

Chapter 7:

DEBT AND SUPERANNUATION LIABILITIES MANAGEMENT

7.1 Introduction

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7.1 INTRODUCTION

The key elements of the Government's debt and liability management strategies were incorporated in the General Government Debt Elimination Act (proclaimed in February 1996) which gives legislative backing for -

- the stabilisation of general government net debt by ensuring a sustainable general government budget surplus within the next three years and thereafter to eliminate by the year 2020 general government net debt;
- full funding of current employer superannuation liabilities and the provision of regular contributions toward past service unfunded liabilities so as to extinguish unfunded superannuation liabilities of the closed schemes by 2044-45; and
- efficient management of the Budget Sector's debt portfolios and superannuation leading to lower debt servicing and superannuation costs.

This chapter provides summary information on debt and superannuation liabilities relating to the New South Wales public sector.

The State's level of borrowings, debt servicing costs and unfunded superannuation liabilities are important measures of the financial position of the public sector. Trends in debt levels and debt servicing costs also provide an indicator of the State's financial performance.

Chapter 3 of Budget Paper No. 6 provides further information on the financial assets and liabilities of the State public sector based upon national uniform reporting standards and Australian Bureau of Statistics definitions.

7.2 STATE DEBT

Table 7.1: Outstanding Capital Value* at 30 June

	1992	1993	1994	1995	1996 (est)
	\$m	\$m	\$m	\$m	\$m
Budget Sector Debt					
Indebtedness under Financial Agreement	4,618	3,529	3,175	2,539	2,189
Other indebtedness to Commonwealth	2,055	2,018	1,986	1,947	1,908
Other	9,910	12,056	12,926	13,548	12,681
Total Budget Sector Debt	16,583	17,603	18,087	18,034	16,778
Financial Assets	3,640	3,719	3,191	3,089	3,553
Net Budget Sector Debt	12,943	13,884	14,896	14,945	13,225
Non Budget Sector Debt	15,487	13,961	15,145	16,052	14,566
Financial Assets	9,047	8,979	10,601	11,449	7,950
Net Non Budget Sector Debt	6,440	4,982	4,544	4,603	6,616
Gross State Debt	32,070	31,564	33,232	34,086	31,344
Total Financial Assets	12,687	12,698	13,792	14,538	11,503
Net State Debt	19,383	18,866	19,440	19,548	19,841

* Capital Value represents face value less any unamortised discount.

** All figures have been revised to reflect expanded ABS GFS coverage represented by inclusion of Building and Construction Industry Long Service Payments Corporation.

*** The 1995 figures have been revised using the audited figures contained in the 1994/95 State Public Sector Consolidated Financial Statements after any adjustment necessary to ensure compliance with ABS reporting standards.

The large reduction in estimated Budget Sector net debt between 1995 and 1996 of \$1.720 billion is mainly due to equity restructure receipts, totalling \$1.8 billion comprising \$1.5 billion from the electricity distribution industry and \$0.3 billion from various other Non Budget Sector organisations, including NSW Treasury Corporation (TCorp), Darling Harbour Authority and the Ports Corporations. Approximately \$1.3 billion of these proceeds is expected to be utilised to retire debt in 1995-96.

Non Budget Sector gross debt and financial asset reductions are mainly a result of TCorp's withdrawal from non-core proprietary trading activities following a recent review of the Corporation's role. The reduction in TCorp's gross debt of approximately \$3.2 billion has been partly offset by an increase in debt by electricity and other corporatised bodies to conform with the new debt/equity structures determined by the Government.

State Net Debt as a percentage of Gross State Product (GSP) is expected to decline from 14.3 per cent to 11.8 per cent over the five years to 30 June 1996, as shown in Figure 7.1.

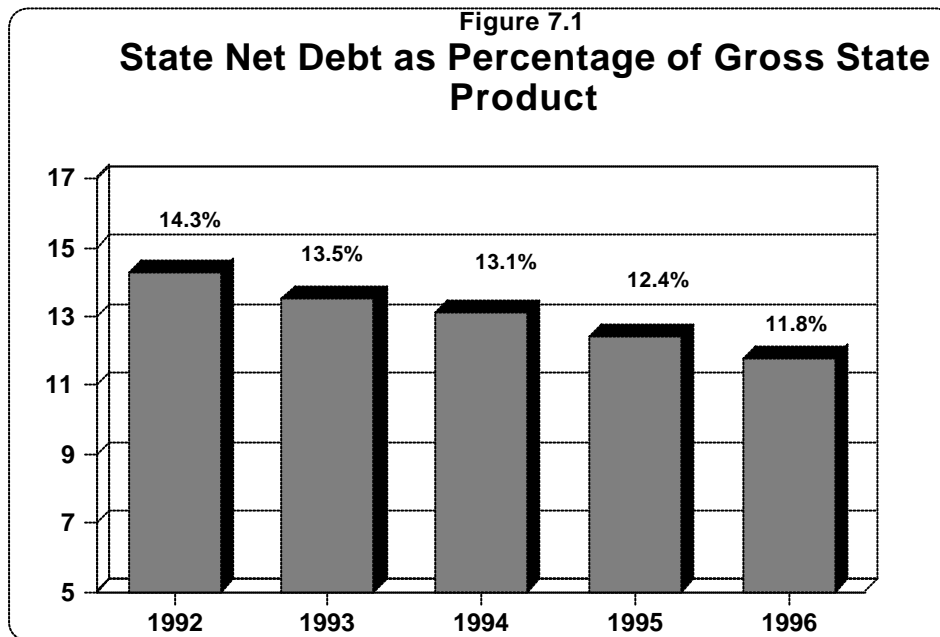
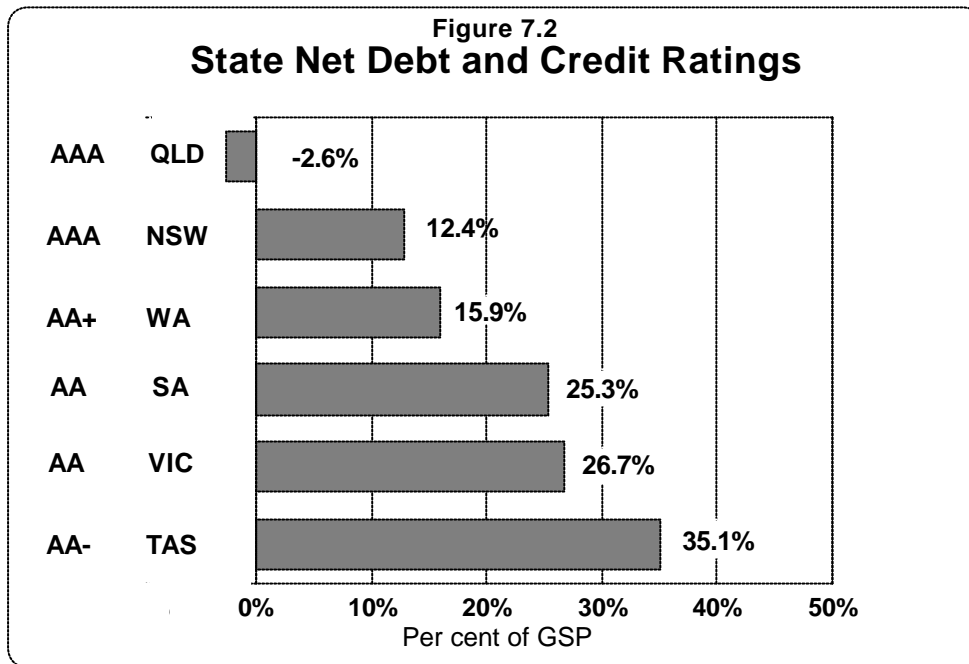


Figure 7.2 compares the State Net Debt to GSP ratios of the Australian States as well as showing the Standard and Poor's credit ratings as at 30 June 1995. New South Wales has the second lowest debt burden among the States and accordingly a AAA credit rating



Queensland's negative net debt position as at 30 June 1995 is partly due to its borrowing program for Brisbane's public bus transport, being the responsibility of the Local Government Sector and not the State. A further reason is because Queensland's employer cash reserves for superannuation are included in their financial assets unlike New South Wales where they are excluded.

If New South Wales net debt was calculated on the same basis as Queensland, net debt would be reported as \$15.092 billion representing 9.6 per cent of GSP.

The State's debt and superannuation liability reduction strategies, the strong budgetary position and the broad based economy and the resultant broad taxing capacity of the Government are some of the major contributing factors to New South Wales's AAA credit rating status.

DEBT MATURITY PROFILE

State debt comprises borrowings from three sources -

- borrowings from the Commonwealth under the Financial Agreement 1995 and Commonwealth repayable specific purpose advances covering a variety of projects of which housing is predominant;
- TCorp; and
- own name borrowings by statutory authorities.

The majority of State debt is actively managed through TCorp with maturities being concentrated in the Corporation's highly liquid benchmark bonds, ranging in maturity from 1 to 12 years.

**Table 7.2: State Debt Maturity Profile
(Face Value)***

Maturity	Treasury Corporation	Commonwealth Debt	Total
	\$m	\$m	\$m
1996-97	2,760	458	3,218
1997-98	4,458	431	4,889
1998-99	666	49	715
1999-00	4,531	621	5,152
2000-01	581	598	1,179
2001-02	3,361	120	3,481
2002-03	275	43	318
2003-04	2,606	104	2,710
2004-05	806	44	850
2005-06	2,409	134	2,543
2006-07	38	45	83
2007-08	3	46	49
2008-09	1	48	49
2009-10	26	49	75
2010-11	416	50	466
2011-12	...	51	51
2012-13	62	52	114
2013-14	0	54	54
2014-15	0	55	55
2015-16	0	49	49
2016-17	12	48	60
2017-18	0	49	49
2018-19	0	50	50
2019-20	643	50	693
2020-42	...	788	788
Government Option and Interminable	...	11	11
	23,654	4,097	27,751

* The face value is the amount to be repaid, ie the principal plus the interest component from issue until maturity.

** Excludes statutory authorities' own name borrowings, as no profiles are readily available.

BUDGET SECTOR DEBT MANAGEMENT

Public authorities borrow within limits approved by the Treasurer under provisions set out in the Public Authorities (Financial Arrangements) Act 1987. The New South Wales borrowing program for the year is in accordance with the annual limits agreed by the Australian Loan Council. All borrowings are centralised through TCorp which enables substantial economies of scale to be achieved, resulting in lower borrowing costs.

TCorp is contracted by Treasury to actively manage the Budget Sector debt portfolio in order to minimise the cost of debt within risk parameters acceptable to the Government. In undertaking debt management assignments, TCorp's fundamental approach is to identify and manage around risk neutral positions. Risk neutrality is normally defined as the matching of the borrowing terms with the term of the asset or project being financed by the borrowing.

The Government has established interest rate risk limits for managing Budget Sector debt. Practice over the last six years has been that the bulk of New South Wales debt is managed within a risk band of plus or minus half a year of the benchmark average debt maturity term of 3½ years. The limits preclude any new foreign currency exposure. Derivatives (mainly futures, swaps and options) are used mainly to vary the duration of the Budget Sector portfolio as an effective way of active debt management.

The debt portfolio structure as at 31 March 1996 has shorter terms to maturity than the benchmark portfolio as shown below.

Table 7.3: Budget Sector Debt Portfolio Structure

	0-4 years	5-7 years	8-15 years
	%	%	%
Actual	59	21	20
Benchmark	56	25	19

Management of the debt portfolio is measured on the basis of the generalised cost of funds which includes interest payments and the capital value of the debt, as against benchmark. For the nine month period ended 31 March 1996 the portfolio debt cost was 6.70 per cent as compared to the 6.75 per cent benchmark cost of funds, the favourable basis points variation being equivalent to notional cost savings of \$6.10 million. The low variation from the benchmark reflects the high level of uncertainty about the future direction of interest rates which has led to the adoption of a conservative risk position, close to the neutral benchmark.

Historical debt management performance is detailed below -

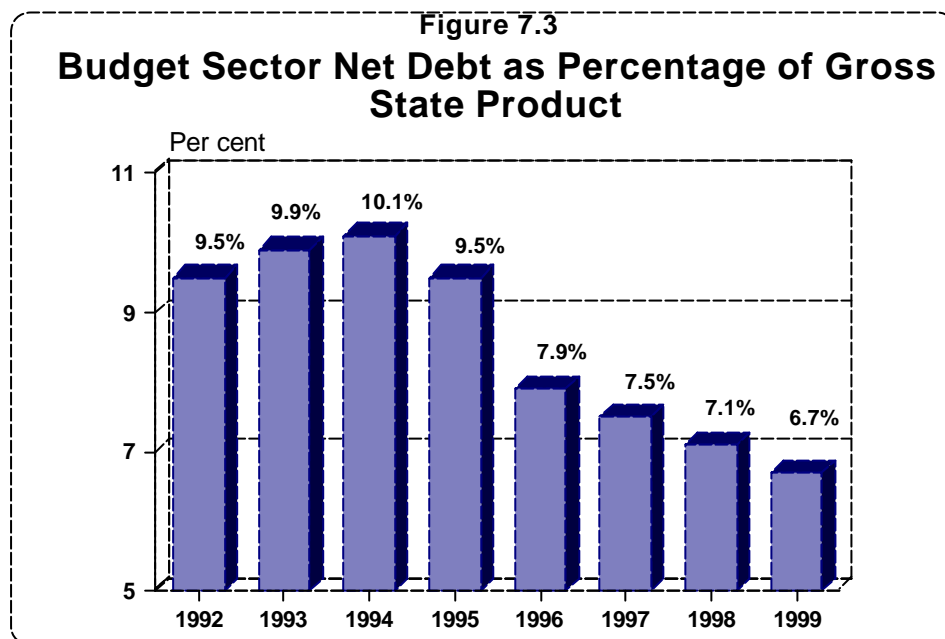
Table 7.4: Budget Sector Debt Management Performance

Year	Basis Points Variation From Neutral	Debt Saving/(Cost)
		\$m
1990-91	2.06	329
1991-92	0.41	67

1992-93	0.60	105
1993-94	(0.96)	(157)
1994-95	0.54	91

BUDGET SECTOR NET DEBT POSITION

The following graph highlights the recent history of the State's Budget Sector net debt levels over the four year period ended 30 June 1995 and forecast position for the four year period ending 30 June 1999.



BUDGET SECTOR INTEREST COSTS

Interest costs of the State are influenced by both average interest rates and variations in the level of debt.

Table 7.5: Trends in Interest Costs

		1991-92	1992-93	1993-94	1994-95	1995-96 (est)	1996-97 (est)
Debt Costs -							
Commonwealth Loans	\$m	738.7	647.1	507.0	462.7	349.0	307.0
Other Loans	\$m	1,131.5	1,224.1	1,218.5	1,240.6	1,153.0	1,121.0
		1,870.2	1,871.2	1,725.5	1,703.3	1,502.0	1,428.0

Debt Costs as percent of -

Budget Sector Receipts	%	11.2	10.6	9.0	8.5	7.0	6.4
Gross State Product	%	1.38	1.34	1.17	1.08	0.90	0.81

Estimated reductions in interest costs are mainly due to the retirement of debt utilising electricity industry equity restructure payments.

TCORP REVIEW

A review of TCorp's role was commissioned by the Treasurer during the financial year. The key issue addressed was the role and function of TCorp including whether the existing functions are consistent with the core role.

As a result of this review the following new guidelines have been established for TCorp involving -

- focus on TCorp's central role of issuing debt and managing State debt and financial assets;
- elimination of risks that do not relate to TCorp's core role; and
- support for the Government's credit rating by lowering overall financial risk exposure.

TCorp will in future focus on serving its 81 public sector clients.

7.3 SUPERANNUATION

KEY STRATEGIES

A fundamental component of the Government's fiscal reforms is the effective management of the State's public sector superannuation liabilities. This involves the reduction and eventual elimination of the State's unfunded superannuation liabilities. To achieve this goal, the following strategies are being gradually implemented -

- to fully fund accruing superannuation liabilities in respect of current service of public sector employees; and
- to make regular contributions towards past service unfunded liabilities.

These strategies are consistent with the principles set out in the General Government Debt Elimination Act. As required by Fiscal principle No. 3 of this Act, the Government aims to -

- phase in full funding of accrued past service employer superannuation liabilities of both the general government and public trading enterprise sectors to eventually eliminate all unfunded liabilities. According to current projections, this will be achieved by 2044-45; and
- phase in full funding of accruing current service employer superannuation liabilities of both the general government and public trading enterprise sectors. With respect to Budget Sector agencies this will be achieved by 2019-20, according to current projections. Non Budget Sector agencies and commercial activities of Budget Sector agencies, on the other hand, are already required to fully fund their current service superannuation costs.

Progress towards the implementation of the above funding policies commenced in 1992, with the establishment of the First State Super (FSS) scheme and the closure of the State Authorities Superannuation Scheme (SASS) and the State Authorities Non-contributory Superannuation (SANCS) scheme, otherwise known as the Basic Benefit scheme.

CURRENT DEVELOPMENTS

Superannuation Administration Review

A comprehensive review of the structural and legislative arrangements for the administration of superannuation in the New South Wales public sector was initiated by the Government in May 1995. The main purpose of the review was to clarify the roles and responsibilities of the State Authorities Superannuation Board (SASB) and the State Superannuation Investment and Management Corporation (SSIMC), which is the funds manager and scheme administrator.

The Government has endorsed the recommendations made by the Working Party which conducted the Review. The major recommendations are -

- The funds management and scheme administration activities of the SSIMC will be separated and carried out by two new agencies;
- The role of the trustee will be separated from the service delivery functions carried out by the funds manager and scheme administrator;
- A new trustee board will be established for the State's two accumulation schemes which are the FSS and the Public Sector Executives Superannuation Scheme (PSESS); and
- The SASB will continue as trustee for the closed defined benefit schemes (the Pooled Fund).

The restructure of public sector superannuation in New South Wales is expected to provide the following benefits -

- the separation of funds management and scheme administration activities will provide the trustee boards and the Government with the capacity to apply a more focused, accountable and cost effective approach to service provision;
- the creation of separate trustee boards for the Pooled Fund and for the accumulation schemes will allow them to eventually become fully compliant with the Commonwealth's Superannuation Industry Supervision Act. It will also allow the different strategies and exposures associated with these schemes to be recognised and fully addressed; and
- despite the increased flexibility of operations to be provided under the revised arrangements, the Government will continue to have the last resort authority to ensure that the financial exposure of the Pooled Fund and the State is properly managed.

Local Government and Electricity Authorities Super Schemes

Consideration is being given to the appropriateness and feasibility of establishing separate superannuation schemes for Local Government and electricity authorities employees. A working party is considering a number of technical issues that need to be resolved before a final policy decision can be made.

Review of University Employee Superannuation Costs and Liabilities

Some employees of universities and former Colleges of Advanced Education in New South Wales have remained members of State public sector superannuation schemes, rather than transfer to the Superannuation Scheme for Australian Universities (SSAU).

Under the current cost sharing arrangements between the Commonwealth and New South Wales, the State meets about half of the annual benefit payments associated with these employees.

In light of the financial reforms adopted by New South Wales, a review is needed to clarify the allocation of liabilities between the Commonwealth and the State, so that an appropriate funding policy can be developed. New South Wales has requested the Commonwealth to undertake such a review with the participation of the other jurisdictions. It is expected that the review will commence in 1996-97.

Allocation of Contributors' Reserve in the State Superannuation Scheme

The Actuarial Investigation of the Pooled Fund, as at 30 June 1994, indicated that there is approximately \$1,000 million held in the Contributors' Reserve in the Pooled Fund. Of this amount, it is estimated that around \$600 million belongs to employers and about \$400 million belongs to employees.

This amount was first identified in the 1992 Triennial Actuarial Review. The bulk of the \$1,000 million arose in 1989-90 during the disaggregation of the one consolidated Reserve Account for all employers into separate Reserve Accounts for individual employers.

The Government proposes to amend the Superannuation Act 1916 to enable the allocation of these amounts to individual employers and employees. The allocation to individual employers is expected to be a straight forward process. The allocation to employee beneficiaries, however, will depend on decisions of the trustee board with regard to an effective and equitable methodology for allocation.

Pacific Power and State Rail Authority (SRA) Unfunded Liabilities

In line with the Government's Competition Reform Policy, Pacific Power was restructured on 1 March 1996 and a restructure of the SRA will take effect on 1 July 1996.

The restructure of Pacific Power resulted in the creation of two new corporatised power generation companies. A majority of Pacific Power employees were transferred to the new generation companies, with the balance remaining at Pacific Power.

The unfunded liabilities (about \$330 million) associated with the transferred staff has been assumed by the Consolidated Fund, to enable the new commercial entities to start on a fully funded basis with respect to their superannuation liability.

In the case of the SRA, the restructure will result in the creation of four new entities including two new State Owned Corporations. Consistent with the approach taken in relation to Pacific Power, the SRA employees will be transferred to the new corporations on a fully funded basis. This will result in the Consolidated Fund assuming about \$1,100 million of unfunded liabilities associated with the transferred staff.

These restructures have increased Budget Sector unfunded liabilities by a total of around \$1,430 million (as reflected in Figure 7.4). As a result, the funding plan to extinguish Budget Sector unfunded superannuation liabilities will be increased by about \$85 million in 1996-97. For subsequent years this amount will be increased by the CPI until 2010, after which time payments will be held constant until the liability is extinguished in 2044-45.

NEW SOUTH WALES PUBLIC SECTOR SUPERANNUATION SCHEMES

Over the last decade, there has been a general move in the public sector throughout Australia away from expensive and inflexible defined benefit superannuation schemes towards less costly, more flexible accumulation schemes. Consequently, defined benefit schemes have been closed to new entrants in most Australian jurisdictions.

In New South Wales, the closed defined benefit schemes are the State Superannuation Scheme (SSS), the SASS scheme, the SANCS scheme and the Police Superannuation Scheme (PSS). These schemes are components of the Pooled (Superannuation) Fund.

The Commonwealth Government's Superannuation Guarantee (Administration) Act 1992 prescribes the minimum level of superannuation support that must be provided by employers for all employees. The FSS is a fully funded accumulation scheme that was introduced in 1992 to meet these requirements.

LIABILITIES OF NEW SOUTH WALES PUBLIC SECTOR SCHEMES

In the past, successive Governments have adopted a policy of largely funding public sector superannuation liabilities on an emerging payment basis. That is, the cost of the benefits was met when the benefits were paid. Additionally, some improvements were made to benefits without accompanying increases in employer or employee contributions.

Consequently, New South Wales, like the Commonwealth and most other States, has accumulated substantial unfunded liabilities. A significant portion of unfunded liabilities relates to the Budget Sector, which has increased from \$7.7 billion in 1988-89 to \$13.4 billion (including about \$330 million assumed from Pacific Power) in 1995-96.

However, as a result of the Government's move towards full funding of employee entitlements, combined with an expected improvement in fund investment earnings, the latest actuarial estimates indicate that the level of unfunded liabilities (in real terms) will decline marginally over the long term.

This is illustrated by Figure 7.4, which shows that by June 2006 unfunded liabilities for the Budget Sector is forecast to be about \$10.9 billion expressed in 30 June 1996 dollars. This represents a real decrease of \$2.5 billion from the level as at 30 June 1996. This result is conditional on the actuarial assumptions underlying the forecast being borne out in practice.

The increase in Budget Sector unfunded liabilities shown on Figure 7.4 for the years 1995-96 and 1996-97, is mainly due to the fact that in 1995-96 the Consolidated Fund assumed \$330 million of Pacific Power's unfunded liabilities and in 1996-97, it will assume \$1,100 million of the SRA's unfunded liabilities. The rationale for this is explained in the earlier part of this chapter.

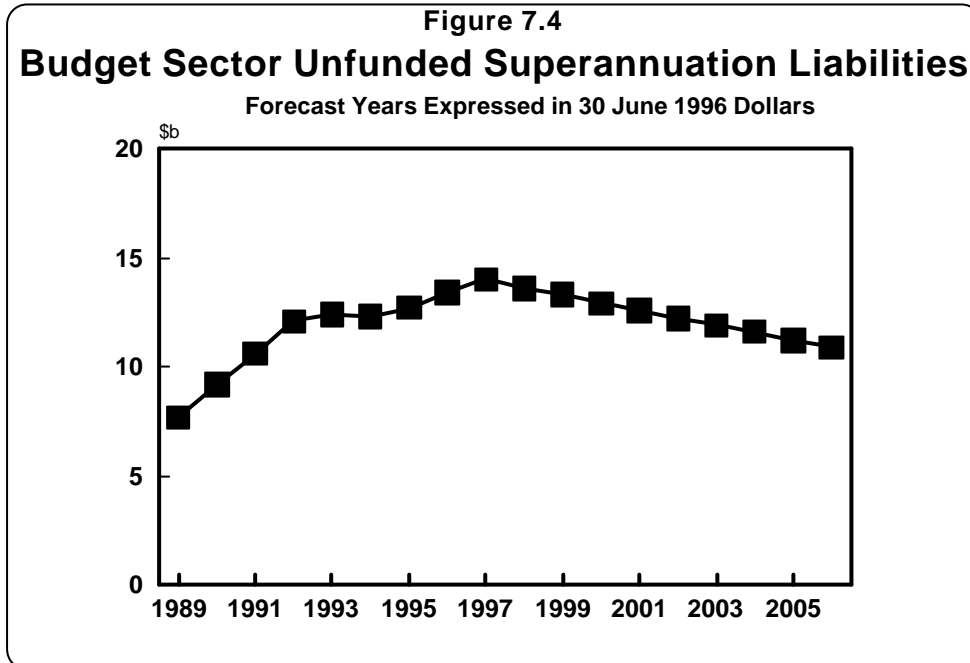


Table 7.6 shows a 5 year history of the estimated employer unfunded liabilities net of employer reserves. The figures for 1995-96 reflect the Pacific Power unfunded liabilities being transferred from the Non Budget Sector to the Budget Sector (ie assumed by the Consolidated Fund). Between 1994-95 and 1995-96 the increase in net unfunded liabilities of the total NSW public sector is estimated to be 1.7 percent. However, as a proportion of Gross State Product (GSP), unfunded liabilities have been declining for both the Budget Sector and the Non Budget Sector.

Table 7.6: Net Unfunded Liabilities of NSW Public Sector Superannuation Schemes as at 30 June

		1992	1993	1994	1995	1996 (a)
Budget Sector -						
4 closed schemes	\$m	11,319	11,662	11,476	11,837	12,654
other (b)	\$m	767	769	774	850	716
Total Budget Sector	\$m	12,086	12,422	12,250	12,687	13,370
Non Budget Sector	\$m	2,458	2,359	2,188	2,004	1,566
Total State Public Sector	\$m	14,544	14,790	14,438	14,691	14,936
Proportion of Gross State Product -						
Unfunded liabilities (Total)	%	10.7	10.6	9.8	9.3	8.9
Unfunded liabilities (Budget)	%	8.9	8.9	8.3	8.1	8.0
Unfunded liabilities (Non Budget)	%	1.8	1.7	1.5	1.2	0.9

(a) Unfunded liability figures are based on NSW Government Actuary's 1996 estimate.

(b) Includes JPS, PCSF and State's share of NSW university employees' unfunded liabilities.

In total terms, net unfunded liabilities as a percentage of GSP has declined from 10.7 per cent in 1992 to 8.9 per cent in 1996. As a result of the Government's current policy regarding the management of superannuation liabilities, this trend should continue over the long term provided there are no significant adverse movements in fund earnings, wage rates or CPI.

Table 7.7 shows the average cost to employers of the major schemes based on 1995-96 actuarial estimates.

Table 7.7: Employer Cost of Major Public Sector Superannuation Schemes

Scheme	Employer Cost as a Percentage of Salary
First State Superannuation Scheme	6.0 to 9.0 ~
State Authorities Superannuation Scheme	8.5 *
State Superannuation Scheme	9.2 *
Police Superannuation Scheme	20.0 *

~ Currently 6.0 per cent increasing to 9.0 per cent by the year 2002.

* Does not include 3 per cent entitlement under Basic Benefit Scheme.

SUPERANNUATION FUNDING

Budget Sector

Table 7.8 provides a breakdown of payments made by the Consolidated Fund into public sector superannuation schemes for the period 1992-93 to 1996-97. The total payment in 1996-97 is projected to be \$1,304.5 million. This represents a projected increase of \$227.4 million compared to 1995-96 and is largely explained by two factors.

Firstly, it reflects an increase in the amount of contribution that needs to be made over and above benefit payments, in line with the long term funding plan to gradually extinguish past service unfunded liabilities by 2044-45. Secondly, it reflects the funding increase that is required (about \$65 million) to ensure that the additional \$1.1 billion of unfunded superannuation liabilities assumed by the Crown on 1 July 1996 (relating to the restructure of the SRA) will also be extinguished by 2044-45.

Table 7.8: Payments by the State into Public Sector Superannuation Schemes

	Actual	Actual	Actual	Estimated	
	1992-93	1993-94	1994-95	Actual	Estimate
	\$m	\$m	\$m	\$m	\$m
First State Superannuation Scheme	96.5	117.2	150.7	174.9	221.9
The Pooled Fund ^(a)	715.3	848.0	846.8	865.0	1,042.6
Other ^(b)	31.4	32.8	34.5	37.2	40.0
TOTAL	843.2	998.0	1,032.0	1,077.1	1,304.5

(a) Includes SSF, SASS, PSS and SANCS schemes.

(b) Includes JPS, PCSF and the State's share of NSW university employees' unfunded liabilities.

A key element of the Government's strategy to reduce unfunded superannuation liabilities over the medium term is to make cash contributions into the four closed superannuation schemes higher than emerging benefit payments.

Based on the latest actuarial advice, the Government's cash payments into the closed schemes will need to be greater than benefits payments by about \$3.4 billion (in 30 June 1996 dollars) over the 10 year period 1996-97 to 2005-06. The effect of this funding strategy is to set future cash payments at a level which, after adjustment for inflation and allowing for the existing level of reserves, will effectively extinguish Budget Sector unfunded liabilities relating to the closed schemes by the year 2044-45.

Non Budget Sector

Consistent with the Government's overall liability management strategy, Non Budget Sector agencies and commercial activities of Budget Sector agencies are required to fully fund their current service costs which represent the employers' obligation in respect of employees' service during the year. This is achieved by making employer superannuation contributions at rates equal to the full funding multiples which are actuarially determined every three years.

An additional requirement placed on commercial authorities is to develop a plan to fully fund their superannuation liabilities arising from employees' past service, over a period not exceeding 30 years and taking into account the age profile of fund members. Most authorities have complied with this requirement resulting in a reduction in their unfunded liabilities over time, as shown at Table 7.6.