into other more risky investment options following the global financial crisis. Can you talk to us about how you have assessed this since the GFC and whether it is likely to continue and to be an ongoing issue for meeting the emerging costs?

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

CHAIR - We can help them out sometimes.

Dr KNOX - They are also closer to retirement and the whole issue of superannuation is more present. It is not surprising, and this evidence is shown elsewhere in tax statistics and other data, that as people age they put more money into super. This is exactly what we have seen here. That costs the government a little bit more.

CHAIR - It confirms some of the evidence RBF provided. They say the biggest factor as they saw it was the demographics. As the majority or the average age increases, which means more people are getting older in these schemes, that is the biggest change. Is that a factor for you or are there other factors that are equally as significant?

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

CHAIR - The other point was that there is a higher uptake of pensions than you assumed. What do you put that down to? Is it a recent phenomenon or has it been going on for a period but it is a greater increase at the moment?

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

I think we will continue to see more and more the benefits taken in pension form as people become increasingly aware of the value of a defined benefits indexed pension from the state government. They look at the lump sum and they say, 'What can I get from that? A term deposit is only giving me 3 per cent. The share market is risky. Hmm, what do I do with my money? Alternatively, the government is going to pay me an indexed pension until I die.' In one sense there is no choice, if you look at it from that perspective. Obviously, some people are in poorer health, so we would never expect a 100 per cent pension take-up. Some people will want lump sums to pay a debt off or to have some money to travel. I think that trend to take a pension is not only there in Tasmania, but it is in most public sector schemes around the country.

CHAIR - We have also had some evidence from some witnesses that the majority of people on pensions are in the lower salary bands when they have retired. They are not the ones we tend to see on the front of the newspaper when someone retires on an annual pension of $200 000 a year, for example. Do you have those figures about how many people are within each salary band or income band level?

Dr KNOX - I do not have those numbers before me at the moment. We could look into those numbers. We do a very major investigation into pensions, not only for Tasmania, but the pensioner mortality around the country where we do look at pensioner mortality rate. I hate to bring these things up but I am an actuary. We do find that the pensioner mortality rate is lower for people with higher benefits. The very simple reason for that is, those with high pensions have higher salaries, they have probably had better education, they have probably had better access to health, and a better lifestyle. There is clearly a life expectancy relationship between socio-economic grouping and life expectancy. That is not quite answering the question you actually asked because I do not have that in front of me.

CHAIR - No, it is an interesting point all the same.

Dr KNOX - But we could look at that if you wanted us to.

CHAIR - It would be helpful if you could. We will try to get some relevant information from RBF as well. It would be good to see from your perspective. It helps dispel some of the myths. Some people say it is a huge rort or a golden handshake everyone receives when they leave the public service. Whereas, other witnesses have said it is not the case. The majority of people are on $25 000 to $30 000 per annum as their pension.

Dr KNOX - It is true. Although I do not have the data in front of me, the average pension is quite modest. We did some work on this last year when the federal government changed the rules or the tax treatment of defined benefit pensions. Most pensioners from the contributory scheme are receiving a part pension from the government which indicates they are not on a lot of money.

CHAIR - Do you have the average pension figure at this stage?

Dr KNOX - No, I do not but I will have a look at it.

CHAIR - It would be helpful if you could provide it. The other point made was the interest earnings were lower than assumed. Is this purely a factor of the GFC or are other factors at play?

Dr KNOX - The investment earnings over the last six years have been pretty close to what has been assumed. If one goes back to the GFC in 2007-08 it was -4.4 per cent. In 2008-09 it was -11.5 per cent. Those two years which were GFC affected, as I said earlier, really caused the deficit or the shortfall. Since then the investment earnings have been close to what we have assumed which is around 7.5 per cent. It moves around every year.

The last financial year, 2014-15, it was 9.9 per cent. The year before that it was 11.3 per cent. Both of those years are above what we assumed long term. You do have some volatility in the markets. We all know it happens. What we are trying to do is look at the long term picture.

CHAIR - I understand there were poor earning returns in 2011 as well, 2008-09, and then 2011. What was that caused by?

Dr KNOX - In 2011-12 the earnings were only at 1.5 per cent. I have to go back and look at it. The equity markets do have their ups and downs. What you tend to find is after a poor year you have a good year either the year after or the year after that. Although in 2011-12 it was

1.5 per cent, then in 2012-13 it was 12.3 per cent which was much higher than our assumed figure or 7.5 per cent. The year after that, as I said, was 11.3 per cent.

You are not going to gain 7 per cent or 7.5 per cent every year. You will have movement around this depending on equity markets both in Australia and globally. Also, the RBF is invested in more than equities. It has a combination of fixed interest property and so on. It is the effect of the investment market.

CHAIR - Thank you. Leonie Hiscutt had a question.

Mrs HISCUTT - Hello, David. I think you have already answered this question in what you have said before. Would it affect the fund favourably if people, after they have retired, were offered at any stage the opportunity to take their full benefits, perhaps with an incentive to tidy up their fund? Do you have a comment to make on this?

Dr KNOX - It depends on what was offered. In the past some funds have offered members the right to commute their pension to a lump sum. Sometimes it is done on terms which are favourable to the fund so it is not the full value of the pension. It might be three-quarters of the value of the pension. To the individual it might look very favourable.

What you tend to find in a situation like this is what is called adverse selection. The people who will take up the lump sum option might be in poor health or they may have lost their partner. The probability of both of them living a bit longer is less than it previously was. While it may appear an attractive option to make an offer to members it very much then depends on how the offer is determined and who takes it up because the people who take it up will not be evenly spread across future life expectancies. We would generally expect on average, and this is very much an average number, but those who are in poor health will grab the lump sum because they may have been diagnosed with cancer or some other ailment, and those who are still in good health will say, 'No, I have another 20 years to go, I will stick to the pension.'

CHAIR - You would have to make some assumptions about what the pension would be worth at that point wouldn't you, because of how long a person might live?

Dr KNOX - That's correct.

CHAIR - They may well have cancer, but some cancers can be treated very successfully and they could live another 20 years anyway.

Dr KNOX - That is right. The other thing that it can do for some people, and again this depends on the rules, is if I take a lump sum I may be able to do something with it that enables me to get a slightly higher age pension from the federal government. Perhaps I add another room onto the house, so the house is not part of the assets test and then I get a bigger pension. If I receive a pension, that is clearly income and I don't have much flexibility as to how I treat it under the age pension increase. You get that sort of behaviour as well, where some individuals, hopefully after taking financial advice, may make a particular decision.

CHAIR - I guess the risk is that people who are vulnerable for whatever reason, whether it is through ill health or maybe through a marriage break-up or something like, make those decisions hastily perhaps. This may not be a question you can explain, it would be more of an RBF question - how are those people assisted to make sure they get good advice? Is it just up to the person to make sure they do?

Dr KNOX - In one sense that is correct because the offer is made to the individual. However, normally in these circumstances the superannuation fund would make financial advice available through financial advisers that RBF have or through some other organisation. You would also put information on the website. Normally you would put a calculator on the website to indicate how long you might live. You might even put a little calculator where people feed in their lifestyle issues - how long did mum and dad live, et cetera, so people can get a bit of a feel for what their life expectancy could be. The view is that many people, particularly shortly after a time - I think life expectancy is 83 to 85 because that is what they read in the newspapers and the media. That life expectancy is somebody who is a baby boy or girl born today. In reality the life expectancy of a pensioner, a 65 year old today, is probably around 91, 92 or 93.

CHAIR - Depends on what they have done with their life too.

Dr KNOX - Of course it does and there are huge variety or diversity in that. Some people live to 100 and some people die in their late sixties or seventies. If you were to go down that route of giving pensioners options you really have to make sure that they get as much information available as possible and they have access to good advice.

CHAIR - One other point that was made in the RBF's submission that they were quoting information that you had provided, they discussed with you, was that expenses during the period in excess of the assumed rate was also a factor that increased the deficit. Can you give us a bit more information about that comment?

Dr KNOX - That comment was basically an assumption that we have to make on what is the level of expenses going forward. Those expenses we normally express as a percentage of either salaries or pensions. They were going through significant reform between 2007 and 2010 and we had to make a note that expenses were higher than previously had been assumed, so looking forward we made that comment. I would expect that those expenses have come down in the last three years. We have not done the numbers for the last three years yet but it will be done later this year. I think the RBF have kept a tight control on expenses but I haven't got the latest numbers.

I should add even when we are talking about an increase in expenses, this might be only an increase, in broad terms for the whole scheme we are talking about the value of future benefits being worth something like $7 billion, or $7 000 million, in 2013. The value of the expenses in today's dollars compared to the $7 million was around $150 million. Yes, it is an important number but it is not a number which is going to blow everything out of the water.

CHAIR - Do you have any input at all into the investment strategy in terms of level of risk?

Dr KNOX - We have discussions from time to time with RBF and their asset consultants. Their assets are reasonably heavily weighted toward equities and relatively high-risk assets. This is reasonably typical for most government funds in this country because they want to earn, over the long term, good money; if the fund is around for the next decades - 30, 40, 50 years. It is not as if the assets are going to have to be crystallised in the next 12 months or so. Most governments take the view that this is a long-term investment. We want good returns and we are going to get a better return over the long term with equities and properties than we would in fixed interest.

We are relatively comfortable with the overall investment strategy. We do not buy into particular investment decisions. Rather, we look at it at a very high level.

CHAIR - Did you have particular communication or give any consideration to the purchase of the Hobart Airport, for example, and the RBF's portion of it?

Dr KNOX - We do not become involved in decisions of this type at all.

CHAIR - I think we have covered most things. Is there anything else you think we should be aware of, from your point of view, in terms of how the assumptions are made and whether there are other factors we need to be aware of into the future? There are people who think this is a liability which is out of control and that the emerging cost is going to decimate the budget. They claim we will have to close hospitals and schools to fund it.

Dr KNOX - Okay, in terms of the costs, I know they are allowed for in the budget. The costs have not blown out exorbitantly. If I go back to 2010 and look at the numbers expected in 2021, it was \$358 million. Three years later is was \$377 million for the same year. Yes, it has increased a little bit but not enormously. It has not gone to the extent it is going to blow the budget apart.

The reason the employer contribution rate is having to escalate and therefore looks as if it is becoming worse and worse is that this employer contribution rate is the percentage paid by the government in respect of new pensions or new benefits. For the pensioners who have their pension commencing in 1990 or 2000, the government is still only paying 70 per cent of the pension and 30 per cent is coming from the fund. It then went up to 75 per cent and so on.

Although the percentage seems to be increasing quite rapidly, that percentage is only for the new pensions whereas the older pensions are still at 70 per cent or 75 per cent.

CHAIR - That is an important distinction to make. I guess as the big bump and the baby boomers retire, it is going to be a significant number. I am sure you have assessed this in your assumptions as to how many people are likely to retire in the next five to10 years, when the percentage of the employer's contribution increases up to 88.5 per cent and further, probably. Whilst I accept what you say, there will be more and more people taking their benefits either as a pension or as a lump sum under the new arrangements, with a much higher percentage being required to be funded by the employer.

Dr KNOX - Sure. You are absolutely right. I think in the Treasury's submission to your committee they showed that projected defined benefits superannuation costs, which we calculated for them. It is steadily increasing. As the baby boomers are retiring, more people go on the pension. That will continue to increase steadily until around 2025 to 2030, and then it will fade away gradually as the pensioners die. This is not an unexpected shape. We have known that this was coming for a long time. Maybe it is a little bit higher than what was previously anticipated, but later this year we will review our assumptions on both salaries, inflation and earning rates. It might shift that curve up or down, I do not know yet, but the general shape of the curve will not change.

CHAIR - Yes. It could also move further to the left or the right to the hump, couldn't it?

Dr KNOX - It could move marginally to the left or the right, but not by much. What we will see there is - the hump is demography. These are people retiring, so by the time we go out another 10 years, there will be very few active members left. They will all be in the pension phase. That is the peak of the hump and then it will gradually move down.

CHAIR - In listening to media reports and looking at other credible reports, in Tasmania there has been a negative wage growth in real terms. Even though you have said there has been evidence of the average salaries going up a bit, if that continues, is it likely to take a bit of pressure off?

Dr KNOX - Yes, that is true. If the salary increase rate is slower than we anticipated, yes, that will take the pressure off a little bit. On the other hand, in 2013 we assumed investment earnings going forward at 7.5 per cent. I am thinking that we will probably reduce that number this year, as we have for other schemes. Interest rates are lower; the outlook for the economy is a little bit softer, so the earnings on the assets will probably be a little bit lower as well. Even if salaries are not growing at the rate we expected, inflation is a little bit lower, so the indexation is a little bit lower than expected. But the earnings on the fund will also be a bit lower than expected.

CHAIR - That is true.

Dr KNOX - There will be swings and roundabouts, and at this stage I am not sure which way it is going to go.

CHAIR - True. Do members have any other questions? No? I will read you a question I asked the Treasury and I am pretty sure that they said it is worth asking you about this, too, in terms of modelling that may or may not have been done. In terms of the superannuation guarantee levy when that was introduced in 1992, and employers had to then contribute super for employees at originally 3 per cent, now 9.5 per cent, as I understand it, the defined benefit scheme employer contributed more than the SGL amounts. They were exempted from the SGL as a result of that. RBF was a generous scheme in those terms and therefore they were not required to put away any extra to satisfy these SGL requirements. The government then effectively was notionally contributing enough pursuant to fund rules to satisfy the SGL legislation. Even though it was not funded, they were still notionally putting away that money; it was being paid, if you like.

Dr KNOX - Yes.

CHAIR - Some people have suggested we could just wind up the scheme and the Government could borrow the $5 billion to $6 billion and put it in some sort of future fund or something like that. In terms of this aspect of the potentially unfunded amount, do you have any idea how much - if the SGL commitments had to be made by the employer, the government, every year since 1992 plus earnings at the fund crediting rate, what the figure would be?

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

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

Dr KNOX - Absolutely. Way back in 1992 you are probably talking about something like 20 000 active members of the contributory scheme. Even if you are putting in 9 per cent and the average Joe is, say, $50 000 - I am going to make the maths a little easier - it might be $5 000 to $6 000 a year times all your 20 000 members over 20 years. With investment earnings it is going to grow into a very significant fund.

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

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

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

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

CHAIR - Thank you very much for your time. Are there any closing remarks you would like to make?

Dr KNOX - Thank you for your questions. I will try to send some data to you on salaries and average pensions. Is it best if I send it to Gabrielle or Allison?

CHAIR - Gabby would be great, yes.

CHAIR - If you have any further questions we will be in touch. We appreciate your input. We have not spoken to the Treasurer yet as he was not available today.

Dr KNOX - If you have any further questions on reflection, do not hesitate to let me know.

CHAIR - Thank you very much. We appreciate your time. Goodbye.

THE WITNESS WITHDREW.