# Defence Force Retirement and Death Benefits Amendment (Fair Indexation) Bill 2010 and related matters

## INTRODUCTION

1.1 On 24 March 2011, the Senate agreed to amendments to the motion that the Defence Force Retirement and Death Benefits Amendment (Fair Indexation) Bill 2010 (the bill) be read a second time to refer the bill, together with the amendments circulated by Senator the Hon Michael Ronaldson on sheet 7027, and proposed mechanisms for funding the bill, to the Finance and Public Administration Legislation Committee for inquiry and report by 10 May 2011.

### Conduct of the inquiry

1.2 The committee advertised the inquiry on the Internet and in *The Australian* and invited submissions from interested organisations and individuals. The committee received 16 public submissions. The list of public submissions received together with other information authorised for publication is at Appendix 1. Submissions can be accessed through the committee's website at: http://www.aph.gov.au/senate/committee/fapa_ctte/index.htm. The committee agreed not to hold a public hearing for this inquiry.

1.3 The committee received a supplementary submission from the Alliance of Defence Service Organisations (ADSO) which commented on matters in relation to the Department of Finance and Deregulation (Finance) submission and noted that it had been provided after the closing date for the receipt of submissions. The ADSO further stated that 'this late submission from DoFD, intrudes into the political arena'. The receipt of submissions after the due date is not an uncommon occurrence and organisations and individuals are often granted extensions of time to provide submissions. This occurred with the Finance submission. In addition, the Finance submission was provided in ample time for consideration by the committee during its deliberations. The committee further considers that the Finance submission provided information directly relevant to the committee's inquiry.

## THE BILL AND AMENDMENTS CIRCULATED

1.4 The bill was introduced in the Senate by Senator Ronaldson on 18 November 2010 to change the indexation methodology applied to the military superannuation pensions of eligible members of the Defence Force Retirement and Death Benefits (DFRDB) Scheme. Amendments circulated on sheet 7027 proposed the same change for eligible members of the Defence Forces Retirement Benefits (DFRB) Scheme. The change in the indexation methodology is to 'recognise the unique nature of military service and the need for a fair, equitable and fiscally-responsible military superannuation system'.[1]

1.5 Currently, the twice yearly indexation of pensions paid under the DFRDB Scheme and the DFRB Scheme is based on the consumer price index (CPI). The bill proposes that from 1 July 2011, pensions paid to DFRDB and DFRB superannuants, aged 55 and over, will be indexed in the same way as other Australian Government income support pensions are indexed. The bill proposes that, in line with present practice and using the pre-determined 'pension MBR factor',[2] DFRDB and DFRB pensions will be indexed to the higher of the CPI, Male Total Average Weekly Earnings (MTAWE) or the Pensioner and Beneficiary Living Cost Index (PBLCI).

1.6 Senator Ronaldson commented that:

> The measures in this Bill will ensure that over 56,000 retired Australian Defence Force personnel who are members of the now closed DFRDB and DFRB schemes have their superannuation pensions indexed more fairly and in a manner which better reflects changes in the costs of living.[3]

### *Provisions*

1.7 The bill and amendments propose that new definitions of LCI and LCI number be inserted into the DFRDB Act (section 98A) and the DFRB Act (section 83). The LCI means the Pensioner and Beneficiary Living Cost Index. This measure is produced by the Australian Bureau of Statistics and is an additional measure for assessing cost of living pressures. The LCI number is defined in accordance with the quarterly publication of the LCI number by the Australian Statistician.

1.8 The bill and amendments also propose to insert new sections 98AB, 98BB and 98BC in the DFRDB Act and new sections 84AA, 84AB and 84AC in the DFRB Act. The effect of these provisions is as follows:

- proposed sections 98AB and 84AA apply to a pensioner who is 55 years of age or older and provides for the DFRDB and DFRB pensions to be indexed at the higher of the CPI, pension MBR method or LCI;
- proposed sections 98BB and 84AB provide for the single pension MBR amount to reflect the changes in MTAWE; and

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1 Defence Force Retirement and Death Benefits Amendment (Fair Indexation) Bill 2010, clause 3.

2 The 'pension MBR factor' is the measure used to determine increases in Australian Government income support pensions, including the Service Pension. The formula is contained in the *Veterans' Entitlement Act 1986* and determined in accordance with statistics provided by the Australian Statistician.

3 Senator the Hon Michael Ronaldson, *Senate Hansard*, 18 November 2010, p. 1569.

- proposed sections 98BC and 84AC provide for the indexing of DFRDB and DFRB pensions if the LCI method is found to be the highest of the three applicable indices.

### *Financial impact*

1.9 It is stated in the Explanatory Memorandum that the amendments proposed are estimated to cost $98 million over the forward estimates. It was further stated that 'ongoing costs associated with the introduction of this bill can be met through the accrued funds of the Future Fund. This additional commitment is entirely affordable in the long-term.'[4]

## BACKGROUND

1.10 The DFRB Scheme was established in 1948 and closed to new members in 1972. As at 30 June 2010, the DFRB Scheme had no contributing members and 3,978 members receiving pensions. The DFRDB Scheme closed to new members in 1990 and as at 30 June 2010 had 4,246 contributing members and 53,003 members receiving pensions. The Military Superannuation and Benefits Scheme (MSBS) is currently open and 54,525 members contribute to the scheme.

1.11 The indexation of the DFRDB and DRFB pensions has been examined a number of times. In 1972, the Joint Select Committee on Defence Force Retirement Benefits Legislation (Jess Review) concluded that the most appropriate method of maintaining the real value of retired pay was to ensure it maintained its relativity with average weekly earnings.[5] In 2000, the matter was considered again by the Senate Select Committee on Superannuation and Financial Services. The Select Committee concluded, in relation to indexation, that the CPI alone, as a measure of inflation, may not be the best method to adjust the value of Commonwealth public sector and defence force benefits, if parity with living standards in the community is to be maintained. The Select Committee went on to recommend that the Government examine the feasibility of adopting an indexation method other than the CPI for Commonwealth public sector and defence force superannuation schemes, to more adequately reflect the actual increases in the cost of living.[6]

1.12 A further review of military superannuation (Podger review) was undertaken in 2007. The review made two recommendations in relation to indexation of military superannuation:

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4 Explanatory Memorandum, p. 1.

5 Joint Select Committee on Defence Force Retirement Benefits Legislation, *Report*, May 1972.

6 Select Committee on Superannuation and Financial Services, *A 'Reasonable and Secure' Retirement?: The benefit design of Commonwealth public sector and defence force unfunded superannuation funds and schemes*, April 2001, p. 44.

- that, 'if the Government is willing to go beyond the envelope of current costs', consideration should be given to indexing DFRDB/DFRB pensions for those over 55 years on a similar basis to that applying to the age pension; and
- that there be no change to the MSBS pension indexation arrangements.

1.13 The most recent Government initiated review of Australian Government superannuation pensions was undertaken by Mr Trevor Matthews. The review recommended that the indexation of military superannuation payments should continue to be based on the CPI. The Government supported this recommendation. The then Minister for Finance and Deregulation, the Hon Lindsay Tanner, stated:

> ...we are satisfied that the CPI is the most suitable index to protect Australian Government superannuation pensions against inflationary price increases available at this time.
>
> It is also in line with the indexation of most other similar pensions in Australia, including all equivalent State Government schemes.
>
> A change to the indexation of these pensions therefore is not warranted, especially as it would come at a significant cost to the taxpayers. It would also be inequitable for superannuants who previously chose to take their superannuation in a lump sum.[7]

## ISSUES

1.14 Submissions from individuals and non-government organisations supported the bill's proposal to index military superannuation to the greater of the CPI, MTAWE or PBCLI. The difference in performance between military superannuation pensions and other government pensions such as the age, disability and War Widows pensions was noted. Submissions also argued that there are significant reasons why military pensions should be indexed in a more favourable way.

### Indexation of military superannuation

1.15 Submitters argued that as a result of indexation based on the CPI, over time defence superannuation pensions will be eroded to an amount that will no longer sustain pensioners.[8] Mr Bernard Nebenfuhr stated:

> If the present form of CPI indexation of pensions were to continue, I am quite convinced that over time, the pension on which I and many other loyal and long serving ex-service men and women of Australia will rely on

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7 Minister for Finance and Deregulation, the Hon Lindsay Tanner, MP, *Media Release*, 'Indexation of Australian Government Civilian and Military Superannuation pensions', 21 August 2009.

8 Mr B Nebenfuhr, *Submission 2*, p. 1; Mr P Thomas, *Submission* 3, p. 1; Returned and Services League of Australia, *Submission* 5, p. 3;Vietnam Veterans Association of Australia, *Submission 9*, p. 1; Wing Commander Paul Johnson, *Submission 10*, p. 2.

> almost exclusively during retirement, will be eroded to an amount that will barely sustain us.[9]

1.16 It was also noted that the average military service pension is less than the age pension but does not include the extra entitlements associated with the age pension.[10]

1.17 Submitters also commented that the age pension, single parents pension and other welfare payments are indexed by the CPI or MTAWE whichever is higher.[11] The Vietnam Veterans Association of Australia (Queensland Branch), concluded:

> Defence Force Superannuates, who have made an important contribution to the quality of life enjoyed by this country, are falling behind in their retired incomes that are the basis of their standard of living and quality of life. If average weekly earnings are increasing at a faster rate than the CPI then those whose income is tied to the CPI will be left behind in the quality of life they can afford.[12]

1.18 The Returned and Services League of Australia (RSL) noted that CPI is a measure of inflation and is not designed to measure cost of living increases.[13] The RSL commented that many military superannuants had been forced to seek welfare assistance and stated:

> ...indexation of their military superannuation pensions has been so inadequate for so long that the decline in purchasing power of their superannuation payments have forced them into applying for funds provided under the nation's safety net for the needy.[14]

1.19 The RSL also pointed to the reviews which had supported a change in the method of indexation of military superannuation. In relation to the Matthew's Review, the RSL stated that the review did not separately examine indexation of military superannuation schemes; accepted the notion of 'productivity' in relation to the defence force when it has no relevance to the service rendered by the ADF; there was a less than objective examination of the impact of a more generous form of indexation on those who elect to take superannuation entitlements as a lump sum; and rejected the evidence that indexation based on the CPI is inequitable as it fails to match increases in the cost of living was rejected.[15]

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9 Mr B Nebenfuhr, *Submission 2*, p. 1.

10 Australian Veterans and Defence Services Council, *Submission 11*, p. 4; Mr P Johnson, *Submission 10*, p. 2;

11 Vietnam Veterans Association of Australia (Queensland Branch), *Submission 9*, p. 1; Australian Veterans and Defence Services Council, *Submission 11*, p. 2.

12 Vietnam Veterans Association of Australia (Queensland Branch), *Submission 9*, p. 2.

13 Returned and Services League of Australia, *Submission* 5, pp 4–5; see also Alliance of Defence Service Organisations, *Submission 7*, p. 1..

14 Returned and Services League of Australia, *Submission* 5, p. 16.

15 Returned and Services League of Australia, *Submission* 5, pp 12–14.

1.20 In addition, the Alliance of Defence Service Organisations (ADSO) argued that over the years the CPI has changed: in the 1980s the CPI methodology changed; and the nexus between movement in the CPI and wage and salary adjustments no longer exist. The ADSO thus concluded that changes made to the CPI since the late 1980s have failed to protect and maintain the purchasing power of retired military pension recipients from erosion over time.[16]

1.21 The committee was provided with analysis of the impact of the different basis of indexation of military pensions. The Vietnam Veterans Association of Australia (Queensland Branch) stated that a military pension of $20,000 in 1990, which had been indexed using the greater of cost of living or average wage over the last 21 years, would be some $11,463 higher now than under the current indexation regime.[17]

1.22 Both the Department of Finance and Deregulation (Finance) and Department of Defence (Defence) commented on the use of the CPI as the basis of indexation for military superannuation pensions. Finance and Defence noted the recommendation of the Matthews review that pensions for Australian Government civilian and military superannuation schemes should continue to be indexed by the CPI. It was also noted that the Matthews review also considered that the unique nature of military service would be more appropriately addressed through specific benefit design features of the military superannuation schemes rather than through indexation.[18]

1.23 Finance also commented that the AGA's advice to Defence indicated that the bill would provide for better indexation arrangements than currently apply to the Age and Service Pensions. Finance went on to state that the age pension and superannuation benefits are not comparable: superannuation is an employment benefit while the age pension is a safety net benefit to ensure that Australians receive a minimum level of income in retirement.[19] Indexation by reference to MTAWE was also not supported as it was noted that the Matthews review found that the purpose of indexing military superannuation pensions was to take account of inflationary price increases. Indexation by MTAWE would provide pensioners with a share of productivity increases.[20]

## Reasons for improvement in pension indexation

1.24 Submitters pointed to a number of factors which they argued supported a change in the indexation method of military pensions.

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16 Alliance of Defence Service Organisations, *Submission 7*, p. 7.

17 Vietnam Veterans Association of Australia (Queensland Branch), *Submission 9*, p. 2; see also Wing Commander Paul Johnson, *Submission 10*, pp 1–2.

18 Department of Defence, *Submission 15*, p. 3; Department of Finance and Deregulation, *Submission 14*, p. 4.

19 Department of Finance and Deregulation, *Submission 14*, p. 4.

20 Department of Finance and Deregulation, *Submission 14*, p. 5.

1.25 The RSL submitted that the separateness of the Australian Defence Forces (ADF) has been recognised since Federation through legislation, including superannuation legislation, and in other areas such as the Australian Honours system. The RSL argued that 'given these facts it is difficult to understand why successive Governments have sought to align the indexation of military superannuation payments with the indexation of superannuation for former Commonwealth employees'.[21] The RSL went on to note that the Parliament had introduced legislation to provide specifically for the ADF and concluded that:

> By these actions the Parliament has made clear that superannuation for members of the nation's armed forces cannot be provided by superannuation schemes enacted for Commonwealth public servants, police, fire fighters or others paid by the Commonwealth Government regardless of whether some of these civilian occupations entail exposure to danger as part of their employment.[22]

1.26 Other submitters also argued that there were specific reasons why DFRB and DFRDB pensions should be indexed more favourably. The ADSO pointed to the unique nature of military service and stated that it 'deserves unique solutions and also places a great burden on the Government as the "employer" to ensure that ADF members are looked after both during and after Service'.[23]

1.27 The Vietnam Veterans' Federation commented that members of the ADF have suffered conditions of service far less favourable than civilians including:

- liability for compulsory high risk combat operations;
- a restriction of liberty in a regimented way of life;
- compulsory long and irregular working hours;
- compulsory statutory retiring ages well below the community norms;
- compulsory high standards of physical fitness;
- frequent compulsory relocation causing schooling and network dislocation; and
- long periods of compulsory separation from family.[24]

1.28 Other submitters noted that very few spouses had careers which contributed to the superannuation benefits of the couple. In some cases, posting cycles prevented continuation of careers of spouses and thus had affected the spouse's superannuation adversely.[25]

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21 Returned and Services League of Australia, *Submission* 5, p. 5.

22 Returned and Services League of Australia, *Submission* 5, p. 6.

23 Alliance of Defence Service Organisations, *Submission 7*, p. 1.

24 Vietnam Veterans' Federation, *Submission 1*, p. 1.

25 Australian Veterans and Defence Services Council, *Submission 11*, p. 3.

1.29 The Australian Veterans and Defence Services Council also noted its research indicated that NCOs, many of whom receive less than $25,000 per annum in superannuation, have difficulty in finding steady employment after discharge to supplement their military pension.[26]

1.30 An additional matter raised by a number of submitters was that defence salaries have risen significantly over the last two decades and are now more in line with civilian salaries. However, for those who retired during the 1970s and 1980s, the pension is based on lower salaries. The lower pension salary, together with lower rate of indexation, has resulted in many of those on military pensions have had to rely on Centrelink support payments.[27]

1.31 Defence responded to these comments and noted that, in addition to superannuation, other remuneration and conditions are available to the ADF. These include service allowance, other salary related and disability related allowances, overseas and locality allowances, ADF specific leave and housing and removals that reflect the special nature of military service. In addition, there are specific health, family support and compensation arrangements for the ADF.[28]

1.32 Finance also noted that there are a number of mechanisms whereby the unique nature of military service is reflected in critical differences between military and civilian superannuation schemes. These include:

- higher employer contribution rates and death and disability arrangements;
- provision of a guaranteed lifetime level of income and indexation to DFRDB pensioners which are not generally available in the wider community. Additionally, DFRDB pensions are not affected by downturns in the economy, such as occurred during the global financial crisis; and
- after 20 years service (at any age) a member of the DFRDB is entitled to a guaranteed lifetime indexed pension set at 35 per cent of superannuation salary. After 30 years service the member is entitled to a guaranteed lifetime indexed pension of 51.25 per cent of superannuation salary even if the former member returns to the workforce.

1.33 Finance went on to note that the provision of an indexed lifetime pension as part of any remuneration package is available to only a limited number of Australian employees, mainly members of Australian Government and State Government defined benefit superannuation schemes that are now closed. The Matthews review found that in the few circumstances where employees receive indexed pensions, these are indexed by CPI increases in nearly all cases. Some, very few, schemes index pensions to wage increases.

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26 Australian Veterans and Defence Services Council, *Submission 11,* pp 3–4.

27 Australian Veterans and Defence Services Council, *Submission 11,* p. 4.

28 Department of Defence, *Submission 15,* p. 5.

1.34 Finance commented that a person's terms and conditions of ADF service result in a rate of employer superannuation contribution in respect of the DFRDB that is generous in comparison to the MSBS, the civilian superannuation schemes and the minimum rate of 9 per cent required under the Superannuation Guarantee arrangements. The employer contribution rate for the DFRDB is 33.4 per cent of superannuation salary; this is more that the Commonwealth Superannuation Scheme (21.4 per cent) and significantly more than the Public Sector Superannuation Accumulation Plan (15.4 per cent). If the bill is passed, the employer contribution for the DFRDB would increase to 40.6 per cent of superannuation salary.[29]

## Application to pensioners over 55 years of age

1.35 The Injured Service Persons Association commented on the application of the bill to pensioners aged over 55 years. The Association stated that 'those who are medically discharged onto an invalidity pension should be financially disadvantaged for the rest of their lives by having their main source of income only indexed to one standard'. The Association went on to state that:

> ...to continue with this so called "fair indexation" amendment bill will be a slap in the face of those who at young ages are restricted in future earnings with no prospect of building a large retirement fund…A soldier aged 24 who is unfortunately discharged invalidity Class A pension in limited for the rest of his financial life whilst his peers progress through their military careers with the ability to increase personal wealth.[30]

1.36 The Association called on any amendments to military superannuation indexation include DFRDB and MSBS Invalidity Pensions.[31]

1.37 The Australian Veterans and Defence Services Council also noted that the bill only applies to those veterans over 55 years. The Council acknowledged that the bill was 'a start', however it would not overcome the financial problems of all veterans.[32]

1.38 Finance commented on the restriction of the bill to those over 55 years of age and stated that it is not clear that there is a superannuation policy rationale for changing the 'employer and employee relationships' for one group of Commonwealth scheme members compared with others. In addition, the bulk of current serving members contribute to the MSBS Scheme and not the DFRDB Scheme.[33]

29 Department of Finance and Deregulation, *Submission14*, pp 2-3.

30 Injured Service Persons Association, *Submission 12*, pp 23.

31 Injured Service Persons Association, *Submission 12*, p. 5.

32 Australian Veterans and Defence Services Council, *Submission 11*, p. 5.

33 Department of Finance, *Submission 14*, p. 3.

## Cost of the change in indexation

1.39 The cost of the proposed change to indexation was canvassed extensively in submissions. The RSL acknowledged that there would be an increased cost to the taxpayer should the proposed bill be passed. However, the RSL argued that a change to indexation may result in fewer military superannuants needing to access Centrelink payments. The RSL also stated that a less tangible but prospectively more substantial financial offset is possible by streamlining the process experienced by some former members of the ADF as they seek settlement of contested benefits during their transition from the ADF to civilian status.[34] In addition, the RSL noted that there would be benefits for recruitment as the ADF has experienced great difficulty in retaining trained and experienced personnel. One of the disincentives to continued service was a perception amongst serving members that the military superannuation benefits on offer after leaving the ADF after a long period of service were less than reasonable.[35]

1.40 The ADSO commented on the Government's costing of alternative indexation arrangements for Commonwealth superannuation pensions and argued that they were exaggerated in the following areas:

- assuming an unfunded liability investment return of 6.0 per cent, which has no recognition of the existence of the Future Fund and the expected higher investment returns on the assets held in the Future Fund in support of the superannuation liabilities;
- assuming the increased rate of indexation (relative to current level of indexation) is 1.5 per cent – this rate appears to reflect short term experience more than expected long term experience in the respective indices, and yet it is applied for 40 plus years into the future with significant compounding effects on the cost; and
- quoting costs gross of the impacts of clawback, despite acknowledging a clawback effect in the order of 30 per cent.[36]

1.41 The ADSO concluded that by taking all of these matters into account, the estimated costs of alternative indexation could be reduced by as much as 50 per cent (20 per cent for investment return and 30 per cent for clawback effect).[37] As a result, the ADSO submitted that:

> Implementation of the community standard of indexation, as adopted for the Age and Service pensions applied to all components of DFRB/DFRDB/MSBS military superannuation pensions, including the total reversionary pension for partners of deceased military superannuation

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34 Returned and Services League of Australia, *Submission* 5, pp 16–17.

35 Returned and Services League of Australia, *Submission* 5, p. 18.

36 Alliance of Defence Service Organisations, *Submission 7*, p. 2; see also pp 9–10.

37 Alliance of Defence Service Organisations, *Submission 7*, p. 2.

pensioners and preserved employer benefits, is estimated not to exceed $16M in FY 2011–2012 and an additional $176M over the forward estimate period before any clawback.[38]

1.42 The ADSO considered that funding of the change to the indexation method could be provided by the Future Fund.[39]

1.43 The submission of Mr Peter Thornton estimated that changing the indexation of military superannuation from CPI to MTAWE would cost $302 million over the next 10 years.[40] However, Mr Thornton's analysis estimated that this cost could be reduced by $82 million to $220 million, if a one off lump sum appropriation of $220 million from the Future Fund was made and transferred to ARIA. This appropriation could be drawn down by Comsuper to pay for the additional pension increases under new indexation.[41]

1.44 Finance and Defence provided the committee with costings of the proposed bill by the Australian Government Actuary (AGA). The AGA estimated the bill would have an immediate increase in the Government's unfunded superannuation liability of $6.2 billion.[42] This would worsen the Government's balance sheet. The fiscal impact is $1,667 million and the cash impact is $175 million over the forward estimates. These cash costs would increase significantly in the years beyond the forward estimates. For example, it increases from $33 million in 2012–13, to $235 million in 2020–21 and to $503 million by 2028–29 in nominal terms.[43] The AGA's costings complied with Australian actuary standards and were verified by an independent actuary.

1.45 Finance noted the Government's commitment to fiscal responsibility, including returning the Budget to surplus by 2012–13. This requires all new proposals to be offset by savings over the forward estimates. Under the Budget Rules, offsetting savings require a decision to reduce expenses below what they would otherwise have been. This would not include second round economic effects, or indirect flow-on effects, because of the difficulties inherent in quantifying such effects. Against these policy settings, Finance commented that a proposal with longer term costs, such as those contained in the bill, would require structural savings elsewhere in the budget in order to meet the objective of delivering budget surpluses, on average, over the life of the economic cycle.

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38 Alliance of Defence Service Organisations, *Submission 7*, p. 10.

39 Alliance of Defence Service Organisations, *Submission 7*, pp 10–11.

40 Mr Peter Thornton, *Submission 6*, p. 3.

41 Mr Peter Thornton, *Submission 6*, p. 4.

42 The Australian Government Actuary's full costing is available on the Finance website at http://www.finance.gov.au/superannuation/DFRDBLetter.html

43 Department of Defence, *Submission 15*, p. 3; Department of Finance and Deregulation, *Submission 14*, p.

1.46 In addition, Finance argued that if the bill were passed, pressure would arise from other groups to be treated in a similar way. This would result in financial implications for the Commonwealth budget and increasing disparity between some Commonwealth superannuation beneficiaries and the broader community.[44]

1.47 It is stated in the Explanatory Memorandum that the ongoing costs for the proposed change can be met through the Future Fund. In response, Finance stated that the Government established the Future Fund 'to help meet unfunded superannuation liabilities that will become payable during a period when an ageing population is likely to place significant pressure on Commonwealth finances'. Finance added that withdrawals from the Future Fund to pay superannuation benefits may only occur once the superannuation liability is fully offset or from 1 July 2020, whichever is earlier. For this purpose a target asset level is calculated by a Designated Actuary (currently the AGA) and represents the assets of the Future Fund that would be required to offset the unfunded superannuation liability at the same point in time. The AGA estimated the target asset level for the Future Fund at $103.2 billion for 2010-11. As at 31 December 2010, the Future Fund had assets of approximately $72 billion. Finance concluded that the impact of the bill would be to exacerbate this gap.[45]

1.48 In relation to the Department of Defence budget, it was stated that any change in indexation arrangements would result in 'an additional pressure on the Defence budget as no funding is currently provisioned in the budget for such a change, which will need to be offset from existing program outcomes'.[46] Defence went on to state that arguments to meet the cost of the change to indexation through a reduction in the growth of Australian Public Service (APS) employees in the Department of Defence 'would require further efficiencies to be found within Defence to enable delivery of ongoing programs'. Instead of the purported growth of 12.6 per cent in APS employees used during debate on the Bill, the growth rate will only be 9.4 per cent by the end of 2013–14.[47]

1.49 Defence concluded:

> Both the Defence Force Retirement and Death Benefits scheme and the Military Superannuation and Benefits Scheme already provide benefits well in excess of the community standard...The Actuary has advised that under the Bill, Defence's notional employer contributions for the Defence Force Retirement and Death Benefits scheme would increase to 40.6 per cent, increasing Defence's contribution by $18.7 million in the first year, but decreasing over time. This is a further direct cost on the Defence budget.

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44 Department of Finance and Deregulation, *Submission 14,* p. 3.

45 Department of Finance and Deregulation, *Submission 14,* p. *5.*

46 Department of Defence, *Submission 15,* p. 4.

47 Department of Defence, *Submission 15,* p. 4.

> Further offsets would need to be identified in addition to any found to cover the underlying cash impacts to government.[48]

## Conclusion

1.50 The committee does not support the proposed change to the indexation of military superannuation. The committee considers that the unique nature of military service is adequately reflected through mechanisms both during and post service. During their period of service, members of the ADF have access to service allowances, other salary related and disability allowances, ADF specific leave, housing, health, family support and compensation arrangements. The employer superannuation contribution rate during the service period is also higher than other government employees: for the DFRDB is it 33.4 per cent compared with the CSS rate of 21.4 per cent. Post service, DFRDB pensions provide a guaranteed lifetime level of income and indexation which is generally not available in the wider community. In addition, the index pension is available, at any age, after 20 years of service.

1.51 The impact on both the Government's fiscal position and the Department of Defence's ability to deliver ongoing programs is significant and cannot be denied. Calls for the changes proposed by the bill to be funded from the Future Fund do not recognise that there is a gap between the target level of assets required in the Future Fund and the assets of the Fund. This gap will be exacerbated if the bill is passed. The committee therefore considers that the bill should not be passed.

**Recommendation 1**

**1.52 The committee recommends that the Defence Force Retirement and Death Benefits Amendment (Fair Indexation) Bill 2010, and the amendments on sheet 7027, not be passed.**

**Senator Helen Polley**
**Chair**

48 Department of Defence, *Submission 15*, p. 6.