

Local Authorities Superannuation Fund

Annual Financial Report
30 June 2014

Contents

	Page
Statement of net assets	1
Statement of changes in net assets	2
Notes to the financial statements	3
Trustee declaration	33
Independent report by approved auditor to the trustee and members	34
Actuary's statement	

Local Authorities Superannuation Fund

**Statement of net assets
as at 30 June 2014**

	<i>Note</i>	2014 \$000	2013 \$000
ASSETS			
Cash at bank and cash equivalents		16,737	48,754
Other receivables		1,074	3,143
Prepayments		-	1,500
Contributions receivable	10	10,805	166,275
Deferred tax assets	13	5	8
Investments			
Units in Vision Pooled Superannuation Trust	17	6,889,588	5,384,465
Total assets		6,918,209	5,604,145
LIABILITIES			
Benefits payable		21,878	15,961
Other payables		3,491	535
Amounts held in trust		383	392
Current tax liabilities	12	63,899	95,254
Deferred tax liabilities	13	1,495	24,951
Total liabilities		91,146	137,093
Net assets available to pay benefits		6,827,063	5,467,052

The above Statement of net assets is to be read in conjunction with the accompanying notes.

Local Authorities Superannuation Fund
Statement of changes in net assets
for the year ended 30 June 2014

	<i>Note</i>	2014 \$000	2013 \$000
Revenue			
Investment revenue			
Changes in net market value of investments	8	<u>629,554</u>	610,926
		629,554	610,926
Contributions revenue			
Employer contributions		315,759	337,120
Member contributions		82,580	59,255
Transfers from other funds		<u>929,288</u>	86,733
		1,327,627	483,108
Other revenue			
Group life insurance proceeds		6,597	3,469
Other revenue		<u>629</u>	2,880
		7,226	6,349
Total revenue		<u>1,964,407</u>	1,100,383
Expenses			
Benefits paid		<u>(520,245)</u>	(422,609)
General administration expenses	9	<u>(27,053)</u>	(21,016)
Group life insurance premium expense	16	<u>(16,236)</u>	(14,360)
Superannuation contributions surcharge		<u>(11)</u>	(8)
Total expenses		<u>(563,545)</u>	(457,993)
Change in net assets before income tax		1,400,862	642,390
Income tax expense	11	<u>(40,851)</u>	(44,467)
Change in net assets after income tax		<u>1,360,011</u>	597,923
Net assets available to pay benefits at the beginning of the year		<u>5,467,052</u>	4,869,129
Net assets available to pay benefits at the end of the year		<u>6,827,063</u>	5,467,052

The above Statement of changes in net assets is to be read in conjunction with the accompanying notes.

Notes to the financial statements for the year ended 30 June 2014

1. Background

(a) Operation of the Fund

Local Authorities Superannuation Fund (the "Fund") is a superannuation fund domiciled in Australia. The address of the Fund's registered office is Level 15, 360 Collins Street in Melbourne.

The Fund's governing rules are contained within the Local Authorities Superannuation Fund Trust Deed dated 26 June 1998. The Fund was established to provide superannuation benefits for members. The majority of the Fund's members and participating employees are from the local government, water and community services sectors.

The Trustee of the Fund is Vision Super Pty Ltd (VSPL). VSPL is the holder of an extended public offer class Registrable Superannuation Entity Licence (licence no. L0000239). In accordance with amendments to the Superannuation Industry (Supervision) Act 1993, the Fund was registered with the Australian Prudential Regulation Authority on 12 December 2005 (registration no. R1000603).

The Fund is a standard employer-sponsored fund with both a defined benefit section, accumulation section and pension arrangements. The defined benefits section of the Fund was closed to new entrants from 31 December 1993, with all new entrants joining the accumulation/pension section of the Fund as appropriate.

(b) Reporting entity

Previously, the Fund presented consolidated financial statements which included its subsidiary Vision Pooled Superannuation Trust. However, as the Fund has elected to adopt AASB10 *Consolidated Financial Statements* and AASB 2013-5 *Amendments to Australian Accounting Standards – Investment Entities* as discussed in Note 2(c)(i) below, the Fund is no longer required to prepare consolidated financial statements. Consequently, the reporting entity for the current and prior period for the purposes of these financial statements is the Fund only.

(c) Merger of the Fund

On 30 June 2014, the Fund merged with the Vision Superannuation Fund. In accordance with the Successor Fund Transfer Deed dated 27 May 2014, all assets and liabilities of the Vision Superannuation Fund were transferred to the Fund as at 30 June 2014. Note 20 provides details of the assets and liabilities transferred into the Fund.

2. Summary of significant accounting policies

(a) Basis of preparation

The financial statements are a general purpose financial report which has been prepared in accordance with Australian Accounting Standard AAS 25 *Financial Reporting by Superannuation Plans*, other applicable Accounting Standards, the provisions of the Trust Deed and the requirements of the Superannuation Industry (Supervision) Act 1993 and Regulations.

The financial statements are presented in Australian Dollars and all values are rounded to the nearest thousand dollars except where otherwise stated.

(b) Statement of compliance

The financial statements comply with AAS 25. Since AAS 25 is the principal standard that applies to the financial statements, other standards, including AIFRS, are also applied where necessary except to the extent that they differ from AAS 25.

Notes to the financial statements for the year ended 30 June 2014

2. Summary of significant accounting policies (continued)

(b) Statement of compliance (continued)

International Financial Reporting Standards ("IFRS") form the basis of Australian Accounting Standards adopted by the AASB. Certain requirements of AAS 25 however differ from the equivalent requirements that would be applied under IFRS.

The financial statements were authorised for issue by the Directors of the Trustee, Vision Super Pty Ltd, on 26 September 2014.

(c) Change of accounting policies

The Fund has early adopted AASB10 *Consolidated Financial Statements* and the amendment thereto AASB 2013-5 *Amendment to Australian Accounting Standards – Investment Entities*. As required under these standards, AASB 12 *Disclosure of Interests in Other Entities* has been adopted at the same time with an initial application of 1 July 2013. These standards have a mandatory effective date of adoption for reporting periods commencing on or after 1 January 2013 (and 1 January 2014 for AASB 2013-5) with early adoption available.

The Fund has also adopted AASB 13 *Fair Value Measurement* effective from 1 July 2013.

Adoption of the above standards has had no significant impact to the financial performance or position of the Fund. However, additional disclosures have been included in the Notes to the financial statements.

The nature and the impact of each new standard and amendment is described below:

(i) Consolidated financial statements and investment entities amendments

AASB 10 *Consolidated Financial Statements* replaces the portion of AASB 127 *Consolidated and Separate Financial Statements* that addresses the accounting for consolidated financial statements. AASB 10 establishes a single control model that applies to all entities including special purpose entities.

In addition, AASB 10 includes an exception from consolidation for entities that meet the definition of an investment entity and requires such entities to recognise all investments at fair value through profit or loss.

The Fund has adopted AASB 10 *Consolidated Financial Statement* and AASB 12 *Disclosure of Interests on Other Entities* from 1 July 2013. In addition, the Fund meets the definition of an investment entity and therefore has also early adopted the investment entity exception in AASB 10 and AASB 12 and from 1 July 2013.

As a result of the adoption of AASB 10 including the early adoption of the AASB 2013-5 investment entity exception, the Fund has changed its accounting policy with respect to determining whether it has control over and consequently whether it consolidates its investees. AASB 10 introduces a new control model that is applicable to all investees. However, where an entity meets the definition criteria of an investment entity, it is not required to consolidate its investees, but must recognise and measure such investments at fair value through profit and loss.

An entity is an investment entity if it:

- 1) obtains funds from one or more investors for the purpose of providing those investor(s) with investment management services;
- 2) commits to its investor(s) that its business purpose is to invest funds solely for returns from capital appreciation, investment income, or both; and
- 3) measures and evaluates the performance of substantially all of its investments on a fair value basis.

Notes to the financial statements for the year ended 30 June 2014

2. Summary of significant accounting policies (continued)

(c) Change of accounting policies (continued)

(i) Consolidated financial statements and investment entities amendments (continued)

As the definition of investment management services is very broad, the Fund satisfies this definition. The Fund invests to obtain returns from capital appreciation and investment income. While the Fund is required to use net market value under AASB 25 for its investments, there is minimal difference between the fair value of its investments compared to the net market value. On this basis, the Fund meets the valuation criteria of the definition of investment entity. As a result, the Fund has early adopted the AASB 10 and AASB 2013-5 investment entity exception.

In accordance with the transitional provisions of the amendments, the Fund has applied the new accounting policy retrospectively and restated comparative information. Accordingly, investments in Vision Pooled Superannuation Trust (VSPT) are no longer being consolidated but recognised as financial assets at fair value through profit or loss.

The change in accounting policy resulted in no adjustments to the net asset available to pay benefits. Note 22 presents, in respect of the period immediately preceding the date of initial application, the resulting changes as previously reported in the consolidated financial statements. The transitional provisions of the amendments do not require disclosure of similar information in respect of the current year.

(ii) Fair value measurement

AASB 13 *Fair Value Measurement* establishes a single framework for measuring fair value and making disclosure about fair value measurements when such measurements are required or permitted by other AASBs. It unifies the definition of fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. It replaces and expands the disclosure requirements about fair value measurements in other AASBs, including AASB 7. As a result, the Fund has included additional disclosures at Note 17(a) in these financial statements.

(d) Significant accounting judgements, estimates and assumptions

The preparation of the Fund's financial statements requires management to make judgements, estimates and assumptions that affect the application of accounting policies and the reported amounts of assets and liabilities, income and expenses. Actual results may differ from these estimates.

Significant accounting judgements, estimates and assumptions are reviewed on an ongoing basis. If there are revisions to accounting estimates, they are recognised in the period which the estimate is revised and in any future period affects.

In particular, information about significant areas of estimation, uncertainty and critical judgements in applying accounting policies and have the most significant effect on the amounts recognised in the financial statements are listed below:

Deferred Tax Asset recognition - The significant accounting judgements are discussed in Note 2(m).

Valuation of Accrued Benefits - The amount of accrued benefits has been actuarially determined. The key assumptions are discussed in Note 4, 6 and 7.

Valuation of Investments - The key assumptions are set out in Note 2(e) and Note 18(a).

Notes to the financial statements for the year ended 30 June 2014

2. Summary of significant accounting policies (continued)

(e) Financial assets and financial liabilities

Financial assets and financial liabilities are included in the Statement of net assets at net market value as at reporting date and movements in the net market value of assets and liabilities are recognised in the Statement of changes in net assets in the periods in which they occur.

The Fund recognises financial assets and liabilities on the date it becomes a party to the contractual provisions of the instrument. Purchases or sales of financial assets that require delivery of assets within the time frame generally established by regulation or convention in the marketplace are recognised on the trade date, i.e., the date that the Fund commits to purchase or sell the asset. From this date, any gains or losses from changes in net market value are recorded.

While the Fund uses net market value to record the value of its investments, the net market value is not materially different to the fair value of those assets. Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date in the principal, or in its absence, the most advantageous market to which the Fund has access at that date.

Estimated costs of disposal have been deducted in determining net market value. As disposal costs are generally immaterial, unless otherwise stated net market value is considered a reasonable approximation of fair value.

The best evidence of the net market value of a financial asset at initial recognition is normally the transaction price – the fair value of the consideration given.

Net market values of investments have been determined as follows:

Units in pooled superannuation trust

Units in pooled superannuation trusts are valued at the redemption price at reporting date quoted by the Trustee of the pooled superannuation trust. This redemption price is based on the net market value of the underlying investments of the pooled superannuation trust.

(f) Cash and cash equivalents

Cash and cash equivalents in the Statement of net assets comprise cash at bank and short-term deposits with an original maturity of three months or less that are readily convertible to cash and subject to an insignificant risk of changes in value.

(h) Benefits payable

Benefits payable are valued at net market value which comprises the entitlements of members who have claimed a benefit prior to the end of the year and the entitlement had not been paid at reporting date. Benefits entitlements rolled over within the Fund are not included as benefits payable. Benefits payable are generally settled within 30 days.

(i) Accrued benefits

For defined benefit members, the amount of accrued benefits has been determined on the basis of the present value of expected future payments which arise from membership of the Fund up to the measurement date. The figure reported has been determined by reference to expected future salary levels, an expected future fund earning discount rate determined by the fund actuary and other relevant actuarial assumptions. Refer to Note 4 for disclosure of accrued benefits.

Notes to the financial statements for the year ended 30 June 2014

2. Summary of significant accounting policies (continued)

(i) Accrued benefits (continued)

For defined contribution members, the liability for accrued benefits is the Fund's present obligation to pay benefits to members and beneficiaries.

This has been calculated as the difference between the carrying amount of the assets and the carrying amounts of the sundry liabilities and income tax liabilities as at balance date.

(j) Other payables

Other payables are carried at nominal amounts which approximate net market value. They represent liabilities for goods and services provided to the Fund prior to the end of the financial year that are unpaid when the Fund becomes obliged to make future payments in respect of the purchase of these goods or services. Payables are normally settled on 30 day terms.

(k) Foreign currency

The functional and presentation currency of the Fund is Australian dollar. There are no foreign currency transactions or items.

(l) Revenue recognition

Revenue is recognised to the extent that it is probable that the economic benefits will flow to the Fund and the revenue can be reliably measured. The following specific recognition criteria must also be met before revenue is recognised.

(i) Changes in net market values

Changes in the net market value of investments and derivatives are calculated as the difference between the net market value at sale, or at balance date, and the net market value at the previous valuation point and recognised in the Statement of change in net assets.

(i) Contributions revenue and transfers in

Contributions revenue and transfers in are recognised when control of the asset has been attained and are recorded, gross of any tax, in the period to which they relate.

Contribution revenue includes the funding call for the unfunded liability of the defined benefits plan and its interest component. The participating employers in the defined benefits plan are compelled by Participation Agreements with the Fund's Trustee to make contributions and fund the deficit.

(ii) Interest revenue

Interest income is recognised in the Statement of change in net assets as it accrues on the amount of cash at bank.

(m) Income tax

Income tax on the benefits accrued as a result of operations for the year comprises current and deferred tax. Income tax is recognised in the Statement of changes in net assets except to the extent that it relates to items recognised directly in members' funds in which case it is recognised directly in members' funds.

Notes to the financial statements for the year ended 30 June 2014

2. Summary of significant accounting policies (continued)

(m) Income tax (continued)

Current tax is the expected tax payable on the taxable income for the year using tax rates enacted or substantively enacted at the reporting date and any adjustment to tax payable in respect of previous years.

Deferred tax is provided using the balance sheet method, providing for temporary differences between the carrying amount of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes. The following temporary differences are not provided for: goodwill, the initial recognition of assets and liabilities that affect neither accounting nor taxable profit, nor differences relating to investments in controlled entities to the extent that it is not probable they will reverse in the foreseeable future. The amount of deferred tax provided is based on the expected manner of realisation of the asset or settlement of the liability, using tax rates enacted or substantively enacted at reporting date.

A deferred tax asset is recognised only to the extent that it is probable that future taxable profits will be available against which the asset can be utilised. Deferred tax assets are reviewed at each reporting date and are reduced to the extent it is no longer probable that the related tax benefit will be realised.

Income tax has been provided in the current year at the rate of 15% as it is the expectation of the Trustee that the Fund will be treated as a complying superannuation fund and its subsidiary VPST's taxable income is "standard income". If the Fund is subsequently deemed to be a non-complying fund for the current year or VPST has "special income", then income tax will be payable at a rate of 45% on the Fund's taxable income.

The expense (and any corresponding liability) is brought to account in the period in which the assessments are received by the Trustee and are payable by the Fund.

(n) Derecognition of financial assets and financial liabilities

A financial asset is derecognised when:

- the rights to receive cash flows from the asset have expired; or
- the Fund transfers substantially all the risks and rewards of the ownership of the assets; and
- the Fund has neither transferred nor retained substantially all the risks and rewards of the asset, but has transferred control of the asset.

The Fund derecognises a financial liability when the obligation under the liability is discharged, cancelled or expires.

(o) No-TFN contribution tax

Where a member does not provide their tax file number to a fund, the Fund may be required to pay no-TFN contributions tax at a rate of 31.50% which is in addition to the concessional tax rate of 15% which applies to the Fund's taxable income.

The no-TFN contributions tax liability recognised by the Fund will be charged to the relevant members' accounts. Where a tax offset is obtained by the Fund in relation to members' no-TFN contribution tax, the tax offset will be included in the relevant members' accounts.

(p) Goods and services tax

Revenue, expenses and assets are recognised net of the amount of goods and services tax (GST) recoverable from the Australian Taxation Office (ATO). In circumstances where the GST is not recoverable, the GST is recognised as part of the cost of acquisition of the asset or as part of the expense.

Notes to the financial statements for the year ended 30 June 2014

2. Summary of significant accounting policies (continued)

(p) Goods and services tax (continued)

Receivables and payables are stated with the amount of GST included.

The net amount of GST recoverable from, or payable to, the ATO is included as a current asset or liability in the Statement of net assets.

(q) Reclassification of financial information

Where necessary, comparative information has been reclassified to achieve consistency in disclosure with current financial year amounts and other disclosures.

(r) Valuation dates

The investment held in VPST has been valued at 30 June 2014 based on valuations obtained from the Custodian taking into account information received post balance date.

For accumulation members, the vested benefits value is based on members' accounts value which is determined by using the daily unit price applicable as at 30 June 2014.

For defined benefits members, the vested benefits value is determined in accordance with Trust Deed and takes into account the members' salary and years of service subject to the minimum requisite benefit threshold.

(s) New accounting standards and interpretations

A number of new standards, amendments to standards and interpretations are effective for annual periods beginning on 1 July 2014, and have not been applied in preparing these financial statements. Those which may be relevant for the Fund are:

AASB 1056 – Superannuation Entities

AASB 1056 replaces AAS 25 *Financial Reporting by Superannuation Plans*. The key changes are:

- The requirement to prepare financial statements which include a statement of financial position; an income statement, a statement of changes in equity; a statement of cash flows; and a statement of changes in member benefits.
- Recognising and measuring defined benefit obligations as liabilities.
- Defined contribution liabilities are measured as the amount of member account balances as at the reporting date.
- Measuring most assets and liabilities at fair value instead of net market value.
- Recognising contributions and benefits payments as movement in the defined contribution or defined benefit obligation rather than revenues or expenses.
- Significantly more disclosures, including deeming defined contribution member liabilities to be within the scope of AASB 7 in respect of credit risk, market risk or liquidity risk and extensive disclosures for defined benefit member liabilities.

The application date of the standard is 1 July 2016 and early adoption is permitted.

Notes to the financial statements for the year ended 30 June 2014

2. Summary of significant accounting policies (continued)

(s) New accounting standards and interpretations (continued)

Application of AASB 1056 will have a significant impact to the Fund's financial statements as stated above. On transition, comparatives are required to be restated as at 30 June 2016 as the standard is to be adopted retrospectively. Management will assess the new standard's impact on the Fund's financials statement in details and decide if the Fund will early adopt the standard for the reporting year ending 30 June 2015.

AASB 9 – Financial Instruments

AASB 9 includes requirements for the classification and measurement of financial assets. It was further amended by AASB 2010-7 to reflect amendments to the accounting for financial liabilities.

These requirements improve and simplify the approach for classification and measurement of financial assets compared with the requirements of AASB 139. The tentative application date of the standard is 1 January 2018. The standard may apply to the Fund for the reporting year ending 30 June 2019. Management has assessed the impact and concluded that there would be no material change in the financial statements by adoption of AASB 9.

3. Investment in subsidiary

The Fund has early adopted AASB 2013-5 *Amendments to Australian Accounting Standards – Investment Entities* as explained in Note 2(c)(i). As a result, the Fund does not consolidate its subsidiary; however it is required to provide certain disclosures, as outlined below:

Name of unconsolidated subsidiary	Principal place of business	Ownership interest (%)	2014 (\$)
Vision Pooled Superannuation Trust (VPST)	Australia	95.6%	6,889,588

The underlining financial assets/liabilities held by VPST are disclosed in the table below:

	2014 \$000	2013 \$000
Financial assets at fair value through profit or loss		
Asset backed securities	2,040	1,508
Cash and deposits	1,213,816	1,320,981
Discount securities	107	6,890
Fixed interest bonds	773,272	561,614
Floating rate notes	15,636	8,106
Indexed bonds	-	69,927
Life insurance policies	164,488	153,502
Listed equities	2,763,660	2,218,258
Listed investment companies	29,763	30,846

Notes to the financial statements for the year ended 30 June 2014

3. Investment in subsidiary (continued)

	2014	2013
	\$000	\$000
Listed property trusts	100,088	59,430
Listed unit trusts	167,388	34,765
Loans	3,487	4,208
Mortgage backed securities	2,637	-
Outstanding settles	31,223	56,674
Pooled development fund	1,336	4,333
Preference shares redeemable	6,688	5,870
Unlisted equities	300,753	279,419
Unlisted managed investment scheme	1,639,373	1,486,401
Unlisted partnership	10,503	16,669
Zero coupon bonds	-	108
FFX contracts	30,202	3,174
Warrants	30	3,138
Options	729	50
Futures	183	156
<i>Financial assets designated at fair value through profit or loss</i>	<u>7,257,402</u>	<u>6,326,027</u>

Financial liabilities at fair value through profit or loss

Financial liabilities designated at fair value through profit or loss

Cash and deposits	(149)	(2,090)
Listed equities	(363)	-
Outstanding settles	(21,953)	(28,784)
FFX contracts	(1,236)	(63,847)
Options	(40)	-
Futures	(15)	(693)
<i>Total financial liabilities designated at fair value through profit or loss</i>	<u>(23,756)</u>	<u>(95,414)</u>
Net assets held by VPST at fair value through profit or loss	<u>7,233,646</u>	<u>6,230,613</u>

4. Accrued benefits

The valuation of accrued benefits was undertaken by the Actuary as part of a comprehensive actuarial valuation as at 31 December 2011. Accrued benefits were previously valued as part of an actuarial review as at 31 December 2008. A summary of the Actuarial Report as at 31 December 2011, prepared by the Fund's actuary from Russell Employee Benefits, is attached as an addendum.

	As at 31 December 2011 \$000	As at 31 December 2008 \$000
Accrued Benefits	<u>4,642,133</u>	<u>3,616,422</u>

Notes to the financial statements for the year ended 30 June 2014

4. Accrued benefits (continued)

The Trustee has a number of steps in place to manage the risks associated with the defined benefit plan. The Trustee has appointed an external actuary to advise on these risks, including establishing suitable funding objectives. The Fund Actuary conducts regular (at least every three years, or more frequently as required) actuarial investigations of the defined benefit plan at the Trustee's request. Taking into account the Trustee's funding objectives and the Fund's circumstances, the Fund Actuary recommends the employers' required contribution levels.

Funding requirements for the Fund are impacted by various financial and demographic factors including investment earnings, salary inflation, benefit claims experience and pensioner mortality rates. The funding arrangements are primarily dependent upon investment performance relative to salary growth and pension growth. The Fund has a current Funding and Solvency Certificate. The next actuarial review for the Fund is as at 30 June 2014 and is currently scheduled completion by 19 December 2014.

The main financial assumptions used to calculate the accrued benefits for the defined benefit categories of the Fund are as follows:

Net investment return	7.50% p.a.
Salary inflation	4.25% p.a.
Price inflation	2.75% p.a.

The Fund's Actuary on completion of the 31 December 2011 actuarial review of the Fund recommended that participating employers pay an additional contribution to the level discussed in Note 7 due to the funding deficiency identified as at 31 December 2011.

The Trustee accepted the actuarial recommendations and informed the employers of the Defined Benefit plans of their share of the unfunded liability as at 31 December 2011.

For the LASF Defined Benefit Plan, the invoices issued were due and payable on 1 July 2013 with an option of a fifteen-year payment plan. The total invoiced amount was \$539 million, which comprised the unfunded accrued liability as at 31 December 2011 of \$406 million, estimated fund earnings accrued to 1 July 2013 on that unfunded accrued liability of \$53 million and contributions tax of \$80 million.

Of this amount, an amount of \$9.6 million remains as contributions receivable as at 30 June 2014 (2013: \$162.0 million). During the 2014 year, the employers of the Defined Benefit plan have paid \$152.4 (2013: \$377.0 million) of the total amount invoiced. The total payments received to 30 June 2014 represent 98% (2013: 70%) of total unfunded liability invoiced amount. Where an employer paid some/all of their invoiced amount prior to the due date of 1 July 2013, the amount of the invoice was discounted at the rate of 7.5% per annum (calculated daily) based on the expected long-term investment return on the assets of the LASF Defined Benefits Plan. The contributions receivable of \$9.6 million at 30 June 2014 represents the outstanding unfunded liability which has been invoiced but not yet paid. These employers have entered into payment plans to pay these outstanding amounts.

5. Guaranteed benefits

No guarantees have been made in respect of any part of the liabilities for accrued benefits.

6. Vested benefits

Vested benefits are benefits which are not conditional upon continued membership of the Fund (or any factor other than resignation from the Fund) and include benefits which members are entitled to receive had they terminated their Fund membership as at the reporting date.

Notes to the financial statements for the year ended 30 June 2014

6. Vested benefits (continued)

	2014 \$000	2013 \$000
Defined benefit plans	2,339,577	2,333,584
Accumulation plans	4,361,104	3,085,572
Total vested benefits	<u>6,700,681</u>	<u>5,419,156</u>
As compared to net assets available to pay benefits	<u>6,827,063</u>	<u>5,467,052</u>

Key results as at 30 June 2014, as estimated by the actuary, on the defined benefit plans are as follows. The Discounted Accrued Benefits Index (DABI) and Minimum Requisites Benefits Index (MRBI) (Solvency basis) for 2014 financial year will be available upon the completion of the 30 June 2014 actuarial investigation which is expected to be completed mid-December 2014.

Plan	Results	30 June 2014 estimated	30 June 2013	30 June 2012
LASF DB	VBI	103.3%	100.7%	94.7%
	DABI		109%	104%
	MRBI		151%	141%
City of Melb	VBI	112.1%	104.6%	87.4%
	DABI		116%	97%
	MRBI		145%	124%
Parks Victoria	VBI	101.8%	95.6%	87.4%
	DABI		111%	97%
	MRBI		150%	126%

7. Funding arrangements

(a) LASF defined benefits

The actuarial investigation of the LASF Defined Benefit Plan conducted as at 31 December 2011 identified an actuarial shortfall of \$406 million. The actuarial shortfall was mainly caused by poor investment returns to 31 December 2011 predominantly due to the global financial crisis (GFC) and the assumed lower investment returns for the future.

The Trustee agreed the following funding plan to bring the LASF Defined Benefit Plan to a favourable financial position by the end of the fifteen-year period covered by the plan. Under the plan:

- Active members would continue to pay 6% of salary;
- Employers would continue to pay 9.25% of members' salaries;
- Employers would make additional contributions to cover the excess of the benefits paid as a consequence of retrenchment above the funded resignation or retirement benefit (the funded resignation or retirement benefit is calculated as the Vested Benefits Index multiplied by the benefit), plus contributions tax; and
- Employers would make a top-up contribution of \$453 million (plus contribution tax) payable on 1 July 2013.

Employers were offered a fifteen-year payment plan for the top-up contribution at the interest rate of 7.5% per annum, the expected long-term investment return on the assets of defined benefits plan. The employers may choose to make their payment prior to the end of this fifteen-year payment plan. It has also been agreed that the employer contribution of 9.25% will increase in line with the increases to the superannuation guarantee (SG) contribution rate.

Notes to the financial statements for the year ended 30 June 2014

7. Funding arrangements (continued)

(a) LASF defined benefits (continued)

The next full actuarial investigation of the LASF Defined Benefit Plan's liability for accrued benefits will be based on the LASF Defined Benefits Plan's position as at 30 June 2014. The anticipated completion date of this actuarial investigation is 19 December 2014.

The funding plan as described above will remain in place for the LASF Defined Benefits Plan until the next full actuarial investigation is completed.

(b) City of Melbourne – defined benefits

The actuarial investigation of the City of Melbourne Plan conducted as at 31 December 2011 identified an actuarial shortfall of \$8.9 million. Based on these actuarial investigations as at 31 December 2011, the Actuary's recommended funding plan below was adopted by City of Melbourne in December 2012 to return City of Melbourne plan VBI to above 100%:

- Increase the employer contribution to 13% of members' salaries from 1 July 2012;
- A single lump sum contribution of \$8.0 million payable at 31 December 2012; and
- Fund the top up payments for existing members equal to the amount increased for contribution tax: *Benefits Payment less (Vested Benefit x VBI)*. Top up payments are to be calculated and invoiced quarterly in arrears from 1 July 2012.

Members contribute at rates between 0% and 9% of salaries.

During the reporting year, City of Melbourne paid their outstanding actuarial shortfall as agreed in the above funding plan.

The next full actuarial investigation of the City of Melbourne Plan's liability for accrued benefits will be based on the City of Melbourne Plan's position as at 30 June 2014. The anticipated completion date of this actuarial investigation is 19 December 2014.

The funding plan as described above will remain in place for the City of Melbourne Plan until the next full actuarial investigation is completed.

(c) Parks Victoria – defined benefits

The actuarial investigation of the Parks Victoria Plan conducted as at 31 December 2011 identified an actuarial shortfall of \$3.2 million. Based on the actuarial investigation as at 31 December 2011, the Actuary's recommended funding plan below was adopted by Parks Victoria in November 2012 to return Parks Victoria Plan VBI to above 100%:

- Increase the employer contribution to 12% of members' salaries from 1 July 2012;
- Contribute an additional \$0.8 million (inclusive of 15% contribution tax) per annum in each of the financial year 2012/13, 2013/14, 2014/15, 2015/16 and 2016/17; and
- Fund the top up payments for existing members equal to the amount increased for contribution tax: *Benefits Payment less (Vested Benefit x VBI)*. Top up payments are to be calculated and invoiced quarterly in arrears from 1 April 2012.

Members contribute at rates between 0% and 7.5% of salaries.

During the reporting year, Parks Victoria paid their remaining actuarial shortfall of \$2.8 million.

Notes to the financial statements for the year ended 30 June 2014

7. Funding arrangements (continued)

(c) Parks Victoria – defined benefits (continued)

The next full actuarial investigation of the Parks Victoria Plan's liability for accrued benefits will be based on the Parks Victoria Plan's position as at 30 June 2014. The anticipated completion date of this actuarial investigation is 19 December 2014.

The funding plan as described above will remain in place for the Parks Victoria Plan until the next full actuarial investigation is completed.

(d) Vision MySuper

The Fund's MySuper category receives both employer and employee contributions on a progressive basis. Employer contributions are normally based on a fixed percentage of employee earnings in accordance with the Superannuation Guarantee legislation for each year (for the year ended 30 June 2014 – 9.25%). This rate increases to 9.5% for the 2014/15 year and will progressively increase to 12% by 1 July 2025 subject to legislative changes. No further liability accrues to the employer as the superannuation benefits accruing to employees are represented by their share of the net assets of the Fund.

(e) Prudential Standard SPS 160 – Defined benefit Matters

Prudential Standard 160 – *Defined Benefit Matters* (SPS 160) applies to the Fund with effect from 1 July 2013. The Trustee has adopted SPS 160 and will put in place a restoration plan to restore the VBI to 100% if:

- (a) the VBI falls below 97% at any time when an actuarial investigation is not completed and there is not a valuation date within 6 months; or
- (b) the VBI falls below 100% at the date an actuarial investigation is completed.

The Fund Actuary agrees with the trustee's shortfall limit of 97% for each of the defined benefit plans.

8. Change in net market values

	2014 \$000	2013 \$000
Investments held at balance date		
Units in VPST:		
Realised gains/(losses)	56,130	111,075
Unrealised gains/(losses)	573,424	499,851
Total changes in net market values	629,554	610,926

9. Administration expenses

	2014 \$000	2013 \$000
Annual lodgement fee – APRA	1,263	1,628
Banking & Regulatory Charges	28	26
External audit fees	91	71
Trustee services fees	25,606	19,247
Other administration fees	65	44
	27,053	21,016

Notes to the financial statements for the year ended 30 June 2014

10. Contributions receivable

Contributions for outstanding 2010 defined benefits unfunded liability accounts are payable by the year 2021.

The funding call resulted from Trustee's actuarial investigation as at 31 December 2011 were payable on 1 July 2013. Employers are offered a fifteen-year payment plan at the interest rate of 7.5% per annum.

Contributions for defined benefits members' ongoing service are payable on the 21 day of the first month in each quarter.

	2014 \$000	2013 \$000
Ongoing service	120	(62)
Past service - 2010	1,050	4,618
Past service - 2011	9,635	161,719
Contributions receivable	<u>10,805</u>	<u>166,275</u>

11. Income tax expense

	2014 \$000	2013 \$000
Current tax expense		
Current income tax	63,885	95,254
Adjustment of current income tax of previous years	416	(32)
	<u>64,301</u>	<u>95,222</u>
Deferred tax expense		
Relating to origination and reversal of temporary difference	(23,450)	(50,755)
Adjustment of deferred income tax of previous years	-	-
	<u>(23,450)</u>	<u>(50,755)</u>
	<u>40,851</u>	<u>44,467</u>

Numerical reconciliation between tax expense and net change for the year before tax

Benefits accrued before income tax	1,400,038	642,391
At the tax rate of 15%	210,006	96,359
Additional tax on no TFN contributions	60	7
Increase in tax expenses due to:		
Non-deductible benefits paid	78,038	63,391
Decrease in tax expenses due to:		
Non-assessable contributions	(12,194)	(8,888)
Non-assessable rollovers	(21,384)	(12,974)
Death and disability insurance	(449)	(833)
Anti-detriment deduction	(387)	(403)
Non-taxable income/loss from PST	(94,433)	(91,639)
No TFN tax credit	(10)	(2)
Over/under provision in previous year	417	(31)
Other	(118,813)	(520)
Income tax expense reported in operating statement	<u>40,851</u>	<u>44,467</u>

Notes to the financial statements for the year ended 30 June 2014

12. Tax assets and liabilities

The current tax liabilities for the Fund of \$63,898,616 (2013: \$95,253,531) represents the amount of income taxes payable in respect of current and prior financial years.

13. Deferred tax assets and liabilities

Recognised deferred tax assets and liabilities

Deferred tax assets and liabilities are attributable to the following:

	2014 \$000	2013 \$000
Deferred tax assets		
Accrued audit expense	2	8
Transfer from VSF	3	-
	5	8
Deferred tax liabilities		
Contributions receivable	1,495	24,951
	1,495	24,951
Net deferred tax assets/(liabilities)	(1,490)	(24,943)

Movement in temporary differences during the year:

2014

	Opening balance \$000	Recognised in income \$000	Acquisition/ disposal \$000	Closing balance \$000
Gross deferred tax liabilities:				
Contribution receivable	24,951	(23,456)	-	1,495
	24,951	(23,456)	-	1,495
Gross deferred tax assets:				
Accrued audit expense	8	(6)	-	2
Transfer from VSF	-	3	-	3
	8	(3)	-	5
	(24,943)	(23,453)	-	1,490

2013

	Opening balance \$000	Recognised in income \$000	Acquisition/ disposal \$000	Closing balance \$000
Gross deferred tax liabilities:				
Contribution receivable	75,698	(50,747)	-	24,951
Other	-	-	-	-
	75,698	(50,747)	-	24,951
Gross deferred tax assets:				
Accrued audit expense	-	8	-	8
	-	8	-	8
	(75,698)	(50,755)	-	(24,943)

Notes to the financial statements for the year ended 30 June 2014

14. Related parties

(a) Trustee and key management personnel

The trustee of the Fund is Vision Super Pty Ltd. The trustee company comprised of nine Directors and five Alternates. The persons who were Directors and Alternates of the trustee during the year were:

Member Directors:

Brian Parkinson
Wendy Phillips
Russell Atwood
Harriet Shing (appointed on 1 July 2013)
Tony Tuohey (resigned on 1 July 2013)

Alternates:

Richard Duffy
Richard Duffy
Richard Duffy
Richard Duffy

Employer Directors:

Peter Wilson
Graham Sherry
Rob Spence
Geoff Lake

Alternates:

Steve Bird
Leigh Harder
Alison Lyon
Alison Lyon

Tony Tuohey was replaced as Member Director on 1 July 2013 by Harriet Shing.

Peter Wilson was the Chairman during the financial year and Brian Parkinson was the Deputy Chairman. Brian Parkinson was appointed as Chairman of the Board and Geoff Lake as Deputy Chairman on 1 July 2014. Joanne Dawson was appointed as an independent Director on 8 August 2014.

Each Director attended the following meetings and Board Committees during the year as a member of the Board or relevant Committee.

Name	Board Meetings	
	Held	Attended
Peter Wilson	12	12
Harriet Shing	12	11
Wendy Phillips	12	10
Brian Parkinson	12	9
Russell Atwood	12	9
Rob Spence	12	10
Graham Sherry	12	10
Geoff Lake	12	10
Tony Tuohey	12	n/a

Board Committees are open to all Directors and were attended by a quorum of Directors on all occasions. Apart from Directors of the Trustee Company, the Chief Executive Officer, Chief Financial Officer, General Counsel, Chief Operating Officer, Chief Investment Officer, Manager Investments, Manager Human Resources, Head of Information Systems and General Manager Fund Development of the Trustee are considered to be Key Management Personnel (KMP) for the purpose of these financial statements.

(b) Key management personnel and executives' compensation

The KMPs' compensation is presented in the table below for year 2014. This compensation was paid by the Trustee. Total compensation received, or due and receivable, by key management personnel amounted to \$2,451,920 (2013: \$3,095,775). The detail is as follows:

Notes to the financial statements for the year ended 30 June 2014

14. Related parties (continued)

(b) Key management personnel and executives' compensation (continued)

	2014	2013
	\$	\$
Short-term employee benefits	2,203,182	2,831,051
Other long-term benefits	-	-
Post-employment benefits	248,738	264,724
	<u>2,451,920</u>	<u>3,095,775</u>

The table below lists the number of Key Management Personnel and executive positions named above whose income falls within the following bands for the financial year ending 30 June:

Amounts falling between...	2014	2013
Up to \$39,999	5	7
\$40,000 - \$49,999	-	7
\$50,000 - \$99,999	8	2
\$100,000 - \$149,999	1	2
\$150,000 - \$199,999	1	2
\$200,000 - \$249,999	2	2
\$250,000 - \$299,999	3	2
\$400,000 - \$449,999	1	1
\$500,000 - \$549,999	-	1

During the year, there were a number of changes to the Directors and their roles on the VSPL's Board. The total remuneration paid during the year was:

	2014	2013
	\$	\$
Chairman	108,951	85,471
Deputy Chairman	74,170	49,053
Other Directors	326,351	267,109
Alternate Directors (retaining fees)	2,731	26,537
	<u>512,202</u>	<u>428,171</u>

There is no additional remuneration for Directors' attendance at Committee meetings.

Any Director of the Trustee or other key management personnel who is a member of the Fund contributes to the Fund on the same terms and conditions as other members. No retirement benefits were paid to Directors or key management personnel during the year.

The Trustee has not made, guaranteed or secured any loan to any Director or member of staff or to any other related party.

Notes to the financial statements for the year ended 30 June 2014

14. Related parties (continued)

(b) Key management personnel and executives' compensation (continued)

	2014	2013
	\$	\$
Roll ins from KMP to LASF/VSF	570,734	-
Benefits paid to KMP	26,000	373,125
Vested Benefits of KMP	9,507,321	10,794,737

(c) Related party transactions

(i) Regional Infrastructure Fund

VPST is the sole shareholder in Regional Infrastructure Fund Pty Ltd (RIF).

RIF was established primarily to invest in regional infrastructure projects. The RIF Directors during the reporting year were Graham Sherry, Geoff Lake, Tony Tuohey and Harriet Shing. Harriet Shing was appointed as RIF Director on 1 July 2013. Tony Tuohey retired as RIF Director on 30 November 2013.

The objective for RIF is to invest in infrastructure projects and it currently wholly owns Regional Wind Farms Pty Ltd.

(ii) Regional Wind Farms Pty Ltd

Regional Wind Farms Pty Ltd was established by RIF to invest in wind farms. Project development, construction and operations are contracted out to third party providers. Tony Tuohey was replaced by Graham Sherry as Director of Regional Wind Farms Pty Ltd on 31 December 2013. Another director is appointed by Industry Funds Management.

(iii) Vision Super Pty Ltd

As described in Note 1, Vision Super Pty Ltd is the trustee of the Fund.

	2014	2013
	\$000	\$000
Trustee services fees for the year	25,606	19,318
Trustee services fees payable at the end of the year	3,456	148

(iv) Vision Pooled Superannuation Trust (VPST)

As described in Note 3, the Fund's unit holding in VPST was \$6,889,587,624 as at 30 June 2014 (2013: \$5,384,465,490) which was 95.6% (2013: 85.8%) of total units issued by VPST.

(v) Pooled Super Pty Ltd (PSPL)

PSPL is the trustee of VPST which the Fund is a significant unit holder. The directors of the Fund's trustee, VSPL, are paid separately for their directorship in PSPL by VSPL.

(vi) Directors

Geoff Lake is also a Director of Hawkesbridge Capital Pty Ltd, a fund manager engaged by the VPST, and excludes himself from any decision making in relation to this manager.

Notes to the financial statements for the year ended 30 June 2014

15. Auditor's remuneration

	2014 \$000	2013 \$000
Amounts received or due and receivable by Ernst & Young for the audit of the financial statements	91	71

16. Insurance

The Fund has a group policy in place with CommInsure to provide both Death & Disability and Income Protection insurance cover for Vision MySuper/Super Saver and Personal plan members. The Fund self-insures Death & Disability insurance cover for Defined Benefits plan members and has a policy in place with CommInsure for Death & Disability insurance cover for the City of Melbourne and Parks Victoria sub-plans.

17. Investments and derivatives

(a) Classification of financial instruments under the Fair Value Hierarchy

AAS 25 requires investments to be measured using net market value which approximates fair value. The valuation method uses the following fair value hierarchy that reflects the significance of the inputs used in making the measurement:

- Level 1 — Quoted (unadjusted) market prices in active markets for identical assets or liabilities
- Level 2 — Valuation techniques for which the lowest level input that is significant to the fair value measurement is directly or indirectly observable
- Level 3 — Valuation techniques for which the lowest level input that is significant to the fair value measurement is unobservable

The level in which instruments are classified in the hierarchy is based on the lowest level input that is significant to the net market value measurement in its entirety. Assessment of the significance of an input requires judgement after considering factors specific to the instrument.

Units in Vision Pooled Superannuation Trust (VPST) are valued at the redemption price at reporting date quoted by the investment managers which are based on the net market value of the underlying investments. The significant inputs to calculate the price are market observable. Therefore, the Fund categorises these investments as Level 2 financial instruments.

	2014		
	Value at quoted market price (level 1)	Valuation technique – market observable inputs (level 2)	Valuation technique – non-market observable inputs (level 3)
	\$000	\$000	\$000
Total			\$000
Units in VPST	-	6,889,588	-
Total investment	-	6,889,588	-

Notes to the financial statements for the year ended 30 June 2014

17. Investments and derivatives (continued)

(a) Classification of financial instruments under the Fair Value Hierarchy (continued)

	2013			Total
	Value at quoted market price (level 1)	Valuation technique – market observable inputs (level 2)	Valuation technique – non- market observable inputs (level 3)	
	\$000	\$000	\$000	\$000
Unit in VPST	-	5,384,465	-	5,384,465
Total investment	-	5,384,465	-	5,384,465

Disclosure of the method and assumptions applied in determining the net market value for each class of financial assets and financial liabilities are included in Note 2(e). The net market value for each class of financial assets and financial liabilities equates to fair value.

(b) Transfers between hierarchy levels

There have been no significant transfers between Levels 1, 2 or 3 of the fair value hierarchy during the year.

18. Risk management

(a) Financial risk management objectives, policies and processes

The Fund's principle financial instruments comprised of units in pooled superannuation trusts and cash. The main purpose of these financial instruments was to generate a return on investment.

Units in pooled superannuation trusts are units in Vision Pooled Superannuation Trust (VPST) only. Therefore, the following financial risk analysis is based on the underlying assets of units in VPST.

The Fund also has various other financial instruments such as sundry receivable and payables, which arise directly from its operations. These are mainly current in nature.

Risks arising from holding financial instruments are inherent in the Fund's activities, and are managed through a process of ongoing identification, measurement and compliance monitoring. The Fund is exposed to credit risk, liquidity risk and market risk, including interest rate risk, equity price risk and foreign currency risk.

The Trustee is responsible for identifying and controlling the risks that arise from these financial instruments. The Trustee reviews and agrees policies for managing each of these risks as summarised below. The Fund also monitors the market price risk arising from all financial instruments.

Information about the total fair value of financial instruments exposed to risk, as well as compliance with established investment mandate limits, is monitored by the Trustee. These mandate limits reflect the investment strategy and market environment of the Fund, as well as the level of risk that the Fund is willing to accept.

This information is prepared and reported to the Trustee on a monthly basis.

Concentrations of risk arise when a number of financial instruments or contracts are entered into with the same counterparty, or when a number of counterparties are engaged in similar business activities, have activities in the same geographic region, or have similar economic features that would cause their ability to meet contractual obligations to be similarly affected by changes in economic, political or other conditions.

Notes to the financial statements for the year ended 30 June 2014

18. Risk management (continued)

(a) Financial risk management objectives, policies and processes (continued)

In order to avoid excessive concentrations of risk, VPST monitors its exposure to ensure concentration of risk remain within acceptable levels in accordance with its mandate and either reduces exposure or uses derivative instruments to manage the excessive risk concentrations when they arise.

(b) Credit risk

Credit risk represents the risk that the counterparty to the financial instrument will fail to discharge an obligation and cause the Fund to incur a financial loss.

With respect to credit risk arising from the underlining financial assets of the Fund, other than derivatives, the Fund's exposure to credit risk arises from default of the counterparty, with the current exposure equal to the fair value of these instruments as disclosed in the Statement of net assets. This does not represent the maximum risk exposure that could arise in the future as a result of changes in values, but best represents the current maximum exposure at the reporting date.

Credit risk arising from derivative financial instruments is, at any time, limited to those with positive fair values. The risk associated with these contracts is minimised by undertaking transactions with high quality counterparties on recognised exchanges, and ensuring that transactions are undertaken with a number of counterparties.

Credit risk arising from investments is mitigated by extensive tax and legal due diligence undertaken by VPST prior to the appointment of fund managers to ensure fund managers have appropriate skills and expertise to manage the allocated investments. In addition, VPST conducts annual review of derivative risk statements and internal controls and processes for all appointed fund managers to ensure fund managers maintain those skills and expertise.

The Fund holds no collateral as security or any other credit enhancements. There are no significant financial assets that are past due or impaired. Credit risk is not considered to be significant to the Fund except in relation to investments in debt securities via VPST.

Credit quality per class of debt instruments

The credit quality of financial assets is managed by the Fund using Standard & Poor's rating categories, in accordance with the investment strategy of the Trustee. The Fund's exposure in each grade is monitored on a monthly basis. This review process allows the Trustee to assess the potential loss as a result of risks and take corrective action. The table below shows the credit quality by class of asset for debt instruments.

Notes to the financial statements for the year ended 30 June 2014

18. Risk management (continued)

(b) Credit risk (continued)

2014

	AAA to AA- \$000	A+ to A- \$000	BBB+ to BBB- \$000	CCC \$000	Short term A-1+ to A2 \$000	Not rated or available \$000	Total \$000
Fixed interest bonds	437,418	48,564	30,133	-	-	257,156	773,271
Floating rate notes	9,368	4,737	1,531	-	-	-	15,636
Mortgage Backed Securities	525	2,112	-	-	-	-	2,637
Asset backed securities	2,040	-	-	-	-	-	2,040
Loans	-	-	-	-	-	3,487	3,487
Discount securities	107	-	-	-	-	-	107
Cash & deposits	-	-	-	-	-	1,218,749	1,218,749
Pooled funds*	-	-	-	-	-	114,969	114,969
Total	449,458	55,413	31,664	-	-	1,594,361	2,130,896

2013

	AAA to AA- \$000	A+ to A- \$000	BBB+ to BBB- \$000	CCC \$000	Short term A-1+ to A2 \$000	Not rated or available \$000	Total \$000
Fixed interest bonds	419,549	35,423	29,719	-	-	76,923	561,614
Indexed bonds	51,582	-	-	-	-	18,345	69,927
Floating rate notes	5,690	2,416	-	-	-	-	8,106
Zero coupon bonds	108	-	-	-	-	-	108
Asset backed securities	1,508	-	-	-	-	-	1,508
Loans	-	-	-	-	-	4,208	4,208
Discount securities	301	-	-	-	-	6,589	6,890
Cash & deposits	-	-	-	-	-	1,340,749	1,340,749
Pooled funds*	-	-	-	-	-	111,437	111,437
Total	478,738	37,839	29,719	-	-	1,558,250	2,104,546

*Instruments are either not rated or ratings are not available at NAS.

Risk concentration of credit risk exposure

Concentration of credit risk is managed by counterparty, by geographical region and by industry sector.

The VPST's underlying financial assets can be analysed by the following geographic regions:

	2014 \$000	2013 \$000
Australia	6,312,502	5,447,494
North America	707,928	572,153
Europe	83,317	177,912
Asia	(55,594)	47,026
Others	190,575	7,886
Total	7,238,728	6,252,471

Notes to the financial statements for the year ended 30 June 2014

18. Risk management (continued)

(b) Credit risk (continued)

Significant economic sector exposure exists for the underlying assets as follows:

	2014 \$000	2013 \$000
Financials	837,072	642,549
Materials	369,561	304,880
Industrials	260,879	232,904
Energy	196,786	157,742
Consumer discretionary	336,075	255,228
Consumer staples	230,117	201,837
Information technology	282,309	212,579
Health care	226,392	187,746
Telecommunication	106,023	83,821
Utilities	39,025	35,192
Total	2,884,239	2,314,478

The above table does not include any underlying investments in unlisted trusts or pooled funds.

(c) Liquidity risk

Liquidity risk is the risk that the Fund will encounter difficulty in meeting obligations associated with financial liabilities. This risk is controlled through the Fund's investment in financial instruments, which under normal market conditions are readily convertible to cash. In addition, the Fund maintains sufficient cash and cash equivalents to meet normal operating requirements.

As at 30 June 2014 -	Less than 1 month (\$000)	1 to 3 months (\$000)	3 to 12 months (\$000)	1 to 5 years (\$000)	Over 5 years (\$000)	No stated maturity (\$000)	Total (\$000)
Financial liabilities							
Benefits payable	21,878	-	-	-	-	-	21,878
Other payables	3,492	-	-	-	-	-	3,492
Vested benefits	6,700,681	-	-	-	-	-	6,700,681
Total undiscounted financial liabilities	6,726,051	-	-	-	-	-	6,726,051

As at 30 June 2013	Less than 1 month (\$000)	1 to 3 months (\$000)	3 to 12 months (\$000)	1 to 5 years (\$000)	Over 5 years (\$000)	No stated maturity (\$000)	Total (\$000)
Financial liabilities							
Benefits payable	15,961	-	-	-	-	-	15,961
Other payables	8,762	-	-	-	-	-	8,762
Vested benefits	5,419,156	-	-	-	-	-	5,419,156
Total undiscounted financial liabilities	5,443,879	-	-	-	-	-	5,443,879

The Fund undertakes cashflow projection analysis daily to ensure minimal exposure to liquidity risk.

The Fund's significant financial liabilities are benefits payable to members.

In relation to vested superannuation benefits, these would be considered on demand, which payments comprise the entire defined contribution component and the vested portion of the defined benefit component.

Notes to the financial statements for the year ended 30 June 2014

18. Risk management (continued)

(c) Liquidity risk (continued)

The Fund manages its obligation to pay the defined contribution component on an expected maturity basis based on management's estimates and actuarial assumptions of when such funds will be drawn down by members. The Fund considers it is highly unlikely that all defined contribution members will request to roll over their superannuation fund account at the same time. Furthermore, in relation to the vested defined benefit component, the Fund has adequate resources readily convertible to cash to satisfactorily meet these obligations when called upon.

Other financial liabilities of the Fund comprise trade and other payables which are contractually due within 30 days and derivative liabilities comprising futures payable within 12 months.

(d) Market risk

Market risk is the risk that the fair value or future cash flows of financial instruments will fluctuate due to changes in market variables such as interest rates, foreign exchange rates, and equity prices. Market risk is diversified through ensuring that all investment activities are undertaken in accordance with established investment policies of the Fund.

The Trustee employs diversification investment strategy to mitigate the market risk in each market segment. Further, the Fund also enters into forward foreign exchange contracts to hedge against adverse foreign exchange movements.

(i) Interest rate risk

Interest rate risk is the risk that the fair value of future cash flows of a financial instrument will fluctuate because changes in market interest rates.

In determining the reasonably possible change for interest rate risk, the sensitivity of the "official cash rate" as set by the Reserve Bank of Australia (RBA) from time to time is used.

Based on the NAS Accounting Policy Manual June 2014, a 25 basis points movement in interest rates is considered reasonably possible for the 2013/2014 reporting period. This analysis assumes that all other variables, in particular foreign currency rates, remain constant.

An increase/decrease of 25 basis points in interest rates at the reporting date would have increased/(decreased) the changes in net assets available to pay benefits by the amounts shown below:

2014

Asset class sector	Change in basis points Increase/decrease	Sensitivity of interest income and changes in net assets Increase/decrease \$000
Discount securities	+/-25	(1)/1
Fixed interest securities	+/-25	(10,942)/10,945
Floating rate notes	+/-25	(36)/36
Loans	+/-25	(9)/9
Mortgage backed securities	+/-25	(1)/2

Notes to the financial statements for the year ended 30 June 2014

18. Risk management (continued)

(c) Liquidity risk (continued)

(i) Interest rate risk (continued)

2013

Asset class sector	Change in basis points Increase/decrease	Sensitivity of interest income and changes in net assets \$000 Increase/decrease
Discount securities	+/-25	(14)/14
Fixed interest securities	+/-25	(7,079)/7,081
Floating rate notes	+/-25	(28)/28
Indexed bonds	+/-25	(2,186)/2,187
Loans	+/-25	(21)/21
Futures	+/-25	(139)/139

(ii) Currency risk

Currency risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate due to changes in foreign exchange rates.

The Trustee manages its exposure to foreign currency risk and mitigates effects of its foreign currency translation exposure placing limits on the portion of the assets which can be invested in different currencies and by appointing specialist currency managers to implement a passive hedge over foreign currency exposure. This foreign exchange policy is monitored against actual results on an ongoing basis throughout the year.

Based on the NAS Accounting Policy Manual June 2014, the movement of the main currency exchange rates below is considered reasonably possible for the 2013/2014 reporting period.

USD	10%
British Pounds	5%
Euro	5%
Japanese Yen	10%

The percentage strengthening/weakening of the AUD against the following basket of foreign currencies as at 30 June would have increase/(decreased) the changes of the year in net assets available to pay benefits by the amounts shown below. This analysis assumes that all other variables, in particular interest rates, remain constant.

Currency	2014		2013	
	Change in Currency rate %	Effect on changes in net assets \$000	Change in currency rate%	Effect on changes in net assets \$000
USD	+/-10	(63,836)/78,021	+/-10	(51,099)/63,455
Euro	+/-5	(2,548)/2,816	+/-5	(4,042)/4,468
Japanese Yen	+/-5	5,402/(5,971)	+/-5	(4,696)/5,740
British pounds	+/-5	(2,667)/2,948	+/-10	(2,453)/2,711

Notes to the financial statements for the year ended 30 June 2014

18. Risk management (continued)

(c) Liquidity risk (continued)

(iii) Equity price risk

Equity price risk is the risk that the fair value of investments in equities decreases or increases as a result of changes in market prices, whether those changes are caused by factors specific to the individual share price or factors affecting all equity instruments in the market. Equity price risk exposure arises from the Fund's investment portfolio.

To limit equity price risk the Trustee diversifies its investment portfolio in line with its investment strategy. The majority of equity investments are of a high quality and are publicly traded on recognised, reputable exchanges. The Trustee monitors the Fund's exposure to various asset classes on an ongoing basis throughout the year ensuring its investment strategy is adhered to.

Based on the NAS Accounting Policy Manual June 2014, a 10% movement in equity price is considered reasonably possible for the 2013/2014 reporting period. This analysis assumes that all other variables, in particular, interest rates and foreign exchange rates, remain constant. The analysis is performed on the same basis for 2013.

The "10%" increase/decrease in the equity price against the investments of the Fund at 30 June would have increased/(decreased) the changes for the year in net assets available to pay benefits by the amounts shown below:

Asset class sector	2014		2013	
	Change in equity price	Effect on changes in net assets	Change in equity price	Effect on changes in net assets
	%	\$000	%	\$000
Life insurance policies	+/-10	16,449/(16,449)	+/-10	15,350/(15,350)
Listed equities	+/-10	276,049/(276,049)	+/-10	221,826/(221,826)
Listed investment company	+/-10	2,976/(2,976)	+/-10	3,085/(3,085)
Listed property trusts	+/-10	9,952/(9,952)	+/-10	5,943/(5,943)
Listed units trust	+/-10	16,739/(16,739)	+/-10	3,477/(3,477)
Pooled Development Fund	+/-10	134/(134)	+/-10	433/(433)
Preference shares	+/-10	669/(669)	+/-10	587/(587)
Unlisted equities	+/-10	30,413/(30,413)	+/-10	27,942/(27,942)
Unlisted MIS	+/-10	163,937/(163,937)	+/-10	148,640/(148,640)
Others	+/-10	3,620/(3,620)	+/-10	21,631/(15,071)

19. Contingent liabilities/assets

The Fund has no contingent liabilities/assets as at 30 June 2014.

Notes to the financial statements for the year ended 30 June 2014

20. Fund transfer-in from Vision Superannuation Fund

Vision Superannuation Fund (VSF) was wound up with an effective date of 30 June 2014 and all assets and liabilities were transferred to the Fund (the Successor Fund) with an effective date of 30 June 2014. The assets and liabilities transferred into the Fund have been merged with the assets and liabilities of the Fund and the resultant net assets transferred from Vision Super Fund has been recognised through profit and loss.

The value of assets and liabilities transferred were as follows:

	\$000
Assets	
Cash at bank	2,278
Accounts receivable	30
Units in Vision Pooled Superannuation Trust	783,634
Deferred tax asset	3
Total Assets	785,945
Liabilities	
Accounts payable	447
Current tax liabilities	14
Total Liabilities	461
Net assets transferred from	785,484
Total vested benefits transferred from Vision Superannuation Fund	783,480

21. Significant event after balance date

Between 30 June 2014 and the date of approval of this financial report, no matters or circumstances have arisen that have not otherwise been dealt with in the financial period that have significantly affected or may significantly affect the Fund.

22. Consolidated financial statements and investment entities amendments

As indicated in Note 2(c)(i), investments in Vision Pooled Superannuation Trust (VSPT) are no longer being consolidated but recognised as financial assets at fair value through profit or loss. The change in accounting policy resulted no adjustments to the net asset available to pay benefits.

The following presents, in respect of the period immediately preceding the date of initial application, the resulting changes as previously reported in the consolidated financial statements. The transitional provisions of the amendments do not require disclosure of similar information in respect of the current year.

Notes to the financial statements for the year ended 30 June 2014

22. Consolidated financial statements and investment entities amendments (continued)

Statement of net assets	30 June 2013 Consolidated \$000	Adjustments \$000	30 June 2013 Fund \$000
ASSETS			
Cash at bank and cash equivalents	52,194	(3,440)	48,754
Contributions receivable	166,275	-	166,275
Other receivables	3,534	(391)	3,143
Prepayments	1,500	-	1,500
ATO tax refund receivable	15,933	(15,933)	-
Deferred tax assets	28,106	(28,098)	8
Investments			
Cash	1,146,003	(1,146,003)	-
Diversified bonds	703,268	(703,268)	-
Australian equities	1,471,058	(1,471,058)	-
International equities	1,226,380	(1,226,380)	-
Property	564,640	(564,640)	-
Private equity	487,883	(487,883)	-
Infrastructure	615,283	(615,283)	-
Absolute return	74,119	(74,119)	-
Units in Vision Pooled Superannuation Trust	-	5,384,465	5,384,465
Derivative assets	6,518	(6,518)	-
Total assets	6,562,694	(958,549)	5,604,145
LIABILITIES			
Benefits payable	(15,961)	-	(15,961)
Other payables	(8,761)	8,226	(535)
Amounts held in trust	(392)	-	(392)
Current tax liabilities	(95,254)	-	(95,254)
Deferred tax liabilities	(24,951)	-	(24,951)
Derivative liabilities	(64,540)	64,540	-
Net assets attributable to non-controlling interests	(885,783)	885,783	-
Total liabilities (excluding net assets available to pay benefits)	(1,095,642)	958,549	(137,093)
Net assets available to pay benefits	5,467,052	-	5,467,052

Notes to the financial statements for the year ended 30 June 2014

22. Consolidated financial statements and investment entities amendments (continued)

Statement of change in net assets	30 June 2013 Consolidated	Adjustments	30 June 2013 Fund
	\$000	\$000	\$000
Investment revenue			
Interest	69,071	(69,071)	-
Dividends and trust distributions revenue	175,851	(175,851)	-
Other investment income	691	(691)	-
Changes in net market value of investments	501,807	109,119	610,926
	747,420	(136,494)	610,926
Direct investment expense	(28,009)	28,009	-
Net investment revenue	719,411	(108,485)	610,926
Contributions revenue			
Employer contributions	337,120	-	337,120
Member contributions	59,255	-	59,255
Transfer from other funds	86,733	-	86,733
	483,108	-	483,108
Other revenue			
Group life insurance proceeds	3,469	-	3,469
Other revenue	2,880	-	2,880
	6,349	-	6,349
Total revenue	1,208,868	(108,485)	1,100,383
Expenses			
Benefits paid	(422,609)	-	(422,609)
General administration expenses	(21,016)	-	(21,016)
Group life insurance premium expense	(14,360)	-	(14,360)
Superannuation contributions surcharge	(8)	-	(8)
	(457,993)	-	(457,993)
Change in net assets before income tax	750,875	(108,485)	642,390
Income tax expense	(88,217)	43,750	(44,467)
Change in net assets after income tax	662,658	(64,735)	597,923

Notes to the financial statements for the year ended 30 June 2014

22. Consolidated financial statements and investment entities amendments (continued)

	30 June 2013 Consolidated	Adjustments	30 June 2013 Fund
	\$000	\$000	\$000
Change in net assets after income tax attributable to non-controlling interests	(64,735)	64,735	-
Change in net assets after income tax & non-controlling interests available to pay benefits	597,923	-	597,923
Net assets available to pay benefits at the beginning of the financial year	4,869,129		4,869,129
Net assets available to pay benefits at the end of the financial year	5,467,052		5,467,052

Trustee declaration

Local Authorities Superannuation Fund

In the opinion of the Trustee of Local Authorities Superannuation Fund:

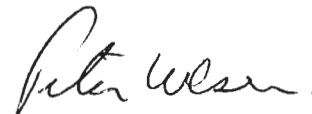
- (i) The accompanying financial statements of the Local Authorities Superannuation Fund are drawn up so as to present fairly the net assets of the Fund as at 30 June 2014 and the changes in net assets for the year then ended; and
- (ii) The operation of the Local Authorities Superannuation Fund has been carried out in accordance with its Trust Deed dated 26 June 1998 and in compliance with:
 - The requirements of the Superannuation Industry (Supervision) Act 1993 and Regulations;
 - The applicable sections of the Corporations Act 2001 and Regulations;
 - The requirements under Section 13 of the Financial Sector (Collection of Data) Act 2001; and
- (iii) The financial statements have been prepared in accordance with the Australian Accounting Standards, other mandatory reporting requirements and the provisions of the Trust Deed dated 26 June 1998 as amended,

Dated at Melbourne this 26 day of September 2014

Signed in accordance with a resolution of the Directors of the Trustee:



Name: BRIAN PARKINSON
Director



Name: PETER WILSON
Director

Part 1- Independent Auditor's Report on Financial Statements

LOCAL AUTHORITIES SUPERANNUATION FUND ABN: 24 496 637 884

REPORT BY THE RSE AUDITOR TO THE TRUSTEE AND MEMBERS

Financial statements

I have audited the financial statements of Local Authorities Superannuation Fund for the year ended 30 June 2014 comprising the statement of net assets, statement of changes in net assets, summary of significant accounting policies, other explanatory notes and the trustee statement.

Trustee's Responsibility for the Financial Statements

The superannuation entity's trustee is responsible for the preparation and fair presentation of the financial statements in accordance with Australian Accounting Standards and the requirements of the Superannuation Industry (Supervision) Act 1993 (SIS Act) and the Superannuation Industry (Supervision) Regulations 1994 (SIS Regulations). The trustee is also responsible for such internal control as the trustee determines is necessary to enable the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

My responsibility is to express an opinion on the financial statements based on my audit. I have conducted an independent audit of the financial statements in order to express an opinion on them to the trustee and members of Local Authorities Superannuation Fund.

My audit has been conducted in accordance with Australian Auditing Standards. These Standards require that I comply with relevant ethical requirements relating to audit engagements and plan and perform the audit to obtain reasonable assurance as to whether the financial statements are free of material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgement, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal controls relevant to the trustee's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the trustee's internal controls. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by the trustee, as well as evaluating the overall presentation of the financial statements.

I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my audit opinion.

Auditor's Opinion

In my opinion the financial statements present fairly, in all material respects, in accordance with Australian Accounting Standards, the net assets of Local Authorities Superannuation Fund as at 30 June 2014 and the changes in net assets for the year ended 30 June 2014.

Ernst + Young

Ernst & Young

Brett Kallio

Brett Kallio
Partner
Melbourne
Date: 26 September 2014

Part 2- Independent Auditor's report on APRA Annual Return and Compliance - Reporting Entity

(A) APRA Annual Return

Independent Auditor's report approved form for registrable superannuation entity

Independent auditor's report to the trustee of Local Authorities Superannuation Fund ABN 24 496 637 884 on *SRF 114.1 Operational Risk Financial Requirement; SRF 320.0 Statement of Financial Position; SRF 330.0 Statement of Financial Performance and SRF 530.1 Investments and Investment Flows*

Trustee's Responsibility for the APRA Annual Return Forms

The superannuation entity's trustee is responsible for the preparation and lodgement of the APRA Annual Return forms in accordance with the *Financial Sector (Collection of Data) Act 2001* (FSCODA Reporting Standards) and for such internal controls as the trustee determines to be necessary to enable the preparation of these forms free from material misstatement, whether due to fraud or error. The APRA Annual Return forms have been prepared for the purposes of fulfilling the trustee's reporting requirements pursuant to the FSCODA Reporting Standards.

Auditor's Responsibility

My responsibility is to express an opinion on the APRA Annual Return Forms based on my audit. I have audited, pursuant to the FSCODA Reporting Standards, APRA Annual Return forms *SRF 114.1 Operational Risk Financial Requirement; SRF 320.0 Statement of Financial Position; SRF 330.0 Statement of Financial Performance and SRF 530.1 Investments and Investment Flows* (collectively known as the 'relevant forms') of Local Authorities Superannuation Fund, which comprise part of the APRA Annual Return, for the year ended 30 June 2014.

I have conducted an independent audit of the relevant forms in order to express an opinion on them to the trustee of Local Authorities Superannuation Fund.

I have also performed an independent audit of the financial statements of Local Authorities Superannuation Fund for the year ended 30 June 2014. My auditor's report on the financial statements was signed on 26 September 2014, and was not modified.

My audit has been conducted in accordance with Australian Auditing Standards. These Standards require that I comply with relevant ethical requirements relating to audit engagements and plan and perform the audit to obtain reasonable assurance as to whether the relevant forms are free of material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the relevant forms. The procedures selected depend on the auditor's judgement, including the assessment of the risks of material misstatement of the amounts and disclosures in the relevant forms, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the trustee's preparation and presentation of the amounts and disclosures in the relevant forms in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the trustee's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by the trustee, as well as evaluating the overall presentation of the amounts and disclosures in the relevant forms.

For the purpose of ensuring that the relevant forms are materially complete and accurate and are in accordance with the relevant prudential reporting standards, my procedures included testing that the information in the relevant forms is consistent with the financial statements for the year ended 30 June 2014. In addition, and for the same purpose, in regard to other information reported in the relevant forms, I examined on a test basis, evidence supporting the amounts and other disclosures in the relevant forms that were not directly derived from the financial statements.

These procedures have been undertaken to form an opinion whether, in all material respects:

- a) the relevant forms are prepared in accordance with the requirements of the FSCODA Reporting Standards, so as to present a view which is consistent with my understanding of the superannuation entity's financial position as at 30 June 2014, its performance, for the year then ended, as reflected in the superannuation entity's financial statements signed on 30 June 2014 or the accounting records of Local Authorities Superannuation Fund in regards to other information that was not directly derived from the financial statements; and
- b) the trustee has complied with the reporting requirements of the FSCODA Reporting Standards pertaining to the preparation of the relevant forms specified above. My procedures did not include an audit of the amounts and other disclosures in those APRA Annual Return forms other than the relevant forms specified above.

I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my audit opinion.

Auditor's Opinion

In my opinion:

- a) the relevant forms are prepared in all material respects in accordance with the requirements of the FSCODA Reporting Standards, the financial position of Local Authorities Superannuation Fund as at 30 June 2014, its performance, for the year then ended, as reflected in the superannuation entity's financial statements signed on 26 September 2014 or accounting records with regard to other information that was not directly derived from the financial statements; and
- b) the trustee of Local Authorities Superannuation Fund has complied in all material respects with the reporting requirements of the FSCODA Reporting Standards pertaining to the preparation of the relevant forms.

Basis of preparation of APRA Annual Return Forms and restriction on use

Without modifying my opinion, I draw to readers' attention that the APRA Annual Return forms have been prepared for the purpose of fulfilling the trustee's reporting responsibilities of the FSCODA Reporting Standards. As a result, they may not be suitable for another purpose. I disclaim any assumption of responsibility for any reliance on this report to any party other than the trustee and APRA (and ASIC where applicable), or for any purpose other than that for which it was prepared.

(B) Compliance

Independent auditor's report to the trustee of Local Authorities Superannuation Fund ABN: 24 496 637 884

I have performed an audit to provide an opinion in relation to the trustee's compliance with applicable provisions under the *Superannuation Industry (Supervision) Act 1993* (SIS Act), *Superannuation Industry (Supervision) Regulations 1994* (SIS Regulations), *Financial Sector (Collection of Data) Act 2001* (FSCODA Reporting Standards), *Corporations Act 2001* (Corporations Act) and *Corporations Regulations 2001* (Corporations Regulations).

Trustee's Responsibility for Compliance

- (a) The superannuation entity's trustee is responsible for complying with the requirements of the SIS Act, SIS Regulations, the Reporting Standards made under s. 13 of the FSCODA Reporting Standards, the *Corporations Act* and *Corporations Regulations*.
- (b) The trustee is also responsible, under the following Conditions of the 'Schedule - additional conditions imposed under Section 29EA of the Act' of the RSE Licence issued by APRA for:
 - (i) Condition C1 -
 - Maintaining an identifiable amount of minimum liquid assets of at least \$250,000 at all times in the form specified; and
 - Ensuring that, at all times, the fund held an identifiable amount of minimum liquid assets of at least an amount, as specified above, in the form specified.
 - Maintaining the required level of minimum liquid assets in the form specified and for determining that this has occurred during the year ended 30 June 2014.
 - Internal control relevant to the maintenance of the form in which the minimum liquid assets is held; and

The trustee is responsible, under Prudential Standard SPS 114 Operational Risk Financial Requirement (SPS 114), for maintaining an operational risk reserve at the required target amount in accordance with its ORFR strategy.

Auditor's Responsibility

I have audited the compliance of Local Authorities Superannuation Fund with the requirements set out above for the year ended 30 June 2014.

My responsibility is to express an opinion on the trustee's compliance with the requirements of the SIS Act, SIS Regulations, FSCODA Reporting Standards, Corporations Act and Corporation Regulations based on the audit. My audit has been conducted in accordance with applicable Australian Standards on Assurance Engagements (ASAE 3000 *Assurance Engagements Other than Audits or Reviews of Historical Financial Information* and ASAE 3100 *Compliance Engagements*). These Standards require that I comply with relevant ethical requirements and plan and perform the audit to obtain reasonable assurance whether the trustee of Local Authorities Superannuation Fund has, in all material respects:

- (a) complied with the relevant requirements of the following provisions (to the extent applicable) of the SIS Act and SIS Regulations:

Sections 19(2), 19(3), , 29VA, 35A, , 65, 66, 67, 69-85, 86-93A, 95, 97, 98, 99F, 101, 103, 104, 105, 106, 107, 109, 117, 118, 122, 124, 125, 126K, 152, 154 and 155(2);

Regulations 2.33(2), 3.10, 4.08(3), 5.08, 6.17, 7.04, 7.05, 9.09, 9.14, 9.29, 9.30, 13.14, 13.17, 13.17A; and

(b) complied with the FSCODA Reporting Standards that are subject to audit (to the extent applicable); and

(c) complied with the relevant requirements of the following provisions of the Corporations Act and Corporation Regulations (to the extent applicable):

Sections 1012B, 1012F, 1012H(2), 1012I, 1013B, 1013D, 1013K(1), 1013K(2), 1016A(2), 1016A(3), 1017B(1), 1017B(5), 1017BA, 1017C(2), 1017C(3), 1017C(5), 1017C(8), 1017D(1), 1017D(3), 1017D(3A), 1017DA(3), 1017E(2), 1017E(3), 1017E(4), 1020E(8) and 1020E(9); and

Regulations 7.9.07Q-7.9.07W, 7.9.11K, 7.9.11N, 7.9.11O, 7.9.11P, 7.9.11Q and 7.9.32(3); and

(d) complied with the requirement to prepare the respective forms comprising the APRA Annual Return.

for the year ended 30 June 2014.

My procedures with respect to SIS Regulation 6.17 included testing whether amounts identified by the trustee as preserved and restricted non-preserved have been cashed or transferred only in accordance with the requirements of Part 6 of the SIS Regulations. These procedures did not include testing of the calculation of the preserved and restricted non-preserved amounts beyond a broad assessment of the apparent reasonableness of the calculations.

My responsibility is also to express an opinion on the trustee's compliance with the respective Conditions of the *'Schedule - additional conditions imposed under Section 29EA of the Act'* of the RSE Licence issued by APRA referred to under the heading Trustee's Responsibility for Compliance, above of Local Authorities Superannuation Fund for the year ended 30 June 2014.

My responsibility is also to express an opinion on the trustee's compliance with their ORFR strategy with respect to maintaining an operational risk reserve at the required target amount for the year ended 30 June 2014.

My procedures in relation to SIS Section 155(2) included assessing the trustee's controls in place to monitor compliance with Section 155(2). These procedures did not include testing the trustee's methodology used to calculate the issue or redemption price.

My procedures included examination, on a test basis, of evidence supporting compliance with those requirements of the SIS Act, SIS Regulations, FSCODA Reporting Standards, Corporations Act and Corporations Regulations.

These tests have not been performed continuously throughout the period, were not designed to detect all instances of non-compliance, and have not covered any other provisions of the SIS Act and SIS Regulations, FSCODA Reporting Standards, Corporations Act and Corporations Regulations apart from those specified. The superannuation entity's trustee is responsible for complying with the SIS Act and SIS Regulations, FSCODA Reporting Standards, Corporations Act and Corporations Regulations.

I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my audit opinion.

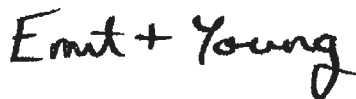
Basis for Preparation and Restricted Distribution

This report has been prepared solely for the trustee in order to meet the APRA reporting requirements of the trustee. This report is not to be used for any other purpose or distributed to any other party. I disclaim any assumption of responsibility for any reliance on this report to any party other than the trustee and APRA (and ASIC where applicable), or for any purpose other than that for which it was prepared.

Auditor's Opinion

In my opinion the Trustee of Local Authorities Superannuation Fund has complied, in all material respects with:

- a) The requirements of the SIS Act and SIS Regulations, FSCODA Reporting Standards, Corporations Act and Corporations Regulations specified above for the year ended 30 June 2014 and
- b) The conditions contained in Conditions C1 of the '*Schedule - additional conditions imposed under Section 29EA of the Act*' of the RSE Licence issued by APRA, specified above.
- c) The requirement to maintain an operational risk reserve at the required target amount in accordance with its ORFR strategy.



Ernst & Young



Brett Kallio
Partner
Melbourne
23 October 2014

Part 3 - Independent Auditor's Limited Assurance report on APRA Annual Return and Compliance

(A) APRA Annual Return

Independent auditor's review report to the trustee of Local Authorities Superannuation Fund ABN 24 496 637 884 on APRA Annual Return forms: SRF 330.2 Statement of Financial Performance; SRF 533.0 Asset Allocation; SRF 540.0 Fees; and SRF 702.0 Investment Performance

Trustee's responsibility for the APRA Annual Return Forms

The superannuation entity's trustee is responsible for the preparation of the APRA Annual Return forms in accordance with the Financial Sector (Collection of Data) Act 2001 (FSCODA Reporting Standards). This responsibility includes establishing and maintaining internal control relevant to the preparation of the APRA Annual Return forms that is free from material misstatement, whether due to fraud or error.

Auditor's responsibility

My responsibility is to express a conclusion, based on my review, on the APRA Annual Return Forms: SRF 330.2 Statement of Financial Performance; SRF 533.0 Asset Allocation; SRF 540.0 Fees; and SRF 702.0 Investment Performance (collectively known as the 'relevant forms') of Local Authorities Superannuation Fund, which comprise part of the APRA Annual Return, for the year ended 30 June 2014

I have conducted my review, in accordance with ASRE 2405 Review of Historical Financial Information Other than a Financial Report (ASRE 2405), pursuant to the FSCODA Reporting Standards, of the APRA Annual Return forms in order to state whether, on the basis of the procedures described, anything has come to my attention that causes me to believe that the relevant forms are not prepared, in all material respects, in accordance with the FSCODA Reporting Standards.

ASRE 2405 requires me to comply with the relevant professional and ethical requirements of the Standards issued by the Accounting Professional and Ethical Standards Board.

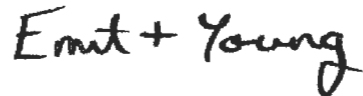
A review consists of making enquiries, primarily of persons responsible for the relevant forms, and applying analytical and other review procedures. A review is substantially less in scope than an audit conducted in accordance with Australian Auditing Standards and consequently does not enable me to obtain assurance that I would become aware of all significant matters that might be identified in an audit. Accordingly, I do not express an audit opinion.

Basis of preparation of APRA Annual Return Forms and restriction on use

Without modifying my conclusion, I draw to readers' attention that the APRA Annual Return forms have been prepared for the purpose of fulfilling the trustee's reporting responsibilities of the FSCODA Reporting Standards. As a result, they may not be suitable for another purpose. I disclaim any assumption of responsibility for any reliance on this report to any party other than the trustee and APRA (and ASIC where applicable), or for any purpose other than that for which it was prepared.

Auditor's Conclusion

Based on my review, which is not an audit, nothing has come to my attention that causes me to believe that the APRA annual return forms for the year ending 30 June 2014 are not prepared, in all material respects, in accordance with the FSCODA Reporting Standards.



Ernst & Young



Brett Kallio
Partner
Melbourne
23 October 2014

(B) Compliance

**Independent auditor's review report to the trustee of Local Authorities Superannuation Fund
ABN 24 496 637 884.**

I have performed a review pursuant to the reporting requirements specified in Australian Prudential Regulation Authority (APRA) Prudential Standard SPS 310 *Audit and Related Matters* (SPS 310), as described in the Scope section, paragraphs *Part A* to *Part D*, of this report.

Trustee's responsibility for compliance

The trustee is responsible for:

- (a) the trustee's systems, procedures and internal controls that are designed to ensure that the trustee has complied with all applicable prudential requirements, has provided reliable data to APRA as required under the reporting standards prepared under the FSCODA, and has operated effectively throughout the year of income;
- (b) the trustee's compliance with its risk management framework; and
- (c) the trustee's compliance with its operational risk financial requirement (ORFR) strategy.

Auditor's responsibility

My responsibility is to perform a review as required by SPS 310, described in Scope paragraphs *Part A* to *Part D* of this report, and to express a conclusion based on my review.

My review has been conducted in accordance with applicable Australian Standards on Assurance Engagements (ASAE 3000 *Assurance Engagements Other than Audits or Reviews of Historical Financial Information* and ASAE 3100 *Compliance Engagements*). These Standards require that I comply with relevant ethical requirements and plan and perform a review, in order to express a conclusion as described in Scope paragraphs *Part A* to *Part D* of this report.

My audit of the financial statements and my audit and review of the APRA annual return forms required under SPS 310 are directed towards obtaining sufficient evidence to form an opinion and conclusion under the appropriate prudential requirements. These procedures were not designed to enable me to conclude on other matters required by APRA's Prudential Standards. I have therefore performed additional procedures beyond those undertaken in order to meet my responsibilities in relation to my audit of the financial report(s) and my audit and review of the APRA Annual Return forms required under SPS 310.

My review consists primarily of making enquiries of the trustee's personnel and applying analytical and other review procedures. I have performed my review procedures having regard to relevant standards and guidance issued by the Auditing and Assurance Standards Board.

Inherent Limitations

A review is substantially less in scope than an audit conducted in accordance with Australian Auditing Standards and consequently does not enable me to obtain assurance that I would become aware of all significant matters that might be identified in an audit. Accordingly, I do not express an audit opinion.

There are inherent limitations in any internal control structure, and fraud, error or non-compliance with laws and regulations may occur and not be detected. As the systems, procedures and controls to ensure compliance with APRA Prudential Requirements are part of the business operations of the trustee, it is possible that either the inherent limitations of the general internal control structure, or

weaknesses in it, can impact on the effective operation of the specific control procedures of the trustee.

Furthermore, projections of any evaluation of internal control procedures or compliance measures to future periods are subject to the risk that control procedures may become inadequate because of changes in conditions, or that the degree of compliance may deteriorate. Consequently, there are inherent limitations on the level of assurance that can be provided.

Accounting records and data relied on for prudential reporting and compliance are not continuously audited and do not necessarily reflect accounting adjustments necessary for end of reporting period financial report preparation, or events occurring after the end of the reporting period.

Basis for Preparation and Restricted Distribution

This report has been prepared solely for the trustee in order to meet the APRA reporting requirements of the trustee. This report is not to be used for any other purpose or distributed to any other party. I disclaim any assumption of responsibility for any reliance on this report to any party other than the trustee and APRA (and ASIC where applicable), or for any purpose other than that for which it was prepared.

Scope

Part A - the trustee's systems, procedures and internal controls are designed and operate effectively to ensure that the trustee has complied with all applicable prudential requirements

During the period 1 July 2013 to 30 June 2014, I performed review procedures that I consider necessary in relation to the trustee's systems, procedures and controls that address compliance with all applicable Prudential Requirements. Prudential Requirements include requirements imposed by the:

- (a) APRA Prudential Standards;
- (b) APRA Reporting Standards;
- (c) APRA conditions on the trustee's licence or authorisation;
- (d) Directions issued by APRA, pursuant to the *SIS Act 1993*; and
- (e) Other requirements imposed by APRA in writing (if applicable).

I have performed these procedures to enable me to state, on the basis of my review as described, whether anything has come to my attention that causes me to believe that, at the date of my review, there did not exist systems, procedures and controls that operated effectively throughout the year of income and address compliance, in all material respects, with applicable Prudential Requirements, specified above.

Part B - the trustee's systems, procedures and internal controls provided reliable data to APRA as required under the reporting standards prepared under the FSCODA

I have performed review procedures that I consider necessary in relation to *trustee's* systems, procedures and controls in place to ensure that reliable data is provided to APRA, as required by APRA Reporting Standards made under the *Financial Sector (Collection of Data) Act 2001*, for the period 1 July 2013 to 30 June 2014.

I have performed the review of systems, procedures and controls in order to state whether, on the basis of the review procedures described, anything has come to my attention that causes me to believe that the trustee does not have in place systems, procedures and controls that operated effectively throughout the year of income and ensure, in all material respects, reliable data is provided to APRA.

Part C - Compliance with the RMF

I have performed review procedures that I consider necessary in relation to the trustee's compliance, in all significant respects, with its Risk Management Framework (RMF) for the period 1 July 2013 to 30 June 2014.

I have performed these procedures to enable me to state, on the basis of my review as described, whether anything has come to my attention that causes me to believe that for the period 1 July 2013 to 30 June 2014 the trustee did not comply, in all significant respects, with its RMF.

Part D - Compliance with the ORFR strategy

I have performed review procedures that I consider necessary in relation to the trustee's compliance, in all significant respects, with its Operational Risk Financial Requirement (ORFR) strategy for the period 1 July 2013 to 30 June 2014.

I have performed these procedures to enable me to state, on the basis of my review as described, whether anything has come to my attention that causes me to believe that for the period 1 July 2013 to 30 June 2014 the trustee did not comply, in all significant respects, with its ORFR strategy.

Auditor's Conclusion

Part A - the trustee's systems, procedures and internal controls are designed to ensure that the trustee has complied with all applicable prudential requirements

Based on my review, which is not an audit, nothing has come to my attention that causes me to believe that, at the date of my review 30 June 2014, the trustee did not have in place systems, procedures and controls that operated effectively throughout the year of income and address compliance, in all material respects, with all applicable Prudential Requirements.

Part B - the trustee's systems, procedures and internal controls provided reliable data to APRA as required under the reporting standards prepared under the FSCODA

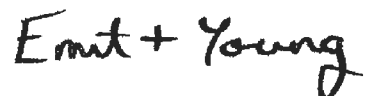
Based on my review, which is not an audit, nothing has come to my attention that causes me to believe that, at the date of my review 30 June 2014, the trustee did not have in place systems, procedures and controls that operated effectively throughout the year of income and provided reliable data to APRA, in all material respects, as required under the reporting standards prepared under the FSCODA.

Part C - Compliance with the RMF

Based on my review, which is not an audit, nothing has come to my attention that causes me to believe that, for the period 1 July 2013 to 30 June 2014, the trustee did not comply, in all significant respects, with its RMF.

Part D - Compliance with the ORFR strategy

Based on my review, which is not an audit, nothing has come to my attention that causes me to believe that, for the period 1 July 2013 to 30 June 2014, the trustee did not comply, in all significant respects, with its ORFR strategy.



Ernst & Young



Brett Kallio
Partner
Melbourne
23 October 2014

Report on the Actuarial Investigation as at 31 December 2011

The Defined Benefit Plan

Local Authorities Superannuation Fund

25 JUNE 2012

Copyright © Russell Employee Benefits Pty Ltd (ABN 70 099 865 013) - a member of Russell Investments. All rights reserved. This material is confidential and proprietary, not to be shared, reproduced, transferred, or distributed in any form to any party without prior written permission from Russell Investments. This material is confidential and is intended only for the recipient. This is delivered on an "as is" basis without warranty. It is not an offer, solicitation, or recommendation to purchase any security or the services of any organization unless otherwise noted. Russell Investments, including its subsidiaries and affiliates, may have past, current or future commercial relationships with investment management firms it researches and evaluates.

TABLE OF CONTENTS

1	EXECUTIVE SUMMARY-----	3
2	INTRODUCTION-----	12
3	DATA AND EXPERIENCE-----	17
4	ASSETS AND INVESTMENTS-----	26
5	VALUATION ASSUMPTIONS AND FUNDING METHOD-----	29
6	FINANCIAL POSITION AT 31 DECEMBER 2011-----	34
7	ASSESSING THE ADEQUACY OF THE FUNDING ARRANGEMENTS-----	41
8	INSURANCE-----	52
9	MATERIAL RISKS-----	55
	APPENDIX A - SUMMARY OF BENEFITS AND CONDITIONS-----	59
	APPENDIX B - MEMBERSHIP MOVEMENTS-----	64
	APPENDIX C - SUMMARY OF CASH FLOWS FROM 1 JANUARY 2009 TO 31 DECEMBER 2011-----	66
	APPENDIX D - SUMMARY OF VALUATION ASSUMPTIONS-----	67
	APPENDIX E - ASSET ALLOCATION-----	71
	APPENDIX F - VALUATION RESULTS-----	72
	APPENDIX G - FINANCIAL POSITION OF THE TOTAL FUND-----	73
	APPENDIX H - STATEMENTS REQUIRED UNDER REGULATION 9.31 OF THE SUPERANNUATION INDUSTRY (SUPERVISION) ACT 1993--	79
	APPENDIX I - CITY OF MELBOURNE PLAN-----	82
	APPENDIX J - PARKS VICTORIA PLAN-----	101
	APPENDIX K - VALUATION RESULTS (COM AND PARKS)-----	122

1 EXECUTIVE SUMMARY

Purpose

- 1.1 This report has been prepared for Vision Super, the Trustee of the Local Authorities Superannuation Fund (the Fund).
- 1.2 The Fund is a "regulated fund" under the provisions of the Superannuation Industry (Supervision) Act 1993 ("SIS"). We understand that the Fund is treated as a complying superannuation fund for taxation purposes.
- 1.3 In accordance with the Superannuation Industry (Superannuation) Act 1993, actuarial investigations are required at intervals of not more than three years. The previous actuarial investigation was conducted as at 31 December 2008 and my report was prepared in two parts dated 13 May 2009. Because the Fund provides pensions, annual actuarial investigations are also completed.
- 1.4 The purpose of this report is:
- to meet the requirements of the Trust Deed and the relevant superannuation legislation;
 - to examine the current financial position of the Fund;
 - to provide advice to the Trustee on the funding arrangements;
 - to provide actuarial certification in respect of the funding of pension entitlements; and
 - to meet the reporting requirements of SIS Regulation 9.31.
- 1.5 The main body of the report covers the actuarial investigation of the Defined Benefit plan. The actuarial investigations of the City of Melbourne plan and the Parks Victoria plan (including the former Ports plan members) are covered in Appendix I and J respectively. The Executive Summary provides a summary of the actuarial investigation for the Defined Benefit plan.

Current Funding Arrangements

- 1.6 The current funding arrangements for the Defined Benefit plan comprise three components:
- (a) contributions in respect of each Authority's share of any funding shortfall that arises. This has included:
- \$321 million unfunded liability at 30 June 1997, plus contribution tax;
 - \$127 million unfunded liability as at 31 December 2002, plus contribution tax;

- \$71 million unfunded liability as at 31 December 2008, plus contribution tax (This amount plus interest was invoiced at 30 June 2011).
- (b) an additional contribution to cover the increase in liability arising from retrenchment benefits paid after 30 June 1997, plus contribution tax, either payable at the time of retrenchment or by increasing the Authority's contributions under (a) above; and
- (c) an ongoing contribution rate, presently 9.25% of current members' salaries, needed to fund the balance of benefits for current members and pensioners.

Data and Experience

1.7 The Defined Benefit plan membership is summarised in the following table:

Summary of Defined Benefit Plan Membership Data		
Active Members	31 December 2008	31 December 2011
Number	6,212	4,971
Average Age	52.5 years	54.1 years
Average Past Membership	21.8 years	24.6 years
Average Salary	\$60,638	\$70,727
Lifetime Pensioners		
Number	5,556	5,132
Average Age	78.9 years	79.1 years
Average Annual Pension	\$5,778	\$7,172
Fixed Term Pensioners		
Number	15	15
Deferred Beneficiaries		
Number	2,420	2,212
Average Age	50.2 years	51.7 years
Average Balance	\$128,183	\$149,842

1.8 As the fund has been closed to new members since 31 December 1993, the defined benefit membership has continued to decline during the last three years to 31 December 2011.

Financial Experience

- 1.9 The rate of return (net of tax and investment expenses) earned by the Defined Benefit plan for the period from 1 January 2009 to 31 December 2011 was 3.0% p.a. which was lower than the expected return of 8.5%p.a. in the 2008 investigation.
- 1.10 The full time equivalent salary of Defined Benefit plan members who remained members as at 31 December 2011 grew by 5.1% p.a. over the three year period. This is a little higher than the assumed salary growth of 4.25%p.a..
- 1.11 In respect of pension liabilities, pension increases averaged 2.7% p.a. over the three years to 31 December 2011 which was broadly in line with the assumed inflation rate of 2.75% p.a..
- 1.12 Overall, the financial experience over the last three years has been unfavourable which has led to a deterioration of the Fund's position.

Demographic Experience

- 1.13 Analysis of the demographic experience has been carried out for the period 1 January 2009 to 31 December 2011. The table below summarises the ratio of the actual number of exits to the "expected" number. "Expected" figures are based on the funding assumptions used in the 2008 investigation.

**Ratio Of Actual To Expected Numbers Over The Period
From 1 January 2009 To 31 December 2011**

	Resignation	Resignation & Retrenchment	Death	Disablement	Retirement
1/1/2009 – 31/12/2011	0.6	0.7	0.5	0.5	0.8

- 1.14 As shown in the table above, the actual exits have been consistently lower for all decrements.
- 1.15 The table below summarises the pensioners mortality analysis over the three years to 31 December 2011:

**Ratio Of Actual To Expected Numbers For The Period
From 1 January 2009 To 31 December 2011**

	Retirement/Spouse Pensioners	Disability Pensioners
Male	102%	117%
Female	126%	N/A

- 1.16 As shown in the table above, the actual deaths among pensioners have been higher than the assumed mortality rates over the three years to 31 December 2011.
- 1.17 Our analysis also showed an increasing trend for members to take-up the pension option and deferred option.

Assumptions and Funding Method

- 1.18 The assumptions used in this actuarial investigation are summarised below:
- (a) Net investment return: 7.5% p.a. (gross: 8.25%p.a.)
 - (b) Salary Inflation: 4.25% p.a.
 - (c) Price Inflation: 2.75% p.a.
- 1.19 The expected investment return was reduced from 8.5%p.a. to 7.5%p.a. while the salary and price inflation were unchanged from the 2008 investigation. These assumptions have been set with consideration of the views of the Board.
- 1.20 Based on experience, the following changes to the assumptions have also been made:
- The proportion of members assumed to defer their benefits upon resignation has been increased from 60% to 70%;
 - The pension take-up rate has been increased from 35% to 50% for eligible active members and from 0% to 30% for eligible deferred beneficiaries;
 - Pensioner mortality rates for males have been reduced slightly, at some ages, to be no higher than the Australian Life Table 2005-2007;

- The assumed level of administration expense has been increased to 2.0% of salaries plus 2.0% of pensions in payment.

- 1.21 The changes to these assumptions will have a negative impact on the fund's financial position.
- 1.22 The funding method used in this investigation is the Aggregate Funding Method which is explained in more detail in Section 5.

Funding position as at 31 December 2011

- 1.23 The following table shows each of the three key indices as at 31 December 2008 and 31 December 2011 for the Defined Benefit plan.

Funding Position	31 December 2008	31 December 2011
Vested Benefit Index (VBI)	104%*	77%
Discounted Accrued Benefit Index (DABI)	100%	84%
Minimum Requisite Benefit Index (MRBI)	106%^	113%

**Based on the old approach where members are assumed to take the immediate lump sum option upon resignation*

^ Based on the vested benefits for deferred beneficiaries and pensioners.

- 1.24 The funding indices have deteriorated since the last triennial actuarial investigation largely because of poor investment returns and changes to the assumptions.
- 1.25 There has been a change in the methodology for the vested benefit calculations which is explained in paragraphs 6.4 – 6.6. Professional Standard 400 from the Actuaries Institute now requires the vested benefit to reflect the benefit options assumed to be chosen upon resignation and retirement for funding purposes. In 2008, consistently with the financial statements, the vested benefits were calculated based on the immediate lump sum option.
- 1.26 In the 2008 investigation, the MRB calculations for deferred beneficiaries and pensioners were based on the vested benefits. The methodology for calculating the MRB for deferred beneficiaries and pensioners have been modified in this investigation following the legal advice from DLA Piper. The change is explained in paragraphs 6.21 and 6.22.

Adequacy of the funding

- 1.27 As at 31 December 2011 there was an actuarial shortfall of \$406 million (excluding contribution tax). This means that the current value of assets plus expected future contributions is less than the value of expected future benefits and expenses by \$406 million, assuming that the Authorities

continue to contribute at 9.25% of salaries. Full details of these calculations are set out in Appendix F.

- 1.28 The increase in actuarial shortfall is mainly caused by the poor investment return over the three years to 31 December 2011 and the assumed lower return in the future.

Recommendations

- 1.29 The following funding plan has been proposed, whereby the Authorities will pay:
- (a) Contributions equal to 9.25% of salary for employee members;
 - (b) An additional contribution to cover the excess of the benefits paid as a consequence of retrenchment above the funded resignation or retirement benefit (the funded resignation or retirement benefit is calculated as the VBI multiplied by the benefit), plus contribution tax;
 - (c) Top up contributions of \$406 million (plus contribution tax and interest from 31 December 2011) payable as at 1 July 2013. While Employers will be encouraged to pay their share of this amount by 1 July 2013, other funding options will be provided. The "actuarial shortfall" with interest to 1 July 2013 is \$453 million (plus contribution tax); and
 - (d) Additional top up contributions that may be required in the future so that Defined Benefit plan is no longer in an unsatisfactory financial position.
- 1.30 We recommend that this proposed funding plan be adopted.
- 1.31 This funding plan is expected to increase the VBI to approximately 95% as at 1 July 2013 (assuming the entire amount of the additional contribution is in the Fund assets at that date) and is not expected to restore the VBI to 100% within three years. We note that the funding plan may need to be revised if draft Prudential Standard (SPS 160) is finalized, and it continues to require funding plans that expect to achieve 100% coverage of vested benefits within three years, unless an adjustment or exclusion from this requirement is provided by APRA for the Defined Benefit plan.
- 1.32 We recommend that the funding plan be reviewed immediately if the Board believes there is a significant risk that APRA will not allow such an adjustment or exclusion. Otherwise, a second additional contribution is likely to be required in the short term to target a VBI of 100% within three years.

Material Risks

Technical Insolvency Risk

- 1.33 Because the MRBI is only 113% there is a risk that the Defined Benefit plan could become Technically Insolvent. The risk is expected to reduce from 1 July 2013 if significant contributions are made by Authorities in respect of the "actuarial shortfall".
- 1.34 However, we understand that under the proposed funding plan, although Authorities would be able to spread their contributions over 15 years, the contributions not yet received could be included in the Defined Benefit plan's audited assets as a contribution receivable. As separately advised, we expect to be able to include this amount as an asset for calculating the MRBI and VBI. There is a risk that this may not be possible in the future if circumstances change or actuarial professional standards change. This is because these assets are not immediately available to pay benefits.

Investment Risk

- 1.35 The most significant risk facing the Defined Benefit plan is that investment returns will not be as high as expected which might result in additional contribution calls in the future, which is of particular concern given that the Defined Benefit plan has been closed to new members since 31 December 1993. For example, if the Defined Benefit plan investment return was zero for the 2012 year, the "actuarial shortfall" would be expected to remain in the order of \$120 million (excluding contribution tax) as at 1 July 2013 if all other experience was as expected.
- 1.36 It is recommended that the funding position of the Defined Benefit plan continue to be considered in setting investment policy. If the Defined Benefit plan ever has an "actuarial surplus" reducing the allocation to growth assets may become more attractive to the Board as a means of reducing the risk of subsequent higher contributions being caused by poor investment experience.

Liquidity Risk

- 1.37 As at 31 December 2011, 43% of the investments are invested in illiquid asset classes which include Private Equity, Infrastructure, Opportunistic Investments and Direct Property.
- 1.38 We understand that the Board has determined that no further commitments are to be made to illiquid investments and is considering plans to reduce the allocation to illiquid assets to 25-30% over approximately three to five years.
- 1.39 Given the maturity of the plan, it is recommended that the Board should consider the time frame over which they will reduce the exposure to illiquid assets in the defined benefit plans to zero. Consideration of the liability run off under various scenarios should form part of this consideration.

Asset Risks

- 1.40 We understand that in preparing the financial statement, Vision Super has determined the Defined Benefit plan assets by deducting the defined contribution assets (or liabilities) from the total Fund assets. This might lead to issues of cross subsidies between the defined benefit and defined contribution plans. There is also a risk that the Defined Benefit plan assets may be under or overstated in the event of unit pricing errors.
- 1.41 We recommend that the Board should satisfy itself that no cross subsidies are occurring or could occur between the defined benefit and defined contribution plans. Consideration should be given to the Fund segregating the accounting process for defined benefit and defined contribution plans.

Retrenchment Risk

- 1.42 The retrenchment benefit is larger than the resignation benefit for most members. Also, currently resignation benefits are not fully funded. Therefore, a significant number of retrenchments would have a negative impact on funding and liquidity unless additional contributions are required to fund the shortfall when a member is retrenched. This is also appropriate when a member over or under 55 is retrenched even if it is not a retrenchment benefit being paid from the Defined Benefit plan.
- 1.43 As per our recommendations, Vision Super should require top-up contributions to be made by the Authorities to manage this risk.

Reserving Risks

- 1.44 In the Draft Prudential Standards, there are proposals to require funds to allocate a proportion of assets to an operational reserve. If the Defined Benefit plan assets were used to establish any of this reserve then the VBI, DABI and MRBI would reduce. Authorities would be required to make additional contributions to achieve the VBI of 100%.

Other Risk

- 1.45 A more complete discussion of these risks and other material risks is included in Section 9.

Standards

- 1.46 We confirm that this actuarial investigation and report meet the requirement of the relevant Professional Standards and Guidance Notes of The Institute of Actuaries of Australia.

Matthew Burgess

Matthew Burgess
Fellow of the Institute of Actuaries of Australia

Quality Assurance

I confirm that Russell Employee Benefit's Quality Assurance standards have been applied in the preparation of this report.

Gabrielle Baron

Gabrielle Baron
Fellow of the Institute of Actuaries of Australia
25 June 2012

Russell Employee Benefits ABN 70 099 865 013 AFSL 220705
Level 13, 8 Exhibition St
Melbourne VIC 3000

2 INTRODUCTION

- 2.1 This is the tenth actuarial investigation of the Local Authorities Superannuation Fund (the Fund) since the Local Authorities Superannuation Act (1988) (the Act) was proclaimed on 25 May 1988. The Act has been replaced and since 1 July 1998, the Fund has been governed by a Trust Deed.
- 2.2 The Fund is a "regulated fund" under the provisions of the Superannuation Industry (Supervision) Act 1993 ("SIS"). We understand that the Fund is treated as a complying superannuation fund for taxation purposes and is a taxed superannuation fund.
- 2.3 In accordance with the Superannuation Industry (Superannuation) Act 1993, actuarial investigations are required at intervals of not more than three years. I completed the previous actuarial investigation as at 31 December 2008 and my report was prepared in two parts dated 13 May 2009. This actuarial investigation has been completed at the request of the Trustee of the Fund.
- 2.4 In accordance with APRA's Modification Declaration No 23 (Mod 23), annual certifications of the Fund's pension liabilities have also been performed, as at 30 June 2009, 30 June 2010 and 30 June 2011.
- 2.5 This actuarial investigation report covers the three defined benefit plans within the Fund, and in particular the Defined Benefit plan in the body of the report. In the appendices of the report we consider in more detail the:
- (a) the City of Melbourne Plan; and
 - (b) the Parks Victoria Plan (including the former Ports Plan members).
- 2.6 In accordance with Clause A.20.1, the Trust Deed requires each Authority to contribute to the Fund in respect of a particular employee the amount or rate of contributions determined by the Trustee after obtaining the advice of the actuary, including any unfunded liability amount. The Trustee also has some flexibility in adjusting benefits in accordance with Clause A.21 in the event that an Authority terminates contributions to the Fund.
- 2.7 The purpose of this report is:
- to meet the requirements of the Trust Deed and the relevant superannuation legislation;
 - to examine the current financial position of the Fund;
 - to provide advice to the Trustee on the funding arrangements;
 - to provide actuarial certification in respect of the funding of pension entitlements; and

- to meet the reporting requirements of SIS Regulation 9.31.

2.8 This report satisfies the requirements of the following Professional Standards and Guidance Notes of the Institute of Actuaries of Australia:

- Guidance Note 465
- Professional Standard 400
- Professional Standard 402
- Professional Standard 404.

Funding Arrangements

2.9 As is the case for all defined benefit funds, the ultimate cost of benefits depends on the future experience of the Defined Benefit plan.

2.10 Arrangements for funding the Defined Benefit plan that were introduced effective from 1 July 1997 were updated as part of the actuarial investigation as at 31 December 2008 and the funding review as at 30 June 2010.

2.11 Briefly, these funding arrangements comprise three components:

- (a) contributions in respect of each Authority's share of any funding shortfall that arises. This has included any outstanding unfunded liability from the 30 June 1997, 31 December 2002 and 31 December 2008 actuarial investigations;
- (b) an additional contribution to cover the increase in liability arising from retrenchment benefits paid after 30 June 1997, plus contribution tax, either payable at the time of retrenchment or by increasing the Authority's contributions under (a) above; and
- (c) an ongoing contribution rate, presently 9.25% of current members' salaries, needed to fund the balance of benefits for current members and pensioners.

Actuarial Investigation as at 31 December 2008

2.12 The report on the actuarial investigation as at 31 December 2008 concluded that the three years to 31 December 2008 had been unfavorable and assessed that there was an "actuarial shortfall" of \$71 million in the Defined Benefit plan as at that date.

2.13 The report recommended that the Trustee develop a plan to fund the shortfall by 31 December 2013 (ie over a five year period).

2.14 We understand that the Trustee consequently adopted the following funding plan:

- require no additional contribution from Authorities at that time (in respect of the actuarial shortfall) ;
- review the funding plan as at 30 June 2010 and request additional contributions from Authorities if an "actuarial shortfall" remains at that date; and
- update the funding plan to target full funding of the "actuarial shortfall" by 31 December 2013.

2.15 It was also noted in the report that because of the experience of the Fund since 31 December 2008, it is likely that the Fund was in an Unsatisfactory Financial Position and would be close to Technical Insolvency (or may already be so). It was recommended that the funding position be reviewed as at 30 June 2009 so that a new Funding and Solvency Certificate could be issued by 13 August 2009.

Funding Review as at 30 June 2010

2.16 The experience of the Defined Benefit plan over the period to 30 June 2010 had been unfavourable due to the poor investment returns since 31 December 2008. This led to a deterioration of the Defined Benefit plan's financial position.

2.17 It was recommended that the funding plan be amended so that Authorities contribute:

- (a) any outstanding unfunded liability from the 30 June 1997 and 31 December 2002 actuarial investigations;
- (b) additional top-up payments for retrenchments;
- (c) 9.25% of members' salaries;
- (d) \$71 million, plus interest at the expected investment return plus contribution tax, be funded by 1 July 2011; and
- (e) any remaining "actuarial shortfall" be funded by 31 December 2013, with the funding plan updated no later than following the 31 December 2011 actuarial investigation.

2.18 We understand that Vision Super requested Authorities contribute \$71 million, plus interest and contribution tax by 1 July 2011. Authorities have been invoiced with the full amount but are able to make the contributions over a 10 year period. Vision Super includes amounts outstanding as an asset (contribution receivable) in its balance sheet and these amounts are included as an asset in this report. The total contribution receivable in the Fund's 31 December 2011 financial

statements was \$11.4 million. Any amount outstanding from an Authority in respect of the "actuarial shortfall" as at 31 December 2008 is increased at 8.5% per annum. It is important to note that we may not be able to continue this approach in the future as discussed in 7.38.

Events since the 31 December 2008 Actuarial Investigation

- 2.19 Since the 31 December 2008 actuarial investigation there has been no legislative change that has materially impacted on the funding of the Defined Benefit plan and no material changes to benefits.
- 2.20 We note that the Government has legislated to increase the Superannuation Guarantee Charge to 12% of Ordinary Times Earnings. We understand that it is likely that this increase will be provided from the defined contribution plan and we have assumed that this is the case in this investigation. There would be expected to be an impact on the Defined Benefit plan funding if the increase was provided from the Defined Benefit plan.
- 2.21 The net investment return for the three years since the 31 December 2008 actuarial investigation was 3.0% p.a.. This is well below the expected investment return of 8.5% p.a. and has led to a deterioration of the Defined Benefit plan's financial position.
- 2.22 Current draft Prudential Standards (SPS 160), if finalized without change, would require actuaries and Trustees to put in place funding plans that would be expected to rectify an unsatisfactory financial position within three years. A funding plan longer than three years would require APRA approval. The potential implications of this for the Defined Benefit plan are discussed later in this report.

31 December 2011 Actuarial Investigation

- 2.23 The remainder of this report is structured in the following manner:
- Section 3 describes the data provided for this investigation and the Defined Benefit plan's experience during the three years since 31 December 2008 compared with the actuarial assumptions used in the 2008 investigation.
 - Section 4 considers the asset allocation in relation to the investments of the Defined Benefit plan
 - Section 5 discusses the assumptions used to value the assets and liabilities of the Defined Benefit plan in this investigation and the actuarial funding method.
 - Section 6 considers the financial position of the Defined Benefit plan at 31 December 2011.

-
- Section 7 considers the long-term funding of the Defined Benefit plan.
 - Section 8 considers the insurance arrangements for the Defined Benefit plan.
 - Section 9 considers the material risks related to the Defined Benefit plan funding.
 - Appendices A to F include supporting details of benefits, assets, accounts and actuarial assumptions;
 - Appendix G considers the financial position of the Total Fund at 31 December 2011;
 - Appendix H contains the statements required under Regulation 9.31 of the Superannuation Industry (Supervision) Act 1993 for the total Fund;
 - Appendix I contains the 31 December 2011 actuarial valuation of the City of Melbourne plan; and
 - Appendix J contains the 31 December 2011 actuarial valuation of the Parks Victoria plan (including former Ports plan members).
 - Appendix K contains a summary of the valuation results of the City of Melbourne plan and the Parks Victoria plan.

3 DATA AND EXPERIENCE

- 3.1 This section deals with the data used in the investigation and comments on the more significant factors bearing upon the financial experience of the Defined Benefit plan.

Membership

- 3.2 For the purposes of this investigation, we were supplied with information on active members of the Defined Benefit plan, deferred beneficiaries and pensioners as at 31 December 2011 together with details of exits during the period from 1 January 2009 to 31 December 2011. From our checking processes we believe that the data is sufficiently accurate for the purposes of this investigation.
- 3.3 A detailed summary of the movement in active and pensioner membership is set out in Appendix B. Briefly, the active membership of the Defined Benefit plan has decreased by 1,241 (or 20.0%) from 6,212 at 31 December 2008 to 4,971 at 31 December 2011. The number of pensioners has decreased by 424 (or 7.6%) from 5,556 to 5,132 over the same period.

Summary of Defined Benefit Plan Membership Data

Active Members	31 December 2008	31 December 2011
Number	6,212	4,971
Average Age	52.5 years	54.1 years
Average Past Membership	21.8 years	24.6 years
Average Salary	\$60,638	\$70,727
Lifetime Pensioners		
Number	5,556	5,132
Average Age	78.9 years	79.1 years
Average Annual Pension	\$5,778	\$7,172
Fixed Term Pensioners		
Number	15	15
Deferred Beneficiaries		
Number	2,420	2,212
Average Age	50.2 years	51.7 years
Average Balance	\$128,183	\$149,842

Salaries

- 3.4 We have analysed the salary experience of Defined Benefit plan members over the intervaluation period from 31 December 2008 to 31 December 2011. The data showed that the full time equivalent salary of Defined Benefit plan members who remained members as at 31 December 2011 grew by 5.1% p.a. over the three year period. This compares to growth of 5.5% p.a. over the three year period to the 31 December 2008 actuarial investigation.
- 3.5 It is of interest to compare the average rate of salary increase with the increase in Australian Average Weekly Ordinary Time Earnings (AWOTE). Over the three years to 31 December 2011, AWOTE increased by 4.7% p.a.. It is therefore apparent that, overall, members received salary increases which are similar but slightly higher than those of the wider community, bearing in mind that the 5.1% p.a. salary increase rate would also reflect some element of promotional increases in addition to the inflationary increases.
- 3.6 Analysis of salary by the age of members suggests some promotional effect for members under age 45. This is consistent with our salary scale assumption for younger members although we assume the promotional effect to cease after age 35. Given that there is only a small proportion of members currently under 45, we have decided to retain the current assumption as the effect of promotion is not expected to be material.

Demographic Experience of Active Members

- 3.7 The demographic experience of active members of the Defined Benefit plan over the three years has been examined for each of the major types of exit. The key results are summarised in the following table:

Actual And Expected Exits Over The Period From 1 January 2009 To 31 December 2011

	Actual	Expected
Resignation	183	319
- Cash 53		
- Deferred 130		
Retrenchments (< age 55)	37	
Retirements	971	1,274
Deaths	22	43
Disablements	35	64

- 3.8 The experience is further examined in the following table, with commentary in the following paragraphs, by giving the ratio of the actual number of exits (during the three years to 31 December 2011) to the "expected" number. "Expected" figures are based on the funding assumptions used in the 2008 investigation.

**Ratio Of Actual To Expected Numbers Over The Period
From 1 January 2009 To 31 December 2011**

Age Band	Resignation	Resignation & Retrenchment	Death	Disablement	Retirement
21-25	0.0	0.0	0.0	0.0	0.0
26-30	0.0	0.0	0.0	0.0	0.0
31-35	0.7	0.7	0.0	0.0	0.0
36-40	0.4	0.5	0.0	3.0	0.0
41-45	0.6	0.8	0.8	0.0	0.0
46-50	0.5	0.6	0.8	1.2	0.0
51-55	0.7	0.8	0.6	0.6	0.6
56-60	0.0	0.0	0.5	0.4	0.5
61-65	0.0	0.0	0.4	0.0	0.9
Total	0.6	0.7	0.5	0.5	0.8

- 3.9 The experience for the three years has been lower than expected in respect of all forms of exit from the Defined Benefit plan.
- 3.10 The number of exits over the intervaluation period has been sufficient to enable a valid demographic analysis to be carried out, although the death and disablement experience will vary over time due to relatively small numbers exiting for these reasons.

Resignation

- 3.11 The table in 3.8 shows that the number of resignations over the period have been lower than expected. Overall, for each 10 resignations expected, 6 resignations actually occurred (the ratio of actual to expected resignations was 0.6 to one).
- 3.12 Members resigning from active service have the option to receive their benefit in cash or as a deferred benefit. As shown in table 3.7, 130 of the 183 resignations (71%) elected the deferred option. Therefore, in this actuarial investigation we have assumed that the proportion of resigning members who elect to take a deferred benefit is 70% which is higher than the assumed proportion in the previous valuation in 2008 of 60%. Because members are eligible to receive the accrued retirement benefit upon deferral, this experience has had a negative impact on the Defined Benefit plan funding.

Resignation and Retrenchment

- 3.13 Under the funding arrangements applying from 1 July 1997, retrenchments prior to age 55 require additional funding by the Authority equal to the excess of the retrenchment benefit over the resignation benefit, plus contribution tax.
- 3.14 Consequently, retrenchments under age 55 are effectively "resignations" from the perspective of the Defined Benefit plan's financial position and do not create any new unfunded liability.
- 3.15 At the 2008 actuarial investigation, an explicit assumption was not made for the number of retrenchments. Instead the resignation decrements were kept at a higher level than justified by resignations alone, in order to implicitly allow for some retrenchments.
- 3.16 For these reasons we have also included a combined "resignation and retrenchment" column in the table in 3.8 above. On this combined basis the actual to expected ratio averaged 0.7 to one. This shows that the combined level of retrenchments and resignations was lower than the assumed level. Because on average the resignation benefit is less than the accrued retirement benefit, a lower number of resignations than expected will have had a small detrimental impact on the financial status of the Defined Benefit plan.
- 3.17 Therefore, we have reduced the resignation rates assumed for this actuarial investigation by 20%. If the new assumptions had applied for the last three years, the actual to expected ratio would have averaged 0.7 to one for resignation and 0.9 to one for resignation and retrenchment combined. We have not reduced the resignation rates assumed to the level of recent experience because the last three years have had lower rates than experienced previously and these low rates may not be sustained in the long term.

Death

- 3.18 The death benefit payable in respect of a particular member would normally exceed the reserve held in respect of that member, often substantially at young ages. Thus it is important that the expected mortality rates do not understate the number of deaths.
- 3.19 During the three year period to 31 December 2011, the ratio of actual to expected deaths was 0.5 to one, however it should be noted that mortality experience for the three year period to 31 December 2008 was in line with the current assumptions. On the basis of the experience for this six year period, the small number of deaths and the importance of not understating the number of deaths, we have retained the mortality rates from the 2008 investigation.

Disability

- 3.20 Like the death benefit, the disability benefit would normally exceed the reserve held in respect of a member. Ideally, the expected disability rates would exceed the actual rates. This is particularly important because no separate allowance is made for the Temporary Disablement benefit.
- 3.21 The ratio of actual to expected disablements based on the experience of the past three years was 0.5 to one. The recent disablement experience has had a favourable impact on the Defined Benefit plan. Although there is a significantly lower number of actual disablements than expected disablements over the past three years, it should be noted that the assumed disablement rates were reduced by 60% at the previous valuation, therefore we have decided to maintain the same assumed rates of disablement.

Retirements

- 3.22 The closer a member is to age 65, the closer the retirement benefit is to the "actuarial reserve" held in respect of that member. Hence a deviation of actual retirements from those expected will have a small effect on the financial status of the Defined Benefit plan. The actual and expected retirements were similar (an overall ratio of 0.8 to one over the three years) and so we have maintained the retirement rates used for the previous investigation.
- 3.23 It is also important to note that retrenchments after age 55 are not distinguishable from retirements and are classified as retirements. Consequently retrenchment "top-up" contributions, under item (b) of the funding arrangements outlined in paragraph 2.11, only apply to retrenchments under age 55.

Pension Election

- 3.24 Members who joined the Defined Benefit plan prior to 25 May 1988 have a choice to convert up to 50% of their retirement benefit into an annual pension.
- 3.25 For the previous investigation we assumed that 35% of eligible active members elect a pension upon retirement. Over the three years to 31 December 2011, almost 60% of retiring members elected a pension. This result may be explained by the investment uncertainty during the three year period to 31 December 2011 during which times retirees may favor a guaranteed pension option. As a result, we have assumed that 50% of eligible active members exercise this option by converting 50% of their benefit to a pension. The higher take up of pension benefits will have had a negative impact on Defined Benefit plan funding.
- 3.26 Our analysis shows that the number of deferred beneficiaries who take a pension upon retirement has increased over the last three years to 31 December 2011. To reflect this trend, we have increased the proportion of eligible deferred beneficiaries taking a pension at retirement from 0% to 30%. Members who exercise this option are assumed to take 50% of their benefit as a pension.

Mortality Experience of Pensioners

- 3.27 The mortality experience of pensioners over the intervaluation period has been examined for males and females, and by type of pension. The key results are summarised in the following table. The "expected" figures are based on the assumptions that were used in the 31 December 2008 actuarial investigation. Given the limited experience for female disability pensioners, less certainty can be placed on the analysis for this group and they are not shown.

**Ratio Of Actual To Expected Numbers For The Period
From 1 January 2009 To 31 December 2011**

	Retirement/Spouse Pensioners	Disability Pensioners
Male	102%	117%
Female	126%	N/A

- 3.28 The analysis over the three years to 31 December 2011 shown in the above table shows that the actual number of deaths had been higher than expected. This is consistent with the previous experience reported on in the 31 December 2005 and 31 December 2008 investigations. The

higher than expected pensioner mortality had a small positive effect on the financial position of the Defined Benefit plan.

- 3.29 The assumed levels of pensioner mortality were also compared to the Australian Life Tables 2005-2007 which reflect the mortality of the Australian population during the 2005-2007 period. The assumed female pensioner mortality is considerably lighter than the mortality of the Australian female population. The assumed male pensioner mortality is generally lighter than the mortality of the Australian male population except for ages between 69 and 81.
- 3.30 The Defined Benefit plan pensioners are likely to have lighter mortality than the Australian population because the pensions are voluntary at retirement so they are likely to be selected by only healthy members. However, the average age of pensioners is 79.1 years and increasing. At older ages the impact of the mortality selection at retirement is likely to be greatly reduced.
- 3.31 We do not believe that the female pensioner mortality experience at this time justifies a change to the assumptions and the 2008 assumptions for the female group have been retained for this investigation. On the basis of the comparison of the recent experience with the Australian Life Tables 2005-2007, the male pensioner mortality rate has been reduced from the rates assumed in the previous investigation as at 31 December 2008 to be in line with the Australian Life tables 2005-2007. Making this change will result in a small increase in the expected future pension payments from the Defined Benefit plan. The rates of mortality assumed for pensioners are summarised in Appendix D.

Administration Expenses

- 3.32 In the 31 December 2008 investigation, the administration expense was assumed to be of the order of 1.0% of salaries plus 2.0% of pensions in payment. The actual expense over the three years has been higher than expected.
- 3.33 Vision Super has advised that the administration expense for the next three years is expected to average about \$6 million a year. Therefore we have increased the assumed level of expenses to 2.0% of salaries plus 2.0% of pensions in payment.

Investment Returns

- 3.34 The rate of return (net of tax and investment expenses) earned by the Defined Benefit plan for the period from 1 January 2009 to 31 December 2011 was 3.0% p.a..
- 3.35 Comparison of the 3.0% p.a. return for the intervaluation period with the average salary increase rate (from paragraph 3.4) of 5.1% p.a. shows a real return of approximately negative 2.0% p.a. which is significantly lower the 4.25% p.a. real return assumed in the 2008 investigation.

-
- 3.36 In respect of pension liabilities, pension increases averaged 2.7% p.a., providing a real return of 0.3% p.a. which is significantly lower than 6.25% p.a. assumed in the 2008 investigation. There is no investment tax paid on investments used to provide pensions, so the real return is actually higher than this, but will still be lower than the assumed return. These two real return items have had a negative effect on the Defined Benefit plan's financial position.

4 ASSETS AND INVESTMENTS

Assets

- 4.1 Copies of the Fund's unaudited financial statements as at 31 December 2011 were supplied by Vision Super for the investigation together with details of investments at 31 December 2011. We understand that they were prepared consistently with the relevant accounting standard (AAS25). A summary of cash flows over the period 1 January 2009 to 31 December 2011 is set out in Appendix C.

Asset Allocation

- 4.2 The Fund invests in a wide range of asset classes such as equity, property and fixed interest investments. The following table shows the Strategic Asset Allocation and the current Actual Asset Allocation as at 31 December 2011. A new strategic asset allocation has been adopted after 31 December 2011, which is also shown in the following table.

Asset Class	Actual Asset Allocation 31 December 2011 (%)	Strategic Asset Allocation 31 December 2011 (%)	2012 Strategic Asset Allocation (%)
Australian Equity	23.0	24.0	26.5
International Equity	17.9	21.0	21.0
Private Equity	12.6	8.0	8.0
Infrastructure	15.5	13.0	13.0
Absolute Return Strategies	1.8	2.0	2.0
Direct Property	8.7	9.0	9.0
Opportunistic Investments	5.9	5.0	5.0
Fixed Interest	11.8	15.0	10.0
Cash	2.8	3.0	5.5
Total	100.0	100.0	100.0
Allocation to Illiquid Assets	42.7%	35.0%	35.0%
Allocation to Growth Assets	73.5%	71.0%	73.5%

- 4.3 The Strategic Allocation to Growth Assets as at 31 December 2011 was 71%, including Australian Equities, International Equities, Private Equity, Opportunistic Investments, Absolute Return Strategies and a portion of the Core Property and Infrastructure asset classes. This has increased slightly to 73.5% in 2012 as a result of the recent changes.
- 4.4 Setting the Strategic Asset Allocation is a balance between:
- (a) A high allocation to growth assets, which is expected to produce relatively high but more variable investment returns and therefore lower but more variable Authority contributions; and
 - (b) A low allocation to growth assets, which is expected to produce relatively low but less variable investment returns and therefore higher but less variable Authority contributions.
- 4.5 We believe that the 73.5% allocation to growth assets is among a range of allocations that could reasonably be used by the Defined Benefit plans.
- 4.6 The Defined Benefit plan has been closed to new members since 31 December 1993. Therefore, its liabilities will reduce significantly over the next ten years in real terms. If future investment returns are higher or lower than expected it is possible that a significant "actuarial surplus" or "actuarial shortfall" will again result. Therefore, it is recommended that the funding position of the Defined Benefit plan continues to be considered in setting investment policy. If the Defined Benefit plan ever has an "actuarial surplus" reducing the allocation to growth assets may become more attractive to the Board as a means of reducing the risk of subsequent higher contributions being caused by poor investment experience.

Liquidity

- 4.7 The Strategic Allocation to illiquid assets is 35%. As at 31 December 2011, 43% of the investments are invested in illiquid asset classes which include Private Equity, Infrastructure, Opportunistic Investments and Direct Property.
- 4.8 In the 31 December 2008 actuarial investigation it was recommended that:
- "The liquidity requirements resulting from the expected benefit payments should also be considered as part of future reviews of the Strategic Asset Allocation because of the Defined Benefit plan's maturity."
- 4.9 Vision Super undertook such a review in 2010. Stress testing has shown that should a significant shock occur, the illiquid asset allocation could become a very significant portion of the three defined benefit plan assets. Because the three defined benefit plans are closed to new members, liquidity modeling has shown that the illiquid asset allocation of the three defined benefit plans will

become even more sensitive to external events over time. Accordingly, we believe that it is appropriate to reduce the target allocation to illiquid assets over time.

- 4.10 We understand that the Board has determined that no further commitments are to be made to illiquid investments. We also understand that Vision Super is considering plans to reduce the allocation to illiquid assets to 25-30% over approximately three to five years.
- 4.11 In any event, eventually the defined benefit plans will require full liquidity. Therefore, we believe that Vision Super should consider the time frame over which they will reduce the exposure to illiquid assets in the defined benefit plans to zero. Consideration of the liability run off under various scenarios should form part of this consideration.

Unit Pricing

- 4.12 Within the Fund there are defined contribution members as well as defined benefit members. The assets and liabilities of the defined contribution members are equal with daily unit pricing being used. There is no investment reserving. We have been advised that the assets of the defined contribution members are segregated from the defined benefit assets and Vision Super has in place processes to limit cross subsidies between defined contribution and defined benefit members.
- 4.13 However, we understand that in preparing the financial statement, Vision Super has determined the Defined Benefit plan assets by deducting the defined contribution assets (or liabilities) from the total Fund assets. To the extent that daily unit pricing may not reflect the underlying assets due to the timing of cash flows and allowance for tax and accruals, any variation will flow on to the Defined Benefit plan assets. This is particularly a concern as the defined contribution assets now form about 60% of the total fund assets and is increasing as a proportion of the total assets. There is also a risk that Defined Benefit plan assets may be under or overstated in the event of unit pricing errors.
- 4.14 We recommend that the Trustee should satisfy itself that no cross subsidies are occurring or could occur between the defined benefit and defined contribution plans. In order to limit the potential cross subsidies, consideration should be given to the Fund segregating the accounting process for defined benefit and defined contribution plans.

5 VALUATION ASSUMPTIONS AND FUNDING METHOD

- 5.1 An appropriate set of both financial and demographic assumptions must be determined before values can be placed on the Defined Benefit plan's liabilities and assets. The assumptions relating to benefit liabilities and assets are discussed under separate headings below.

Valuation of Benefit Liabilities

- 5.2 The assumptions for this actuarial investigation have been determined on a "best estimate" basis.
- 5.3 "Best estimate" describes assumptions which reflect "mean" estimates for the various factors, rather than choosing assumptions with explicit margins to cope with uncertainty about future experience. These "best estimate" assumptions might be described as being realistic. They are equally likely to prove to be conservative or to be optimistic and are less likely to be able to absorb fluctuations in future experience.
- 5.4 As the Defined Benefit plan is closed to new members and as a result has declining membership, "best estimate" assumptions continue to be relevant because using conservative assumptions would be expected to eventually result in excess assets.
- 5.5 Appendix D contains a summary of the assumptions used.

Key Financial Assumptions

- 5.6 Financial assumptions for investment earnings, salary inflation and pension increases are required to value the liabilities.
- 5.7 The factor of major significance in the investigation of the Defined Benefit plan's active member benefit liabilities is the differential between the assumed future rate of investment earnings and the assumed rate of salary growth due to inflation. (These factors are almost exactly compensating in their effect upon the present value of the Defined Benefit plan's future benefit liabilities - hence, the difference between the rates is important, rather than their absolute values.)
- 5.8 In addition to salary increases due to inflation, an allowance needs to be made for salary increases for other reasons e.g. promotion, etc.
- 5.9 For valuing the current pensioner liabilities, the differential between investment earnings and the rate of price inflation is relevant because pensions are indexed semi-annually to the change in the Consumer Price Index (CPI). The historical long-term differential between the changes in CPI and AWE (salary inflation) has generally ranged between 0% and 2% p.a.
- 5.10 The "best estimate" financial assumptions adopted at the 31 December 2008 actuarial investigation were:

- 4.25% p.a. real investment return over salary inflation. This comprised an 8.5% p.a. net of tax investment return assumption and a 4.25% p.a. salary inflation assumption.
- 6.25% p.a. real investment return over price inflation. This comprised a 9.0% p.a. gross of tax investment return and a 2.75% p.a. CPI assumption.

Investment Return

- 5.11 In order to determine the best estimate assumptions for this investigation, we have considered the capital market assumptions of Russell and the Fund's asset consultants, Frontier. A net investment return of 7.5% p.a. has been adopted for this investigation.
- 5.12 The assumed gross of tax investment return used in this investigation is 8.25% p.a.. The additional 0.75%p.a. investment return takes into account the fact that no investment tax is paid on assets backing pensioner liabilities.
- 5.13 The investment return assumption has been reduced from the 31 December 2008 investigation to reflect a lower expected return.

CPI Increases

- 5.14 Russell and Frontier's CPI estimate is of the order of 2.5% - 3.0% p.a. which is consistent with the Reserve Bank's target CPI range of 2.0% p.a. to 3.0% p.a.. Therefore, we have retained the CPI assumption of 2.75% p.a. for the investigation.

Salary Inflation

- 5.15 The actual salary increases of Defined Benefit plan members have been broadly in line with AWOTE (refer 3.4-3.5). As the average age of Defined Benefit plan members is now 54.1 years, significant benefit payments are expected in the next few years and the short term salary inflation assumption is important. The Board has confirmed that the salary inflation assumption of 4.25% p.a. is consistent with Authorities' expectation of the future salary growth and therefore has been retained for this investigation.
- 5.16 A salary increase assumption of 4.25% p.a. is 1.5% p.a. above the assumed 2.75% p.a. CPI, which is within the historical long term 0% to 2% p.a. differential. Given recent experience and the maturity of the Defined Benefit plan, this is appropriate.

- 5.17 Therefore, the "best estimate" financial assumptions adopted for the 2011 investigation are:
- 3.25% p.a. real investment return over salary inflation. This comprised a 7.5% p.a. net of tax investment return assumption and a 4.25% p.a. salary inflation assumption.
 - 5.5% p.a. real investment return over price inflation. This comprised an 8.25% p.a. gross of tax investment return and a 2.75% p.a. CPI assumption.
- 5.18 In determining these assumptions the views of the Board were considered, particularly in respect of salary increases.
- 5.19 The same promotional salary scale as adopted in the previous actuarial investigation has been used. This assumes no promotional salary increases for the vast majority of Defined Benefit plan members. Therefore, for most members the inflationary salary increases of 4.25% p.a. are the only salary increases assumed.
- 5.20 The investments for fixed term pensions are matched to the liabilities by investing in fixed interest securities including CPI linked bonds. Based on current CPI indexed bond interest rates a real discount rate (i.e. discount rate above CPI) of 1.0% has been assumed. This discount rate includes a reduction of 0.75% to allow for investment management fees and administration costs.

Demographic Assumptions

- 5.21 The demographic assumptions that affect the Defined Benefit plan have been discussed in Section 3 in the light of the Defined Benefit plan's experience over the period 1 January 2009 to 31 December 2011. The recommended changes to the demographic assumptions are discussed in Section 3. Appendix D summarises the demographic assumptions adopted for this investigation.

Benefits

- 5.22 The benefits which have been valued are summarised in Appendix A. Members of the Defined Benefit plan on 25 May 1988 have certain guarantees or options in relation to benefits provided under the 1958 Act. As discussed in Section 3, we have assumed that 50% of eligible retirees, who joined the Defined Benefit plan prior to 25 May 1988, elect to take the pension option and 30% of eligible deferred beneficiaries elect to take the pension option. We have made no allowance for any other guarantees and options these members may be entitled to, as we continue to believe they are not likely to have a material impact on the results of this investigation.

Valuation of Assets

- 5.23 In the previous investigation we adopted the approach of market value of assets for all purposes. In Section 6 we note that the funding position of the Defined Benefit plan in the short term may be variable because of the current high volatility in asset valuations.
- 5.24 The market value of the Defined Benefit plan assets as at 31 December 2011 used in the investigation was \$1,692.2 million. This asset value is the amount available for the Defined Benefit liabilities for the members, deferred beneficiaries and pensioners (including fixed term pensioners) of the Defined Benefit plan. It does not include any amount in respect of voluntary accumulation accounts held by Defined Benefit plan members.

Actuarial Funding Method

- 5.25 In recommending a funding plan which aims to be sufficient to fund the members' benefits in the long-term, it is necessary to project the operation of the Defined Benefit plan into the future, using the actuarial assumptions set out above.
- 5.26 Briefly the projection operates in the following manner:
- (a) project total benefits and expenses expected to emerge in all future years in respect of current members, deferred beneficiaries and pensioners. The projection is based on the long-term actuarial assumptions including allowance for all the contingencies under which benefits can be paid (retirement, death, disablement and resignation), salary and pension increases;
 - (b) discount these projected benefits to a present value at the assumed long-term investment return;
 - (c) in a similar manner to (a) and (b), project the ongoing employer contribution (9.25% of salaries) and member contributions over all future years for current members, and discount them to present values; and
 - (d) determine the additional funding required by the Authorities by comparing (b) with (c) plus the appropriate value of the assets at the investigation date.
- 5.27 This projection is known as the aggregate funding method, which is considered to be appropriate for a closed fund. Application of this general method has been modified to reflect the funding arrangements outlined in paragraph 2.11.
- 5.28 The key question to be answered by this investigation is whether the current ongoing Authority contribution rate of 9.25% of members' salaries, together with future member contributions and

the market value of assets, will be sufficient to fully fund the benefits for current members, including deferred beneficiaries and pensioners.

- 5.29 Under the proposed new prudential standard (SPS 160), it is expected that APRA will require superannuation funds to fully fund their vested benefits within three years if the fund's assets are less than the vested benefits, also known as being in an "Unsatisfactory Financial Position"
- 5.30 The shortfall relative to vested benefits is likely to vary from the actuarial shortfall calculated using method set out in 5.26. It is possible that the recommended funding amount under this funding method may not be sufficient to restore the fund's Vested Benefits Index (VBI) to 100% within the timeframe required by APRA. Additional contributions can be made to target a VBI of 100% but where these contributions are higher than the actuarial shortfall calculated using the aggregate funding method described above a surplus would be expected to result in the long term if experience is as expected.
- 5.31 We understand that it is the intention of the Board to seek an exemption from APRA to extend the timeframe for funding vested benefits to more than three years.
- 5.32 In the next section we review the financial position as at 31 December 2011 (including the shortfall relative to vested benefits) and then we return, in Section 7, to the adequacy of the long term funding arrangements.

6 FINANCIAL POSITION AT 31 DECEMBER 2011

- 6.1 The financial position of the Defined Benefit plan at the investigation date provides some insight into the progress towards fully funding members' benefits in the long-term.
- 6.2 A convenient means of assessing the financial position of the Defined Benefit plan involves the calculation of various indices of benefits compared to assets.
- 6.3 For the purpose of the indices as at 31 December 2011 (reported in the following paragraphs in this section) assets have been taken as the assets reported in the 31 December 2011 Fund's unaudited accounts. The market value of Defined Benefit plan assets was \$1,692.2 million as at 31 December 2011.

Vested Benefits Index

- 6.4 The first of the indices is the "Vested Benefits Index" (VBI). Vested Benefits are defined as the benefits that would be due and payable if all the members voluntarily terminated their service with their employers at the investigation date.
- For active members, the Vested Benefits are thus the resignation benefit or the early retirement benefit (if aged 55 or more). Upon resignation from LASF, a member has the choice of an immediate lump sum or a more valuable deferred benefit. Also, upon retirement certain members have the option of taking a pension. In calculating the vested benefits, we have allowed for the best estimate assumption regarding the take up of deferred benefits and pensions.
 - For deferred beneficiaries, the vested benefit will be the present value of the liabilities, allowing for the pension take up rate.
 - For pensioners, the vested benefit is the present value of expected future pension payments.
- 6.5 This method is consistent with the new Professional Standard 400 (revised in August 2010) of the Actuaries Institute which covers actuarial investigations and requires Vested Benefits to be calculated taking into account the value of pension and deferred benefits. This professional standard also requires "best estimate" assumptions to be used, including realistic assumptions about the proportion of members who take a pension or deferred benefit.
- 6.6 Historically, the vested benefits in the LASF financial statements have been calculated by Vision Super and subject to audit. For contributing members and deferred members the calculation assumed that members took the immediate lump sum option. We cannot use this approach in this investigation, given the requirements of the new professional standard.

6.7 The Vested Benefits Index is calculated as follows:

$$\text{VBI} = \frac{\text{market value of assets}}{\text{total of vested benefits}}$$

6.8 Vested Benefits as at 31 December 2011 are:

Defined Benefit plan assets (\$m)		\$1,692.2
<u>Vested Benefits (\$m)</u>		
Active Members		\$1,516.4
Life-time Pensioners		\$357.6
Fixed term Pensioners		\$2.2
Deferred beneficiaries		<u>\$334.8</u>
Total Vested Benefits		\$2,211.0
Vested Benefit Index		77%

6.9 The calculated VBI for the Defined Benefit plan at 31 December 2011 is 77%. This compares with a VBI of 104% at the 31 December 2008 investigation. Note that this VBI was calculated consistently with Fund financial statements as described above. The previous approach differed from the current VBI calculation (in which it is assumed that a proportion of members would take up a pension or deferred benefit).

6.10 The VBI for the Defined Benefit plan has decreased from 31 December 2008 to 31 December 2011 primarily due to lower than expected investment returns during the period, the change in financial assumptions and the different methodology adopted as discussed in paragraph 6.4 to 6.6.

Discounted Accrued Benefits Index

6.11 Discounted Accrued Benefits means the present value of the benefit payable in the future (based on the assumptions) accrued in respect of service to the investigation date. The method of apportioning active members' benefits to past service for the main Defined Benefit plan is as follows, effectively recognising the portion of future benefits arising due to service to date:

- (a) Retirement, disablement, deferred resignation and retrenchment benefits – the past service benefit (based on accrued lump sum multiples and accrued pensions where relevant) at the calculation date, with allowance for future salary growth to the assumed exit date.

- (b) Death benefits – the total projected death benefit at the assumed exit date multiplied by the ratio of service to the calculation date divided by service to the retirement date.
- (c) Immediate Resignation Benefit – the past service benefit at the calculation date (based on the resignation multiple at the calculation date) with allowance for future salary growth up to the assumed resignation date.

- 6.12 The Discounted Accrued Benefits are not subject to a minimum of the Vested Benefits.
- 6.13 The index is more a measure of the Defined Benefit plan's on-going capacity to meet Accrued Benefits in the long run.
- 6.14 The "Discounted Accrued Benefits Index" (DABI) is calculated as follows:

$$\text{DABI} = \frac{\text{market value of assets}}{\text{total of discounted accrued benefits}}$$

- 6.15 Discounted accrued benefits as at 31 December 2011 are:

Defined Benefit plan assets (\$m)		\$1,692.2
<u>Discounted Accrued Benefits (\$m)</u>		
Active Members		\$1,328.5
Life-time Pensioners		\$357.6
Fixed term Pensioners		\$2.2
Deferred beneficiaries		<u>\$334.8</u>
Total Discounted Accrued Benefits		2,023.1
Discounted Accrued Benefit Index		84%

- 6.16 The calculated DABI for the Defined Benefit plan at 31 December 2011, based on the "best estimate" assumptions, used in this investigation, is 84%. The DABI was estimated to be 100% at the 31 December 2008 investigation. The reduction in DABI was mainly due to the poor investment returns and the change in financial assumptions adopted.
- 6.17 Because the DABI is less than 100%, it means current assets are not expected to be sufficient to provide the benefits of members' accrued benefits based on service to 31 December 2011.

Minimum Requisite Benefits Index

- 6.18 We have also considered the asset coverage of members' Minimum Requisite Benefits.
- 6.19 The Minimum Requisite Benefits (MRBs) are the minimum amount of benefit that must be provided to enable Authorities to satisfy their Superannuation Guarantee obligations. The method to calculate the amount of MRBs for the active members is specified in my Benefit Certificate.
- 6.20 We understand that the MRBs for Defined Benefit plan have not been configured on the administration system, on the basis that the Defined Benefit plan's benefits exceed the MRBs. Therefore, for the purposes of this valuation, I have estimated the MRBs. While the estimates are of the right order they are not precise.
- 6.21 Previously, the MRB for deferred beneficiaries and pensioners were estimated based on the vested benefits for these members. Vision Super has sought legal advice from DLA Piper regarding the determination of the MRB for deferred beneficiaries and pensioners. DLA Piper stated their view that the MRB should be crystallised when members cease to be an employee and there was no basis to adopt a higher benefit beyond their MRB entitlements.
- 6.22 In accordance with this legal advice, we have estimated the MRB for these members on the following basis:
- (a) For deferred beneficiaries, their MRBs are based on their resignation benefits (ie the immediate cash benefit which is the MRB defined in the Benefit Certificate for employee members under age 55); and.
 - (b) For the current pensioners who retired after 1992 (since the introduction of the Superannuation Guarantee legislation), their MRBs are expected to be less than their retirement benefits); whereas for those current pensioners who retired prior to 1992, their MRBs are assumed to be their retirement benefit. On retirement, all Defined Benefit plan members are required to take at least half of their benefit as a lump sum, which means that the portion of the pension that is funded by the MRB will often be low. Vision Super is unable to provide information regarding members' MRB at the time of retirement. Based on the data available, we have estimated the proportion of MRB benefits relative to the retirement pensions to be 65% for all current pensioners.
- 6.23 The Minimum Requisite Benefit Index is calculated as follows:

$$\text{MRBI} = \frac{\text{market value of assets}}{\text{total of Minimum Requisite Benefits}}$$

6.24 Minimum Requisite Benefit as at 31 December 2011 are:

Defined Benefit plan assets (\$m)	\$1,692.2
<u>Minimum Requisite Benefits (\$m)</u>	
Active Members	\$1,099.5
Life-time Pensioners	\$232.5
Fixed term Pensioners	\$2.2
Deferred beneficiaries	<u>\$163.5</u>
Total Minimum Requisite Benefits	1,497.7
Minimum Requisite Benefit Index	113%

6.25 As at 31 December 2011 we estimate that the ratio of the market value of assets to the amount of Minimum Requisite Benefits was approximately 113%. This compares with a MRBI of 106% at the 31 December 2008 investigation using the old approach. The increase in the MRBI was mainly due to the change in the methodology. This was slightly offset by a lower investment return.

6.26 In accordance with the legal advice from DLA Piper, this ratio has been calculated including the pension MRBs and the deferred MRBs in the total of MRBs (rather than a deduction from the market value of assets).

6.27 If this ratio for the entire Fund falls to below 100%, the Fund becomes Technically Insolvent as defined in the SIS Regulations. If this occurs the Trustee must take certain steps to restore solvency. The Trustee needs to continue to monitor the "Notifiable Events" defined in the Funding and Solvency Certificate to identify if the Fund is at risk of becoming, or becomes, Technically Insolvent so appropriate action can be taken.

Other Measures of Financial Position

6.28 In accordance with Clause A.21.1(a) of the Trust Deed, an Authority requires the approval of the Board to terminate its contributions to the Defined Benefit plan. We assume this approval would not be provided unless any future funding risk is adequately managed. Also, in accordance with Clause A.21.1(b), such an Authority remains responsible for its share of any actuarial shortfall.

6.29 However, if an Authority does terminate its contributions, Clause A.21 of the Trust Deed states that:

"the Trustee, after obtaining the advice of the Actuary and subject to A.21.5, may adjust any benefit which is or may become payable to or in respect of any person whom the Trustee may consider is affected by that termination to the extent and in the manner the Trustee considers appropriate and equitable"

6.30 Further it states in Clause A.21.5 that:

"...Unless otherwise agreed between the Trustee and the Employer, an adjustment made ...must not increase the amount of any benefit which, in the opinion of the Trustee after obtaining the advice of the Actuary, has accrued in respect of a person immediately prior to the effective date of that adjustment in respect of the period up to that date or improve the basis upon which benefits accrue during or in respect of any period after that date."

- 6.31 Therefore, in the case of the termination of contributions by one or more Authorities the Trustee has some flexibility in respect of the benefits provided, subject to superannuation law, and there is no alternative measure of financial position that needs to be calculated in respect of this situation.
- 6.32 On retrenchment, members are entitled to the lump sum accrued retirement benefit. As at 31 December 2011, the ratio of the market value of assets to the amount of retrenchment benefits was 75%. The corresponding index as at 31 December 2008 investigation was 83%. This decrease in the index was mainly due to the poor investment returns during the period.
- 6.33 For members under age 55, an additional contribution is required from the relevant Authority in respect of each retrenchment so that there is no additional financial strain on the Defined Benefit plan under the current funding plan. The funding of retrenchments is considered further in Section 7.
- 6.34 The liabilities of pensioners used to determine all of the funding measures have been calculated using the funding assumptions and assuming the liabilities will be met by continuing to make pension payments until all pensioners have died. It should be noted that if the pension liabilities were to be transferred to a life insurance office, the assets required to be transferred could be significantly higher than the amount of the vested benefits calculated in this investigation because the assumptions used for this purpose would need to be calculated consistently with the capital adequacy requirements of life insurance offices. The increase in pension liability on this basis as at 31 December 2011 is likely to be approximately \$190 million, which would result in a 6% lower VBI (i.e. reducing the 77% VBI to 71%).
- 6.35 In Appendix E the Defined Benefit plan's asset allocation is shown and there is currently a 43% allocation to illiquid assets. The funding indices have been calculated based on the valuation of these assets at market value from the 31 December 2011 unaudited financial statements. In the

unlikely event that these assets had to be quickly liquidated it is possible that this could occur at discounted values resulting in lower funding ratios. For example, a 20% discount on forced sale of illiquid assets would reduce the funding indices by approximately 7%.

- 6.36 The Authorities have ten years to make each of the three lump sum contributions requested by Vision Super (as at 30 June 1997, 31 December 2002 and 30 June 2011). Outstanding amounts are included in the market value of assets as contributions receivable. If these amounts are not paid the funding position would be materially worse than set out in this report. The total contribution receivable in the Fund's 31 December 2011 financial statements was \$11.4 million, however only a portion of this amount relates to the Defined Benefit plan. This means that the exclusion of contributions receivable would reduce the indices by well under 1%.
- 6.37 The VBI and DABI would increase (or decrease) if a lower (or higher) proportion of employee members were assumed to defer upon resignation or take a pension upon retirement. If it was assumed that 100% of eligible members elected the pension option and 100% of resigning members elected the deferred option, the impact on the VBI and the DABI would be a reduction of 4% and 2% respectively.

7 ASSESSING THE ADEQUACY OF THE FUNDING ARRANGEMENTS

The Present Funding Arrangements

- 7.1 Since 1 July 1997 the Authority funding arrangements for the Defined Benefit plan have comprised three components:
- (a) contributions in respect of each Authority's share of any funding short fall that arises. This has included:
 - \$321 million unfunded liability at 30 June 1997, plus contribution tax; and
 - \$127 million unfunded liability as at 31 December 2002, plus contribution tax;
 - \$71 million unfunded liability as at 31 December 2008, plus contribution tax (this amount plus interest was invoiced at 30 June 2011).
 - (b) an additional contribution to cover the increase in liability arising from retrenchment benefits paid after 30 June 1997, plus contribution tax; and
 - (c) an ongoing Authority contribution rate based on current members' salaries, needed to fund the balance of benefits for current members and pensioners initially set at 9.25% of salaries.
- 7.2 We have not reviewed the 9.25% of salaries Authority contribution rate on the basis that the funding impact of doing so is small, because the average employee's future service is low.

Assessment at 31 December 2011

- 7.3 Our calculations at 31 December 2011 using the "best estimate" funding assumptions show that the present funding arrangements are inadequate to meet the expected Defined Benefit plan liabilities.
- 7.4 As at 31 December 2011 there was an actuarial shortfall of \$406 million (excluding contribution tax). This means that the current value of assets plus expected future contributions is less than the value of expected future benefits and expenses by \$406 million, assuming that the Authorities continue to contribute at 9.25% of salaries. Full details of these calculations are set out in Appendix F.
- 7.5 At the previous actuarial investigation dated 31 December 2008, there was an "actuarial shortfall" of \$71 million (excluding contribution tax). The movement from an "actuarial shortfall" of \$71 million at 31 December 2008 to a significantly greater "actuarial shortfall" of \$406 million at 31 December 2011 is shown in the following table:

Changes in Funded Status	Net of Tax (\$m)
Funding Status as at 31 December 2008	(71)
<i>Investment return lower than expected</i>	(239)
<i>Salary inflation higher than expected</i>	(36)
<i>Additional contributions</i>	80
<i>Other</i>	(2)
Funding Status as at 31 December 2011 (Old Assumptions)	(268)
<i>Change to demographic assumptions</i>	(5)
<i>Change to expense assumption</i>	(16)
<i>Reducing discount rates from 8.5%pa to 7.5%pa (gross: 9%pa to 8.25%)</i>	(117)
Funding Status as at 31 December 2011 (New Assumptions)	(406)

- 7.6 The increase in actuarial shortfall is mainly caused by the poor investment return over the three years to 31 December 2011 and the lower expected return in the future.
- 7.7 The components of this experience and changes to the funding assumptions have been discussed in detail in earlier sections.
- 7.8 The existing funding arrangements are not expected to be adequate and additional contributions are expected to be required.
- 7.9 Nevertheless, it needs to be recognised that the ultimate cost of benefits for members of the Defined Benefit plan will depend on the actual future experience of all the relevant factors (investment earnings, salary growth, pensioner mortality, turnover rates, etc.). Therefore, the contribution arrangements will need to be varied as the actual experience unfolds.

Sensitivity of Funding Arrangements to Future Assumptions

- 7.10 As outlined in Section 5, factors that affect the future experience of the Defined Benefit plan are split into two broad categories. They are the financial assumptions and the demographic assumptions. The assumptions are more sensitive to changes in the financial assumptions and the sensitivity of the "actuarial shortfall" to the financial assumptions is considered below.
- 7.11 The key financial assumption is the differential or "gap" between the investment return and the growth in salaries. If the actual experience for the "gap" varies from the assumed "best estimate" assumption of 3.25% p.a., it can have a very significant effect on the ongoing contribution rate and any unfunded liability contributions (as demonstrated in this investigation relative to the last investigation). Similarly for pensioners, the differential or "gap" between the investment return and the price inflation is the key factor which drives the funding cost.
- 7.12 There have been an increasing number of members who have elected a pension over the last few years. The value of the pension is generally greater than the lump sum benefit. A higher pension election will therefore increase the funding cost.
- 7.13 Upon resignation, the Defined Benefit plan members have the option to defer their benefits until age 55 to be entitled to a higher benefit. The value of the deferred benefit is generally greater than the immediate cash benefit. The funding cost is likely to be higher if more members elect this option in the future.
- 7.14 To quantify the potential impact of variations in financial and demographic experience the following table shows the impact of changing some of the assumptions on the "actuarial shortfall" as at 31 December 2011.

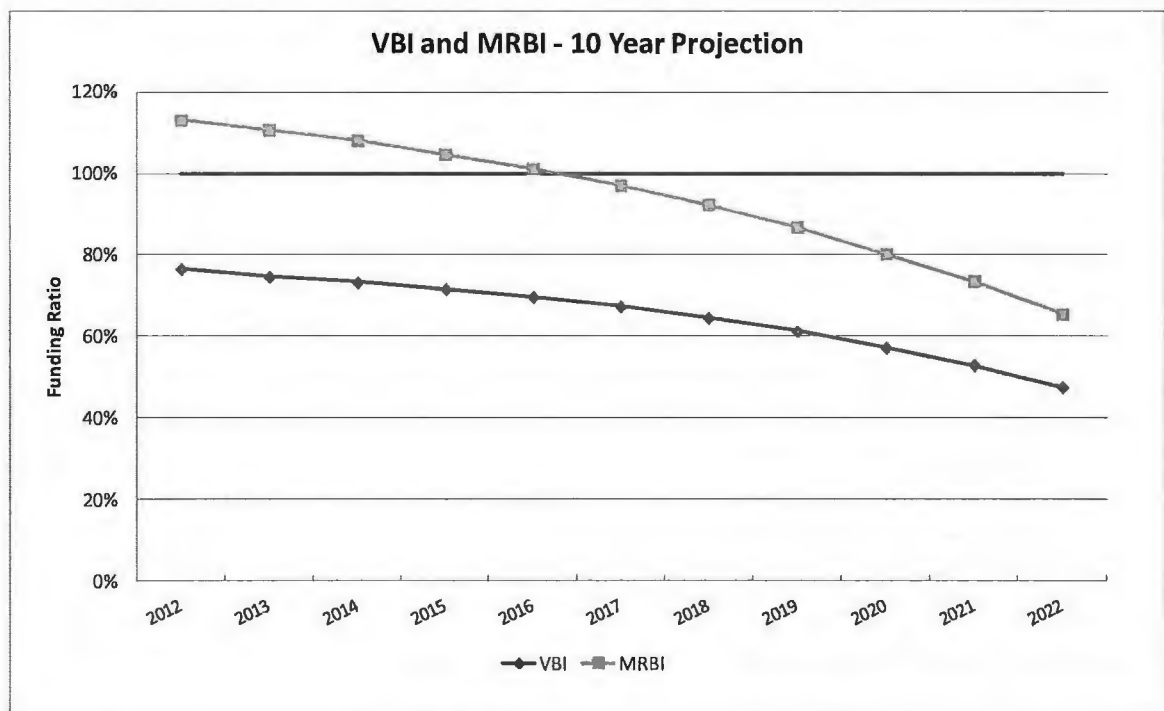
Impact of Changes in Key Assumption

	Actuarial Shortfall
	\$ Million
Best estimate assumptions	406
Decrease the gap by 1%	558
Increase the gap by 1%	276
100% of entitled members elect deferred and pension option	451

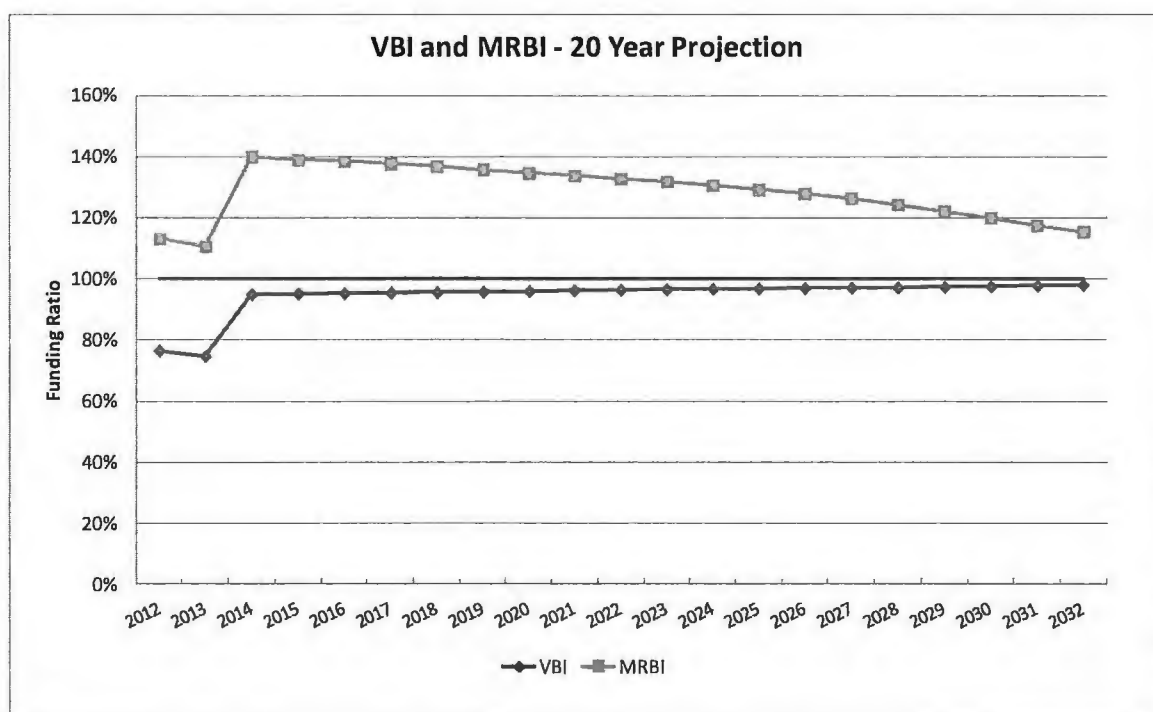
- 7.15 The table shows that a variation in the "gap" has a very significant impact on the actuarial surplus or shortfall. It is possible that the actual "gap" may vary from our best estimate assumption by significantly more than 1% and the impact would be greater than what was shown in this sensitivity analysis.
- 7.16 There is also a risk that the demographic experience may differ from our assumption which would lead to a lower or higher funding cost (as demonstrated in the table above when the percentage of eligible members who elect the deferred benefit or the pension is increased to 100%).

Projection of VBI Funding Levels

- 7.17 The adequacy of the funding arrangements can also be considered by projecting the Defined Benefit plan's future funding levels. This projection is based on the "best estimate" funding assumptions discussed in Section 5 and Appendix D and assumes that only contributions of 9.25% of salaries are made in the future.
- 7.18 The following projection of the various funding indices (refer to Section 6) shows that the vested benefits (VBI) and Minimum Requisite Benefits (MRBI) are expected to deteriorate quickly in the future without additional contributions.



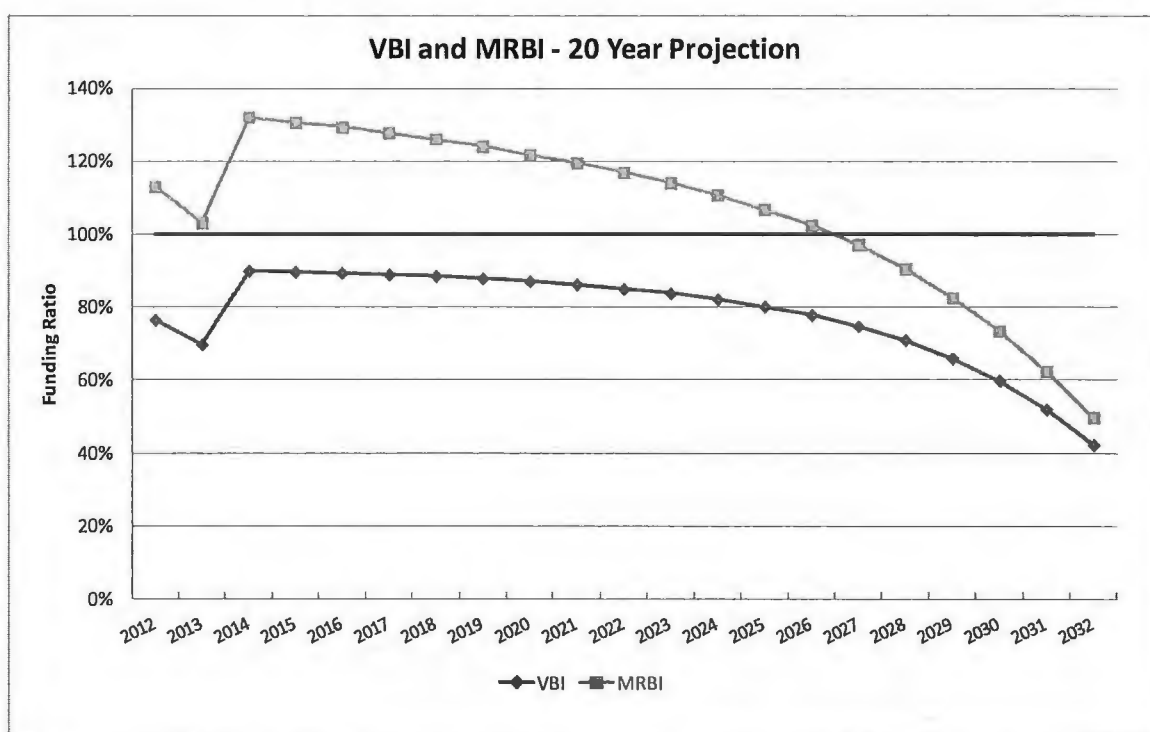
- 7.19 The chart shows that there is a significant risk of Technical Insolvency until additional contributions from Authorities are received. Technical Insolvency occurs when a Fund's assets are not sufficient to cover members' Minimum Requisite Benefits.
- 7.20 If the Fund is Technically Insolvent, legislation requires Special Funding and Solvency Certificates to be issued annually. Among other requirements, the Special Funding and Solvency Certificates must contain a plan by which additional contributions restore solvency within 5 years from its commencement.
- 7.21 The chart below shows the projected funding indices if Authorities make an additional contribution of the amount of the actuarial shortfall of \$406 million (plus contribution tax and interest) at 1 July 2013.



- 7.22 As shown in the chart above, the additional contribution of \$406 million will reduce the likelihood of technical insolvency and provide an adequate margin for the MRBI to remain above 100% in the future.
- 7.23 The VBI is expected to increase to 95% with the additional contributions. The projected VBI is expected to increase to 100% over the very long term. However, on the basis of the best estimate assumptions, it is expected that the VBI will not quite reach 100% within the projection period.

Other Funding Issues

- 7.24 The Defined Benefit plan is mature and its funding is very sensitive to future experience. As shown in Section 7.14, a lower than expected investment return would significantly increase the "actuarial shortfall".
- 7.25 The chart below shows the impact on the VBI and the MRBI if the return is 0% next year (assuming that the additional contribution of \$406 million, plus interest and contribution tax is made by 1 July 2013).



- 7.26 If the return is 0% in 2012, the top-up contribution of \$406 million will not be sufficient to fund the shortfall. Additional amounts may be required to avoid Technical Insolvency and to restore the fund's VBI to 100% within a reasonable timeframe. In this scenario, the "actuarial shortfall" as at 1 July 2013 would be in the order of \$120 million (excluding contribution tax) if all other experience was as expected.
- 7.27 On the other hand, if experience is favourable a large "actuarial surplus" could result. The Board would need to consider how to treat such an "actuarial surplus". It is possible that such a surplus could be so significant that providing Authorities an indefinite contribution holiday would not use

all of it. We understand that if this occurs any residual assets would eventually be distributed to relevant Authorities in accordance with Clause A.15 of the Trust Deed.

Consideration of a funding plan

7.28 Section A.20.1 of the Trust Deed states:

"each Employer must contribute to the Fund in respect of a particular Employee at any particular time the amount or rate of contributions determined by the Trustee after obtaining the advice of the Actuary, including the Unfunded Liability Amount...."

7.29 The Board has advised that in framing the funding plan, they wish to encourage the Authorities to pay their deficiency quickly where they are able to do so, but that the funding plan should also take into account the special nature of the Authorities as an arm of Government.

7.30 On this basis, the following funding plan has been proposed, whereby the Authorities will pay:

- (a) Contributions equal to 9.25% of salary for employee members;
- (b) An additional contribution to cover the excess of the benefits paid as a consequence of retrenchment above the funded resignation or retirement benefit (the funded resignation or retirement benefit is calculated as the VBI multiplied by the benefit), plus contribution tax;
- (c) Top up contributions of \$406 million (plus contribution tax and interest from 31 December 2011) payable as at 1 July 2013. While Employers will be encouraged to pay their share of this amount by 1 July 2013, other funding options will be provided as set out below. The "actuarial shortfall" with interest to 1 July 2013 is \$453 million (plus contribution tax); and
- (d) Additional top up contributions that may be required in the future so that the Defined Benefit plan is no longer in an unsatisfactory financial position.

7.31 The top up contributions to be invoiced of \$406 million (plus contribution tax and 7.5% p.a. interest from 31 December 2011 to 1 July 2013) are expected to be sufficient to fully fund members' current and future benefits by the time they are paid.

7.32 Recognising the impact that this contribution requirement will have on some Authorities, it is proposed that the Authorities will also be given the option of paying their share over a period of no more than 15 years. A minimum annual payment will be required from those Authorities that do not pay the entire amount immediately. In order to encourage the Authorities to pay these

contribution requirements more quickly, the amounts outstanding from Authorities will be increased at 7.5% p.a..

- 7.33 It should be noted that an amount of \$519 million (plus contribution tax), rather than \$406 million, is expected to be required as at 31 December 2011 in order that the Defined Benefit plan was no longer in an unsatisfactory financial position. It is proposed that the Trustee not invoice this higher amount initially, recognising that it is not expected to be required to fully fund members' current and future benefits by the time they are paid, if future experience is as expected. It would create inequity between Authorities if some Authorities were to immediately pay their share of this higher amount and future experience meant that the funding was excessive when some Authorities had not paid their share.
- 7.34 It is also recognised that future experience may be better or worse than expected. In the case that experience is better than expected, the initial top up contribution may be sufficient so that the Defined Benefit plan is no longer in an unsatisfactory financial position. If experience is worse than expected then additional top up contributions are likely to be required from the Authorities in order for the Defined Benefit plan to no longer be in an unsatisfactory financial position.
- 7.35 We believe that the proposed funding plan above meets the requirements of the current legislation on the basis that there is no maximum term for restoring a Fund to a VBI of 100% in the current legislation. However, we note that the proposed funding plan may not meet the requirement of the draft Prudential Standard (SPS 160) to restore a Fund to a "satisfactory financial position" within three years (which is due to take effect from 1 July 2013). We understand that it is the current intention of the Trustee to seek an adjustment or exclusion from this requirement from APRA in order to continue with this proposed funding plan after 1 July 2013.
- 7.36 If APRA approval is not provided, the Board may need to require Authorities to pay:
- (a) Their share of the \$406 million "actuarial shortfall" within three years; and
 - (b) Additional amounts needed to increase the VBI to 100% within three years.
- 7.37 Therefore, if the Board considers there is a significant risk that APRA will not provide approval for the proposed funding plan then it needs to consider an alternative funding plan immediately.
- 7.38 We understand that under the proposed funding plan, although Authorities would be able to spread their contributions over 15 years, the contributions not yet received could be included in the Defined Benefit plan's audited assets as a contribution receivable. As separately advised, we expect to be able to include this amount as an asset for calculating the MRBI and VBI. There is a

risk that this may not be possible in the future if circumstances change or actuarial professional standards change. This is because these assets are not immediately available to pay benefits.

- 7.39 From a funding perspective this reinforces the need to gain APRA approval to the funding plan. If a material amount of contributions are outstanding the Technical Insolvency risk may remain high beyond 1 July 2013 even if experience to that time is favourable.
- 7.40 While it is acknowledged that it is likely many Authorities would pay their contributions quickly, spreading the contributions over 15 years also raises the question of whether the Defined Benefit plan assets could be exhausted within that time. If future experience is poor then we assume additional contributions would be required. Therefore, we considered the scenario of:
- (a) All deferred members receiving their benefits at the earliest age possible (i.e. age 55);
 - (b) A 20% increase in the rates of resignation and retirement; and
 - (c) All members electing a lump sum upon retirement rather than a pension.
- 7.41 In this scenario, assuming the additional contributions are spread evenly over 15 years and other experience was as expected, the Defined Benefit plan assets are expected to be sufficient to pay benefit payments as they arise.
- 7.42 Retrenchments can pose a risk to both funding and liquidity. Currently, when a member under age 55 is retrenched, Authorities are required to make a top-up contribution equal to the difference between the amount of the retrenchment benefit and the immediate resignation benefit (plus contribution tax). However, this does not provide any additional funding to reflect that immediate resignation benefits may not be fully funded or when a member over age 55 is retrenched. For this reason the proposed funding plan requires a top up contribution for all benefits paid as a consequence of retrenchment when the VBI is less than 100% and for this top up contribution to be the difference between the retrenchment benefit and the funded benefit that would normally be payable (i.e. VBI times resignation benefit or retirement benefit as applicable) plus contribution tax. The inclusion of top up contributions with respect to members over the age of 55 will assist in protecting liquidity should a large retrenchment program occur.

Events subsequent to 31 December 2011

- 7.43 Vision Super has advised that the Defined Benefit plan investment return from 1 January 2012 to 8 June 2012 has been 2.8%. While this is below the assumed investment return of 7.5% per annum, it is not materially below. Given the current volatility in investment markets we do not consider it necessary to revise our calculations to reflect this difference.

-
- 7.44 Except for the release of draft Prudential Standard (SPS 160) as discussed in Section 7.35 and the legislation to increase the Superannuation Guarantee Charge to 12% as discussed in 2.20, we are not aware of any other event subsequent to 31 December 2011 that would materially impact upon the results of the actuarial investigation of the Defined Benefit plan.

Recommendation

- 7.45 The experience of the Defined Benefit plan over the three year period to 31 December 2011 has been unfavourable. Based on revised assumptions there is an "actuarial shortfall" of \$406 million in the Defined Benefit plan.
- 7.46 We recommend that the proposed funding plan (described in 7.29 to 7.34) be adopted. However, we note that this funding plan may need to be revised if it does not meet the requirement (if finalised) to restore a Fund to 100% VBI within three years set out in draft Prudential Standard (as discussed in Paragraph 7.35) unless an adjustment or exclusion from this requirement is provided by APRA for the Defined Benefit plan. We recommend that the funding plan is revised immediately if the Board believes there is a significant risk that APRA will not allow such an adjustment or exclusion.
- 7.47 If the "best estimate" assumptions described above are borne out in practice, then the funding arrangements outlined in paragraph 7.29 are expected to be adequate to meet the expected liabilities of the Defined Benefit plan.
- 7.48 It is very important to understand that each of the components of the funding arrangements is very dependent on the actual future experience of the Defined Benefit plan. Consequently all contribution components are subject to regular review by the Trustee using actuarial advice and could vary from the current recommendations at any time in the future.
- 7.49 It is also recommended that the funding position of the Defined Benefit plan continue to be considered in setting investment policy (refer to Section 4 for more information).

8 INSURANCE

Self Insurance Arrangements

- 8.1 The Defined Benefit plan provides death and disablement benefits that are significantly higher than the resignation/retirement benefits. The Fund self insures this risk. This continues to be appropriate in light of the Fund's size, experience, present membership and benefit levels.
- 8.2 The death and disablement benefits are funded by Authorities' contributions to the Defined Benefit plan. It is ultimately the Authorities that bear the financial risk if the amount of death and disablement benefits paid is significantly higher than expected.
- 8.3 Section 3.8 showed that over the three years to 31 December 2011 there were 0.5 deaths for every one expected and 0.5 disablements for every one expected. On average, the total death and disablement benefits paid (past and future service) in each of the three years was approximately \$6.3 million compared to expected benefits of approximately \$11.6 million per annum. We believe the funding arrangements allow adequately for expected death and disablements.
- 8.4 The following table summarises the Defined Benefit plan's exposure to future service death and disablement risk as at 31 December 2011.

Statistics as at 31 December 2011

Net Assets Available ¹ (Defined Benefits plan assets available to meet benefits)	\$973.9m
Expected Annual Future Service death and disablement benefits to be paid for 2012 ²	\$5.6m
Total Future Service death benefits ³	\$1,173.7m
Maximum death or disablement Future Service Benefit of any Member	\$1,926,181

1. Active Defined Benefit plan assets excluding assets in respect of pensioners and deferred beneficiaries.

2. Based on assumptions adopted in this investigation.

3. The amount of future service death benefits shown is the amount of death benefit t which is in excess of the "funded" accrued retirement benefit. Hence the future service death benefits quoted in this Section include the underfunded portion of the accrued retirement benefit.

- 8.5 Because of the large number of members, it is unlikely that the actual future service death and disablement benefits would be double the expected number in any year. If this occurred in the 2012 year, additional benefits of approximately \$5.6 million would be expected to be paid. This

represents 0.6% of the Defined Benefit plan's available assets so would not alone place a significant additional financial strain on its funding.

- 8.6 The following table shows the distribution of the future service death benefits. The death benefit has been used because it is generally slightly higher than the disablement benefit.

Distribution of Future Service Benefits as at 31 December 2011

	Total Future Service Benefits \$ million	% of Total Future Service Benefits	Number of Members	% of Total Defined Benefit Membership
Nil	-	-	0	0%
\$1 - \$99,999	66.1	6%	1,738	35%
\$100,000 – \$249,999	194.7	16%	1,122	23%
\$250,000 - \$499,999	560.2	48%	1,573	32%
\$500,000 - \$999,999	303.1	26%	476	9%
\$1,000,000 or more	49.6	4%	40	1%
TOTAL – all plan members	1,173.7	100%	4,949	100%
Oldest 10% of members	12.1	1%		
Youngest 10% of members	244.1	21%		
Highest salaried 10% of members	264.1	23%		
Largest 10% of future service benefits	341.5	29%		

- 8.7 This table shows that:

- (a) 90% of members have future service death and disablement benefits of \$500,000 or below and that the aggregate for these members' benefits is 70% of the total amount;
- (b) the average future service benefit is approximately \$237,000; and
- (c) there is no small sub group of members that expose the Defined Benefit plan to significant additional risk in respect of future service death and disablement benefits.

-
- 8.8 The Defined Benefit plan's membership is spread throughout Victoria, reflecting the distribution of Authorities. There is a relatively low concentration of risk.
- 8.9 There is a very remote possibility of a catastrophe occurring that may result in around 100 death or disablements benefits. If this occurred, and assuming the average future service death or disablement benefit was \$237,000 for each member, the total claim amount would be approximately \$23.7 million. This represents 2.4% of net available assets and is therefore considered a manageable risk.
- 8.10 No explicit allowance has been made in this investigation for either delays in processing of claims or incurred but not reported claims. Any such allowance is unlikely to be greater than 1.0% of the assets.

9 MATERIAL RISKS

- 9.1 The funding of the Defined Benefit plan is dependent upon future experience. I have briefly considered below the material risks in respect of funding. If experience is adverse the Authorities will be required to make additional contributions. Furthermore, it may take longer than expected for the Fund's VBI to return to 100% and the "actuarial shortfalls" to reduce to zero, depending upon the additional contributions made.

Technical Insolvency

- 9.2 Because the MRBI is only 113% there is a risk the Defined Benefit plan could become Technically Insolvent. The risk is expected to reduce once the additional \$453 million (plus contribution tax) expected to be received from 1 July 2013 is included in the assets.

Investment Risk

- 9.3 The **most significant risk** facing the Defined Benefit plans is that investment returns will not be as high as expected.
- 9.4 The Trustee should continue to consider the liabilities and the funding position when determining the Defined Benefit plans' investment strategy.

Salary and Price Inflation Risk

- 9.5 Salary increases or price inflation exceeding expectations will have a negative impact on funding.
- 9.6 It is the excess of the investment return above the rates of salary and price inflation increases that is most important because the assets increase with the investment return and the liabilities with salary or price inflation.

Catastrophe Risk

- 9.7 The Defined Benefit plans self insure the death and disability benefits and are therefore subject to the risk of higher than expected claims. The self insurance risk is considered in section 8.
- 9.8 While the risk is low, particularly given the geographic spread of members, a high number of death or disability (or terminal medical condition) benefits caused by a single event is likely to put further significant strain on the funding.

Pensioner Longevity Risk

- 9.9 At 31 December 2011 there were 5,132 life time pensioners in the Fund. There is a risk that pensioners may live longer than expected and this would have a negative impact on the funding position.

- 9.10 In the 31 December 2011 actuarial investigation it was found that the mortality assumptions adopted were lighter than the experience of the Fund. Pensioner longevity risk is less significant than investment risk and salary risk.
- 9.11 Vision Super includes 15 fixed term pensioners. As at 31 December 2011 the assets held in respect of these pensioners was \$1.4 million and the liabilities were valued at \$2.2 million. This means there is a \$0.8 million funding shortfall. In our funding considerations the fixed term pensioners are included as part of the Defined Benefit plan and Vision Super has confirmed that the Defined Benefit plan's assets will be available to meet these liabilities.

Liquidity Risk

- 9.12 In Section 4 liquidity risk is discussed. Also, Section 6.35 considered the potential impact on funding of having to liquidate investments at a discount.
- 9.13 We believe that Vision Super should consider a plan to reduce their exposure to illiquid assets in the Defined Benefit plan to zero over time given the maturity of the plan.

Assets

- 9.14 We understand that in preparing the financial statement, Vision Super has determined the Defined Benefit plan assets by deducting the defined contribution assets (or liabilities) from the total Fund assets. To the extent that daily unit pricing may not reflect the underlying assets due to the timing of cash flows and allowance for tax and accruals, any variation will flow on to the Defined Benefit plan assets. This is particularly a concern as the defined contribution assets now form about 60% of the total fund assets and is increasing as a proportion of the total assets. There is also a risk that defined benefit plan assets may be under or overstated in the event of unit pricing errors.
- 9.15 We recommend that the Trustee should satisfy itself that no cross subsidies are occurring or could occur between the defined benefit and defined contribution plans. In order to limit the potential cross subsidies, consideration should be given to the Fund segregating the accounting process for defined benefit and defined contribution plans.

Retrenchments

- 9.16 The retrenchment benefit is larger than the resignation benefit for most members. Also, currently resignation benefits are not fully funded. Therefore, a significant number of retrenchments would have a negative impact on funding and liquidity unless additional contributions are required to fund the shortfall when a member is retrenched. This is also appropriate when a member over or under 55 is retrenched even if it is not a retrenchment benefit being paid from the Defined Benefit plan.

- 9.17 We have recommended that such top-up contributions are made by the Authorities to manage this risk.

Prudential Standard SPS 160

- 9.18 In the Draft Prudential Standards (SPS 160), there are proposals to require the full funding of Vested Benefits within three years, which may impact on the recommended funding plan in this report (and future funding plans) because it is not expected to achieve full funding of Vested Benefits within this timeframe (refer to Section 7.34 to 7.36).
- 9.19 We understand that Vision Super is seeking an exemption from APRA in relation to the impact of this funding requirement on the funding plan recommended in this report. There is a risk that the exemption might not be granted which is likely to result in further contribution calls to fund the vested benefits within three years of 1 July 2013 by all of the Authorities.
- 9.20 In the Draft Prudential Standards, there are proposals to require funds to allocate a proportion of assets to an operational reserve. If the Defined Benefit plan assets were used to establish any of this reserve then the VBI, DABI and MRBI would reduce. Authorities would be required to make additional contributions to achieve the VBI of 100%.
- 9.21 In the Draft Prudential Standards there is a proposal for self insured defined benefit plans to maintain a self insurance reserve. The Vested Benefits calculated in this report do not include an allowance for any Incurred But Not Reported (IBNR) death or disablement claims. Because the average age of members is approaching 55, the estimated annual cost of providing death and disablement benefits is in the order of \$5 million per annum (refer Section 8). This means that any reserve required is likely to be small relative to the size of the Defined Benefit plan.

Other Legislation Risk

- 9.22 There is a risk that other legislation changes could impact on funding. For example:
- (a) The Government has legislated to increase the Superannuation Guarantee Charge to 12% of Ordinary Time Earnings. This will materially impact Fund benefits if this increase is provided from the Defined Benefit plan;
 - (b) Changes to legislation may impact investment returns or other aspects of experience; and
 - (c) Changes to tax may impact funding;

Other

- 9.23 Operational risks (eg. unit pricing and administration) are not considered in this report.

-
- 9.24 The risks associated with a higher take up of deferred benefits on resignation and pension benefits on retirement is discussed in Section 6.37.
- 9.25 There are many other risks in respect of the funding of the Defined Benefit plans but we have not included those we do not consider to be currently material.

APPENDIX A - SUMMARY OF BENEFITS AND CONDITIONS

The benefits are set out in the Fund's Trust Deed. The Fund has been governed by the Trust Deed originally dated 26 June 1998 on and from 1 July 1998. The Trust Deed has subsequently been amended numerous times.

Defined Benefit plan

Membership

The Defined Benefit plan was closed to new members on 31 December 1993. From that date, new employees have joined Vision Super Saver, which provides accumulation style benefits.

The benefits and conditions described below relate to Defined Benefit plan members only.

Contributions

Members contribute at a rate of 6% of salary. Their contributions cease after 40 years of service. Authorities pay the balance required to provide the benefits.

Retirement Benefit

A lump sum benefit calculated as a percentage of final salary for each year (part years counting pro rata) of membership to retirement. The percentage is 21% for membership completed prior to 1 July 1993 and 18.5% for membership completed after 30 June 1993. A maximum of 40 years of membership counts towards the retirement benefit. Members may retire from age 55 and benefits cease to accrue at age 65.

Death Benefit

For members under 60 years of age, a lump sum of 21% of final salary for each year of actual and prospective membership to age 60. For members aged 60 or over, a lump sum of 21% of final salary for each year of actual membership. A maximum of 40 years of membership counts toward the death benefit.

Members with a medical classification of Grade B, C or D are entitled to a lower death benefit.

Total and Permanent Disablement Benefit

For members under 60 years of age, a lump sum equal to a percentage of final salary for each year of actual and prospective membership to age 60. The percentage is 21% for actual membership completed prior to 1 July 1993, 18.5% for actual membership completed after 30 June 1993, and 21% for prospective membership between the date of disablement and age 60. For members aged 60 or more, the benefit is a lump sum equal to the retirement benefit. A maximum of 40 years of membership counts towards the total and permanent disablement benefit.

"Disablement" generally means a continuous or recurring impairment of health of a member which renders him or her unable to perform his or her duties, or any other duties for which he or she is suited by education, training or experience, or would be suited as a result of retraining.

Members with a medical classification of Grade B, C or D are entitled to a lower disability benefit.

III-Health and Retrenchment Benefits

The accrued retirement benefit (i.e. counting membership to date of ill health or retrenchment).

Resignation Benefit

A lump sum of either:

- (a) an immediate benefit equal to the sum of:
 - 15% of final salary for each year (if any) of membership prior to 1 July 1993, excluding any portion of the last five years relating to pre 1 July 1993 membership;
 - 13.5% of final salary for each year (if any) of membership after 30 June 1993, excluding the last five years;
 - 9% of final salary for the last five years of membership; or
- (b) a deferred benefit payable at age 55 equal to the accrued retirement benefit at the date of leaving, increased with the relevant investment return to payment after age 55.

Part of the immediate resignation benefit may be subject to preservation regulations.

"Old Benefit" Entitlements

Members who joined prior to 25 May 1988 have the option of taking up to 50% of their lump sum retirement benefits as a pension, based on prescribed conversion factors. The conversion factors reduce from 13.6 at age 55 to 12.6 at age 60 and 12.0 at age 65.

Certain other minimum benefits apply in respect of previous entitlements for certain groups of members.

Superannuation Guarantee

The benefits are subject to a superannuation guarantee minimum. Like all defined benefit members, the minimum is based on salary as defined in the Trust Deed. If Ordinary Time Earnings is higher than salary then top-up contributions are made to an accumulation account within the Fund and do not need to be considered from a funding perspective.

City of Melbourne plan

Membership

The City of Melbourne Plan was established in 1995 following the transfer of the City of Melbourne Superannuation Fund into Vision Super. The benefits are set out in the City of Melbourne Fund Trust Deed, and now incorporated in the Fund's Trust Deed. This plan is closed to new members.

Contributions and Accrual Rate

Members are allowed to contribute at a rate between 0% and 9% of salary. The accrual of member's benefit multiple is dependent on member contribution rate, as follows:

Contribution Rate (%)	Accrual Rate Post 30 June 1993 (%)	Accrual Rate Pre 30 June 1993 (%)
0	7.7	9.00
1	9.50	11.00
2	11.25	13.00
3	13.00	15.00
4	14.75	17.00
5	16.50	19.00
6	18.25	21.00
7	20.00	23.00
8	21.75	25.00
9	23.50	27.00

Accrued Benefit Multiple (ABM)

The sum of accrual rate for each year of membership in accordance to the table above.

Retirement Benefit

The accrued retirement benefit calculated as Accrued Benefit Multiple x Final Average Pay (FAP).

Death Benefit

The lump sum benefit is calculated as the sum of:

- (i) ABM based on pre 30 June 1993 accrual rate x FAP; and
- (ii) 21% x Prospective Service to age 60 x FAP

Total and Permanent Disablement Benefit

The lump sum benefit is calculated as the sum of:

- (i) ABM x FAP; and
- (ii) 21% x Prospective Service to age 60 x FAP

Retrenchment Benefits

The accrued retirement benefit.

Resignation Benefit

The lump sum benefit of either:

- (a) Immediate benefit equal to:
 - If member resigns before reaching age 50:

$$ABM_5 \times FAP + C_5$$
 - If member resigns between age 50 and 55:

$$\frac{[(ABM_5 \times FAP + C_5) \times (55 - \text{age}) + (ABM \times FAP) \times (\text{Age} - 50)]}{5}$$

ABM5 – Accrued Benefit Multiple five years ago

C5 – contributions over the last five years plus credited investment returns

(b) Retained Benefit

Members can elect to retain their benefit within the fund and upon reaching age 55 members are entitled to the greater of the two benefits below:

- Resignation Benefit adjusted with investment earnings; or
- Accrued Retirement Benefit at the date of exit adjusted with CPI indexation

Salary Continuance Benefit

On temporary disablement or illness, members may receive 70% of salary payable up to two years after a 90-day waiting period.

Superannuation Guarantee

The benefits are subject to a superannuation guarantee minimum. Like all defined benefit members, the minimum is based on salary as defined in the Trust Deed. If Ordinary Time Earnings is higher than salary then top-up contributions are made to an accumulation account within the Fund and do not need to be considered from a funding perspective.

Parks Victoria plan

The benefits and conditions for Division E members are those which applied as at 31 October 1995, as set out in By-Law No. 235 of the Melbourne and Metropolitan Board of Works Act 1958, as amended, and now incorporated in Division E of the Fund's Trust Deed.

Division F of the Local Authorities Super Trust Deed ("the Deed") makes provision for miscellaneous members of the Fund. In particular it covers members who were former members of the Transport Superannuation Fund (now the Transport Scheme in the State Superannuation Fund) and the Revised Scheme in the State Superannuation Fund..

In accordance with the current Trust Deed, the benefit accruals and benefit entitlements for Division F Members continue to have the same status, operation and effect as they would have had under the 1988 Act pursuant to section 120 of the Port Services Act 1995 (Vic).

APPENDIX B - MEMBERSHIP MOVEMENTS

Defined Benefit Plan

Membership as at 1 January 2009 6,212

Adjustments* 7

Exits

■ Retirement	971
■ Retrenchment	37
■ Death	22
■ Total and Permanent Disablement	35
■ Resignation (Cash payment)	53
■ Resignation (Deferred benefit)	130

Total exits 1,248

Membership as at 31 December 2011 4,971

* These were members who were not included at the last valuation as at 31 December 2008 but were recorded as exits during the period or active members at 31 December 2011. They were active at 31 December 2008, hence they have been accounted for in the adjustment item above. This includes a small number of transfers from the City of Melbourne plan who transferred to the Defined Benefit plan when they changed employer.

Pensioners

Pensioners as at 1 January 2009		5,556
Adjustments*		33
New pensioners		
■ Retirement of active members	361	
■ Disablement of active members	13	
■ Spouses of deceased pensioners	211	
■ Children of deceased pensioners	0	
Total new pensioners		585
Pensions ceasing		
■ Death	1,041	
■ Other	1	
Total pensions ceasing		1,042
Pensioners as at 31 December 2011		<u>5,132</u>

*These were pensioners who were receiving a pension at 31 December 2008 but were not included in the 31 December 2008 actuarial investigation.

APPENDIX C - SUMMARY OF CASH FLOWS FROM 1 JANUARY 2009 TO 31 DECEMBER 2011

	(\$ '000)
Market Value at 1 January 2009	3,630,432
<u>Plus</u>	
Net Investment Revenue	424,882
Contribution Revenue	1,327,062
Other Revenue	<u>4,338</u>
	1,756,282
<u>Less</u>	
Benefits paid	862,512
Administration Expenses	53,285
Superannuation Contribution Surcharge	7
Insurance Premium	27,779
Taxation Provision	<u>125,847</u>
	1,069,430
Market Value at 31 December 2011	<u>4,317,284</u>
Comprised of:	
Defined Benefit Plan	1,692,173
City of Melbourne	52,403
Parks Victoria including Ports*	31,617
Accumulation Accounts & Reserves	2,541,091

* This includes contribution receivable of \$1.96 million.

APPENDIX D - SUMMARY OF VALUATION ASSUMPTIONS

Financial Assumptions

The most significant financial assumptions are:

- active members:

- investment returns (net of tax; expenses) 7.5% p.a.
- salary inflation growth 4.25% p.a.[^]

[^] For Parks plan, an additional salary increase rate of 6.0%p.a. immediately after 31 December 2011 in addition to the assumed long term rate of 4.25%p.a.

- pensioners:

- investment returns (gross of tax; expenses) 8.25% p.a.
- CPI increases 2.75% p.a.

Other financial assumptions used are:

- administration expenses:

- Defined Benefit plan payments 2.0% of salaries and 2.0% of pension
- COM plan 2.0% of salaries
- Parks plan 3.0% of salaries

- "promotional" salary scale:

- see table below (under "Other Assumptions")

For Fixed term pensions a real investment return of 1.0%p.a. has been assumed.

Other Assumptions

Active Members

The table below illustrates the decrement rates and the promotional salary scale assumed for active members. The decrement rates represent the percentage of members leaving the plan each year by each cause. The salary scale represents the annual rate of salary increase at that age for reasons other than salary inflation.

Year of Age	Deaths %	Disabilities - COM %	Disabilities - Defined Benefit and Parks %	Resignations %	Retirements %	Salary Scale %
20	0.03	0.05	-	13.42	-	7.1
30	0.02	0.14	0.01	6.48	-	1.5
40	0.05	0.35	0.05	3.77	-	0.0
50	0.14	0.60	0.27	2.44	-	0.0
60	0.43	2.37	0.82	-	15.0	0.0
64	0.66	0.00	0.00	-	15.0	0.0

The table below illustrates the age based premium rates for City of Melbourne's salary continuance benefits.

Annual Premium Per \$1000 of Annual Benefit

Age	Male Premium (\$)	Female Premium (\$)
Up to 30	1.5	2.0
35	1.8	2.4
40	2.6	3.5
45	4.2	5.8
50	7.3	9.4
55	13.0	14.4
60	22.9	20.6
65	6.6	5.0

Pensioners – Defined Benefit plan

The table below illustrates the rates of mortality assumed for pensioners. The figures represent the percentages dying in the years of age shown.

Year of Age	Retirement /Spouse Male %	Disability Male %	Retirement /Spouse Female %	Disability Female %
60	0.62	1.26	0.37	0.58
65	1.07	1.95	0.63	0.99
70	1.92	3.00	1.08	1.68
75	3.31	4.56	1.85	2.84
80	5.76	6.84	3.16	4.74
85	9.28	10.06	5.33	7.72
90	14.27	14.39	8.82	12.18

Deferred Benefit Option on Resignation – Defined Benefit plan

It has been assumed that 70% of those who resign will take the deferred benefit option.

Pension Option – Defined Benefit plan

It has been assumed that 50% of active members and 30% of deferred beneficiaries who joined the Defined Benefit plan prior to 25 May 1988 will elect to take the pension option upon retirement. Members who take this option are assumed to take 50% of their benefit as a pension. Deferred benefits are assumed to be accessed at age 60.

APPENDIX E - ASSET ALLOCATION

Asset Class	Actual Asset Allocation 31 December 2011 (%)	Strategic Asset Allocation 31 December 2011 (%)	2012 Strategic Asset Allocation (%)
Australian Equity	23.0	24.0	26.5
International Equity	17.9	21.0	21.0
Private Equity	12.6	8.0	8.0
Infrastructure	15.5	13.0	13.0
Absolute Return Strategies	1.8	2.0	2.0
Direct Property	8.7	9.0	9.0
Opportunistic Investments	5.9	5.0	5.0
Fixed Interest	11.8	15.0	10.0
Cash	2.8	3.0	5.5
Total	100.0	100.0	100.0
Allocation to Illiquid Assets	42.7%	35.0%	35.0%
Allocation to Growth Assets	73.5%	71.0%	73.5%

Vision Super classifies 73.5% of the assets as growth under the strategic asset allocation. The defensive assets are the fixed interest, cash and 40% of the Infrastructure assets and 65% of the direct property investments.

The actual asset allocations shown are for the Defined Benefit plan. The asset allocation of the remaining defined benefit assets were broadly similar.

APPENDIX F - VALUATION RESULTS

Defined Benefit Plan

The calculation of the Authority funding rate in respect of active members, deferred beneficiaries and current pensioners (including fixed term pensioners) in the Defined Benefit plan at 31 December 2011 based on the assumptions set out in Appendix D is as follows:

	(\$million)
Present Value of Active Member Liabilities	1,625.5
<ul style="list-style-type: none"> ■ Retirement 1,425.6 ■ Death 42.2 ■ Disablement 55.3 ■ Resignation 102.4 	
<i>plus</i> Deferred Beneficiary Liability	334.8
<i>plus</i> Present Value of Life Time Pensions	357.6
<i>plus</i> Present Value of fixed Term Pensions	2.2
<i>less</i> Family Offset and Surcharge Account balances	(7.4)
<i>plus</i> Present Value of Future Expenses	48.9
<i>plus</i> Allowance for tax on Contributions	<u>15.9</u>
Total Benefit Liability	2,377.5
Compared to:	
Assets	1,692.2
<i>plus</i> Value of ongoing member contributions (6%)	109.8
<i>plus</i> Value of ongoing Authority contributions (9.25%)	<u>169.3</u>
Total Assets	1,971.2
Shortfall of Total Assets over Total Benefit Liability	(406.3)

The Shortfall of Total Assets over Total Benefit Liability makes no allowance for contribution tax needed to fund the shortfall.

APPENDIX G - FINANCIAL POSITION OF THE TOTAL FUND

Individual financial positions for the defined benefit plans are detailed in Section 6 and Appendices I and J of this report. This appendix sets out the financial position of the total Fund.

The value of the accumulation liabilities has been provided by Vision Super. Members' accounts in the accumulation sections are unitized and credited with actual investment returns. The accumulation liabilities are expected to have no impact on the defined benefit plan funding.

Vested Benefits Index

The solvency position of the total Fund has been assessed by considering the vested benefits index for the total Fund.

Vested benefits are defined as the benefits which would be due and payable if all the members resigned at the investigation date. In relation to the Defined Benefit plan:.

- For active members, the Vested Benefits are thus the resignation benefit or the early retirement benefit (if aged 55 or more). Upon resignation from LASF, a member has the choice of an immediate lump sum or a more valuable deferred benefit. Also, upon retirement certain members have the option of taking a pension. In calculating the vested benefits, we have allowed for the best estimate assumption regarding the take up of deferred benefits and pensions.
- For deferred beneficiaries, the vested benefit will be the present value of the liabilities, allowing for the pension take up rate.
- For pensioners, the vested benefit is the present value of expected future pension payments.

This method is consistent with the new Professional Standard 400 (revised in August 2010) of the Actuaries Institute which covers actuarial investigations and requires Vested Benefits to be calculated taking into account the value of pension and deferred benefits. This professional standard also requires "best estimate" assumptions to be used, including realistic assumptions about the proportion of members who take a pension or deferred benefit.

The Vested Benefits Index for the Fund is calculated as follows:

$$\text{VBI} = \frac{\text{market value of assets}}{\text{total of vested benefits}}$$

The vested benefits for Vision Super Saver members are equal to the balances of these accounts. The VBI for the total Fund at 31 December 2011 is 89%. The VBI as at 31 December 2008 was 102%.

A funding plan has been recommended to restore the funding position, which is set out separately for each of the three defined benefit plans within the Fund.

Discounted Accrued Benefits Index

For the "Discounted Accrued Benefits Index" (DABI), the "Accrued Benefit" means the benefit payable at future exit accrued in respect of service to the investigation date. Discounted Accrued Benefits means the present value of the benefit payable in the future (based on the assumptions) accrued in respect of service to the investigation date. The method of apportioning active members' benefits to past service for the main Defined Benefit plan is as follows, effectively recognising the portion of future benefits arising due to service to date:

- Retirement, disablement, deferred resignation and retrenchment benefits – the past service benefit (based on accrued lump sum multiples and accrued pensions where relevant) at the calculation date, with allowance for future salary growth to the assumed exit date.
- Death benefits – the total projected death benefit at the assumed exit date multiplied by the ratio of service to the calculation date divided by service to the retirement date.
- Immediate Resignation Benefit – the past service benefit at the calculation date (based on the resignation multiple at the calculation date) with allowance for future salary growth up to the assumed resignation date.

The index is more a measure of the Defined Benefit plan's on-going capacity to meet accrued benefits in the long run.

The Discounted Accrued Benefits Index is calculated as follows:

$$\text{DABI} = \frac{\text{market value of plan assets}}{\text{total of discounted accrued benefits}}$$

The DABI for the total Fund at 31 December 2011 is 93%. The DABI as at 31 December 2008 was 100%.

Minimum Requisite Benefits

We have also considered the asset coverage of members' Minimum Requisite Benefits (i.e. Superannuation Guarantee Benefits). This is the Minimum Requisite Benefit Index (MRBI).

We understand that the MRBs for Defined Benefit plan have not been configured on the administration system, on the basis that the Defined Benefit plan's benefits equal or exceed the MRBs. Therefore, for the purposes of this valuation, the MRBs have been estimated. While the estimates are of the right order they are not precise.

Based on the legal advice from DLA Piper, we have estimated the MRB for deferred beneficiaries and pensioners on the following basis:

- For deferred beneficiaries, their MRBs are based on their resignation benefits (ie the immediate cash benefit which is the MRB defined in the Benefit Certificate for employee members under age 55); and.
- For the current pensioners who retired after 1992 (since the introduction of the Superannuation Guarantee legislation), their MRBs are expected to be less than their retirement benefits); whereas for those current pensioners who retired prior to 1992, their MRBs are assumed to be their retirement benefit. On retirement, all Defined Benefit plan members are required to take at least half of their benefit as a lump sum, which means that the portion of the pension that is funded by the MRB will often be low. Vision Super is unable to provide information regarding members' MRB at the time of retirement. Based on the data available, we have estimated the proportion of MRB benefits relative to the retirement pensions to be 65% for all current pensioners.

The MRBI for the total Fund at 31 December 2011 is 105%.

If the MRBI for the entire Fund falls to below 100% it becomes Technically Insolvent as defined in the SIS Regulations. If this occurs the Trustee must take certain steps to restore solvency. The Trustee needs to continue to monitor the "Notifiable Events" defined in the Funding and Solvency Certificate to identify if the Fund is at risk of becoming or becomes Technically Insolvent so appropriate action can be taken.

Other Funding measures

In the case of the termination of contributions by one or more Authorities the Trustee has some flexibility in respect of the benefits provided, subject to superannuation law, and there is no alternative measure of financial position that needs to be calculated in respect of this situation.

Also, on retrenchment Defined Benefit plan members are entitled to an accrued retirement benefit. It is proposed in this report that an additional contribution be required from the relevant Authority in respect of

each retrenchment from the Defined Benefit plan so that there is no financial strain on the Fund. As at 31 December 2011, the ratio of the market value of plan assets to retrenchment benefits is 88%.

Section 6 of this report discusses the potential reduction in the VBI of the Defined Benefit plan that would occur if the life-time pensioners were outsourced to a life insurance company or if the illiquid assets had to be sold immediately. This impact would flow through to the Fund VBI.

In Appendix E the asset allocation for the Defined Benefit plan is shown and there is currently a 43% allocation to illiquid assets. The funding indices have been calculated based on the valuation of these assets at market value from the 31 December 2011 unaudited financial statements. In the unlikely event that these assets had to be quickly liquidated it is possible that this could occur at discounted values resulting in significantly lower funding ratios.

The Authorities have several years to make each of the three lump sum contributions requested by Vision Super (as at 30 June 1997, 30 June 2002 and 30 June 2011). Outstanding amounts are included in the market value of assets as contributions receivable. If these amounts are not paid the funding position would be worse than set out in this report. The total Fund contributions receivable as at 31 December 2011 was \$11.4 million.

Probability of making Pension Payments

In order to satisfy the requirements of Modification Declaration No. 23 to certify that "there is a high degree of probability that the fund will be able to pay the pensions as required under the fund's governing rules", without any clear priorities for benefits being specified in the Fund Trust Deed, we looked to the following points in relation to contributions.

- (1) As envisaged by Circular 12/97 (issued by the Board under the 1988 Act), any future funding shortfall arising from pension liabilities can be funded under the Unfunded Liability Amount provisions in the Trust Deed.
- (2) Under Part A.21 of the Fund's Trust Deed, participating employers are generally able to terminate their contributions to the Fund at any time. However:
 - (a) Under clause A.21.1(b), a participating employer in Division C with an "Unfunded Liability Amount" is not able to terminate contributions. The "Unfunded Liability Amount" is the amount identified in respect of each participating employer using the methodology set out in Circular 12/97.
 - (b) A participating employer without an "Unfunded Liability Amount" is able to terminate contributions to the Fund under clause A.21.1(a) after giving 60 days notice and obtaining the Trustee's approval. Presumably, the Trustee would not give approval to terminate if there is an unfunded liability or material future funding risk.

-
- (3) The Participating Employer Agreement signed by each defined benefit employer imposes a contractual obligation on that employer, in addition to the contribution requirements in the Trust Deed. The Agreement also provides that employers with Unfunded Liability Amounts cannot terminate contributions and that those who do not have an Unfunded Liability Amount must follow clause A.21.1(a) of the Trust Deed.
- (4) The combination of the Trust Deed provisions and the Participating Employer Agreements essentially mean that an employer cannot unilaterally cease contributions to the Fund unless it ceases to exist:
- (c) Under the terms of the Participating Employer Agreement, if such an employer does cease to exist, the terms of the Agreement are binding on that employer's successor at law and that employer's "Unfunded Liability Amount" obligation (if any) must be assumed by any successor body.
 - (d) If there were no direct successor, the Trustee could initiate action to identify a relevant successor (possibly the State Government as most, if not all, of these employers would be engaged in the provision of essential public services which the state is constitutionally bound to provide). Such a situation is expected to be very rare.

Legal advice has been obtained by the Fund from DLA Piper that confirms the Employers cannot avoid their contribution responsibilities.

When forming a statement of opinion in accordance with Guidance Note 465, the assets and future contributions from which future pension payments are assumed to be met need to be identified. Under normal circumstances, it is considered inappropriate to take future employer contributions into account when determining the assets available to cover pension payments. However, paragraph 25(a) of Guidance Note 465 provides allowance for future contributions to be taken into account in limited circumstances, in order to form a positive opinion.

We believe that, given the nature of the Employers, the historical circumstances of Vision Super's funding arrangements fall within the scope of the 'limited circumstances' referred to in paragraph 25(a) of Guidance Note 465.

For most of its history, Vision Super was a public sector fund and was operated on a pay-as-you-go basis rather than on a fully funded basis. It has only been a Regulated fund under SIS since 1 July 1998 and employers remain public sector employers.

Changes to the Fund benefit design and funding policy in 1988 included a process to eventually achieve full funding of the accrued benefit liabilities, including the pension liabilities.

To achieve this full funding target over time, the contractual contribution arrangements outlined above were instigated.

In conclusion, this analysis allows us to provide the required certification under Regulation 9.31(1)(ba).

APPENDIX H - STATEMENTS REQUIRED UNDER REGULATION 9.31 OF THE SUPERANNUATION INDUSTRY (SUPERVISION) ACT 1993

Local Authorities Superannuation Fund Valuation at 31 December 2011

As the Actuary to the Fund, I hereby certify that:

- (a) The market value of the assets of the Local Authorities Superannuation Fund attributable to Defined Benefit members, City of Melbourne members, Parks Victoria members and pensioners as set out in the 31 December 2011 unaudited Financial Statements has been taken as the value of assets for the purpose of the actuarial valuation as at 31 December 2011. These amounts (allowing for appropriate adjustments) are summarised below:

Value of Assets as at 31 December 2011	
	\$ Million
Defined Benefit members, deferred beneficiaries and pensioners	1,692.2
City of Melbourne members	52.4
Parks Victoria members (including Ports) [^]	29.7
Other assets	<u>2,541.0</u>
Total	4,315.3

[^] excludes contribution receivable of \$2 million

- (b) In my opinion, the assets of the Fund as at 31 December 2011 were not sufficient to meet the liabilities of the Fund in respect of accrued benefits as at the date of the investigation (measured as the present value of members' accrued entitlements using the valuation assumptions).
- (c) Until the next actuarial investigation, due not later than 31 December 2014, the employers should make contributions to the Fund as follows:
- Defined Benefit plan:
 - Any outstanding unfunded liability from the 30 June 1997, 31 December 2002 and 31 December 2008 actuarial investigations;
 - An additional contribution to cover the excess of the benefits paid as a consequence of retrenchment above the funded resignation or retirement benefit (the funded resignation or retirement benefit is calculated as the VBI multiplied by the benefit), plus contribution tax;

-
- 9.25% of members' salaries;
 - Top up contributions of \$406 million (plus contribution tax and interest at 7.5% p.a. from 31 December 2011) payable as at 1 July 2013. While employers will be encouraged to pay their share of this amount by 1 July 2013, other funding options will be provided;
 - Additional top up contributions that may be required in the future so that Defined Benefit plan is no longer in an unsatisfactory financial position.
 - City of Melbourne plan:
 - 13% of members' salaries;
 - additional payments, calculated quarterly in arrears, for exiting members equal to the following amount (increased for contribution tax):
 - Benefit Payments less (Vested Benefit x VBI)
 - Additional contribution of \$2.2 million per annum in financial year 2012/13, 2013/14 and 2014/15.
 - Parks Victoria plan:
 - 12% of members' salaries for Division E members;
 - contribution due by 1 July 2012 of approximately \$400,000 as per the previous funding plan;
 - additional payments, calculated quarterly in arrears, for exiting members equal to the following amount (increased for contribution tax):
 - Benefit Payments less (Vested Benefit x VBI)
 - additional contribution of \$1.9 million per annum in financial year 2012/13, 2013/14 and 2014/15;;
 - also as per the following table for Division F members:

Former fund	Current Member Contribution Rate % of salaries	Employer Accruing Cost Contribution Rates % of salaries
Transport Scheme	0.0	9.5
	2.5	9.5
	5.0	13.5
	7.5	18.0
Revised Scheme	N/A	17.0
PMASS	N/A	18.0

- Contributions should be made in respect of other members in accordance with the Trust Deed.

- (d) The Fund's financial position is unsatisfactory as at 31 December 2011 in terms of SIS Regulation 9.04.
- (e) Funding and Solvency Certificates for the Fund covering the period from 1 January 2009 to 31 December 2011 required by the Superannuation Industry (Supervision) Act have been provided. In my opinion, the solvency of the Fund is likely to be able to be certified in any Funding and Solvency Certificate required under the Superannuation Industry (Supervision) Regulation during three year period to 31 December 2014 based on the assumptions used in this report.
- (f) In my opinion, at the investigation date, 31 December 2011, there is a high degree of probability that Vision Super will be able to pay pensions as required by the Trust Deed.

Matthew Burgess

Matthew Burgess
Fellow of the Institute of Actuaries of Australia

Gabrielle Baron

Gabrielle Baron
Fellow of the Institute of Actuaries of Australia
25 June 2012

APPENDIX I - CITY OF MELBOURNE PLAN

Purpose

- I.1 This report has been prepared for Vision Super, the Trustee of the Local Authorities Superannuation Fund (the Fund).
- I.2 The Fund is a "regulated fund" under the provisions of the Superannuation Industry (Supervision) Act 1993 ("SIS"). We understand that the Fund is treated as a complying superannuation fund for taxation purposes.
- I.3 In accordance with the Superannuation Industry (Superannuation) Act 1993, actuarial investigations are required at intervals of not more than three years. The previous triennial actuarial investigation was conducted as at 31 December 2008 and set out in the "Report on the Actuarial Investigation as at 31 December 2008 – Part 2" dated 13 May 2009.
- I.4 The purpose of this review is:
- to meet the requirements of the Trust Deed and the relevant superannuation legislation;
 - to examine the current financial position of the Fund;
 - to provide advice to the Trustee on the funding arrangements;
 - to meet the reporting requirements of SIS Regulation 9.31.

Introduction

- I.5 The City of Melbourne Superannuation Fund transferred into the Fund effective from 1 November 1995.
- I.6 A separate plan is operated for City of Melbourne defined benefit members who transferred into the Fund. Contributions and benefits in respect of the City of Melbourne members are made to (and from) this plan, as are proportionate shares of investment earnings and expenses.
- I.7 The City of Melbourne plan is closed to new entrants. New employees of the City of Melbourne join Vision Super Saver. The vast majority of the plan's members are employed by City of Melbourne but a small number are employed by other Authorities.
- I.8 I carried out the previous triennial actuarial investigation of the plan at 31 December 2008.
- I.9 The key recommendation from the report as at 31 December 2008 was that City of Melbourne should continue to contribute a minimum of 4.0% of salaries, subject to ongoing review by the Trustee on actuarial advice. This contribution rate was expected to be more than adequate in the

long term. However it was also noted that there is a significant risk that the Vested Benefit Index may fall below 100% in the short term.

- I.10 It was also recommended that a top-up contribution on retrenchment (based on the difference between the retrenchment benefit and the resignation benefit, grossed up for contribution tax) should continue to be paid.

Data and Experience

- I.11 Data was provided by Vision Super in respect of current members of the City of Melbourne plan as at 31 December 2011:

Number of Members:	177
Average Age:	53.4
Average Salary:	\$83,900

- I.12 Assets were obtained from the 31 December 2011 unaudited Fund accounts provided by Vision Super. We understand the net market value has been calculated consistently with AAS25. The net market value of assets as at 31 December 2011 was \$52.4 million.
- I.13 This asset value excludes \$7.2 million in respect of retained benefit accounts.
- I.14 All City of Melbourne plan accounting transactions are recorded in a separate sub account. In this way over time the contribution rate will reflect the actual experience of the City of Melbourne plan. The sub-account is invested in substantially the same way as the assets of the Defined Benefit plan.
- I.15 Over the three years to 31 December 2011 the investment return was 5.2% p.a., which is lower than the assumed investment return of 8.5% p.a.. The salary increases were 4.7% p.a., which is higher than that the expected increases of 4.25% p.a.. The "gap" between investment returns and salary increases was about 0.5% p.a., which is significantly lower than the "gap" of 4.25% p.a. assumed in the previous actuarial investigation. Therefore, the financial position of the City of Melbourne plan has deteriorated significantly.

Investments

Asset Allocation

- I.16 The plan assets are invested in a wide range of asset classes such as equity, property and fixed interest investments. The following table shows the Strategic Asset Allocation and the current Actual Asset Allocation as at 31 December 2011. A new strategic asset allocation has been adopted after 31 December 2011, which is also shown in the following table.

Asset Class	Actual Asset Allocation 31 December 2011 (%)	Strategic Asset Allocation 31 December 2011 (%)	2012 Strategic Asset Allocation (%)
Australian Equity	21.4	24.0	26.5
International Equity	18.4	21.0	21.0
Private Equity	12.1	8.0	8.0
Infrastructure	15.7	13.0	13.0
Absolute Return Strategies	2.2	2.0	2.0
Direct Property	8.7	9.0	9.0
Opportunistic Investments	6.2	5.0	5.0
Fixed Interest	13.9	15.0	10.0
Cash	1.4	3.0	5.5
Total	100.0	100.0	100.0
Allocation to Illiquid Assets	42.7%	35.0%	35.0%
Allocation to Growth Assets	72.8%	71.0%	73.5%

- I.17 The Strategic Allocation to Growth Assets as at 31 December 2011 was 71%, including Australian Equities, International Equities, Private Equity, Opportunistic Investments, Absolute Return Strategies and a portion of the Core Property and Infrastructure asset classes. This has increased slightly to 73.5% in 2012 as a result of the recent changes.

- I.18 Setting the Strategic Asset Allocation is a balance between:
- (a) A high allocation to growth assets, which is expected to produce relatively high but more variable investment returns and therefore lower but more variable employer contributions; and
 - (b) A low allocation to growth assets, which is expected to produce relatively low but less variable investment returns and therefore higher but less variable employer contributions.
- I.19 We believe that the 73.5% allocation to growth assets is among a range of allocations that could reasonably be used by the City of Melbourne plan.
- I.20 The City of Melbourne plan is closed to new members. Therefore, its liabilities will reduce significantly over the next ten years in real terms. If future investment returns are higher or lower than expected it is possible that a significant "actuarial surplus" or "actuarial shortfall" will again result. Therefore, it is recommended that the funding position of the City of Melbourne plan continue to be considered in setting investment policy. If the City of Melbourne plan ever has an "actuarial surplus" reducing the allocation to growth assets may become more attractive to the Board as a means of reducing the risk of subsequent higher contributions being caused by poor investment experience.

Liquidity

- I.21 The assets for City of Melbourne plan are invested in a similar strategy as the Defined Benefit plan..
- I.22 Currently the strategic asset allocation to the illiquid asset classes (which include Private Equity, Infrastructure, Opportunistic Investments and Direct Property) is 35%.
- I.23 We understand that the Board has determined that no further commitments are to be made to illiquid investments and is considering plans to reduce the allocation to illiquid assets to 25-30% over approximately three to five years.
- I.24 Given the size and the maturity of City of Melbourne plan, and that it pays lump sum benefits, it is inappropriate for the plan to hold any illiquid assets unless other assets within the Fund continue to act as the "liquidity provider" for the City of Melbourne plan when members exit the plan.
- I.25 However, it is recommended that the Board should consider the time frame over which they will reduce the exposure to illiquid assets in the City of Melbourne plan to zero.

Unit Pricing

- I.26 Within the Fund there are defined contribution members as well as defined benefit members. The assets and liabilities of the defined contribution members are equal with daily unit pricing being used. There is no investment reserving. We have been advised that the assets of the defined contribution members are segregated from the defined benefit assets and Vision Super has in place processes to limit cross subsidies between defined contribution and defined benefit members.
- I.27 We recommend that the Trustee should satisfy itself that no cross subsidies are occurring or could occur between the defined benefit and defined contribution plans.

Valuation Assumptions and Funding Method

- I.28 The financial assumptions adopted for the City of Melbourne plan are the same as for the Defined Benefit plan (refer to Appendix D). In summary:
- | | | |
|-----|-------------------|------------|
| (a) | Investment Return | 7.5% p.a. |
| (b) | Salary Inflation | 4.25% p.a. |
| (c) | Price Inflation | 2.75% p.a. |
- I.29 The assumed administration expense has been increased from 1.3% of salaries from the previous investigation to 2.0% of salaries in this investigation based on the experience over the three years to 31 December 2011.
- I.30 Demographic assumptions include rates of resignation, retirement, mortality and disablement. The plan does not have sufficient members to develop assumptions from its own experience. Therefore, except for disablement, the same assumptions as for the Defined Benefit plan have been adopted (refer to Appendix D). The same assumptions used previously for disablement have been retained because the definition of disablement is different for the plan than for the Defined Benefit plan.
- I.31 As per the 2008 investigation, the funding method adopted is the aggregate funding method. It is described in more detail in Section 5 of this report. The aggregate funding method seeks to have sufficient assets to pay all benefits as they fall due.
- I.32 Under the proposed new prudential standard (SPS 160), it is expected that APRA will require superannuation funds to rectify an unsatisfactory financial position within three years. Hence the main objective of our proposed funding plan will be to restore the VBI to above 100% within the next three years.

- I.33 We will also consider the adequacy of funding in the long term.

Financial Position at 31 December 2011

- I.34 The financial position of the City of Melbourne plan has been assessed by considering the same indices as for the Defined Benefit plan (refer to Section 6 for background information on these indices).

Vested Benefits Index

- I.35 For the City of Melbourne plan, the Vested Benefits Index is calculated as follows:

$$\text{VBI} = \frac{\text{market value of plan assets}}{\text{total of vested benefits}}$$

(*This amount also includes allowance for the value of the retained benefits which is in excess of the amount held in the Retained Benefits Account in the Fund accounts).

- I.36 The VBI as at 31 December 2011 is shown in the table below:

VBI as at 31 December 2011 - COM		(\$m)
COM assets		\$52.4
<u>Vested Benefits</u>		
Active Members		\$59.2
Present Value of Additional Retained Benefit		\$0.4
Total Vested Benefits		\$59.6
Vested Benefit Index		88%

- I.37 The calculated VBI for the plan at 31 December 2011 is 88%. This compares with a VBI of 103% at the 31 December 2008 investigation.

Discounted Accrued Benefits Index

- I.38 For the City of Melbourne plan, the Discounted Accrued Benefits Index is calculated as follows:

$$\text{DABI} = \frac{\text{market value of plan assets}}{\text{total of discounted accrued benefits}^*}$$

(*This amount also includes allowance for the value of the retained benefits which is in excess of the amount held in the Retained Benefits Account in the Fund accounts).

I.39 The DABI as at 31 December 2011 is shown in the table below:

DABI as at 31 December 2011 - COM	(\$m)
COM assets	\$52.4
<u>Discounted Accrued Benefits</u>	
Active Members	\$54.1
Present Value of Additional Retained Benefit	\$0.4
Total Discounted Accrued Benefits	\$54.5
Discounted Accrued Benefits Index	96%

I.40 The calculated DABI for the plan at 31 December 2011 is 96%. This compares with a DABI of 118% at the 31 December 2008 investigation.

Minimum Requisite Benefits Index

I.41 The Minimum Requisite Benefits (MRBs) are the minimum amount of benefit that must be provided to enable City of Melbourne to satisfy their Superannuation Guarantee obligations. The method to calculate the amount of MRBs for the active members is specified in my Benefit Certificate.

I.42 The MRBs for City of Melbourne members are provided by Vision Super. While we are not able to independently verify the calculations, we have performed some reasonableness checks and these benefits appear to be in the right order.

I.43 The Minimum Requisite Benefit Index is calculated as follows:

$$\text{MRBI} = \frac{\text{market value of assets}}{\text{total of Minimum Requisite Benefits}}$$

The calculated MRBI for the plan at 31 December 2011 is 124%. The MRBI was not calculated as at 31 December 2008.

- I.44 The major use of these indices is in monitoring the performance of the City of Melbourne plan over time. The Vested Benefit Index and the Discounted Accrued Benefit Index have decreased since 31 December 2008 due to poor investment performance of the fund. The decrease in DABI has been greater as the real investment return assumed (the excess of the assumed investment return over the salary inflation assumption) has decreased from 4.25% used in the last investigation to 3.25% in this investigation. The City of Melbourne contributions have also been below the accruing cost of members' benefits.

Other Considerations

- I.45 On resignation, members have the option to retain their benefits in the fund and receive the accrued retirement benefit from age 55. The accrued retirement benefit is indexed with CPI whereas the account balance is increased with investment return. Additional liability may incur if the accrued retirement benefit is greater than the account balance at retirement age. As at 31 December 2011, the additional liability in respect of retained members was \$418,884.
- I.46 Based on the recent experience, we have assumed that no currently employed members will elect the deferred benefit option upon resignation. Similarly, members can elect a pension in certain situations but as far as we are aware none have done this so we have assumed no pensions are taken. If material numbers of members elect to either defer their benefit or take a pension then funding may be adversely impacted.
- I.47 The City of Melbourne may direct the Trustee to augment benefits in accordance with Rule D.4.8 of the Trust Deed. We are not aware of any augmentations that have taken place and none have been allowed for in this investigation. The Trustee may require additional contributions (after consulting the Actuary) from the City of Melbourne prior to such an augmentation. We recommend that no augmentation be made without seeking actuarial advice in respect of funding.

Other Measures of Financial Position

- I.48 Rule D.2.1 of the Trust Deed allows the transfer of members out of the Fund in certain circumstances. The amount of assets to be transferred must be agreed between the Trustee and City of Melbourne but must not exceed the members' equitable share of assets. This means that there is no additional funding measure to be calculated in this circumstance.
- I.49 In accordance with Clause A.21.1(a) of the Trust Deed, an Employer requires the approval of the Board to terminate its contributions to the Defined Benefit plans. We assume this approval would not be provided unless any future funding risk is adequately managed.

- I.50 However, if an Authority does terminate its contributions, Clause A.21.3 (a) of the Trust Deed states that:

"the Trustee, after obtaining the advice of the Actuary and subject to A.21.5, may adjust any benefit which is or may become payable to or in respect of any person whom the Trustee may consider is affected by that termination to the extent and in the manner the Trustee considers appropriate and equitable"

- I.51 Further it states in Clause A.21.5 that:

"...Unless otherwise agreed between the Trustee and the Employer, an adjustment made ...must not increase the amount of any benefit which, in the opinion of the Trustee after obtaining the advice of the Actuary, has accrued in respect of a person immediately prior to the effective date of that adjustment in respect of the period up to that date or improve the basis upon which benefits accrue during or in respect of any period after that date."

- I.52 Therefore, in the case of the termination of contributions by the City of Melbourne the Trustee has some flexibility in respect of the benefits provided, subject to superannuation law, and there is no alternative measure of financial position that needs to be calculated in respect of this situation.
- I.53 On retrenchment, members' are entitled to the accrued retirement lump sum. As at 31 December 2011, the ratio of the market value of assets to the amount of retrenchment benefits was 83%. The corresponding index as at 31 December 2008 investigation was 95%. This decrease in the index was mainly due to the poor investment returns during the period.
- I.54 For members under age 55, an additional contribution is currently required from the employer in respect of each retrenchment so that there is no additional financial strain on the City of Melbourne plan under the current funding plan. The funding of retrenchments is considered further in the next section.
- I.55 In Section I.16 the City of Melbourne plan's asset allocation is shown and there is currently a 43% allocation to illiquid assets. The funding indices have been calculated based on the valuation of these assets at market value from the 31 December 2011 unaudited financial statements. In the unlikely event that these assets had to be quickly liquidated it is possible that this could occur at discounted values resulting in lower funding ratios. For example, a 20% discount on forced sale of illiquid assets would reduce the funding indices by approximately 8%.

Assessing the Adequacy of the Funding Arrangements

- I.56 We understand that the City of Melbourne has been contributing at 4.0% of salaries including a provision for salary continuance insurance. We also recommended top-up payments on retrenchment (equal to the difference between the retrenchment benefit and the resignation

benefit and an allowance for contribution tax). It is assumed that any salary sacrifice member contributions are paid in addition to these amounts.

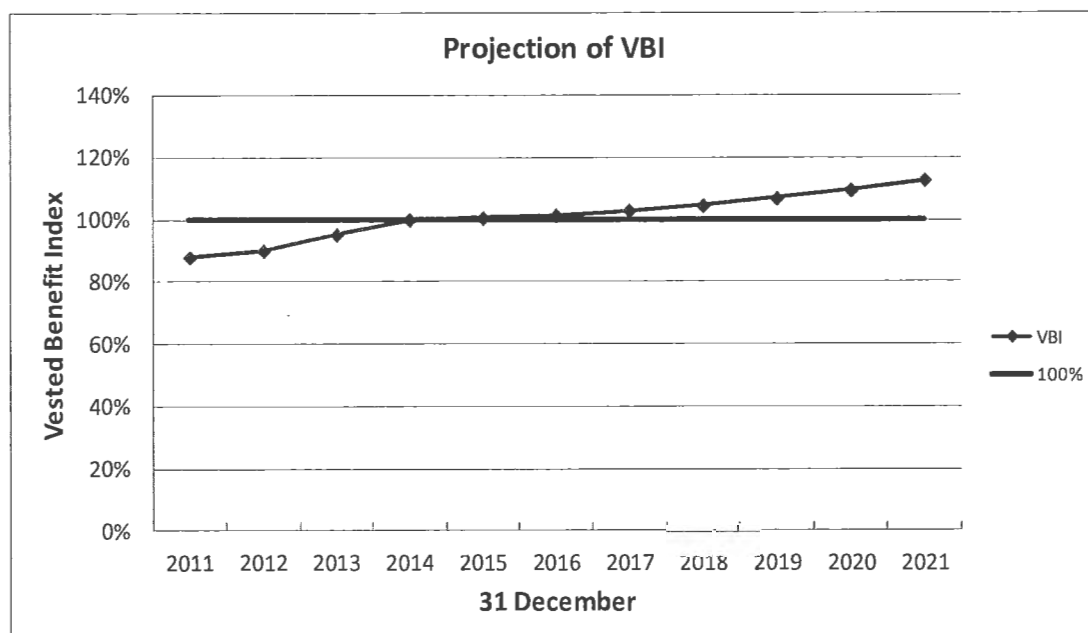
- I.57 Because of the small number of members and the maturity of the City of Melbourne plan, its funding is very sensitive to experience. As at 31 December 2011 the Vested Benefits were \$7.2 million less than the available assets. As discussed earlier, this deficiency has resulted primarily due to lower than expected investment returns.
- I.58 Under the proposed Prudential Standard, APRA will require superannuation funds to put in place plans to fund vested benefit deficits within three years. It is preferable that the deficiency be funded as quickly as possible.
- I.59 I recommend that the Trustee develop a funding plan that is expected to return the plan VBI to above 100% in no more than 3 years.
- I.60 One of a range of reasonable alternatives is for City of Melbourne to:
- (a) Increase the ongoing contribution rate from 4% to 13% of salaries (inclusive of 1% for salary continuance cover) from 1 July 2012;
 - (b) Contribute an additional \$2.2 million (inclusive of 15% contribution tax) per annum by 30 June 2013, 30 June 2014 and 30 June 2015;
 - (c) Fund the top-up payments for exiting members equal to the following amount increased for contribution tax:

Benefit Payment less (Vested Benefit x VBI)

Top-up payments are to be calculated and invoiced quarterly in arrears from 1 July 2012.

- I.61 Each component of this funding plan is considered below.

I.62 The chart below shows the projected VBI under the proposed funding plan:



I.63 As shown in the chart, the VBI is expected to be above 100% in three years' time. Note that the VBI is expected to stay above 100% if the best estimate assumptions are borne out in practice. However, there is a risk that the VBI will either not increase as quickly as expected or will subsequent fall below 100% because of worse experience than expected.

I.64 The table below shows the total service liability surplus/(shortfall) under the proposed funding plan and the impact of assumptions change:

Funded Status as at 31 December 2011 (\$ million)

Surplus/(Shortfall) based on 2008 assumptions and 2010 funding plan	(5.1)
Surplus/(Shortfall) based on 2011 assumptions and 2010 funding plan	(8.9)
Surplus/(Shortfall) based on 2011 assumptions and the proposed funding plan	2.5

- I.65 The methodology used to determine the actuarial surplus/(shortfall) is similar to the method used for the Defined Benefit plan which is set out in paragraph 5.25-5.26. The calculations under the proposed funding plan are summarised in Appendix K.
- I.66 The shortfall under the 2008 assumptions and 2010 funding plan is mainly caused by the poor investment return over the three years to 31 December 2011. The change in assumptions has led to an increase in the shortfall of \$3.8 million mainly due to a lower expected return in the future.
- I.67 As shown in the table in Section I.64, the recommended contributions in paragraph I.60 would be \$2.5 million more than adequate to fund the benefits in the long term if experience is as expected. However, given the maturity of the fund, the funding requirement is highly dependent on the actual experience. Under the new prudential standard which places a greater emphasis on the short term solvency (ie VBI), the future contributions are likely to be volatile. It would be prudent to allow for some margin in the VBI in order to reduce the need for additional funding. This risk of volatile contributions may also be managed by reducing the exposure to growth assets, which may be more attractive to the Board if the VBI becomes above 100%. However, de-risking the investments may reduce the expected return and hence increase the funding cost.
- I.68 As at 31 December 2011, the long-term cost of funding the future service benefits was determined to be 12.8% of members' salaries. This is the employer contribution rate required assuming that assets at the valuation date were equal to the present value of accrued benefit liabilities. This reflects the ongoing cost to the employer of providing the defined benefits accruing in respect of future service.
- I.69 In recommending the ongoing contribution rate for City of Melbourne, we have adopted a lower rate of 12% recognising this rate combined with the top up amount is expected to provide adequate funding in the long term. An additional 1% of salary has also been allowed for to cover the salary continuance cover.
- I.70 In this funding plan, top up contributions on retrenchment have been replaced by top-up contributions for all exits. This is necessary because with a VBI of less than 100%, the amount of assets paid from the City of Melbourne Plan exceeds the amount available. If no top up contributions were made the funding position would deteriorate with each exit. Once the VBI returns to 100%, the amount of the top-up contributions would reduce to zero in all cases except where a benefit greater than the vested benefit is paid.

Sensitivity Analysis

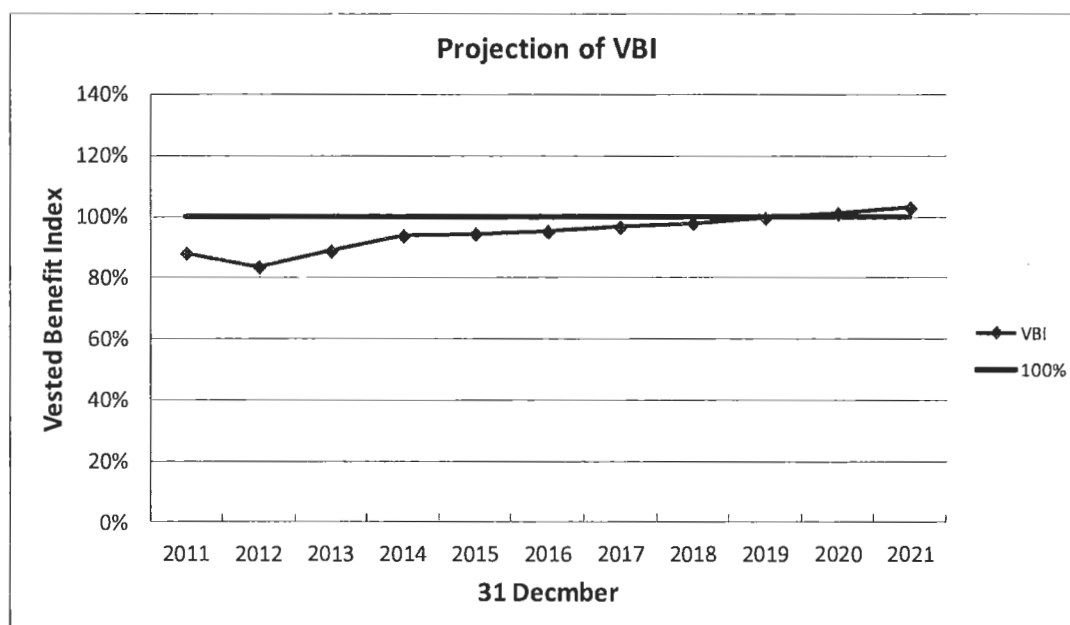
- I.71 The factors affecting the ultimate funding cost depends on future experience of the plan and are generally split into two broad categories. They are the financial assumptions and the demographic assumptions. The assumptions are more sensitive to changes in the financial assumptions and the sensitivity of the "actuarial surplus/(shortfall)" to the financial assumptions is considered below.
- I.72 The key financial assumption is the differential or "gap" between the investment return and the growth in salaries. If the actual experience for the "gap" varies from the assumed "best estimate" assumption of 3.25% p.a., it can have a very significant effect on the ongoing contribution rate and any unfunded liability contributions (as demonstrated in this investigation relative to the last investigation).
- I.73 To quantify the potential impact of variations in financial experience, the following table shows the impact of changing the gap on the "actuarial surplus/(shortfall)" as at 31 December 2011.

Impact of Changes in Key Assumption

	Actuarial Surplus/(Shortfall)
	\$ Million
Best estimate assumptions	2.5
Increase the gap by 1%	5.5
Decrease the gap by 1%	(0.9)

- I.74 The table shows that a variation in the "gap" has a very significant impact on the actuarial surplus or shortfall. It is possible that the actual "gap" may vary from our best estimate assumption by significantly more than 1% and the impact would be greater than what was shown in this sensitivity analysis.

- I.75 We have also considered the investment risk in the short term. The chart below shows the impact on the VBI if the investment return is 0% next year.



- I.76 As shown in the chart, the VBI is not expected to increase to 100% in three years' time if the return is lower than we expect. Without additional contributions, it would take more than 8 years to restore the plan's VBI to 100% if the investment return is 0% next year. Once the draft Prudential Standard comes into effect, additional contributions would be required in the short term to fund the vested benefit shortfall.
- I.77 The chart in I.75 does not take into account the impact on the retained members. Our analysis shows that if the return is 0% next year, the additional liability for retained members will increase by approximately \$77,000.

Events subsequent to 31 December 2011

- I.78 Vision Super has advised that the City of Melbourne plan investment return from 1 January 2012 to 8 June 2012 has been 2.8%. While this is below the assumed investment return of 7.5% per annum, it is not materially below. Given the current volatility in investment markets we do not consider it necessary to revise our calculations to reflect this difference.
- I.79 We are not aware of any other event subsequent to 31 December 2011 that would materially impact upon the results of the actuarial investigation of the City of Melbourne plan. It is assumed that the increases to the Superannuation Guarantee Charge to 12% will be provided from the defined contribution plan.

Self Insurance

- I.80 The plan provides death and disablement benefits that are significantly higher than the resignation/retirement benefits. The plan also includes a salary continuance benefit. The Fund self insures these risks. The death and disablement benefits have been considered first followed by the salary continuance benefit.
- I.81 The death and disablement benefits are funded by contributions from City of Melbourne. It is the City of Melbourne that bears the financial risk if the amount of death and disablement benefits paid is significantly higher than expected.
- I.82 The following table summarises the plan's exposure to future service death and disablement risk as at 31 December 2011.

Statistics as at 31 December 2011	
Net Assets Available ¹ (COM plan assets available to meet benefits)	\$52.0 m
Expected Annual Future Service death and disablement benefits to be paid ²	\$291,300
Total Future Service death benefits ³	\$35.3 m
Average Future Service death benefits	\$199,000
Maximum death or disablement Future Service Benefit of any Member	\$893,600

1. Active plan assets excluding \$0.4 m assets in respect of retained benefits (i.e. the liability in respect of the retained benefit members is \$0.4 million higher than the retained benefit assets).

2. Based on assumptions adopted in this investigation.

3. The amount of future service death benefits shown is the amount of death benefit in excess of the "funded" accrued retirement benefit. Hence the future service death benefits quoted in this Section includes the underfunded portion of the accrued retirement benefit.

- I.83 Because of the small number of members, it is possible that the actual future service death and disablement benefits could be five times the expected number in any year. If this occurred in the 2012 year, additional benefits of approximately \$1.5 million would be expected to be paid. This represents approximately 3% of the plan's available assets. This unlikely event would have a significant impact on the solvency of the fund, given that the VBI was under 100% as at 31 December 2011. Additional contributions in excess of the recommended amount would be required to fund the additional benefits.

-
- I.84 The plan is currently subject to the risk of catastrophe although the risk is reduced as the membership of the City of Melbourne plan is spread over several locations.
- I.85 There is a very remote possibility of a catastrophe occurring that may result in around 50 death or disablements benefits. If this occurred, and assuming the future service death or disablement benefit was equal to the average of \$199,000 for each member, the total claim amount would be approximately \$10.0 million. This represents approximately 19% of net available assets. Therefore, if this occurred in the short term the VBI would further deteriorate and significant contributions would be required from City of Melbourne to fund the shortfall.
- I.86 The plan also provides a salary continuance benefit of 70% of salary, payable for two years after a 90 day waiting period. This is self insured but the expected annual cost has been calculated using age based premium rates of other superannuation funds providing a similar benefit. The age based rates assumed are set out in Appendix D.
- I.87 Based on these rates the expected annual salary continuance benefit payments is \$0.1 million. This represents 1.0% of salary. Because this percentage is likely to increase with the ageing membership of the plan, it is recommended that an allowance of at least 1% of salary be included in the contribution rate in respect of the salary continuance benefit.
- I.88 The plan's salary continuance experience has historically been low. In the unlikely event that 20 benefits are paid and assuming 70% of average salary is paid for two years for each of these members, this represents \$2.3 million which was 4.4% of the plan's assets as at 31 December 2011. Given the current weak funding position of the plan, in this situation the VBI will further deteriorate and additional contributions may be required.
- I.89 Given the discussion above, there are material risks with self insuring only 177 members because experience could vary significantly. Variation in the claim experience could have a large impact on the plan's funding position and increase the likelihood of more variable contributions. We recommend that the plan seek external insurance in relation to the death and disablement benefits and the salary continuance benefits in order to mitigate these risks.
- I.90 We recommend that the funding plan proposed in I.60 above would be appropriate if the plan was externally insured (including the 1% of salary contribution for salary continuance cover). There would likely be a margin applied by the insurer to the premiums for costs and profit, however we do not believe that it would have a material impact on the financial position of the plan.
- I.91 In the proposed funding plan in I.60, the top-up payments for exits would be calculated excluding the externally insured benefit payment on death or disablement.

Material Risks

Investment Risk

- I.92 The most significant risk facing the City of Melbourne plan is that investment returns will not be as high as expected. If investment returns are lower than expected the City of Melbourne will be required to make further top-up contributions. Subject to our comments below about liquidity, the asset allocation is within the range of reasonable asset allocations (refer to Section 4 of the report).
- I.93 There were \$7.2 million of retained benefits as at 31 December 2011. These members are entitled to receive from age 55 the greater of an inflation indexed benefit and an account balance increasing at the investment return. This means that if the investment returns are very poor the amount by which the deferred benefits exceed the account balances could increase substantially. Additional contributions would be required from the City of Melbourne if this occurs.
- I.94 The Trustee should continue to consider the liabilities and the funding position when determining the City of Melbourne plan's investment strategy.

Salary Inflation Risk

- I.95 Salary increases exceeding expectations will have a negative impact on funding.
- I.96 It is the excess of the investment return above the rates of salary increases that is most important because the assets increase with the investment return and the liabilities with salary inflation.

Mortality/Morbidity Risk

- I.97 The City of Melbourne plan self-insures the death and disability benefits and is therefore subject to the risk of higher than expected claims. Given the size of the plan and that it is under-funded, Vision Super should externally insure the insurance risk.
- I.98 While the risk is low, a high number of death or disability (or terminal medical condition) benefits caused by a single event is likely to put significant strain on the funding if this occurs prior to the external insurance being put in place.

Liquidity Risk

- I.99 In Section I.21 - I.25 liquidity risk is discussed. Also, Section I.55 considered the potential impact on funding of having to liquidate investments at a discount.

-
- I.100 We believe that Vision Super should consider a plan to reduce their exposure to illiquid assets in the City of Melbourne plan to zero over time given the maturity of the plan and the possibility of large lump sum benefit payments.

Legislation Risk

- I.101 There is a risk that legislation changes could impact on funding. For example:
- (a) The Prudential Standard in its draft form has been considered in this report, however if the finalised form of the Prudential Standard is different to the draft version, there may be implications for funding requirements.
 - (b) The Government has legislated to increase the Superannuation Charge to 12% of Ordinary Time Earnings. This will materially impact Fund benefits if this increase is provided from the Parks plan;
 - (c) Changes to legislation may impact investment returns or other aspects of experience; and
 - (d) Changes to tax may impact funding;

Other

- I.102 Operational risks (eg. unit pricing and administration) are not considered in this report.
- I.103 If Members increase their member contribution rates this would be expected to increase their future service benefits and the funding required from City of Melbourne.
- I.104 There are many other risks in respect of the funding of the City of Melbourne plans but we have not included those we do not consider to be currently material.

Recommendation

- I.105 We recommend that the death, disability (including terminal medical condition) and salary continuance benefits be externally insured.
- I.106 We recommend that the Trustee develop a funding plan that is expected to return the plan VBI to above 100% in 3 years. A shorter funding period would be preferred but 3 years is the maximum timeframe that is required under the draft Prudential Standard.
- I.107 A suitable funding plan for City of Melbourne is:
- (e) Increase the ongoing contribution rate from 4% to 13% (inclusive of 1% salary continuance cover) of salaries for Division D members from 1 July 2012;
 - (f) Contribute an additional \$2.2 million (inclusive of 15% contribution tax) per annum by 30 June 2013, 30 June 2014 and 30 June 2015.
 - (g) Fund the top-up payments for exiting members equal to the following amount increased for contribution tax:

Benefit Payment less (Vested Benefit x VBI)

Top-up payments are to be calculated and invoiced quarterly in arrears from 1 July 2012.

- I.108 We also recommend that the Board consider a plan to reduce the exposure to illiquid assets in the City of Melbourne plan to zero over time given the maturity of the plan and the possibility of large benefit payments. It is very important that other assets within the Fund continue to act as liquidity provider for the City of Melbourne plan.

APPENDIX J - PARKS VICTORIA PLAN

Purpose

- J.1 This report has been prepared for Vision Super, the Trustee of the Local Authorities Superannuation Fund (the Fund).
- J.2 The Fund is a "regulated fund" under the provisions of the Superannuation Industry (Supervision) Act 1993 ("SIS"). We understand that the Fund is treated as a complying superannuation fund for taxation purposes.
- J.3 In accordance with the Superannuation Industry (Superannuation) Act 1993, actuarial investigations are required at intervals of not more than three years. The previous triennial actuarial investigation was conducted as at 31 December 2008 and set out in the "Report on the Actuarial Investigation as at 31 December 2008 – Part 2" dated 13 May 2009.
- J.4 The purpose of this review is:
- to meet the requirements of the Trust Deed and the relevant superannuation legislation;
 - to examine the current financial position of the Fund;
 - to provide advice to the Trustee on the funding arrangements;
 - to meet the reporting requirements of SIS Regulation 9.31.

Introduction

- J.5 Members of the Water Industry Superannuation Fund (WISF) employed by Parks Victoria transferred into the Fund effective from 1 November 1995 and are covered by Division E of the Local Authorities Super Trust Deed ("the Deed").
- J.6 The Parks Victoria plan ("Parks plan") now also covers members of Division F of the Deed. These members were former members of the Transport Superannuation Fund (now the Transport Scheme in the State Superannuation Fund), the Revised Scheme in the State Superannuation Fund or the Port of Melbourne Authorities Superannuation Scheme (PMASS). All PMASS members have exited the fund prior to 31 December 2011. Note that one of the former Ports plan members is not employed by Parks Victoria and has been included in the main Defined Benefit plan. It is understood that the assets (and contributions) in respect of this member are in the main Defined Benefit plan assets not in the Parks plan assets.
- J.7 The previous triennial actuarial investigation of the Parks plan has been carried out by Matthew Burgess as at 31 December 2008.

- J.8 A separate notional plan is operated for Parks Victoria defined benefit members (Division E & F members) who transferred into the Fund. Contributions and benefits in respect of the Parks Victoria members are made to (and from) this plan, as are proportionate shares of investment earnings and expenses.
- J.9 The Parks plan is closed to new entrants. New employees of Parks Victoria join Vision Super Saver.
- J.10 Following the 31 December 2008 investigation we recommended that the Trustee develop a funding plan that is expected to return the plan VBI to 100% by 31 December 2013. One of a range of reasonable alternatives was for Parks Victoria to:
- (a) Continue to contribute 10% of salaries for Division E members and the current accruing cost contribution rate for Division F members;
 - (b) Contribute an additional \$1,176,000 (\$1 million grossed up for contribution tax) over the period to 1 July 2010;
 - (c) Review the funding again after 30 June 2010. Further contribution may be required if VBI remains below 100%.
- J.11 We carried out a funding review as at 30 June 2010 and the key recommendations were:
- (a) Continue contributing 10% of salaries for Division E members and the current accruing cost contribution rates for Division F members;
 - (b) Contribute any outstanding amounts from the additional contributions of \$1.0 million (plus contribution tax and expected investment return) required by 1 July 2010;
 - (c) Contribute an additional \$1.2 million (plus contribution tax) over the period to 1 July 2011;
 - (d) Contribute an additional \$1.3 million (plus contribution tax) over the period to 1 July 2012;
 - (e) Review the funding again after the 31 December 2011 actuarial investigation. At that date the VBI was expected to remain below 100% and additional contributions were expected to be required.
- J.12 Subsequent to the recommendations in the previous report at 30 June 2010, Parks Victoria continued to contribute 10% of salaries for Division E members and to contribute the accruing cost contribution rates for Division F members. Parks Victoria also agreed to contribute the additional amounts set out in the paragraph above. The full amounts were invoiced but the amounts were being paid in installments over 10 years.

Data and Experience

J.13 Data was provided in respect of current members of the Parks plan:

SUMMARY OF PARKS PLAN MEMBERSHIP AS AT 31 DECEMBER 2011

Former fund	Number	Average Age (years)	Average Service (years)	Average Salaries
WISF	95	53.9	28.3	\$78,372
Transport Scheme	9	55.4	30.4	\$74,657
Revised Scheme	1	49.1	29.6	\$68,193
Total	105	53.9	28.5	\$77,957

- J.14 Assets were obtained from the 31 December 2011 unaudited Fund accounts provided by Vision Super. We understand the market value of assets has been calculated consistently with accounting standard AAS25. The market value of assets as at 31 December 2011 was \$31.6 million, including \$2.0 million of additional contribution (net of contribution tax) due in 2010 and 2011. While not all of the top-up contributions have been received by Vision Super, the amount not yet received has been included in the unaudited financial statements as a contribution receivable.
- J.15 For the purpose of this valuation, we have excluded the contribution receivable in the net assets. The new funding plan will take into account the unpaid contributions. The net assets as at 31 December 2011 excluding the contribution receivable of \$2.0 million was \$29.7 million.
- J.16 All Parks plan accounting transactions are recorded in a separate sub account. In this way over time the contribution rate will reflect the actual experience of the Parks plan. The sub-account is invested in substantially the same way as the assets of the Defined Benefit plan.
- J.17 Over the three years to 31 December 2011 the salary increases were 2.9% p.a.. This is lower than the rate of 4.25% p.a. assumed in the previous investigation which has been favourable for the plan.

- J.18 However, the investment return was 5.2% p.a. over the three years, which is lower than the assumed investment return of 8.5% p.a.. This has caused deterioration in the Parks plan's financial position.

Investments

Asset Allocation

- J.19 The plan assets are invested in a wide range of asset classes such as equity, property and fixed interest investments. The following table shows the Strategic Asset Allocation and the current Actual Asset Allocation as at 31 December 2011. A new strategic asset allocation has been adopted after 31 December 2011, which is also shown in the following table.

Asset Class	Actual Asset Allocation 31 December 2011 (%)	Strategic Asset Allocation 31 December 2011 (%)	2012 Strategic Asset Allocation (%)
Australian Equity	21.4	24.0	26.5
International Equity	18.4	21.0	21.0
Private Equity	12.1	8.0	8.0
Infrastructure	15.7	13.0	13.0
Absolute Return Strategies	2.2	2.0	2.0
Direct Property	8.7	9.0	9.0
Opportunistic Investments	6.2	5.0	5.0
Fixed Interest	13.9	15.0	10.0
Cash	1.4	3.0	5.5
Total	100.0	100.0	100.0
Allocation to Illiquid Assets	42.7%	35.0%	35.0%
Allocation to Growth Assets	72.8%	71.0%	73.5%

- J.20 The Strategic Allocation to Growth Assets as at 31 December 2011 was 71%, including Australian Equities, International Equities, Private Equity, Opportunistic Investments, Absolute Return Strategies and a portion of the Core Property and Infrastructure asset classes. This has increased slightly to 73.5% in 2012 as a result of the recent changes.

- J.21 Setting the Strategic Asset Allocation is a balance between:
- (a) A high allocation to growth assets, which is expected to produce relatively high but more variable investment returns and therefore lower but more variable employer contributions; and
 - (b) A low allocation to growth assets, which is expected to produce relatively low but less variable investment returns and therefore higher but less variable employer contributions.
- J.22 We believe that the 73.5% allocation to growth assets is among a range of allocations that could reasonably be used by the Parks plan.
- J.23 The Parks plan is closed to new members. Therefore, its liabilities will reduce significantly over the next ten years in real terms. If future investment returns are higher or lower than expected it is possible that a significant "actuarial surplus" or "actuarial shortfall" will again result. Therefore, it is recommended that the funding position of the Parks plan continue to be considered in setting investment policy. If the Parks plan ever has an "actuarial surplus" reducing the allocation to growth assets may become more attractive to the Board as a means of reducing the risk of subsequent higher contributions being caused by poor investment experience.

Liquidity

- J.24 The assets for Parks plan are invested in a similar strategy to the Defined Benefit plan, which is summarised above.
- J.25 Currently the strategic asset allocation to the illiquid asset classes (which include Private Equity, Infrastructure, Opportunistic Investments and Direct Property) is 35%.
- J.26 We understand that the Board has determined that no further commitments are to be made to illiquid investments and is considering plans to reduce the allocation to illiquid assets to 25-30% over approximately three to five years.
- J.27 Given the size and the maturity of Parks plan, and that it pays lump sum benefits, it is inappropriate for the plan to hold any illiquid assets unless other Fund assets will continue to act as the "liquidity provider" for the Parks plan when members exit the plan.
- J.28 However, it is recommended that the Board should consider the time frame over which they will reduce the exposure to illiquid assets in the Parks plan to zero.

Unit Pricing

- J.29 Within the Fund there are defined contribution members as well as defined benefit members. The assets and liabilities of the defined contribution members are equal with daily unit pricing being used. There is no investment reserving. We have been advised that the assets of the defined contribution members are segregated from the defined benefit assets and Vision Super has in place processes to limit cross subsidies between defined contribution and defined benefit members.
- J.30 We recommend that the Trustee should satisfy itself that no cross subsidies are occurring or could occur between the defined benefit and defined contribution plans.

Valuation Assumptions and Funding Method

- J.31 The long term financial assumptions adopted for the Parks plan are the same as for the Defined Benefit plan (refer to Appendix D) except for the salary increases. In summary:
- | | | |
|-----|-------------------|------------|
| (a) | Investment Return | 7.5% p.a. |
| (b) | Salary Inflation | 4.25% p.a. |
| (c) | Price Inflation | 2.75% p.a. |
- J.32 We have assumed an additional salary increase rate of 6.0%p.a. immediately after 31 December 2011 in addition to the assumed long term rate of 4.25%p.a.. This is because Parks Victoria staff have had limited salary increases for some years and there are currently negotiations taking place to determine future salary increases that may include retrospective elements.
- J.33 The assumed administration expense has been increased from 1.5% of salaries from the previous investigation to 3.0% of salaries in this investigation based on the experience over the three years to 31 December 2011. As the Parks plan reduces in membership and salary base, fixed costs will cause the expenses to increase as a percentage of salaries.
- J.34 Demographic assumptions include rates of resignation, retirement, mortality and disablement. The plan does not have sufficient members to develop assumptions from its own experience. Therefore, the same assumptions as for the Defined Benefit plan have been adopted for Division E members (refer to Appendix D).
- J.35 As there are only 10 Division F members in the Parks plan, experience could differ significantly from that assumed. All Division F members are assumed to retire at age 60.

- J.36 As per the 2008 investigation, we have adopted the funding method known as the Aggregate Funding Method. It is described in more detail in Section 5 of the report. The aggregate funding method seeks to have sufficient assets to pay all benefits as they fall due.
- J.37 Under the proposed new prudential standard (SPS 160), it is expected that APRA will require superannuation funds to rectify an unsatisfactory financial position within three years. Hence the main objective of our proposed funding plan will be to restore the VBI to above 100% within the next three years.

Financial Position at 31 December 2011

- J.38 The financial position of the Parks Victoria plan has been assessed by considering the same indices as for the Defined Benefit plan (refer to Section 6 for background information on these indices).

Vested Benefits Index

- J.39 Vested Benefits are defined as the benefits that would be due and payable if all the members voluntarily terminated their service with their employers at the investigation date. For active members, the Vested Benefits are thus the resignation benefit or the early retirement benefit (if aged 55 or more).
- J.40 For the Parks Victoria plan, the Vested Benefits Index is calculated as follows:

$$\text{VBI} = \frac{\text{market value of plan assets}}{\text{total of vested benefits}}$$

J.41 The VBI as at 31 December 2011 is shown in the table below:

VBI as at 31 December 2011 - Parks		(\$m)
Parks assets		\$29.7
<u>Vested Benefits</u>		
Parks		\$31.2
Former Ports		\$3.8
Total Vested Benefits		\$35.0
Vested Benefit Index		85%

J.42 The calculated VBI for the plan at 31 December 2011 is 85%. This compares with a VBI of 84% at the 31 December 2008 investigation.

J.43 It is preferable for the VBI of the Parks plan to be greater than 100% because this means that there are sufficient assets to pay members' benefits should all members voluntarily cease employment immediately. In recommending employer contributions rates for the Parks plan it is necessary for a VBI of at least 100% to be targeted so that it is not in an unsatisfactory financial position. This is discussed further below when considering the funding arrangements.

Discounted Accrued Benefits Index

J.44 Discounted Accrued Benefits means the present value of the benefit payable in the future (based on the assumptions) accrued in respect of service to the investigation date.

J.45 The Discounted Accrued Benefits are not subject to a minimum of the Vested Benefits.

J.46 The index is more a measure of the Defined Benefit plan's on-going capacity to meet Accrued Benefits in the long run.

J.47 For the Parks Victoria plan, the Discounted Accrued Benefits Index is calculated as follows:

$$\text{DABI} = \frac{\text{market value of plan assets}}{\text{total of discounted accrued benefits}}$$

J.48 The DABI as at 31 December 2011 is shown in the table below:

DABI as at 31 December 2011 - Parks		(\$m)
Parks assets		\$29.7
<u>Discounted Accrued Benefits</u>		
Parks		\$28.0
Former Ports		\$3.6
Total Discounted Accrued Benefits		\$31.6
Discounted Accrued Benefits Index		94%

J.49 The calculated DABI for the plan at 31 December 2011 is 94%. This compares with a DABI of 106% at the 31 December 2008 investigation.

J.50 The major use of these indices is in monitoring the performance of the Parks plan over time. The Discounted Accrued Benefit Index has decreased since 31 December 2011 predominantly due to changes in the financial assumptions. The real investment return assumed (the excess of the assumed investment return over the salary inflation assumption) has decreased from 4.25% used in the last investigation to 3.25% in this investigation.

Minimum Requisite Benefits Index

J.51 The Minimum Requisite Benefits (MRBs) are the minimum amount of benefit that must be provided to enable Parks Victoria to satisfy their Superannuation Guarantee obligations. The method to calculate the amount of MRBs for the active members is specified in my Benefit Certificate.

J.52 The MRBs for Parks members are provided by Vision Super. While we are not able to independently verify the calculations, we have performed some reasonableness checks and

these benefits appear to be in the right order. MRBs for Ports members are not provided and therefore we have used the vested benefit as the proxy.

J.53 The Minimum Requisite Benefit Index is calculated as follows:

$$\text{MRBI} = \frac{\text{market value of assets}}{\text{total of Minimum Requisite Benefits}}$$

The calculated MRBI for the plan at 31 December 2011 is 121%. The MRBI was not calculated as at 31 December 2008.

Other Measures of Financial Position

J.54 In accordance with Clause A.21.1(a) of the Trust Deed, an Employer requires the approval of the Board to terminate its contributions to the Defined Benefit plans. We assume this approval would not be provided unless any future funding risk is adequately managed. Also, in accordance with Clause A.21.1(b), such an Employer remains responsible for its share of any actuarial shortfall.

J.55 However, if an Authority does terminate its contributions, Clause A.21.3 (a) of the Trust Deed states that:

"the Trustee, after obtaining the advice of the Actuary and subject to A.21.5, may adjust any benefit which is or may become payable to or in respect of any person whom the Trustee may consider is affected by that termination to the extent and in the manner the Trustee considers appropriate and equitable"

J.56 Further it states in Clause A.21.5 that:

"...Unless otherwise agreed between the Trustee and the Employer, an adjustment made ...must not increase the amount of any benefit which, in the opinion of the Trustee after obtaining the advice of the Actuary, has accrued in respect of a person immediately prior to the effective date of that adjustment in respect of the period up to that date or improve the basis upon which benefits accrue during or in respect of any period after that date."

J.57 Therefore, in the case of the termination of contributions by Parks Victoria, the Trustee has some flexibility in respect of the benefits provided, subject to superannuation law, and there is no alternative measure of financial position that needs to be calculated in respect of this situation.

J.58 On retrenchment, members' are entitled to the accrued retirement lump sum. This benefit may also be payable on partial disablement. As at 31 December 2011, the ratio of the market value of assets to the amount of retrenchment benefits was 84%. The corresponding index as at 31

December 2008 investigation was 87%. This decrease in the index was mainly due to the poor investment returns during the period.

- J.59 In section J.19, the Parks plan's asset allocation is shown and there is currently a 43% allocation to illiquid assets. The funding indices have been calculated based on the valuation of these assets at market value from the 31 December 2011 unaudited financial statements. In the unlikely event that these assets had to be quickly liquidated it is possible that this could occur at discounted values resulting in lower funding ratios. For example, a 20% discount on forced sale of illiquid assets would reduce the funding indices by approximately 7%.
- J.60 In certain situations some members can elect a pension. While there are no current pensioners, a member electing a pension is likely to cause a strain on funding.

Assessing the Adequacy of the Funding Arrangements

- J.61 We understand that Parks Victoria is currently contributing at 10% of salaries for Division E members and accrued cost contribution rates for Division F members (see table below). It is assumed that any salary sacrifice member contributions are paid in addition to the contribution rate.

Former fund	Current Member Contribution Rate % of salaries	Employer Accruing Cost Contribution Rates % of salaries
Transport Scheme	0.0	9.5
	2.5	9.5
	5.0	13.5
	7.5	18.0
Revised Scheme	N/A	17.0

- J.62 Because of the small number of Division F members the overall Parks plan funding is not very sensitive to the employer contributions paid in respect of them. Therefore, it is recommended that these contribution rates remain unchanged.
- J.63 Because of the small number of members and the maturity of the Parks plan its funding is very sensitive to experience. As at 31 December 2011 the Vested Benefits were \$5.3 million less than the available assets. As discussed earlier, this deficiency has resulted primarily due to lower than expected investment returns over the periods to the last two actuarial investigations.

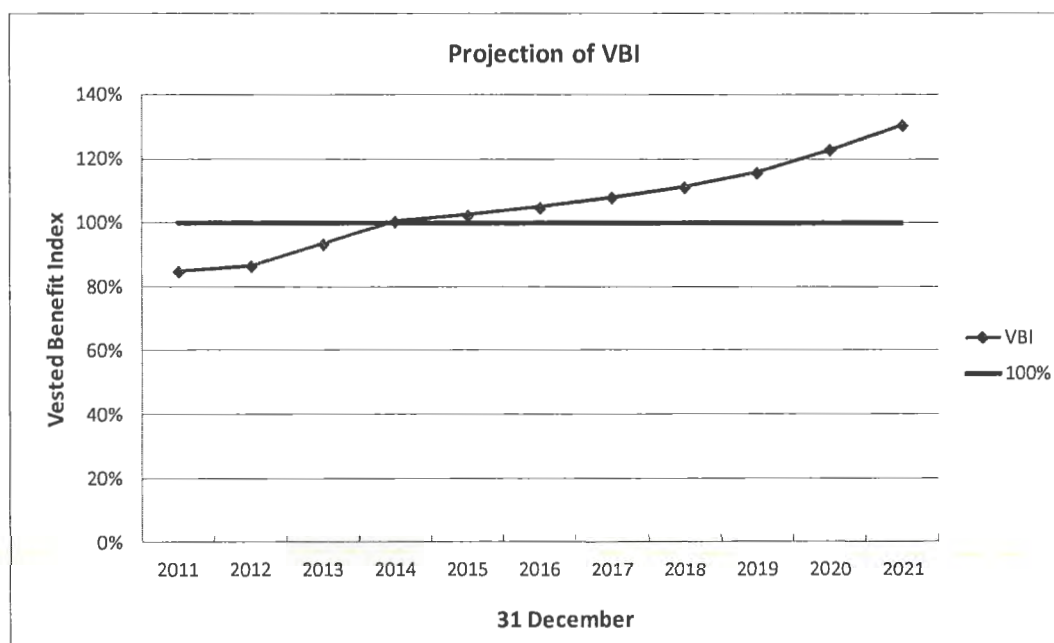
-
- J.64 Under the proposed Prudential Standard, APRA will require superannuation funds to put in place funding plans to fund vested benefit deficits within three years. It is preferable that the deficiency be funded as quickly as possible.
- J.65 I recommend that the Trustee develop a funding plan that is expected to return the plan VBI to 100% in no more than 3 years.
- J.66 One of a range of reasonable alternatives is for Parks Victoria to:
- (a) Contribute the amount due in 2011/12 of approximately \$0.4 million as per the previous funding plan;
 - (b) Increase the ongoing contribution rate from 10% to 12% of salaries for Division E members from 1 July 2012 and retain the current accruing cost contribution rates for Division F members;
 - (c) Contribute an additional \$1.9 million (inclusive of 15% contribution tax) per annum by 30 June 2013, 30 June 2014 and 30 June 2015.
 - (d) Fund the top-up payments for exiting members equal to the following amount increased for contribution tax:

Benefit Payment less (Vested Benefit x VBI)

Top-up payments are to be calculated and invoiced quarterly in arrears from 1 April 2012.

- J.67 Each component of this funding plan is considered below.

J.68 The chart below shows the projected VBI under the proposed funding plan:



J.69 As shown in the chart, the VBI is expected to be above 100% in three years' time. Note that the VBI is expected to be well above 100% if the best estimate assumptions borne out in practice over the long term. However, there is a risk that the VBI will either not increase as quickly as expected or will subsequent fall below 100% because of worse experience than expected.

J.70 The table below shows the total service liability surplus/(shortfall) under the proposed funding plan and the impact of assumptions change:

Funded Status as at 31 December 2011 (\$ million)

Surplus/(Shortfall) based on 2008 assumptions and 2010 funding plan	(0.9)
Surplus/(Shortfall) based on 2011 assumptions and 2010 funding plan	(3.2)
Surplus/(Shortfall) based on 2011 assumptions and the proposed funding plan	2.2

- J.71 The methodology used to determine the actuarial surplus/(shortfall) is similar to the method used for the Defined Benefit plan that is set out in paragraph 5.25-5.26. The calculations under the proposed funding plan are summarised in Appendix K.
- J.72 The shortfall under the 2008 assumptions and 2010 funding plan is mainly caused by the poor investment return over the three years to 31 December 2011. The change in assumptions has led to an increase in the shortfall of \$2.3 million mainly due to a lower expected return in the future.
- J.73 As shown in the table in J.70, the recommended contributions would be \$2.2 million more than adequate to fund the benefits in the long term if experience is as expected. However, given the maturity of the fund, the funding requirement is highly dependent on the actual experience. Under the new prudential standard which places a greater emphasis on the short term solvency (ie VBI), the future contributions are likely to be volatile. It would be prudent to allow for some margin in the VBI in order to reduce the need for additional funding. This risk of volatile contributions may also be managed by reducing the exposure to growth assets if the VBI becomes well above 100%. However, de-risking the investments may reduce the expected return and hence increase the funding cost.
- J.74 As at 31 December 2011, the long-term cost of funding the future service benefits for the Parks plan members (excluding the Ports plan members) was determined to be 13.5% of members' salaries. This is the employer contribution rate required assuming that assets at the valuation date were equal to the present value of accrued benefit liabilities. This reflects the ongoing cost to the employer of providing the defined benefits accruing in respect of future service.
- J.75 In recommending the ongoing contribution rate for Parks Victoria, we have adopted a lower rate of 12% recognising this rate combined with the top up amount is expected to provide adequate funding in the long term.
- J.76 In this funding plan, top up contributions for all exits have been recommended. This is necessary because with a VBI of less than 100%, the amount of assets paid from the Parks plan exceeds the amount available. If no top up contributions were made the funding position would deteriorate with each exit. Once the VBI returns to 100%, the amount of the top-up contributions would reduce to zero in all cases except where a benefit greater than the vested benefit is paid.

Sensitivity Analysis

- J.77 The factors affecting the ultimate funding cost depends on future experience of the plan and are generally split into two broad categories. They are the financial assumptions and the demographic assumptions. The assumptions are more sensitive to changes in the financial

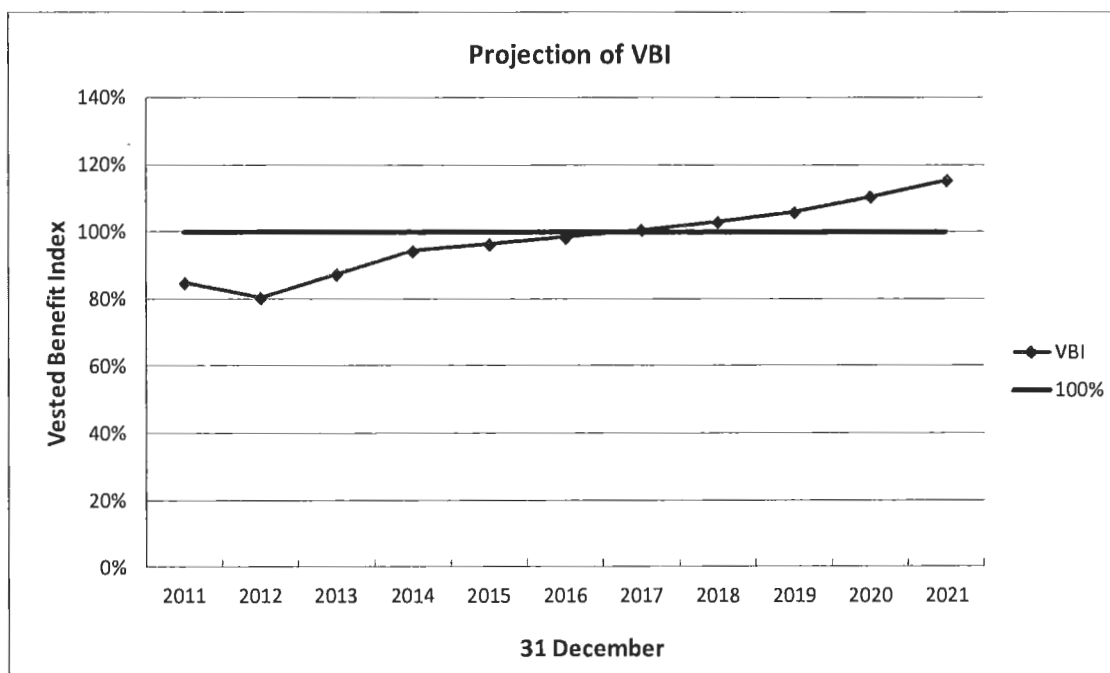
assumptions and the sensitivity of the "actuarial surplus/(shortfall)" to the financial assumptions is considered below.

- J.78 The key financial assumption is the differential or "gap" between the investment return and the growth in salaries. If the actual experience for the "gap" varies from the assumed "best estimate" assumption of 3.25% p.a., it can have a very significant effect on the ongoing contribution rate and any unfunded liability contributions (as demonstrated in this investigation relative to the last investigation).
- J.79 To quantify the potential impact of variations in financial experience the following table shows the impact of changing the gap on the "actuarial surplus/(shortfall)" as at 31 December 2011.

Impact of Changes in Key Assumption	
	Actuarial Surplus/(Shortfall)
	\$ Million
Best estimate assumptions	2.2
Increase the gap by 1%	4.0
Decrease the gap by 1%	0.2

- J.80 The table shows that a variation in the "gap" has a very significant impact on the actuarial surplus or shortfall. It is possible that the actual "gap" may vary from our best estimate assumption by significantly more than 1% and the impact would be greater than what was shown in this sensitivity analysis.

J.81 We have also considered the investment risk in the short term. The chart below shows the impact on the VBI if the investment return is 0% next year.



J.82 As shown in the chart, the VBI is not expected to increase to 100% in three years' time if the return is 0% next year. Without additional contributions, it would take more than 5 years to restore the plan's VBI. Once the prudential standard comes into effect, additional contributions would be required in the short term to fund the vested benefit shortfall.

Events subsequent to 31 December 2011

J.83 Vision Super has advised that the Parks plan investment return from 1 January 2012 to 8 June 2012 has been 2.8%. While this is below the assumed investment return of 7.5% per annum, it is not materially below. Given the current volatility in investment markets we do not consider it necessary to revise our calculations to reflect this difference.

J.84 We are not aware of any other event subsequent to 31 December 2011 that would materially impact upon the results of the actuarial investigation of the Parks plan. It is assumed that increases to the Superannuation Guarantee Charge to 12% will be provided from the defined contribution plan.

Self Insurance

- J.85 The Parks plan provides death and disablement benefits that are significantly higher than the resignation/retirement benefits. The Fund self insures these risks.
- J.86 The death and disablement benefits are funded by Parks Victoria's contributions. It is Parks Victoria that bears the financial risk if the amount of death and disablement benefits paid is significantly higher than expected.
- J.87 The following table summarises the plan's exposure to future service death and disablement risk as at 31 December 2011.

Statistics as at 31 December 2011

Net Assets Available (Defined Benefits plan assets available to meet benefits)	\$29.7m
Expected Annual Future Service death and disablement benefits to be paid ¹	\$87,800
Total Future Service death benefits ²	\$17.5m
Average Future Service death benefits	\$167,000
Maximum death or disablement Future Service Benefit of any Member	\$537,000

1. Based on assumptions adopted in this investigation.

2. The amount of future service death benefits shown is the amount of death benefit in excess of the "funded" accrued retirement benefit. Hence the future service death benefits quoted in this Section include the underfunded portion of the accrued retirement benefit.

- J.88 Because of the small number of members, it is possible that the actual future service death and disablement benefits could be five times the expected number in any year. If this occurred in the 2012 year, additional benefits of approximately \$439,000 would be expected to be paid. It is noted that the maximum death or disablement future service benefit is larger than this amount so such a payment could be required. It represents 1.5% of the plan's available assets. Because the VBI is currently 85%, the funding would deteriorate further if such an event occurred. Therefore, additional contributions may be needed if death and disablement benefit payments are greater than expected.
- J.89 The plan is currently subject to the risk of catastrophe although the risk is reduced as the membership of the Parks plan are spread over several locations.
- J.90 There is a very remote possibility of a catastrophe occurring that may result in around 25 death or disablements benefits. If this occurred, and assuming the average future service death or disablement benefit was \$167,000 for each member, the total claim amount would be

approximately \$4.2 million. This represents 14% of net available assets. Therefore, if this occurred in the short term the VBI would further deteriorate and significant contributions will be required from Parks Victoria to fund the shortfall.

- J.91 Given the risks discussed above, variation in the claims experience could have a large impact on the plan's funding position and increase the likelihood of more variable contributions. We recommend that the plan seek external insurance in relation to the death and disablement benefits in order to mitigate these risks.
- J.92 We recommend that the funding plan proposed in J.66 above would be appropriate if the plan was externally insured. There would likely be a margin applied by the insurer to the premiums for costs and profit, however we do not believe that it would have a material impact on the financial position of the plan.
- J.93 In the funding plan in J.66, the top-up payments for exits would be calculated excluding any externally insured benefit payment on death or disablement.

Material Risks

Investment Risk

- J.94 The most significant risk facing the Parks plan is that investment returns will not be as high as expected. If investment returns are lower than expected the Parks Victoria would be required to make further top-up contributions. Subject to our comments below about liquidity, the asset allocation is within the range of reasonable asset allocations (refer to Section 4 of the report).
- J.95 The Trustee should continue to consider the liabilities and the funding position when determining the Parks plan's investment strategy.

Salary Inflation Risk

- J.96 Salary increases exceeding expectations will have a negative impact on funding.
- J.97 It is the excess of the investment return above the rates of salary increases that is most important because the assets increase with the investment return and the liabilities with salary inflation.

Mortality/Morbidity Risk

- J.98 The Parks plan self-insures the death and disability benefits and is therefore subject to the risk of higher than expected claims. Given the size of the Parks plan and that it is under-funded, Vision Super should externally insure the insurance risk.

- J.99 While the risk is low, particularly given the geographic spread of members, a high number of death or disability (or terminal medical condition) benefits caused by a single event is likely to put further significant strain on the funding if this occurs prior to the external insurance being put in place.

Liquidity Risk

- J.100 In Section J.24 - J.28 liquidity risk is discussed. Also, Section J.59 considered the potential impact on funding of having to liquidate investments at a discount.
- J.101 We believe that Vision Super should consider a plan to reduce their exposure to illiquid assets in the Parks plan to zero over time given the maturity of the plan and the possibility of large benefit payments.

Legislation Risk

- J.102 There is a risk that other legislation changes could impact on funding. For example:
- (a) The Prudential Standard in its draft form has been considered in this report, however if the finalised form of the Prudential Standard is different to the draft version, there may be implications for funding requirements.
 - (b) The Government has legislated to increase the Superannuation Charge to 12% of Ordinary Time Earnings. This could materially impact Fund benefits if this increase is provided from the Parks plan;
 - (c) Changes to legislation may impact investment returns or other aspects of experience; and
 - (d) Changes to tax may impact funding;

Other

- J.103 Operational risks (eg. unit pricing and administration) are not considered in this report.
- J.104 If eligible Members increase their member contribution rates this would be expected to increase their future service benefits and the funding required from Parks Victoria.
- J.105 Some of the Parks plan members are eligible to a pension on retirement or disablement. In our valuation, we assumed that all members take the lump sum option on retirement. There is a risk that members may exercise this option at retirement or receive a disability pension from the plan. Additional funding may be required as a pension is generally more valuable than the lump sum option.

- J.106 There are many other risks in respect of the funding of the Parks plans but we have not included those we do not consider to be currently material.

Recommendation

- J.107 We recommend that the death and disability (including terminal medical condition) benefits be externally insured.
- J.108 We recommend that the Trustee develop a funding plan that is expected to return the plan VBI to 100% in 3 years. A shorter funding period would be preferred but 3 years is the maximum timeframe that is required under the draft Prudential Standard.
- J.109 The key recommendations for Parks Victoria are:
- (a) Contribute the amount due in 2011/12 of approximately \$0.4 million as per the previous funding plan;
 - (b) Increase the ongoing contribution rate from 10% to 12% of salaries for Division E members from 1 July 2012 and retain the current accruing cost contribution rates for Division F members;
 - (c) Contribute an additional \$1.9 million (including 15% contribution tax) per annum by 30 June 2013, 30 June 2014 and 30 June 2015.
 - (d) Fund the top-up payments for exiting members equal to the following amount increased for contribution tax:

Benefit Payment less (Vested Benefit x VBI)

Top-up payments are to be calculated and invoiced quarterly in arrears from 1 April 2012.

- J.110 At the date of signing this report ongoing discussions were being held between the Trustee and Parks Victoria to agree a funding plan. If the agreed funding plan differs from the plan recommended above, separate advice will be provided on the funding plan.

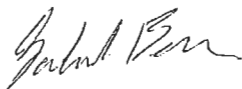
J.111 We also recommend that the Board consider a plan to reduce the exposure to illiquid assets in the Parks plan to zero over time given the maturity of the plan and the possibility of large benefit payments. It is very important that other assets within the Fund continue to act as liquidity provider for the Parks plan.



Matthew Burgess

Fellow of the Institute of Actuaries of Australia

25 June 2012



Gabrielle Baron

Fellow of the Institute of Actuaries of Australia

Russell Employee Benefits

Level 13, 8 Exhibition St

Melbourne VIC 3000

APPENDIX K - VALUATION RESULTS (COM AND PARKS)

	City of Melbourne (\$m)	Parks Victoria (\$m)
Present Value of Active Member Liabilities		
• Retirement	55.4	33.5
• Death	1.6	0.9
• Disablement	4.8	1.2
• Resignation	4.6	2.7
Total	66.5	38.3
Plus Present Value of Additional Retained Benefits	0.4	-
Less Surcharge and Family Law Balance	(0.6)	(0.1)
Plus Present Value of Future Expenses	1.6	1.4
Plus Allowance for Contribution Tax	1.7	1.4
Total Benefit Liability	69.6	41.0
Compared to:		
Net Assets	52.4	29.7
Plus Present Value of Member Contributions	4.2	2.2
Plus Present Value of Employer Contributions	15.5	11.4
Total Assets	72.1	43.2
Surplus/ (Shortfall)	2.5	2.2