ATTN: SUE
SPGC

Minister for Finance and Administration

SENATOR THE HON NICK MINCHIN

Senator John Watson
Chair
Senate Select Committee on Superannuation
Parliament House
CANBERRA ACT 2600

11 DEC 2002

Dear John

I am writing to provide you with a copy of the Government's response to the recommendations arising from the inquiry by the Senate Select Committee on Superannuation and Financial Services into the benefit design of the Commonwealth unfunded civilian and defence force superannuation schemes.

The response is attached for your information. I have also provided copies to the Assistant Treasurer and the Minister Assisting the Minister for Defence.

Yours sincerely

Nick Minchin

presented to President 13/12/02

Government response to the Senate Select Committee on Superannuation and Financial Services in relation to their report *A 'Reasonable and Secure' Retirement?*

Recommendations of the Majority Report

Recommendation 1

The Committee recommends that the Government examine the feasibility of adopting an indexation method other than the Consumer Price Index (CPI) for Commonwealth public sector and defence force superannuation schemes, to more adequately reflect the actual increases in the cost of living.

Government response

The use of the Consumer Price Index as an index for the Commonwealth civilian and defence force superannuation schemes, including for the indexation of pensions from those schemes, needs to be considered in the context of the overall benefit design and cost of the schemes. In this regard the Government understands that the use of CPI to update pensions is consistent with arrangements that State and Territory Governments have for indexing superannuation pensions from their main superannuation schemes.

In the CSS and the PSS the cost to the Commonwealth of providing superannuation benefits varies depending on individual member's circumstances. However, the Commonwealth like other employers has to provide employer contributions no less than the minimum superannuation guarantee rate of 9%. The 1999 PSS and CSS Long Term Cost Report estimated the PSS and CSS notional average employer contribution rates as 14.2% and 21.9% of superannuation salaries respectively. Similarly, the 1999 DFRDB scheme and MSBS Long Term Cost Report estimated the DFRDB scheme and MSBS notional average employer contribution rates as 33.0% and 22.3% of superannuation salaries respectively.

A change to another indexation method would have a considerable financial impact. For example, moving to an Average Weekly Ordinary Times Earning (AWOTE) index for the Commonwealth civilian superannuation schemes, for both pensions and preserved benefits, would increase the notional average employer contribution rates of the PSS and the CSS to 16.5% and 25.6% of superannuation salaries respectively. Also, as indicated by the Department of Finance and Administration's responses to the Committee, it would increase unfunded liabilities by around $6.9 billion and worsen the Budget fiscal balance by around $600 million per annum.

Again, the impact on the defence force superannuation schemes is similar. The notional average employer contribution rates for the DFRDB scheme and MSBS would increase to 41.4% and 29.3% of superannuation salaries respectively. The increase in unfunded liability would be around $6 billion and worsen the Budget fiscal balance by around $500 million per annum.

The initial underlying cash balance impact, while smaller, would grow over time due to the compounding effect of higher indexation.

A change in the scheme costs and expenses of this magnitude would need to be assessed against other policy priorities, in the context of scarce budgetary resources and the need to ensure equity across the community.

However, the Government understands that the Commonwealth's superannuation schemes should make an equitable and appropriate contribution to the retirement living standards of Commonwealth employees and members of the defence force and will continue to monitor the schemes to ensure they meet retirement income objectives.

Recommendation 2

The Committee recommends that the Government immediately introduce a bi-annual adjustment of the CPI, which should flow through to Commonwealth public sector and defence force pensions to ameliorate the effects of the current 'indexation lag'.

Government response

The Government announced in the 2001-2002 Budget new arrangements for indexation of Commonwealth civilian superannuation indexed pensions.

The *Superannuation Legislation Amendment (Indexation) Act 2001* was passed in September 2001 and changes to the PSS Trust Deed were made in September 2001 to ensure that from January 2002 these pensions, and those paid to former members of the defence force, would be indexed twice yearly. Since January 2002 these pensions are to be adjusted in January and July each year by the upward movement in the CPI for the preceding six month period ending in the preceding September and March quarters respectively. These changes were also made to the Papua New Guinea (Staffing Assistance) (Superannuation) Regulations in respect of former employees of the Papua New Guinea Administration.

This initiative will help reduce the delay between price increases and compensatory adjustments to the superannuation pensions while also increasing each superannuant's purchasing power.

Recommendation 3

The Committee recommends that, for equity reasons, the changes made to Commonwealth public sector schemes proposed in this report also apply to State public sector schemes, where appropriate.

Government response

As the individual State Governments are responsible for the superannuation arrangements for their employees it would be a matter for those Governments to consider this issue.

Recommendation 4

The Committee recommends that the Productivity Commission, in its review of the Superannuation Industry (Supervision) Act 1993 and related superannuation legislation, should be mindful of the Act's intention of ensuring that, within a sound prudential framework, superannuation fulfils its role as the preferred savings mechanism by which Australians provide for their retirement.

Government response

The Productivity Commission issued its report, entitled *'Review of the Superannuation Industry (Supervision) Act 1993 and Certain Other Superannuation Legislation'* on 10 December 2001. The Government issued an interim response on 17 April 2002.

The Commission took into account the role of superannuation as the preferred savings mechanism by which Australians provide for their retirement and indicated this in several places throughout the Report. In the Overview section of the report (page xvi), the Productivity Commission states:

> "While superannuation saving has grown, there has been little change in total household saving. Superannuation appears to have displaced other forms of saving by households and been accompanied by increased household wealth and higher borrowing."

Furthermore, on page 2 of the Report, under the heading, 'Legislation under review', the PC states:

> "The major legislation under review is the SIS Act. Its overarching purpose is to contribute to the Government's retirement incomes policy by providing the regulatory framework for the prudent management of superannuation entities and for their supervision by the Australian Prudential Regulation Authority (APRA), Australian Securities and Investments Commission (ASIC) and the ATO."

Recommendations of the Minority Report

Recommendation 1

- *That the unfunded employer component of preserved benefits should be credited at the fund's crediting rate effective from 1 July 2001, but not retrospectively.*
- *That the Commonwealth should consider means of improving the portability of public sector superannuation schemes over time by fully funding employer contributions as they fall due and allowing full portability of such a component.*

Government response

Any changes to the indexation of PSS preserved benefits and portability of such benefits would require consideration of the effect on the PSS scheme costs as well as the Budget. For example:

- indexing at the PSS Fund crediting rate would increase the notional average employer contribution rate of the PSS from 14.2% to 15.7% of superannuation salaries. It would also increase PSS unfunded liabilities by around $0.9 billion;
- if all existing preserved members and members who exit the PSS in the future prior to age 55 were able to rollover their PSS preserved employer financed benefits to another fund, the PSS unfunded liabilities would increase by $0.6 billion and the PSS notional average employer contribution rate would increase from 14.2% to 15.1% of superannuation salaries.

Fully funding employer contributions as they fall due would involve ongoing payments in the order of $700m a year.

Changes in the scheme costs and the impact on the Budget would need to be assessed against other policy priorities, in the context of scarce budgetary resources and the need to ensure equity across the community.

The Government is already seeking to address, particularly for new employees, the lack of portability inherent in the current Commonwealth civilian superannuation arrangements. The superannuation Bills rejected by the Senate in August 2001, that proposed closure of the PSS and allowing CSS and PSS members to leave their scheme, would have addressed this issue. The changes proposed by the Bills were designed to provide Commonwealth civilian employees with more flexible superannuation arrangements therefore giving them the opportunity to seek fund earnings based returns and improved portability in relation to their future superannuation contributions. Also under these proposals the Government has proposed to fund future accruals for new employees and those who choose to leave the CSS or the PSS. The Budget impact of this proposal is already factored into the estimates for the Budget forward years.

The proposed new arrangements will not, however, allow former Commonwealth employees with PSS preserved employer benefits to transfer those benefits into another superannuation scheme because this would have a significant impact on scheme and Budget costs.

Recommendation 2

That public sector superannuation pensions be indexed quarterly to movements in the CPI, and investigations be conducted on identifying an index that better reflects the cost of living of aged pensioners.

Government response

The Government has considered the issue of the frequency of indexation of Commonwealth civilian superannuation indexed pensions, as well as those paid to former members of the Defence Force, and has decided that twice yearly indexation is appropriate. Age pensions are indexed twice yearly as are pensions paid to former State employees by Victoria, South Australia, Western Australia and Tasmania.

The response to Recommendation 1 of the Committee's majority report addresses the matter of identifying a different index.