2013 - 2014

THE PARLIAMENT OF THE COMMONWEALTH OF AUSTRALIA

HOUSE OF REPRESENTATIVES

DEFENCE FORCES RETIREMENT BENEFITS LEGISLATION AMENDMENT (FAIR INDEXATION) BILL 2014

EXPLANATORY MEMORANDUM

(Circulated by the authority of the
Minister for Veterans' Affairs Senator the Hon Michael Ronaldson)

DEFENCE FORCES RETIREMENT BENEFITS LEGISLATION AMENDMENT (FAIR INDEXATION) BILL 2014

GENERAL OUTLINE

The Bill gives effect to the Government's 2013 election commitment to index Defence Forces Retirement Benefits (DFRB) and Defence Force Retirement and Death Benefits (DFRDB) pensions from 1 July 2014 for those pensioners aged 55 or older (on 1 January or 1 July as appropriate) in the same way as age and service pensions are indexed (but not at the same time as age and service pensions are indexed).

The measure will apply to DFRB and DFRDB retirement pensions, invalidity pensions, reversionary pensions paid to the surviving spouses of deceased pensioners and contributors and pensions for those associates whose pensions result from a family law split where the associate is aged 55 or older. Any component of these pensions which is currently unindexed will remain unindexed.

Constitutional advice

The Australian Government Solicitor (AGS) has advised the operation of the Act will not result in the acquisition of property within the meaning of section 51(xxxi) of the Constitution. AGS suggests the provisions in the Act will have either a neutral or beneficial impact on pensioners' entitlements, but no entitlements will be diminished.

Current indexation arrangements

Currently, all pensions paid from the DFRB and DFRDB schemes are indexed in line with positive movements in the consumer price index (CPI) from the first pay day in July and January. The adjustment is based on the preceding two quarters of CPI reporting.

A July CPI pension increase is generally based on the following formula:

$$\frac{\text{Latest March quarter CPI figure} - \text{Previous September quarter CPI figure}}{\text{Previous September quarter CPI figure}} \text{ x } 100 = \text{CPI change}$$

If the new March CPI figure (rounded to the nearest tenth of one per cent) exceeds the previous relevant September CPI figure, the pension is increased. If the new March CPI figure does not exceed the previous September CPI figure, there is no increase (for the January pension increase, the same process is carried out, but using the latest September quarter CPI figure and the previous March quarter CPI figure).

Where there have been falls in the CPI figures, there are carry forward provisions that prevent a pension increase unless the latest March (or September) quarter CPI figure exceeds the highest historic March or September quarter’s CPI figure. Where this situation occurs, the highest historic March or September quarter’s CPI figure replaces the *Previous September quarter CPI figure* in the above formula.

Indexation of commuted DFRDB pensions

Annual indexation of DFRDB pensions was introduced from 1 July 1976 and was applied to the reduced pension that was payable had a member commuted four times the pension. If a member did not commute, or commuted less than the maximum allowed at the time, there was a component of the DFRDB pension that was not indexed.

Commutation is the lump sum prepayment of part of future retirement benefit. If a member is entitled to retirement benefit the member can elect to commute a portion of that future retirement benefit for a lump sum. Similarly, if a member is classified Class C after being discharged medically unfit for further service and the member would have been entitled to receive retirement benefit had they voluntarily discharged, they can also elect to commute a portion of their benefit. From 2002, the maximum amount that a member may commute is five times the annual rate of retirement.

The indexed portion of the DFRDB pension for retirees is the lesser of the total pension actually being paid, or what is referred to in the DFRDB legislation as the *notional rate of retirement pay* (that is the rate of pension that would be payable if the member had commuted four times the annual pension).

Indexation of reversionary pensions

On the death of a DFRDB retirement pensioner, a reversionary pension is paid to the surviving spouse. The reversionary pension is based on the pension that would have been paid to the deceased pensioner immediately before death if the deceased pensioner had not commuted any part of the pension. This means that reversionary pensions paid to the spouse of a deceased retirement pensioner will have a component that is not indexed.

Reversionary pensions are also paid to the surviving spouse of a contributing member. Those pensions are equal to 62.5% of the pension that would have effectively been paid to the contributing member had that member served for forty years (a pension of 76.5% of the contributing member's salary and service allowance for the highest increment for rank held at the date of death) and there is no unindexed component.

The indexation changes being introduced by this Bill will not apply to child and orphan pensions as these pensions can only be paid to eligible children and eligible orphans up to age 25 (that is, the component of these pensions that is indexed will continue to be indexed in line with positive movements in the CPI).

Age/service pension indexation arrangements

The calculation of increases in both the age and service pension that occur in March and September each year is effectively a two step process. The first step is to calculate the pension that would result if it were increased in line with the better of CPI and the pensioner and beneficiary living cost index (LCI). The difference between the June and December quarter figures inform March indexation increases

and the difference between the December and June quarters inform September indexation increases.

In the second step, the resulting pension is compared to male total average weekly earnings (MTAWE) which is measured for the June and December quarters. No further adjustment is made if the calculated pension is greater than the specified floor percentage (27.7% of MTAWE for the single rate pension). If the resultant pension calculated in the first step is less than the floor percentage of MTAWE, it is increased so that it equals the floor percentage of MTAWE.

Establishing an indicative pension to measure MTAWE increases

Single rate age and service pensions are fixed amounts and are amenable to measurement against MTAWE, which is also a fixed amount measured for each six monthly period (the MTAWE reference period is the last pay period ending on or before the third Friday of the middle month of the reference quarter; either May or November).

DFRB pensions are based on the number of units of pension a member was allowed to purchase at particular ages and at particular salary levels and the value of those units at retirement. DFRDB pensions are based on the member's years of service and the salary and service allowance for the highest increment for rank held by the member at the date of retirement. For example, a DFRDB pension equal to 35% of salary and service allowance for the highest increment for rank held is payable after 20 years of service, increasing incrementally to 76.5% after 40 or more years of service.

In order to apply age/service pension indexation methodology and to obviate the need to measure every individual DFRB and DFRDB pension as a percentage of MTAWE at 1 January 2014 (to establish the base so that 1 July 2014 changes can be determined), an indicative pension is being established against which percentage increases (the better of CPI and LCI against the MTAWE floor) can be measured.

For this purpose, MTAWE at May 2013 (for the middle month of the June 2013 quarter which is the MTAWE published immediately prior to 1 January 2014 by the Statistician) has been used to set the starting indicative pension at 1 January 2014 so that the change as a result of the new indexation methodology for those aged 55 or older at 1 July 2014 can be measured. The July 2014 change will be based on MTAWE at November 2013 (the MTAWE that is published by the Statistician immediately prior to 1 July 2014).

MTAWE for May 2013 was $1,356.70. This is converted to an annual amount by multiplying it by 52. The result, $70,548.40, is then multiplied by 27.7% to establish the MTAWE result; $19,541.91, which is the indicative pension set for 1 January 2014. The 27.7% figure was chosen as it represents the current MTAWE floor percentage used in calculating increases in the single rate age/service.

Under the new arrangements for pensioners aged 55 or older, the indicative pension will be increased by the better of CPI and LCI. If the increased indicative pension is more than 27.7% of MTAWE, pensions for those aged 55 or older at either 1 January or 1 July will be increased by the better of CPI and LCI. If the increased indicative

pension is less than 27.7% of MTAWE, the increased indicative pension will be adjusted to be equal to 27.7% of MTAWE. The percentage increase required to raise the original value of the indicative pension before indexation to the level of 27.7% of MTAWE is then used to adjust pensions for those age 55 or older at either 1 January or 1 July.

A hypothetical example of how the new indexation arrangements work is set out in the explanation to changes introduced by items 12 and 20 of the Bill.

Division 293 tax

The *Tax and Superannuation Laws Amendment (Increased Concessional Contributions Cap and Other Measures) Act 2013* amended the income tax and superannuation laws and the *Taxation Administration Act 1953* to reduce the tax concession that individuals with incomes and concessionally taxed contributions above $300,000 receive on their concessional superannuation contributions from 30% to 15%.

This is achieved by the imposition of an additional 15% (Division 293 tax) on those individuals where total income (including concessionally taxed contributions) exceeds the $300,000 threshold. The tax is levied on that component of concessionally taxed contributions (including notional contributions by employers to defined benefit schemes) that results in the $300,000 threshold being exceeded (or the whole amount of the concessionally taxed contributions where non superannuation income already exceeds the $300,000 threshold). The measure applied from 1 July 2012.

The changed DFRB/DFRDB indexation arrangements for those aged 55 or older on 1 July 2014 will have two impacts for Division 293 tax purposes. The first is a very large one-off past service impact reflecting the capitalised value of the improvement in relation to benefits that have already accrued (that is, if the schemes operated on a funded basis, a substantial additional contribution would be required to ensure that assets were sufficient to cover the higher future pensions that would be payable in respect of service already rendered).

The second impact relates to the ongoing increased employment cost of future service. Since this will be recognised on an annual basis, the impact in any one year will be relatively minor.

Without an exemption, the one-off additional notional contribution will result in some individuals on moderate income, but with significant past service, incurring a Division 293 tax liability. The Government has therefore decided to exclude the capitalised value of the one-off benefit improvement for past service at 1 July 2014 from the operation of Division 293 tax. It is not excluding the ongoing increased employment cost of future service from the operation of Division 293 tax.

The Bill

The Bill will amend Part VID of the *Defence Forces Retirement Benefits Act 1948* and Part XA of the *Defence Force Retirement and Death Benefits Act 1973* to incorporate a different pension indexation regime to apply from 1 July 2014 for those

DFRB and DFRDB pensioners who are age 55 or older on either 1 January or 1 July when pensions are indexed (a person who turns age 55 on either 1 January or 1 July will get the benefit of the new indexation arrangements)

There will be no change to the way DFRB and DFRDB pensions are indexed for those under age 55, until they reach age 55 (for example, a person who turns 55 on 2 January or 2 July will not get the benefit of new indexation arrangements until the following indexation period, either 1 July or 1 January respectively).

Any part of a DFRB or DFRDB pension that is currently unindexed will continue to be unindexed.

The new indexation methodology will not result in a DFRB or DFRDB pension that is currently less than the MTAWE floor percentage increasing to the floor percentage used for age and service pension purposes or to the value of the indicative pension (and conversely, that a pension that is currently in excess of the floor percentage or the indicative pension reducing to those respective levels).

The Bill will also amend the *Income Tax Assessment Act 1997* to ensure the one-off capitalised value of past service of DFRB and DFRDB members at 1 July 2014 is excluded from the operation of Division 293 tax.

In broad terms, the amendments:

- Retain the current indexation methodology for pensions paid to pensioners under age 55.

- Make upward movements in the CPI, PBLCI and the MTAWE floor a part of the indexation methodology for pensions paid to pensioners aged 55 or older on either 1 July or 1 January.

- Ensure DFRB and DFRDB members with significant past service are not required to pay Division 293 tax on the value of that past service as a result of the benefit improvement brought about by this measure.

Financial Impact Statement

The Australian Government Actuary has costed this measure, exclusive of any impact on taxation receipts or other government payments as follows:

Impact on underlying cash

	2014-15 **$m**	**2015-16** **$m**	**2016-17** **$m**	**2017-18** **$m**	**Total FE 2014-15 to 2017-18** **$m**
Gross Impact	-12.5	-30.4	-49.5	-69.8	-162.2
Contingency Reserve*	10.2	26.1	41.0	57.8	135.1
Defence	2.3	4.3	8.5	12.0	27.1

Impact	0.0	0.0	0.0	0.0	0.0

* $135.1m of the impact on underlying cash has already been attributed to the Contingency Reserve as at the 2013-14 Mid-Year Economic and Fiscal Outlook update.

Impact on fiscal balance

2014-15 $m	2015-16 $m	2016-17 $m	2017-18 $m	Total FE 2014-15 to 2017-18 $m
320.3	336.5	352.6	368.6	1,378.0#

\# $1,350m of this impact was attributed to the Contingency Reserve as at the 2013-14 Mid-Year Economic and Fiscal Outlook update.

The unfunded liability at 1 July 2014 is estimated to increase by $5.1billion.

Defence's notional employer contribution rate, expressed as a percentage of salaries and service allowance, for current DFRDB contributing members will increase by 6 percentage points of salaries and service allowance (from 29.5% to 35.5%).

ComSuper, the administrator of the DFRB and DFRDB schemes will require $1.1m for system and administration costs.

The Department of Defence will offset $27.1m from its Departmental appropriation to enable this proposal to be implemented with zero impact on underlying cash as shown in the table above. Defence will also meet the additional costs associated with increased employer superannuation contribution rates and ComSuper's costs from Departmental appropriations.

An exemption from the Division 293 tax has no budget revenue implications as no allowance was made for the interaction with the Division 293 tax in the forward estimates. The out years' revenue consequences of the increased indexation of DFRB/DFRDB pensions due to the interaction with Division 293 tax is a small but unquantifiable gain to revenue.

DEFENCE FORCES RETIREMENT BENEFITS LEGISLATION AMENDMENT (FAIR INDEXATION) BILL 2014

Section 1 – Short title

This clause provides for the citation of the Act as the *Defence Forces Retirement Benefits Legislation Amendment (Fair Indexation) Act 2014*.

Section 2 – Commencement

This clause provides that the Act commences on the day after the Act receives the Royal Assent.

Section 3 – Schedule

This clause is a formal provision specifying that amendments or repeals are made to the provisions set out in the sections in the schedule.

Schedule 1 – Amendments

Defence Force Retirement and Death Benefits Act 1973

Item 1 inserts a new Division (Division 1) as an introduction that provides a simplified outline (under new section 98AA) of the operation of Part XA of the Act which deals with pension increases. The outline explains that pension benefits are indexed each 1 January and 1 July in each year, continues current indexation arrangements for pensions paid to pensioners aged under 55 and sets out new indexation arrangements (the 55-plus percentage) for pensions paid to pensioners aged 55 or older. The introduction also incorporates definitions and some general rules about changed CPI numbers, reference bases and rounding.

Item 2 removes the word *Interpretation* from the heading of section 98A and replaces it with the word *Definitions*.

Item 3 removes the reference to subsection (1) in section 98A under what was previously the *Interpretation* heading in line with current drafting standards.

Item 4 inserts new definitions into section 98A to cater for the new indexation arrangements to apply to DFRDB pensions paid to pensioners aged 55 or older. New terms defined for this purpose are:

- ***55-plus percentage*** (is the new method for indexing pensions paid to pensioners aged 55 or older and is explained in step 7 of the method statement in new subsection 98GB(2))
- ***current indicative pension amount*** (is the base pension amount that is adjusted as part of the 55-plus percentage increase and is explained in step 4 of the method statement in new subsection 98GB(2))

- ***December quarter*** (included to distinguish from March and September quarters upon which CPI and LCI indices are based – MTAWE is based on the middle months of the June and December quarters)
- ***indicative pension amount*** (is the base pension for 1 January 2014 and subsequent prescribed half years that is explained in new subsection 98GC(1))
- ***June quarter*** (to distinguish from March and September quarters upon which CPI and LCI indices are based – MTAWE is based on the middle months of the June and December quarters)
- ***LCI percentage*** (is worked out using the All Groups Pensioner and Beneficiary Living Cost Index published by the Statistician and explained in new section 98GD)

The following terms that are currently used in Part XA are now defined for a better understanding of the Part:

- ***March quarter*** (CPI and LCI indices are based on the March and September quarters)
- ***pensioner*** (identifies the recipient of a pension benefit)
- ***prescribed percentage*** (is worked out using the All Groups Consumer Price Index published by the Statistician and explained in new subsection 98B(3))
- ***September quarter*** (CPI and LCI indices are based on the March and September quarters)

<u>Item 5</u> repeals:

subsection 98A(2)	which provides that if the Statistician substitutes a new CPI number for a particular quarter, the new CPI number is to be disregarded.
subsection 98A(3)	which provides that if the Statistician changes the reference base for the CPI, then the CPI numbers based on the new reference base are to be used for calculating future pension increases.
subsection 98A(4)	which provides for the rounding of a CPI percentage increase to a fraction of one-tenth of 1%.

<u>Item 6</u> inserts new sections 98AB and 98AC in lieu of subsections 98A(2), 98A(3) and 98A(4) which are repealed by item 5.

New subsection 98AB(1) has the same effect as repealed subsection 98A(2), that is, disregard new numbers for a particular quarter substituted by the Statistician. New subsection 98AB(1) now refers to the Statistician substituting a new CPI number referred to in repealed subsection 98B(3) or a new LCI number referred to in new subsection 98GD(1) or a new amount for MTAWE referred to in new subsection 98GE(2).

New subsections 98AB(2) and 98AB(3) have the same effect as repealed subsection 98A(3), that is, if the Statistician changes the reference base (or period), then numbers based on the new reference base (or period) are to be used for calculating future pension increases. New paragraph 98AB(2)(a) applies this principle if the CPI reference period is changed and new paragraph 98AB(2)(b) applies this principle if the LCI reference period is changed.

New subsection 98AB(3) applies the same principle for changes to MTAWE.

New section 98AC has the same effect as repealed subsection 98A(4) except that it provides for the rounding of percentages for the prescribed percentage, the LCI percentage and the 55-plus percentage to a fraction of one-tenth of 1%.

Item 6 also establishes a new Division 2, which sets out general provisions about pension increases, incorporating new section 98AD which is a simplified outline of the Division. The outline explains that pension benefits are indexed each 1 January and 1 July in each year, identifies that current indexation arrangements for pensions paid to pensioners aged under 55 are based on positive movements in the CPI, explains that movements in the CPI are only a part of the indexation arrangements for pensions paid to pensioners aged 55 or older and identifies there are rules dealing with special cases.

The new Division 2 also incorporates section 98B which provides for increases in certain pensions. Items 7, 8 and 9 make changes to aspects of the current section 98B.

Item 7 repeals:

subsection 98B(1) which provides for an increase in pensions payable to a pensioner if the CPI number in the first quarter of a half year commencing on either 1 January or 1 July immediately preceding a prescribed half-year (defined) exceeds the highest CPI number for any earlier half-year after 1 July 1985 (the first year when the all groups CPI number was based on the weighted average of the 8 capital cities – previously it was 6 capital cities).

subsection 98B(2) which provides that any increase ascertained in line with subsection 98B(1) is the prescribed percentage that is to apply to the relevant rate of pension ascertained in accordance with subsection 98B(4).

subsection 98B(3) which provides the formula for working out the prescribed percentage for the purposes of subsection 98B(2) and subsection 98B(5A) which provides for the CPI indexation of the fixed component of a child's pension ($312 per annum) and orphan's pension ($5,000 per annum).

Item 7 substitutes new subsections 98B(1) under a new heading *Increase*, 98B(2) under a new heading *Increase by prescribed percentage* and 98B(3) under a new heading *Prescribed percentage* and inserts new subsection 98B(3A).

New subsection 98B(1) confers an entitlement to an increase in the relevant rate of a pensioner's pension (the relevant rate is set out in subsection 98B(4)). The new subsection 98B(1) provides that the increase is worked out by using the prescribed percentage (that is, CPI increases) for pensions paid to pensioners aged under 55 and by using the 55-plus percentage for pensions paid to pensioners aged 55 and older.

New subsection 98B(2) provides that the relevant rate of pension paid to a pensioner aged under 55 on either 1 January or 1 July is only increased by the prescribed percentage (it is relevant to note that section 37A of the *Acts Interpretation Act 1901* provides - *For the purposes of any Act, the time at which a person attains a particular age expressed in years is the commencement of the relevant anniversary of the date of the birth of that person*).

New subsection 98B(3) sets out the formula for calculating the prescribed percentage and explains the terms used in the formula. That formula is:

$$\frac{\text{First quarter CPI number} - \text{Base quarter CPI number}}{\text{Base quarter CPI number}} \times 100$$

New subsection 98B(3A) provides that when determining whether there is to be a July pension increase, the CPI number for the March quarter in the immediately preceding half-year must be more than the historic highest CPI number for any previous September or March quarter. When determining whether there is to be a January pension increase, the CPI number for the September quarter in the immediately preceding half-year must be more than the historic highest CPI number for any previous March or September quarter.

If the CPI numbers are equal to or less than the highest CPI number for any previous relevant quarter (either September or March), there is no increase in a pension being paid to a pensioner aged under 55 for the half year.

Item 7 also incorporates a new sub-heading for subsection 98B(4) to identify that the subsection deals with the increase in the relevant rate of a reversionary, child or orphan pension where the recipient member dies on 30 June or 31 December.

Item 8 removes a reference to the previous subsection 98B(2) (substituted by item 7) and now makes it clear that the relevant rate of pension for a prescribed half-year is set out in paragraphs 98B(4)(a), (ab), (ac), (b), (c), (d), (e) and (f).

Item 9 inserts a new subsection 98B(4A) to make it clear that it is the age of the pensioner on or after 1 July 2014, not the age of the deceased recipient member, that dictates how the method of indexation is to be applied to the *notional rate of retirement pay* for reversionary, child and orphan pensions from the date of the recipient member's death or 1 July 2014, whichever is later.

For example, consider a recipient member aged 58 at 1 July 2014 with a spouse aged 45 at 1 July 2014. The recipient member dies on 25 July 2018. For the indexation dates 1 July 2014 to 1 July 2018, the *notional rate of retirement pay* increases at the 55-plus percentage as the recipient member is aged 55 or more at each indexation date. For the indexation date at 1 January 2019 and subsequent indexation dates prior to the reversionary spouse attaining age 55, the *notional rate of retirement pay* increases at the prescribed percentage as the reversionary spouse has not attained age 55. For any indexation dates after the reversionary spouse attains age 55, the *notional rate of retirement pay* increases at the 55-plus percentage as the reversionary spouse is aged 55 or more at each indexation date.

Item 10 inserts a heading before subsection 98B(5A) to identify that subsections 98B(5A), (5B) and (6) refer to increases in children's pensions (which includes orphans).

Item 11 inserts a heading before subsection 98B(7) to identify that subsection 98B(7) provides rules for indexation when a pensioner dies on 30 June or 31 December.

Item 12 inserts a new Division 3 into Part XA to provide for increases of pensions paid to those aged 55 or older. New Division 3 incorporates new sections 98GA, 98GB, 98GC, 98GD, 98GE and 98GF.

New section 98GA provides a simplified outline of Division 3 setting out that for pensioners aged 55 or older, their pensions are indexed by the better of positive movements in the CPI and LCI with an adjustment, if necessary, to reflect MTAWE increases. The outline explains the establishment of a hypothetical pension (the indicative pension) against which MTAWE changes are measured and indicates that the better of CPI and LCI movements will be applied as a pension increase from either 1 January or 1 July if that increase is greater than the increase in the hypothetical pension as a result of MTAWE changes. Otherwise, the percentage increase in the hypothetical pension as a result of the MTAWE changes will be the pension increase for the half-year.

New section 98GB establishes the 55-plus percentage for indexing pensions paid to pensioners aged 55 or older.

New subsection 98GB(1) makes it clear that the pension increase provided for by subsection 98B(1) for a pension paid to a pensioner age 55 or older is to be the 55-plus percentage.

New subsection 98GB(2) is a method statement explaining the seven steps to work out the 55-plus percentage. A hypothetical example of how the 55-plus percentage is to be ascertained in line with the method statement is as follows:

A hypothetical example

Year 1 – July adjustment

Latest March quarter CPI figure	171.0
Previous September quarter CPI figure	168.6

Latest March quarter LCI figure 110.1
Previous September quarter LCI figure 108.2

Previous November MTAWE $1,402.10

Current indicative pension $19,541.91

Step 1 – calculate the prescribed percentage for the prescribed half-year (CPI adjustment)

$$\frac{\text{Latest March quarter CPI figure} - \text{Previous September quarter CPI figure}}{\text{Previous September quarter CPI figure}} \text{ x } 100 = \text{CPI change}$$

$$\frac{171.0 - 168.6}{168.6} \text{ x } 100 = 1.014 \text{ (or 1.4\% calculated to the nearest one-tenth of 1\%)}$$

Step 2 – calculate the LCI percentage for the prescribed half-year (LCI percentage)

$$\frac{\text{Latest March quarter LCI figure} - \text{Previous September quarter LCI figure}}{\text{Previous September quarter LCI figure}} \text{ x } 100 = \text{LCI change}$$

$$\frac{110.1 - 108.2}{108.2} \text{ x } 100 = 1.018 \text{ (or 1.8\% calculated to the nearest one-tenth of 1\%)}$$

Step 3 – Determine the higher of the percentages - if they are the same, use the step 1 percentage (CPI/LCI percentage)

1.018 (or 1.8%) calculated at step 2.

Step 4 – Identify the current indicative pension for the prescribed half-year immediately before the relevant prescribed half-year (current indicative pension amount)

$19,541.91

Step 5 – Work out the amount that is the CPI/LCI percentage of the current indicative pension amount and add it to the current indicative pension amount (CPI/LCI result)

$19,541.91 x 1.018 = $19,893.66

Step 6 – calculate the MTAWE result

Previous November MTAWE x 52 = annual MTAWE
Annual MTAWE x 27.7% = MTAWE result

$1,402.10 x 52 = $72,909.20
$72,909.20 x 27.7% = $20,195.85

Step 7 –work out the 55 plus percentage - if the CPI/LCI result is the same as or higher than the MTAWE result, the 55-plus percentage for the prescribed half-year is the CPI/LCI percentage (from step 3). If the CPI/LCI result is lower than the MTAWE result, the 55-plus percentage for the prescribed half-year is the percentage increase needed to maintain the indicative pension at 27.7% of MTAWE which, in this example is:

$$\frac{\text{MTAWE result} - \text{Current indicative pension amount}}{\text{Current indicative pension amount}} \text{ x } 100$$

$$\frac{\$20{,}195.85 - \$19{,}541.91}{\$19{,}541.91} \text{ x } 100 = 3.3\% \text{ (calculated to the nearest one-tenth of 1\%)}$$

The year 1 July adjustment is 3.3% (the result calculated at step 7, because it is higher than the result calculated at step 3, which is 1.8%).

Year 2 – January adjustment

Latest September quarter CPI figure	173.3
Previous March quarter CPI figure	171.0
Latest September quarter LCI figure	111.0
Previous March quarter LCI figure	110.1
Previous May MTAWE	$1,403.10
Current indicative pension	$20,195.85

Step 1 – calculate the prescribed percentage for the prescribed half-year (CPI adjustment)

$$\frac{\text{Latest September quarter CPI figure} - \text{Previous March quarter CPI figure}}{\text{Previous March quarter CPI figure}} \text{ x } 100 = \text{CPI change}$$

$$\frac{173.3 - 171.0}{171.0} \text{ x } 100 = 1.013 \text{ (or 1.3\% calculated to the nearest one-tenth of 1\%)}$$

Step 2 – calculate the LCI percentage for the prescribed half-year (LCI percentage)

$$\frac{\text{Latest September quarter LCI figure} - \text{Previous March quarter LCI figure}}{\text{Previous March quarter LCI figure}} \text{ x } 100 = \text{LCI change}$$

$$\frac{111.0 - 110.1}{110.1} \text{ x } 100 = 1.008 \text{ (or 0.8\% calculated to the nearest one-tenth of 1\%)}$$

Step 3 – Determine the higher of the percentages - if they are the same, use the step 1 percentage (CPI/LCI percentage)

1.013 (or 1.3%) calculated at step 1.

Step 4 – Identify the current indicative pension for the prescribed half-year immediately before the relevant prescribed half-year (current indicative pension amount)

$20,195.85

Step 5 – Work out the amount that is the CPI/LCI percentage of the current indicative pension amount and add it to the current indicative pension amount (CPI/LCI result)

$20,195.85 x 1.013 = $20,458.40

Step 6 – calculate the MTAWE result

Previous May MTAWE x 52 = annual MTAWE
Annual MTAWE x 27.7% = MTAWE result

$1,403.10 x 52 = $72,961.20
$72,961.20 x 27.7% = $20,210.25

Step 7 –work out the 55 plus percentage - if the CPI/LCI result is the same as or higher than the MTAWE result, the 55-plus percentage for the prescribed half-year is the CPI/LCI percentage (from step 3). If the CPI/LCI result is lower than the MTAWE result, the 55-plus percentage for the prescribed half-year is the percentage increase needed to maintain the indicative pension at 27.7% of MTAWE which, in this example is:

$$\frac{\text{MTAWE result} - \text{Current indicative pension amount}}{\text{Current indicative pension amount}} \times 100$$

$$\frac{\$20{,}210.25 - \$20{,}195.85}{\$20{,}195.85} \times 100 = 0.1\% \text{ (calculated to the nearest one-tenth of 1\%)}$$

The year 2 January adjustment is 1.3% (the result calculated at step 3, because it is higher than the result calculated at step 7, which is 0.1% - the current indicative pension for the Year 2 July adjustment will be $20,195.85 x 1.013 = $20,458.40).

New subsection 98GB(3) effectively provides that if neither the CPI/LCI result nor the MTAWE result calculated using the method statement in subsection 98GB(2) provides for an increase, then there is to be no pension increase for the prescribed half-year.

New section 98GC establishes the indicative pension amount which is a component of the 55-plus percentage for indexing pensions paid to pensioners aged 55 or older.

New subsection 98GC(1) establishes $19,541,91 as the indicative pension (that is, the hypothetical amount) at 1 January 2014 (paragraph 98GC(1)(a)) against which

subsequent MTAWE changes are to be measured for the purposes of applying the 55-plus percentage (paragraph 98GC(1)(b)).

New subsection 98GC(2) provides for the increase in the value of the indicative pension at 1 January and 1 July each year from 1 July 2014 by the 55-plus percentage. The increased amount is the indicative pension for working out the 55-plus percentage for the next prescribed half-year.

New subsection 98GC(3) provides that the increased indicative pension referred to in subsection 98GC(2) can be the same as the indicative pension for the previous prescribed half-year because the 55-plus percentage calculated for that previous prescribed half-year was nil (see new subsection 98GB(3)).

New section 98GD establishes the LCI percentage which is a component of the 55-plus percentage for indexing pensions paid to pensioners aged 55 or older.

New subsection 98GD(1) sets out the formula for calculating the LCI percentage and explains the terms used in the formula. That formula is:

$$\frac{\text{First quarter LCI number} - \text{Base quarter LCI number}}{\text{Base quarter LCI number}} \times 100$$

New subsection 98GD(2) provides that when determining the LCI percentage (Step 2 of the method statement in subsection 98GB(2)):

- for the July pension increase, if the LCI number for the March quarter in the immediately preceding half-year is not more than the historic highest LCI number for any previous September or March quarter then the LCI percentage is taken to be 0%; and

- for the January pension increase, if the LCI number for the September quarter in the immediately preceding half-year is not more than the historic highest LCI number for any previous March or September quarter then the LCI percentage is taken to be 0%.

New section 98GE establishes the MTAWE result set out in step 6 of the method statement in subsection 98GB(2) which is a component of the 55-plus percentage for indexing pensions paid to pensioners aged 55 or older.

New subsection 98GE(1) provides the MTAWE result is 27.7% of the annualised MTAWE figure for the most recent reference period published by the Statistician.

New subsection 98GE(2) sets out the process for determining the annualised MTAWE figure published by the Statistician and identifies the document from which to extract the MTAWE figure.

New subsection 98GE(3) ensures that if the Statistician publishes the MTAWE figure under a different heading than that identified under subsection 98GE(2) (paragraph 98GE(3)(a)) or renames a document in which the MTAWE figure is published (paragraph 98GE(3)(b)), then the annualised MTAWE figure is to be calculated in

accordance with subsection 98GE(2), based on the figure published by the Statistician under the new heading and/or in the new document.

New subsection 98GE(4) stipulates that the recent reference period published by the Statistician is the last pay period ending on or before the third Friday of the middle month of the June or December quarters.

New section 98GF sets out that for the purposes of step 7 in the method statement in new subsection 98GB(2), the formula for calculating the 55-plus percentage if the CPI/LCI result calculated in step 5 of the method statement is less than the MTAWE result calculated at step 6. That formula is:

$$\frac{\text{MTAWE result} - \text{Current indicative pension amount}}{\text{Current indicative pension amount}} \times 100$$

Defence Forces Retirement Benefits Act 1948

Item 13 inserts a new Division (Division 1) as an introduction that provides a simplified outline under new section 83A of the operation of Part VID of the Act which deals with pension increases. The outline explains that pension benefits are indexed each 1 January and 1 July in each year, continues current indexation arrangements for pensions paid to pensioners aged under 55 and sets out new indexation arrangements (the 55-plus percentage) for pensions paid to pensioners aged 55 or older. The introduction also incorporates definitions and some general rules about changed CPI numbers, reference bases and rounding.

Item 14 removes the word *Interpretation* from the heading of section 83 and replaces it with the word *Definitions*.

Item 15 removes the reference to subsection (1) in section 83 under what was previously the *Interpretation* heading in line with current drafting standards.

Item 16 inserts new definitions into section 83 to cater for the new indexation arrangements to apply to DFRB pensions paid to pensioners aged 55 or older. New terms defined for this purpose are:

- ***55-plus percentage*** (is the new method for indexing pensions paid to pensioners aged 55 or older and is explained in step 7 of the method statement in new subsection 84H(2))
- ***current indicative pension amount***(is the base pension amount that is adjusted as part of the 55-plus percentage increase and is explained in step 4 of the method statement in new subsection 84H(2))
- ***December quarter*** (included to distinguish from March and September quarters upon which CPI and LCI indices are based – MTAWE is based on the middle months of the June and December quarters)
- ***indicative pension amount*** (is the base pension for 1 January 2014 and subsequent prescribed half years that is explained in new subsection 84J(1))

- ***June quarter*** (to distinguish from March and September quarters upon which CPI and LCI indices are based – MTAWE is based on the middle months of the June and December quarters)
- ***LCI percentage*** (is worked out using the All Groups Pensioner and Beneficiary Living Cost Index published by the Statistician and explained in new section 84K

The following terms that are currently used in Part XA are now defined for a better understanding of the Part:

- ***March quarter*** (CPI and LCI indices are based on the March and September quarters)
- ***pensioner*** (identifies the recipient of a pension benefit)
- ***prescribed percentage*** (is worked out using the All Groups Consumer Price Index published by the Statistician and explained in new subsection 84(3))
- ***September quarter*** (CPI and LCI indices are based on the March and September quarters)

Item 17 repeals:

subsection 83(2)	which provides that if the Statistician substitutes a new CPI number for a particular quarter, the new CPI number is to be disregarded.
subsection 83(3)	which provides that if the Statistician changes the reference base for the CPI, then the CPI numbers based on the new reference base are to be used for calculating future pension increases.
subsection 83(4)	which provides for the rounding of a CPI percentage increase to a fraction of one-tenth of 1%.

Item 18 inserts new sections 83B and 83C in lieu of subsections 83(2), 83(3) and 83(4) which are repealed by item 17.

New subsection 83B(1) has the same effect as repealed subsection 83(2), that is, disregard new numbers for a particular quarter substituted by the Statistician. New subsection 83B(1) now refers to the Statistician substituting a new CPI number referred to in repealed subsection 84(3) or a new LCI number referred to in new subsection 84K(1) or a new amount for MTAWE referred to in new subsection 84AL(2).

New subsections 83B(2) and 83B(3) have the same effect as repealed subsection 83(3), that is, if the Statistician changes the reference base (or period), then numbers based on the new reference base (or period) are to be used for calculating future pension increases. New paragraph 83B(2)(a) applies this principle if the CPI reference period is changed and new paragraph 83B(2)(b) applies this principle if the LCI reference period is changed.

New subsection 83B(3) applies the same principle for changes to MTAWE.

New section 83C has the same effect as repealed subsection 83(4) except that it provides for the rounding of percentages for the prescribed percentage, the LCI percentage and the 55-plus percentage to a fraction of one-tenth of 1%.

Item 18 also establishes a new Division 2, which sets out general provisions about pension increases, incorporating new section 83D which is a simplified outline of the Division. The outline explains that pension benefits are indexed each 1 January and 1 July in each year, identifies that current indexation arrangements for pensions paid to pensioners aged under 55 are based on positive movements in the CPI, explains that movements in the CPI are only a part of the indexation arrangements for pensions paid to pensioners aged 55 or older and identifies there are rules dealing with special cases.

The new Division 2 also incorporates section 84 which provides for increases in pensions (it also incorporates section 84A, 84B, 84C, 84D, 84E and 84F, none of which are being changed).

Item 19 substitutes new subsections 84(1) under the heading *Increase*, 84(2) under the heading *Increase by prescribed percentage* and 84(3) under the heading *Prescribed percentage* and inserts a new subsection 84(3A).

New subsection 84(1) confers an entitlement to an increase in the rate of a pensioner's pension. The new subsection 84(1) provides that the increase is worked out by using the prescribed percentage (that is, CPI increases) for pensions paid to pensioners aged under 55 and by using the 55-plus percentage for pensions paid to pensioners aged 55 and older.

New subsection 84(2) provides that the rate of pension paid to a pensioner aged under 55 on either 1 January or 1 July is only increased by the prescribed percentage (it is relevant to note that section 37A of the *Acts Interpretation Act 1901* provides - *For the purposes of any Act, the time at which a person attains a particular age expressed in years is the commencement of the relevant anniversary of the date of the birth of that person*).

New subsection 84(3) sets out the formula for calculating the prescribed percentage and explains the terms used in the formula. That formula is:

$$\frac{\text{First quarter CPI number} - \text{Base quarter CPI number}}{\text{Base quarter CPI number}} \text{ x } 100$$

New subsection 84(3A) provides that when determining whether there is to be a July pension increase, the CPI number for the March quarter in the immediately preceding half-year must be more than the historic highest CPI number for any previous September or March quarter. When determining whether there is to be a January pension increase, the CPI number for the September quarter in the immediately preceding half-year must be more than the historic highest CPI number for any previous March or September quarter.

If the CPI numbers are equal to or less than the highest CPI number for any previous relevant quarter (either September or March), there is no increase in a pension being paid to a pensioner aged under 55 for the half year.

Item 19 also incorporates a new sub-heading for subsection 84(4) to identify that the subsection deals with the increase in the rate of a reversionary, child or orphan pension where the recipient member dies on 30 June or 31 December.

Item 20 inserts a new Division 3 into Part VID to provide for increases of pensions paid to those aged 55 or older. New Division 3 incorporates new sections 84G, 84H, 84J, 84K, 84L and 84M.

New section 84G provides a simplified outline of Division 3 setting out that for pensioners aged 55 or older, their pensions are indexed by the better of positive movements in the CPI and LCI with an adjustment, if necessary, to reflect MTAWE increases. The outline explains the establishment of a hypothetical pension (the indicative pension) against which MTAWE changes are measured and indicates that the better of CPI and LCI movements will be applied as a pension increase from either 1 January or 1 July if that increase is greater than the increase in the hypothetical pension as a result of MTAWE changes. Otherwise, the percentage increase in the hypothetical pension as a result of the MTAWE changes will be the pension increase for the half-year.

New section 84H establishes the 55-plus percentage for indexing pensions paid to pensioners aged 55 or older.

New subsection 84H(1) makes it clear that the pension increase provided for by subsection 84(1) for a pension paid to a pensioner age 55 or older is to be the 55-plus percentage.

New subsection 84H(2) is a method statement explaining the seven steps to work out the 55-plus percentage. A hypothetical example of how the 55-plus percentage is to be ascertained in line with the method statement is as follows:

A hypothetical example

Year 1 – July adjustment

Latest March quarter CPI figure	171.0
Previous September quarter CPI figure	168.6
Latest March quarter LCI figure	110.1
Previous September quarter LCI figure	108.2
Previous November MTAWE	$1,402.10
Current indicative pension	$19,541.91

Step 1 – calculate the prescribed percentage for the prescribed half-year (CPI adjustment)

$$\frac{\text{Latest March quarter CPI figure} - \text{Previous September quarter CPI figure}}{\text{Previous September quarter CPI figure}} \text{ x } 100 = \text{CPI change}$$

$$\frac{171.0 - 168.6}{168.6} \text{ x } 100 = 1.014 \text{ (or 1.4\% calculated to the nearest one-tenth of 1\%)}$$

Step 2 – calculate the LCI percentage for the prescribed half-year (LCI percentage)

$$\frac{\text{Latest March quarter LCI figure} - \text{Previous September quarter LCI figure}}{\text{Previous September quarter LCI figure}} \text{ x } 100 = \text{LCI change}$$

$$\frac{110.1 - 108.2}{108.2} \text{ x } 100 = 1.018 \text{ (or 1.8\% calculated to the nearest one-tenth of 1\%)}$$

Step 3 – Determine the higher of the percentages - if they are the same, use the step 1 percentage (CPI/LCI percentage)

1.018 (or 1.8%) calculated at step 2.

Step 4 – Identify the current indicative pension for the prescribed half-year immediately before the relevant prescribed half-year (current indicative pension amount)

$19,541.91

Step 5 – Work out the amount that is the CPI/LCI percentage of the current indicative pension amount and add it to the current indicative pension amount (CPI/LCI result)

$19,541.91 x 1.018 = $19,893.66

Step 6 – calculate the MTAWE result

Previous November MTAWE x 52 = annual MTAWE
Annual MTAWE x 27.7% = MTAWE result

$1,402.10 x 52 = $72,909.20
$72,909.20 x 27.7% = $20,195.85

Step 7 –work out the 55 plus percentage - if the CPI/LCI result is the same as or higher than the MTAWE result, the 55-plus percentage for the prescribed half-year is the CPI/LCI percentage (from step 3). If the CPI/LCI result is lower than the MTAWE result, the 55-plus percentage for the prescribed half-year is the percentage increase needed to maintain the indicative pension at 27.7% of MTAWE which, in this example is:

$$\frac{\text{MTAWE result} - \text{Current indicative pension amount}}{\text{Current indicative pension amount}} \text{ x } 100$$

$$\frac{\$20{,}195.85 - \$19{,}541.91}{\$19{,}541.91} \text{ x } 100 = 3.3\% \text{ (calculated to the nearest one-tenth of 1\%)}$$

The year 1 July adjustment is 3.3% (the result calculated at step 7, because it is higher than the result calculated at step 3, which is 1.8%).

Year 2 – January adjustment

Latest September quarter CPI figure	173.3
Previous March quarter CPI figure	171.0
Latest September quarter LCI figure	111.0
Previous March quarter LCI figure	110.1
Previous May MTAWE	$1,403.10
Current indicative pension	$20,195.85

Step 1 – calculate the prescribed percentage for the prescribed half-year (CPI adjustment)

$$\frac{\text{Latest September quarter CPI figure} - \text{Previous March quarter CPI figure}}{\text{Previous March quarter CPI figure}} \text{ x } 100 = \text{CPI change}$$

$$\frac{173.3 - 171.0}{171.0} \text{ x } 100 = 1.013 \text{ (or 1.3\% calculated to the nearest one-tenth of 1\%)}$$

Step 2 – calculate the LCI percentage for the prescribed half-year (LCI percentage)

$$\frac{\text{Latest September quarter LCI figure} - \text{Previous March quarter LCI figure}}{\text{Previous March quarter LCI figure}} \text{ x } 100 = \text{LCI change}$$

$$\frac{111.0 - 110.1}{110.1} \text{ x } 100 = 1.008 \text{ (or 0.8\% calculated to the nearest one-tenth of 1\%)}$$

Step 3 – Determine the higher of the percentages - if they are the same, use the step 1 percentage (CPI/LCI percentage)

1.013 (or 1.3%) calculated at step 1.

Step 4 – Identify the current indicative pension for the prescribed half-year immediately before the relevant prescribed half-year (current indicative pension amount)

$20,195.85

Step 5 – Work out the amount that is the CPI/LCI percentage of the current indicative pension amount and add it to the current indicative pension amount (CPI/LCI result)

$20,195.85 x 1.013 = $20,458.40

Step 6 – calculate the MTAWE result

Previous May MTAWE x 52 = annual MTAWE
Annual MTAWE x 27.7% = MTAWE result

$1,403.10 x 52 = $72,961.20
$72,961.20 x 27.7% = $20,210.25

Step 7 –work out the 55 plus percentage - if the CPI/LCI result is the same as or higher than the MTAWE result, the 55-plus percentage for the prescribed half-year is the CPI/LCI percentage (from step 3). If the CPI/LCI result is lower than the MTAWE result, the 55-plus percentage for the prescribed half-year is the percentage increase needed to maintain the indicative pension at 27.7% of MTAWE which, in this example is:

$$\frac{\text{MTAWE result} - \text{Current indicative pension amount}}{\text{Current indicative pension amount}} \times 100$$

$$\frac{\$20{,}210.25 - \$20{,}195.85}{\$20{,}195.85} \times 100 = 0.1\% \text{ (calculated to the nearest one-tenth of 1\%)}$$

The year 2 January adjustment is 1.3% (the result calculated at step 3, because it is higher than the result calculated at step 7, which is 0.1% - the current indicative pension for the Year 2 July adjustment will be $20,195.85 x 1.013 = $20,458.40).

New subsection 84H(3) effectively provides that if neither the CPI/LCI result nor the MTAWE result calculated using the method statement in subsection 84H(2) provides for an increase, then there is to be no pension increase for the prescribed half-year.

New section 84J establishes the indicative pension amount which is a component of the 55-plus percentage for indexing pensions paid to pensioners aged 55 or older.

New subsection 84J(1) establishes $19,541,91 as the indicative pension (that is, the hypothetical amount) at 1 January 2014 (paragraph 84J(1)(a)) against which subsequent MTAWE changes are to be measured for the purposes of applying the 55-plus percentage (paragraph 84J(1)(b)).

New subsection 84J(2) provides for the increase in the value of the indicative pension at 1 January and 1 July each year from 1 July 2014 by the 55-plus percentage. The increased amount is the indicative pension for working out the 55-plus percentage for the next prescribed half-year.

New subsection 84J(3) provides that the increased indicative pension referred to in subsection 84J(2) can be the same as the indicative pension for the previous

prescribed half-year because the 55-plus percentage calculated for that previous prescribed half-year did not result in a change to the indicative pension was nil (see new subsection 84H(3)).

New section 84K establishes the LCI percentage which is a component of the 55-plus percentage for indexing pensions paid to pensioners aged 55 or older.

New subsection 84K(1) sets out the formula for calculating the LCI percentage and explains the terms used in the formula. That formula is:

$$\frac{\text{First quarter LCI number} - \text{Base quarter LCI number}}{\text{Base quarter LCI number}} \times 100$$

New subsection 84K(2) provides that when determining the LCI percentage (Step 2 of the method statement in subsection 84H(2)):

- for the July pension increase, if the LCI number for the March quarter in the immediately preceding half-year is not more than the historic highest LCI number for any previous September or March quarter then the LCI percentage is taken to be 0%; and

- for the January pension increase, if the LCI number for the September quarter in the immediately preceding half-year is not more than the historic highest LCI number for any previous March or September quarter then the LCI percentage is taken to be 0%.

New section 84L establishes the MTAWE result set out in step 6 of the method statement in subsection 84H(2) which is a component of the 55-plus percentage for indexing pensions paid to pensioners aged 55 or older.

New subsection 84L(1) provides the MTAWE result is 27.7% of the annualised MTAWE figure for the most recent reference period published by the Statistician.

New subsection 84L(2) sets out the process for determining the annualised MTAWE figure published by the Statistician and identifies the document from which to extract the MTAWE figure.

New subsection 84L(3) ensures that if the Statistician publishes the MTAWE figure under a different heading than that identified under subsection 84L(2) (paragraph 84L(3)(a)) or renames a document in which the MTAWE figure is published (paragraph 84L(3)(b)), then the annualised MTAWE figure is to be calculated in accordance with subsection 84L(2), based on the figure published by the Statistician under the new heading and/or in the new document.

New subsection 84L(4) stipulates that the recent reference period published by the Statistician is the last pay period ending on or before the third Friday of the middle month of the June or December quarters.

New section 84M sets out that for the purposes of step 7 in the method statement in new subsection 84H(2), the formula for calculating the 55-plus percentage if the

CPI/LCI result calculated in step 5 of the method statement is less than the MTAWE result calculated at step 6. That formula is:

$$\frac{\text{MTAWE result} - \text{Current indicative pension amount}}{\text{Current indicative pension amount}} \text{ x } 100$$

Item 21 is an application provision that provides the amendments made by the Schedule apply to working out pension increases for half-years commencing on and after 1 July 2014 (that is, the "underlying" pension that is currently being paid to a pensioner aged 55 or over cannot be indexed by the 55-plus percentage before 1 July 2014).

Item 22 is a transitional provision that excludes the amount that represents the increased value of the accrued retirement benefit as at 1 July 2014 as a result of the amendments by the Schedule from the operation of Division 293 of the *Income Tax Assessment Act 1997.*

Statement of Compatibility with Human Rights

Prepared in accordance with Part 3 of the Human Rights (Parliamentary Scrutiny) Act 2011

Defence Forces Retirement Benefits Legislation Amendment (Fair Indexation) Bill 2014

This Bill is compatible with the human rights and freedoms recognised or declared in the international instruments listed in section 3 of the *Human Rights (Parliamentary Scrutiny) Act 2011*.

Overview of the Bill

The Defence Forces Retirement Benefits Legislation Amendment (Fair Indexation) Bill 2014 amends the *Defence Forces Retirement Benefits Act 1948* and the *Defence Force Retirement and Death Benefits Act 1973* to provide a different pension indexation regime to apply from 1 July 2014 for those Defence Forces Retirement Benefits (DFRB) and Defence Force Retirement and Death Benefits (DFRDB) pensioners who are age 55 or older on either 1 January or 1 July when pensions are indexed.

Under the Bill, pension benefits for pensioners under age 55 will continue to be indexed in line with positive movements in the consumer price index. However, when a pensioner reaches age 55 (and for those who are age 55 or older at 1 July 2014), indexation will potentially be more favourably based; using the method for indexing age and service pensions, that is, the better of positive movements in the consumer price index and the pensioner and beneficiary living cost index measured against a floor percentage of male total average weekly earnings.

Human Rights Implications

The Bill engages the following rights:

- Article 7, International Covenant on Economic, Social and Cultural Rights (ICESCR), the right to just and favourable conditions of work;
- Article 9, ICESCR, the right to social security;
- Article 11, ICESCR, the right to an adequate standard of living;
- Article 2(2), ICESCR, the right to equality and non-discrimination; and
- Article 26, International Covenant on Civil and Political Rights (ICCPR), the right to equality and non-discrimination.

The proposals promote the rights contained in article 7 (the right to just and favourable conditions of work), article 9 (the right to social security) and article 11 (the right to an adequate standard of living) of the ICESCR, for those aged 55 or older from 1 July 2014.

The amendments are also likely to engage the following human right:

Rights of Equality and Non-Discrimination – Article 2(2) of the ICESCR and Article 26 of the ICCPR

Article 2(2) of the ICESCR requires State Parties to guarantee the exercise of the rights contained in the ICESCR without discrimination on prohibited grounds. Age is considered to fall within the 'other status' prohibited ground.

In order for article 2(2) of ICESCR to be engaged, there would need to be a limitation on:

- the right to just and favourable conditions of work (article 7), which includes the right to equal remuneration that could extend to pension benefits;
- the right to social security (article 9), which extends to social insurance and it is likely pension benefits fall within the scope of the right to social security; or
- the right to an adequate standard of living (article 11), which includes the right to adequate food, clothing, housing and to the continuous improvement of living conditions and pension benefits assist persons to meet an adequate standard of living.

Article 26 of the ICCPR prohibits discrimination on a prohibited ground in law or in fact in any field regulated and protected by public authorities, including the provision of pension entitlements.

However, under international human rights law, not every differentiation of treatment will constitute discrimination for the purposes of article 2(2) of the ICESCR and article 26 of the ICCPR. The principle of legitimate differential treatment allows State parties to treat particular groups differently, provided particular criteria are met. In its General Comment No. 20, the United Nations Human Rights Committee noted:

> *Differential treatment based on prohibited grounds will be viewed as discriminatory unless the justification for differentiation is reasonable and objective. This will include an assessment as to whether the aim and effects of the measures or omissions are legitimate, compatible with the nature of the Covenant rights and solely for the purpose of promoting the general welfare in a democratic society. In addition, there must be a clear and reasonable relationship of proportionality between the aim sought to be realized and the measures or omissions and their effects.*

Under the ICCPR, differential treatment will be legitimate if it is justified on reasonable and objective grounds in pursuit of an aim that is legitimate under ICCPR. The same factors that are relevant to an assessment of legitimate differential treatment under the ICCPR are relevant to an assessment under the ICESCR and it is highly likely that both tests would produce the same result.

The effect of the measure is to distinguish between recipients of DFRB and DFRDB pensions on the basis of their age when calculating the increase in their pensions. This measure does not constitute discrimination under the *Age Discrimination Act 2004* on the basis that the Act excludes actions done by any person in direct compliance with Commonwealth legislation in relation to superannuation.

Legitimate aim: The aim of the measure is to ensure that DFRB and DFRDB pensioners age 55 and over have their pensions indexed in the same manner as age

and service pensions are indexed. This addresses a long standing grievance of the veteran and ex-service community about the differing indexation arrangements that apply to DFRB/DFRDB pensions (indexed to inflation) and the age/service pensions (indexed to reflect cost of living increases).

Reasonable, necessary and proportionate: The proposal is a discrete change in indexation arrangements for two closed superannuation schemes in recognition of the unique nature of military service and the special nature of the DFRB and DFRDB schemes. The DFRB scheme closed in September 1972 and all contributing members at that time were compulsorily transferred to the DFRDB scheme – the only current beneficiaries of the DFRB scheme are pensioners. The DFRDB scheme closed to new members in September 1991 and all contributing members had the option of transferring to the Military Superannuation and Benefits (MSB) scheme - there are currently some 3,000 DFRDB contributing members.

There are some 56,000 DFRB and DFRDB pensioners; it is estimated that 99.5% of DFRB pensioners and 80% of DFRDB pensioners will be age 55 and over at 1 July 2014.

Both the DFRB and DFRDB schemes are unfunded defined benefit schemes that are not subject to the superannuation regulatory regime. They are non-complying schemes for the purposes of that regulatory regime and benefits are paid from the Consolidated Revenue Fund (that is, there is no DFRB/DFRDB fund into which contributions are paid or from which benefits are paid).

DFRB and DFRDB pensions were/are available to members of the schemes after 20 years of service (or 15 years of service after having reached retiring age for rank held), irrespective of the age at which a member ceased/ceases service. The only way a member of either scheme could obtain a lump sum was/is to commute part of their pension in return for a reduced pension.

When the DFRDB scheme closed, the compulsory retiring age for the majority of the members of the Australian Defence Force was age 55 (and this is the age from which members of the MSB scheme can generally access their MSB benefits). Officers who were DFRDB members who retired of their own volition after having served for 20 years, but before reaching the notional retiring age for rank held, had their pensions reduced by 3% for every year that their actual retiring age was less than the notional retiring age.

DFRB pensions are based on the number of units of pension a member was allowed to purchase at particular ages and at particular salary levels and the value of those units at retirement. DFRDB pensions are based on the member's years of service and the salary and service allowance for the highest increment for rank held by the member at the date of retirement.

The decision to use age 55 as the starting age for the new indexation arrangements:

- reflects the compulsory retiring age when the DFRDB scheme was closed to new members; and

- the preservation age that existed in the superannuation regulatory laws before 1 July 1998 (when preservation ages were gradually increased from age 55 to age 60 depending on the person's date of birth).

It is appropriate to reflect these concepts when introducing a new indexation regime as set out in the Bill as it is not now possible to make changes to the closed DFRB and DFRDB schemes to make these schemes/benefits fit within the broader regulatory regime without a major restructure of the scheme arrangements and the benefits provided.

Pensions paid to pensioners under age 55 will continue to be indexed in line with positive movements in the consumer price index. There will be no reduction in the benefits paid to pensioners aged under 55. They will get the benefit of the new indexation arrangements when they reach age 55.

Michael Ronaldson
Minister for Veterans' Affairs