

# PAYSAFE ADVISORY SERVICES

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The article below, our annual New Year assessment of ESS/GSO State Super Schemes aims to inform you about the actual position of your scheme rather than perceived doom and gloom. *This information is general in nature and may not be relevant to your individual circumstances. You should refrain from doing anything in reliance on this information without first obtaining suitable professional advice.*

## ESS CREDITING RATE 0%: IS THERE ANY GOOD NEWS?

At the time writing, early February 2010, the ESS has had a 0% crediting rate for its funds from 19 December 2008 to January 21 2010. (See ESS state super crediting rates on their website)

On the face of it this does not appear to be good news. However, like the curate's egg, it is good in places.

What is the good news about a 0% crediting rate? That depends on your super Scheme and where you are in relation to your anticipated date of retirement or 54/11 resignation.

The two ESS/GSO Schemes are largely protected from short term market negativity. Although all investment is, and should be a long term process, because of its trust deed the ESS/GSO Revised Scheme must always give a positive return i.e. your contributions plus interest lump sum cannot have a negative return. Thus while your contributions plus interest lump sum has only advanced by your own contributions during this period there has been no diminution of the capital base of your monies.

### THE NEW SCHEME:

Provided that it is your intention is to retire in the New Scheme, **the lump sum retirement benefits of the New Scheme are defined benefits which are not impacted in any way by the share market.** (Were you to resign in the Scheme you would be impacted by the 0% crediting rate)

The ESS/GSO New Scheme is a defined benefit lump sum scheme (**designed to peak at age 60**) which **guarantees** to pay a lump sum based on the calculation format -

**LUMP SUM = YEARS OF SERVICE X COMBINED CONTRIBUTION RATE X FAS**

**Thus this guaranteed sum is underpinned by a rising salary and promotion** for the only real variable is Final average salary if the contribution is maximised. If a nil contribution rate is chosen the return will be 8.5% of FAS x years of service. The maximum average contribution rate is 5%. A 5% Contribution = 17.5% x FAS x years



of service. The standard increase in salary which may be expected is 3% per annum. However there will be periods like the principal class pay rises of 2001 when the standard pay rises undergo a rapid upward revision with the result that end benefits increased dramatically.

Thus while contributions will have been made at substantially lower superable salaries the pay out is in terms of the average of the aggregate of the last two years salary. Given that typically New Scheme members work longer and are thus likely to have the benefit of both rising salaries and promotion over time, it is surely logical that members will benefit most from a Scheme which guarantees its benefit. Thus security lies in maximizing your New Scheme contribution and then letting your salary rises and promotions multiply your benefits.

### **REVISED SCHEME:**

**Similarly the retirement and resignation pension benefits of the Revised Scheme are defined benefits which are not affected by the share market. It is only the 54/11 resignation lump sum benefit of the Revised Scheme which is in any way impacted by the market and this may be minimal.** Your current contributions plus interest balance is the product of a long period of strong markets and cannot be negatively impacted i.e. Its balance cannot decline, you will simply earn less on the accumulated balance. For those near 54/11 it will only be the current crediting rate which will impact future growth, it will not impact current capital value and this impact will be marginal.

For most of those with a full service history it is not whether or not they will have a substantial advantage from 54/11 only the relative scale of what that advantage is, analysed both in terms of lump sum and income. It is important that short term negative sentiment does not blind those approaching 54/11 to the long term advantage to be received from this strategy. It is important that you have analysis carried out by long term experienced analysts who have long experience of the scheme and how it operates and who can clearly show the lump sum and income advantages in a clear simple understandable form.

### **HOW 54/11 WORKS:**

The 54/11 **resignation** benefit consists of two parts, a pension benefit and a lump sum benefit. A **retirement**, (which operates on or from the 55<sup>th</sup> birthday or after) is expressed solely as a pension benefit which has the option of converting part of, or the whole of, the pension benefit into a lump sum using a set multiple determined by a set of tables which relate to your age in years and months. This conversion factor diminishes as you get older and the table of conversion multiples diminishes by the month.

There is a mistaken belief that 54/11 benefits everyone, this is not so, the benefit operates only for those with an appropriate service history. Unfortunately the unsophisticated only use one test to assess whether there is a 54/11 advantage. In fact two tests must be conducted to assess whether an individual is benefited by a 54/11 strategy.

The first test is an asset test which by comparing a 54/11 pension and lump sum benefit with a retirement benefit with an identical pension and commuted lump sum pension residue establishes what lump sum advantage exists if there is any.

The second test is an income test which by comparing a 54/11 pension and lump sum benefit, expressed as income, with a retirement benefit with a full pension establishes what income advantage exists if there is any.

This test is crucial in that ultimately all retirement benefits must fund an income. An asset test alone should not be used to determine 54/11 advantage. After an accurate analysis using both tests has been made individual needs and circumstances can then be factored in to allow individual decisions to be made which are advantageous to the individual circumstances of the superannuant.

### **PRIVATE SUPER: BAD NEWS?**

The benefits of both schemes may be supplemented by judicious salary packaging, and for those nearing 54/11 who have seen their lump sum expectations diminished it is worth considering additional super salary sacrifice to compensate for shortfall. This should be approached carefully after consultation with an appropriately qualified and experienced adviser.

The budget of 2009 radically altered the rules for contribution to private super via salary sacrifice. From July 1 2009 the maximum which may be contributed pre tax by salary sacrifice by those over age 50 will be \$50,000 until June 30 2012. **This sum includes your ESS contributions to either the New or Revised Scheme which are currently paid pre tax by salary sacrifice.**

For those under age 50 the former contribution limit for salary sacrifice of super was \$50,000. It will now be \$25,000. These new contribution rulings will be subject to an **excess contributions tax** should you exceed your contributions limit. This is 31.5% in addition to the 15% contributions tax.

The point at which there is a tax advantage to be derived from packaging private super is \$35,000 (after July 1 2010 this will be \$37,000) which is the point where the 30% tax range begins.

Those people who have been packaging substantial portions of their pre tax income should review the tax efficiency of that packaging and make such changes as are needed. For those contemplating a 54/11 strategy and return to work this means that there may need to be a review of how much may be efficiently packaged. (You must also be mindful of the maximum age based contribution limits, now called concessional contributions cap). Thus it would be prudent to review your super position and anticipated retirement strategies to ensure that they may be realised.

The changes to the contribution limits for super means that all salary packaging should be reassessed to ensure that it complies with these limits and allows for a maximising of contributions. For some this may mean that they opt to pay their ESS/GSO contributions post tax rather than pre tax. (This needs to be done carefully for outcomes are balanced on a razor as to advantage and there is no one size fits all solution)

**OVERVIEW:** The article opened with reference to the current 0% crediting rate for the ESS/GSO state super schemes, and looked at the tendency for short term negativity to overwhelm objective judgement. If an objective view is used and the experience of the past utilised, then it is clear that both New and Revised Scheme members are very well served by their schemes and that short term negativity should

not blind members to the long term advantages of their schemes . Throughout we have stressed the need to obtain advice from experienced advisers with established expertise in the operation of the schemes to facilitate objective decision making to achieve the best outcome for each individual member of the schemes.

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