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Superannuation Legislation Amendment Bill 2007

Leslie Nielson
Economics Section

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Superannuation Legislation Amendment Bill 2007

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House: House of Representatives

Portfolio: Finance and Administration

Commencement: Sections 1 to 3 and Schedules 4 and 5, Part 2 on Royal Assent, Schedules 1 and 2 on 1 July 2008, Schedule 3 on the latter of two dates either Royal Assent or 1 January 2008, Schedule 5, Part 1 on a date fixed by proclamation or 1 July 2008, Schedule 6 on a date fixed by proclamation or on the 1st day after a 6 month period after Royal Assent.

Links:
The relevant links to the Bill, Explanatory Memorandum and second reading speech can be accessed via BillsNet, which is at http://www.aph.gov.au/bills/. When Bills have been passed they can be found at ComLaw, which is at http://www.comlaw.gov.au/.

Purpose

The Bill contains the legislative provisions necessary for the changes to the Commonwealth's civilian and military superannuation schemes announced in the 2007–08 budget measures as well as some changes first announced as part of the Government's *Better Super* package (also known as the Simplified Superannuation measures).[1]

There are changes giving members of the Commonwealth's existing civilian defined benefit superannuation schemes increased flexibility in dealing with their retirement savings arrangements. Further, the Bill makes reversionary benefits paid by the Commonwealth's two older military superannuation schemes more accessible.

The Bill proposes to amend the following Acts:

- *Superannuation Act 1922*
- *Superannuation Act 1976*
- *Superannuation Act 1990*

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1. Senator the Hon. Nick Minchin, Minister for Finance and Administration, Increased choice for public service superannuation contributions, *media release*, Parliament House, Canberra, 8 May 2007 and the Hon Peter Costello MP, Treasurer, 'Second reading speech: Appropriation Bill (No. 1) 2006–07', House of Representatives, *Debates*, 9 May 2006, p. 57.

- *Superannuation Act 2005*
- *Defence Forces Retirement Benefits Act 1948,* and
- *Defence Forces Retirement and Death Benefits Act 1973*.

Background

Increasing the flexibility and choice for individuals participating in Australia's retirement income system has been a core policy of the Coalition government since first taking office in 1996.[2] Indeed, one of the Coalition's stated policy aims in 1996 was to:

> Review vesting and portability issues which inhibit movement [of superannuation benefits] between Federal and State public services and the private sector.[3]

During the intervening years various Coalition governments have increased the degree of choice and flexibility in the retirement income system, particularly by the introduction of the:

- portability of benefits regime, where from 1 July 2004 most superannuation fund members may direct a superannuation fund trustee to transfer their benefits to a superannuation fund of their choice
- choice of superannuation funds regime, where, from 1 July 2005, an employee may choose the fund into which their employer pays superannuation guarantee payments made on the employees behalf
- contributions splitting regime, where from 1 July 2006 a superannuation fund member can direct that up to 85 per cent of his tax deductible contributions and up to 100 per cent of his after tax contributions for the previous financial year may be sent to a spouses superannuation account in the same, or a different, superannuation fund of the sending member, and
- simplified superannuation regime, where from 1 July 2007 the tax arrangements on the payment of superannuation benefits, and the options for the payment of those benefits, have been greatly simplified, leading to a highly flexible superannuation system in retirement.

The proposed changes to public sector superannuation contained in this Bill are a continuation of the policy first announced in 1996 and enacted by the above changes.

2. The Australian Liberal Party and the Australian National Party, *Super for all – Security and Flexibility in Retirement: the Federal Coalition's superannuation and retirement incomes policy*, 19 February 1996, p. 4.

3. ibid, p. 20.

The proposed changes

The 2007–08 Budget announced a number of measures relating to the Commonwealth Superannuation Scheme (CSS) and the Public Sector Superannuation Scheme (PSS):

- removal of the current mandatory requirement for CSS and PSS members to contribute a set minimum percentage of their after tax salary to these schemes
- CSS and PSS members to be able to withdraw amounts from the scheme on either financial hardship or compassionate grounds
- PSS members to be able to choose their own superannuation arrangements. Previously, PSS members were not able to choose to have contributions made to a scheme other than the PSS
  - if a PSS member choses to leave the scheme, they cannot rejoin at a later date
- spouse pensions cancelled upon remarriage before 1976 in some civilian schemes and 1997 in certain military schemes will be reinstated
- requirements for the payment of spouse pensions from the Defence Force Retirement and Death Benefits Scheme (DFRDB) and the Military Superannuation and Benefits Scheme (MSBS), where the marital relationship commenced after the retired service pensioner turned 60, are eased, and
- an anomaly in the Family Law provisions of the *Defence Force Retirement and Death Benefits Act 1973*, is to be corrected.[4]

Government Superannuation Schemes

The CSS was closed to new members on 30 June 1990. The DFRDB was closed to new members on 30 June 1991 and the PSS was closed to new members on 30 June 2005. The MSBS remains open to new members; however military superannuation arrangements are currently under review.[5] All these schemes are defined benefit or hybrid schemes, where the final benefit is either partly, or fully, determined by a set formula applied to a person's years of service and their final salary on retirement.

Those joining the Commonwealth public service on or after 1 July 2005 may become members of the Public Sector Superannuation Accumulation Plan (PSSAP) or choose to have the government's superannuation contributions put into another superannuation fund of their choice. The PSSAP is an accumulation scheme, where the final benefit is determined by the contributions made and the investment returns on those contributions

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4 The Hon. Peter Costello MP, Treasurer, *Budget Paper No. 2*, 2007–08, p. 200 and Senator the Hon. Nick Minchin, ibid.

5. The Hon. Bruce Billson MP (Minister Assisting the Minister for Defence), Review of Military Superannuation, *media release*, Parliament House, Canberra, 27 February 2007.

over the period of membership. The overwhelming majority of superannuation funds in Australia are accumulation schemes.[6]

Basis of policy commitment

The measures contained in this Bill were first announced in a number of ways, as follows:

- in the second reading speech by the Treasurer (the Hon Peter Costello MP) for Appropriation Bill (No. 1) 2006–07 on 9 May 2006
- in Budget Paper No. 2, 2007–08,[7] and
- in a press release by the Hon. Nick Minchin, Minister for Finance and Administration, on 8 May 2007.[8]

Position of significant interest groups/press commentary/political parties

Press commentary generally restricted itself to describing the proposed changes, not expressing an opinion on them.

One industry commentator has suggested that the proposed changes would provide an incentive for Commonwealth public servants to cease contributing to the CSS and PSS and accumulate their superannuation benefits in alternative accumulation schemes.[9] However, other commentators point out that the benefits provided by the PSS and CSS are very generous and it may be to a member's advantage to stay in these schemes.[10]

To date the non-government parliamentary political parties have not expressed an opinion on this Bill.

Pros and cons

Generally, the above changes allow CSS, and particularly PSS, members enhanced flexibility and choice in their superannuation arrangements. Consequently, these measures

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6. The government has estimated that only 10 per cent of superannuation fund members are members of defined benefit or hybrid schemes, Australian Government, *A Plan to Simplify and Streamline Superannuation: Detailed Outline*, May 2006, p. 5.

7. The Hon. Peter Costello MP, Treasurer, op. cit.

8. Senator the Hon. Nick Minchin, op. cit.

9. Ian Davis, 'More changes for super', *Superfunds*, June 2007, p. 11.

10. John Wasiliev, 'Still pays to stay in public sector plan', *Australian Financial Review*, 12 May 2007, p. 39 and Daryl Dixon, 'Now for the July 2008 super changes' *Canberra Times*, 3 July 2007, p. 33.

will give these members many of the same rights and advantages enjoyed by those public servants in the other government superannuation funds and private sector workers.[11]

In particular, these will allow members of the PSS to place their superannuation benefits in an accumulation fund. Such funds are' taxed' funds; that is, funds that have been subject of full rate of the superannuation fund income tax (15 per cent tax on all tax deductible contributions and 15 per cent tax on investment earnings). The benefits paid by a taxed fund are tax free if taken by the person upon reaching 60 years of age.

CSS members will be able to direct their contributions to a taxed fund. However, they will not be able to transfer their accumulated CSS superannuation benefits into such a fund.

The government expects that the additional flexibility given to public servants by these changes will result in a significant proportion opting out of their membership in the PSS and CSS. The exit of these members is expected to slightly reduce the long term cost of these schemes (see further comments on financial implications below).[12]

The restoration of spouse military pensions cancelled upon remarriage is an overdue equity measure; as are the changes to make access to reversionary military service pensions easier where the marriage relationship commenced after the primary pensioner reached 60 years of age.

There are no adverse effects of the proposed changes. However as noted above, it may not always be to a CSS or PSS member's advantage to cease contributions to these schemes and join an accumulation fund. Such decisions must be made on a case by case basis.

Financial implications

The Explanatory Memorandum notes that the changes to CSS and PSS will cost approximately $160m over 4 years.[13] This cost is to be offset by the expected savings of $200.2m over the same period arising from the expected exit of members from the PSS and the reduction in CSS expenses. These would arise if members of these schemes chose to accumulate benefits in an accumulation scheme.[14]

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11 Other government superannuation funds include the Public Sector Scheme Accumulation Plan and the Australian Government Employees Superannuation Trust. Both are accumulation style plans and operate in largely the same manner as private sector accumulation style plans.

12. The Hon Peter Costello MP, Treasurer, Second Reading Speech, op. cit.

13. Explanatory Memorandum, Superannuation Legislation Amendment Bill 2007, 21 June 2007, p. 5.

14. The Hon Peter Costello MP, Treasurer, op. cit.

Standing appropriations

These changes are expected to produce a reduction in the standing appropriation for CSS and PSS expenses of approximately $200.2m over the 4 year period from 1 July 2007.

Comment

In view of the financial advantages of continuing to contribute to the Commonwealth's civilian superannuation schemes it is possible that the expected savings may not be realised.

Main provisions

Schedule 1 – Basic contributions

Item 5 of **Schedule 1** amends **section 46** of the *Superannuation Act 1976* (the CSS Act). The effect of this particular amendment is to allow a CSS member to cease making the basic contributions to the scheme.

A person's basic contributions are 5 per cent of their basic fortnightly salary after tax.

Item 7 inserts new **section 51AA** into the CSS Act. The effect of the new section is to require that a CSS member continue to make the required basic contributions to the scheme, if they are on extended leave without pay (longer than 12 weeks) due to sick leave, compensation leave, leave due to injury sustained during service with the military reserves or leave due to undertaking employment outside the Australian Public Service (APS).

This requirement applies even if the CSS member has made an election to not make the required basic contributions under the provisions of item 5 above.

Normally, individuals who are on extended leave due to injury or sickness will have their superannuation paid for by Comcare (or some other organisation) or from their wages for employment outside the APS. Where this does not occur new **subsection 51AA(4)** allows regulations to be made to modify the operation of the provisions of this item. The Explanatory Memorandum notes that the purpose of this particular subsection is to avoid a potentially harsh outcome from the operation of these provisions.[15]

Item 10 repeals current **section 51B** of the CSS Act. Under this section CSS members, whose period of service is 40 years or greater, may request that they cease making the basic contribution. The repeal of this section will require CSS members whose period of

15. Explanatory Memorandum, op. cit., p. 11.

service is 40 years or greater to continue making the required basic contributions to the CSS.

Comment

Generally, a CSS member's pension benefits reached their upper limit once they had served for 40 years. That is, after 40 years service, if the member resigns after reaching age 55, they are entitled to a pension equal to 52.5 per cent of a member's final average salary at age 65.[16] In addition, upon retirement the member receives a lump sum equal to their basic contributions and the associated investment earnings.

The removal of this option to cease contributing to the CSS after 40 years service will not increase a member's pension benefits. However, continued contributions past this stage will increase a member's lump sum benefits.

Very few CSS members actually accumulate 40 years service with the APS. However, with increased rates of workforce participation by older workers there may be an increasing number of CSS members who do so.

Under **clause 2** of the Bill the above provision commences on 1 July 2008.

Schedule 2 – Choice of funds

Items 1 and **2** of the Bill amend **section 6** of the *Superannuation Act 1990* (the PSS Act). The effect of these amendments is to deny a former PSS member access to the scheme at a later date, once they have made an election under new **section 6B** of this Act (see below).

Where a PSS member has a preserved benefit in the scheme, as a result of ceasing employment in the APS, they may again become contributing members of this scheme if they again resume employment in the APS. This feature of the PSS is not altered by the proposed changes noted above.

Item 3 of **Schedule 2** inserts new **section 6B** into the PSS Act. This new section allows a PSS member to cease their membership of the scheme and become a member of another superannuation fund (providing it is a complying superannuation fund and their employer agrees to contribute to this fund).

Prior to this amendment the only way a person could cease to be a contributing member of the PSS was if they ceased employment in the APS and either received, or transferred, their benefit. **Item 3** allows the ending of PSS membership while the person is still employed in the APS.

16 If the benefit is taken before age 65 it is reduced by a factor to allow for the additional time over which the pension will be paid.

As noted above, once this election is made it cannot be reversed. They cannot resume contributing membership of the PSS, even if they retain a preserved benefit in the PSS. The Rules of the PSS fund will further define this particular matter.[17]

Schedule 3 – Early release of benefits

Item 1 of **Schedule 3** inserts new **Division 4A** (the early release of benefits) into the CSS Act. This Division allows for the early release of superannuation benefits from the CSS on either financial hardship or compassionate grounds.

Generally, superannuation benefits are preserved inside a superannuation fund until the member has permanently retired from the workforce. Normally, retirement occurs after the person's preservation age (55 for those born before 1 July 1960, 55 to 60 for those born after that date).

However, if a person is suffering severe financial hardship, or requires finance to meet a compassionate need (such as an urgent medical expense that they cannot reasonably meet in any other way) they may withdraw the required amounts from their superannuation fund. What may constitute financial hardship or compassionate grounds are defined in the *Superannuation Industry (Supervision) Act 1992* and its associated regulations.

The facility has been available to most Australian superannuation fund members, but it has not been available to CSS and PSS members.

Item 1 inserts new **section 79B** into the CSS Act. This section does not require the payment of these amounts. It simply says that the amounts 'may be paid'. The Explanatory Memorandum notes that this is to allow for the possibility that the member's financial circumstances may have dramatically improved between the time the application for such a withdrawal is made and the time at which the payment is actually made.[18]

Further, the new section allows for amounts withdrawn under financial hardship or compassionate grounds to be paid for the 'benefit of the member'. This means that the amounts are not paid directly to the member. Rather, the CSS's manager, the Australian Reward Investment Alliance (ARIA), may pay these amounts to a third party, depending on the circumstances. For example, a third party may be the mortgagee of a member's residence for the repayment of an overdue mortgage payment if the amount is withdrawn under financial hardship grounds. Another example of these circumstances is where it is appropriate to pay this amount to a dependent, such as where the dependent's medical expenses are being paid, and a better tax outcome for the member is achieved by doing

17. Explanatory Memorandum, op. cit., p. 13.

18. ibid., p. 16.

so.[19] This said, the new section does not prevent the payment of the benefit directly to the member if circumstances so require it.

Schedule 4 – Restoration of pensions to remarried widows and widowers

Item 1 of **Schedule 4** inserts new section 44 into the *Defence Force Retirement and Death Benefits Act 1973* (DFRDB Act). This new section requires the Defence Force Retirement and Death Benefits Authority (the Authority) to grant the pension to either widows or widowers who had lost their pension entitlements upon their remarriage where it is satisfied that the person is entitled to such a pension.

Comment

This legislative measure will be giving effect to the established policy of the Authority. The guide to the Defence Force Retirement and Death Benefit scheme notes:

> It is a common misconception that spouses loses their eligibility and have their benefits stopped if their circumstances change. However, you can be assured that once the Authority decides that your spouse is eligible to receive a benefit, then he/she will get that benefit for life and it will not be stopped under any normal circumstances **(e.g. in the event of your spouse's remarriage)**. [20] (emphasis added)

Item 6 inserts new **sections 64A** into the *Defence Force Retirement Benefits Act 1948* (DFRB Act). The effect of this section is to require the authority to grant a pension to a widow or widower who lost their entitlement to a pension and where the Authority is satisfied that they are entitled to that pension.

The DFRB Act governs the military superannuation scheme (DFRB) that predates the DFRDB scheme. The DFRB scheme was closed to new members in 1972. The majority of its members transferred to the DFRB.

Item 7 repeals **section 48AA** of the *Superannuation Act 1922* (the 1922 Act) and substitutes a new section of the same number. The effect of this new section is to require the Commissioner for Superannuation to pay a pension to either a widow or widower who ceased to receive these payments due to their remarriage. The Commissioner must be satisfied that such individuals are eligible to claim this payment.

The 1922 Act governed the operation of the Commonwealth civilian superannuation scheme that preceded the CSS. This scheme was closed to new members in 1976.

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19. Amounts withdrawn under financial hardship or under compassionate grounds are subject to tax in the hands of the recipient.

20. Australian Government, *The Defence Force Retirement and Death Benefits Scheme*, September 2004, p. 24.

Application

Under **Section 2** of this Bill the changes in **Schedule 4** commence operation from Royal Assent.

Item 8 requires that any pension payable to a claimant under the provisions of **Schedule 4** do not have to be paid at the full rate before 1 January 2008. That said, nothing stops the Authority from paying pensions at the full rate before this date. Any pensions claimed under the provisions of this Schedule must be paid at the full rate after this date. These pensions will not be paid retrospectively.

Schedule 5 – Amendments relating to better superannuation

Schedule 5 makes necessary changes to the 1976 Act arising from the recently implemented Simplified Superannuation arrangements.[21]

Part 1 – Employer productivity contributions

Part 1 makes the necessary changes to ensure that the CSS can continue to accept productivity benefit payments made on a member's behalf, even where that member has not quoted their Tax File Number to ARIA, or had it quoted on their behalf by the Australian Tax Office. This change gives members the same rights to have payments made to their superannuation funds in these circumstances as are enjoyed by members of private sector superannuation funds.

What is a 'productivity benefit payment'?

The payments for the productivity benefit are equal to about 3 per cent of the member's salary, payable each fortnight. It is paid under the *Superannuation (Productivity Benefit) Act 1988* to Commonwealth public sector workers. It is paid on a 'before tax' basis and is subject to the 15 per cent contributions tax.

Application

The amendments in **Part 1** of this schedule commence on a date to be proclaimed, or on 1 July 2008 if this proclamation has not been made earlier.

Part 2 - Release Authority payments

Part 2 alters the 1976 Act to allow payment of superannuation excess contributions tax from the funded component of the CSS, in the event that a member's contributions breach

21. See Leslie Nielson, Tax Laws Amendment (Simplified Superannuation) Bill 2006, *Bills Digest*, no. 65, Parliamentary Library, Canberra, 2006–07.

the annual limits on contributions applying from 1 July 2007. This tax applies to excess contributions made to all private sector superannuation funds.

The funded component of a CSS benefit is the amount made up of the member's own after tax contributions plus the associated investment earnings. Briefly, from 1 July 2007 the annual limits on contributions to superannuation funds are:

- $50 000 in pre tax contributions
- $150 000 in post tax contributions, or
- $450 000 over 3 years in post tax contributions.

These limits are subject to annual indexation by increases in the Average Weekly Ordinary Time Earnings calculated by the Australian Bureau of Statistics.

Comment

It is unlikely that the majority of CSS members will be in a position to exceed the annual contribution limits.

Application

Item 10 requires that the amendments in **Part 2** of the schedule commence on the date of Royal Assent.

Part 3- Rolled over superannuation benefits

Part 3 makes consequential amendments arising from the Simplified Superannuation changes. **Item 12** requires that the changes in **Part 3** take effect from 1 July 2007.

Schedule 6 – Military superannuation

Part 1 – reversionary benefits for post-retirement marriages

Part 1 of **Schedule 6** amends the DFRDB Act to allow spouses, who have married a DFRDB pensioner after age 60, to receive superannuation benefits after the DFRDB pensioner's death.

Items 1 and **2** remove the requirement that a spouse be married to a DFRDB pensioner for at least five years, if they married after that pensioner reached 60 years of age, to receive superannuation benefit after the DFRDB pensioner's death.

Item 3 inserts new **section 6BA** into the DFRDB Act. Under this new section, if the marital relationship between the DFRDB pensioner and their spouse begun after that pensioner was 60 years of age, and has lasted for at least three years, the surviving spouse is entitled to the full rate of benefits from the DFRDB scheme paid in these circumstances.

If the relationship had lasted less than three years in these circumstances the surviving spouse will be entitled to a pro-rata rate of pension, based on the length of time the relationship lasted before the death of the DFRDB pensioner. Further, the surviving spouse is entitled to a lump sum in certain circumstances.

Application

This schedule commences on a date to be proclaimed. But if that date is more than 6 months after Royal Assent, they commence on the first day after the 6 month period has ended.

Conclusion

The provisions of this Bill are minor in nature and align the Commonwealth's superannuation arrangements with the legislative provisions applying to superannuation in general.

The increased flexibility they afford participants in the CSS and PSS is to be welcomed. However, those wishing to take advantage of this new found flexibility should first seek competent and qualified financial advice: for leaving the PSS and ceasing contributions to the CSS may entail giving up benefits that are very hard, if not impossible, to replicate through private sector arrangements.

That said, the features of the CSS and PSS are not necessarily the most appropriate for all public servants. For example, those with a comparatively short life expectancy in retirement will have little use for the pension paid by the CSS. And those who desire to take an enhanced level of investment risk in the accumulation of their retirement benefits will have little use for the security of the PSS. These points simply underline the need for Commonwealth public servants to seek appropriate advice before taking advantage of the flexibility that these provisions give them in respect to the CSS and PSS.

Disclosure

The author is a contributing member of the CSS and has, as of the date of writing, a comparatively long life expectancy!