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The report on financial position, from which this extract of pages 8 and 9 has been taken, was prepared by the late Mr Allan Archer and it includes a description of the effect that the rule changes, made on 28 June 2002, had on the financial position of the scheme. The paragraphs (a) and (b) on page 8 are most pertinent.

Paragraph (a) reports that poor investment returns in 2001/2 placed a 'substantial strain' on the defined benefit schemes, particularly the pension scheme. Paragraph (b) then reports that this financial strain was 'more than counterbalanced by the impact of tax reductions to benefits.' This is a clear indicator that smaller benefit reductions would have been sufficient to meet the additional tax cost and that the actual benefit reductions have met the cost of making up for the poor investment returns as well. One might expect this to have led the EISS Board to suspect that the Treasurer's rule changes were reducing employer costs.

In a defined benefit scheme the employer carries the investment risk. When returns are better than expected the employer gets the advantage, not members, and when returns are worse than expected the employer must make up the difference through additional contributions if necessary. It is the job of a Trustee to ensure that members of defined benefit schemes do not have their benefits reduced to compensate employers for a year of poor investment returns.

Paragraph (b) includes the statement:

'Overall the tax reductions do not alter employer costs. However, they have reduced the immediate funding targets, by reducing the benefits built up to date by more than the assets.'

This raises the question – how is it possible for the employer's immediate funding targets to be reduced without that reducing overall employer costs? **Until a credible answer has been given to this question EISS pension division members are entitled to claim that their pensions have been reduced excessively.**

Omb pensions
S.A.

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MERCER
Human Resource Consulting

**ELECTRICITY INDUSTRY**

**REPORT ON THE FINANCIAL POSITION**
**OF THE PART OF THE SCHEME RELATING TO**
**ETSA UTILITIES**
**AS AT 30 JUNE 2002**

# APPENDICES

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# 4. APPENDIX 4: Comparison with Previous Year

The following table compares the assets against benefits as at 30 June 2002 with the corresponding position as at 30 June 2001.

| Assets as a % of - | 30/6/01 | 30/6/02 |
|---|---|---|
| - vested benefits | 101% | 107% |
| - benefit liabilities | 101% | 106% |

The principal causes of the changes in the percentages are as follows:

(a) **Investment earnings:** The investment earnings of the Scheme over 2001/02 was minus 7.7%. This was around 15% lower than the average return previously expected. This put a substantial strain on the Scheme's financial position in respect of the defined-benefit sections of the Scheme – principally the Pension Scheme and, to a lesser extent, the Lump Sum Scheme.

(b) **Tax Changes:** As it turned out, the financial strain from negative investment earnings was more than counterbalanced by the impact of tax reductions to the benefits. Overall the tax reductions do not alter employer costs. However they have reduced the immediate funding targets, by reducing the benefits built up to date by more than the assets.

Overall the financial position based upon the tests improved over the year to 30 June 2002.

- ***Scheme-by-Scheme Comparison***

The following table compares the assets held for each sub-Scheme as a percentage of benefits liabilities of that sub-Scheme.

| Scheme | Assets as % of Benefit Liabilities | |
|---|---|---|
| | 30/6/01 | 30/6/02 |
| Lump Sum | 98% | 111% |
| Pension | 102% | 103% |
| RG | 102% | 104% |
| Accumulation | 98% | 109% |
| **Total** | **101%** | **106%** |

The effect of low investment earnings has been cushioned by the fact that around one-third of the assets counted in the calculations relate to **future** Government-guaranteed contributions whose value has not fallen.

This latter point concerning the future Government-guaranteed contributions has caused an **increase** in the funding level where the liabilities are all linked to investment earnings. For instance, in the **Accumulation Scheme**, the benefits have all declined on account of the minus 7.9% crediting rate for 2001/02, whereas only the invested assets have declined by this figure. Thus the funding level has risen from 98% to 109%.

The **Lump Sum Scheme** percentage has risen from 98% to 111% for a similar reason, as a substantial part of its liabilities are linked to investment earnings.

In the **RG Scheme**, the percentage has increased to a smaller extent as this Scheme has a higher proportion of liabilities linked to salaries (through the operation of the salary-cap on the main employer-financed benefit).

In the **Pension Scheme**, the improvement has been counterbalanced by the fact that practically all of the benefits in the Pension Scheme are linked to salaries, which are assumed to increase, while the invested assets have fallen in value.

The comparison is also affected by the differing impact of the benefit reductions that occurred during the year. These reductions are related to the change in the taxation status of the Scheme, and affect each division (and often, member) differently.