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ROBERT GOTTLIEBSEN

Lift the lid on pension blowout

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ROBERT GOTTLIEBSEN
Business columnist | Melbourne | @BGottliebsen

Around the world public servants in collaboration with their actuarial mates have been misleading politicians about the real cost of the bonanza pension schemes they have been promised.

As I have described in previous commentaries, nowhere has the game been played better than Australia, where the politicians are trying to grab a few beans from the private sector while the concealed public sector cost is exploding at a much faster rate — the net gains are a negative.

Fortunately for Australia, in the US the politician/general public "hoodwinking" game has been exposed and the actuarial profession has split between those that want to reveal the truth and those that want to keep the concealment game going.

I am indebted to Mary Williams Walsh in the *New York Times* for exposing the situation.

We have seen in so many situations that mass concealment games are often exposed by minor events. And so it was in the US where a tiny fund — the Citrus Pest Control District No. 2, serving just six people in California — decided it wanted to shift from a pension plan to the US equivalent of Australia's accumulation funds.

It seemed a simple task because the actuaries had stated that the fund had a surplus, so conversion came at no cost. Accordingly, the Citrus fund people went along with the group managing its plan, Calpers, to get a payout figure. The six-member fund then discovered to its horror that it was not in surplus as the actuaries had declared but rather had a shortfall of $500,000.

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Calpers demanded the fund pay the money to execute the conversion.

In the process, Americans discovered how they were being deceived — and the deception turns out to be similar to what is taking place in Australia.

According to the *New York Times*, Calpers keeps two sets of books: the officially stated numbers and another set that reflect the “market value” of the pensions that people were entitled to.

At the time, the second number was not publicly disclosed. As you might expect, in the American Academy of Actuaries, a dispute arose between those who wanted the truth disclosed and those who did not.

There are two competing ways of valuing a pension fund. One is called the “actuarial approach” (which conceals the real numbers) and the other the “market approach”, which reflects current reality

The market value of a pension reflects today’s full cost of providing a steady, guaranteed indexed income for life. It’s alarmingly high, which is why most US governments and local authorities want the facts concealed.

They are frightened the non-government people in the community might take the generous pensions away, particularly as non-government people are seeing their benefits eroded.

With the US debate now out in the open, some struggling local governments doubt they can really afford their pension plans and have told Calpers they want out.

Today in California, both the market values and the actuarial pension values for many funds are available and the truth via market values is usually horrific. Every year the problem gets worse.

As the *New York Times* explains, much of the debate surrounds the routine practice of translating future pension payments into today’s dollars, which is called discounting.

The tiny pension plan at Citrus Pest Control District No. 2 graphically illustrated how the actuarial system works.

At Citrus, everybody had virtually retired so there was no guesswork in determining everybody’s pensions. The actuaries at Calpers projected each of the future monthly payments that were to go to retirees, assuming they will live to the age of 90. Then, they translate all those future payments into today’s dollars via a rate — often called a discount rate.

To determine that discount rate, Calpers calculated bond market returns at 2.56 per cent which uncovered the previously concealed $500,000 shortfall.

In the original actuarial sums, Calpers and virtually all other public pension funds use an assumed annual rate of return on assets, now generally around 7.5 per cent — it’s a nonsense rate of return in today’s environment. On the basis of this inflated expected rate of return, Citrus thought it had a surplus when in reality it had a deficit.

In fairness to members of the US actuarial profession, these unrealistic returns are enshrined in the actuarial standards. And since adhering to the standards makes public pensions look affordable, there is a powerful incentive to preserve those standards.

You can imagine the debate among the US actuaries who want to tell the truth and those who want the truth concealed. There is no certainty that the truthful actuaries will actually win the debate but at least it’s out in the open.

Here in Australia, the official actuaries reckon the promises we have made to public servants result in a deficit of about $250 billion.

But anyone who looks closely at the real figures knows that the truth is somewhere around a deficit of $500bn to $600bn — and its growing at $6bn a year.

In addition, it is doubtful whether the actuaries have taken into account some of the recent rorts that favour young, newly-acquired dependants.

The market worth of the pensions held by some of the advisers to the government on superannuation is more than $10m — that's why I call them the $10m club. One day we will face the truth but the $10m club will try and conceal it for as long as possible.

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