Australian Government
Department of Finance and Administration

DEPARTMENT OF FINANCE AND ADMINISTRATION

Submission to the

Senate Finance and Public Administration Committee

Inquiry into the provisions of the Superannuation Legislation Amendment Bill 2007

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INTRODUCTION

The *Superannuation Legislation Amendment Bill 2007* (the Bill) primarily makes enhancements to the Australian Government civilian superannuation schemes. The Bill also addresses a number of issues in the military superannuation schemes, though these schemes are currently the subject of a review commissioned by the Minister Assisting the Minister for Defence on 27 February 2007. The Bill:

- removes, from 1 July 2008, the requirement for contributory members of the Commonwealth Superannuation Scheme (CSS) to make member contributions to the CSS, thereby generally making all member contributions voluntary and providing members with the same flexibility and incentives to contribute to superannuation that are available to the broader community;

- allows, from 1 July 2008, eligible members of the Public Sector Superannuation Scheme (PSS) to elect to leave the PSS and join another superannuation arrangement for the payment of future contributions, which will provide eligible members with the flexibility for future contributions that is already available to most of the Australian workforce;

- enables, from 1 January 2008, members of the CSS to obtain early release of their funded account balances on severe financial hardship and compassionate grounds;

- provides, on successful application, for the prospective restoration, from 1 January 2008, of spouse pensions that were cancelled upon remarriage, prior to 1976 in certain civilian schemes and prior to 1977 in military schemes;

- makes consequential and technical amendments to the CSS arising from the Government's *Better Super* reforms;

- ensures that the entitlement to benefits in the *Defence Force Retirement and Death Benefits Act 1973* (DFRDB Act) scheme relating to post retirement marriages is consistent with the treatment in the civilian schemes; and

- addresses an anomaly in the treatment of the benefits payable in the DFRDB Act scheme upon marriage breakdown.

BACKGROUND

2. Since 1996, the Australian Government has changed the superannuation framework applying to the Australian workforce by implementing a number of policies designed to introduce greater flexibility and simplicity, encourage older employees to remain in the workforce longer and provide a greater incentive for employees to increase their private savings for retirement through superannuation. The Government has also committed to the simplification of superannuation, with effect from 1 July 2007, under the *Better Super* reforms.

3. The introduction of the Public Sector Superannuation Accumulation Plan (PSSAP), on 1 July 2005, marked a significant change in the superannuation arrangements for new civilian Government employees. The PSSAP is a fully funded accumulation scheme. PSSAP members have access to most of the flexibilities and modern features available to private sector accumulation schemes.

4. The majority of the Government's current employees are, however, members of the CSS and PSS, which are both (largely unfunded) defined benefit schemes. These schemes are governed by the regulatory and prudential framework established by the *Superannuation Industry (Supervision) Act 1993* and regulations (SIS legislation), and members will be covered by the Government's *Better Super* reforms. However, members of these schemes do not generally have access to the flexibilities introduced by the Government in the broader superannuation framework.

5. The overall design of both the CSS and PSS is prescriptive and can be inflexible for many members of these schemes and can act as a disincentive for members to remain in Government employment. For example, contributory members cannot leave the schemes unless they resign from Government employment and, if a past member resumes Government employment, they must typically rejoin their old scheme – either the CSS or PSS. In addition, members must make mandatory member contributions from after tax salary and this is not imposed on the broader community.

6. Not providing access to more contemporary superannuation arrangements is reducing the incentive for CSS and PSS members to remain in Government employment. The risk of not addressing this is a negative impact on the retention of the Government's current employees, especially experienced and senior employees for whom opportunities exist to move to the private sector, or who see early retirement as the "only option". In general, the APS has an older age profile than the Australian labour force, with a much lower proportion of young people. Retention of the Government's existing ageing workforce is equally important as the retention of employees in the broader Australian community. Superannuation is a more material factor for older employees, particularly in determining whether they retire early or remain in employment longer.

7. The proposals set out in the Bill have been designed to align with the Government's long-term objectives of encouraging people to remain in the workforce longer. They provide some flexibility for CSS and PSS members to tailor their retirement and superannuation arrangements to best meet their needs and would assist with employee retention in response to the challenges of an ageing APS workforce.

FINANCIAL IMPLICATIONS

8. The major financial implications of this Bill relate to the reforms to public sector superannuation that were announced in the 2007-08 Budget, which will cost approximately $160 million over 4 years. This cost largely relates to employer contributions being made to accumulation arrangements, for those eligible members who elect to leave the PSS under the new choice of fund option.

9. There will, however, be small cost savings for the PSS and CSS associated with the introduction of voluntary contributions for CSS and PSS members and choice of fund for PSS members.

10. Further information in relation to the expenses associated with these measures is provided in the 2007-08 Budget Paper No. 2.[1]

11. The other changes in the Bill are expected to have a minimal impact on the Budget.

[1] The measure "Superannuation – reforming the Public Sector Superannuation Scheme (PSS) and the Commonwealth Superannuation Scheme (CSS)" as outlined on page 200 of Budget Paper No. 2 relates to these reforms.

DESCRIPTION OF ENHANCEMENTS

<u>Schedules 1 to 4 of the Bill – Budget Reforms</u>

Making CSS Member Contributions Voluntary

12. The *Superannuation Act 1976* (CSS Act) includes a requirement for contributory members of the CSS to pay basic member contributions of 5 per cent of their salary for superannuation purposes. The Bill includes amendments to the CSS Act that will remove this requirement and allow CSS contributors to elect, on or after 1 July 2008, to cease making basic member contributions. Special provisions will apply in relation to some periods of leave of absence without pay of more than 12 weeks.

13. It is intended that the requirement for PSS members to make mandatory contributions will also be removed through a PSS Amending Deed. A PSS Amending Deed is a delegated legislative instrument made by the Minister for Finance and Administration (and in most cases made with the consent of trustee of PSS) that is subject to Parliamentary disallowance. Currently under the PSS, member contributions of between 2 per cent and 10 per cent of superannuation salary have to be made.

14. These changes will provide CSS and PSS members with the same flexibility and incentives to contribute to superannuation that are available in the broader community. This change will mean that members of the CSS and the PSS will be able to choose, like their private sector counterparts, and members of the Public Sector Superannuation Accumulation Plan (PSSAP), whether to make their own contributions to superannuation and where and how those contributions will be made.

Choice of Fund for PSS Members

15. The *Superannuation Act 1990* (PSS Act) provides the eligibility requirements for membership of the PSS and generally only allows members to cease contributing on leaving Australian Government employment or on retirement. Further, when former members return to the public sector they must go back into the scheme, even if they have not worked in the public sector for an extended period and have substantial retirement savings in private sector funds. Such restrictions may act as deterrents to recruitment.

16. The Bill includes amendments to that Act that will allow eligible PSS members to elect to cease membership of the scheme, preserve their accumulated PSS benefit and have their future employer contributions paid to an accumulation scheme, thereby having access to the Government's broader choice of fund arrangements. PSS members who elect to leave the scheme are not eligible to return to the PSS in the future. These changes will commence on 1 July 2008.

17. The mechanism for providing access to choice of fund is for the PSS member in the first instance to transfer to PSSAP (if eligible to join) or another scheme with the agreement of their employer. It is from this point that the member will have access to the Government's broader choice of fund arrangements. This mechanism is considered legislatively simple and

more efficient to administer as, unlike the PSS, the PSSAP is within the choice of fund framework.

18. A member’s eligibility to join another superannuation arrangement will be determined by the choice arrangements that their employer has in place. For example, a member who is able to join the PSSAP, will move to that scheme in the first instance and from there will have access to the Government’s broader choice of fund arrangements.

19. The Bill also amends the *Superannuation Act 2005* (PSSAP Act) to allow eligible PSS members who have elected to join the PSSAP to become members of that scheme.

20. The ability to elect to leave the PSS will provide eligible members with the flexibility for future contributions that is already available to most of the Australian workforce.

21. The Bill does not provide CSS members with choice of fund. This is due to the differences between the defined benefit structure of the CSS and the PSS. In addition CSS members have in the past been offered two opportunities, in 1990 and 1996, to transfer from the CSS to the PSS.

22. It is also necessary to change the PSS Rules. These changes will be made through a PSS Amending Deed.

Early Release

23. The regulatory framework established under the *Superannuation Industry (Supervision) Act 1993* (SIS Act), which governs superannuation arrangements in Australia, allows people to obtain early release of their funded account balances on severe financial hardship or compassionate grounds, provided this is permitted by the rules of their superannuation scheme. However, the CSS and PSS Rules only allow a limited operation of the SIS Act early release provisions.

24. The Bill contains amendments to the CSS Act that will, from 1 January 2008, enable CSS members to obtain early release of their funded account balances on severe financial hardship or compassionate grounds, to the extent allowed under the SIS Act.

- Early release on severe financial hardship grounds is specified in Regulation 6.01(5) of the *Superannuation Industry (Supervision) Regulations 1994*. Circumstances covered by this regulation might include, for example, to prevent foreclosure by a mortgagee.

- Early release on compassionate grounds is specified in Regulation 6.19A of the *Superannuation Industry (Supervision) Regulations 1994*. Circumstances covered by this regulation might include, for example, to treat life threatening illnesses, for palliative care, funeral and burial expenses.

25. Early access to superannuation benefits on hardship and compassionate grounds is already available to most employees in Australia, who generally contribute to accumulation schemes, rather than defined benefit schemes such as the CSS and PSS. Early access is currently available to members of the PSSAP, which is an accumulation scheme.

26. Corresponding changes to the PSS are proposed to be made by a PSS Amending Deed, as the relevant provisions for the PSS reside in regulation, not the primary legislation.

Pension Restoration

27. Prior to 1976, in the *Superannuation Act 1922* (1922 Act) civilian scheme, and 1977, in the *Defence Forces Retirement Benefits Act 1948* (DFRB Act) and DFRDB Act schemes, spouse pensions were cancelled on remarriage.

28. Rules cancelling spouse pensions on remarriage were removed from the Australian Government's civilian superannuation schemes in 1976 and the military superannuation schemes in 1977. However, certain spouses who remarried before those times continue to be affected by the previous rules.

29. The Bill will enable, on successful application, the prospective restoration of pensions for persons who have previously had their spouse pensions cancelled upon remarriage.

30. This change applies to the 1922 Act scheme, the DFRB scheme and the DFRDB scheme. The provisions never applied in the PSS, the CSS or the Military Superannuation Benefit Scheme.

Schedule 5 of the Bill – Amendments in relation to the Government's *Better Super* reforms

31. The Government's *Better Super* reforms generally commence from 1 July 2007. However, these changes do not automatically flow to the CSS and PSS. As a result, the Bill includes amendments to the CSS Act as a consequence of the Government's *Better Super* reforms.

32. The main amendment will ensure the continued payment of employer productivity contributions for a member who cannot make member contributions because they have not provided their tax file number (TFN). This is consistent with the arrangements in the broader community where employer contributions would still be payable even though the member has not provided their TFN. Currently under the CSS Act there is a direct link between the payment of member contributions and employer productivity contributions.

33. The Bill also includes amendments to take account of the payment of amounts from the CSS Fund in relation to release authorities issued by the Commissioner of Taxation and to reflect changed superannuation terminology.

34. Under the *Better Super* reforms, superannuation contributions will be subject to annual caps. Contributions in excess of the relevant caps will be subject to additional tax (excess contributions tax) which can be paid from an interest (other than a defined benefit interest) held in a member's superannuation fund through the provision of a release authority to the fund. Certain amounts held in the CSS are not defined benefit interest for the purpose of the new superannuation reforms and therefore can be subject to a release authority.

35. Under the CSS Act, members are able to pay amounts that come within the term "transferred amount" into the CSS. The term currently includes a reference to an amount that is an eligible termination payment for the purposes of the *Income Tax Assessment Act 1936*. Under the Better Super reforms, this term is being replaced with new terminology. Therefore the Bill makes consequential terminology changes to the relevant provisions of the CSS Act.

36. The *Better Super* reforms generally commence from 1 July 2007. The amendments in relation to the CSS Act may commence between 1 July 2007 and 1 July 2008 depending on the particular amendment.

37. Amendments to the PSS Act are not required as the necessary changes are proposed to be made by a PSS Amending Deed.

Schedule 6 – Defence related changes

38. The Bill contains changes to the DFRDB scheme to ensure consistency with the civilian schemes in relation to the payment of benefits in the case of a post retirement marriage. The Bill also addresses an anomaly in the DFRDB Act in relation to the splitting of superannuation on marriage breakdown.

Reversionary benefits for post-retirement marriages

39. The Bill amends the DFRDB Act to improve access to reversionary benefits in certain circumstances where the pensioner commenced a marital relationship after age 60.

40. Currently, a spouse's pension under the DFRDB Act scheme is generally not payable if the pensioner, who commences a marital relationship after age 60, dies within 5 years of the relationship commencing.

41. To ensure consistency between the military schemes and the civilian schemes, the Bill ensures that a pro-rata rate of the spouse's pension will be payable where the relationship existed for less than 3 years immediately before the pensioner's death, and the full rate of spouse pension is payable after 3 years.

42. These amendments will also apply to the MSBS and the Department of Defence proposes that the necessary changes be made by amending the MSBS Trust Deed and Rules.

Family Law Splitting

43. The Bill will address an anomaly in the Family Law provisions of the DFRDB Act to allow Family Law orders to be applied as intended.

44. The amendments will remove a current anomaly whereby a DFRDB member who is subject to family law superannuation splitting may, in certain limited circumstances, be legally entitled to receive their superannuation benefits as though there was no marriage breakdown and no splitting. The amendments will ensure that both parties to the marriage breakdown in the DFRDB scheme receive the appropriate level of benefits.

45. The Department of Defence can provide further information on these measures concerning the military superannuation schemes.