

Statement of Corporate Intent 2011/12

GESB (Government Employees Superannuation Board)
July 26 2011

Chairman's Introduction

I am pleased to present the 2011/12 Statement of Corporate Intent (SCI) for GESB. The SCI has been developed following a consultative process involving the Chair of the Superannuation Reform Implementation Steering Group (SRISG) and areas within the Department of Treasury, including the Public Private Partnerships Unit.

This SCI provides information on –

- the environment in which GESB will operate in 2011/12;
- the State's policy objectives;
- GESB's corporate objectives;
- the initiatives GESB will pursue during the next twelve months in order to achieve those objectives; and
- GESB's key performance targets.

The SCI also sets out how GESB will work with the State in implementing the State Government's superannuation reforms.

Importantly, the SCI delivers on the Treasurer's request to provide government with a 5% efficiency dividend, expressed as savings of \$2.7 million per annum.

GESB's purpose is to improve the long-term financial well-being of its members. This is consistent with the *State Superannuation Act 2000* and GESB's core values. GESB's primary objective is to deliver value to members and the State while managing risk for the State.

GESB seeks to deliver value to its members through above market-average investment returns, below industry-average costs, diversified investment risk and efficient, above market levels of service.

In addition to managing its core business, GESB will be allocating resources through 2011/12 in working with the State Government to implement the Government's superannuation reforms outlined in "Putting Members First - A Review of Superannuation Arrangements for the WA Public Sector". (The Whithear Report).

The recommendations from this report were endorsed by State Cabinet in March 2010. The SRISG was established by the Treasurer in August 2010 to oversee the implementation of these superannuation reforms. This SCI outlines how those reforms will be progressed.

In preparing this SCI, it is recognised that the State Government aims to provide choice of fund for its employees and implement its superannuation reforms by March 2012. The introduction of choice for public sector workers is a positive initiative and is fully supported by the Board. Cabinet has endorsed outsourcing of superannuation administration services and testing the market for a new default fund. Although precluded from tendering, GESB's operations and default fund will be used as a benchmark for market testing. Any outsourcing or default fund decisions must deliver better value to members than what is delivered by GESB and be in members' best (financial) interests.

GESB's financial forecasts for 2011/12, which are presented in this SCI, show projected funds flows, balance sheet position, budgeted expenses and capital investment that will enable GESB to continue to comply with highest industry standards to maintain core systems, and to deliver efficient services to its members. The financial outcomes for future years are being reviewed having regard to the potential impacts that will flow from implementation of the Whithear recommendations.

GESB has received confirmation that the Treasurer has agreed to waive GESB's requirement to submit a Strategic Development Plan for the 2011/12 financial year.

John Langoulant
Chairman
26 July 2011

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1. Industry Overview

GESB operates as an Exempt Public Sector Superannuation Scheme (EPSSS) in the Australian superannuation industry. An EPSSS is a scheme that the Commonwealth has agreed to exempt from the *Superannuation Industry (Supervision) Act 1993* (SIS Act) governing legislation. This is in recognition of the complexities associated with, and the relevant State laws governing, public sector schemes.

The Australian superannuation industry comprises nearly 400 funds, 33 million accounts, half a million self managed funds and \$1.3 trillion in funds under management¹. The industry is characterised by regulatory and product complexity, large volumes of manual transactions, increasing competition and commoditisation, and changing economies of scale through industry and account consolidation.

Several major industry reviews have been undertaken recently which could result in the greatest reforms to the industry since compulsory superannuation was introduced. The most significant was the Cooper review into superannuation. The Commonwealth government's objectives in response to this review are to:

- increase efficiency in the system through electronic and standardised transactions;
- improve the level of overall fund governance through standards and regulation;
- reduce the number of superannuation accounts per individual; and
- reduce investment costs in default funds through legislated, simplified product design.

GESB meets many of these objectives with strong fund governance, efficient electronic processing, account consolidation programs, effective risk management and sound long-term net returns. The superannuation industry is expected to change significantly during the next 3 - 5 years with rapid consolidation of superannuation funds and individual member accounts. Funds will need to ensure they have sufficient administration and investment scale to operate efficiently with diversified portfolio risk. Recent merger announcements include Westscheme with Australian Super and Health Super with First State Super. By 2015, the number of super funds is expected to almost halve to 225.

Superannuation administrators will need to invest to accommodate the Commonwealth's "Super Stream" electronic processing objective and "MySuper" default fund. In addition, capital investment to accommodate fund mergers together with reducing revenue from reduced numbers of accounts will place significant financial pressure on administrators who have not already invested in electronic straight-through processing. GESB's current administration expense ratio (excluding investment management) of 0.42% is lower than the 2009/10 industry average of 0.55%². This is due to GESB's early investment in web-enabled, straight through processing which results in over 99% of transactions being processed electronically.

However, it is anticipated that GESB will be undertaking work during 2011/12 to accommodate the "Super Stream" tax file number matching process, and in particular to accommodate the State policy to consolidate accounts under \$10,000 as detailed in the Whithear Report.

Further, the Commonwealth Treasury is currently consulting with the State and Territory Treasuries to determine what, if any, aspects of the resulting 'Stronger Super' initiative will apply to the EPSSS, most likely through amendments to the Heads of Government Agreement.

The Commonwealth government has also announced reforms in response to the Parliamentary Joint Committee on Corporations and Financial Services' Inquiry into financial products and services in Australia. The objectives of the 'Future of Financial Advice' reforms are to increase transparency and ensure that financial advisers act in the best interests of their clients. These reforms will cover the availability of low-cost 'simple (personal) advice' within the ASIC licence framework. The ASIC discussion paper on financial advice identifies that superannuation funds should provide personal advice to members regarding their superannuation interests. Superannuation funds are the preferred source for this advice, and members have high trust in advice from their fund. GESB will continue to monitor and assess this issue against its current operations.

At a State level, in March 2010, Cabinet endorsed 18 recommendations from the Whithear Report which are now the State Government superannuation reforms. These reforms include implementing 'one-way choice' to provide choice of fund for WA public sector employees, outsourcing superannuation administration, assessing the market for a new default fund, and encouraging members with accounts under \$10,000 to consolidate into other funds. They also include closing GESB's financial advice subsidiary, changes to reserving and funding, and new governance arrangements.

¹ APRA Quarterly Superannuation Performance – December 2010, published March 2011; APRA, Annual Superannuation Bulletin, June 2010, published January 2011

² APRA, Annual Superannuation Bulletin, June 2010 (Issued 19 January 2011), Table 11, p32

External changes at both a Commonwealth and State level present a range of emerging issues for the industry and GESB, related primarily to scale economies, liquidity, the impact of regulatory changes, and the impact of sub-scale administration or investment on costs and risks to members.

2. Overview of GESB

2.1. Heads of Government Agreement

The State of Western Australia is a signatory to the Heads of Government Agreement (HOGA) with the Commonwealth in respect of the GES schemes. Under the HOGA, in recognition of the circumstances surrounding the GES schemes (such as the complex nature of the defined benefit schemes, the public accountability of the schemes, the State laws governing the schemes and State prudential controls), the Commonwealth agreed to exempt the GES schemes from the relevant Commonwealth governing legislation for superannuation funds, i.e. (SIS Act).

As a consequence, the SIS Act provides that exempt public sector superannuation schemes, such as the GES schemes, are deemed to be complying superannuation funds for superannuation guarantee purposes under the *Superannuation Guarantee (Administration) Act 1992* and for income tax purposes under the *Income Tax Assessment Act 1936*.

In return for these exemptions, the State Government agreed to ensure that members' accrued benefits will be fully protected and that the GES schemes will conform to the principles of the Commonwealth's Retirement Income Policy. The incorporation of some of these principles is evident in the *State Superannuation Act 2000* (SSA) and State Superannuation Regulations 2001 (SSR).

2.2. Our Business – nature and scope

GESB is a State government owned superannuation and retirement services entity that manages an investment portfolio of over \$12 billion (as at 30 June 2011). Some 80% (\$9.6bn) of this fund is managed for members in market linked schemes where members bear investment risk. A \$2.5 billion investment portfolio is managed for the State to support its defined benefit liabilities. GESB manages superannuation accounts and investments for more than 320,000 current and former WA public sector workers. As at 30 June 2011 GESB maintained a workforce of 215.7 FTEs.

The schemes that GESB manages are governed under State laws, in particular the SSA and SSR. While some other State Government funds have become Commonwealth regulated, GESB manages the West State Super (WSS) scheme which is an untaxed accumulation scheme. This scheme's tax status has constitutional protection which is why it remains State regulated. Some \$10 billion of the GES Fund is 'untaxed' (i.e. 15% tax paid on benefits rather than on contributions and earnings). While the taxed, market-linked schemes could be transferred to other funds if a new default fund be selected by the State, the assets and management of the untaxed market-linked scheme (WSS) will remain with the State for a period of around 40 years.

GESB's 2010/11 unaudited financials include contributions received of \$1.7 billion and a net funds inflow of \$950 million. Contributions are forecast to be \$1.8 billion in 2011/12 but net funds flow will reduce to \$693 million due to increasing retirements and the introduction of choice of fund for WA Public Sector employees. Positive net funds flow results from high levels of member voluntary contributions and roll-ins from active members, and benefits retained into retirement accounts.

GESB's investment framework operates in accordance with Prudential Guidelines updated in 2011. GESB is currently in the process of working with the Department of Treasury to introduce revised guidelines which will be consistent with the proposed changes to GESB's governing legislation.

GESB's primary functions under the SSA³ include to:

- "Administer the schemes;
- Manage the Fund,
- Provide information, advice and assistance to the Minister and the Treasurer on matters relating to superannuation; and
- Provide or facilitate provision of products and services to members of schemes administered by the Board and Employers."

³ *State Superannuation Act 2000*, section 6 (1) (a) – (e)

Proposed amendments to the SSA are expected to be passed through Parliament in early 2011/12. Under these amendments, GESB's primary functions will be to:

- Provide a service of receiving superannuation contributions paid by Employers and crediting them to the Fund or remitting them on behalf of Employers to other funds;
- Manage the Fund; and
- Administer the schemes or select and appoint external administrators of the schemes and monitor their administration.

Key activities undertaken by GESB include:

- processing account transactions;
- providing financial and retirement education through metro and regional seminars, printed and electronic communication;
- assisting members via phone, mail, email or on-line; and
- delivering personal financial advice related to members' interests in GESB schemes under an ASIC licensed framework. A subsidiary entity currently holds the Australian Financial Services Licence.

Under the State government superannuation reforms, many of these activities will be tendered for possible outsourcing to commercial administration and advisory companies. It is anticipated that these activities may transition to a commercial supplier in 2012/13 with no material change to activities conducted internally at GESB in 2011/12.

GESB is primarily a self-funded agency, though it draws on the Consolidated Account to fund the operational costs of administering the State's defined benefit schemes and other government related activity including the cost of Government relations, reform related employee costs and GESB reform costs. Income is generated by recovering the costs of providing each product or service from members. This includes the costs of development, capital, operations and risks for each portfolio of products within a commercially sound period. These costs are recovered through:

- account administration fees debited to accounts for members of market linked schemes;
- investment management fees from member funds of market linked schemes;
- insurance administration fees from member insurance premiums; and
- financial advice fees charged directly to members.

From July 2011, the superannuation recoupment rate used to fund the defined benefit schemes, will also cover administration expenses, rather than drawing on the GES Fund to cover these expenses. This is one of the State Government superannuation reforms currently being progressed by GESB and the Department of Treasury.

Charges to the State for administration of the defined benefit schemes does not include a contribution to reserves for ongoing development, operational risk events or application of the government guarantee. The State will continue to fund these costs as they arise either from the GES Fund or the Consolidated Account.

GESB maintains insurance cover for risk events through RiskCover which provides \$300 million cover for general and professional liability which includes fraud or operating risk events and maintains Directors & Officers liability cover through the open market. Business insurance does not protect against investment volatility. The Board also aims to mitigate fraud risk through a range of internal security controls and the State aims to mitigate investment volatility risk for its defined benefit schemes through its investment strategy.

Operating under the SSA, GESB is accountable to the responsible Minister, who is also the Treasurer. GESB operates within prudent cost ratios and risk reserving, delivering low-cost products and services to members and the State.

In 2010, GESB was again highly recognised in the industry, and by members and employers:

- 1st quartile ranking for GESB Super's default Balanced Growth Plan's returns (1 year) and above median (3 years)⁴
- Top 300 largest pension funds globally (Towers Watson)

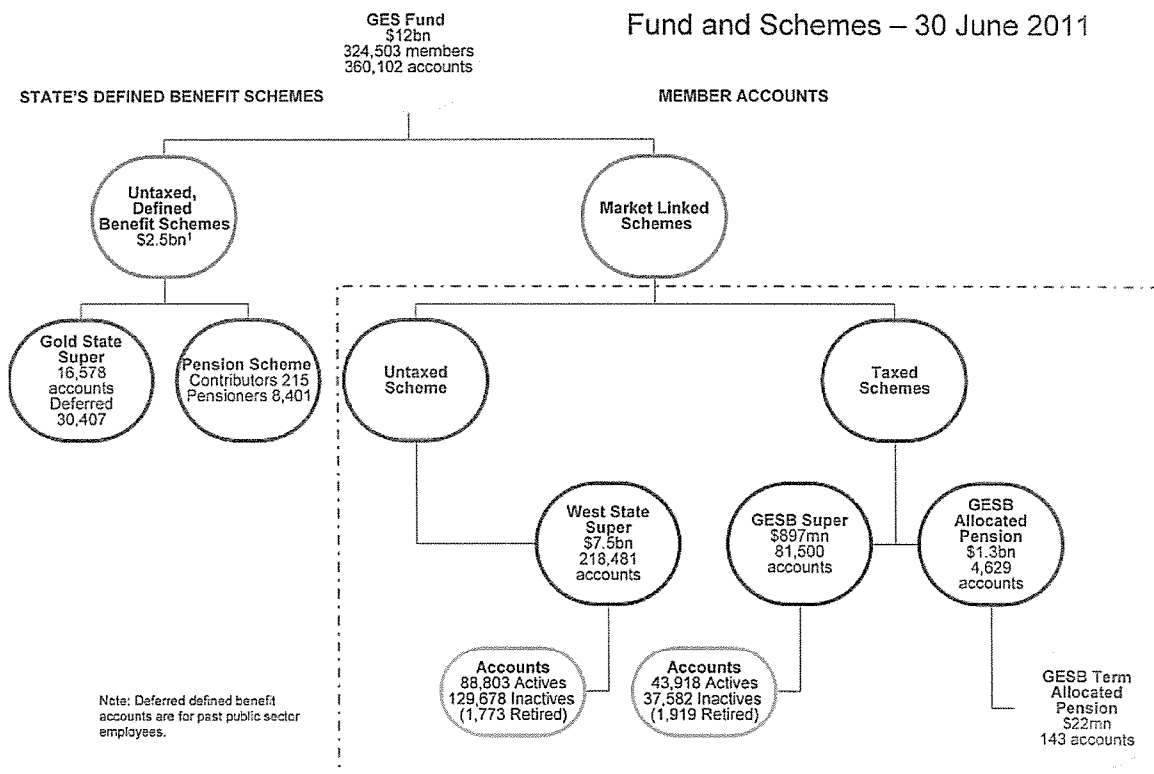
⁴ SuperRatings, Fund Crediting Rate Survey, January 2011

- One of only 5 funds in Australia to have both a Top 10 superannuation product and Top 10 pension product (SuperRatings)
- Rated "Well Above Benchmark" for investment, fees and charges, advice and education (SuperRatings Benchmark Report for 2010)
- Top 10 Personal Super Fund rating and '5 Apple' ratings for superannuation and pension products (ChantWest)
- One of the top 3 funds for superannuation education (Investment Trends)
- 95% employer satisfaction⁵
- 90% member satisfaction with service⁶.

2.3. Fund Overview

GESB manages \$12 billion of funds which includes approximately \$2.5 billion managed for the State. Of the \$12 billion in funds under management 80% is held in market linked schemes where members bear investment risk for their chosen investment plan. The Board determines an appropriate investment strategy for each investment plan, within guidelines issued by the Treasurer, to achieve the targeted long-term net return objectives for these members.

a Schemes Profile



⁵ TNS Global, GESB Employer Research, August 2010

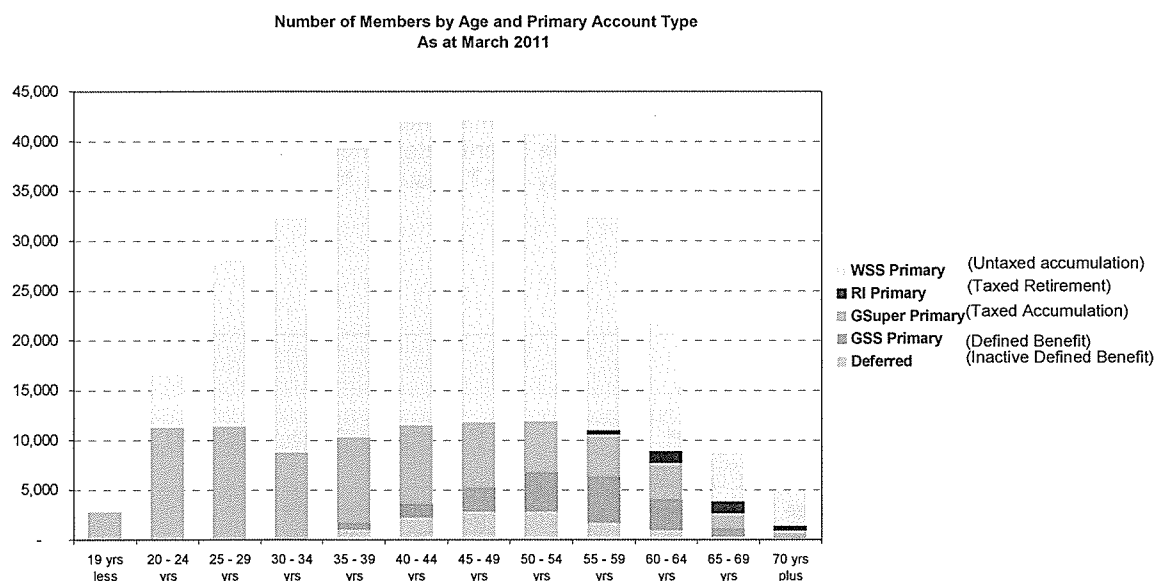
⁶ Painted Dog, GESB Member Experience Research, April 2011

b Guarantees

The State guarantees to pay every benefit payable under a scheme, including the accumulation, retirement and defined benefit schemes.⁷ This is particularly relevant for members of the State's defined benefit schemes which are not fully funded.

The State does not guarantee any particular investment performance for members of the retirement and accumulation schemes. The State does guarantee that there are sufficient assets and liquidity to pay an accrued benefit when it is due and payable. The guarantee also protects the Fund and members' benefits in the event of loss as a result of an operating risk event.

c Membership



Nearly 65,000 members are currently of retirement age. However, approximately 75,000 members in the untaxed West State Super accumulation scheme do not reach retirement age for at least another 25 years.

2.4. Purpose

GESB's purpose is to improve the long-term financial well-being of its members.

To meet our purpose we provide superannuation administration and member services, financial advice, and other ancillary products and services for our members. We also provide investment services for members and the State with effective diversification to deliver sound, risk adjusted, long-term net returns.

In meeting our purpose we aim to provide the best value, quality service fund available for current and former WA public sector employees. This is consistent with our governing legislation, the SSA, which requires GESB to act, as far as is practicable, in the best interests of members while performing its functions.

2.5. Strategic Objectives – State and Corporate

a State Policy Initiatives

The Government's major superannuation policy initiatives to be actioned in 2011-12 include the -

- introduction of Choice for Western Australian public sector employees and implementation of the Whithear Report recommendations by March 2012;
- determination of a policy response to the Commonwealth's 'Stronger Super' initiatives; and
- delivery of a 5% Efficiency Dividend as outlined in the State Government's Budget.

⁷ State Superannuation Act 2000, Division 5, Sections 31 and 32

A State objective to minimise risk is also assumed, as is the objective for the State to not be a provider of superannuation services that can be obtained in the private sector⁸

b Corporate Goal

In fulfilling its purpose, GESB's corporate goal is to increase value for members. GESB also aims to help manage risk for the State.

Value to members means providing efficient and competitive superannuation and retirement products and services with above market-average, risk based net returns, with highly rated member services. Value to the State means providing efficient and competitive administration and investment returns with appropriate risk management.

These outcomes will continue to be achieved through a focus on members, efficient operations, and people management, underpinning GESB's sustainable financial performance.

Within these strategic themes, GESB's objectives remain to:

- Build financial strength and sustainability;
- Deliver above market net returns;
- Increase member access and engagement; and
- Further streamline operations.

Our Values

GESB is a values-based organisation. Our values are:

- **Put members first** – We are committed to improving our members' long-term financial well-being through understanding their needs and considering their interests in everything we do.
- **Sustainable performance** – We pride ourselves on being knowledgeable and insightful. We make balanced decisions for the long term. We think ahead and always look for ways to improve our performance at every level.
- **Achieve together** – We partner with our members, inspiring confidence in their future through education and advice. We are positive and energetic in the way we provide services to our members and the State, and in the way we manage their monies.
- **Act with integrity** – We make responsible decisions based on thorough analysis and make a point of sharing our knowledge. We approach every aspect of our work ethically and accountably. We operate transparently and with full accountability. We demonstrate our sense of responsibility on a daily basis, by 'taking ownership' of members' issues and seeing enquiries through to ensure a satisfactory outcome.

2.6. Corporate Responsibilities

At all times, GESB operates to achieve its purpose under prudent commercial principles, the specific requirements of its governing legislation and broader responsibilities of good corporate citizenship. Our corporate responsibilities include:

- **State Regulatory Compliance.** The SSA governs the powers and functions of the Board and responsibilities toward members. The SSR set out the rules of the superannuation schemes.
- **State Government Policy.** As a government trading enterprise, GESB acts in accordance with relevant State Government legislation and policies.
- **Heads of Government Agreement.** Schemes managed by GESB are exempt from the Commonwealth governing legislation for superannuation funds (the *Superannuation Industry Supervision Act 1993*) but, under the Heads of Government Agreement with the Commonwealth, these schemes are to conform to the principles of the Commonwealth's Retirement Income Policy.
- **Commonwealth Regulatory Compliance.** GESB aligns to Commonwealth regulatory requirements as a matter of best practice, where practicable. A subsidiary entity, GESB Wealth Management Pty Ltd, currently delivers financial advisory services, under an Australian

⁸ Porter, C. "State Superannuation Amendment Bill 2011", Second Reading Speech, 15 June 2011

Financial Services Licence and complies with the Corporations Act. The Treasurer has confirmed that GWM can continue to operate as a going concern under the scope of the approval granted by the then Treasurer on 28 November 2006. An appropriate model will be determined for delivery of personal, financial advice, related to a member's interest in GESB schemes once the outcomes of the tender process for administration outsourcing are known..

- **Competition and Consumer Act.** GESB manages compliance with the Australian Consumer Law in the *Competition and Consumer Act (2010)* through policies, procedures and internal legal review.

2.7. The Board

As a statutory authority, the GESB Board has powers and functions under the SSA and has a statutory obligation to act in members' best interests. GESB is ultimately accountable to its responsible Minister, also currently the Treasurer.

Under Statutory Corporations (Liability of Directors) Act (1995) GESB's directors are required to owe the corporation similar duties to those owed by directors under the Commonwealth Corporations Act. The Board, in serving the corporation, must serve the interests of its members.

The Board is responsible for the overall governance and performance of GESB in accordance with the SSA. The Board has responsibility for all matters relating to the operation of GESB. In governing GESB, the Board sets the values and standards and ensures that GESB's obligations to its members and other stakeholders are understood and met.

In carrying out its responsibilities, the Board undertakes to act honestly, fairly and diligently to create and build value for members, having regard to the interests of all stakeholders including members, employers, employees, the State, suppliers and the broader community.

The Board comprises a Chairman, three Employer Directors and three Member Directors.

a The roles of the Minister and Treasurer

The Minister responsible for GESB is the Hon C. Christian Porter, MLA. The Minister also holds the portfolios of Treasurer and Attorney General. Under current legislation the Minister and the Treasurer have separate and distinct roles.

The Treasurer

The Treasurer has a role in matters that affect the financial rights and obligations of the State. Specific responsibilities of the Treasurer under the SSA include (but are not restricted to):

- approving Prudential Guidelines that cover the nature of investments that the Board can make;
- approving the appointment of Investment Managers;
- approving GESB's Statement of Corporate Intent (SCI) and Strategic Development Plan (SDP);
- certifying changes to regulations; and
- approving regulations that affect the financial rights and obligations of the Crown.

The Minister

The Board is accountable to the Minister in performing its obligations under the SSA. This contrasts with the role of the Treasurer to consider the financial rights and obligations of the State. Specific responsibilities of the Minister include:

- receiving GESB's SCI, SDP and annual report, and tabling these in Parliament;
- approving changes to regulations and scheme rules contained in the regulations;
- directions to the Board;
- directing employers around superannuation practice and procedures; and
- consulting with the Treasurer before performing a function that may impact on the financial rights and obligations of Crown.

3. Performance Targets

Major initiatives and key business activities in 2011/12 are aligned with GESB's four key result areas:

1. Financial Sustainability
2. Member Focus
3. Efficient Operations
4. People Management

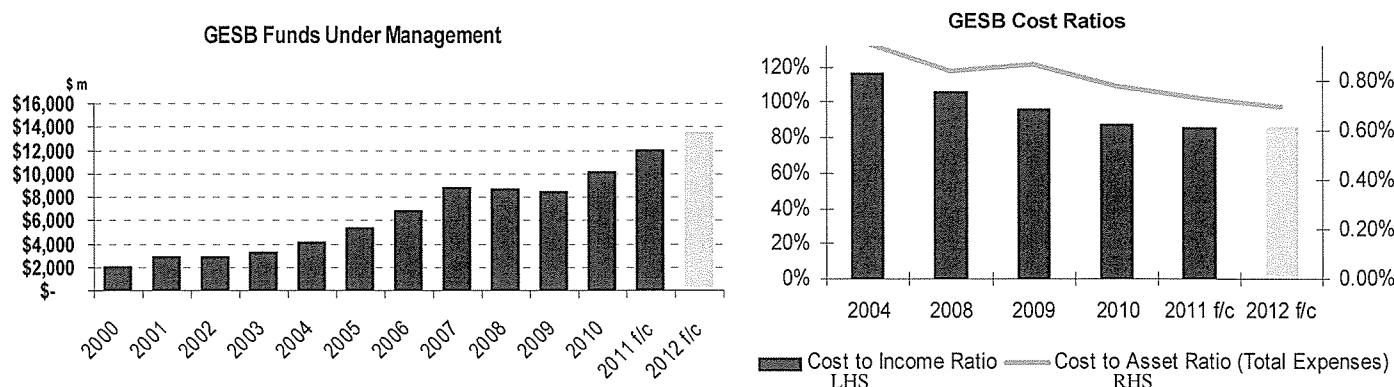
GESB will continue to deliver good value to members and the State, and be self-sustaining in 2011/12. Ongoing strong net funds flow and prudent cost management together with sound investment returns during the past year have resulted in a 2010/11 year end investment portfolio of \$12.1 billion and a lowering of costs and cost ratios. Growth of funds under management at above-market growth rate for the past seven years has improved investment scale economies. This correlates with reducing investment management costs, reducing cost to income ratios and reducing cost to asset ratios. Improved scale economies have enabled members to benefit from low fees, investment risk diversification, and increased information and education services. GESB's total cost to asset ratio in 2010/11, including investment management costs, is 0.7%, below the industry fund average of 1.0% in 2010.

In 2011/12 GESB's total cost to asset ratio will reduce again to 0.65% - below the target objective for the Cooper reforms (0.66%). The total cost to asset ratio is a key measure together with (risk appropriate) returns as these two measures provide the end net value to both members and the State. In 2011/12, net value is forecast to remain top quartile in the industry. GESB's total cost to asset ratio (Total Expense Ratio) and member net value are key measures in the future as services become outsourced and relative investment scale declines.

The accumulation and retirement income schemes are forecast to generate GESB's \$19 million operating surplus in 2011/12. This will be achieved with Retirement Income members receiving a 0.2% decrease in fees from April 2011.

GESB Super, introduced in 2007, will operate at break-even in 2011/12 due to ongoing cost reductions and efficiency gains and no pricing changes are forecast for this product during 2011/12. This product remains best quartile for fees across the industry; for administration, investment and total expenses.

A cumulative surplus of \$51m, generated from the accumulation and retirement income schemes, is anticipated by June 2012. This surplus is held in reserve to cover any operational risk events. If administration services are outsourced, the application of this reserve to members, by way of pricing reductions, capital investment or ongoing risk cover will be reassessed.



Historically GESB's Cost to Income and Cost to Assets ratios have been declining compared to an increase in funds under management. Investment management costs do not necessarily reduce in line with increases in funds under management as they are influenced by investment strategy and performance. The current year's budget is higher than forecast based on assumptions around new investment strategies.

Choice of fund is a significant benefit for members. Delivery of a choice of fund solution for State Government employees, as part of the superannuation reform process, is a focus of both the State Government and GESB.

Net funds flow is expected to remain reasonably strong in 2011/12, ahead of choice of fund for public sector employees. This will ensure that liquidity remains sound during 2011/12. However, the introduction of

choice, restricted financial advice services and increasing retirements of an ageing public sector workforce mean that net funds flow and relative investment scale will be under pressure from 2012.

The analysis recognises that the SRISG is working towards one-way choice of fund and other reforms being implemented by March 2012. Revised projections and performance targets, if any for 2011/12, will be submitted once dates for choice and any outsourced activities are known, and default fund status is confirmed. Implementation of the State Government superannuation reforms and consolidation of accounts are likely to have an impact on future projected financial outcomes.

GESB uses a balanced scorecard approach to performance measurement. The key performance indicators in this report measure value delivered to members, sustainability and quality of delivery of services. These include key effectiveness and efficiency performance indicators, as required by the *Financial Management Act 2006*.

The following measures and targets have been set for GESB's key result areas for 2011/12:

Key Result Area	Key Performance Indicator	2011/12 Budget	2010/11 Budget	2010/11 Forecast	2009/10 Actual
Financial Performance	Funds Under Management ¹	\$13.6bn	\$12.0bn	\$12.1bn	\$10.3bn
	Net Funds Flow ¹	\$693m	\$880m	\$875m	\$885
	Cost-to-Income Ratio ^{2,3}	81% ⁶	90%	86%	88%
	Cost-to-Assets Ratio ^{2,3}	0.65% ⁷	0.80%	0.73%	0.88%
	Investment Management Cost to Assets Ratio ^{2,4}	0.36%	0.38%	0.34%	0.34%
	Return Quartile ¹	Above Median	Above Median	Above Median	Above Median
	Operating Expenses	\$46.4m	\$51m	\$50m	\$47.2m
Member Focus	Member Satisfaction ¹	80%	80%	78%	75%
Efficient Operations	Default Plan Fee Quartile ² (Total Expense Ratio) (All funds Australia)	Best quartile	Best quartile	Best quartile	Best quartile
People Management	Full-Time Equivalents(FTE) ⁵ (including GWM staff)	220	235	225	213

1 Effectiveness measures

2 Efficiency measures

3 Costs include administration, trustee, investment costs and depreciation (and excludes GWM direct costs). Assets are the average FuM. Income includes administration fees, MER income, insurance income and expense recoups.

4 Costs of managing investments. This is not the member Management Expense Ratio (MER). The MER includes the cost of managing investments and a contribution to capital and is reflected in the Default Plan Total Expense Ratio.

5 Forecast FTE as at June 2011 is a maximum FTE number and includes unpaid leave (including parental leave and secondments to other agencies where GESB is no longer paying for the person) and vacancies.

6. The Cost to Income Ratio is calculated by using budgeted Costs of \$83.3m against budgeted Income of \$102.5m

7. The Cost to Assets Ratio is calculated by using budgeted Costs of \$83.3m against budgeted Average FUM of \$12.8b.

Key assumptions for 2011/12 budget:

- Projections include assumptions around investment performance, salary increases and member behaviour. Any variations between these and actual performance could impact GESB's key result areas.
- Gross investment returns are assumed to be 8.2% for 2011/12 and are based on individual assets class returns provided by GESB's asset consultants – Mercer Investment Nominees Limited. This return is based on an investment strategy assuming current funds flows. Liquidity and volatility of the investment return assumption will be affected by any impact from choice of fund and any changes to default fund arrangements.
- In the cost ratios, costs include operating and investment management expenses and income includes all fee and investment management revenue.
- The following costs are excluded from Operational Expenses that are used to calculate the Cost-to-Income and Cost-to-Asset ratios:
 - (i) direct costs of superannuation reform;
 - (ii) costs of the Department of Treasury Superannuation Management Branch;
 - (iii) costs of advisers on superannuation used by the Department of Treasury;
 - (iv) GWM direct costs
- GWM is a self-funding subsidiary entity. Costs incurred by the entity are paid from revenue received from advice fees.
- Investment management costs include proposed changes within the investment portfolio.
- Investment management costs include manager out-performance fees.
- GESB continues to be default fund.
- 49,000 small accounts consolidated, including 20,000 transfers to the ATO in April 2012 and \$42 million outflows.
- Choice attrition factored in from 1 March 2012 as follows
 - GESB Super Actives - 16.7% reducing by 50% per annum
 - WSS Actives - 6.9% reducing by 50% per annum

- GESB Super inactive > \$10,000 - 25.5% reducing by 50% per annum
 - WSS inactive > \$10,000 – 15.3% reducing by 50% per annum
- <\$10,000 are considered as part of the small account consolidation and ATO transfer assumption.

Operational Risk Reserve target is 60 basis points of market linked FuM.

4. Major Programs of Work 2011/12

In 2011/12, GESB remains committed to continuing to provide efficient, low-cost superannuation and retirement products and services that meet our members' and the State's needs in a sustainable and responsible manner. To enable this, GESB will invest \$2.6m in capital programs during 2011/12, primarily for software upgrades to maintain operations and further improve processing efficiencies. Initiatives commenced in 2010/11 that are scheduled for completion in 2011/12 include low balance member identification and account consolidation.

GESB will upgrade its core operating systems to maintain ongoing vendor support; increase efficiencies through continued online access and automation; improve member data management; and improve insurance benefits.

Capital expenditure is depreciated in accordance with accounting standards, reflected in administration expenses, and recovered through fees and charges.

4.1. Efficient Operations

GESB's cost ratios have decreased over the past five years, with a direct relationship to the size of funds under management and investment in web-enabled processing efficiencies. A cost to income ratio below 90% on the accumulation and retirement income schemes has enabled continued investment in systems and surpluses allocated to risk and capital reserves. Relatively low cost products and services, and therefore low fees, requires continual improvement in operating efficiency, in addition to maintaining relative scale economies.

Key maintenance projects planned for 2011/12 include:

- Software upgrades for the core operating system, web content management system and phone system.
- With delays in implementation of superannuation reform, these upgrades are now critical and required to maintain vendor support throughout any service transition period. The State aims to conclude the tendering process for administration services by March 2012. The transition period to a new administrator is expected to take at least 12 months. Core systems and vendor support are required to keep the business operating until the point of transition.

Key initiatives planned for 2011/12 to further streamline operations include:

- Improvements to the Gold State Super recoups process;
- 'Lost member' consolidation and reporting; and
- West State Super fee reductions.

4.2. Investment Portfolio Diversification

Managing investment risk for members and the State is a key responsibility of GESB's Board. GESB's prudent approach to portfolio risk has resulted sound investment returns, competitive investment costs and a managed exposure to illiquid assets. GESB is working with the State to implement these strategies as soon as is practicable.

In 2011/12, GESB aims to progress the implementation of a broad-based portfolio diversification initiative, as approved by the Board in 2009. This strategy was developed so as to diversify GESB's portfolio away from equity risk and build a more robust and stable portfolio. This level of diversification is required to deal with the dynamic and unstable financial market conditions that are expected to persist for the foreseeable future. The Treasurer's approval is required to invest in a broader range of asset types to fully implement this strategy.

The following investment initiatives, including those carried over from prior years, have been prioritised by the Board:

- Revised asset allocations;
- Australian equity strategy review;

- Infrastructure strategy review; and
- Unlisted property diversification.

4.3. Member Focus

GESB provides a range of superannuation and retirement products as well as member education and advice services. Members can access GESB's information and education services through seminars, over the phone, in printed materials and on-line. GESB has an ongoing focus to maintain our high member satisfaction and national recognition of education services. To further improve member access to, and efficiency of, superannuation and retirement education activities, initiatives planned for 2011/12 include:

- The introduction of choice for State Government employees.
- Improved online access and automation of member servicing, information and education. This includes the introduction of e-statements.
- Consolidation of low account balances.
- Consolidation of lost inactive members with the ATO.

Other initiatives focused on GESB's core membership of public sector employees will include:

- Improved insurance benefits and pricing.

One of the State Government superannuation reforms recommendations relates to GESB's financial advice subsidiary, GESB Wealth Management (GWM) Pty Ltd. As noted, the subsidiary will continue to operate in its current form. GWM currently holds an Australian Financial Services Licence issued by the Australian Securities and Investment Commission (ASIC) to provide personal financial product advice (i.e. advice that takes into account a member's personal financial situation and objectives).

Once the outcomes of the expression of interest and tender process for outsourcing are known, an appropriate model will be determined for delivery of personal, financial advice, related to a member's interest in GESB schemes.⁹

4.4. Employer Services

Employers from across the Western Australian public sector are key stakeholders in GESB. State Government employers are highly satisfied with GESB's services¹⁰, working in partnership with GESB to implement employee retention strategies through superannuation (e.g. transition to retirement strategies). This is particularly important given the ageing demographic profile of the Western Australian public sector and average employee tenure of 7 years in the sector.

We will continue to service these stakeholders through work-place education and advice programs throughout metro and regional Western Australia. In addition, GESB will provide support for choice of fund implementation. This will include the continued rollout of a clearing house service to maintain efficiencies for employers.

4.5. Policy & Legislative Changes

Given the emerging changes in Commonwealth and State superannuation policy and legislation, GESB will work with the State to detail a response to implement programs of work to effect these changes.

GESB has a strong risk management and compliance culture that ensures protection of members' and the State's funds. Initiatives in 2011/12 to ensure that GESB remains compliant with relevant legislation and is managing its risks in a prudent manner include:

- Ensuring our products and services reflect policy and legislative changes stemming from the Commonwealth Government's response to the Cooper Review into superannuation and the Henry Tax Review. This includes any response required to the Commonwealth's MYSuper default product, processing standardisation, and governance changes;
- Superannuation scheme alignment with State regulatory and legislative changes, including regulatory changes resulting from the Whithear Review, such as one-way choice of fund for public sector employees.

⁹ GESB's schemes are not defined as financial products in the *Corporations Act*. See *Corporations Act, Section 765A(1)(q)*, *Corporate Regulations, Regulation 7.1.05*, *Superannuation Industry Supervisory Act, Section 10* and *Schedule 1AA*

¹¹ TNS Global, GESB Employer Research, *ibid*

The SRISG will continue to oversee 10 project streams related to State legislative changes and the Whithear Review recommendations. GESB's CEO and Chairman are members of this Steering Group.

While the Steering Group oversees implementation, the GESB Board is the accountable body with specific powers under State Superannuation legislation. GESB will work with the Department of Treasury to progress outsourcing through market-testing of administration services and default fund.

GESB's performance is rated highly in SuperRatings Benchmarking report, indicating that GESB is the appropriate benchmark for a range of services, efficiency, service standards, cost, and investment performance.

GESB has significant risks to manage during the outsourcing project. The outcome of market testing for administration services and default fund may present other significant risks that are not considered in this SCI.

GESB will continue to manage 5 project streams under this program of work as outlined below. The Department of Treasury is responsible for the remaining project streams.

SUPERANNUATION REFORM PROJECT STREAMS	Responsibility GESB / DTF	SCHEDULED COMPLETION
1. Adjustment of reserves	GESB	Completed June 2011 Includes Whithear recommendations on reserves and adjustment to the treatment of expenses in recoup and employer contribution rates. The administrative recoupment processes are being finalised with the DoT as part of business as usual activities.
2. Winding up of GML Group	GESB	Completed February 2011 No further action
3. Re-allocation of advertising budget	GESB	Completed February 2011 Budget approved by Board for small account consolidation
4. Transfer of small superannuation holdings to other funds.	GESB	March 2012 Being progressed in three tranches from May 2011 to December 2011.
5. Winding up of GWM Pty Ltd	GESB	March 2012 Program of work to Identify how personal advice can be provided to members under appropriate regulation. (GWM currently has an AFS Licence whereas GESB does not hold a Licence)
6. Amendment of legislation (State Superannuation Act)	DoT	August 2011 Amendment Bill introduced into Parliament on 15 June 2011.
7. Choice of Superannuation Fund	DoT	March 2012 Delivery of project being revised and new project manager to be appointed
8. Choice of Superannuation Communication	DoT	March 2012 DoT responsible for State employer and employee communications. GESB responsible for member disclosure & communications.
9. Treasurer's Guidelines	DoT	June 2011 Reserves – completed Investment - in progress Board Powers – in progress
10. Administration Outsourcing	DoT	July 2012 Transition to commence The scope of services is to be determined during project planning phase: by end of August 2011.

There are two separate initiatives contributing to account consolidation. Item 4 in the table above relates to the State Government's superannuation reform as opposed to the Commonwealth's initiative to consolidate

unclaimed monies for lost members. The State is yet to consider the implications of the Superannuation (Unclaimed Money and Lost Members) Act 1999.

a Transfer of small superannuation holdings

A communications program to inactive, small balance account holders regarding the benefits of account consolidation commences in May 2011, continuing ongoing member education on the benefits of consolidation. This program continues throughout 2011/12. With an above industry response rate, 29,000 accounts with balances under \$10,000 are expected to consolidate to other funds in 2011/12. In March 2012, it is anticipated that approximately 20,000 inactive accounts with invalid addresses will be transferred to the Australian Taxation Office as part of the new Commonwealth account consolidation processes.

b GWM Pty Ltd

The Treasurer has confirmed that GWM can continue to operate as a going concern under the scope of the approval granted by the then Treasurer on 28 November 2006. An appropriate model will be determined for delivery of personal financial advice, related to a member's interest in GESB schemes once the outcomes of the tender process for administration outsourcing are known.

c Impact of Whithear Recommendations

During 2011/12, considerable work will be undertaken by GESB in implementing the recommendations of the State Government superannuation reforms. It has been assumed for simplicity purposes that the impact of those recommendations on GESB's operations will be confined to 2012/13. However, certain costs will be measured in 2011/12 for implementation purposes and those costs have been reflected in this year's financial forecasts.

5. People Management and Workforce Transition

Ongoing people management strategies of training and leadership development to help improve employee satisfaction will continue throughout 2011/12. This is particularly important to help retain key skills during a time of uncertainty and transition for many staff.

With significant changes to the business likely in 2012 from implementation of one-way choice of fund and potential outsourcing of administration activities and new default fund, an initiative on workforce transition will commence during 2011/12. This will focus on:

- Change management;
- Ensuring the right skills are retained within GESB; and
- Assisting staff through any major organisational restructure.

6. Risk Management

GESB is governed by the SSA and SSR. It is also subject to relevant Government guidelines as published from time to time¹¹. Appropriate risk management is an important element of good corporate governance and is a specific requirement under the SIS Act for Registrable Superannuation Entity (RSE) licence holders. Although not a RSE, GESB complies with the spirit of the SIS Act as a matter of best practice and under the Heads of Government Agreement.

GESB operates under a Risk Management Framework and the strategic planning process takes into account GESB's material risks when considering our purpose, corporate objectives, strategic issues and strategic direction. Risks are reviewed quarterly and reported to the Board, and Audit & Risk Committee.

The level of risk that the organisation is willing to accept to achieve its objectives is determined by the Board. With a new strategic path to be determined, The Board has identified material risks to be monitored going forward. Risks of moving to an outsourced provider will be considered once the scope and timing of outsourcing and default fund status are determined. The key material risks being monitored relate to key person risk including leadership and capability, alignment of member and state interests, effective relationships with the State Government, and failure to develop and monitor an appropriate investment strategy for schemes and reserves.

¹¹ Public Sector Commissioner's Circular 2009-19 – Risk Management and Business Continuity Planning.

These risks are highly related to the superannuation reform program and will be significant risk for GESB to manage during 2011/12.

7. Financial Forecasts

7.1. Financial Statements and Projections

Total funds under management are forecast to increase from \$12.1 billion at 30 June 2011 to \$13.6 billion at 30 June 2012. Funds under management are reported in the financial statements as investments plus cash and cash equivalents.

7.2. Accounting Policies

GESB has prepared its financial statements in accordance with Australian Accounting Standards, including AAS25 Financial Reporting by Superannuation Plans as amended by AASB 2005-13, Amendments to Australian Accounting Standards, and other authoritative pronouncements of the Australian Accounting Standards Board (AASB) as applied by the Treasurer's Instructions (TI) and the SSA.

7.3. Borrowing Arrangements

On 30 May 2001, the Western Australian Treasury Corporation and GESB entered into a \$635 million lending facility for a fixed-rate loan. The loan was incurred to enable the balances on West State Super members' accounts at 1 July 2001 to be fully funded from an investment perspective. This funding was a pre-requisite for GESB to introduce Member Investment Choice from 1 July 2001. The loan is unsecured and is repayable in quarterly instalments over 20 years. It bears interest at a fixed rate of 6.5699% plus a government fee of 0.2% p.a. The interest payment for 2010/11 will be \$29.48m; the forecast for 2011/12 is \$27.7m.

This loan balance was \$420m at June 30th 2011 and will reduce to \$390m by June 2012.

7.4. State Administration and Services Expense Recovery Process

The costs of administering the State's defined benefit schemes and providing government services related to superannuation policy were recovered through charges to the GES Fund. A revised approach to reserving for and recouping expenses related to State activities, and setting employer contributions from self-funded agencies, will be implemented for 2011/12.

7.5. Superannuation Reform Budget

The Department of Treasury has endorsed the reform budget expenses to be incurred by GESB in delivering superannuation reform as well as costs associated with providing government services and defined benefits administration.

7.6. Projected Financial Statements - GESB

a Statement of Change in Net Assets

	FORECAST	BUDGET
	2011	2012
	\$'000	\$'000
Net Assets Available To Pay Benefits At The Beginning Of The Financial Year	9,705,506	11,694,281
REVENUE		
Investment Revenue		
Realised Income	309,092	304,515
Realised Changes in Net Market Value of Investment Assets	581,441	304,515
Unrealised Changes in Net Market Value of Investment Assets	405,481	406,019
Income from Investments ¹	1,296,014	1,015,049
Superannuation Revenue		
Contributions		
Member	446,521	486,072
Employer	1,237,103	1,270,416
Rollover into Retirement Products ²	574,064	630,399
Inward Transfer from Other Funds ³	481,285	630,629
Member Insurance Benefits Received	23,228	25,976
Other Income	7,842	11,004
	2,770,043	3,054,496
TOTAL REVENUE	4,066,057	4,069,545
EXPENSES		
Superannuation Benefit Payments ⁴	1,829,493	2,291,858
Administration Expenses	41,867	39,058
Treasury Funded Reform Expenses (through EERC)	2,661	2,026
Consolidated Account Appropriation Direct Expenses	-	200
Group Life Insurance Premiums	76,499	75,545
Investment Expenses ⁵	35,479	40,207
GWM Financial Advice fees	3,091	4,155
Changes in Net Market Value of Financial Liabilities	(22,103)	-
Changes in Net Market Value of Other Assets	4,394	4,036
Loan Interest	29,477	27,700
TOTAL EXPENSES	2,000,858	2,484,785
CHANGE IN NET ASSETS BEFORE INCOME TAX	2,065,199	1,584,760
INCOME TAX EXPENSE	(76,424)	(84,853)
CHANGE IN NET ASSETS AFTER INCOME TAX	1,988,775	1,499,907
Net Assets Available To Pay Benefits At The End Of The Financial Year	11,694,281	13,194,188

Notes to the Key Variances:

1. The budgeted investment income figure for 2012 reflects a gross long-term earnings rate of 8.2%.
2. Continued growth in superannuation benefit payments has impacted rollovers into retirement products.
3. Includes increased internal transfers between untaxed and taxed schemes pre-retirement, which are also reflected in increased benefit payments, and UK pension transfers.
4. Superannuation Benefit Payments are forecast to increase in 2012 due to members leaving as a result of implementation of Choice of Fund from March 2012
5. Investment expenses are expected to increase in the 2012 budget due to budgeted increases in Funds under Management and implementation of investment strategy.

b Statement of Net Assets

	FORECAST	BUDGET
	2011	2012
	\$'000	\$'000
ASSETS		
Cash and Cash Equivalents	32,777	36,573
Investments	12,111,758	13,581,188
Plant & Equipment	1,882	1,692
Intangible Assets	11,742	10,533
Receivables	33,567	34,910
Prepayments	1,970	1,843
Deferred Tax Assets	5,115	4,092
TOTAL ASSETS	12,198,811	13,670,831
LIABILITIES		
Contributions Paid in Advance	1,454	1,512
Unapplied Member Contributions	4,118	4,283
Payables	45,000	46,350
Provision for Employee Entitlements	4,143	4,267
Provision for Post Employment Liabilities	2,023	2,084
Interest Bearing Loans & Borrowings	420,077	389,600
Current Tax Liabilities	27,715	28,547
TOTAL LIABILITIES	504,530	476,643
NET ASSETS AVAILABLE TO PAY BENEFITS	11,694,281	13,194,188

c Statement of Administration Expenses

	FORECAST	BUDGET
	2011	2012
	\$'000	\$'000
Employment Expenses ¹	24,111	21,986
IT Services ²	6,863	7,141
Consultants	208	260
Accommodation	2,455	2,505
Professional Fees (Actuarial, Legal and Audit)	1,102	1,276
Printing, Postage & Records Management	2,180	2,089
Promotions and Advertising	848	713
Other Administration costs ³	7,371	6,425
TOTAL ADMINISTRATION EXPENSES	45,138	42,395
Less Investment Expenses	(3,271)	(3,337)
ADMINISTRATION EXPENSES AS PER STATEMENT OF CHANGES IN NET ASSETS	41,867	39,058

Notes to the Key Variances:

1. Employment Expenses are expected to fall in 2012 with a reduction in the number of employees supporting business as usual activities
2. IT Services forecast figures for 2011 are under budget due to lower than expected IT contractor requirements. The 2012 budget includes a return to 2011 expected IT contractor levels and additional costs as a result of a short term ICT Asset Outsourcing contract extension.
3. Significant "Other Administration Costs" include training, irrecoverable GST, insurance, contractors and travel.

d Capital Expenditure

	FORECAST	BUDGET
	2011	2012
	\$'000	\$'000
Office Furniture, Equipment & Renovations	50	50
Intangible Assets comprising computer software costs and development projects ¹	4,621	2,588
Total Capital Expenditure	4,671	2,638

Notes to the Key Variances:

1. GESB capital investment will focus on upgrading its core operating systems to maintain ongoing vendor support; increase efficiencies through continued online access and automation; improve member data management; and improve insurance benefits.

e Cost Allocations

The total budgeted expenses (in \$000's) for 2011/12 of \$48,657, which include Administration Expenses (before allocation to investment expenses) of \$42,395 (refer table c), Treasury funded through Economic and Expenditure Reform Committee (EERC) submission costs of \$2,026 (refer table a), Consolidated Account Appropriations costs of \$200 (refer table a) and Depreciation of \$4,036 (refer table a) are allocated based on GESB's Activity Based Costing allocation model as follows -

	FORECAST	BUDGET
	2011	2012
	\$'000	\$'000
Investment Expenses	3,271	3,337
GESB Wealth Management	3,865	4,087
Superannuation Reform	4,079	2,587
Redeployments	453	245
Government Relations	325	208
Insurance	3,401	2,731
GESB Super	7,353	7,104
West State Super	17,988	16,634
Retirement Income	1,294	1,526
Retirement Allocated Pension	43	44
Gold State	8,595	8,551
Pension Scheme	1,514	1,589
Parliamentary & Judges	12	14
Total Administration Expenses	52,193	48,657

f Consolidated Account Appropriation

The following table details GESB's costs to fund Government Services and DB administration which are recouped from Consolidated Account Appropriation.

	BUDGET
	2012
	\$'000
Government Services – Superannuation Reform	200
Redeployment	245
Government Relations	208
Government Services – Government Relations	453
Gold State Administration Expenses	8,551
Pension Scheme Administration Expenses	1,589
Parliamentary Administration Expenses	14
DB Administration	10,154
Consolidated Account Appropriation	10,807

g Treasury Funded Reform Expenses (through EERC)

The following table details GESB's costs to fund superannuation reform which are Treasury funded through submission to the EERC.

	BUDGET
	2012
	\$'000
Superannuation Reform Direct expenses	2,026
Superannuation Reform Indirect expenses	361
Treasury Funded Reform Expenses (through EERC)	2,387

h Accumulation Scheme Surplus / (Deficit)

	FORECAST	BUDGET
	2011	2012
	\$'000	\$'000
West State Super		
Revenues	58,615	59,032
Expenses	(45,262)	(43,203)
Surplus / (Deficit)	13,353	15,829
GESB Super		
Revenues	10,042	10,919
Expenses	(11,765)	(10,836)
Surplus / (Deficit)	(1,723)	83
Retirement Income		
Revenues	7,750	8,635
Expenses	(4,387)	(5,692)
Surplus / (Deficit)	3,363	2,943
Retirement Allocated Pension		
Revenues	214	211
Expenses	(103)	(104)
Surplus / (Deficit)	111	107
Total Accumulation Scheme Surplus	15,104	18,962

i Efficiency Dividend Costs Comparison

The efficiency dividend requested of \$2.7m is based on 5% of 2010-11 budgets. This table shows the 2010-11 budget and a comparison against the original Board approved 2011-12 SCI and this revised 2011-12 SCI. Savings achieved against the 2010-11 budget are \$6m.

	Efficiency Dividend Baseline 2010-11 Budget \$Mn	Original 2011-12 SCI \$Mn	Revised 2011-12 SCI \$Mn
Administration Expenses (before allocation to investments)	47	48	42
Depreciation	4	4	4
Reform	3	10	2
Total Costs	54	62	48

