

CORPORATE SUPER ASSOCIATION

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By e-mail to jlonsdale@treasury.gov.au

8 May 2007

Dear Mr Lonsdale

UNIVERSAL ADOPTION OF OTE AS EARNINGS BASE FOR SUPERANNUATION GUARANTEE PURPOSES IMPACT ON DEFINED BENEFIT FUNDS – ACTUARIAL CERTIFICATES

I refer to the changes to the Superannuation Guarantee Administration Act 1992 (“SGAA”) which will come into force from 1 July 2008. These include the universal adoption of Ordinary Time Earnings (“OTE”) as the earnings base in relation to which minimum support must be provided in order to avoid the superannuation guarantee charge (“SGC”).

Background – Corporate Superannuation Association

The Corporate Superannuation Association represents some thirty major not-for-profit corporate superannuation funds and their corporate sponsors. Defined benefit funds form a major element of our membership base.

Superannuation Guarantee and OTE

Our defined benefit fund members have raised technical issues relating to the SGAA changes indicated above. As you will be aware, the employer-sponsors of defined benefit funds rely on actuarial certification that support is being provided for members of the funds at a notional rate sufficient to ensure that SGC is not incurred. Many defined benefit funds have been running for many years, and hence their deeds specify benefits using a notional earnings base other than OTE (arising from arrangements in place before 21 August 1991).

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We would like to make it clear that we do not oppose the move to universal use of OTE as a basis for calculating required minimum levels of support. However, the change is going to entail some major reporting changes. These have been noted on the first page of the attached paper and are included as background information only.

Major concern – regulations and guidance on preparing benefit certificates

The major concern we wish to raise at this point relates to the required format for preparation of Benefit Certificates. The attached paper has been prepared by the actuarial advisers to a number of our major funds. As noted in the paper, some references in the existing regulations under section 10 will become obsolete on 1 July 2008, as they refer to provisions that will be repealed from that date. This letter is intended as a formal request for early release of amendments to the regulations under section 10 of the SGAA. Issue of such amendments, at a point as early as possible, would assist the funds in generating the information required to support calculations and will assist the actuaries in developing systems to handle the calculations required.

In particular, we note that questions are raised in the paper regarding the averaging of OTE, including the averaging of OTE for SG support measurement purposes, and for the calculation of Minimum Requisite Benefits. We would support the averaging recommendations made, given that these averaging strategies would reduce the administration burden on funds without any foreseeable damage to the interests of members of the funds.

We would be happy to participate in discussions regarding the requirements.

Please let me know if you require further information from our organisation.

Yours sincerely



Elizabeth Goddard
Head of Research
Corporate Superannuation Association

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ATTACHMENT 1

Prepared by Russell Investments

Transition to OTE for Defined Benefit funds

Background

From 1 July 2008 superannuation funds will need to use Ordinary Time Earnings as the salary definition for Superannuation Guarantee (SG) purposes. Currently superannuation funds can continue to use salary definitions in place on 21 August 1991, the date when the SG legislation was introduced. Employer sponsors of defined benefit funds meet their SG obligations by receiving a Benefit Certificate from an actuary in accordance with Section 10 of the SG (Administration) Act. Section 10(6) allows Regulations to be made to provide additional detail to actuaries preparing Benefit Certificates.

This note sets out the major implications of the move to OTE for defined benefit funds and raises a number of issues yet to be resolved because updated Regulations are not yet available. Actuaries require updated Regulations to enable definitive advice to be provided to employers and superannuation funds.

Implications for Employers and Superannuation Funds

As a result of the move to OTE:

- OTE and Superannuation Salary will both need to be provided to defined benefit fund administrators. OTE will now be needed to ensure the SG requirements are met and Superannuation Salary will continue to be needed to calculate the Trust Deed benefits that are often more generous than required by SG legislation. To simply replace Superannuation Salary with OTE for Trust Deed benefits would unnecessarily increase employers contribution obligations;
- Benefit configuration on administration systems will need to be updated for defined benefit funds. This will often be a major task because some superannuation funds have never before coded Minimum Requisite Benefits (MRBs) for SG purposes because they were always lower than Trust Deed benefits. The use of OTE to calculate MRBs for SG purposes means that very occasionally (where Superannuation Salary is significantly lower than OTE) this may no longer be the case.
- There may be an increase in cost to employers in circumstances where the SG Minimum Requisite Benefit (MRB) applies because members' benefits will increase; and
- For some superannuation funds it will be necessary to communicate MRBs to members for the first time because in the past it could be certain that they would never apply.

It will be necessary to communicate to employers and administrators well before 30 June 2008 (and probably before 31 December 2007) what needs to take place so that it can be implemented.

Definition of Notional Earnings Base

The SG (Administration) Act currently defines notional earnings base in Sections 13, 13A, 13B and 14. All these sections have been repealed from 1 July 2008. This means that the term 'notional earnings base' is no longer defined. Instead the amended legislation refers directly to OTE. Section 10 specifies that Regulations may make provision in respect of how Benefit Certificates are prepared. The current Regulations require that Benefit Certificates be based on notional earnings base, a term that will no longer be defined.

Therefore, the Regulations will need amendment to provide actuaries guidance on preparing Benefit Certificates. This issue may impact superannuation funds that already have MRBs based on OTE.

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Averaging of OTE

Currently employers are required to satisfy their SG obligations quarterly. It is expected (and hoped) that the amended Regulations will continue to allow the averaging of OTE. For example:

- Will it be possible to use OTE at a particular date each year (i.e. a birthday OTE or review date OTE as are used for some funds to calculate FAS)?;
- Will it be possible to use OTE over twelve months rather than just the current quarter to date?; and
- Will it be possible to average OTE in the MRB formula (i.e. a FAS based on OTE) so that the MRB does not increase/decrease frequently with changes in OTE?

If actuaries do not have the flexibility to average OTE in these ways it will extremely difficult to prepare sensible MRBs for defined benefit funds. This is because a defined benefit MRB will be multiples (based on years of service) of a salary based on OTE. If averaging of OTE is not used then the MRB will increase and decrease from period to period based on changes of hours, allowances etc.

Likely form of new defined benefit MRBs

It will not generally be appropriate to simply replace Superannuation Salary with OTE in the MRB formula. This is because if OTE is higher than Superannuation Salary it would result in a once-off retrospective increase in MRB in respect of all past service.

Therefore, it is likely that the pre 1 July 2008 portion of the MRB will continue to be based on Superannuation Salary at that date (albeit it may be increased in line with future OTE). However, some employers may prefer the entire MRB to be based on OTE because it will be easier to communicate to members and administer.

If averaging of OTE is allowed, it will make is much easier to replace Superannuation Salary with OTE for some superannuation funds.