

Chapter Ten

Application of the Regulations

Introduction

10.1 This chapter examines the application of the portability regulations with respect to:

- a) Defined benefit schemes;
- b) Unfunded public sector superannuation schemes;
- c) Member benefit protection; and
- d) The Queensland Local Government Superannuation Scheme.

Defined benefit schemes

10.2 Under regulation 6.30(2)(c) of the Superannuation Industry (Supervision) Amendment Regulations 2003, it is proposed that portability will not apply:

In respect of a defined benefit component of a superannuation interest in a defined benefit fund, if the member who holds the interest is an employee of an employer-sponsor of the fund.

10.3 The Committee notes that regulation 6.30(2)(c) differs from the draft regulation released on 27 May 2003. The draft regulation stated that portability would not apply:

In respect of a defined benefit component of a superannuation interest in a defined benefit fund, if the member who holds the interest is eligible to contribute to the fund under the governing rules of the fund.

10.4 In its supplementary written submission, Watson Wyatt welcomed the gazetted regulation as redressing the issues it raised in its initial written submission in relation to the draft regulation. Specifically, Watson Wyatt indicated that the gazetted regulation 6.30(2)(c):

- a) Removes the considerable problems that would have been caused if defined benefit entitlements were subject to portability; and

- b) Addresses the inconsistency between exempting contributory defined benefit arrangements and not exempting non-contributory defined benefit arrangements.¹

10.5 The Committee notes that Mr Shallue from IAA also supported the exemption of defined benefit components under the gazetted regulations.²

10.6 However, in its supplementary written submission, Watson Wyatt expressed concern that the gazetted regulations raise a new issue. Watson Wyatt indicated that it is quite common for a defined benefit fund in Australia to have a benefit design that provides:

- a) On resignation prior to the attainment of a specified period of service or age, a benefit that is accumulative in nature (eg. a benefit that is the sum of a member account and a company account, or a benefit that is expressed as a multiple of member account); or
- b) On attainment of the specified period of service or age, a benefit that is defined benefit in nature (eg. a benefit based on a certain factor multiplied by years of service multiplied by average salary).

10.7 Watson Wyatt submitted in its supplementary submission that such interests should be classified as defined benefit components for the purposes of regulation 6.30(2)(c), even where the member's current entitlement is in accumulation form (as outlined in point 'a' above).³ The Committee notes that this issue was also raised by Mr Shallue from IAA in the hearing on 1 August 2003:

There was a minor change to the wording in the regulations yesterday, but on my reading I do not think it addresses the issue that we were trying to get to. ... the difficulty is that a common defined benefit is designed to have a resignation benefit, which might be determined as an accumulation type benefit with a defined salary related benefit on retirement. So a defined benefit component may have a withdrawal benefit that is not defined by reference to salary or one of the other items referred to but it may have a retirement benefit component that is. In our view that would still be a defined benefit component.⁴

Unfunded public sector superannuation schemes

10.8 Regulation 6.30(2)(b) of the Superannuation Industry (Supervision) Amendment Regulations 2003 provides that the regulations do not apply to an

1 *Submission 27*, Watson Wyatt, p. 1.

2 *Committee Hansard*, 1 August 2003, p. 39.

3 *Submission 27*, Watson Wyatt, p. 2.

4 *Committee Hansard*, 1 August 2003, p. 39.

unfunded public sector superannuation scheme. In turn, subregulation 1.03(1) inserts a definition of unfunded public sector superannuation schemes as:

... a regulated superannuation fund that is declared to be an unfunded defined benefits superannuation scheme under regulation 2A of the *Superannuation Contributions Tax (Assessment and Collection) Regulations 1997*.

10.9 In its written submission, the Government Employees Superannuation Board of Western Australia noted that Part 1 of Schedule 1 of the *Superannuation Contributions Tax (Assessment and Collection) Regulations 1997* refers to two Acts in relation to Western Australia:

- a) The *Government Employees Superannuation Act 1987*; and
- b) The *Superannuation and Family Benefits Act 1938*.

10.10 However, the Board noted that both these Acts have been repealed and the schemes established under them continued under the *WA State Superannuation Act 2002*. This amendment is not reflected in the *Superannuation Contributions Tax (Assessment and Collection) Regulations 1997*.

10.11 Accordingly, the Board suggested that the *Superannuation Contributions Tax (Assessment and Collection) Regulations 1997* be amended to reflect current legislative circumstances.⁵

10.12 The Government Employees Superannuation Board of Western Australia also noted the proliferation of definitions in Commonwealth legislation relating to superannuation schemes administered by the states:

- a) The superannuation schemes administered by Western Australia are prescribed as ‘*constitutionally protected funds*’ in the *Income Tax Regulations 1936*, reflecting the limits placed on the Commonwealth’s taxing powers by the Constitution.
- b) Schemes established under Commonwealth, State or Territory Law are referred to as ‘*exempt public sector schemes*’ in Schedule 1AA of the *Superannuation Industry (Supervision) Regulations 1994*, for the purposes of concessional taxation treatment under the *Income Tax Assessment Act 1936*.
- c) As discussed above, the term ‘*unfunded public sector superannuation scheme*’ is used in the *Superannuation Contributions Tax (Assessment and Collection) Regulations 1997* in relation to the assessment and collection of the superannuation surcharge.

5 *Submission 3*, Government Employees Superannuation Board of Western Australia, p. 1.

10.13 Accordingly, the Board suggested that for the purposes of interpreting the application of Commonwealth legislation, and to avoid confusion, the Government should consolidate the terms used to refer to superannuation schemes administered under Commonwealth, State or Territory Law.⁶

Member benefit protection

10.14 Member benefit protection standards aim to prevent small superannuation benefits from being eroded by fees and charges. In general, the standards provide that if a member's withdrawal benefit is less than \$1000, the fund must 'protect' it by limiting any fees and charges. In effect, this is a compulsory cross-subsidisation of members with small accounts by those with larger accounts.

10.15 However, regulation 1.03B(3) of the Superannuation Industry (Supervision) Amendment Regulations 2003 amends the definition of a 'protected member' as follows:

If the trustee of a regulated superannuation fund has rolled over or transferred an amount that is the whole or part of a member's withdrawal benefit to another regulated superannuation fund or to an approved deposit fund, RSA or EPSSS in accordance with Division 6.5, the member is not a protected member of the fund from which the amount was rolled over or transferred.

10.16 As indicated earlier in this report, the gazetted regulations provide that if a member of a superannuation fund wishes to make a partial roll over/transfer (less than their entire withdrawal benefit), the trustee can require the member to leave a balance of up to \$5,000 behind in the fund.

10.17 The Committee notes the evidence of Mr Korchinski from AAS on 31 July 2003 that the new \$5,000 limit has obviated the concerns of AAS in relation to member benefit protection costs. AAS had originally been concerned that members would leave less than \$1,000 in the fund, resulting in a higher member protection cost for the fund.⁷ Similarly, Mr Silk from IFF observed in the hearing on 1 August 2003:

Aside from family law considerations, the requirement for a \$5,000 minimum account balance to be retained would serve to protect the member benefit protection interests of the fund from which the transfer was occurring albeit, depending on the amount of money transferred out of the fund, member benefit protection costs may still be incurred by the fund into which the money is to be transferred.⁸

6 *Submission 3*, Government Employees Superannuation Board of Western Australia, p. 2.

7 *Committee Hansard*, 31 July 2003, p. 57.

8 *Committee Hansard*, 1 August 2003, p. 3.

The Queensland Local Government Superannuation Scheme

10.18 In its supplementary written submission, the Queensland Local Government Superannuation Board, which is trustee of Queensland Local Government Superannuation Scheme (LG Super), noted that under section 1183 of the *Local Government Act 1993* (Qld), all permanent employees of Queensland Local Government must be members of LG Super. They must contribute 6 per cent of their salary to the scheme, while participating employers currently contribute 12 per cent of the member's salary (3 per cent in excess of the SG requirement). LG super has about 21,000 members in an accumulation benefit fund, and about 9,000 members in a defined benefit fund.

10.19 Significantly, the Board indicated that as a scheme to which employers are required by state legislation to contribute at a rate in excess of the SG, the Board understood that LG Super was to be excluded from the operation of the Government's choice of fund legislation. However, under the draft regulations, LG Super's 21,000 members in the accumulation benefit fund would be covered by portability (the 9,000 members in the defined benefit fund are excluded).⁹

10.20 The Committee notes that this was reiterated by Mr Smith from the Queensland Local Government Superannuation Board during the hearing on 31 July 2003. Mr Smith advised that in 1998, the office of the Assistant Treasurer indicated in written advice to the Board that the special circumstances of the fund warranted a specific exclusion from the operation of the proposed choice of fund legislation.¹⁰

10.21 In turn, the Queensland Local Government Superannuation Board raised in its written submission the possibility that under the portability regulations, employers and unions may reconsider the payment of contributions in excess of SG if there is potential for those contributions to be moved to another fund, while presumably incurring costs for LG Super.

10.22 To emphasise this concern, the Queensland Local Government Superannuation Board further cited the findings of a review conducted in 2002 for the National Competition Policy into the potential anti-competitive provisions of the *Local Government Act 1993* (Qld):

During the course of the review, stakeholders expressed strong support for retaining the current arrangements as a means to meet the objectives of the legislation and maximise benefits of the LGSS to its members. Furthermore, stakeholders participating in the consultation process (which included councils, the LGAQ, unions, the Board and Queensland Government Super Office) did not regard the LGA as restricting competition in a way that was detrimental to maximizing benefits to LGSS members.

9 *Submission 7*, Queensland Local Government Superannuation Board, pp. 2-3.

10 *Committee Hansard*, 31 July 2003, p. 42.

In sum, the review found that ... maintaining the status quo has the broad support of stakeholders, has demonstrated net benefits to date and is regarded as the best option for achieving the public interest objective of section 1189(1). (This) option... also supports Queensland's Priority Outcome. The retention of section 1189 (1) is therefore recommended as a result of this review.¹¹

10.23 In the hearing on 31 July 2003, Mr Carpendale from the Queensland Local Government Superannuation Board argued that unless LG Super's 21,000 members in the accumulation benefit fund were excluded from the operation of the portability regime, the fund would face the following issues:

- a) Firstly, an inefficient and disruptive disconnection between what members can do with their accrued benefits under the portability regulations, and what they can do with their ongoing contributions under the proposed choice of fund regime.
- b) Secondly, the economies of scale achieved by LG Super to the advantage of scheme members would be eroded by the one-way impact of portability on the scheme. Existing moneys could be rolled over/transferred out of the scheme, but state legislative restrictions would prevent replacement funds from flowing back in via new membership groups.
- c) Thirdly, the at-call nature of members' accrued entitlements would force the board to abandon its growth-oriented investment strategy combined with crediting-rate smoothing as a default option for active accumulation benefit members, resulting in an earnings loss of up to one per cent per annum.¹²

10.24 The Committee notes in particular that Queensland Local Government Super is in a unique position through its proposed exclusion from choice of superannuation (should it be introduced) while potentially being simultaneously subject to the portability regime. In addition, the fund's membership is restricted by State legislation, meaning that it cannot seek new members under a portability regime.¹³

10.25 In its supplementary written submission, the Queensland Local Government Superannuation Board indicated that the gazetted regulations do not make any material difference to the substance of the Board's concerns outlined above. Accordingly, the Board requested the exclusion of Queensland Local Government Super from the provisions of the portability regulations through an amendment to

11 *Submission 7*, Queensland Local Government Superannuation Board, pp. 2-3.

12 *Committee Hansard*, 31 July 2003, p. 44

13 *Committee Hansard*, 31 July 2003, p. 44.

regulation 6.30(2) of the Superannuation Industry (Supervision) Amendment Regulations 2003 (ie. funds to which the Division does not apply).¹⁴

14 *Submission 28, Queensland Local Government Superannuation Board, p. 2.*