

**SUPERANNUATED COMMONWEALTH OFFICERS'
ASSOCIATION**



SUBMISSION TO

**THE PARLIAMENTARY JOINT COMMITTEE ON
CORPORATIONS AND FINANCIAL SERVICES**

Inquiry into the structure and operation of the superannuation industry

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SCOA'S RECOMMENDATIONS

Recommendations Reference 4

The Parliamentary Joint Committee recommends a sustained and more intense superannuation education and promotion program aimed at Australian workers to:

1. Increase their understanding of superannuation and the superannuation guarantee;
2. Know when they need expert advice; and
3. Put in place realistic financial strategies they need, over and above the superannuation guarantee, to support a reasonable and secure retirement.

Recommendations - Reference 8

The Parliamentary Joint Committee recognizes and reports on:

1. The trend in the shift by employers from defined benefit funds, for their employees, to accumulation funds with contributions being reduced to the level of the superannuation guarantee, in some instances;
2. Major defined benefit funds, although closed to new members, will continue to need monitoring and regulation for many decades to come; and
3. There is a need for superannuant representation (through SCOA) on the ARIA Board.

Recommendations – Reference 15

The Parliamentary Joint Committee recognizes:

1. The value so far of the superannuation guarantee is that it has brought superannuation to most Australian workers; and
2. The superannuation guarantee is inadequate and needs to be gradually increased to at least double its present level to be the mainstay insuring adequate retirement incomes for all Australian employees.

Superannuated Commonwealth Officers' Association

SUBMISSION TO THE PARLIAMENTARY JOINT COMMITTEE INQUIRING INTO THE STRUCTURE AND OPERATION OF THE SUPERANNUATION INDUSTRY

Scope of this submission

The Superannuated Commonwealth Officers Association provides comment and recommendations against references 4, 8 and 15 for the consideration of the Parliamentary Joint Committee.

REFERENCE 4

THE ROLE OF ADVICE IN SUPERANNUATION

The answer to 'the role of advice in superannuation' is dependent on many things and will not be constant across the population.

The majority of SCOA's constituents are in the 1922 Superannuation Act Scheme, the Commonwealth Superannuation Scheme (CSS) or the Public Sector Superannuation Scheme (PSS). These are identified as defined benefit or hybrid schemes and are deemed to be untaxed schemes. In the main there was only one scheme available to them. So the majority were/are not in one of these by choice.

For the bulk of these Commonwealth employees or former Commonwealth employees superannuation advice is/was non existent or virtually non existent and in the main only becomes/became a matter for consideration on resignation, redundancy or retirement.

Most of these people left their superannuation affairs in the hands of ComSuper during their period of Commonwealth employment.

So what happened when they resigned, were made redundant or chose to retire?

They entered a mystery world whose language was more aligned with ancient Greek instead of plain English. This applied and still applies in relation to superannuation and taxation legislation and procedures.

For many, this was also their first introduction to the world of Financial Planners.

They quickly found out that financial planners promised a lot, spoke quickly and mostly in this foreign language. They were also good at cajoling these people to let them manage their financial affairs.

Unfortunately, for many, it took 12-18 months before they had a layman's understanding of what was happening to them and more particularly to their money.

Again, for many, the bottom line was that the management and other fees equalled or exceeded the return on their money.

Because of entry and exit fees, it was a costly and bitter experience, for many, when they chose to move their money elsewhere.

So why did they choose to use a Financial Planner?

The key reason was that they found themselves in a situation where they suddenly had more money than they had previously had and that it needed to be invested for a return greater than bank interest.

In some instances it needed to be turned into an allocated pension to supplement their ComSuper pension and they therefore needed guidance on options.

Secondly, they needed someone who had more understanding than they did of current superannuation and taxation law and procedure and who would be able to advise them of the implications of the multitude of changes that occur to superannuation and taxation law and procedures each year.

Finally and importantly they were deterred from putting more time into trying to understand retirement income matters because of the complexity of the laws and procedures.

What is the current situation?

The current situation is

- No change to the complexity of the system
- The need for professional advice has increased because of the introduction of the PSSap and 'Super Choice'
- Fee transparency and standard of reporting to clients has improved since introduction of the Financial Services Reform Act but are capable of further improvement
- In-house products are still a problem as evidenced by recent events associated with AMP Financial Planning Pty Ltd and others and could get worse given the high percentage of funds that are now managed by banks
- 'Super Choice' remains a nightmare for some people
- ASIC is aware, from the regular studies it does with the Australian Consumers Association and other sources, of most of the problems associated with the industry and the impact that is having on clients but ASIC appears most to be 'a toothless tiger'.
- The 9% Superannuation Guarantee is seen by too many as being adequate to fund their retirement

So what about government websites, publications and call centres?

Government websites, especially the Australian Taxation Office (ATO), website should be a major source of assistance – but it's not.

The ATO website is poorly designed which makes it difficult to find material. When the information is found there is no guarantee that it is up to date.

In fact the ATO website is easier to access if done through Google.

It is a similar position with government publications.

With call centres the operator reads from a prepared script and is often unable to answer posed questions. In addition there is no guarantee that if a caller uses the advice received that they will get the required outcome.

So what about off the shelf publications?

The position is similar to that above due to the regular changes made to superannuation and taxation law and procedure.

What have government and independent studies said about the situation?

They all point to the need for a total revision and simplification of superannuation and taxation law.

Studies show that people, especially women, currently at or near retirement age consider themselves ill-educated and with little experience in superannuation and financial matters.

In August 2005, a study conducted by the Victorian Government Office of Women's Policy concerning financial security revealed many significant statistics about women and their views of their finances. Some examples are:

- 40% of women do not consider themselves financially secure
- one-third of women were just making ends meet
- almost 90% believe that they are in a weaker financial position than men
- 40% indicated they did not know whether they would be financially secure in retirement
- 34% said they would not be financially secure in retirement, while only 24% indicated that they would be secure in retirement

A study done for the Federal Government earlier this year had similar findings.

There are other studies concerning casual workers, with a range of employers, that raise concern about the difficulties associated with superannuation portability and lost superannuation funds.

So what needs to be done?

- Priority needs to be given to a full review and re-write of all material. associated with superannuation and taxation law and procedures.
- Plain English needs to be used.

- The ATO website needs to be replaced by a user friendly one.
- ASIC needs to be ‘given more teeth’ so that it can protect the interests of persons with funds in superannuation including those using Financial Advisers.
- The Federal government should sponsor regular seminars for younger workers, casual workers, women and men so that their concerns can be addressed and their needs met.
- Employers should have available for employees a range of superannuation material that explain the basics of superannuation and the benefits, including taxation benefits, of superannuation.
- There should be more regular Government sponsored advertisements that explain superannuation portability and lost superannuation.

Reference 4 Recommendations

The Parliamentary Joint Committee should consider recommending a sustained superannuation education and promotion program aimed at Australian workers to:

1. Increase their understanding of superannuation and the superannuation guarantee;
2. Know when they need expert advice; and
3. What realistic financial strategies they need to put in place over and above the superannuation guarantee to support a reasonable and secure retirement.

What is SCOA doing to assist persons in the workforce and retirees?

SCOA has become more active in recent years in areas including:

- Sponsoring and arranging 'Information Seminars' for persons approaching retirement and already retired
- Obtaining and distributing material to SCOA members
- Including, approved superannuation and taxation articles, in its quarterly newsletter SuperTime
- Membership of advisory groups such as the Personal Tax Advisory Group
- Making representation on behalf of Commonwealth employees and Commonwealth superannuants

REFERENCE 8

THE DEMISE OF DEFINED BENEFIT FUNDS AND THE USE OF ACCUMULATED FUNDS AS THE INDUSTRY STANDARD FUNDS

The number of defined benefit funds has been steadily declining over recent years. The reason for the decline in defined benefit funds is mainly due to but not limited to the following:

1. The risk and cost uncertainties to the fund member's employer
2. Compulsory superannuation through the introduction of the superannuation guarantee
3. Superannuation surcharge
4. Increasing acceptance and popularity of salary sacrificing to superannuation
5. Higher administration costs for defined benefit funds including actuarial costs
6. New defined benefit funds having at least 50 members

Risk and cost uncertainties

Benefits arising out of defined benefit funds are based on a set formula. Usually the formula relates to the fund member's salary (average salary over the last 3 years of membership), length of membership and in some cases personal contributions made by the member to the defined benefit fund. Benefit accruals, where member contributions are part of the formula relate to the rate of member contributions. Exemplifying this is the Public Sector Superannuation Scheme defined benefit plan (PSSdb) employee member contributions are between 2% and 10% and have a bearing on benefit accruals. The PSS is also an example of a defined benefit fund where the employer is a Government that has chosen to make no ongoing contributions and to meet the cost of the benefits, out of revenue, when the benefits fall due.

Therefore, defined benefit funds provide a predetermined level of retirement benefits for its members. In contrast, retirement benefits paid from accumulation funds are uncertain and depend on contributions paid into the superannuation fund by members and their employers and investment earnings generated on those contributions.

Defined benefit funds must ensure that there are sufficient contributions paid into the fund to enable benefits to be paid when they fall due. If the earnings of the fund are reduced or become negative the employer is required to cover the shortfall. Where the defined benefit fund offers pension benefits the fund needs sufficient funds to be able to fund pension payments for many years.

The risks associated with defined benefit funds has recently been demonstrated in the United States where there has been considerable criticism of defined benefit pension funds where employers such as Ford and General Motors are suffering under the burden of being required to make large payments to fund pension payments to retired

employees. Low interest rates and low returns on fund investments have caused these defined benefit funds to become severely under funded.

Basically, the risk for employers is that the fund may not have sufficient funds to meet its liabilities and to be able to pay benefits when they fall due. Where such a situation arises the employer is required to fund the shortfall to enable predetermined defined benefits to be paid. Many Australian employers are not willing to take this risk and would prefer just to accept their legal obligation in relation to superannuation and pay the superannuation guarantee of 9% of their employees' salary into an accumulation superannuation fund.

Many employees are also inclined to accept the risk that accumulation funds will provide them with greater retirement benefits than would be payable under a defined benefit fund. Generally, benefits in defined benefits funds accrue at the same rate as salaries whereas in accumulation funds benefits increase at the crediting rate of the superannuation fund or the increase in the value of units held in the fund.

Where members have a choice between joining a defined benefit fund or an accumulation fund SCOA has noticed that younger members often opt to join accumulation funds while older employees, close to retirement, will join a defined benefit fund. Younger members are prepared to accept the risk that fund earnings will generate increased retirement benefits to that of defined benefit funds while older employees prefer the certainty of a predetermined retirement benefit.

Amendments in 1994 to the *Superannuation Industry (Supervision) Act 1993* and Regulations (SIS) strengthened the requirements to ensure solvency of defined benefit funds. These requirements placed further responsibilities on employers to ensure that their sponsored defined benefit funds meet certain solvency tests. This caused some defined benefit funds to be wound up with members moved to accumulation funds.

Employers are now required to accept:

- Greater responsibility when sponsoring defined benefits funds for their employees;
- The risks associated with such funds;
- Ensuring that these funds are adequately funded; and
- Ensuring member benefits are protected.

Consequently fewer employers, including Government employers, are willing to accept this responsibility.

Compulsory superannuation through the introduction of the superannuation guarantee

Before the introduction of compulsory superannuation through the superannuation guarantee very few Australians had access to superannuation. It was optional for an employer to provide superannuation for its employees. Generally, superannuation was only provided to executives or certain employees as a reward and to public sector employees. Superannuation provided for these employees was generally in the form of defined benefit funds.

With the introduction of compulsory superannuation through the superannuation guarantee system employees were only required to pay a set percentage of an employees' salary to superannuation to satisfy the superannuation guarantee requirements. All that was required of employers was to pay contributions at a set percentage of salary (currently 9%) into an accumulation superannuation fund. In order to receive superannuation guarantee contributions from employers there needed to be accumulation superannuation funds willing to accept superannuation contributions. Many industry funds were set up for this purpose.

For example, the Commonwealth Government set up an industry fund for its own employees. This industry fund known as the Australian Government Employees Superannuation Trust (AGEST) was set up with the express purpose of receiving superannuation guarantee contributions for Australian Government employees including those who were unable to join the Commonwealth Superannuation Scheme (CSS) or the PSS and/or to receive superannuation guarantee contributions paid in respect of performance bonus payments made to Australian Government employees. Defined benefit schemes such as the CSS and PSS were unable to accept superannuation guarantee contributions in respect of the payment of performance bonuses as these contributions were outside of the formula for determining benefits under the rules of those schemes.

Superannuation surcharge

The introduction of the surcharge tax in 1997 was detrimental for members of defined benefit funds including unfunded defined benefit schemes. SCOA believes that the surcharge tax had a more severe effect on members of defined benefit funds than it had on accumulation funds.

There are no account balances for members of defined benefit funds and therefore the amount of surcharge tax due could not be deducted from a member's account and paid to the ATO. As a result a different method of assessing and accounting for the surcharge tax was required for defined benefit funds.

There is no set employer contribution attributable to each member of a defined benefit fund. The employer pays sufficient employer contributions to cover benefit payments from the fund when they fall due.

To determine the amount of surchargeable contributions for each member an actuarial calculation was required. Once the surchargeable contribution had been calculated and advised to the ATO, the ATO then made a surcharge assessment for each member of the defined benefit fund for the fund to pay to the ATO. However, as there was no account balance from which to deduct the surcharge debt the fund administrator was required to run a separate surcharge account (usually compounding at an interest rate equivalent to the investment earnings of the fund) until the member retired at which time the surcharge debt was deducted from the defined benefit that was payable. Over many years the surcharge liability in the member's account could become quite large and significantly reduced the defined benefit payable.

A similar process was applied to unfunded defined benefit funds except the surcharge liability that was built up over a number of years was not paid to the ATO until deducted from the member's retirement benefit when it was then paid to the ATO. The surcharge liability that was determined each year compounded at an interest rate equivalent to the 10-year bond yield. Members of unfunded defined benefit schemes such as members of the CSS and PSS could voluntarily pay the surcharge liability to the ATO with after tax private income through their superannuation scheme. This arrangement meant that the member was taxed on the surcharge tax the member was required to pay.

SCOA believes that the considerable extra burden placed on employers, members and fund administrators of defined benefit funds to comply with the surcharge tax arrangements provided a more significant incentive to move away from defined benefit funds. Some employers transferred fund members to an already established industry accumulation superannuation fund. Others closed defined benefit funds to new members with new employees being required to join accumulation superannuation funds. The Commonwealth Government is an employer that used the second of these strategies when it closed the PSS defined benefit fund to new members, established the PSS accumulation fund and directed new employees to it.

Increasing acceptance and popularity of salary sacrificing to superannuation

Defined benefit funds enabled members to be aware of their retirement benefits on retirement. Generally, these retirement benefits would be a set percentage of the fund member's salary. With the knowledge of what their retirement benefits would be some members would decide to supplement their benefit entitlements from defined benefit funds by salary sacrificing to superannuation.

However, defined benefit funds were unable to accept salary sacrifice superannuation contributions as it did not fit within the formula for determining accrued benefits. As a result members were required to seek alternative accumulation superannuation funds to accept their salary sacrifice superannuation contributions. Generally they would choose industry accumulation superannuation funds.

Employers were then required to process two separate superannuation arrangements for many of their employees – the employer sponsored defined benefit fund plus pay salary sacrifice superannuation contributions to an industry accumulation superannuation fund.

SCOA believes that employers incurring the extra costs associated with sponsoring a defined benefit fund and paying salary sacrifice superannuation contributions to an industry fund found it more cost effective to transfer their employees to an industry accumulation fund where they would only be required to pay the superannuation guarantee plus any salary sacrifice contributions to the same industry superannuation fund.

Higher administration costs including actuarial costs

Most employers that sponsor a defined benefit fund administer the fund in house. The cost of administering a defined benefit fund has risen dramatically over the years due

to additional requirements under SIS. These requirements include actuarial investigations at least every three years to determine that the fund remains solvent and can pay benefits when they fall due. The actuarial investigations are also required to determine the level of superannuation contributions that the employer is required to pay to the fund to insure solvency of the fund.

SCOA believes that the costs associated with the administration of defined benefit funds including meeting SIS requirements have become too great. The easy solution for many is to wind up the defined benefit fund and transfer the members to an accumulation fund of their choice.

There may also be an absurdity in Government defined funds being required to determine whether the funds are solvent. In the case of the CSS, PSS and other Commonwealth defined benefit funds there are no contributions invested to cover the pension payments as past Commonwealth Governments had chosen to meet the costs of pensions as they arise. While being able to project the future costs of the PSS, CSS and other Commonwealth defined benefit funds has value, SCOA wonders if some of the compliance costs for these funds may be part of a 'one size fits all' approach to regulation and as such could be trimmed.

New defined benefit funds having at least 50 members

One of the advantages of defined benefit funds which are an attraction to high wealth individuals is Reasonable Benefit Limits (RBL) compression. The formula contained in SIS to calculate the RBL amounts of defined benefits is very favourable and produces a much lower RBL value than would be the case of an equivalent benefit paid from an accumulation fund.

Instead of changing the factors used in the calculation of the RBL amounts for benefits paid from defined benefit funds and aligning them more with benefits paid from accumulation funds, the Government decided that any new defined benefit fund had to have at least 50 members. This rule meant that no new defined benefit self managed superannuation fund or small APRA funds with less than 50 members could be established.

Accordingly, under SIS no new defined benefit funds with less than 50 members can now be established. This has had the effect of turning employees of small companies away from defined benefit funds into industry accumulation funds.

Reference 8: Concluding Remarks

SCOA believes that the Government through its supervision and regulation of the superannuation industry has made it more difficult for defined benefit funds to continue to provide superannuation for employees of both large and small companies as well as for Government employees. It is more cost effective and simpler for an employer to pay superannuation contributions to an accumulation superannuation fund. This also has the advantages of shifting risks to the accumulation funds to manage and, ultimately, to employees to bear.

As a result there has been a steady decline in defined benefit funds and an increase in the use of accumulation superannuation funds. Industry accumulation superannuation funds have a low cost structure and are available to all Australians. With their easy access and lower costs structures, industry accumulation superannuation funds are being seen as more desirable when compared to other accumulation funds.

There also may be a growing misunderstanding, by the bulk of Australian workers, that their superannuation guarantee contributions alone, in accumulation funds, will fund a reasonable and secure retirement.

SCOA's concerns

In regard to the shift from defined benefit funds by the Commonwealth Government and state governments, as the organisation representing retired Commonwealth employees, SCOA has the following concerns:

There may be a tendency for Government, industry, and regulators to increasingly neglect the members and pensioners belonging to closed defined benefit funds. SCOA cannot stress strongly enough that when the CSS accepted its last 18 year old in 1990 as a contributor that fund may have begun a relationship that could last longer than 80 years. The same applies with the more recent closure of the PSS. To underscore this SCOA cites a survey of its members conducted in 2006 that elicited a response from a SCOA member of the 1922 fund who was born in 1904. SCOA emphasizes that the CSS, the PSS and the closed military funds have an army of contributors and pensioners. Indeed the latter fund could still be taking contributions for in excess of another 40 years.

The Future Fund is lately touted as the repository of funds that will be used, one day, to defray perhaps, even pay, pensions to retired members of the CSS, PSS, and other Commonwealth and military superannuation funds. The way the fund is set up there is no certainty the monies it holds cannot or will not be used for other 'worthwhile purposes'. SCOA believes the Future Fund, in its present form, may engender a mindset of there being no need to worry any further about the closed Commonwealth defined benefit funds, their members and pensioners.

There are symptoms of indifference to the needs of these superannuants already. SCOA is the one organisation that is dedicated to the interests of members and pensioners from the Commonwealth Governments defined benefit funds, as such SCOA is very concerned about:

1. SCOA, representing pensioners, not being consulted in relation to the changes outlined above including the closure of the PSS and creation of the PSSap;
2. SCOA (pensioners) not being represented on the CSS and PSS Boards nor being represented on the ARIA Board which recently replaced these Boards;
3. The inequities outlined above and at Reference 15 affecting defined benefit members and pensioners; and

4. Discrimination against members and pensioners of Commonwealth defined benefit schemes.

Reference 8 Recommendations

The Parliamentary Joint Committee recognizes and reports on:

1. The trend in the shift by employers from defined benefit funds, for their employees, to accumulation funds with contributions being reduced to the level of the superannuation guarantee in some instances;
2. Major defined benefit funds, although closed to new members, will continue to need monitoring and regulation for many decades to come; and
3. There is a need for superannuant representation (through SCOA) on the ARIA Board.

REFERENCE 15

ANY OTHER RELEVANT MATTERS

Adequacy of superannuation provision with undue sole dependence on the superannuation guarantee, currently at 9%

There has been a wholesale shift to accumulation funds by Governments across Australia. Now, the key and often only government/employer contribution to the superannuation of their workforce is the 9% superannuation guarantee, the same for most employers. SCOA recognises the PSS (ap) is one of the better funded government superannuation accumulation funds but believes its benefits will be less than those received by current superannuants who are pensioners from Commonwealth defined benefit funds. SCOA acknowledges the superannuation guarantee of 9% employer contribution is a beginning in terms of superannuation provision for most employees many who would have had no superannuation in place before the superannuation guarantee. However it represents a serious decline for government employees and has the potential to give a false sense of financial security for future retirees who may rely on it, perhaps in combination with the age pension, for their retirement income.

SCOA members are a good cross section of Commonwealth Government employees and are retirees from the 1922 superannuation fund, the CSS and the PSS. All SCOA members are recipients of pensions from one or more of these defined benefit schemes where the employer's notional contribution has been at least double the superannuation guarantee. Yet the average Commonwealth Government funded pension through the 1922, the CSS, the PSS and the Military funds is currently about \$20,500 per annum which is about \$1,000 per annum less than the combined age pension for a couple. Consequently SCOA members know first hand that very many retired former Commonwealth government employees are reliant on age pension top ups for their economic survival.

So why is this?

There is a combination of factors that constrain superannuation pension levels from Commonwealth Government defined benefit schemes such as the 1922 Scheme, the PSS, CSS, and the military funds. There are the factors that set the levels of pension at retirement. These include age, salary level and time in the fund. After that there is indexation which is set at a lower level than the indexation rate for the age pension. Two Senate Committee inquiries have recommended improvements in indexation but these have not been agreed by the current Commonwealth Government. This still needs to be addressed.

Based on the retirement experience of its members, SCOA strongly believes the superannuation guarantee needs to be progressively lifted to at least double its present level. SCOA strongly urges the government to address this for the benefit of all Australian workers, whether employed by government or the private sector, and for the benefit of future Australian tax payers.

Recommendations – Reference 15

The Parliamentary Joint Committee recognizes:

1. The value so far of the superannuation guarantee in that it has brought superannuation to all Australian workers;
2. The superannuation guarantee is inadequate and needs to be gradually increased to at least double its present level to be the mainstay insuring adequate retirement incomes for all Australian employees.

Attachment

ABOUT SCOA

The **Superannuated Commonwealth Officers' Association (SCOA) Inc.** is 83 years old; it is non-political, not for profit and financed entirely by its members. It represents the interests of:

- Retired Australian and Territory Government employees, Government business enterprise employees and their families who are in receipt of pensions from any of the CSS, PSS, and OS 1922 superannuation schemes;
- People in the public service who will receive a Commonwealth superannuation benefit (or lump sum) on retirement; and
- Former Commonwealth and Territory employees who have deferred (preserved) their pension entitlement.

At 30 June 2005 there were 408,894 members of the CSS, PSS and OS 1922 schemes, being:

- 123,807 pensioners;
- 186,894 contributors; and
- 98,253 who had a preserved benefit.

In addition there would have been upwards of 200,000 persons who may, one day, access a spouse reversionary benefit.

SCOA helps its members by focusing on issues relating to:

- Superannuation changes and related indexation provisions
- Taxation concerns
- General financial information
- Concessions
- Social security benefits
- COMCARE compensation
- Health
- Residential and aged care planning
- Mature age employment

SCOA monitors development of legislation and policies by Government. It represents the interests of its constituency in various forums. Where appropriate, it lobbies members of Parliament and Government bodies to maintain and improve conditions for Commonwealth superannuants and superannuation contributors.

SCOA networks with other national and State organisations to exchange views on retirement issues. These organizations include ACPSRO and the RDFWA.