CHAPTER 6

SURPLUSES AND INACTIVE ACCOUNTS

Surpluses in Defined Benefit Funds

6.1 The Committee heard a great deal of conflicting evidence about the ownership of the surpluses in defined benefit funds. In general, the industry has argued that the trust deed is the arbiter of who owns the surplus; but that where this is not clear, the sponsoring employer should be entitled to any of the surplus because the employer bears all of the investment risk. However, many in the industry acknowledge that there is a need for some legislative guidance. For example, Noble Lowndes in its submission to the Committee suggested that in addition to any trust deed requirements:

- there be a minimum funding standard which must be satisfied immediately after any repatriation;
- this minimum standard be that the market value of assets represent at least 110% of accrued retirement benefits; and
- details of any repatriation be disclosed to the fund members.[1]

6.2 The Attorney-General's submission notes that greater certainty as to the ownership of superannuation fund surpluses needs to be established to avoid costly court proceedings and to ensure equity.[2] The ALRC recommended repatriation of surpluses be illegal except where:

- the actuary has certified there is a surplus;
- the amount (or sum of the amounts) paid since the actuary's certificate was given is not more than 50% of the amount certified by the actuary;
- the responsible entity has given members two months written notice of the intended repatriation.[3]

6.3 ASFA, Mercers, and Mr Cliff Newman[4] argued in their evidence that if the Government were to regulate the treatment of surplus as it arises, employers will tend to under-fund, rather than contribute at the optimal level. They all stressed that a surplus can be a transitory affair because of movements in the stockmarket and other asset prices and that any legislative requirements need to be carefully considered.

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1 Sub No. 80, p 12.

2 Sub No. 107, p 19.

3 ALRC, Report No. 59, op cit p 248.

4 Evidence, pp 48, 664, 735.

6.4 From 1 July 1992, the ISC will require that a return of surplus be disclosed in advance to members. This will be a significant improvement on current rules which only require trustees to notify the members and the ATO within two weeks of the repatriation. The Committee is also aware that from 1995 the return of a surplus in a defined benefit fund to the sponsoring employer will no longer be tax deductible to the fund. Under current taxation arrangements, the surplus repatriated to the employer is included in the employer's assessable income and the fund is entitled to a corresponding deduction so that future deductible contributions up to the same amount may be made by the employer without attracting any tax liability to the fund. However, contributions of the same dollar amount made in later years will not, in real terms, be of the same value to the fund as the amount refunded. Any additional contributions beyond the amount of the repatriation will attract tax. From 1 July 1995, no deduction will be available to the fund on repatriation of the surplus and the future contributions will have to be increased to cover the cost of the tax.[5] These changed taxation arrangements will remove much of the incentive to return the surplus; hence, employers are more likely to take advantage of contribution holidays if the fund builds up a substantial surplus.

6.5 The Committee has some difficulty accepting the view of many in the industry that, because the employer bears all the investment risk, the employer should be entitled to the surplus where the trust deed is silent. The repatriation of surpluses, even if conducted in accordance with the trust deeds, always has the potential to destabilise the employer-employee relationship. The Committee was particularly concerned about the issues involving a surplus in defined benefit funds that were raised by Chifley Superannuation Services, Mr Noel Davis, Mr Cliff Newman, Mr Ian Langfield-Smith, the Shell Superannuation Rights Committee and Mr David Hughes. The Committee understands that all employer sponsored trust deeds have a provision for the employer to wind up the plan at any time should the employer so decide. This action may be taken to protect the employer from any major downside on the investment return.

6.6 Both the Shell Superannuation Rights Committee and Mr D Hughes[6] argued that surpluses arise from a variety of factors, including the vesting arrangements operating before 1987 which meant that members leaving the fund received only their own contributions plus a nominal rate of interest on those contributions, plus the investment return on employer and member contributions. They provided a schematic representation of how the surplus in the Shell fund arose (see Figure 6.1). Whilst Shell has not made a formal submission to the Committee, it has provided a copy of a letter sent to Shell staff regarding the surplus. An excerpt from that letter is given in Figure 6.2.

6.7 Both the Shell Superannuation Rights Committee and Mr Hughes argue that there should be:

> *some form of legislation to say that if members do contribute to superannuation funds, especially defined benefits funds, any surplus that is generated and subsequent re-allocation of assets, if there is any, should go*

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5 E A Slater, *Superannuation Fund Surpluses*, Butterworths, Service 14, Sydney 1991, p 12 412.

6 Evidence, p 632, p 636.

back in part to the members.[7]

6.8 Mr Noel Davis argued that large surpluses in superannuation funds are a form of tax minimisation[8] and suggested that restrictions similar to those which have been imposed in the United States and the United Kingdom be developed in Australia.[9] He suggested that if the surplus was restricted to an amount that was 10-20 per cent greater than the liabilities of the fund, this would represent an adequate reserve in the fund and there would be no tax avoidance as presently occurs.[10] The ATO told the Committee that to its knowledge the accumulation and repatriation of surpluses had not been used as a tax minimisation measure.[11]

Recommendation 6.1:

The Committee recommends that the Government conducts an investigation to determine whether surpluses are being used for the purposes that are intended; that is, to act as a reserve against investment fluctuations. Following this review, the Committee recommends that the Government re-examine the 1995 timetable for removing the tax deductibility to the fund of a repatriation of surplus to the employer.

6.9 Mr Davis also raised the issue of employers gaining access to the superannuation fund moneys by the employer company terminating the employment of their employees and re-employing them in an associated company. Unless the trust deed provides for vesting, the amount remains in the fund and invariably gets distributed to the principals of the organisation.[12] This was an issue vigorously taken up by Chifley Superannuation Services which calls the practice 'Legal Stealing'. (Refer to Figure 6.3.)

6.10 The Committee believes that much needs to be done to combat the problem of employers 'creaming off' the surplus. The Committee is particularly concerned about the repatriation of a surplus consequent to changes to the trust deed.

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7 *ibid*, p 634.

8 Evidence, p 621.

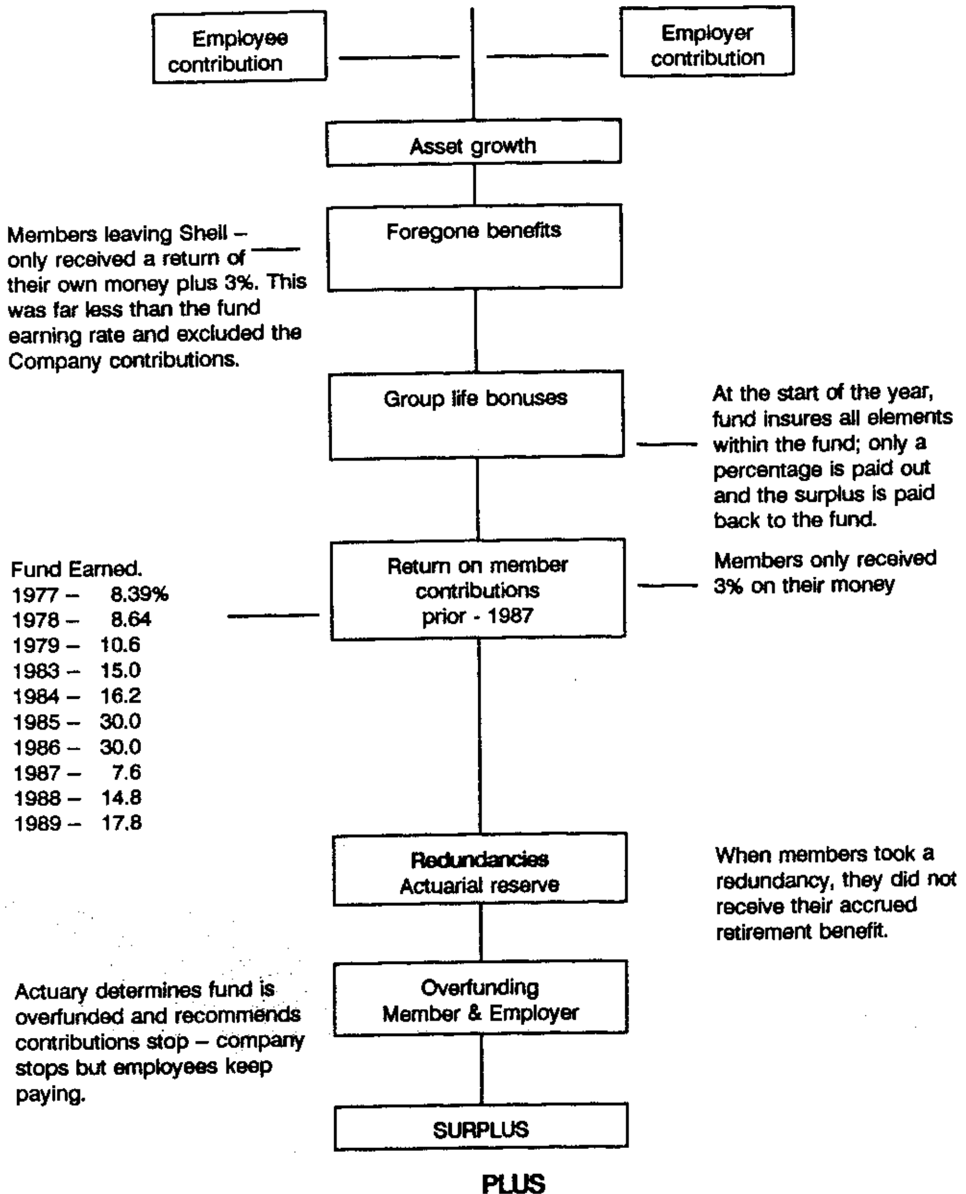
9 *ibid.*

10 *ibid*, p 622.

11 Evidence, p 2059.

12 *ibid*, pp 622-23.

Figure 6.1 HOW THE SHELL SURPLUS WAS MADE



PLUS

Fund receives a 15% tax credit for surplus removed.

Source: Shell Superannuation Rights Committee, Submission No. 166. (Similar diagram tabled by Chifley Superannuation Services at Sydney public hearings).

Figure 6.2

Shell's Response:

In 1990, most members of the Shell Australia Contributory Pension Fund (SACPF) exercised their choice to switch to a new Fund, the Shell Australia Superannuation Fund (SASF). There are many differences between the two funds, with the fund providing additional benefits to members and to the company, but what has led to the controversy is the difference in how they handle surpluses.

A surplus occurs when the amount in the fund is more than is needed to pay all fund benefits as estimated by the independent actuary. Under the SACPF, surpluses had to stay in the fund. The company could stop making contributions to the fund if there was a surplus, but it could not take the surplus back. Under the new SASF, Shell has the right to take the surplus back after allowing a cushion for safety sake. This is of benefit to Shell, since having the surplus to use in the business is worth more than suspending contributions until it is reduced.

The unions are arguing that 50 per cent of the surplus should be credited to union members' accounts. Shell is arguing that the surplus comes from excess company contributions not from employee contributions, and the company should control how it is dealt with.

At the time of the switch to the SASF, the surplus was between $250-$300 million. While the value of the surplus has moved with the value of the fund's investment portfolio and with benefits paid to members, it is obviously still substantial. It is not surprising therefore that some employees think it is worth a legal fight to try to get some of this money for themselves. On the legal front, only arguments about the appropriate forum to deal with the dispute have so far been heard in the Australian Industrial Relations Commission and the High Court, where a decision is pending. There has as yet been no hearing on the substance of the dispute. I believe our case is strong, but this is now a matter for the courts. The company is committed to the process and the decision will eventually be made as it should be made - legally and peacefully.

Why does Shell claim the Surplus?

Both the old SACPF and the SASF are 'defined benefits funds'. This means that employees' contributions and benefits are both fixed by the terms of the fund. The company's contributions are estimated in advance but, unlike the employees' contributions, they are not fixed. If the fund does worse than expected, the company's contributions go up. If the fund does better than expected, the company's contributions go down. Either way, your payments and your benefits stay the same. Shell takes the risks.

For many years, as a result of conservative actuarial estimates, Shell put more money into the SACPF than was needed to cover all the benefits, so the surplus grew. Eventually the fund's legal, tax and actuarial experts told us the surplus was getting much too high, far higher than any reasonable margin of safety, and high enough to endanger the tax preferred status of the fund. When we designed the SASF, treatment of the surplus was one of the things we changed. The SASF lets Shell get the surplus back when it chooses, instead of retrieving it a little at a time by taking a 'contributions holiday'. We did our best to explain this.

When Shell employees and members elected in 1990 to switch to the SASF -- as more than 99% did -- one of the things they also agreed was the change in how the surplus was handled. We recognised that you had a right to know that before you made your choice.

We therefore included information about the surplus and the company's intention in the materials sent to all members, and dealt with the issue specifically as a formal part of the approximately 100 site meetings held to discuss the switch.

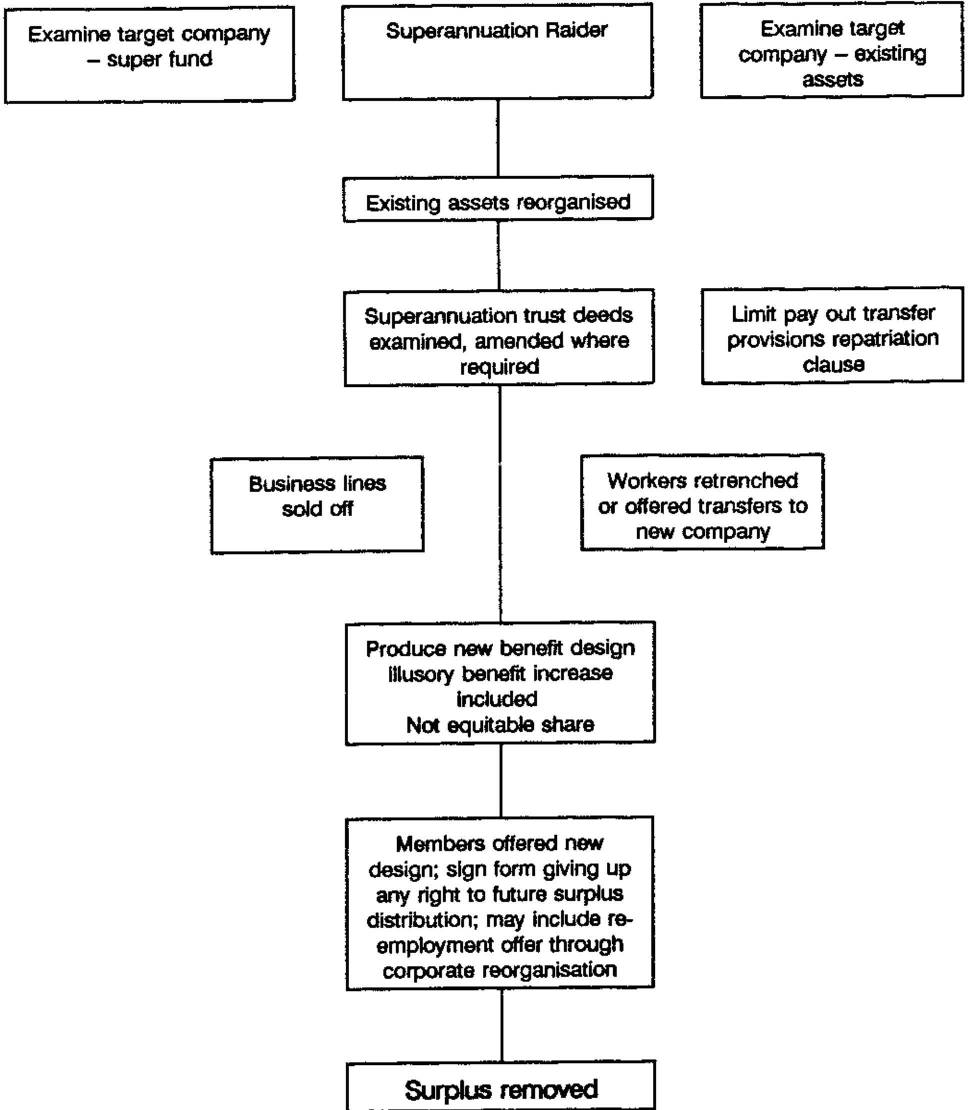
It was also addressed over the 'hot line' established to answer members' queries. The unions who are leading the fight now were certainly well informed from the outset, judging by the cartoons they circulated attacking Shell well before the 1990 transfer deadline.

How do I see this issue being resolved?

Objectively, Shell's old fund was at least equal to the best of its type in Australian industry. The new fund, the SASF, is better still. We have over 4 000 members, of whom about 1 900 are unionised. In addition, we have 1 100 pensioners. Our history has been for the one scheme to apply to all Shell employees, which I believe has been one of the strengths of Shell in comparison with many companies.

Source: Excerpt from letter to Shell staff, from Mr Ric Charlton, Shell Chair and Chief Executive Officer. Forwarded to the Committee following evidence given by Mr Hughes and Mr Collins.

Figure 6.3 'LEGAL STEALING'



Reproduced from documents tabled by Chifley Superannuation Services at Sydney public hearings, 18 February 1992.

6.11 The case put by Chifley Superannuation Services was that in the event of a takeover, members of the fund in the takeover target are transferred into the raider's superannuation fund and the surplus is tied up in the fund in the takeover target. Chifley contends that the new fund usually has what it calls 'illusionary' increased benefits, commonly better vesting, but the transfer provisions and winding up provisions in the new fund are different. Chifley suggested that key amendments to the original deed were:

- 'Members Interest' was changed to 'Accrued Rights';
- 'Equitable Distribution' was changed to 'Ascertained Benefit';
- 'No Reversion' was changed to 'Reversion to Employer'; and
- 'Company Contributions Irrevocable' was changed to 'Reversion to Employer'.

6.12 Mr Newman corroborated Chifley's evidence and said that he had

> *... seen the trust deed altered in such a way that the members can only get a certain level of benefit – it certainly would not be less than their vested benefits – and the balance can be repatriated to the principal employer under the trust deed.*[13]

13 Evidence, p 728.

Recommendation 6.2:

The Committee recommends that OSSA be amended so that for defined benefit schemes:

- *all trust deeds be required to include clauses outlining the methods by which a surplus can be repatriated to the sponsoring employer, and that any changes required to give effect to this requirement be submitted to members for approval beforehand;*
- *members be given at least three months' prior notice before a surplus is repatriated;*
- *members must be supplied with a summary when such notice is given which includes the financial status of the fund, including the accrued retirement benefits index;*
- *members upon request are entitled to a copy of the original trust deed and all amendments and dates of amendments up to the date of the proposed or actual repatriation of any surplus or transfer;*
- *a minimum funding standard be satisfied immediately after repatriation – this minimum standard to be at least 110% of accrued retirement benefits;*
- *the amount of surplus that can be held in a fund is restricted – the level to be an amount not more than 20 per cent of the liabilities of the fund;*
- *where members are to be transferred from one scheme to another, members must be advised of the clause(s) in the deed under which the transfer is being effected; and*
- *where members are to be transferred from one scheme to another, that members be given two months' prior notice so that they have adequate time to seek advice on the implications of the transfer.*

6.13 Mr Langfield-Smith, in his evidence to the Committee, said that he was aware of some schemes which expressly limit the payout to the member to the RBL limit. However, the fund did not take that into account in determining the level of employee contributions so that employee contributions were in fact enabling employer contributions to be reduced. Mr Langfield-Smith said that under current regulatory arrangements the fact that employee contributions were excessive need not be brought to the attention of members.[14]

14 Evidence, p 169.

> *Recommendation 6.3:*
>
> *The Committee recommends that the fund's actuary be required to report on the level of employee and employer contributions in the context of members' RBLs.*

Surpluses in Accumulation Schemes – Lost or Inactive Members

6.14 In accumulation schemes, surpluses arise for three reasons:

- investment earnings are not credited in full to members' accounts;
- contributions on or behalf of lost members are credited to reserves; and
- where employer contributions do not immediately vest in the employee.

6.15 With respect to the first issue, the Committee believes that accumulation schemes should be able to build up reserves to smooth the investment returns that are available over a period of years. Smoothing of investment returns in this way may also help attenuate the focus on short term investment returns and redirect attention to the long term performance of the fund. The Committee is conscious however, that reserves in accumulation schemes raise concerns between different generations in the fund (inter-generational equity concerns) and that these require careful consideration.

> *Recommendation 6.4:*
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> *The Committee recommends that the Government investigate the nature and extent of reserves in accumulation schemes and whether reserves are being maintained for their proper purposes. The Committee further recommends that the status of reserves in accumulation schemes be clarified in the OSS Regulations.*

6.16 The Committee heard a wide range of views on the best means of dealing with benefits attributable to lost members. The ISC noted in its evidence that tax file numbers should be used to trace inactive members and advised the Committee that it had 'worked feverishly'[15] on developing approved preservation vehicles. These would have included the development of an ADF for that purpose, but the Attorney-General's Department had advised that an approved deposit fund would not be able to accept such payments. The Committee was advised that the ISC was considering

> *allowing a fund, or groups of funds, to set up a superannuation fund, the sole purpose of which would be the sweeping in of such unclaimed moneys or to preserve benefits where the beneficiary cannot be found.*[16]

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15 Evidence, p 1856.

16 *ibid.*

6.17 The ISC suggested at least two other options to the Committee. The first was that industries could decide to set up a vehicle to cover all industry funds with lost members, or employers could decide to set up a fund that covered employer-sponsored funds. The second approach would be to have an unclaimed-money approach with provisions similar to those in the Banking Act or in the LIA where moneys that were clearly not traceable to any particular individual would revert to consolidated revenue, but would be available at some later date if the individual was discovered.[17]

6.18 The Committee has conducted its own research on lost members (See Table 6.1). Survey results show that in the hospitality industry, lost and inactive members can be as high as 40% of total membership. The practice of dealing with lost members varies between funds and the Committee believes it desirable that uniform standards be developed.

Recommendation 6.5:

The Committee recommends that:

- *a central fund be established for lost member accounts so that all funds can be swept periodically, say every six or 12 months, in order that administration charges on such accounts be minimised;*
- *the accounts could be identified either by tax file numbers or by a superannuation number;*
- *an appropriate Commonwealth agency should tender out the administration of such a fund on a fee for service basis, on a long term contract (for example, five years) and that arrangements be made with the Australian Tax Office so that information on the balance of the account could be forwarded to individuals; and*
- *where the person is in irregular employment or changes employment frequently, the person should have the option of rolling over contributions in the central fund into an appropriate industry or employer scheme.*

[17] Evidence pp 1856-57.

Table 6.1

SURVEY OF LOST OR INACTIVE MEMBERS IN INDUSTRY FUNDS				
Name of Fund	Number of Members as at April 1992	No. of Lost or Inactive Members	% Members Lost or Inactive	Treatment of Lost Members Funds
ARF	279 400	30 700	11	Not addressed to date
BUS	188 000	Lost 35 000* Inactive 112 000#	18 60	Forfeiture to reserves provision in trust deed but not exercised to date.
HESTA	149 300	14 000	9.4	Unclaimed benefits return to fund
HOSTPLUS	104 200	41 000	40	Continued deduction account keeping fees
REST	287 900	Lost 25 300 Inactive 65 100	8.6 18.1	Forfeiture to reserves provision in trust deed but not exercised to date
STA	120 400	16 500	9.7	Forfeiture to reserves provision in trust deed but not exercised to date
TasPlan	31 200	7 200	23	Forfeiture to reserves provision in trust deed but not exercised to date
Westscheme	34 900	9 186	38	Not available
NSW Govt State Authorities Basic Benefit Scheme	Regular employees 103 000 Irregular employees 417 000	**	10 (statements returned)	Unclaimed moneys retained by Board
Qld Government GOSUPER Plan	280 600	Preserved Members 113 400***		Unclaimed moneys go to consolidated revenue account
WA Govt Employees Super Board	89 620	20	0.02	Unclaimed moneys retained in fund and available to beneficiaries at any time
SA State Superannuatio n Scheme	25 049	–	Less than 1% 'inactive' members	'Inactive' moneys paid into Government's unclaimed money account

* 'lost' defined as members for whom current address is not available.
\# 'inactive' defined as those who did not receive contributions in previous six months.
** Figures not available.
*** Includes members who have 'preserved' funds – actual number of 'lost members' not provided.

Source: Response to survey undertaken by Committee. Fourteen industry funds were asked to respond to a series of questions.