



SUPERANNUATION REVIEW SUBMISSION

DATE OF SUBMISSION: 30 March 2007

DETAILS OF PERSON MAKING SUBMISSION:

(please choose which categories reflect your current situation)

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| <input type="checkbox"/> Army | <input type="checkbox"/> Retired Army | <input checked="" type="checkbox"/> DFRDB |
| <input checked="" type="checkbox"/> Navy | <input checked="" type="checkbox"/> Retired Navy | <input checked="" type="checkbox"/> MSBS |
| <input type="checkbox"/> Air Force | <input type="checkbox"/> Retired Air Force | |

ORGANISATION REPRESENTED (if applicable):

Naval Association of Australia

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DO YOU WISH TO REMAIN ANONYMOUS?

(If you chose yes, your name will not be recorded in any public reporting that occurs):

NO

SUMMARY OF SUBMISSION: (Please indicate the Key Points)

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Main Submission:

Submission is attached.

Submissions should be sent to:

E-mail: militarysuper.review@defence.gov.au

Or Post to:

The Superannuation Review Team
1 Thynne Street
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30 March 2007

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BRUCE ACT 2617

REVIEW OF MILITARY SUPERANNUATION ARRANGEMENTS SUBMISSION BY THE NAVAL ASSOCIATION OF AUSTRALIA

The Naval Association of Australia (NAA) welcomes the opportunity to make a submission to the Review of Military Superannuation Arrangements. The broad terms of reference are appreciated and the emphasis of the unique nature of military service encapsulated in the Terms of Reference is welcomed.

The Naval Association has a long history of service to the ex-naval community and to the Royal Australian Navy including its ancillary Reserve Forces and Naval Cadet schemes. Originating in 1920 as the Ex-Navalmen's Association, it changed to the Naval Association of Australia in 1961 when women who had served in the naval forces of the British Commonwealth were admitted to the Association as full members.

With regard to the existing military superannuation schemes the NAA is particularly concerned with the erosion of the pension value by the application of indexation based only on movements in the Consumer Price Index (CPI). Whilst there have been repeated applications to the Federal Government to change this to include adjustments in line with Male Total Average Weekly Earning (MTAWE), the response has been that no change to the DFRDB scheme would be entertained. In the meantime the basis for the calculation of the CPI has been adjusted considerably since the Defence Forces Retirement and Death Benefits (DFRDB) scheme was introduced in 1973. This problem also applies to MSBS.

The NAA is also concerned that the amount of pension paid after commutation in the DFRDB system is still based on life expectancy tables generated in 1962. There are still 6295 members (30 June 2006) of the Australian Defence Force serving who are covered by the DFRDB. Use of a table that gives the male a life expectancy of 72 years instead of the current 84 years is a severe disadvantage to those people retiring on DFRDB pensions at present and in the future.

The NAA submission addresses other areas of concern with the deficiencies of the current systems which are resulting in gradual erosion of the value of benefits paid to military superannuants at present. It also addresses future options for military superannuation.

This review presents a unique opportunity to resolve issues that have created discontent and angst within the Australian Ex Service community for many years and also with the benefit of hindsight either improve or develop a superannuation scheme that will provide attractive benefits to those who choose to serve their country in the Australian Defence Force.

The assistance of the Regular Defence Forces Welfare Association and the Australian Council of Public Sector Retiree Organisations is acknowledged in the preparation of this submission.

A handwritten signature in dark ink, appearing to read 'P.J. Cooke-Russell', written in a cursive style.

P.J. Cooke-Russell
Commander RAN Rtd

National Secretary
Naval Association of Australia

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Item 1

Indexation of Pensions and Preserved Employer Benefits

Proposal:

- Military pensions and Preserved Benefits should be indexed at the higher of CPI or MTAWWE

Basic Problem:

- Use of either CPI or MTAWWE can, in differing economic circumstances, allow military pensions and reversionary spouse benefits to lose value relative to the living standards of the rest of the community.
- The Government solved this problem for the politically sensitive social welfare pensions and benefits by indexing them to the higher of CPI or MTAWWE.
- The military pension reversionary spouse benefit loses further relative value because it is indexed at a rate even lower than the CPI.
- The preserved employer benefits of members in the MSBS, of those ADF members electing discharge, are only indexed at CPI. Again this represents an unacceptable erosion of relative value.

Key Elements of the Proposal:

- Index all military pensions and reversionary spouse benefits and MSBS Preserved Employer benefits, using the same indexation factor as is used for social welfare benefits and pensions, ie the higher of CPI or MTAWWE.
- Research available to the NAA suggests that the fiscal effect would be to increase the annual cost to the Government of military pensions by about 1.57%. The Commissioner for Superannuation reported the total pension benefits paid in 2005-06 under DFRDB and MSBS was \$1,224m, so the increased cost of adopting the proposed indexation factor would be about \$19.2m, of which some would be recovered through income tax and reduced welfare payments.

Item 2

The Application of Contemporary Life Tables to DFRB and DFRDB Pension Calculations

Proposal:

- The current' Life Tables' used in the calculation of DFRB & DFRDB pension and associated commutation calculations should be replaced by the most contemporary life tables available.
- A complete review of all current DFRB & DFRDB pensions, including reversionary benefits, should be completed using these contemporary life tables and revised pensions should be applied prospectively from an appropriate date.

Basic Problem:

- The life tables applying to DFRB & DFRDB pensions, associated commutation and reversionary benefits are over 42 years out of date. The use of these tables is disadvantageous to recipients, by reducing residual pensions after commutation by a factor that is no longer representative of contemporary expectations.

Key Elements of the Proposal:

- The use of life tables that are considerably outdated results in residual pensions after commutation being lower than they otherwise might be, given the increasing life expectancy.
- The application of contemporary life tables to both future DFRDB and past DFRB & DFRDB pensions will resolve this disadvantage.
- There is no suggestion that the outcomes of any review of appropriate calculations should be applied in retrospect, rather the proposal is that the revised outcomes should be applied prospectively from the first payday after completion of the review.
- The 'closed' nature of the DFRB & DFRDB schemes and the ministerial 'cast iron guarantee' should not be accepted as reasons to reject this long overdue reform. The 'cast iron guarantee' was provided in the context of providing an assurance that no disadvantageous amendments to the DFRDB scheme would be countenanced.

Item 3

Review of Reduced Pensions on Attaining the Notional Life Expectancy used in Calculating Commutation.

Proposal:

- A review of current DFRB & DFRDB pensions should be completed to discontinue the application of a 'reduced pension' consequent on commutation, and provide reversion to the pre-commutation pension, once a recipient reaches the notional life expectancy used in calculation of the post-commutation pension.

Basic Problem:

- The increasing disparity between the actual age to which DFRB & DFRDB pensioners are living and the 'notional life expectancy and dated life tables' used in calculation of the post-commutation pension results in members receiving a reduced pension well beyond the date at which the commutation has been 'repaid'.

Key Elements of the Proposal:

- This Topic is related to Item 2 - The Application of Contemporary Life Tables.
- A considerable number of DFRB & DFRDB members regard the commutation as a 'pre-payment' or 'advance' on their full pension entitlement. They perceive the consequential reduction in pension as being the repayment of that advance over the period between their age at discharge and the notional life expectancy derived from the life table applied.
- The continuance of the reduced pension beyond the life expectancy age, an ever increasing occurrence as members live longer, is a source of considerable anger and angst.
- The issue might not be so widespread had contemporary life tables been applied progressively over the years.
- Acceptance of this proposal will assuage to a considerable degree this anger and angst and might well lead to a more benign if not supportive attitude to military superannuation in the ex-service community.
- Such a supportive attitude would contribute to a more receptive audience to future changes both in the community at large and the current ADF.

Item 4

Constitution of the DFRDB Authority

Proposal

- That the DFRDB Authority be reconstituted to reflect a more appropriate representation of contributing members and recipient members.

Basic Problem

- The composition of the DFRDB Authority is no longer representative of the stakeholders. The ADF has 6,295 (30 Jun 2006) contributing members and has three ADF officers on the Authority, whereas the 56,934 (30 June 2006) recipient members have no representation at the authority whatsoever.

Key elements of the proposal

- That the three ADF members appointed in accordance with Part II Section 8 Sub-Section (3) b, c and d (Service appointments) be reduced to one appointment and that to be on the nomination of the Chief of the Defence Force (CDF) and for that appointment to lapse when the number of ADF contributing members falls to a figure of less than 1000.
- That three members, be appointed in rotation on the nomination of:
 - (a) The President of the Naval Association of Australia,
 - (b) The President of the Returned Services League of Australia, and
 - (c) The President of the RAAF Association of Australia.
- That the appointments be for an initial period of two years each with a one off extension for a further year as rotation takes effect. This would help to stagger the appointments of nominees.
- That those appointed be paid a sitting fee and an incidental allowance similar in amounts to those received by retired ADF members who sit on the Veterans Review Board (VRB).
- That the contact details of all members of the Authority be made public and promoted in the Navy, Army and Air Force Newspapers and the newsletters of the major ESO's

Item 5

Retired Pay, Disparity between Male and Female Pay

Proposal

- That the disparity between male and female pensions post commutation be ameliorated.

Basic Problem

- It is a fact that male and females have equality with Service pay, allowances and conditions, pay the same in DFRDB contributions (5.5%) and receive equal DFRDB retirement benefits up to the moment commutation is made. From that point on there is an ever increasing difference of reduced retired pay, due to commutation, between male and females, biased in favour of females.

Key elements of the proposal

- Life expectancy for females remains greater than equivalent aged males. Whilst this difference causes the above disparity, the compounding effect can be eliminated by calculating the indexation on the pre-commutation amount of pension.
- A secondary and probably more important effect of the above proposal would be that the cost of commutation to the pensioner would be stabilised. At present the cost of commutation varies and is compounded with every subsequent indexation adjustment of a member's pension.

Item 6

General Background on Military Superannuation Schemes

Proposal:

- Any new proposals, which should be the minimal necessary to accommodate perceived enhancements, must demonstrate adherence to both the fundamental requirements reflecting the '*unique nature of military service*' and the principles of '*no-detriment or diminution*'.
- Any such proposals will require careful, comprehensive and full consultation with, and education of, both serving and ex-service members.

Basic Problem:

- The value and utility of current and previous schemes is often overlooked.
- Legitimate criticism of current schemes associated with requests for advantageous amendments are often misconstrued as representing significant dissatisfaction with the schemes as whole.
- Concerns, justified or otherwise, regarding possible detriment to current entitlements or future entitlements within long standing rules often leads to serving members electing early discharge.

Key Elements of the Proposal:

- The Terms of Reference Annex A, treatise on the '*unique nature of military service*' is agreed as a sound basis for progressing the Review.
- All recent Military Superannuation Schemes DFRB, DFRDB and MSBS have served the ADF well, reflecting the arrangements necessary to accommodate the '*unique nature of military service*'.
- There is no overwhelming groundswell of dissatisfaction with the core components of current schemes; criticism of certain aspects does exist.
- These criticisms reflect considerable dissatisfaction from DFRB & DFRDB pensioners, including those on reversionary benefits, relating to both a failure to apply indexation sufficient to maintain relativity with Australian standard of living and the continuation of the post-commutation pension beyond repayment of the commutation amount.
- Changes and improvements to the schemes have been made over the years for reasons well documented but the fundamental arrangements have not been compromised.
- Any changes have always contained a 'no-detriment' clause for current serving members and ex-service members in past schemes.
- Any new proposals must demonstrate adherence to both the fundamental requirements reflecting the unique nature of military service and the principles of '*no-detriment or diminution*'.
- Any such proposals will require careful, comprehensive and full consultation with and education of both serving and ex-service members.
- Any changes should be clearly and unambiguously linked to specific deficiencies or enhancements, wholesale omnibus changes should be avoided.

Item 7

The essential Fundamentals of any Military Superannuation Scheme

Proposal:

- Any new proposals must address and include death, disability and invalidity, and superannuation arrangements for both members and entitled dependents.

Basic Problem:

- That the *'unique nature of military service'* predicates unique or at a minimum very special arrangements is often overlooked or devalued in considerations.

Key Elements of the Proposal:

- Drawing on the above any scheme must address and include:
 - o Death benefits.
 - o Disability and Invalidity Benefits and
 - o Superannuation / Pension benefits.
- Within these parameters any scheme must address and include:
 - o Reversionary benefits to spouse and dependents.
 - o Compulsory termination of service on grounds other than disciplinary or misconduct, including age, invalidity, and management initiated early retirement or other involuntary circumstances.
- Any failure to address these issues or to suggest new arrangements that introduce uncertainty or suggestions of disadvantage, real or perceived, will raise the possibility of serious recruitment and retention problems.
- The historically sound nature of military superannuation arrangements in relation to these issues predicates a degree of benign acceptance, particularly among young and junior serving members; but any suggestion of disadvantageous change quickly heightens interest and scrutiny, particularly among spouses and the ex-service member community.
- Any changes should be clearly and unambiguously linked to specific deficiencies or enhancements, wholesale omnibus changes should be avoided.

Item 8

Tax Free Treatment of Employment Termination (Invalidity) Payments from Military Superannuation Schemes

Proposal:

- In the context of the Government's Simplified Superannuation legislation, amend taxation legislation to enable all invalidity pension payments for recipients medically discharged from the ADF as a result of disabilities caused or aggravated by military service and in receipt of a Class A incapacity assessment by ComSuper and any associated reversionary benefits to dependents recipient will be:
 - tax exempt from the recipient's date of medical discharge in prospective cases; or
 - tax exempt from date of effect of new provisions for current recipients.

Basic Problem:

- Government superannuation initiatives over recent years have not provided equity to either members or their reversionary dependent beneficiaries of the ADF military superannuation schemes medically discharged as a result of injury or illness attributable to military service and in receipt of Class A invalidity pensions or their reversionary dependant beneficiaries.
- The military superannuation schemes do not include provisions for Class A invalidity pensioners, should they wish, to contribute to their private superannuation funds and access the incentives associated with Simplified Superannuation. This factor remains central to recognition and justification of special dispensation for Class A invalidity pensions received from the military superannuation schemes. Fundamental to a determination of a Class A invalidity assessment by ComSuper is the determination, supported by medical evidence, that an individual cannot undertake employment.

Key Elements of the Proposal:

- Recognition of Class A pension recipient's inability to enhance their retirement income and to participate in the intended benefits of the Simpler Super legislation.
- Similar tax exemption treatment of UK and US military invalidity pensions.
- Recognition of the legality of the High Court Case 1977 and UK legislation.
- Recognition of the unique aspects of military service.

Item 9

The Alignment of Compulsory Retirement Age and Preservation Age

Proposal:

- Compulsory Retirement Ages and Preservation Ages for ADF members must be aligned to avoid disadvantage.
- *Simpler Super* taxation legislation needs to comprehend and make appropriate provisions for Compulsory Retirement Ages below 60 years.

Basic Problem:

- Currently there is a misalignment between the normal ADF Compulsory Retirement Age of 55 years and the Preservation Age which in accordance with Superannuation Legislation is to progressively increase from 55 years to 60 years.
- ADF members compulsorily retired at age 55 years have no access to the *Simpler Super* arrangements until they attain 60 years of age.

Key Elements of the Proposal:

- The significant disadvantage suffered by progressively more ADF members who, on reaching compulsory retirement at age 55 years, will be denied access to their superannuation pension entitlements until aged between 56 years and 60 years, depending upon their date of birth; should, on grounds of equity, be redressed.
- Similarly, the disadvantage suffered by ADF members compulsorily retired at Age 55 years through not being eligible for *Simpler Super* rules should be redressed.
 - o The Senate economics Committee in its report to Parliament said this was an issue appropriate to any Review of Military Superannuation Arrangements.

Item 10

Simplified Superannuation Tax Treatment of Military Superannuation and Compulsory Termination

Proposal:

- Simplified Superannuation tax treatments should be correlated with military career patterns, associated military retirement schemes and reversionary benefits.
- Alternatively, military career patterns, associated military retirement schemes and reversionary benefits should be correlated with Simplified Superannuation tax treatments.
(Note that these proposals are not intended to cover members compulsorily terminated on discipline or misconduct grounds. Proposals to cover members compulsorily terminated on invalidity grounds prior to age 60 are addressed separately, at Item 8.)
- Additional disadvantages for recipients of pensions from untaxed funds, as identified by the Senate Economics Committee, should be addressed in modifications to military retirement schemes.

Basic Problem:

- The unique nature of military service, which places demands on individuals - fitness, training, etc,- requires them to retire at ages earlier than the minimum national retirement age of 60 which has been determined by the Simplified Superannuation policy.
- That means that those compulsorily retired personnel, and their dependents, in the event of their death, are unable to take advantage of the benefits of the Simplified Superannuation policy -10% tax offset, etc - despite having been made to leave military service.
- Additionally, as noted in the Senate Economics Committee report on Simpler Super legislation, recipients of the 10% tax offset on pensions from "untaxed" funds will suffer disadvantage compared to those receiving pensions from "taxed" funds because "untaxed" fund pensions must be included on tax returns for purposes of assessing taxable income. Consequently, where the amount of "untaxed" pension exceeds the tax free threshold, further income will be taxed at marginal rates in lieu of attracting the normal tax-free threshold.
- There may also be similar disadvantage in the application of 'Centrelink and Veterans' entitlements, where pensions from `untaxed' funds count as assessable income while those from `taxed' funds will not.

Key Elements of the Proposal:

- This should be redressed by:
 - (a) recognising the unique requirements of military service in the Simplified Superannuation legislation; or
 - (b) changing the structure of all individual military careers, and possibly the operational effectiveness of the ADF as a whole, to comply with the Simplified Superannuation policy; or
 - (c) re-structuring the military retirement schemes to compensate compulsorily retired members for this new, Government-initiated relative disadvantage. The tax offset and Centrelink's/DVA's treatment of income from 'untaxed' superannuation schemes such as DFRB, DFRDB & MSBS should be further adapted, beyond the proposed 10% offset, to overcome the disadvantages identified in the Senate Economics Committee report.

Item 11

Three and Five Year Rule for Pensioners over the Age of Sixty and who Marry

Proposal:

- Reduce the qualifying period for eligibility for reversionary spouse pensions to three years.

Basic Problem:

- The current military superannuation schemes require a marital relationship to have existed for five years.
- Several years ago public service schemes were amended to reduce the period from five years to three years but no action was taken until 2006 to amend the military schemes.
- A 2006 Budget announcement promised to make the change, which requires legislative action.

Key Elements of the Proposal:

- Amend all current and future military superannuation schemes to reduce the qualifying period for eligibility for reversionary spouse pensions to three years.

Item 12

Calculation of DFRDB Pensions

Proposals:

- Include the full period of a member's service when calculating pension entitlements, instead of just the number of completed years.
- Calculate the DFRDB pensions using the same formula as for DFRB, MSBS, CSS and PSS schemes.

Basic Problem:

- The current schemes are calculated on the number of completed full years of service. Thus a member may have completed 29 years, 11 months and 30 days service but the pension may be calculated on just 29 years service. Most members taking voluntary retirement can avoid this trap, but those being compulsorily retired cannot. Modern computer systems can cope with the more precise calculation.
- DFRDB pensions are calculated as $14/365$ (ie 0.0383561) of the annual pension, whereas the other schemes use $1/26$ (ie 0.0384615) of the annual pension. After 20 years on the DFRDB pension, the amount lost starts to become appreciable.

Key Elements of the Proposals:

- Include the full period of a member's service when calculating pension entitlements.
- Calculate the DFRDB fortnightly pensions using the same formula as for DFRB, MSBS, CSS and PSS schemes.

Item 13

Immediate Death Benefit Insurance

Proposal:

- Military superannuation schemes should include the provision of death benefit insurance for serving members, payable almost immediately on notification of death.

Basic Problem:

- A complex process ensues after the death of a serving member, because the authorities administering various aspects of the current military retirement schemes have a primary responsibility to the Commonwealth, rather than to alleviate any financial stress on the bereaved family. This can delay the receipt of entitlements, thereby adding to the stress on the dependents.

Key Elements of the Proposal:

- Death benefit insurance should be offered as part of any military superannuation scheme, just as it is with many private superannuation schemes, taking advantage of the combined purchasing power of the scheme.
- The policy would be owned by the member, who would be at liberty to nominate the beneficiary.
- The value of the insurance should be the same for each member, whether an Able Seaman or an Admiral, possibly \$50,000, and indexed. That should be enough to ensure that dependents can pay for any associated travel, accommodation and legal costs in the immediate aftermath of the death, and not have immediate financial concerns pending the resolution and establishment of compensation and pension matters.
- A typical large civilian scheme currently offers \$80,000 of cover for \$1 /week. Even if the higher risk of military service reduces that amount, \$50,000 cover should be achievable for \$1/week. (If even that lower cover cannot be obtained, then such an objective actuarial assessment of the risks associated with military service should be reflected in higher salaries for military personnel!)
- The payment would need to be made to the dependents within five working days of reasonable certainty, eg as assessed by the ADF, of the death.

Item 14

The Introduction of a Fully Funded Accumulation Scheme – Acceptability and Support

Proposal:

- If it were to be suggested that the scheme be changed to a fully funded accumulation scheme reflecting those available within the private sector, then there are critical characteristics and issues which would need to be clearly and unambiguously addressed to gain this organisation's support and endorsement and in our opinion that of ADF members.

Basic Problem:

- Acceptance of any revised military superannuation arrangements by current and future ADF members will be influenced in large measure by the issues detailed in Item 8.
- Any suggestion of disadvantage, detriment or diminished entitlements to current or future ADF members would be unlikely to receive acceptance by ADF members, this organisation, the ex-service community and the Australian community at large.

Key Elements of the Proposal:

- If it were to be suggested that the scheme be changed to a fully funded accumulation scheme reflecting those available within the private sector, then the following critical characteristics and issues would need to be clearly and unambiguously addressed to gain this organisation's support and endorsement.
 - o A 'no-detriment' clause for current serving members.
 - o 'No detriment, disadvantage or diminution' in relation to:
 - Death benefits.
 - Disability and Invalidity Benefits and
 - Superannuation / Pension benefits
 - Reversionary benefits to spouse and dependents.
 - Compulsory termination of service on grounds other than disciplinary or misconduct, including age, management initiated early retirement or other involuntary circumstances.
 - o No diminution in current Government contribution to military superannuation.
 - o Enhancements to both existing schemes and future schemes including:
 - Tax-free Invalidity Benefits to Cat A medical dischargees and their reversionary pension recipients.
 - Alignment of Compulsory Retirement Ages to Preservation Ages
 - Simpler Super Tax Treatment of Compulsory Termination below age 60 years.
 - An ability to transfer funds to Fund of Choice on discharge, if not available during service.
 - This aspect is of course capable of implementation by simply changing the rules of MSBS to allow transfer of the preserved employer benefit, without a need to adopt a fully funded accumulation scheme.