



Committee for  
Economic  
Development of  
Australia

**CEDA Study**

# **SUPERANNUATION — AT WHAT COST?**

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## SECTION I

### THE PURPOSE OF SUPERANNUATION

The objective of superannuation is to provide for the financial needs of a member of a superannuation fund after he has ceased to work. Superannuation is also directed towards covering those personal risks of the employee not yet covered by Workmen's compensation, national insurance, third party insurance which impinge on his capacity to earn.

### COVERAGE

There are, in Australia, five methods whereby the needs of the aged for real income are met: households savings, including the acquisition of durable real assets such as houses and cars; the maintenance of elderly people by their own families; charity; the Commonwealth Government's aged pension scheme; and work related superannuation.

Occupational superannuation has, apparently, been spreading. In February, 1974, a household survey conducted by the Australian Bureau of Statistics provided the estimates at 32% of employees belonging to occupational schemes. Another household survey in May, 1979, indicated that 42% of employees working 20 hours or more in a week belong to superannuation schemes arranged by employers.

There are vast differences in the coverage of superannuation, both between industries and between income levels. At the 1979 survey, the highest coverage rates among the twelve industry groups were in communication, (77%), public administration (75%) and electricity, water and gas (67%); the lowest were in agricultural (14%), entertainment, etc. (16%) and wholesale and retail trade (27%). The survey showed that coverage rises steadily as we move from low to higher income groups. For example, among people earning from \$120-\$140 per week the proportion in superannuation schemes was 20%, whereas among people earning \$300 or more per week the percentage was 73%.

### ESSENCE OF THE DEBATE

The issue of superannuation came to public attention in the first half of 1979, when strike action was taken by Woolworths employees, members of the Storemen and Packers' Union, in pursuit of a log of claims, which included as Claim 21:

"the companies to become associated companies of the Federated Storemen and Packers' Union Retirement Fund, thus allowing employees to be members of the retirement fund".

The dispute which followed lasted many weeks, with Woolworths supported by other employer groups, firmly opposing the union's scheme. The strikers finally accepted an agreement which did not embrace the clause in relation to the union superannuation plan. However, many other companies approached by the Storemen and Packers' Union did in fact join the retirement fund.

Events surrounding the Woolworths dispute brought the issue to the forefront of public attention. However, the issue of the control of "super" funds has been a concern of some sections of the Trade Union Movement for many years. The motive behind the efforts of sections of the Trade Union Movement in attempting to gain significant control over "super" funds is perhaps best illustrated in the passage below from the paper delivered by Mr Simon Crean, Federal Secretary of the Storemen and Packers' Union.

"The Trade Union Movement in Australia has, throughout its history, acted in a manner consistent with the view that the provision of Social Security or a Social Service Benefit is properly the responsibility of government and employers, whether at a private level or government level.

Our efforts for nearly 100 years to have government provide adequate security benefits for working people has produced a less than satisfactory result. The private sector partly fills the gap, and the economy, to a degree, has become dependent upon such provision to provide investment and long-term capital ...

The Federated Storemen and Packers' Union takes the view that it is no longer adequate to only seek protection for its members by government services provided through taxation. But that in addition we must intervene in the private system if we are serious as a union in our concern to protect the interests of our members".

In support of their move in to the superannuation area, the union movement has generally highlighted the total inadequacy of government to maintain adequate benefit programmes, and the presently haphazard arrangements for retirement which exist.

Employers have on the whole resisted strongly attempts by unions to gain control and management over super funds, with some exceptions.

Essentially, employers have quite contrary objectives and desire to resist the prospect inherent in the union proposal of there being more and higher employer payouts, arguing either higher prices for produced goods or diminished profitability will be the result.

It is argued by employers that if Occupational Superannuation is to spread across the private sector, then this will impose a considerable cost burden on industry. Mr George Polites, in an article in the Australian Financial Review of the 24th September, 1979, pointed out that:

"Irrespective of whether the trade unions are successful in their current superannuation campaign, whether a national superannuation scheme is introduced, or whether employers continued to exercise discretion and control over superannuation, any extension of superannuation coverage to a wider proportion of the workforce will be an extremely expensive proposition for industry and commerce and consequently for the community".

Employers have also argued that union organisational structures are not suited to administer superannuation schemes, and to substantiate their case, have pointed out that few union ventures into business have been successful.

Since the Woolworths dispute, and the attempt by the Storemen and Packers' Union to launch its own fund, the L.U.C.R.F. (Labour Union Co-operative Retirement Fund) the superannuation issue has remained alive although it has not recently received the degree of media exposure which it did previously.

## SECTION II

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### MAJOR ISSUES IN THE 'SUPER DEBATE'

#### Responsibility for the Investment, Control and Administration of Superannuation Funds

In the past, company management has been largely responsible for the control of superannuation funds. In the vast majority of schemes the trustees<sup>1</sup> who manage the funds are selected by the employer, or the trustee may be the employer company, or a company nominated by the employer. It has been common practice to date to appoint trustees from the directors or senior executives of the company concerned.

It should be noted that the Trustees are responsible for administering funds under the terms of their trust - they have no power to vary the benefits, although in some cases Trustees have some discretionary powers. Union representation on the Board of Trustees would enable the union to exercise influence on administration and on investment policy, but would have no effect on any claims for improved benefits - that remains a matter for negotiation between employer and employees or unions, whether or not there is union representation amongst the Trustees.

Outside of those funds for which the responsibility for administration has been delegated to professional managers, Trade Union representation on the Board of Trustees or Management Committee of a fund has been limited.

Management of funds has largely been considered the preserve of company management, and little pressure had been placed on existing arrangements to accommodate union representation.

Only in recent years, when the union movement has come increasingly to concentrate on broader aspects than the immediate living standard of members, has there been any consideration to union involvement in the management and control of super funds.

In view of the historical context, it therefore has not been surprising that the recent moves by unions such as the

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1. The Trustees are legally responsible for the administration of funds. The Trust deed defines the rights, discretions and obligations of employers, members and trustees.

Storemen and Packers' Union to gain control over superannuation funds, have caused considerable alarm to company management who perhaps envisaged the uses to which funds might be applied in the absence of any controlled measures.

One of the issue areas in the 'super' debate has been the fear that unions may use their newly won control over funds to develop their power base. Whilst this issue has been aired quite often in public debate, it would appear that union controlled funds are currently placed in the same investment areas as traditionally administered schemes. In some cases, unions have steered clear of investing directly in shares of companies whose activities are opposed by the general union movement. However, apart from such cases, unions schemes general objective is to receive the highest return in order to augment contributions. Whether this continues to be the case is, of course, difficult to say.

The main areas in which private sector superannuation funds are invested include:

1. The purchase of individual endowment assurance policies from life offices, a method widely used for schemes with few members;
2. The direct purchase of investment assets, for example, Government securities, equities, property, etc.
3. The payment of money to life offices under the terms of deposit administration contracts, essentially a method of accumulating money with interest. This form of investment is usually accompanied by group life assurance.
4. The payment of money into 'pooled funds' operated by institutions other than life offices.<sup>2</sup>

It has been argued within employers ranks that superannuation is a complex area and that fund management should be carried out by those expert in the field. Whilst it is true that to some extent it could be argued that unions may have conflicting interests in the area of fund management, or may lack necessary professional skills, experience to date has revealed that unions have relied heavily on assistance and advice from expert consultants in the superannuation area.

The Hancock Committee of Inquiry in Part Two of the Report on 'Occupational Superannuation in Australia', 1976, remarked that in the appointment of fund managers, it should be hoped that "many employers would voluntarily seek to involve members in aspects of scheme administration (whether by providing for the election of trustees by the members, by establishing advisory committees, or in other ways). Trade Union initiatives to achieve this kind of participation should be welcomed".

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2. Final Report of the National Superannuation Committee of Inquiry, Occupational Superannuation in Australia. Part Two, March, 1977, p. 10.

Despite what has been the case in the past, it appears clear that the environment has changed to the extent that no longer can it be expected that control and administration of superannuation funds will remain the sole responsibility of company management. The question of union involvement in 'super' seems now to be merely one of degree, and it is likely that in the future the establishment of funds administered by both relevant union and employer groups, as well of course as those run solely by unions, will be more common.

#### The Level of Benefits

The union push in this area, as indicated previously, has been largely prompted by the general feeling of discontent by unions with the schemes of a large number of companies. Many company schemes have been accused by the unions of being laggard, not responsive to the needs of the workers, especially in relation to the actual provision of benefits, and of being used to prop up companies in difficult times.

It is for these reasons that the unions have moved, in the words of Mr Greg Sword, to "offer an alternative" to the employer run schemes, an alternative which is argued would in most cases be better able to meet the needs of members.<sup>3</sup> Whatever the reason, there seemed to be a view amongst those involved that levels of benefit had in the recent past been reviewed by a number of schemes and had already resulted in some improvements.

#### Vesting

The issue of vesting has been prominent in the 'super' debate, and a significant area of criticism of employer run schemes in the past. Unions have argued that company managed schemes have been reluctant to accept in many cases any element of vesting.<sup>4</sup>

Some of the more traditional schemes have in the past adopted the attitude that company contributions are intended for the employee who ultimately retires from the company's service, or alternatively, have argued that it is essential to preserve the corpus of the fund intact so as to provide maximum benefits for continuing members at lowest cost to the company and thus to the community.

It is true that a large number of private superannuation funds have adopted minimal vesting conditions partly based on the belief

3. It should be noted that a limitation on union-sponsored schemes, is that unions face difficulties in providing defined-benefit schemes to members, the sort of which has become increasingly common in employer-sponsored schemes. Defined benefit schemes are usually defined in relation to pre-retirement salary, making it difficult to assess the rate of contribution required which with other earnings from the fund will be needed to finance the benefit.
4. A 'withdrawal' benefit refers to the benefit paid or credited to an employee who leaves the fund before retirement. If the amount paid or credited represents the total accrued up to the time of leaving service, the benefit is fully vested. Most benefits are not fully vested, i.e. the employer who leaves before retirement receives only some part of the accrued amount.

that if full vesting occurred this may well lead to employees terminating employment simply to obtain lump sums thereby producing a result contrary to the initial purpose of the scheme.

The union movement argue that the employee's company career will, in a great majority of cases, fall short of a lifetime, and that the employee deserves to share in the benefits provided by all employers in his working lifetime, not just the last one. The unions argue that it is only equitable and moral that some proportion of company contribution be paid on premature retirement from service to the company.

Further, unions argue that whilst it is true that some employees who are entitled to lump sum payments from a fully vested fund may leave simply to gain the accrued sum, or may use the funds unwisely, they have the opportunity with advice from their union to continue to make provision for adequate security and retirement.

The Hancock Inquiry expressed concern relating to the impairment of the individual's economic security by the provision of many schemes paying withdrawal benefits. The Committee recommended that the following requirements should apply to all schemes:

- (1) Accrued benefits attributable to employee contributions should be fully vested at all times;
- (2) The employer-financed component of accrued benefits should be subject to graded vesting such that 50 per cent would be vested after ten years service, or after five years service if the employee's age plus length of service sum to 45 or more, and that a further 10 per cent would be vested for each subsequent year of service (up to maximum of 100%).

However, the Committee also recommended that cash payments of withdrawal benefits be not permitted. They argued that there were a number of acceptable methods of preservation, for example retention in the fund ('cold storage'), transfer to the fund of another employer, the transfer of title to a life insurance policy, the purchase of a deferred annuity and payment into a public superannuation fund.

In his address to the Melbourne forum, Mr Robson argued that the essential issue was the question of how schemes could be structured so as to prevent the benefit being used unwisely, i.e. as a readily available 'nest-egg', whilst ensuring that members receive an equitable portion of company superannuation contributions along their path. Mr Robson suggested preservation of the benefits until normal retiring age as a means of minimising the possibility of misuse of the benefit, but also progressive vesting after a substantial qualifying period, or the intermediate tax treatment of benefits lying somewhere between full taxation of lump sum receipts and the present 5% tax in the year.

In his address at the same forum, Mr Crean argued that "all systems of administering preserved benefits suffer from the likely

complexity in cost associated with keeping track of ex-fund members who have changed jobs many times. Mr Crean further pointed out that if "proper consideration is given to the reality of the situation it would be revealed that many workers who may have changed jobs 15 to 20 times during their working life, would be confused and unsure of their entitlement and from whom they should claim it. This problem would be compounded in the case of death, where the beneficiary tries to claim the entitlement".

The problems surrounding developing a sound vesting arrangement are complex. It is arguable as to what type of structural changes should be made to superannuation schemes to facilitate an efficient and equitable vesting arrangement. Many suggestions have been put forward, but none that stand the test of simplicity and equity whilst imposing a discipline over use of the benefit. As such, this area is likely to remain a central focus for debate concerning 'super' arrangements.

### Portability<sup>5</sup>

Portability can be looked upon as one of several methods of preserving vested benefits, and therefore is less significant than the issue of vesting. However, considerable attention has been focussed on the subject of portability in recent debates on superannuation. It is generally recognised that the lack of portability in the current structure of superannuation in Australia today acts as a severe constraint on the mobility of the workforce, and therefore upon economic efficiency.

In past years it was not uncommon to find a worker devoting his entire working lifetime to one company. The situation has now changed to the degree that it is now generally accepted that several changes of employment in a working life will not only be a fact of life, but indeed essential to our economic growth. Optimal resource allocation, and the process of structural change that is required to achieve this, should ensure constant shifts in employment areas.

In relation to superannuation arrangements, this implies that unless benefits are transferable, this may well lead to the situation of little financial security for the individual on retirement.

In outlining the Federated Storemen and Packers' Union Fund, Mr. Crean pointed out that it allows its members to transfer from one employer to another and remain in the fund without loss of entitlement provided that both employers participate in the fund.

Mr Crean argued that to this extent, the SPU had been able to offer a limited solution to the problem of portability. He said that this was so because there were only a limited number of participating employees; but that as the union progressed in reaching

5. Currently private sector superannuation schemes in Australia have a very low level of portability, i.e. the existence of formal arrangements whereby an employee leaving one fund can transfer his entitlement without loss to his next employer's fund.

agreement for participation in the fund with employers, then the principle of portability would become more of a reality.

The general objective of greater portability, indeed universal portability in relation to superannuation schemes is generally accepted to be sound in principle. Problems arise however, in terms of the specific criteria according to which all funds should operate, and according to which fund transfers could take place, and this has severely limited the existence of portability in the private sector.

Mr Robson argued that what is required is a model superannuation scheme which all companies should accept as a target. For example, companies with schemes qualifying as being equivalent to the target scheme could offer, on a reciprocal basis complete portability, expecting that the cost of transfers out will be balanced by contributions of transfers in. Mr Robson in his address pointed out that the uniformity of treatment under such a plan would reduce fund design cost, make the scheme better and more widely understood, and overcome many of the special problems which the union movement has raised.

As previously mentioned, the issues of portability and vesting are closely linked. With full portability existing between schemes the issue of vesting would necessarily decline in importance.

Portability is a central issue in the whole superannuation debate. To the extent that the union funds such as that of the SPU offer employees the opportunity to transfer employment without suffering financial loss, they are fulfilling a very real need.

## SECTION III

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### THE FUTURE

Sections of the Trade Union movement have repeatedly affirmed their attention to pursue greater control of superannuation funds in Australia. There will be therefore continuing pressures for change from the unions.

Pressures from the unions, but also importantly the general realisation within business that there is a need to make superannuation schemes "really do their job", has resulted in a climate in which substantial change is inevitable.

Already we have seen improvements in a number of company schemes in such areas as the reduction of eligibility periods, improvement of resignation benefits, improvements in the level of wage employee benefits, and the better communication of superannuation benefits available to employees.

### A COMPLEX ISSUE

Within the superannuation area, there dovetail many issues. The structure of schemes, the legal requirements, the large number of different types of schemes, the taxation aspects are but a few of the areas which add to this complexity. Further, the impact superannuation has in other areas, including interest rates, financial markets, industrial relations, industry competitiveness, add even further to the maze.

Because of this, change will necessarily only take place slowly.

Of the issues which will in the future bear heavily on the outcomes, two are deserving of mention here:

#### (i) Taxation and Superannuation

It is difficult to isolate the taxation aspects in any discussion on superannuation in Australia. The main reason for this is that there is no specific mention of the subject of superannuation in the Commonwealth Constitution and this influence has been exerted indirectly by the Government by the use of the taxation power.

The power is used by a mixture of benefits and obligations and is directed at a number of different points, not all of them independent. These include trustees of superannuation funds,

employers contributing to funds and employees also contributing. In addition there are former employees who were contributors and have either retired or left the employer's firm to take up employment elsewhere. Additional interested parties may include self-employed persons and the dependents of both current employees and former employees. Retired employees may have received a lump sum or be in receipt of a continuing pension which may or may not be subject to some form of adjustment for the effects of inflation.

The overall impact of taxation has been to give strong encouragement to the development and extension of superannuation in Australia. By comparison with ordinary saving, superannuation has the following taxation advantages:

1. Contributions to superannuation funds by employees are allowable as an expense for tax purposes.
2. The income earned on investments of superannuation funds is, in general, untaxed.
3. If the benefit is paid as a lump sum, tax is levied on not more than five per cent of it and in some cases not even this small amount of tax is paid.

The future of superannuation schemes will therefore depend heavily on Government policy in the tax area. As the percentage of the workforce in superannuation increases (in response to pressure from the unions; importance of superannuation to attract top staff, etc ...) it is likely that the Government might move to close off some of the taxation concessions. One area that might be affected is in relation to lump sum benefits. Current taxation rules are generally believed to make benefits payable in lump sum form more attractive to retirees than benefits in pension form. This could have the effect of increasing the net government outlay on social security and nullify some of the tax concessions on superannuation contributions.

Also, tax concessions have led to some schemes being established apparently for tax saving purposes rather than for genuine superannuation. This has been more noticeable in small funds which invest a high proportion of their assets back in the employer's business.

Already there has been evidence of a move toward pension schemes, in addition to the development of more flexible superannuation arrangements in response to tax pressures.

#### (ii) The Public Service vs. Other Schemes

A considerable disparity exists between public service schemes and private sector schemes, and it is likely that in the future this will act as a catalyst in producing change in the overall superannuation network.

Professor Hancock, in his paper, referred in length to this problem. Referring to the level of generosity of public service

schemes, he argued that converting promised benefits in the public sector schemes to present values suggests that taxpayers are adding 20-30 per cent, as a fringe benefit, to the salaries of public servants. Professor Hancock pointed out that few if any private sector schemes match this level of provision.

There appears little justification for this disparity, saving the general contention that Governments should provide the lead to private sector employers.

Almost certainly this disparity will place increasing pressure on Government to review public sector schemes, and pay attention to reforming the structure of superannuation schemes both private and public to attain greater uniformity.

#### A NATIONAL SUPERANNUATION SCHEME

The 1976 Final Report of the Committee of Inquiry on National Superannuation recommended a national superannuation scheme for Australia providing national superannuation pensions for those aged 65 and over, ancillary benefits and death benefits.

However, to date the Government has not taken any action in relation to these recommendations. Presently, a Task Force is examining the recommendations of Part Two of the National Superannuation Committees Report on Occupation Superannuation.

The concept of a national scheme has been criticized by significant sections of the private sector. It is argued that it would create an excessive bureaucracy resulting in lower cost effectiveness; it would result in a lack of self determination at the operating level; and would place excessive power in the securities market through lack of market forces on investment managers subject to review and reappointment in any private scheme.

Unions have generally been in support of a comprehensive approach to superannuation, and therefore generally support the concept of a national scheme. It has the advantage in that it solves the twin problems of vesting and portability, two areas which have prompted unions such as the SPU to take steps to set up their own scheme.

However, the present thrust of Government policy has been generally against any major revision or replacement of the age pension and in favour of extensions of work-related superannuation, hence, as indicated, the Government's decision to establish the Task Force on occupational superannuation.

#### CONCLUSION

The pressures for significant change in the superannuation area are now on, and over the ensuing years it is most likely that we will see significant changes especially in the cover, design, operation and to a lesser extent in the control of superannuation schemes in Australia. Of the factors which will bring about this change, many have been mentioned in this report, foremost among them pressure from the union movement.

Already we have seen in the last two years a move towards reform. However, although significant change is likely, it is doubtful that union controlled and administered schemes will become the more common type of fund. Several union schemes, notably that of the SPU have been quite successful in the limited period of time in which they have operated, however, other initiatives, for example the proposed A.C.T.U. Fund, have yet to get off the ground.

Employers have responded to a limited extent. They have realized that in the future if reforms are not made then substantial control over superannuation funds may be lost.

Mr Bruce Cook, in his paper presented in the forum, concluded by saying that "if employers doggedly keep going in the same direction, they may be dragged reluctantly by Unions and by Government to accept such things as a much greater degree of preservation, pensions instead of lump sums, quite rigid controls on fund investment policy, the provision of the same level of benefits for wages and salaried employees, etc."<sup>11</sup>.