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19<sup>th</sup> March 2008

## REVIEW OF MILITARY SUPERANNUATION - SUBMISSION ON REVIEW REPORT

### **Introduction**

1. This submission has been prepared by the Returned and Services League of Australia (RSL) and the Defence Force Welfare Association (DFWA) in conjunction with the Ex-Service Organisations (ESOs) listed on the cover of the Attachment to this letter. The detailed analysis and comments on the Report of the Review into Military Superannuation released on 24 December 2007 represent our collective views.
2. Both the RSL and DFWA, and several of the ESOs, made substantial submissions to the Review and the following comments are consistent with those.

### **Overview**

3. In considering the Report and its recommendations the following broad principles reflecting the policy guidance of both RSL and DFWA have been used:
  - a. Any Military Superannuation scheme must appropriately recognise the unique nature of military service.
  - b. Any Military Superannuation scheme amendment must:
    - o be viewed in the context of its effect upon Retired members, Current members and Future members.
    - o demonstrate as an absolute minimum, no disadvantage to all of these classes of members in respect of Superannuation, Death and Disability provisions and preferably offer enhanced outcomes.
  - c. Any transference of 'risk' to ADF members in relation to Military Superannuation scheme outcomes must be accompanied by an appropriate and

- demonstrable 'reward' for the acceptance of that risk.
- d. Any new scheme or changes must provide for flexibility in managing any personal contributions.
4. The RSL & DFWA believe the Review has:
    - a. Incorporated an unacceptable premise not contained within the endorsed Terms of Reference – the containment of costs within current levels,
    - b. Extrapolated considerations, analysis and conclusions based upon this unacceptable premise so that, if the recommendations were to be accepted without change, then current military superannuants, ADF members transferring to the scheme, and future ADF members would suffer disadvantage. Additionally, similar disadvantage would accrue to eligible dependents of such future ADF members.
    - c. Failed to offer proposals likely to enhance recruitment and retention.
  5. We are disappointed in the outcomes of the Review. There are some aspects of the report that could be described as innovative and can be supported but there are other aspects that need further explanation and clarification before we could recommend their acceptance. Finally there are some proposals in the report with which we disagree.

## ***Considerations***

### **Unacceptable Premise – Future Costs**

6. The Review clearly acknowledges that its considerations were governed by both the endorsed Terms of Reference (TOR) and a series of Guiding Principles (GP) set out by the Review Team. Fundamentally, the RSL & DFWA have no objection to any of the criteria contained in these two documents.
7. However, the Review then acknowledges that its deliberations were governed and guided by the principle that the costs of any future scheme and associated recommendations should not exceed the costs of current arrangements (future cost cap). No such guidance or governing requirement was contained with the Terms of Reference or Guiding Principles.
8. The effect of this self imposed criterion so skewed and inhibited the Review Team's deliberations that accepting its recommendations would result in:
  - Direct disadvantage to current DFRDB and MSBS superannuants in the context of pension indexation.
  - Potential disadvantage to current DFRDB and MSBS contributors and their eligible dependents were they to transfer from these schemes to the proposed future scheme, vis a vis current arrangements.
  - Potential disadvantage to future ADF members and their eligible dependents in the proposed future scheme, vis a vis current MSBS arrangements.

## **DFRDB and MSBS Pension Indexation**

9. The Review received a considerable number of representations seeking amendment to the current CPI based indexed arrangement for DFRDB and MSBS pensions to the ‘the same benchmark method used for age / service pensions’. The Review asserts that the CPI is an adequate reflection of ‘Cost of Living’ variations. This is a matter of considerable dispute, not only within ex-service circles but also within the wider community and is at odds with the official view of the Australian Bureau of Statistics (compiler of the CPI) which states that the “CPI is not a purchasing power or cost-of-living measure”. At least the Review Team acknowledges that CPI does not reflect and is not designed to reflect, positive changes in the ‘standard of living’ of the Australian community at large.
10. The Review Team then constructs a view within the self-imposed ‘future cost cap’ and using the average weekly ordinary time earnings (AWOTE) index as a basis, that only a portion of military superannuants should be subject to more favourable indexation arrangements. The injection of the AWOTE index which has never been sought by either the RSL or DFWA, results in a higher cost basis that is then used to justify this low priority recommendation. The Review does concede though there is merit in the representations for changes to indexation arrangements. However it then uses the future cost cap criterion and the spurious and unsubstantiated argument that DFRDB and MSBS arrangements are ‘generous’, to say that a growing number of Defence superannuants should continue to suffer reductions in their standard of living relative to the Australian community at large. Such an inequitable policy based in large degree on false logic and inappropriate criteria cannot be endorsed by the RSL or DFWA.

## **Defined Benefit vs Defined Contribution Scheme – Transfer of Risk**

11. The Review proposes the substitution of a ‘Defined Contribution Scheme’ for the current ‘Defined Benefit Scheme’ nature of both DFRDB and MSBS. Additionally, they acknowledge that such an arrangement transfers the ‘risk’ relating to the magnitude of the final superannuation account from the Government to the individual; primarily through the final account balance being controlled by market forces.
12. Such a fundamental change in the character and nature of military superannuation was not unexpected, given the character of superannuation in the wider Australian community and is consistent with the broad tenor of both TOR and GP. However, if the risk is to be transferred to the individual ADF member then any improvement in the superannuation account balance, vis a vis defined benefit entitlements, is a ‘reward’ for carrying the risk. Conversely, any deterioration in the account balance is the ‘price’ of carrying the risk. It is neither logical nor equitable to then use *projections* of more favourable superannuation account balances, which may or may not eventuate, to mask fundamentally adverse changes to superannuation scheme arrangements.
13. The Review projects superannuation account balances in a future defined contribution scheme using various financial projections and advice and

calculations. The RSL & DFWA have no reason to doubt the veracity of that actuarial advice, but believe such advice should be subject to independent scrutiny.

14. When it comes to the conversion of lump sums to indexed pensions by eligible members or their dependents very significant and adverse changes in conversion factors are proposed. Under current MSBS arrangements for an eligible member (or surviving spouse) the conversion factor for a lump sum at age 55 years is 12:1. That is \$12 of lump sum buys \$1 of lifetime CPI indexed pension, with appropriate reversion and child benefits. Under the proposed arrangements a conversion factor of 20:1 is proposed for members and 18.6:1 to spouses for a similar CPI indexed pension. Thus for each \$100,000 of lump sum current MSBS arrangements would yield \$ 8333 of pension. Under the proposed scheme the pension would be \$5000 - a difference of \$3333 or 40% less. In the proposed scheme electing to have a 'wage based' indexation requires a conversion factor of 24:1 a reduction of 50% in pension! Such an outcome is masked in the report by the construction of the examples. Again, the fundamental driving factor is the inappropriate application of the future cost cap criterion.
15. Similar adverse outcomes apply to surviving spouses and children when current vs. future entitlements projections are based on valid comparisons and not the inappropriate basis used by the Review Team. Proposals with such inequitable outcomes cannot be accepted by the RSL & DFWA.

### **Other Issues of Concern**

16. The following issues are also of concern to the RSL & DFWA:
  - Death & Disability Provisions. Within the Review's recommendations several arithmetic factors (eg. Surviving spouse % of pension reduces from 67% to 62.5%) are proposed for amendment. These variations and the absence of precise knowledge about related policies, procedures and appeal mechanisms predicate caution in providing any endorsement. The practical consequences of the termination of salary maintenance and employer superannuation contributions at age 60yrs, in the proposed scheme, remain to be validated in the context of both future accumulation returns and associated risk. The RSL & DFWA remain to be convinced that the arithmetic changes relating to death benefits do not result in an adverse outcome and that the proposed disability arrangements will be truly advantageous in their practical application.
  - Other Issues. In addition to the indexation issue detailed above the RSL & DFWA remain concerned that several other deficiencies in the existing schemes were not positively addressed by the Review Team. These include Life Expectancy Factors and associated pension calculations.
  - A Positive Impact on Recruitment and Retention. The RSL / DFWA are not convinced that the Review's recommendations containing the shortcomings detailed above will have a positive impact on recruitment and retention. Indeed any documented disadvantage of the proposed arrangements or a perception of the same might well have exactly the opposite effect.

17. A comprehensive analysis and response to the Report's recommendations is attached to this submission.

### **Conclusion**

18. The RSL & DFWA believe the Review has incorporated an unacceptable premise not contained within the endorsed Terms of Reference. This self imposed future cost cap has been a major contributor to the analysis, conclusions and recommendations that would result in;
  - a. Direct disadvantage to current DFRDB and MSBS superannuants and contributors if they transfer to the proposed future scheme and potential disadvantage to future ADF members; and
  - b. A failure to offer proposals likely to enhance recruitment and retention.
19. The RSL & DFWA are disappointed in the outcomes of the Review and are unable to recommend acceptance of many of the Review's recommendations, in their current form, to either the Government, or past, present and future members of the Australian Defence Force (ADF). The RSL & DFWA remain available to discuss in detail the above considerations and other issues, contained in the Attachment, relating to the Review recommendations.

### **Recommendation**

20. The RSL & DFWA recommend that the Report of the Review into Military Superannuation not be accepted by Government until the issues detailed in this submission are re-evaluated and the anomalies which would result in adverse outcomes to serving and former members of the ADF are rectified. As stated above, we stand willing to assist in that re-evaluation.

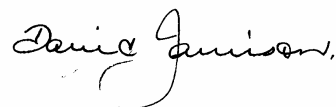
### **Further Submissions**

21. We have a number of outstanding matters we are pursuing with the Review Team and reserve the right to make submissions on these if that proves necessary as a result of the responses received.



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### **Attachment:**

Detailed Analysis and Comments on the Report of the Review into Military Superannuation Released on 24 December 2007