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SUPERANNUATION – ESSENTIAL INFORMATION FOR VICTORIAN GOVERNMENT EMPLOYEES

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GENERAL INFORMATION

Why has the State Services Authority commissioned this briefing?

The SSA wants to provide superannuation information for Victorian government employees who are members of the Revised Scheme, New Scheme and ESS Defined Benefit Fund (ESSS DBF) and Accumulation schemes such as ESSSuper Accumulation Plan or VicSuper.

The plan is to update the website information from time to time and to draw attention to new opportunities which may benefit some employees.

You mentioned the benefits of taking out death and disability coverage in an accumulation super fund. Are these really worthwhile?

They are very significant benefits. Personal payments for death and disability cover are not tax deductible and have to be paid out of after-tax income. Only personal payments for income protection coverage are eligible for a tax deduction.

By arranging for your death and disability coverage to be provided in your super fund, the contributions can be funded pre-tax from employer or salary sacrifice super contributions. Australians, especially those with families and mortgage commitments, are notoriously underinsured. Obtaining coverage within your super fund provides an excellent opportunity to obtain essential cover. Again, this is an issue worth exploring with a financial advisor.

Please note that the Revised, New and ESSS DBF automatically have death and disability (D&D) cover built into the benefit structure and there is no extra cost involved.

Is there anything that I should be wary of when it comes to contributing to super?

Because you receive tax concessions by investing in super the government has set annual limits on what you can contribute per person as shown in the table below.

Anything you contribute over and above these limits will be subject to additional taxation. It is recommended that you monitor your contributions closely and consider leaving a margin of error.

Annual Limits

Period	**Concessional contribution limit*** e.g. 9% superannuation guarantee, salary sacrifice and notional contributions to defined benefit schemes	**Non-concessional contribution limit^** e.g. after tax contributions, lump sum contributions, spouse contributions and small contributions to get the government co-contribution
1 July 12 to 30 June 13	$25,000	$150,000
1 July 13 to 30 June 14	$25,000	$150,000
Tax for exceeding the limit	31.5% of excess amount and excess counts towards non concessional limit	46.5% of excess amount

**The Government has announced that the Concessional Contribution Limit for people aged 50 or over with a total superannuation balance of less than $500,000 will be $50,000 from 1 July 2014. How this is to apply to Defined benefit funds has not yet been announced.*
^You are also eligible to contribute up to $450,000 using the 'averaging provision' to bring forward two years' worth of non-concessional contributions. We recommend seeking independent advice before undertaking such a strategy.

Notional Taxed Contribution (NTC) explained

For many defined benefit funds, the contributions counted for the purpose of the concessional contributions limits are called 'notional taxed contributions'.

This is because employer contributions to defined benefit funds are not allocated specifically to individual member accounts; rather member benefits are funded from the defined benefit pool.

Calculating Concessional Contributions

A member's NTC is calculated at the end of each financial year, or at the time of their exit from the fund. For example:

Calculating Concessional Contributions				
Notional Taxed Contributions (NTC)	**+**	**Employer contributions (including salary sacrifice) to an Accumulation Plan**	**+**	**Employer contributions (including salary sacrifice) to other funds**

'Grandfathering' Arrangements

Currently there is an existing 'grandfathering arrangement' whereby, for eligible defined benefit members, their NTC's are limited to their concessional contributions limit. In other words, no excess contributions tax can arise because of their defined benefit notional taxed contributions being greater than the limit.

Please note, grandfathering arrangements can be lost with an increase in contribution rate or a significant increase in remuneration. This should be confirmed before making any additional contributions.

SALARY SACRIFICE

Why is being able to contribute on a pre-tax basis to defined benefits super schemes a benefit to eligible Victorian public servants?

There are two reasons. Firstly, the salary sacrifice super options offered to Victorian public servants will generate a substantial tax saving, provided the income used to make the pre-tax contributions to super does not reduce taxable income below $20,542 a year. Secondly, the resulting tax benefits reduce the after-tax cost of contributing to the Revised, New and ESSS DBF, freeing up additional money which may allow you to afford a higher level of contribution to these schemes, if you are eligible, or other super funds.

What is the benefit of a higher level of contribution to these super funds?

Members of the Revised Scheme do not have any choice about the level of their member contribution to their fund. It depends solely on their age. New Scheme and ESSS DBF members can be eligible to contribute between 0% and 7% of their salary to these funds. It should be noted that ESSS DBF members can only pay 8% as a catch up rate if certain limited circumstances apply, including where total benefits accrued are less than the 7% rate. Generally, New Scheme members can only pay 0%, 3% or 5%. It should be noted that New Scheme members can only pay 7% if certain limited circumstances apply, including where total benefits accrued are less than the 5% rate or prescribed members. An important fact not understood or appreciated by all New Scheme members is that a higher rate of member contribution attracts a larger matching employer contribution to the fund resulting in a significantly improved benefit.

Does this mean that by allowing public servants to contribute to their defined benefits superannuation on a pre-tax basis the government is also helping members to obtain additional superannuation benefits from the New Scheme and ESSS DBF funds?

Precisely. If you generate tax savings as a result of your salary sacrifice, you can use the money to increase the rate at which you contribute to the New and ESSS DBF funds. Doing so can significantly improve the rate your vested benefits accrue in those schemes. The tax savings from salary sacrifice contributions can also be used to increase your take home pay if you are already maximising, or prefer not to increase, your contributions to your fund.

I see the point. This could be a big help but I'd like to see the actual figures.

This is why the SSA requested that this briefing cover all the Victorian government super schemes and help public servants maximise the benefits of their superannuation savings.

Before that detailed coverage, could you outline the basic facts about superannuation as a way of saving?

Certainly. Super is attractive both because of the tax advantages offered by the federal government and the contributions made by your employer. It is a tax-effective way of putting money aside for retirement. Generally, employer contributions and fund earnings are only subject to 15% income tax. This compares with the normal income tax rates of 20.5%, 34%, 38.5% and 46.5% (including Medicare levy) you have to pay on any personal income received in excess of $20,542 annually. Super also offers a low cost way of obtaining death and permanent disability insurance coverage. Your super fund pays the premiums out of money contributed by you or your employer to your fund. If you pay the premiums personally, you have to make the payments out of take-home pay that has already been subject to personal income tax.

That sounds pretty good. But I have always believed that paying off my home mortgage provides better benefits than putting more into super. Also, I can't touch my super till I retire.

This briefing can only provide general information. It does not extend to providing specific personal financial advice which can only be given with full knowledge of individual financial situations. The following comments may assist you in making a personal decision about the best option. Superannuation now has several attractions which can compensate for the fact that benefits have to be preserved until retirement. Specifically, super lump sums from funded schemes can be withdrawn after age 60 totally free of any further tax. ESSS DBF members also have an option to take their benefit as an untaxed benefit with amounts up to $1.255M taxed at 15% after age 60 with any balance being taxed at marginal rates. In both these situations, the money can be used to pay off mortgages at that time. Pensions from taxed funds such as the Revised Scheme and New Scheme or account based pensions from ESS**Super** or VicSuper are also tax free after age 60. Given the favourable ways of accessing your super at retirement, building up super may be better than paying off a mortgage in two situations – when there are substantial tax savings and when your contributions attract additional employer funded benefits.

Salary sacrifice super. How does this operate and are there limits on how much of my wage income can be contributed to super?

The Victorian government has adopted a flexible approach to allow its employees to arrange to make additional contributions to super on a pre-tax basis. The term salary sacrifice describes the arrangement allowing employees to exchange or sacrifice pre-tax wage income for additional employer super contributions which are then taxed in the superannuation fund at 15%. This arrangement allows public servants earning more than $20,542 a year to significantly lower the costs of making additional super contributions out of income that would otherwise be subject to personal income tax at marginal rates of 34% (including Medicare levy) or more. Public servants are not eligible for a tax deduction for any personal after-tax super contributions. Unlike the self employed and other people not receiving substantial wage income, public servants are not able to claim a tax deduction for personal super contributions.

Are there any limits on how much I can salary sacrifice to superannuation?

Yes, there are. In the 2012/13 financial year, concessional contributions to superannuation (including all employer and salary sacrifice contributions) are restricted to $25,000 per person per annum.

When a member exceeds the applicable concessional contribution an additional 31.5 per cent tax is payable – this is on top of the 15 per cent contribution tax. Importantly, for defined benefit funds a notional taxed contribution (NTC) is counted as part of the concessional contribution limit and must be allowed for when determining the desirable salary sacrifice level.

To assess your personal NTC, please refer to the NTC calculator available on the ESS**Super** website – www.esssuper.com.au/calculators.

Are the tax savings from salary sacrifice super worth the complication involved?

Definitely. Especially when you are obliged to make contributions or will obtain a definite benefit from contributing to your super fund. The tax savings depend on the taxable income of the taxpayer as shown below:

Taxable Income (p.a.)	Marginal Tax Rate (including Medicare levy)	Gain from Salary Sacrifice*
$20,542^ to $37,000	20.5%	5.5%
$37,001 - $80,000	34%	19%
$80,001 to $180,000	38.5%	23.5%
$180,001 and above	46.5%	31.5%

** The gain from salary sacrifice is the marginal tax rate less the 15% super contributions tax rate.*
^ Income above $18,201 is subject to a marginal tax rate of 20.5%, however when including the Low Income Tax Offset, tax is only payable above this amount.

Even a 19% tax saving provides a substantial benefit for lower and middle income taxpayers especially when the superannuation fund investment returns over time are factored in (this is not an issue for defined benefit funds).

*Earlier you stated that **eligible** members of the Revised, New and ESSS DBF can salary sacrifice their member contributions to these funds. What's the benefit of this?*

This is a fantastic opportunity for **eligible** members of these funds to increase their take-home pay or put additional money into their defined benefit fund on a tax-effective basis. Previously, all contributions had to be made out of after-tax dollars. With Revised Scheme member contributions as high as 9.5% and New Scheme and ESSS DBF contributions potentially as high as 8%, your employer has, by allowing the salary sacrifice option, put more money into public servant's pockets or their savings.

The following table illustrates just how large the benefit is, depending on the level of member contribution to the relevant fund (please note this table does not take into account any additional salary sacrifice contributions a member may be making into another super fund):

Tax saving for 2012-13 by salary sacrificing contributions								
Salary for Superannuation Purposes*	Salary sacrifice rate	3.6%	5.9%	8.3%	9.5%	10%	10.6%	11.2%
	(Post tax rate)	(3.0%)	(5.0%)	(7.0%)	(8.0%)	(8.50%)	(9.0%)	(9.5%)
$50,000		$339	$597	$823	$936	$1,025	$1,082	$1,138
$60,000		$407	$717	$988	$1,124	$1,230	$1,298	$1,366
$70,000		$437	$786	$1,103	$1,261	$1,385	$1,464	$1,543
$80,000		$499	$885	$1,218	$1,384	$1,520	$1,603	$1,686
$90,000		$708	$1,235	$1,706	$1,942	$2,115	$2,233	$2,347
$100,000		$786	$1,372	$1,896	$2,158	$2,350	$2,481	$2,612

**Salary for superannuation purposes may differ from both your total remuneration and your total income. For further clarification of the above numbers, please refer to the 'Salary Sacrifice" calculator on the ESSSuper website.*

Please note these tax savings only apply to members who are solely making contributions to the Revised, New or ESSS DBF schemes. For members aiming to make additional salary sacrifice contributions, it may be beneficial to make after-tax contributions to their fund. It is recommended they seek professional advice to determine the most appropriate strategy.

CO-CONTRIBUTION

What is the government co-contribution and how much can you receive?

Lower income taxpayers may be eligible for additional benefits through the superannuation system via a federal government co-contribution, which provides up to $500 to complement super members' post-tax contributions. It is possible for members to benefit from both the co-contribution and salary sacrifice.

For the 2012/13 financial year, taxpayers receiving assessable incomes of less than $46,920 p.a. are automatically eligible for a federal government co-contribution of up to $500 p.a. if they contribute personal money post-tax to a super fund. Reportable fringe benefits and reportable employer superannuation contributions are also considered in this income test.

People on lower incomes need to remember to make an appropriate post-tax personal contribution annually to be eligible for the co-contribution when they switch their member contributions to the Revised, New and ESSS DBF funds to a pre-tax basis.

The following table sets out the value of the co-contribution at various levels of salary:

Taxable Income	After-tax Super Contribution	Maximum Co-Contribution
$31,920 or less	$1,000	$500
$36,920	$666	$333
$41,920	$333	$166
$46,920	$0	$0

The lower the public servant's income, the greater the value of the co-contribution. When there is insufficient income available to deposit the required additional post-tax contribution you would need to look carefully at the value of entering into a salary sacrifice arrangement.

Can you provide an example for a New Scheme member working part-time and earning $35,000 a year contributing 5% post-tax to the New Scheme to maximise the employer subsidy?

Definitely. This is a very interesting example.

The 5% New Scheme contribution costs $1,750 p.a. after tax. If this contribution is made before tax (5.9%), it would cost $2,065 p.a. and reduce the public servant's taxable income to $32,935 p.a. Therefore by contributing $2,065 p.a. on a pre-tax basis, there's a saving of $139 p.a.

If the $139 p.a. was then deposited into another super fund, this would provide access to a co-contribution of $70 and an overall gain of $209.

These are complex calculations. Is there any way to summarise the point you are making?

Yes. If you have a low taxable income, probably below $35,000 a year, and can't afford to deposit additional personal money into a super fund each year, it may be appropriate to continue to contribute on a post-tax basis to your Revised, New or ESSS DBF to continue to receive the co-contribution. It is, however, even more attractive to contribute on a pre-tax basis to your defined benefit fund and also contribute up to an additional $1,000 post-tax to a second fund. For ESSS members, this could be ESS**Super** Accumulation Plan.

What about VicSuper members?

This fund has no fixed rate of member contributions but accepts employer superannuation guarantee, salary sacrifice and personal contributions. For lower income members of this fund, it's advantageous to make post-tax contributions each year to gain access to the co-contribution. The maximum $500 federal grant annually is paid to those with incomes of less than $31,920 a year. As income rises, the maximum co-contribution is reduced by 3.333 cents for each dollar above $31,920, until income reaches $46,920 per annum at which no co-contribution is payable

Are there any other issues relating to accessing the co-contribution?

Yes. Two other matters are important. First, reportable fringe benefits (such as are available in salary packaging in the hospital sector) are added to assessable income in measuring annual income for purposes of calculating the co-contribution.

Second, any amounts which are voluntarily salary sacrificed to superannuation will be recorded as 'reportable employer super contributions' and included as part of your total income when assessing if you are eligible to receive the co-contribution payment. In other words, salary sacrificing will not increase your eligibility to receive the co-contribution.

How do I obtain the co-contribution? Does it involve making a claim to the Australian Tax Office?

No. The ATO pays the co-contribution directly to your super fund on your. In assessing your annual tax return, your eligibility for the co-contribution is automatically assessed using information provided to the ATO by your super fund.

REMEMBER: Seek independent financial advice

TRANSITION TO RETIREMENT ACCOUNT-BASED PENSION (TRIS)

What other super issues are relevant to Victorian public servants

There are three:

1. Being able to start a Transition to Retirement Income Stream (TRIS) after age 55, even if you are still working.
2. Spouse Super Splitting.
3. Being able to purchase additional insurance coverage at a low cost.

The Transition to Retirement Income Stream (TRIS), also know as Transition to Retirement Account-Based Pension, option is available through ESSSuper and other providers like VicSuper. It is not available to members of the Revised, New (unless eligible to become exempt and take the total lump sum to a rollover fund and then purchase an allocated pension) and ESSS DBF. The entitlements in these funds are not crystallised until the date of exit from the fund.

Can you provide more details about TRIS?

They were introduced to encourage people to continue working after they reach the minimum retirement age of 55. Under the previous rules, super fund members could gain access to their super after 55 only by retiring from the workforce to take a lump sum or start a pension. Now the super rules permit people aged 55 and over to start a pension while they are still working.

What's the benefit of doing this?

The TRIS income can provide money to live on or service the mortgage while allowing public servants either to work part time or increase their salary sacrifice super contributions. There are substantial tax advantages from starting a pension, particularly when taxable income is less than $80,000 a year.

The tax advantages include a 15% tax rebate on taxable pension income and the exemption of pension fund income from the 15% tax levied on super fund investment income. This is an issue that people aged 55 and over with super fund benefits that can pay allocated pensions might care to explore with a financial advisor.

CONTRIBUTION SPLITTING

How can spouse super splitting help me?

In several ways. ESS**Super** and VicSuper (but not the defined benefit funds) allows fund members to split contributions with an eligible spouse. The rules require that the super contributions are directed initially into the member's account, then after 1 July each year, up to 85% of new employer and salary sacrifice contributions can be transferred to an eligible spouse account. The main condition for eligibility is that the spouse must be aged less than 55, or between age 55 and 65 and not permanently retired from the workforce.

How will this help me?

It depends on your situation. Spouse splitting can provide a number of different benefits. If your spouse is older or about the same age, contributions splitting can give you access to your super benefits earlier than otherwise possible. If your spouse has a lower income and is about the same age, building up the spouse account can help lower the tax liability otherwise payable on a TRIS started between ages 55 and 60. Spouse splitting may also provide more flexibility in the future and improve superannuation balance equity between couples. Again, this is an option that could be worth exploring with a financial advisor.

REMEMBER: Seek independent financial advice

FINAL AVERAGE SALARY

What does the term Final Average Salary (FAS) mean and why is it important?

FAS is only relevant for defined benefit fund members. It is defined as your average salary over your last two years of employment. Overtime and some allowances do not count in the calculation of FAS. All the defined benefit funds use your FAS in the formula used to calculate final benefits. Over your last two years of service, annual salary increases and promotions will increase your final superannuation benefits.

THE VICTORIAN GOVERNMENT SUPERANNUATION SCHEMES

What's the best source of information about my super fund?

You should start by looking at the ESS**Super** website:
www.esssuper.com.au

If you are a member of VicSuper you can access information at
www.vicsuper.com.au

These websites provide detailed information about your superannuation scheme but aren't able to provide individual financial advice about the options available to you. The briefing which follows highlights information relevant to the development of your personal strategies. Each of the funds is discussed in order below.

THE REVISED SCHEME

I am a member of the Revised Scheme. Could you give me a brief summary of how this scheme operates?

The Revised Scheme requires a compulsory member contribution which increases from 8.0 to 9.5 per cent of post-tax salary as your age increases. As previously highlighted, Revised Scheme members can now elect to make these contributions out of pre-tax salary ranging from 9.5 to 11.2 per cent of pre-tax salary. For this contribution, a member receives a final benefit available either as a CPI-indexed pension or a part pension and a lump sum which has been significantly funded by the employer. If desired by the member, all the benefit can be commuted to a lump sum. ESS**Super** can provide more detailed information about your options.

How are the Revised Scheme retirement and resignation benefits calculated?

The final benefit depends on your final average salary over your last two years of employment, your age and your years of service at the time of your exit from the fund. Members resigning before age 55 are treated differently from those retiring after age 55 and members should obtain quotes from ESS**Super** to assist in comparing these options. Choosing whether or not to resign before age 55 (frequently referred to as the 54/11 months option) or retire after age 55 can be a difficult decision and employees should obtain independent advice when considering these options.

What about some precise figures about my pension entitlement?

My advice is always to obtain up-to-date quotes from the ESS**Super** but here is a short summary of the pension benefit calculated as the reduced taxed benefit as currently shown on the ESS**Super** benefit statement.

At 55, after 20 years' service, the pension is **41.20**% of FAS whereas after 30 years of service it is **52.90%** of FAS. At this age, the pension for 10 additional years of service is **11.7**% of FAS.

Generally, the first 25 years of Revised Scheme membership generates a larger annual increase in pension entitlement to age 55, than further membership in the fund. The pension entitlement, as would be expected, increases with the age at retirement. At age 55, 25 years' service gives a pension of **51.50**% of FAS. At age 60, the 25 years' membership pension is **55.60**% of FAS, while at 65, the pension is **58.30**% of FAS.

It's not easy to interpret these figures. How do I assess whether it's worth my while to work past 55?

It's quite difficult, but here are some pointers. You need to consider these as well as other personal factors including your attitude to working:

1. How rapidly is your FAS increasing or likely to increase in the future?
2. How much does each additional year of membership increase your pension entitlement?
3. What is the impact of retiring at a later age?

In assessing each of these you need to realise that once started your pension is CPI indexed every year. Consider this example. If your FAS is increasing annually by around 5% a year and the CPI by 3% a year each year, your pension will increase by 2% a year in real terms.

Further, at age 55 if you have less than 25 years' service, your pension will increase by 2.1% of FAS each year.

At age 55 after 25 years' recognised service, the pension increases by only 0.3% a year up to 30 years' service. Age is also important in increasing pension entitlement up to age 60.

After age 60 additional years are valuable only for people with less than 30 years of service.

Does all my service count for superannuation purposes?

Not necessarily. Service does not include apprenticeships, cadetships or teacher training that happen prior to becoming a member of the Revised Scheme. Leave Without Pay can have a significant effect on the number of years of fund membership.

Should I look closely at my options once I reach 30 years' membership?

That would be a good idea. Indeed, every super fund member is well advised to monitor the annual growth in their benefits. With the Revised Scheme, particularly approaching age 60, eligible members may find it worth getting quotes from ESS**Super** and consider if there might be an advantage in becoming an exempt officer (only available to certain employees) and joining another super fund like the ESS**Super** Accumulation Plan.

Other issues relevant to your decision include:

- Are you ready for retirement?
- Are there other employment opportunities for you?
- What other benefit options do you have such as receiving a lump sum?

REMEMBER: Seek independent financial advice

Revised Scheme – Exempt Officer

I've never heard of that option ("becoming an exempt officer"). Tell me more.

Becoming an exempt officer is an option **NOT** available to all public sector employees. Check with ESS**Super** whether you can become an exempt officer before taking any action.

By electing to be an exempt officer, you crystallise your benefit in the Revised Scheme before you retire. This could be attractive, say at age 60 after 30 years' service, particularly for those wanting to take part of their benefit as a lump sum. Before taxed fund adjustments, the crystallised Revised Scheme Pension at age 60 is two thirds of FAS (as an untaxed pension). This deferred pension is indexed by changes in CPI and increased by an actuarial factor, depending on your age at retirement. The benefit of doing this is that your employer will pay the compulsory 9% employer contribution to a fund of your choice such as the ESS**Super** Accumulation Plan and you'll no longer be required to contribute to the Revised Scheme. If this additional amount is invested over time, it would generate a useful lump sum on retirement. It is possible at age 65 for a member to become exempt, have their pension paid and continue employment.

Can you provide an example?

This illustrative example which represents a scenario with a common theme considered by ESSSuper members.

Alice is a Revised Scheme member aged 60 and has thirty years' service. She wants to work until she is 65. Her Final Average Salary at age 60 is $90,000. She was promoted last year and does not anticipate any further promotions. She thinks her current salary of $100,000 will simply keep pace with inflation. She has asked for advice about her options.

Assuming a 3% annual increase in salary, her retirement benefit at age 65 will be a pension of $70,711 based on a FAS of $114,239. Her own contributions over the five years will be almost $52,000.

Her exempt officer benefit at age 60 is a deferred pension of $53,617 which will have increased to $65,265 with CPI (3%) and actuarial adjustments at age 65. If she goes exempt at age 60, she will be entitled to the Superannuation Guarantee at 9%, which will amount to almost $41,000 at age 65 and will have saved $52,000 in contributions.

In this particular circumstance, the best option might be to go exempt at age 61 when the full impact of her promotion will be included in her Final Average Salary. This will provide a pension at age 65 of over $70,000 plus $33,000 Superannuation Guarantee with contribution savings of about $42,000.

REMEMBER: Seek independent financial advice

Transitioning to Retirement and FAS (Final Average Salary)

Can you provide more information about Final Average Salary (FAS) and its importance?

Your FAS plays an important part in determining your final benefit. Because it is the average of your salary over your last two years of service, annual salary increases and promotions will increase your final superannuation benefits. If your salary is rising faster than the CPI, there can be a substantial benefit from delaying your retirement. Superable salary does not include overtime and some allowances.

I'd like to know how working part time would affect me. Would it reduce my FAS?

The Revised Scheme legislation especially caters for part-time work so that reduced hours do not impact on FAS. The FAS is based on equivalent full-time earnings and all the adjustments are made on a pro rata basis for the time factor and contributions. This means a person working, say, half time pays 50% of the annual full-time contribution and two years' part-time employment counts as one year of service. To ascertain accurately how part-time service would affect your benefits, you should seek benefit estimates via the ESS**Super** website.

How can this be of benefit?

Well, here's an example. Jane is 56 and started work when she was 28. Her service in the Revised Scheme is 28 years. She plans to retire at age 60 and would like to work part time till then but is concerned that it might affect her retirement pension. Because Jane needs only two more years' service at age 60 to secure the two-thirds pension (taxed fund adjustments would apply), she could work at a time fraction of 0.5 and still accrue 30 years' service by the time she retires. Her contributions would reduce by 50% but she would still receive the same pension at age 60. The only impact of going part time would be on her take-home salary. Her superable salary would be based on equivalent full-time earnings. This example would be especially profitable for Jane if her FAS were increasing significantly faster than the CPI over this period.

You haven't covered the option of resigning before 55. Everyone in the office is talking about it. Just how valuable is this option?

Frankly, it can be very valuable but in many cases it is less valuable than office gossip would lead Revised Scheme members to believe. Married women who entered the scheme during the 1975 and 1982 amnesties and are required to pay for prior service recognition may not find 54/11 attractive but other longer serving members would be advised to see if 54/11 helps them. The resignation option (commonly called 54/11) allows members at age 54/11 to receive a refund of their member contributions and accrued interest plus a pension of five-sevenths of the full pension entitlement accrued up to the date of resignation. The benefit from a 54/11 resignation comes from receiving a larger lump sum than could be obtained by commuting two-sevenths of the pension at age 55.

What's the case if I want to take all my benefit as an indexed pension?

The 54/11 option could still be attractive if you want to retire at 55 or not long after. In some cases of long periods of service prior to 55 and relatively low increases in FAS, the age 54/11 lump sum could purchase a larger private sector pension than the two-sevenths of the Revised Scheme pension lost by taking the lump sum.

How do I evaluate my options?

You should always seek professional advice, particularly from an advisor able to assess the value of an indexed pension to you. The ESS**Super** will provide you with information about the lump sum available on resignation and the remaining age 55 pension entitlement. You can then compare this with the age 55 retirement pension and the lump sum that could be obtained by commuting your preferred percentage up to 50% or 100% of the pension at that time.

Here's an illustrative example that is representative of a scenario with a common theme considered by ESS**Super** members.

Jim joined the Revised Scheme in 1981 at age 24. In 2012, he was approaching age 55 and had 31 years' service. His Final Average Salary was $72,000. His contributions and interest had grown to $253,360. If he had waited till he was 55, he would have been entitled to a full pension of $34,083. His resignation benefit just prior to age 55 would have been a deferred pension of five-sevenths, or $24,345, plus a lump sum of $253,360.

Questions to ask your advisor:

Is the lump sum more valuable than the lost pension of $9,798?

How much pension would you have to commute to a lump sum at age 55 to deliver an equivalent lump sum?

Jim does not want to retire yet and at age 55, after claiming his deferred pension, he goes back to work for a further five years. He rolls over the lump sum (resignation benefit), which increases with interest to $346,000. In addition, he contributes the equivalent of his pension back into superannuation which delivers an extra $130,000 plus. His employer Superannuation Guarantee contributions provide a further $35,000 and, for comparison purposes, he has continued to make an equivalent Revised Scheme contribution of 9.5% to net a further $44,000.

Jim retires at age 60 by which time his pension has increased through CPI adjustments to $28,222 and he has a lump sum of over $555,000 tax free.

Had Jim remained in the Revised Scheme, assuming reasonable salary increases lifted his Final Average Salary to $84,000, he would be entitled to a pension of $49,519.

Questions to ask your advisor:

Would his additional lump sum be worth the $21,297 annual pension foregone?

How much pension would he have to commute to deliver an equivalent lump sum?

What is your financial assessment of Jim's situation?

The 54/11 option is highly attractive for Jim provided he is able to obtain a comparable replacement job which permits him to work on for as long as he wants until age 60. There are no restrictions on returning to employment under the State Superannuation Act but individual employers may have their own policies in place. If proceeding with resignation before 55, it is important to claim the pension at age 55 in order to provide the cash flow needed for future salary sacrifice contributions.

One other observation is that the benefits available to Jim from 54/11 are larger than those available to Revised Scheme members with shorter periods of service. To gain some idea of the value of a CPI-indexed pension, it would not be possible to purchase such a pension at age 55 for less than 20 times the pension. At the time of making the 54/11 decision, Jim received a lump sum of $253,360 for giving up a pension of $9,798 a year. The lump sum amounted to 25.86 times the annual pension foregone. At age 60, on the estimates, the additional available lump sum of $555,000 would represent 26.06 times the annual $21,297 pension foregone.

Clearly, before making a 54/11 resignation election, Revised Scheme members need to examine the magnitude of the benefits to be gained as well as their prospects to gain comparable employment after resignation.

Assuming I decide to stay on past 55, what are the attractions of taking part of my Revised Scheme pay-out as a lump sum?

The rules allow you to commute up to 50% or 100% of your Revised Scheme pension to a lump sum. As for the analysis of the 54/11 option, you need to compare the value of the pension foregone with the lump sum obtained. ESS**Super** can provide precise figures for individual situations, but the 50% commutation offer either within three months of retirement or just before age 65 allows you to retain a surviving spouse pension option.

ESS**Super**'s website provides an example of a 50% commutation at age 57 where the lump sum equates to 10.8 times the annual pension foregone, maintaining the full surviving pension benefit and 12.8 times the pension foregone for forfeiting 50% of the surviving pension benefit. Before making any decisions on taking any part of your pension as a lump sum, obtain independent financial advice. Commutation can be attractive if there are serious health issues that reduce the expected lifespan. As always, seeking personal financial advice is essential.

REMEMBER: Seek independent financial advice

THE NEW SCHEME

Can you tell me simply how the New Scheme works and what my best options are?

I'll try, but you'll need to make your own decisions about the best options for your personal situation.

Unlike the Revised Scheme where member contributions are compulsory, New Scheme members can contribute 0%, 3%, 5% or 7% of salary to their fund annually. The 7% rate is available to allow people who have previously contributed on average less than 5% of salary to catch up and to prescribed officers. The New Scheme retirement and resignation benefits are provided solely as lump sums calculated as multiples of FAS based on the period of membership and the average contribution level.

Certain prescribed class officers may contribute at 7% indefinitely.

So what benefit comes from contributing to the New Scheme and what level of contribution do you recommend?

- A 0% contribution rate accrues a retirement benefit of 8.5% of FAS for every year of service.
- A 5% of salary contribution increases the benefit accrual to 17.5% of FAS.
- This means that the 5% of salary personal contribution generates an additional benefit of 9% of FAS each year.

While FAS is the average of your last two years salary and lower than your current salary, there is still a substantial annual return in excess of 3% of your current salary from contributing 5% of salary annually to the fund.

Are you recommending a 5% contribution to the New Scheme?

That's for you to decide, but it represents a pretty good investment, especially now that you can make your contribution on a pre-tax basis. Made on a pre-tax basis, a 5% personal contribution costs you 5.9% of pre-tax salary. But if your marginal tax rate is 34%, the cost to your take-home (post-tax) income is only 3.89%. This outlay increases your New Scheme benefit accrual by 9% of FAS each year. No other safe investment offers such a high immediate return.

REMEMBER: Seek independent financial advice

But I can't touch my super till 55 and I have a large mortgage. Surely I can make more by paying off my mortgage?

Unfortunately, no, you can not. The return from paying off your mortgage will be at most 7.5% p.a. compounded annually. Your FAS is likely, on past experience, to increase by between 4% and 6% a year and enterprise bargaining increases are set to be a minimum of 2.5% per annum in the future, but lets say, 5% annually. Even if you are aged 35 and can't touch your super till age 60 under the preservation rules, investing 3.89% of salary after tax in the New Scheme will increase in value to approximately 30% of FAS over the next 25 years.

How about some more examples?

The following table considers a range of situations assuming that the 5% contribution to the new scheme is made on a pre-tax basis and the taxpayer's marginal rate is 34%. The calculations also use a standard 7.0% p.a. mortgage interest rate and three assumptions about the average rate of growth of FAS over a career.

Value of Paying Off Mortgage Compared with Contributing 5% to New Scheme

Period to Retirement[1]	Paying off Mortgage	Contributing to New Scheme		
Years	% of FAS	Growth in FAS		
		4%	5%	6%
25	22.6%	24%	30%	39%
20	16.8%	19.7%	23.9%	28.9%
15	12.6%	16.2%	18.7%	21.65%
10	9.4%	13.3%	14.7%	16.1%
5	7%	10.9%	11.5%	12.0%[1]

[1] 55 for people born before 1 July 1960 increasing in annual steps to age 60 for people born after that date.

What these figures show is that the closer you are to retirement age, the greater the advantage to you from maximising your contribution to the New Scheme. It's also a highly attractive proposition when your FAS is increasing at a rapid rate.

Surely there are other advantages from not tying up money in super?

If you opt not to contribute to the New Scheme, you'll need to save in some other way to be in a comparable situation in retirement. What you lose by not contributing to the New Scheme is the part, or all of, the matching employer contribution. You can opt not to contribute while you are young, and then increase your contributions at a later date as you get closer to retirement. This is why the New Scheme allows a 7% annual catch-up contribution rate, but it is all too easy to run out of time. If you made no contributions for

10 years, it would take more than 15 years at the catch-up rate to achieve a 5% average contribution over your period of membership.

What are the precise figures involved?

A 3% annual contribution generates an additional 5.5% of FAS for each year of contribution at this level compared with a 9% of FAS increase for a 5% contribution level. The 7% contribution rate generates an additional benefit of 12.5% of FAS. The first 3% of salary contributed generates a slightly higher matching employer contribution than the 5% or 7% contribution, but the differences are marginal. The 7% that prescribed class officers can pay will give an even greater return.

Are there any 54/11 issues involved with the New Scheme?

There are no special benefits from resigning before 55 from the New Scheme. However, members who transferred from the Revised Scheme to the New Scheme during 1988-90 and SERB to New Scheme transfers who have part of their benefit as a pension entitlement should at least investigate resigning before age 55 as compared to retiring at age 55. Eligible New Scheme members at age 55 or over should look at the exempt officer benefit available at that age. This option allows the New Scheme benefit to be rolled over to an accumulation fund. It could grow at a faster rate than FAS, which sets the limit on the rate of growth of the New Scheme benefit. The option of becoming an exempt officer (if eligible) is less attractive before age 55 because transfer of the New Scheme deferred benefit to an accumulation fund is discounted by 4% for each year you are under age 55.

How about an example?

This is an example of an ESS**Super** New Scheme member considering his options at age 55. This member has averaged a 5% contribution over his period in the fund and has no option to increase his contribution rate.

Andrew just turned 55 and is a member of the New Scheme. He joined the Scheme in 1994 (18 years service) and has contributed 5% since commencing.

His lump sum multiple of his Final Average Salary at 30 June 2012 is:
0.175 (accumulation factor) x 18 years = 3.15 (a lump sum of $315,000).
Based on his Final Average Salary of $100,000 and his current salary is $103,000.

He has heard of some colleagues becoming exempt officers and wants to understand the implications. He plans to retire at age 60 and anticipates a salary increase of 3% per annum till then.

If Andrew stays in the New Scheme to age 60, his multiple will have increased to 4.025 and his Final Average Salary will be $112,583. His retirement lump sum at 60 will be $453,146.

If he goes exempt at age 55, he would have a lump sum of $315,000 to invest in superannuation. If we assume 5% rate of return, the lump sum will have grown to $402,029. When the equivalent of the New Scheme contribution and Superannuation Guarantee are factored in an additional $76,000 (excluding investment earnings) would be payable, making him over $25,000 better off by becoming an exempt officer.

The effectiveness of this strategy is very dependent upon the interest rate achieved compared to salary movement. An additional 2% in interest makes the net rate of return on the lump sum increase by over $40,000. This would not be a good option if you anticipated a promotion or a significant increase in superable salary in the critical years.

It is critical that you obtain independent financial advice before making any decisions on your superannuation options.

REMEMBER: Seek independent financial advice

ESSS DEFINED BENEFIT FUND (ESSS DBF)

It would be good to have a brief summary of how the ESSS Defined Benefit Fund works.

I recommend you examine the Product Disclosure Statement on the website www.esssuper.com.au because the scheme has complex provisions, especially for resignation within a relatively short period of time. The fund is open only to emergency service workers including police, fire brigade, ambulance employees , some Department of Sustainability & Environment employees, CFA employees and related services. All members need to be operational to join the ESSS DBF. Benefits can be paid as taxed or untaxed. Because of the high pressure nature of these activities, the defined benefit fund offers members the possibility of obtaining a maximum benefit multiple of 7.5 times FAS after 30 years' membership (sometimes referred to as the 8.4% Optional Untaxed benefit). Someone joining at 20 can thus achieve maximum benefit multiple at age 50, facilitating early retirement.

That sounds good. Is there a catch?

Essentially, the only requirement is to maintain a member contribution of 7% of salary over the whole period. The ESSS DBF allows members to contribute at 0%, 3%, 5%, 6%, 7% or 8% and the employer contribution will be determined by an actuarial rate consistent across membership.

What are the benefits of the ESSS DBF?

To allow a rapid build up of benefits, ESSS DBF provides generous matching arrangements up to an 8% member contribution rate, the 8% being a 'catch up' rate. A 0% contribution rate generates an annual benefit of 8.5% of FAS while the 7% rate generates a total benefit of 25% of FAS. The 7% of salary member contribution generates an additional benefit of 16.5% of FAS providing a strong incentive to contribute at this level.

What happens if I just can't afford to contribute at the 7% rate?

You should contribute as much as you can afford. For example, a 3% contribution rate generates an annual retirement benefit of 14% of FAS. This is a big improvement on the 8.5% of FAS annual rate when you choose not to contribute to the fund at all. The 5% and 6% contribution rate similarly provide additional benefits of 18% and 21.5% of FAS, respectively. You should obtain independent financial advice when making decisions with respect to your contribution rate.

You said earlier that ESSS DBF members can contribute on a salary sacrifice basis. How significant a factor is this?

It is very important. Instead of having to contribute after paying personal marginal tax rates, usually of 34%, 38.5% and for some 46.5%, pre-tax contributions only involve paying the 15% super contributions tax. A 7% post-tax member contribution equates to an 8.25% pre-tax contribution to the fund. In post-tax dollar terms, the cost amounts to 5.45% of salary for a 34% rate taxpayer and 4.41% of salary for the top 46.5% rate payer. Contributing to the ESSS DBF is now much more affordable than it has been in past years.

*How does contributing to the ESSS DBF on a salary sacrifice basis compare with salary sacrificing to ESS**Super** Accumulation Plan or other accumulation funds?*

Additional salary sacrifice super contributions to separate schemes are best considered once the maximum salary sacrifice contribution is made to the ESSS DBF. This will allow the member to determine their 'notional contribution rate' and identify the remaining contributions allowable under the concessional contribution caps. By maximising the salary sacrifice to the DBF, you gain not only the tax saving from salary sacrifice super but also the higher employer contribution to the DBF.

Are there any 54/11 or similar benefits in the ESSS DBF?

Not really. Once ESSS DBF members have achieved their maximum benefit multiple of 7.5 times of FAS, there is an incentive to look elsewhere for employment unless their FAS is increasing significantly each year. Unlike members of accumulation funds, DBF members can't commence transition to retirement pensions with their fund benefits. This can also be an incentive to contribute to an accumulation scheme such as ESSSuper Accumulation Plan or VicSuper once you reach this stage of your employment.

REMEMBER: Seek independent financial advice

ESSSUPER ACCUMULATION PLAN, VICSUPER & OTHER ACCUMULATION SCHEMES

Defined Benefit vs Accumulation Schemes

One of the major differences between Defined Benefit and Accumulation schemes is investment risk. In a defined benefit scheme, generally a member bears no investment risk, whereas in an accumulation scheme the member does bear this risk. This is a significant issue that defined benefit members need to consider before deciding whether to reduce defined benefit contributions in favour of contributing to an accumulation fund.

*What about ESS**Super** Accumulation Plan and VicSuper? How do accumulation products compare?*

The funds are an accumulation scheme into which employers contribute the Superannuation Guarantee of 9% of salary. Members are able to contribute and are completely free to take advantage of all the benefits available to accumulation fund members including any combination of post-tax contribution, where they may gain a co-contribution, salary sacrifice contribution, where it is tax effective, spouse contribution splitting and commencing transition to retirement pensions as soon as they reach preservation age.

Aren't you gilding the lily a bit?

Obviously, the larger the annual employer super contribution, the greater the benefit to the employee. But, particularly for younger people, the defined benefit funds require regular member contributions to the super fund to gain the maximum benefit. This requirement can put pressure on the family budget, especially when incomes are relatively low.

With an accumulation fund such as operated by ESS**Super** or VicSuper, members have much greater flexibility in when and how they contribute to super. One attractive option is to minimise contributions while income is low and then fast track super contributions at a later age when income is higher and the tax savings from salary sacrifice super is larger.

I agree that defined benefit funds represent an excellent way to force, or at least encourage, people to make regular contributions to their super fund. Accumulation funds require more discipline on the part of the fund member.

*Do you have any specific points to help ESS**Super** Accumulation Plan or VicSuper fund members?*

I certainly do.

- The first is to take the maximum advantage of the salary sacrifice super options when you have sufficient income or when you get closer to retirement age.
- Second, lower income earners should remember that the co-contribution benefit of up to $500 a year provided by the federal government is available if the requisite personal contribution is made.
- Third, both ESS**Super** and VicSuper offer the spouse contribution splitting option to its members. At the end of each financial year, you can transfer up to 85% of new employer and salary sacrifice super to a spouse account.
- Fourth, for those aged 55 or more, ESSSuper and VicSuper offers the option of a Transition to Retirement Account-Based Pension even if they are still working.
- Finally, members of ESS**Super** Accumulation Plan and VicSuper, like all other super fund members, should ensure they have an adequate level of income protection, death and disability insurance cover in the fund.

SERB and Transport Schemes

What other schemes does the ESSSuper administer that might be of interest?

The ESS**Super** Board also administers two small schemes being the State Employees Retirement Benefits Scheme (SERB) and the Transport Superannuation Scheme. Members of these schemes should contact the ESS**Super** for details of salary sacrifice and other benefit options

In general terms, SERB members should consider the information provided in this document regarding the Revised Scheme as a guide because there is a smaller age 54/11 benefit available from this scheme.

Transport Scheme members should consider the information provided regarding the New Scheme with contribution options of 0%, 2.5%, 5% and, in some instances, 7.5% of superable salary instead of the New Scheme rates.

REMEMBER: Seek independent financial advice