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PRIVATE PENSIONS IN OECD COUNTRIES - AUSTRALIA

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SUMMARY

As most other OECD Member countries had already done, Australia has, since 1991, supplemented an existing flat-rate universal (but means-tested) residence-based old-age pension by a compulsory earnings related second tier for employees known as the "Superannuation Guarantee". However, it was the first Member country in which the favoured format of participation in the second tier is in the form of pure "money purchase" schemes in which benefits are determined solely by the amount which accumulates in individual accounts. Benefits are predominately paid as lump-sums on retirement, although tax arrangements are being changed to encourage beneficiaries to purchase annuities.

This report, compiled by two Australian experts, describes this system and its relation to pre-existing tax-advantaged voluntary provision, which only covered one-third of employees but remains predominant in terms of assets accumulated and benefits payable.

The report discusses the sources of retirement income, taxation arrangements, administration and investment of funds and their regulation and supervision. A final chapter assesses the Superannuation Guarantee System in terms of its contributions to retirement income security and its impact on national savings rates, and considers some options for reform.

This report is one of a series on private pensions in OECD Member countries. Reports on the United States, New Zealand, Ireland and Canada have been published in the OECD Social Policy Studies Series (numbers 10, 11, 13 and 15 respectively). Reports on the United Kingdom and France are being released as Occasional Papers. The report was finalised in August 1996.

RESUME

Comme la plupart des autres pays Membres de l'OCDE l'avaient fait avant elle, l'Australie a, depuis 1991, complété son régime de retraite universel à taux uniforme (mais lié à un niveau de ressources), par un second pilier d'épargne retraite obligatoire proportionnelle aux gains pour les salariés, appelé système de garantie de retraite. Toutefois, c'est le seul pays à avoir privilégié, pour le deuxième pilier d'épargne, les régimes à cotisations définies dans lesquels les prestations sont uniquement fonction des sommes accumulées sur les comptes des bénéficiaires. Les prestations sont la plupart du temps servies sous la forme d'un capital versé intégralement au moment du départ à la retraite, mais une réforme des dispositions fiscales visant à encourager les bénéficiaires à opter pour le paiement d'une rente est en préparation.

Ce rapport, rédigé par deux experts australiens, décrit ce système de garantie de retraite et ses liens avec le régime volontaire préexistant auquel étaient associés des avantages fiscaux. Ce régime ne couvrait qu'un tiers des salariés mais continue d'occuper la première place en termes d'actifs accumulés et de prestations à verser.

Il passe en revue les sources des revenus de retraite, les dispositions fiscales, les conditions d'administration et de placement des fonds de pension, leur réglementation et leur surveillance. Un dernier chapitre consacré au système de garantie de retraite analyse sa place dans le dispositif de retraite et son incidence sur les niveaux d'épargne, et propose des mesures de réforme de ce système.

Ce rapport fait partie d'une série de monographies sur les régimes de retraite privés dans les pays de l'OCDE. Les monographies des régimes de retraite des Etats-Unis, de la Nouvelle-Zélande, de l'Irlande et du Canada ont été publiées dans la série des Etudes de politique sociale de l'OCDE (numéros 10, 11, 13 et 15). Celles consacrées au Royaume-Uni et à la France sont diffusées sous forme de documents hors série. Le rapport a été achevé en août 1996.

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We are grateful to Peter Scherer for his detailed comments on an earlier draft. In addition, we are indebted to Geoffrey Kingston for his insightful suggestions. Kirsten Armstrong provided useful comments on an early draft, and Alex Dunnin, of the Australian Insurance and Superannuation Commission, supplied and interpreted much previously unpublished data. None of these individuals necessarily agrees with the views expressed, and all errors are our sole responsibility. The research reported here was funded by the Australian Research Council, and the OECD.

NOTE:

Unless otherwise stated, policy provisions, including dollar amounts, outlined in this document refer to the situation at 30 June 1995. All values are expressed in Australian dollars. At the time of writing (May 1996) and Australian dollar could buy about 80 cents US.

CHAPTER 1. AUSTRALIAN PRIVATE PENSIONS AT THE CROSSROADS

Introduction

This survey is being written at a critical time for the private pension industry in Australia, and has proved a difficult job. Fifteen years ago, the task, while not entirely straightforward, would have been much simpler. In the private sector, pensions, or *superannuation*, to use the Australian term, was then largely confined to relatively well paid employees - superannuation coverage (the proportion of employees participating in a superannuation scheme) in the private sector stood at about 30 per cent. Superannuation was heavily tax preferred - much more so than in most OECD countries - and investment was circumscribed to ensure adequate demand for government and semi-government bonds. Benefits were often paid as a *lump sum* at retirement. There was no requirement that they be taken as an income stream, and income tax was payable on only 5 per cent of the value of the lump sum, so the prevalence of lump sum payments was hardly surprising.

The rest of the private sector work force relied for their retirement on the national *age pension* - a flat rate, means tested social security payment - and on the owner-occupied dwelling that most of them had bought and paid for throughout their working lives. There was no employment related national pension plan, such as existed in most OECD countries.

A much higher proportion of public sector workers - both government employees and workers in government business enterprises - enjoyed superannuation benefits. Coverage hovered at around 65 per cent. These benefits were largely unfunded, however, being paid for from current tax collections, or from the revenues of government business enterprises. We include these occupationally based public sector superannuation arrangements as part of the private system, since benefits are paid as part of a private employment contract.

On this basis, then, a 1980 survey focussing on private pensions would have discussed the low overall coverage of *occupational superannuation*; the tax advantages to the well off from access to a superannuation scheme; the future liability of the unfunded public sector funds; the regulations which circumscribed superannuation investment; the anomaly of benefit availability as a lump sum; and the associated practice of individuals, having received generous tax preferred benefits from private superannuation, arranging their financial affairs so as to become eligible for the age pension as well.

Today, while many of these features still form part of Australia's retirement provision landscape, superannuation has changed dramatically. This is because retirement benefit coverage has become mandatory for Australian employees - a policy embodied in the *Superannuation Guarantee*. The development of this policy is complex. But to put it at its simplest, in 1992 the government legislated that employers should pay into an "approved" *superannuation fund* a percentage of the earnings of their employees, thus effectively mandating what had been, since the mid eighties, part of a national agreement between employers and employee organisations. A phase-in schedule was also legislated, with employer contributions rising to 9 per cent of earnings by the year 2002. It is envisaged that by then, a 3 per cent employee contribution will also be required.

As a result of this *mandatory retirement saving* policy, superannuation coverage has increased from 40 per cent of all employees in 1987 to over 90 per cent in 1995. This in turn is predicted to enhance national saving significantly, to increase the private retirement incomes of many Australians and thereby reduce reliance on the age pension over coming decades, and to sharply increase the value of investment under superannuation fund management. In the public sector, coverage increased to 97 per cent by 1994, compared with 63 per cent in 1987, and the degree of fundedness of public sector schemes has also increased significantly. It should be noted that under the definition of "private pensions" that we have adopted, all superannuation in Australia is "private".

In contrast to most of the surveys in this series, then, this monograph will cover not only what might be termed voluntary private superannuation, but pension arrangements which have been effectively mandated under the Superannuation Guarantee. It is possible to think of this as Australia's employment related social security scheme, with private mandating replacing public provision. Since this development is central to an understanding of the current state of Australia's private pension industry, we describe its development in some detail in this introductory chapter, and outline its features and links with other forms of retirement income in Chapter 2.

While it is the most dramatic of the changes in private superannuation over the last decade, the Superannuation Guarantee is not the only major policy initiative to have occurred over that time. There have also been major changes to the taxation of retirement saving; to *vesting*, *portability* and *preservation* requirements; to investment regulations; to the prudential supervision and other regulation of superannuation funds; and to the way in which superannuation saving and benefits interact with the age pension.

One issue of definition needs to be highlighted at the beginning of any discussion of private pensions in Australia. On a strict interpretation, such pensions hardly exist. Because of the continuing option of lump sum withdrawals, there are very few private pensions, in the sense of income streams providing longevity and purchasing power insurance. Overall private retirement provision in Australia is termed "superannuation", and it is this collection of policies, practices, and institutions which is the subject of this monograph.

The remainder of this chapter will present a (recent) historical overview of private pensions in Australia, offer some projected growth patterns, and summarise the major current policy issues. In Chapter 2, private pensions are placed in the broader context of retirement income, and the interaction between private and public pensions is discussed. Chapters 3 through 5 describe in turn tax policy, industry administration and investment and regulation. In Chapter 6, we offer an assessment of the Superannuation Guarantee, since that is really novel, and the Australian experience may be of general interest. A concluding section outlines a possible future policy agenda.

A Historical Overview[1]

Traditional sources of retirement income

Traditionally, Australia has relied on a targeted universal flat rate age pension for retirement. Entitlement to this transfer is based on age (currently 65 for men and 60 for women), residency status, income, and assets, but not on employment history. It is paid from general revenues. Although tax and other concessions have always existed for occupational superannuation, participation was voluntary. There was no government policy to compel participation in an employment or earnings related retirement income scheme, as is typical in other OECD countries. As a consequence, the introduction of mandatory private retirement saving does not entail transition problems of the kinds anticipated in countries with well established earnings related pay-as-you-go schemes.

Australia's status as odd man out in this regard seems to have been more a matter of historical and political accident than of any consistent policy stance. It was always recognised that the public age pension alone was not sufficient to fund adequate provision for the retired in a developed and rich society such as Australia’s. Between 1913 and 1938, three unsuccessful attempts were made to introduce earnings related retirement income arrangements similar to those which were proving popular in Western Europe and the Americas. In 1938 Australia even got as far as passing the enabling legislation, but, with the coming of World War II, deferred implementation indefinitely. On each occasion the government of the day succumbed to widespread opposition: from elements of the financial sector already providing such support, from the State governments because such arrangements would extend the Commonwealth government’s constitutional powers, and from employers who were concerned about adding to the costs of production.

In the early 1970s, the Whitlam Labor Government commissioned a Report on retirement income. The resulting Hancock Report also recommended a scheme along the lines of US and European style arrangements (Hancock 1976). The Report, however, was not completed until after the change of government in 1975, and its recommendations were never acted upon.[2]

The origins of the Superannuation Guarantee

From the mid 1970s, support for a national superannuation scheme was carried by the trade union movement. Prominent union leaders argued that superannuation should be a central feature of negotiated industrial conditions. At this time, private sector superannuation remained very narrowly based, confined mostly to the banking and insurance industries, and middle to senior management elsewhere. The union movement argued that superannuation should be provided to all employees, including casuals and part timers.

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1 This section draws on Bateman and Piggott (1993).

2 The new Conservative Government favoured voluntary occupational superannuation rather than compulsory national arrangements. When announcing its rejection of the Hancock Report in 1979, it established a Task Force to examine the role of occupational superannuation and the possible involvement of the union movement. The Task Force reported in 1983 with recommendations for a regulatory framework for the superannuation industry, proposals for vesting and preservation requirements and proposals to encourage annuity purchase. (Commonwealth Task Force on Occupational Superannuation 1983).

When the Hawke Labor Government was elected in March 1983, a major plank in its economic strategy was a continuing contract with the union movement, the "Accord", which survived through Labor's tenure of office. The Accord, along with Australia's then centralised wage determination system, was the crucible for establishing the broad superannuation arrangements that constituted the first working version of mandatory private superannuation. This was known as *Productivity Award Superannuation (PAS).*

Discussions between the unions and the government on national superannuation had taken place as early as 1983. In January 1985, the idea of building an employer superannuation contribution into a national centralised wage decision was being discussed between the then Treasurer, Paul Keating, and the Secretary of the Australian Council of Trade Unions (ACTU), Bill Kelty. The idea became reality in 1986, when the Accord Mark II was agreed. The crucial element in that agreement was that while the increase in compensation to employees should be 6 per cent, to keep pace with inflation, half of the increase would accrue in the form of a 3 per cent employer superannuation contribution, to be paid into an individual account in an *industry fund*. This agreement was subsequently ratified by the nation's industrial court, and survived a High Court challenge brought by the Confederation of Australian Industry questioning its constitutionality.[3]

Over the next three years, as individual industrial award agreements were negotiated and ratified under the umbrella of the 1986 national wage case decision, superannuation coverage of employees nearly doubled. In the private sector, where superannuation coverage had traditionally been low, it increased from 32 per cent in 1987 to 68 per cent in 1991.

The Government embraced PAS because it helped to solve two problems. First, the Australian economy was booming, and it was becoming necessary to contain aggregate demand. A full 6 per cent wage increase, consistent with real wage maintenance, was seen as likely to magnify this upswing of the business cycle. Second, PAS helped to mollify sections of the Australian Labor Party, which had been advocating national superannuation for some time. The ageing of the population was making their calls more urgent. Further, compulsory saving in the form of superannuation could be seen to address the problem of deficient national saving.

The union movement saw PAS as a method of securing retirement rights additional to the age pension for its membership. It was also able to claim that it had achieved full compensation for inflation. Further, because the industry funds were defined around union membership, unions saw in PAS the long term prospect of gaining some degree of control over substantial capital funds. Employer reactions were mixed, but were much less negative than might be anticipated because PAS was included as part of an agreed overall wage package. PAS contributions were seen, at least in part, as a substitute for higher wage payments.

In its early years, PAS won surprisingly general support. Plans were mooted for two more such decisions that might carry the total PAS commitment to 9 per cent of earnings. These, combined with a 3 per cent employee contribution, were seen as sufficient to generate adequate income replacement in retirement.

Experience proved, however, that the PAS was not being paid to many employees who were entitled to it. Employees were confused about the nature of their entitlement. Because the awards

3 In May 1986, the High Court ruled unanimously that this court, the Conciliation and Arbitration Commission, had jurisdiction to hand down decisions with respect to superannuation - see Dabscheck (1989), p.99.

called for payment to an industry fund, and some unions had not established such funds, employer liability was unclear. Further, a case would have to be mounted before the Commission for each award - of which there are several thousand - to enforce compliance.

A further problem with the PAS structure was that a substantial minority of employees already enjoyed occupational superannuation rights. No blanket PAS decision could recognise this, and any attempt to differentiate between employees on the basis of their current occupational superannuation status would significantly increase the already confusing complexity of the awards.

As a result, in 1991 the Australian industrial court[4] rejected an application, supported by both the government and the unions, for a further 3 per cent PAS increment. The government responded by introducing legislation requiring employers to make superannuation contributions to an approved fund on behalf of their employees. If the contribution was not made, a charge would be levied on the employer to enable the government to make the contribution. This mechanism - the *Superannuation Guarantee Charge (SGC)* - is the legislative linchpin of the Superannuation Guarantee.

It should be noted that while the Superannuation Guarantee formally removed further increments to mandatory retirement saving from union agreement, the influence of the union movement remains strong. This is mainly because PAS continues to be paid into industry funds, and it is administratively simpler for subsequent Superannuation Guarantee contributions to be paid into these funds. The composition of the boards of trustees of these funds requires employee and employer representation in equal numbers.

In a way, the Superannuation Guarantee can be seen as a way of "privatising" social security, an initiative which is now being advocated in a number of countries. The driving force behind this general policy thrust is the onset of demographic transition, which will see the age dependency ratio in many OECD countries, including Australia, double over the next 30 years. The implied projected public pension liabilities have caused concern among some policy makers. It is argued that a retreat from publicly funded earnings related pension obligations will require private replacement, and that this is probably easier to implement now than later.

However, the Superannuation Guarantee did not, so far as we are aware, have its genesis in any such concerns. Australia's means tested age pension does not have anything like the same implications for future public sector obligations as those which exist in some other countries. Nevertheless, the Superannuation Guarantee's relatively smooth passage through the policy formulation and implementation process reflects a recognition among policy makers that it partially addressed some of the problems associated with population ageing.

Other policy developments

As well as the establishment of the Superannuation Guarantee, other changes were introduced. The extremely generous taxation treatment which had been given to superannuation saving prior to 1983 was reshaped towards the idea of a saving deduction from the income tax base (although, as we will explain in Chapter 3, current tax treatment of superannuation remains poorly designed). The changes were unrelated to the introduction of PAS, but taxation treatment would have had to have been amended before mandatory retirement saving was introduced - government

4 Now called the Industrial Relations Commission.

revenues would have been too seriously eroded had the pre-1983 tax treatment been applied to mandatory contributions.

Secondly, investment requirements which had been placed on superannuation fund investment were significantly reformed, in line with the deregulation of financial markets more generally which took place through the first half of the eighties. Economists and the industry agree that the current restrictions on *asset allocation* - limits on in-house share purchase and a non-borrowing rule - are reasonable. These issues will be discussed further in Chapter 4.

Further, superannuation saving has become much more the vested right of the employee than was previously the case. Rules on vesting, portability and preservation were all amended with this aim. All Superannuation Guarantee contributions must satisfy stringent requirements which effectively give the employee property rights in his or her accumulation. The introduction of *rollover funds* in 1983 facilitated these requirements. These and other regulations are discussed in Chapter 5.

Trends

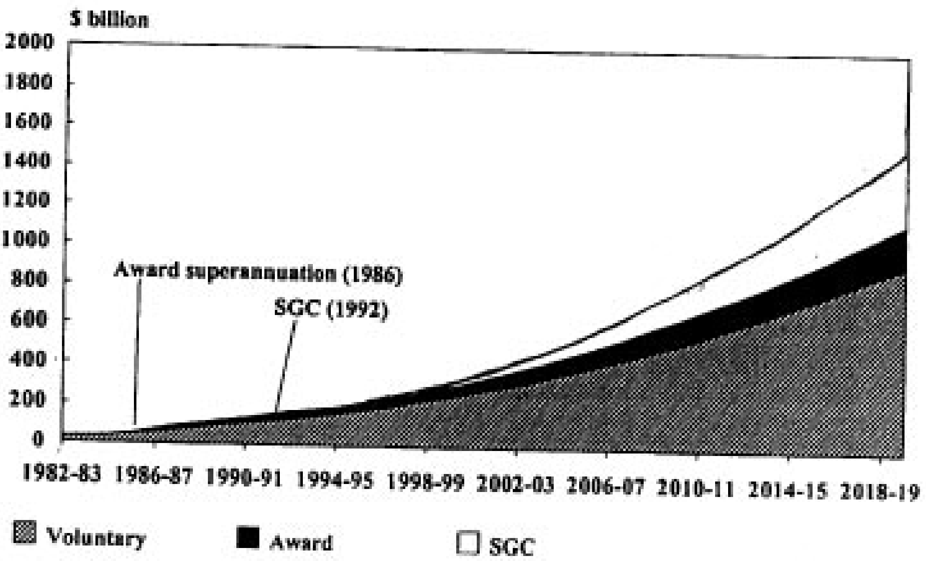
There are two obvious indices of the importance, and the change in importance, of superannuation. First, the value of assets under management may be traced over time. This shows how superannuation contributions, and the earnings thereon, have increased over the last decade, and gives some quantitative guide to the importance of the policy reforms we have outlined above. Second, changes in the extent of coverage may be charted. This gives some indication of how, in the future, patterns of the sources of retirement income in Australia may change as a result of current retirement income policy.

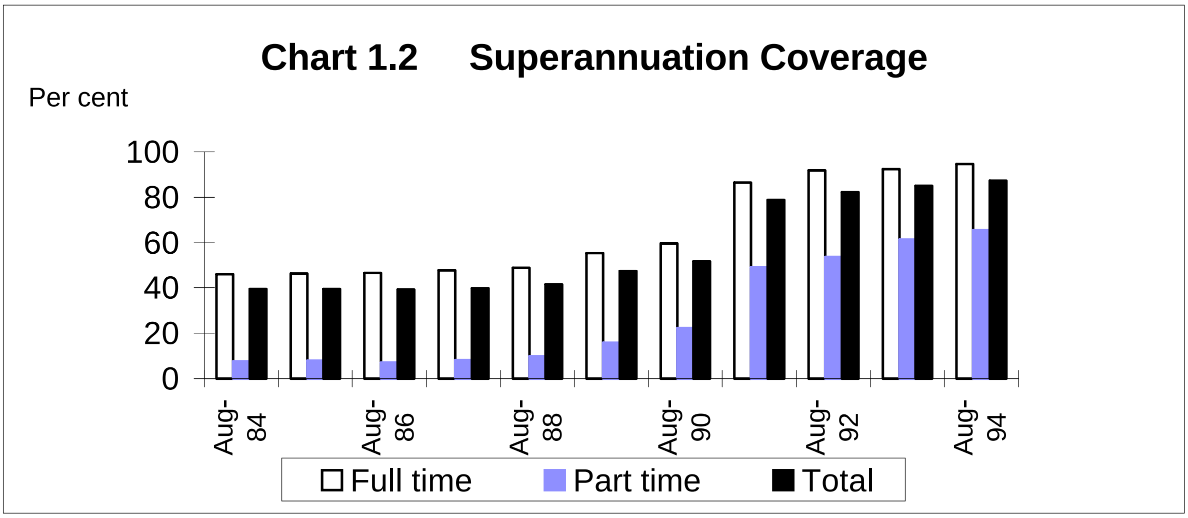
As Chart 1.1 indicates, total superannuation assets have grown from $A21.6 billion in June 1983 to $A230.7 billion by September 1995. They are projected to reach over $A800 billion by 2010 and to approach $A1,500 billion by 2020.

Superannuation assets comprise contributions to superannuation funds and the earnings thereon. Currently, most of the growth in superannuation assets is due to long standing voluntary superannuation. Mandatory arrangements, in the form of productivity award superannuation from 1986 and the Superannuation Guarantee from 1992, have yet to make a significant impact: the initial mandatory contributions are quite low and the buoyant, high inflation environment of the 1980s resulted in high nominal investment earnings for voluntary superannuation. However, by the early decades of the 21st century, mandatory superannuation will account for a significant proportion of superannuation fund assets.

Chart 1.2 shows how superannuation coverage has increased over the period since PAS was introduced. By August 1995, full time coverage (averaged across both private and public sectors) stood at more than 90 per cent of employees, compared with 40 per cent in 1984. Even more dramatic, coverage of part time employees increased from 8.4 per cent in 1984 to over 70 per cent in 1995. Most of these part time workers are women, and it is therefore not surprising that “women and super” has become a policy issue in its own right.

Chart 1.1: Superannuation Assets by Source of Contributions, 1983-2020





Overview of Current Policy Issues

Although much has happened in private pension policy over the last decade, there are many further outstanding issues, which need to be resolved before policy becomes cohesive. They are of two kinds. The first comprises issues which need to be dealt with through some direct policy action. The second comprises unforseen challenges to industry practice raised by a mandatory private pension scheme. Sometimes issues require the attention of both policymakers and the industry. Some examples of each are given here, but the list is not meant to be comprehensive. It could not be: because private pension policy in Australia is so novel, problems arise as the system evolves which have not been anticipated in advance.

Perhaps the most important outstanding policy issue is the form in which retirement benefits may be taken. While there is a consensus among informed commentators that benefits should be taken as an income stream, there is less agreement on its exact form. This issue is made more complicated by a political perception that the public at large wish to have the right to take their retirement benefits as a lump sum - the so-called *lump sum mentality*.

A second unresolved policy issue concerns the interaction between private superannuation and the age pension. As we have already noted, the age pension is means tested on both assets and incomes. But assets are valued when eligibility age is reached - 65 for men and 60 for women. The current *preservation age* for superannuation benefits is 55.[5] The gap between these allows ample time for even a very substantial lump sum to be disposed in a way which will allow the retiree to receive the age pension. These include *inter vivos* gifts, the purchase or upgrading of an owner occupier home (the value of which is not counted as an asset, and the imputed income from which is not counted as income, under age pension means test rules), or simply consumption after early retirement. This practice, known as *double dipping*, is potentially expensive to government tax collections and

5 Legislation has been enacted to increase the eligibility age for women to 65 by the year 2014. Legislation has also been passed to increase the preservation age to 60 years, although this target will not be reached until the year 2025.

revenue, and is widely perceived as inequitable. It is related to retirement benefits; both require urgent legislative attention.

A third issue relates to the way in which mandated private superannuation affects women. Prior to the initial mandatory contributions under PAS, many working women had no superannuation coverage at all. Many were part time workers, less than 10 per cent of whom enjoyed superannuation coverage, and others were not covered because their connection with an employer was not as strong as that of the typical primary worker. Because women tend to earn less than men, and to have more disrupted working lives, their accumulation at retirement tends to be significantly below that of men. Further, because they live longer, the same accumulation will buy a much smaller annuity for a woman than a man. A separate gender related issue concerns property rights in superannuation accumulations on divorce.

Finally, investment strategies for mandatory private pensions pose many problems. The clientele that the pension industry confronts under a mandatory scheme is very different from the group it has traditionally serviced. Policymakers are confronted with the question of how much member choice they should allow: should fund members be able to change funds whenever they wish, regardless of cost? Should each fund be required to offer a menu of portfolios with different risk return characteristics? Should trustees be required to guide younger members towards riskier portfolios, and older members towards safer investment mixes? On the industry side, what are the preferences towards risk of a clientele whose participation in the fund is mandated in the first place? Should special investment policies be introduced to counter *myopic loss aversion*, or what is sometimes called *short termism*?

It should be apparent that in many critical respects, Australian retirement income policy is currently in transition. In what follows, we try to give an account and an assessment of current policy - where it has come from, what it is now, and where it is likely to go. More than in some other surveys, we will focus on policy issues which have not, in our view been satisfactorily resolved - an emphasis implied by the transitional nature of the current situation. The first of these tasks is attempted in Chapter 2, where we give an account of the major sources of retirement income for Australians.

CHAPTER 2. SOURCES OF RETIREMENT INCOME[6]

Introduction

In developed countries, retirement income can be thought of as having three main components. The first is a social welfare safety net, access to which is not conditional upon past employment. The second component is compulsory employment related retirement provision, either provided by or mandated by the public sector. Finally, there is voluntary retirement provision. Chart 2.1 depicts this typology, along with the main design alternatives for each component. In the terminology of pension policy, these can be thought of as the three pillars of retirement income provision.[7]

At the cost of some oversimplification, most OECD retirement provision policies can be characterised using this schema. For example, safety net payments may be universal, as in Canada, or targeted, as in Australia. The compulsory pension contribution component can be provided by central government, as in the US, mandated through a public authority, as in Singapore, or through the private sector, as in Chile and Australia. Voluntary saving for retirement can be facilitated through various tax preferred channels - such as IRAs and RRSPs in the US and Canada - or they can be confined to occupational superannuation pension schemes, as in Australia.

The Australian profile of retirement provision is indicated in Chart 2.1 by the **bold type** branches. As a result of the Superannuation Guarantee, Australian retirement income policy now approximates the three pillar approach common throughout the developed world. The first pillar is the universal (but targeted) public age pension financed from general revenues;[8] the second pillar is the slowly maturing mandatory private provision under the Superannuation Guarantee; the third pillar is voluntary saving, including tax preferred superannuation. The public age pension provided under the first pillar is withdrawn where retirement income and assets provided under pillars two and three exceed statutory thresholds.

Each Australian component will now be briefly described in turn, and the interaction between them will then be discussed.

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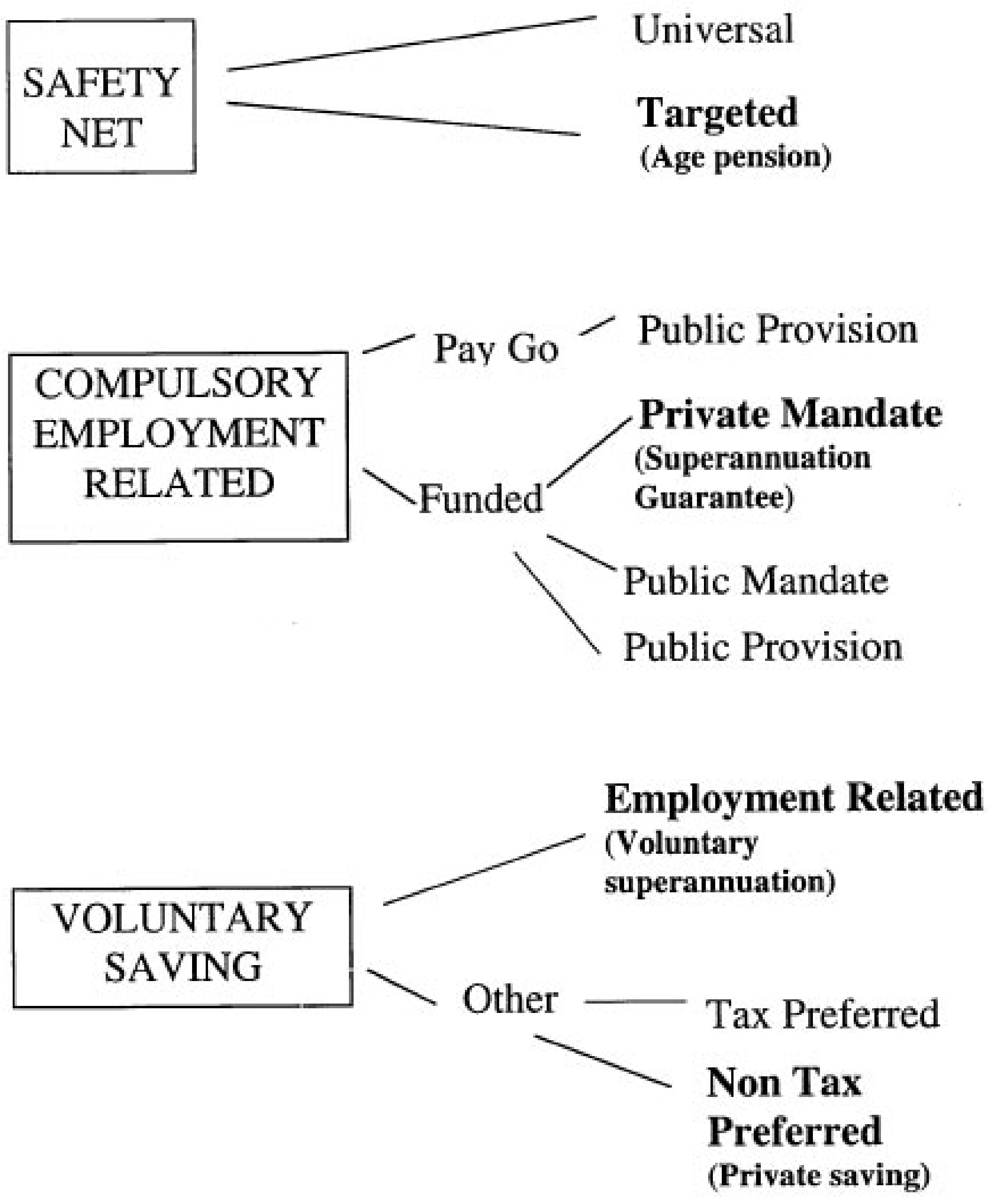
6 This chapter draws on Senate (1988) and Bateman and Piggott (1993).

7 The standard classification relies on the *source* of funds, and therefore distinguishes between public and private retirement provision arrangements - see World Bank (1994). By contrast, our typology emphasises *function*, and therefore distinguishes between safety net payments, compulsory employment related benefits, and voluntary saving.

8 The Australian public age pension is universal to the extent that all residents of qualifying age are eligible, but targeted to the extent that it is subject to income and assets means tests.

Chart 2.1: Components of Retirement Provision



The Age Pension[9]

Since its inception in 1908 the age pension in Australia has performed two distinct social policy functions. It has served as a social welfare safety net for the elderly; and it has provided a major source of income for most retired people. This remains true today. About 80 per cent of the retired of eligible age receive some age pension, around 70 per cent of which are paid at the full rate. Only gradually will this change, as the Superannuation Guarantee matures. In order to give a complete account of the role of private pensions in Australia, therefore, it is necessary to offer at least an outline of the age pension.

The age pension has the following three basic elements:

- a flat rate maximum entitlement;
- a rate at which that entitlement is withdrawn as private income and assets increase beyond a given level; and
- an income and assets limit at which all entitlement ceases.

Other non cash benefits, such as concessional public transport travel, and subsidised medical care and medication, are associated with age pension eligibility. In contrast to most OECD countries, the age pension is financed from general revenues - no "social security tax", or similar earmarked revenue collection device, exists.

The age pension is payable to women aged 60 years and over, and to men aged 65 years and over. Claimants must also satisfy certain residency qualifications. The pension is means tested in accordance with either a person's income or, since March 1985, a person's assets, whichever determines the lower rate of pension. A higher rate of pension is payable to a single person than to each member of a married couple. Twice yearly the value of the pension is indexed automatically against the effects of inflation in accordance with movements in the Consumer Price Index (CPI). Assistance received through the pension is subject to personal income tax but a pensioner rebate is available. This fully exempts full-rate pensioners from income tax and provides partial exemption for part-rate pensioners.

Means testing

Initially, the age pension was subject to both an income test and a separate property test. Under the *Invalid and Old Age Pensions Act 1908* no pension was payable if a person's income exceeded £52 a year, or if accumulated property amounted in value to more than £310. The annual rate of pension was reduced on a pound for pound basis once earnings exceeded a free area equal to the then prevailing annual value of the pension (£26), and also by £1 for every £10 of the value of property above a second free area of £50. Where property included a home in which the claimant permanently resided, and which brought in no income, the deduction for property commenced at £100

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9 This section draws heavily on Senate (1988). In the discussion, we ignore the distinction between the age pension and the service pension, which is paid to ex-servicemen and women. The two pensions are very similar, except that the service pension is paid five years earlier. Details are drawn from Ageing Agendas (1994) and Department of Social Security (1995).

instead of £50. In December 1912 the Invalid and Old Age Pensions Act was amended to exempt the family home, regardless of its value, from the assessment of property when determining the amount of pension payable. In the same year, income received from children and grandchildren in the form of gifts or allowances was also excluded for income-testing purposes.

In the three decades following the Second World War, pension means tests were gradually liberalised. This brought about a substantial change in the character of income support provision for the aged. By the early 70s, means tests themselves were under threat, and in the 1972 election campaign, both major parties undertook to abolish means testing for the age pension. In 1973, the Whitlam (Labor) Government removed the means test on pensions for people aged 75 or more, and in May 1975 the means test was abolished for those aged 70-74 years. This was taken further by the Fraser (Coalition) Government in 1976; it abolished the assets test altogether.

This represented the high watermark of liberalisation for the age pension means test. In 1978 the first step towards tightening the means test was taken when partial means testing was introduced for pensioners aged 70 or more. By the mid 80s, means testing on both income and assets was once again being applied to all pensioners.

At the moment, average earnings in Australia stands at about $A34,000 annually. The single pension is currently approximately 25 per cent of this figure, and the married pension 40 per cent. Compared with other rich developed countries, these magnitudes are roughly in line with safety net payments, but fall far short of the payments promised under compulsory employment related pension schemes.

Present means testing arrangements

The pension amounts at January 1996 were $A8,733.40 pa for a single retiree and $A14,570.40 pa for a couple. Under the income test, the maximum rate of pension is reduced by 50c for every $A1 by which other income exceeds a free area of $A47 a week for a single pensioner and $A82 a week (combined income) for a married pensioner couple. Payment of the pension ceases altogether once weekly income reaches $A388.30 for a single pensioner and $A647.80 (combined income) for a married pensioner couple.[10]

The assets test reduces the pension by $A1.50 per week for every $A1,000 of assets above specified thresholds. The family home is exempt, but the thresholds differ between homeowners and non-homeowners. They also distinguish between singles and couples. The homeowner thresholds at January 1996 were $A118,000 for singles and $A167,500 for a married couple; the corresponding thresholds for non-homeowners were $A202,000 and $A251,500.

These income and asset limits are indexed to annual movements in the CPI.

Development of Occupational Superannuation

The emergence of occupational superannuation in Australia as a popular method of providing income in retirement is a relatively recent phenomenon. Although its history can be traced back to the mid-nineteenth century, most development has occurred during the present century and, in

10 These amounts are for January 1996.

particular, in the period following the outbreak of the Second World War. By this time, occupational superannuation was relatively widespread in the public sector - the Commonwealth Employees' Superannuation Fund having been established in 1922 - but was less common in the private sector where it grew haphazardly, covering some occupations and not others and providing markedly variable conditions and benefits.

An important factor influencing the growth of superannuation has been the attitude of the trade union movement. On the whole, it was not until the late 1970s that unions began to perceive superannuation as a valuable benefit for their members and to include it in logs of claims on their behalf. In addition to seeking the co-operation of employers to extend superannuation coverage to their members, unions began operating their own schemes. The entry of the trade union movement to the area was especially significant as it represented a fundamental change in direction away from the conventional employer sponsored and controlled superannuation model towards trade union-initiated and often industry-wide schemes. Trade union involvement in superannuation was consolidated with the introduction of PAS in the 1980s.

Occupational superannuation became mandatory with the introduction of the Superannuation Guarantee in 1992.

In Table 2.1, we report occupational superannuation coverage in both the private and public sectors before the advent of mandatory superannuation under PAS and the Superannuation Guarantee, and currently. A striking feature of the data reported there is the unevenness of coverage by industry. In the industry category, recreational, personal and other services, for example, private sector coverage stood at 10.7 per cent before PAS; it is currently (1993-94) 88.3 per cent. While the increased coverage in other sectors has been less dramatic, it is almost always very significant. Public sector coverage has also increased, although from a higher base. Over 90 per cent of employees are now covered by occupational superannuation.

Table 2.1 Occupational Superannuation - Coverage

Occupation	Private		Public		Total;	
	1986-87	1993-94	1986-87	1993-94	1986-87	1993-94
Mining	71.9	96.4	92.9	100.0	73.6	96.6
Manufacturing	44.6	96.0	54.3	99.7	45.1	96.1
Electricity, gas, water	85.7	98.2	79.6	98.1	79.9	98.1
Construction	41.3	91.9	62.9	98.9	45.3	92.5
Wholesale trade		93.2		98.2		93.2
Retail trade	23.6	81.8	62.2	87.2	23.9	81.8
Hospitality	n.a.	87.6	n.a.	97.1	n.a.	87.6
Transport and storage		94.4	65.5	99.4		96.4
Communication	35.7	87.3	91.7	98.5	62.9	97.8
Finance		83.9		99.8		88.0
Property and business services	35.2	90.0	74.3	99.5	41.0	90.9
Government administration and defense				96.9		96.9
Education		85.2	74.2	96.8	74.2	94.2
Community	18.1	89.9	50.7	93.5	39.2	91.6
Recreational		81.0		97.5		84.3
Personal and other	10.7	88.3	41.5	99.6	13.1	92.3
Total	31.8	89.4	63.4	97.0	41.6	91.5

The Superannuation Guarantee

The Superannuation Guarantee may be thought of as analogous to national earnings related retirement income schemes operating overseas, such as the US Social Security system, or the UK State Earnings-Related Pension Scheme, with mandating replacing public provision. Its evolution was discussed in Chapter 1. Table 2.2 summarises its main features.

The Superannuation Guarantee commenced in 1992. It mandates employers to make superannuation contributions on behalf of their employees to complying superannuation funds of their choice: employers that fail to do so are subject to the Superannuation Guarantee Charge.[11] These contributions are placed in individual accounts and invested on behalf of the employees. In current practice, the chosen funds are frequently industry-based.

Employees may access the accrued benefits in the form of a lump sum or an income stream upon reaching the preservation age of 55. (This is legislated to increase to age 60 by 2025.) The arrangements apply to all employers and to almost all employees.[12] Employees earning less than $A450 per month were specifically excluded on the grounds of high relative administrative costs for small contributions.[13]

The minimum level of superannuation support is being phased in, gradually increasing over the next 6 years. The timetable for implementation has been legislated, with the target of a 9 per cent employer and a proposed 3 per cent employee contribution to be reached by 2002.[14] It is thought that

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11 It costs more to pay the Superannuation Guarantee Charge than the required contribution. The Superannuation Guarantee Charge comprises the shortfall in the minimum level of support plus an interest and an administrative component. The shortfall is calculated as the difference between the minimum superannuation support the employer is expected to provide and the actual superannuation support provided; the interest component is a proxy for superannuation fund earnings - it is based on the interest rate applying for underpayments and overpayments of income tax; and the administrative component is a flat amount of $A50 plus $A30 for each employee not covered to the prescribed minimum amount. The charge is not a tax deductible expense for employers. It is paid to the Tax Office which transfers it to the chosen fund of the uncovered worker.

12 Not included are: employees who earn less than $A450/month, part-time employees under 18, employees over 65, members of the Defence Reserve Forces, and certain non-resident employees and employees of non-resident employers. A proposal to allow workers earning between $A450/month and $A900/month to opt out in favour of higher take home wages was announced in the August 1996 Budget.

13 This threshold has been the subject of considerable political debate. In the original proposal the threshold had been set at $A250. It was increased to ensure passage through the Senate controlled by the opposition parties.

14 The remaining timetable for the employer contribution is:

1996-97	6 %
1997-98	6 %
1998-99	7 %
1999-00	7 %
2000-01	8 %
2001-02	8 %
2002-03	9 %

over the next 6 years there will be sufficient labour productivity growth to more than offset the impost of the Superannuation Guarantee, so that real wages will not actually fall.

Table 2.2: Features of the Australian Superannuation Guarantee

Established	1992
Contributions (by 2002):	9% employer + (proposed) 3% employee[a]
Funding	Fully funded Individual accounts Many private funds Few investment restrictions
Benefits:	Defined contribution Fully vested, portable and preserved to aged 55 (being increased to 60) No early withdrawals Choice of lump sum, pension, annuity - tax incentives to encourage income streams
Statutory coverage:	All employees aged 18-65 with earnings > $A450 month Self employed not covered
Taxation	Employer contributions tax deductible Fund income (contributions and earnings) and benefits taxed at concessionary rates
Administration and costs	Perceived to be complex. Member protection rules for workers contributing small amounts.
Safety net:	Public age pension provided to all elderly residents, subject to income and assets means tests.

a) The 9 per cent employer contribution is being phased in over the period to 2002.

Employer superannuation support under the Superannuation Guarantee must be fully vested (ie., the member is fully entitled to all accrued benefits), fully preserved (ie., accrued benefits must remain in a fund until the statutory preservation age for access to benefits is reached), fully funded and be paid into a *complying superannuation fund*.[15]

15 For public sector employers, a government guarantee can substitute for full funding.

Because the legislation frames its requirements in terms of contributions rather than benefits, *defined benefit schemes* pose a special problem. Most public sector superannuation schemes and many long established company schemes have a substantial defined benefit component. These count in meeting Superannuation Guarantee obligations provided an actuarial benefit certificate specifying the implicit level of superannuation support is obtained.

The earnings base for calculation of minimum contributions is generally that applying under the relevant industrial award. This is subject to a cap of $A80,000.[16] In other words, the Superannuation Guarantee applies only to the first $A80,000 of earnings.

Voluntary Superannuation

There are considerable voluntary superannuation contributions over and above the mandatory requirements under the Superannuation Guarantee. Table 2.3 reports the extent of voluntary employee contributions in the year following the introduction of the Superannuation Guarantee. Around 50 per cent of members made voluntary contributions at an average rate of 5.7 per cent of earnings.

Table 2.3: Employee Superannuation Contributions

	Members making voluntary contributions %
Males	56.2
Females	41.0
Full time	54.7
Part time	25.4
Public Sector	71.4
Private Sector	41.1
Total	49.7

***Source*:** Superannuation, Australia, November 1993, ABS 6319.0, Table 12, page 18.

16 $A80,000 is equivalent to around 2½ times average earnings. It is indexed annually to average earnings.

Other Voluntary Saving

There is no tax preferred channel for non-occupational financial saving in Australia, and data on this category of saving are therefore more than usually sparse. Almost all personal saving is directed either through superannuation or into owner occupier housing. With this caveat in mind, the data indicate that where other personal saving does occur, it is likely to be in negatively geared property investment. Property is favoured over equities because income flows are likely to be more even, facilitating interest payments, and because capital gains are indexed for tax purposes (making bonds less attractive). Because investment assets held prior to 1987 remain capital gains tax free, this type of accumulation is still attractive. However, it is used predominantly by those in the top income decile. Bank balances average only a few hundred dollars - perhaps enough to pay off the average credit card debt - and probably mainly represent transactions and precautionary holdings.

Retirement Benefits

Retirement benefits accumulated under the Superannuation Guarantee or voluntary superannuation may be taken as a lump sum or an income stream. Retirement income streams can be broadly classified into *immediate* and *deferred annuities*, *superannuation pensions* and *allocated pensions* and *annuities.*

Annuities are purchased from life offices and may be either for a fixed term (term annuity) or for life (life annuity). Possible features include indexation, *reversion*, a guarantee period or residual capital value. Annuities purchased with a retirement accumulation are called *rollover annuities*, while other annuities, including those purchased with a net of tax lump sum, are called *ordinary annuities*.

Superannuation pensions are pensions paid by, or on behalf of, superannuation funds and may be provided with or without indexation and reversion.

An *allocated pension* or *annuity* is an arrangement whereby an individual regularly draws down amounts from an account containing all or part of a retirement accumulation (and the investment earnings thereon) subject to legislated annual limits. The maximum is specified so that the account will run out by age 80 while under the minimum the account lasts indefinitely, subject to increasingly smaller withdrawals.

As will be discussed further in Chapter 3, taxation differs among benefit types. Lump sums are taxed at 15 per cent above an indexed threshold and while income streams are voluntary they are encouraged through tax incentives.

Because superannuation accumulations do not have to be taken as a well defined income stream, a wide range of retirement income stream products has been developed to take advantage of policy specification and individual circumstances. Most of these try to gain as high a tax concession as possible while maximising age pension payments in later life. Among these are allocated pensions, which have been one of the most rapidly growing categories of income stream products in recent years.[17] The holder of an allocated pension can draw down his accumulation at varying rates within wide limits, and still be entitled to the tax advantages which apply to more conventional income

17 In Chile, these are known as "phased withdrawals".

stream products. Recently, a product has been marketed which combines an allocated pension taken at retirement with a deferred life annuity to commence at a later stage.

Such private sector innovations have tended to militate against the development of a life annuity market where products must offer longevity and inflation insurance. On the other hand, it is sometimes argued that products such as allocated pensions provide a vehicle for breaking down the lump sum mentality, thus making it easier to mandate income streams providing adequate retirement income insurance in the future. This issue is taken up again in Chapter 6.

At the moment there is still a strong preference among retirees for lump sums and the majority of superannuation funds provide only lump sum benefits. The ABS superannuation survey of November 1993 reported that for superannuation fund members aged 45 to 74, nearly 74 per cent expected to receive a lump sum payment at retirement. Further, ISC[18] data for the financial year 1992-93 shows that 84 per cent of the value of superannuation benefits were paid as lump sums compared with 10 per cent as income streams. The remaining 6 per cent was paid as death and temporary or permanent disability benefits. Benefits paid in 1992-93, by type of fund, are reported in Table 2.4.

Table 2.4: Benefits Paid by Type of Fund 1992-93
($A million)

	Benefits Paid					
	Pensions	Lump Sum	Annuities	Transfers or Rollovers	Death or Disability Payments	Total Benefits
Type of Fund						
Public Sector	1,690	3,093	0	2,390	549	*7,721*
Private Sector						
Single Employer Spon.	134	2,906	12	3,132	259	*6,444*
Multi-Employer Spon.	47	1,285	0	944	117	*2,394*
Personal	19	317	1	167	15	*518*
Total	*1,890*	*7,600*	*13*	*6,634*	*939*	*17,077*

***Source*:** Insurance and Superannuation Commission, Superannuation Bulletin, 1992-93, Table 5.

18 Insurance and Superannuation Commission.

Table 2.5: Intended Disbursement of Expected Lump Sum, November 1993

	% of persons
Rollover	24.4
Purchase immediate annuity	0.7
Invest elsewhere	19.2
Owner occupied housing	10.0
Purchase car/caravan/boat	1.0
Clear outstanding debts	2.2
Pay for holiday	3.2
Other	39.3
Total	100.0

***Source*:** Superannuation, Australia, November 1993, ABS 6319-0, Table 3, page 7.

Nevertheless, survey data does suggest that it is common for the lump sum to be used to generate an income stream. Some results from the 1993 ABS survey on retirement and retirement intentions are reported in Table 2.5.

Total Retirement Income

In Australia, most people currently retiring rely in some degree on all three pillars of retirement income to finance their post-working years. Occupational superannuation provides the major source of income in only a small minority of cases. Survey data suggest that of those retirees aged 45 and over, superannuation was the major source of income for only 14 per cent of males, and 10 per cent of persons.

The major source of income for most retirees of eligible age remains the age pension, with more than half receiving the full pension, and about 80 per cent receiving some pension in 1994-95. However, only 15 per cent of full rate pensioners rely solely on the pension. Around 80 per cent of age pensioners also had some interest income, but only 9 per cent had superannuation pension income. This is not surprising with the Superannuation Guarantee in its infancy. This balance will change over coming decades as more Australians reach retirement with long periods of coverage under the Superannuation Guarantee.

Both mandatory occupational superannuation under the Superannuation Guarantee and voluntary saving impact on the age pension income and assets tests. The relationships are, however, quite complicated with different rules applying to different forms of retirement benefits. The most important of these are:

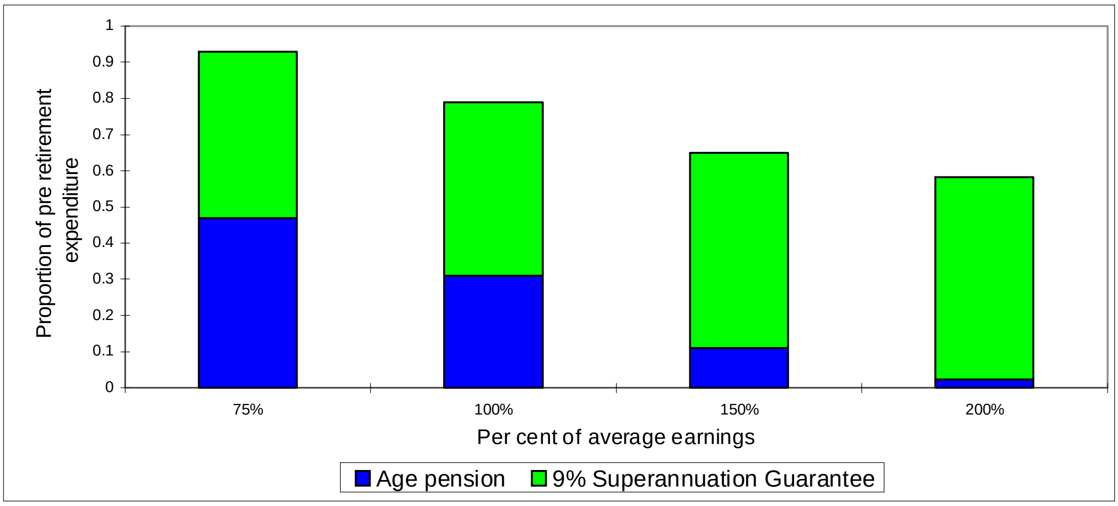
- The income test[19] applies to annuities and pensions but the assets test to annuities only[20].

- The capital value of a lump sum (to the extent it is not consumed) is subject to the assets test while any income stream is subject to the income test.

- From July 1996, *extended deeming* applies to a range of financial investments - excluding retirement income streams - under the income test. The deeming rates are 5 per cent for the first $A30,000 (single retiree)/$A50,000 (couple) and 7 per cent for the remainder.[21]

Chart 2.2 summarises the expected composition of net retirement income for a full working life of coverage under the Superannuation Guarantee for single males on fixed income levels of between 75 per cent and 200 per cent of average earnings. It does not include voluntary retirement income provision in the form of non mandatory occupational superannuation or personal saving. Replacement rates are calculated as a percent of pre retirement expenditure rather than income.[22].

Chart 2.2 Expected Composition of Net Retirement Income



19 Although the *undeducted purchase price*, which determined the amount of income subject to the income test, differs between pensions, rollover annuities and ordinary annuities.

20 The assets test applies to the reduced purchase price of annuities. The reduced purchase price is the actual purchase price less an annual amount representing the return of capital.

21 Included are bank, credit union and building society savings accounts, cash, shares, friendly society bonds, managed investment, loans and debentures. Excluded are property, cars, boats, caravans, antique, stamp and coin collections, standard life insurance policies and all annuities and pensions (under review). Previously deeming applied only to bank accounts.

22 Pre-retirement expenditure is defined as gross income less taxation and compulsory employee contributions.

Chart 2.2 reflects the targeted structure of Australia's public age pension scheme, and its function as a social welfare safety net. Its contribution ranges from about half of net retirement income for a single male retiree who has worked 40 years at 75 per cent of average weekly earnings to almost nothing for a male earning twice average weekly earnings. [It is assumed that 25 per cent of the superannuation accumulation is dissipated at retirement, and an indexed lifetime annuity is then purchased].

The age pension will be more important for those whose dissipation rates are higher, who have shorter working lives, or who are married and buy reversionary annuities. These facts reflect some of the difficulties of interaction and integration between the first two retirement income pillars, and will be returned to in Chapter 6.

CHAPTER 3. THE TAXATION OF SUPERANNUATION[23]

Introduction

In common with most OECD countries, Australia offers concessional tax treatment for retirement saving. It is of course possible to tax private pension accumulations at three points - contributions, earnings, and benefits. Australia is unique in applying taxes at all these points. Given Australia's heavy reliance on direct taxes and high marginal rates of personal income tax, the rates of tax on retirement accumulations are highly concessionary. Nevertheless, the implicit cascading of tax liabilities leads in some cases to effective tax rates which are high when compared with retirement saving taxes prevailing in other developed countries. In what follows, we attempt to provide a simple guide to the tax treatment of superannuation in Australia.

The current tax treatment of superannuation largely reflects changes announced in 1988 (Keating 1988) and 1992 (Dawkins 1992). Many of these changes are subject to transitional provisions which we ignore. We aim to provide a description and assessment of the reforms in the long run.

Chart 3.1 sets out the tax treatment of superannuation, which applies in the same way to both Superannuation Guarantee and voluntary occupational arrangements. It is convenient to split these arrangements into three parts - contributions in the hands of the contributor, the taxation of fund income, and the taxation of benefits. In some cases the tax treatment differs between funded and unfunded[24] schemes. The discussion that follows is for the more common funded approach, with the alternative tax treatment of unfunded arrangements noted where appropriate.

Contributions[25]

Employer contributions are tax deductible provided they are made to a complying superannuation fund and are within the age-based contributions limits. Deductions are limited to \$A9,405 of contributions for employees aged less than 35, \$A26,125 for those aged 35 to 49 and \$A64,700 for those over 50.[26] There is no limit on non-deductible contributions.

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23 A more detailed exposition of the taxation of superannuation can be found in Bateman and Piggott (1992a), and McDiarmid (1994).

24 Some funded State public sector schemes are constitutionally protected from Commonwealth taxation. For tax purposes, these are treated as unfunded.

25 Substantial changes to the taxation of contributions, and related matters, were foreshadowed in the August 1996 budget. They are listed in Appendix A.

26 These amounts apply from 1 July 1995 and are indexed annually.

Contributions by employees are typically made out of after-tax income. However, a self employed person or an employee with no employer superannuation support, is entitled to a tax deduction for contributions up to the employer contribution limits[27] and employees with employer support but earning less than $A31,000 can claim a tax rebate of up to $A1,000 pa.[28]

Fund Income

Fund income has been taxable since July 1988. While there is a single statutory rate of 15 per cent,[29] the treatment of income accruing in different forms varies sharply. Taxable fund income comprises contributions and investment earnings. Contributions which have received tax concessions in the hands of the contributor (employer or employee) are taxed, but those paid out of net-of-tax income are exempt.

The assessable investment income of superannuation funds is generally determined in the same manner as for other taxpayers. However, the following features are worth noting:

- Superannuation funds have access to the *imputation system* and full *imputation credits* are given to superannuation funds for *franked dividends* received from Australian companies. These imputation credits may be set off against tax on any income of the fund.

- The capital gains tax (CGT) applies to all assets, except securities or gains attributable to currency exchange rate fluctuations, disposed of on or after 1 July 1988. For gains accrued prior to 30 June 1988 the cost base is the lesser of the gain or loss from the market value of the asset at 30 June 1988 or the actual cost.[30]

- Complying superannuation funds are exempt from tax on investment income earned on assets held to fund current pension liabilities.

- The foreign tax credit system applies the taxation of any foreign source income of superannuation funds on a remittance basis with a credit given to funds for any direct foreign taxes paid. Since 1 July 1990 some foreign source income has been taxed on an accruals basis.

These features mean that the exact form of the taxation of fund income depends on the legal classification of income. For example, income in the form of interest and rent attract full taxation, gains from asset trading are subject to the CGT and income in the form of fully franked dividends are

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27 The annual tax deduction is for contributions up to $A3,000 plus 75 per cent of contributions in excess of this up to the age-based employer contributions limits.

28 A 10 per cent rebate on the first $A1,000 of contributions is available to employees on incomes less than $A27,000. The rebate is phased out at a rate 25 cents in the dollar for income above $A27,000, so is fully phased out at $A31,000.

29 Which is considerably lower than the company rate or the rate for life offices and somewhat lower than the lowest non-zero marginal personal tax rate.

30 As a concession, the CGT applies to the disposal of some assets that would otherwise be treated as trading transactions (and would therefore be subject to tax on nominal gains).

taxed at the full rate of 15 per cent but carry full imputations credits. The effective tax rate has been considerably lower than the 15 per cent statutory rate.

Any income (including contributions) of unfunded schemes remains untaxed. To compensate, benefits are taxed at a higher rate.

Benefits

Superannuation benefits may be taken as a lump sum, an annuity or a pension, or placed in an *eligible rollover fund*.[31]

The taxation of benefits differs according to a number of factors, including, the type of benefit - lump sum, annuity or pension; the size of the benefit - whether it is above the relevant *reasonable benefit limit*; and the age at which the benefit is taken - higher tax rates apply where the benefit is allowed to be taken before the statutory preservation age.[32] As well, grandfathering provisions may apply.

Further, different components of the benefits are taxed differently. In particular, that part of the final benefit relating to non-deductible employer or employee contributions remains untaxed. For benefits taken as lump sums this is called the *undeducted contribution* and for benefits taken as pensions or annuities, the undeducted purchased price (UPP). The current preservation age is 55, which is enforced either through regulation or through tax penalty.

Reasonable benefit limits (RBL)

RBLs restrict the amount of superannuation benefit that a person is permitted to receive on a concessionally taxed basis. Since July 1994, flat dollar RBLs have applied.[33] RBLs restrict the availability of tax preferred superannuation benefits for high income earners. The limits are $A400,000 for benefits taken as a lump sum and $A800,000 where at least half of the benefit is taken as an annuity or pension which meets the prescribed minimum standards.[34]

Undeducted contributions or the undeducted purchase price are excluded from the amount of the benefit for RBL purposes and, for unfunded benefits, the RBLs apply to only 80 per cent of the retirement benefit.

Benefits paid in excess of the relevant RBLs are not concessionally taxed. Excess lump sums are taxed at the highest personal marginal tax rate and excess annuities or pensions are not rebatable.

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31 If a benefit is rolled over, it is not subject to tax until it is withdrawn.

32 Funded schemes represent a taxed source while unfunded, including constitutionally protected funded, schemes are an untaxed source. Benefits from an untaxed source are taxed at a higher rate.

33 These replaced marginal RBL multiples which had provided greater access to tax concessions for high income earners.

34 These limits are indexed annually to average earnings. For 1996-97 the limits are $A434,720 and $A869,440. For pensions and annuities the RBL relates to the capital value equivalent.

Lump sums

Ignoring transitional provisions, a lump sum is split up into three main components for tax purposes - undeducted contributions which are tax free, an amount up to and including the RBL which are taxed at concessional rates and an amount above the RBL which is taxed at the highest marginal personal tax rate.[35] For the concessionally taxed part, the first $A86,495 is tax free, with the remainder taxed at 15 per cent.[36]

Annuities and superannuation pensions

As illustrated in Chart 3.1, superannuation pensions and annuities are taxed as ordinary income for all types of superannuation schemes. However, the net tax may be substantially reduced by a number of concessions. First, that part of the superannuation pensions or complying annuity that represents its undeducted purchase price (UPP) is exempt from tax. Secondly so-called *rebatable annuities and pensions* attract a rebate of 15 per cent of the taxable annuity/pension. As well, the *spouse rebate*, *low income rebate* and *medicare levy* exemption may apply. Finally, where the retirement benefit is provided in conjunction with the age pension, the *pensioner rebate* may apply.[37] Pensions or annuities paid out of unfunded arrangements are non rebatable.

Tax Expenditures

One of the more confusing elements in the Australian policy debate on superannuation has stemmed from the practice of developing estimates of tax expenditures for superannuation tax concessions. The idea of tax expenditures, which goes back to Surrey (1973), was to explicitly consider government budget items which were funded from tax breaks as well as those funded from direct government outlays. It is highly questionable whether this concept can be consistently applied to superannuation tax concessions.

The revenue, or tax expenditure, costs of superannuation tax concessions are conventionally measured by comparing the revenue collected from superannuation contributions, or superannuation earnings, with an estimate of the revenues which would have been collected had the personal income tax been applied to these bases in a non-concessional way.[38] This procedure, which is followed in the government's annual Tax Expenditures Statement, thus attempts to measure the cost of departing from the traditional Haig-Simons definition of the income tax base. It is estimated that the tax expenditures

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35 This applies only where the employee has reached the statutory presentation age of 55. Otherwise the tax applies at the greater of the persons marginal tax rate plus 20 per cent for the entire lump sum less undeducted contributions.

36 The lump sum tax free threshold is indexed annually. The amount, $A86,495 applies from 1 July 1996.

37 Rebateable annuities and pensions are those paid from a taxed source.

38 This methodology was first laid out in Surrey 1973, and is used in the Tax Expenditure Statement produced annually by the Treasury. However, for its official estimates of the contribution of the Superannuation Guarantee to national saving, the Government assumes that only 50 per cent of the earnings on future superannuation contributions would otherwise be taxed at benchmark rates. (Dawkins 1992, p.84).

associated with the superannuation tax concessions amounted to $A7.3 billion in 1994-95 (Treasury 1995).

The critical flaw in tax expenditure calculations of tax references towards retirement saving is that they are based on a single period.[39] Retirement saving is by its nature a multiperiod phenomenon. When tax expenditures are adjusted to capture this temporal dimension, a very different perception of revenue cost emerges. When consequent reduced age pension entitlements are factored in, the present value of revenue cost can be negative. Bateman and Piggott (1992b) and Brown (1993) provide examples.

While these do not report the flow of net revenues over time, they do call into question the practice of using tax expenditure estimates to calculate the revenue costs of policies such as the Superannuation Guarantee.

Economic Issues

The tax treatment of superannuation and retirement income in Australia raises two specific economic issues on which we comment briefly.

Consumption tax equivalence

Many countries design their tax concessions so that saving for retirement effectively faces an expenditure tax regime - tax is paid on either contribution or benefits, but not both, and the earnings of pension funds accrue tax free.[40] Australia's convoluted taxation arrangements do not allow a simple mapping to compare fiscal outcomes with a consumption tax system. However, rough calculations suggest that for a taxpayer on a marginal rate of 38 per cent (the average of the marginals in Australia), the Australian arrangements are somewhat more generous than a consumption tax, but not dramatically so. For those facing lower marginal income tax rates, the effective consumption tax rate lies above the marginal rate, and for top marginal rate taxpayers, the tax concessions are significantly more generous than a consumption tax regime.

It would simplify the Australian system greatly to move to a contributions tax only regime. This, however, is probably only feasible on a "grandfathered" basis, and would therefore add yet another layer of complexity on the tax treatment of retirement income. This issue is taken up again in Chapter 6.

Interaction of taxation, social security and superannuation

The superannuation and social security (that is, age pension) arrangements in Australia are poorly integrated.

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39 A more complete critique of tax expenditure applications to retirement saving tax preferences appears in Bateman and Piggott (1992b).

40 Some other countries, including Denmark, Japan and Sweden, tax some earnings in limited circumstances.

First, the current eligibility age for superannuation benefits, the preservation age, is 55, compared with an age pension age of 60 for females and 65 for males. Despite a gradual increase in the preservation age to 60 (by the year 2025) and the female pension age to 65 (by 2014), a disparity will still exist. This allows lump sums to be taken and dissipated prior to the age pension age.

Further, as has been pointed out above, it is not mandatory to take retirement benefits as an income stream in Australia. Lump sums are often preferred, as Table 2.6, which gives pension fund benefits outlays for the year 1992-93, indicates. This allows beneficiaries to take lump sums before they are old enough to be eligible for the age pension, and to arrange their financial affairs so that their retirement benefit does not disqualify them from the pension. This can be achieved, for example, through investment in the owner occupied home; through gifts to children; and through consumption. The more naive may fall back on the pension not through intent, but rather through mismanagement of their retirement benefit. In all these cases, much of the saving enhancement potential of self provision for retirement is lost through double dipping.

Finally, the provisions are very complicated with similar benefit types being treated differently under the taxation and social security rules.

Policymakers are aware of the lump sum focus (which leads to adverse selection in the life annuities market) and have introduced tax incentives which are supposed to encourage retirees to choose the income stream option. *Rebatable annuities or pensions* are exempt from the 15 per cent lump sum tax and, have access to a 15 per cent rebate on the tax payable on annuity and pension income.[41] Required features include that the income stream payments be made at least annually and be within legislative limits. Further, annuities and pensions which satisfy the more stringent *prescribed minimum standards* are eligible for more generous limits to the levels of benefits which enjoy tax preference (i.e., higher *reasonable benefit limits*). These standards include payment for life, indexation to at least the lesser of 5 per cent pa or the annual CPI, no residual capital value and no commutation.

However, these incentives have been shown to fail in their effect (Bateman *et al* 1993). First, much of the tax incentive is removed because rollover annuities face income tax on more than just the interest component.[42] Further, the criteria which must be satisfied for tax preferred annuities

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41 However, due to the complex relationship between the retirement income streams and the tax and social security rules, it is unclear whether these incentives have their intended effect (Bateman *et al* 1993).

42 In particular, that part of the annual annuity income which is excluded from taxable income - the undeducted purchase price - is greater for ordinary annuities than for rollover annuities.

have now been watered down to the point where longevity insurance is not required.[43] The adverse selection problem is therefore not addressed. Again, this issue is discussed further in Chapter 6.

43 Initially, only income streams satisfying the currently defined prescribed minimum standards qualified for the tax concessions.

Chart 3.1: The Taxation of Superannuation[a]

Type of scheme	Type of contribution	Contributions	Fund income	Benefits[c]
Funded	Employer	Tax deductible up to age-based contribution limits		Lump sum: - undeducted contributions, untaxed - first $A86,495 of taxable benefit, untaxed - excess to RBL taxed at 15% - Excess over RBL taxed at highest personal marginal tax rate
	Employee	Limited tax deductions if no employer support. Rebate if earnings below $31,000. Otherwise not tax deductible or rebatable	Contributions: deductible contributions taxed at 15%. Otherwise not taxed	: Pension/annuity - UPP untaxed[d] - up to RBL taxed as ordinary income less 15% rebate[e] - excess over RBL, taxed as ordinary income, no rebate
	Self-employed	Limited tax deductions	Earnings: taxed at 15%	
Unfunded [b]	No contributions		No income	Lump sum: - as above + 15% for benefits below RBL Pension/annuity: - as above with no rebate

a) Transitional provisions ignored
b) Including funded but constitutionally protected schemes.
c) Only applies where presentation age of 55 is reached. Otherwise higher taxes of benefits.
d) UPP - the undeducted purchase price - refers to that part of the purchase price of a pension or annuity which has not been claimed as a tax deduction.
e) Rebate equal to 15% of taxable annuity/pension.

CHAPTER 4. INDUSTRY ADMINISTRATION AND INVESTMENT

Introduction

The legal entities around which private retirement savings are organised are called superannuation funds. (Roughly speaking, these correspond to the pension funds familiar in many OECD countries). These operate as *trusts* with the board of trustees given the responsibility for the administration and operation of the fund. In many cases equal representation of employee and employer trustees is required. In practice trustees delegate many of their duties to a variety of superannuation industry service providers. These include professionals such as fund administrators, *investment managers*, asset consultants, custodians, actuaries, auditors, lawyers and communications consultants; and financial entities such as life offices, *pooled superannuation trusts* and unit trusts.

In September 1995 there were 107,000 superannuation funds with assets totalling around $A230 billion. The vast majority (99,000) are *excluded funds* that contain fewer than five members. However, these account for only 200,000 of the 6 million Australians with superannuation. The remaining 8,000 funds include *corporate funds*, industry funds, *retail funds* and *public sector funds* and represent 97 per cent of all member accounts.

As we indicated in Chapter 1, a particular feature of the industry has been the huge growth of superannuation fund assets since the mid 1980s. As Table 4.1 shows, since 1983 superannuation fund assets have grown from around 13 per cent to nearly 50 per cent of GDP. By June 1995 there were 15 million superannuation accounts covering 6 million members or 87 per cent of the labour force.[44] The average balance per member was $A37,000.

This chapter is divided into three parts. The first part considers the superannuation industry which comprises superannuation funds and other superannuation entities. It covers industry structure and fund management and administration. The second part looks at superannuation fund investments and covers the extent of funding, asset allocation and performance. Finally we consider the costs associated with private provision of retirement income.

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44 Individuals may hold more than one account. Multiple accounts arise because of job mobility, among other reasons.

Table 4.1: Size of the Superannuation Fund Industry

	Number of superannuation funds	Fund assets	
	('000)	($A bill)	% GDP
June 83	na	32	19
June 84	na	36	19
June 85	66	40	19
June 86	54	51	21
June 87	127	73	28
June 88	122	95	32
June 89	105	108	32
June 90	87	124	34
June 91	73	135	36
June 92	74	155	40
June 93	81	183	45
June 94	88	203	47
June 95	107	223	49

Source: Australia - Census of Superannuation Funds, 1982-83, ABS 5636.0; Superannuation Funds, Australia 1984-85, 1985-86, ABS 5649.0; Assets of Superannuation Funds and ADFs, ABS 5656.0 and ISC, unpublished data.

The Superannuation Industry

Industry structure

The superannuation industry comprises superannuation funds and a range of specialist professionals and financial entities which provide services to superannuation funds. In this section we describe the diverse pattern of superannuation fund type, and comment briefly on the structure of the associated service provision industry.

Superannuation funds

Superannuation funds can be categorised as corporate funds, industry funds, retail funds, public sector funds and excluded funds. The assets and membership of these funds are set out in Table 4.2. With the exception of excluded funds all of these can be established as either *standard employer funds* or *public offer funds*.

Corporate funds characterise the traditional form of occupational superannuation. They originally catered for white collar workers but their coverage has become more comprehensive since the introduction of mandatory superannuation. They are sponsored by a single employer or a group of employers. In September 1995 there were 4,750 corporate funds covering 1.3 million members and with assets of $A47 billion, or 20 per cent of total superannuation assets. The features of corporate funds are varied. They may be funded or unfunded, defined contribution and/or defined benefit and may provide retirement benefits as a lump sum or an income stream. The larger and longer established corporate funds tend to be of the defined benefit type.

Table 4.2: Characteristics of Superannuation Funds, September 1995

	Assets ($A billion)	Number of funds	Number of accounts (millions)
Type of fund			
Corporate	47	4,740	1.3
Industry	12	100	5.2
Retail	53	3,060	5.8
Public Sector	60	100	2.7
Excluded	20	99,000	0.2
Balance of Statutory Funds	39[a]		
All funds	231	107,000	15.2

a) The balance of statutory funds is the remaining superannuation assets residing in Life Office Statutory Funds after the assets explicitly known to reside in the other fund types have been allocated.

***Source*:** ISC Bulletin, September 1995, Tables 1 and 2.

Industry funds are generally multi-employer based. Most were set up in the 1980s to accept contributions under productivity award superannuation and are now the main recipients of the mandatory employer contributions under the Superannuation Guarantee. They exist for employees of a particular industry or range of industries and will accept contributions from any employers in those industries. By 1995 there were more than 100 industry funds covering over 5 million employees and with assets of around $A12 billion or 5 per cent of total superannuation assets. In line with the requirements of mandatory superannuation, industry funds are generally defined contribution, accumulation arrangements. While they are small in terms of total superannuation fund assets, they are the fastest growing part of the industry.

Retail funds are publicly offered superannuation funds that members may join by purchasing investment units or policies. They are used by the self employed, by employers not wishing to establish their own superannuation fund and for personal superannuation.

Retail funds in the form of *master trusts* have become very popular since the introduction of mandatory employer contributions and the increased compliance required under the new supervisory legislation[45]. Master trusts allow non-related individuals or companies to operate superannuation under a single common trust deed and are primarily designed for smaller companies who are mandated to provide superannuation but do not wish to establish their own fund. The administration and management of superannuation assets is handled by an independent trustee appointed by the promoter of the trust and generally several funds are grouped under a single master trust deed with each having a variety of investment, benefit design and insurance options. This allows what would otherwise be small funds, access to wholesale investments and facilitates member investment choice. There are currently around 60 master trusts offered in

45 The Superannuation Industry Supervision (SIS) Act 1994.

Australia, by life offices, banks and other financial institutions. In June 1995 they accounted for $A13 billion of superannuation assets.

Another form of retail fund are *approved deposit funds* (ADFs). These were set up in the early 1980s to encourage the preservation of superannuation benefits, especially following early retirement. Contributions to approved deposit funds are restricted to *rollovers* of accrued superannuation benefits made when employees retire, are retrenched or change jobs. There are around 2,600 ADFs in Australia which account for about $A13 billion of superannuation assets. In 1994 legislation was passed to allow a superannuation fund to become an eligible rollover fund. This has reduced the importance of ADFs as a separate category.

A **public sector fund** provides benefits to government employees. In September 1995 there were around 100 public sector funds accounting for 2.7 million members and about $A60 billion in superannuation fund assets. Most public sector funds are of the defined benefit type and provide benefits either as a lump sum only or as a combination of lump sum and pension. Many public sector schemes are only partially funded.

An **excluded fund** is a superannuation fund with less than five members. These small membership funds are generally established by a family-owned company with family members as directors or trustees. Some 99,000 of the 107,000 superannuation funds fall into this category, but they account for only 200,000 members and 9 per cent of total superannuation fund assets. Excluded funds are exempt from some of the industry regulatory requirements[46].

Any of the corporate, industry or public sector funds may be established as standard employer funds or **public offer funds** which are open to any employed person. These are available to the self employed who would otherwise not have access to occupational superannuation. Australia's largest industry fund, Construction and Building Union Superannuation (C+BUS), has recently become a public offer fund so that self employed construction and building workers can become members.

Superannuation funds may provide benefits on a defined benefit and/or a defined contribution or accumulation basis. Traditionally, defined benefit has dominated. However, since mandatory superannuation under both PAS and the Superannuation Guarantee is based on defined contributions, this balance is changing. The relative importance of defined benefit and defined contribution arrangements in terms of the percentage of members, assets and superannuation funds is summarised in Table 4.3. Accumulation arrangements account for the majority of superannuation funds and superannuation fund members, but are only marginally ahead in terms of superannuation fund assets. This situation is expected to change as the Superannuation Guarantee matures.

46 The regulatory environment is discussed in detail in Chapter 5.

Table 4.3: Defined Benefit and Accumulation Funds, June 1995

	Members	Assets	Number of Funds
	%	%	%
Public sector			
Defined benefit	19	34	44
Accumulation	27	4	21
Both	53	62	35
Private sector			
Defined benefit	5	14	2
Accumulation	86	68	97.5
Both	9	18	0.5
Total superannuation			
Defined benefit	8	19	2
Accumulation	75	51	98
Both	17	29	1

***Source*:** ISC, unpublished data.

Although the Superannuation Industry comprises a very large number of superannuation funds, assets are highly concentrated. As Table 4.4 indicates, the largest 10 funds control more than a third of total superannuation assets.

Table 4.4: Concentration of Superannuation Funds, June 1994

Superannuation fund size by assets	Per cent of all assets
Top 10 funds	35
Top 50 funds	57
Top 100 funds	66
Top 500 funds	82
Top 1000 funds	86
Remaining 106,000 funds	14
Total superannuation funds (107,000)	100

***Source*:** ISC, unpublished data.

Other superannuation entities

Superannuation fund trustees, while responsible for all fund decisions and activities, frequently call on experts to help with fund administration and asset management. Industry surveys indicate that the majority of non excluded funds use external administrators with around 70 per cent of funds with between 51 and 10,000 members using external administrators. Excluded funds and the very large funds tend to self administer.

There is also a high incidence of external asset management. While excluded funds rarely use external investment managers, they are used by around half of the medium size funds and almost all funds with more than 10,000 members. In 1995, 80 per cent of superannuation fund assets were under the control of external investment managers. This has increased from around 70 per cent in the late 1980s.[47]

When using external investment managers trustees have a number of choices including contracting a single investment manager to manage the investments as a single portfolio, contracting a number of investment managers to invest parts of the portfolio, purchasing a superannuation policy from a life insurance company or purchasing units in a collective superannuation product such as a unit trust or a pooled superannuation trust. As shown in Table 4.5, there has been an increase in the proportion of funds managed by both life offices and professional investment managers. In 1995, 43.6 per cent of superannuation assets were managed by life offices and 37.5 per cent by professional investment managers. The remaining 19 per cent was directly invested.

Table 4.5: Funds Management, per cent of assets

	Life Offices	Managed by: Professional investment managers	Directly invested
June 1989	39.8	31.3	28.9
June 1990	41.2	31.2	27.7
June 1991	43.1	30.7	26.1
June 1992	44.3	34.9	20.8
June 1993	43.9	35.9	20.2
June 1994	43.7	36.9	19.4
June 1995	43.6	37.5	18.9

***Source*:** ISC, unpublished data.

47 Recent surveys carried out by the ISC suggest that the use of external fund managers may be less prevalent than suggested by the previous surveys.

There is a high degree of concentration in this part of the superannuation industry, just as there is with superannuation funds. A small number of financial and professional groups are responsible for the bulk of the administration and asset management of Australian superannuation assets. For example, of the 1,150 superannuation funds selected to participate in the new ISC quarterly survey of superannuation, around 60 per cent are administered by only 12 different superannuation administrators. Further the 1995 annual report of the Australian Investment Managers Association (AIMA) reports that only four investment managers are responsible for nearly 40 per cent of externally managed superannuation assets, with 10 investment managers responsible for nearly 60 per cent of these assets.

Superannuation Fund Investments

Funding

Until recently, private sector superannuation tended to be funded with the public sector largely unfunded. However, this is changing. Mandatory employer contributions under productivity award superannuation and the Superannuation Guarantee generally require defined contribution, fully funded arrangements[48]. While unfunded schemes can qualify, compliance is more onerous and with concerns about greater public sector accountability there has been a move towards increased funding of public sector superannuation[49]. Another reason for this is the much higher retirement benefit obligations implied by increased public sector coverage under the Superannuation Guarantee.

The State governments have taken the lead. Several States have closed their older unfunded schemes to new members and established new fully funded schemes. Queensland, in particular, has completely converted to fully funded superannuation and has no unfunded liabilities[50].

The unfunded liabilities of the State superannuation schemes peaked in 1993 and are now starting to trend down. In Victoria, for example, unfunded liabilities fell from $A18.4 billion in 1993 to $A14.7 billion in 1994. The unfunded superannuation liabilities of the States and the Commonwealth are detailed in Table 4.6. The total unfunded liabilities of Australian public sector superannuation funds in 1993 was $A93.6 billion or 23 per cent of GDP.

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48 Although defined benefit, unfunded schemes can qualify in some circumstances.

49 Another reason is the practice of rating agencies to include unfunded superannuation liabilities in their financial assessments.

50 However, the assets held are largely Queensland government securities.

Table 4.6: Public Sector Unfunded Superannuation Liabilities, 1993 and 1994

	1993	1994
	$A bill	
States		
New South Wales	14.8	14.4
Victoria	18.4	14.7
Western Australia	4.5	4.5
South Australia	4.3	4.3
Tasmania	1.3	1.3
Queensland	0	0
ACT	0.2	0.3
Total States	43.5	39.5
Commonwealth		
Employees	40.3	na
Defence Forces	20	na
Total Commonwealth	60.3	na
Total	93.6	na

***Source*:** Standard and Poors and reported in Mace J (1995) "Public Sector Super Liabilities - Empty Pockets or Empty Figures", Superfunds, July 1995, pp 16-19.

Asset allocation

Australian superannuation funds face few investment restrictions[51]. There are no asset requirements or floors and no minimum rate of return requirements. As a result, superannuation funds tend to invest in a wide variety of assets with a mix of duration and risk/return characteristics. The average asset allocations of Australian superannuation funds are set out in Chart 4.1.

There are, however, large differences in investments by size and structure of fund. Smaller funds tend to have fairly conservative portfolios with a large proportion of assets in the form of cash and generally small holdings of equities. On the other hand the larger funds have more varied asset mix with more emphasis on equities and other risky assets. These differences are illustrated in Table 4.7.

These data also suggest considerable differences between the investments of defined benefit and defined contribution funds. For example, defined benefit funds held 40 per cent of their assets in equities, 10 per cent in life office policies and 4 per cent as cash, while defined contribution funds held 22 per cent in equities, 31 per cent in life office policies and 12 per cent as cash. This may be due to the transitory investment practices of the recently established industry funds.

51 The investment restrictions are discussed in Chapter 5.

Chart 4.1 Assets of Superannuation Funds, September 1995

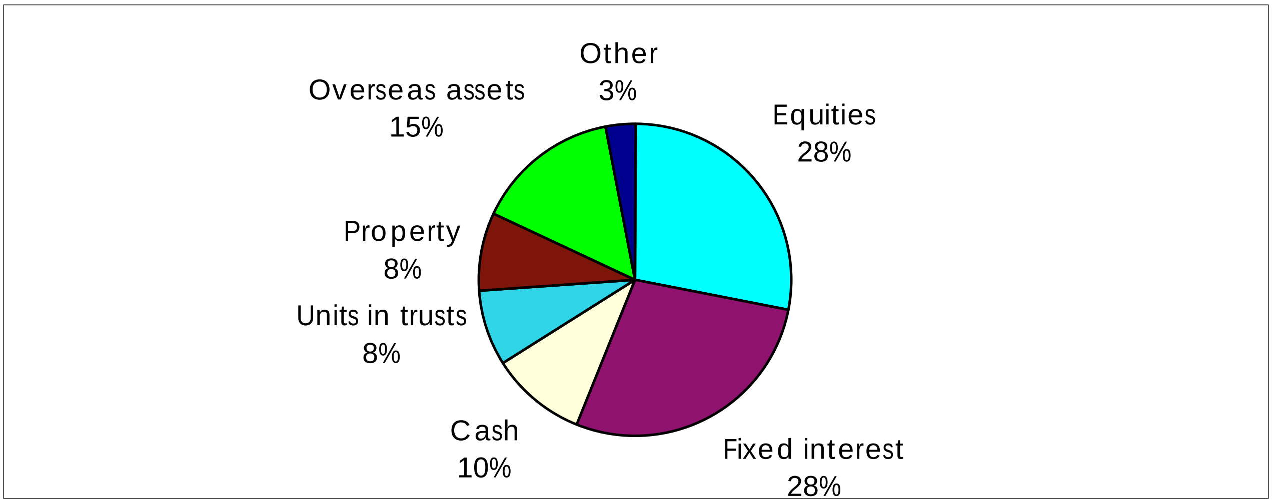

Table 4.6: Characteristics of superannuation funds, June 1995 [(a)]

	Assets ($ billion)	Number of funds millions	Number of accounts millions
Type of fund			
Corporate	51	4,740	1.4
Industry	11	100	4.9
Retail	68	3,060	5.9
- ADFs	13	2,600	0.4
- Master Trusts	13	60	1.6
- Other	42	400	3.9
Public Sector	53	100	2.8
Excluded	16	99,000	0.2
All funds	198	107,000	15.2

(a) The ISC notes that due to the survey design, the assets of excluded funds are probably undervalued.
***Source*:** ISC, unpublished statistics.

Table 4.7: Asset Allocation by Fund Size and Structure, 1993-94

	Cash[a]	Fixed Interest[b]	Domestic Equities %	Life Office Policies[c]	Pooled Super Trust[d].	Property[e]	Other	Overseas Assets[f]
Size of fund assets ($)								
0 to 100,000	49	5	26	4	4	8	4	0
100,001 to 200,000	39	6	24	4	5	19	4	0
200,001 to 500,000	35	5	25	5	5	21	4	0
500,001 to 1m	32	5	26	7	7	20	3	0
1m to 10m	13	4	10	28	38	5	3	1
10m to 100m	4	7	20	22	36	2	3	6
over 100m	5	12	38	20	5	5	4	10
Structure of fund								
defined benefit	5	10	40	10	15	4	6	11
defined contribution	13	8	22	31	12	8	2	4

a) Cash includes deposits in banks and other financial institutions and loans.
b) Fixed interest: short term securities such as bills of exchange and bank certificates of deposit and long term government securities and corporate bonds.
c) Includes capital guaranteed, capital stable and capital protected products sold by Life Offices.
d) Investment in a balanced fund of a pooled superannuation trust. Unlike Chart 4.1, assets have not been separated into the individual asset categories.
e) Property includes land and non-residential buildings.
f) Overseas assets includes equities, fixed interest and other types of investments.

***Source*:** ISC, unpublished data

Table 4.8: The Asset Allocation of Six Large Industry Funds, percent of total assets

	1990	1991	1992	1993	1994
Cash	-	-	6.7	6.4	10.3
Fixed interest	13.3	16.9	21.3	21.1	18.6
Equities (Domestic)	9.2	11.4	20.6	26.8	30.0
Life Office policies					
capital guaranteed[(a)]	58.7	48.2	34.9	25.2	2.7
capital stable[(b)]	-	0.8	4.2	4.5	-
capital protected[(c)]	-	-	4.2	4.5	-
Pooled superannuation trust	18.8	22.5	-	-	7.6
Property	-	-	-	2.6	9.5
Other	-	0.2	4.1	2.9	2.5
Overseas assets	-	-	4.0	10.5	15.4

a) An investment fund which guarantees no capital loss. Invests primarily in cash and fixed interest (and equities if sufficient reserves are available).
b) An investment fund which aims to minimise the loss of capital, but without offering specific guarantees. Generally invests around 70 per cent of assets in fixed interest or cash and a minimal amount in equities and property. This provides a fairly stable income stream.
c) A form of capital stable fund which uses derivatives to reduce the risk of capital loss.

***Source*:** Daley (1992), "Industry Funds' Investment Strategy is on Target", Superfunds, September 1992, pp 36-37; Daley (1995), 'A New Investment Landscape', Superfunds, March 1995, pp26-27.

Initially industry funds held very conservative portfolios and invested heavily in fixed interest and capital guaranteed products offered by life offices. However, as they have matured, their asset allocations have moved closer to those of the more established superannuation funds[52]. The asset allocations of the six largest industry funds over the period June 1990 to June 1994 are summarised in Table 4.8. In June 1990, the assets of the six largest industry funds comprised 58.7 per cent capital guaranteed investments and only 9.2 per cent equities but, by June 1994, capital guaranteed investments accounted for only 2.7 per cent of assets and equities (both domestic and international) had grown to over 45 per cent of total assets[53]. Future asset allocations are likely to

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52 Another reason is that defined contribution funds may be more prone to a 'short term' approach to investments than defined benefit funds. This is investigated in Bateman (1995).

53 The initial conservative approach of the industry funds was justified on the basis that they were immature and wanted to build up reserves before moving to a more diversified portfolio and that the life offices were offering good deals on capital guaranteed investments.

become even more diverse as the industry funds expand into public infrastructure, development capital and home loans[54].

Investment performance

Australian superannuation funds are not subject to statutory rate of return requirements. Trustees and investment managers are guided in their asset allocation decisions by the prudent man principle. The recent investment performance of superannuation funds compares reasonably with alternative assets such as 10 year bonds, Australian shares and favourably against movements in the Australian consumer price index. Table 4.9 sets out a comparison over the past 8 years.

Table 4.9: Investment Performance of Superannuation Funds[(a)]

	Investment returns:			
	Superannuation funds	10-year bonds	Australian shares	CPI
June 1987	14	21	47	9
June 1988	8	19	-5	7
June 1989	9	13	3	8
June 1990	11	13	3	8
June 1991	10	19	5	3
June 1992	13	19	14	1
June 1993	12	12	9	2
June 1994	9	-9	21	2
Average	11	13	12	5

a) All returns are pre tax, but for superannuation funds are net of other superannuation fund expenses such as benefit payments and administrative costs.

***Source*:** ISC, unpublished data.

Member investment choice

Member investment choice is a keenly debated issue. It has two facets - choice of superannuation fund and choice of investment strategy within a fund. Commonwealth legislation does not require either fund or investment choice although a number of State governments - New South Wales, Victoria, Tasmania and Western Australia - have legislated to allow choice of superannuation fund for employees covered by state awards. However, the degree of choice is quite limited and the extent to which it has been exercised is unclear.

54 For example, the life office National Mutual and the ACTU have recently launched a superannuation members' home loan program with which over 40 industry funds have become associated.

For voluntary occupational superannuation, members tend to be restricted to the superannuation arrangements used, or the fund sponsored, by the employer, while the Superannuation Guarantee mandates employers to make superannuation contributions to a complying fund of their choice. Under productivity award superannuation, unions have had some say into which fund or funds the mandatory employer contributions must be paid and these have generally been industry funds. Currently only about 20 per cent of funds provide for member choice of investments. Members can, of course, choose their own superannuation fund for any personal superannuation.

Member investment choice has become a political issue with quite diverse views among the major players. Industry funds have argued strongly against mandatory member investment choice, largely on the grounds of its impact on administrative costs, while a recent report of the Senate Select Committee on Superannuation (Senate 1995) argued in its favour. The current government's pre-election policy proposals included the provision of greater choice of fund, but details have yet to be announced.

Costs

The costs associated with the Australian superannuation industry are hard to estimate. The ISC reports that the overall level of fees paid by fund members is around 2 per cent of the value of their accounts. However, many relevant fees and charges are implicit and not reported, particularly if the fund administration and investments are internally managed. Further, costs vary considerably between types of funds. For corporate funds, the employer sponsors often absorb many of the fund expenses, while costs of retail funds are generally explicit in the form of establishment fees, contribution fees, administration fees, investment management charges and exit fees. Industry funds generally impose an administrative charge of around $A1 per member per week but since investment managers tend to report net investment returns, the investment management fees by fund are not reflected in this charge.[55]

Following the introduction of the Superannuation Guarantee in July 1992, there was widespread concern about the high administrative charges applying to small accounts - particularly in relation to low income earners and part time and casual workers. In June 1993, around 22 per cent of all superannuation accounts held less than $A1,000. On this definition, 46.8 per cent of industry fund accounts are small as are 23.5 per cent of master trust accounts, 15.0 per cent of public sector accounts and 11.9 per cent of corporate accounts. This is not a surprising result with the industry funds the main recipients of the 3 per cent productivity award and progressively implemented Superannuation Guarantee contributions[56].

The government responded to the initial concerns with the introduction of member protection rules and the establishment of a small accounts system administered by the Australian Taxation Office (ATO) to commence in July 1996. All industry funds have implemented member protection. The member protection rules require that for superannuation accounts of less than $A1,000, fund administration costs cannot exceed fund earnings, although accounts can be debited for investment losses, contributions tax and insurance premiums. If trustees decide not to operate the

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55 The ISC is currently working on estimates of investment management charges by fund.

56 Which are being phased in starting at 4 or 5 per cent depending on size of employer.

member protection rules they are required to transfer members' accounts free of charge to another fund of their choice[57].

Where employers are unable to find a superannuation fund willing to accept small contributions, they can use the ATO collection mechanism. Under this scheme employer contributions are paid directly to the ATO who aggregate multiple employee accounts and hold the contributions within its "Superannuation Holding Accounts Reserve". There is no limit on the amount of money that can be paid in under the scheme but employers are only entitled to a tax deduction for the first $A1,200 per employee per year. This is not a superannuation fund but a holding account for small employer contributions and the ATO anticipates that it will be used only as a last resort.[58]

57 Implementation of member protection will require cross subsidisation within funds.

58 The August 1996 Budget, the first for the new Coalition government, included a proposal to phase out these arrangements.

CHAPTER 5. REGULATION AND SUPERVISION[59]

Introduction

Until the 1980s, the Australian superannuation industry was largely self-regulated and was therefore subject to much less control than was the practice elsewhere. However, in conjunction with its policy of broadening the coverage of superannuation the government began to play a larger role in the regulation and supervision of the industry.

The first major regulatory initiative was the implementation of in-house asset limits in March 1985. This was followed by the introduction of a comprehensive set of operational standards for superannuation funds[60] under the Occupational Standards and Supervision Act (OSSA) and Regulations of 1987. This legislation established an industry supervisory body, the Insurance and Superannuation Commission (ISC), and set out requirements for tax concessions, investments, benefit standards, member participation and reporting and disclosure. As the Australian Government does not have the constitutional power to make laws concerning superannuation *per se*, the enforcement of the OSSA was tied to the tax concessions provided to superannuation funds. Non-complying superannuation funds - that is, funds which did not comply with the requirements of the OSSA - were not eligible for superannuation tax concessions. The main tax concession for complying funds is the 15 per cent rate on fund income. Non-complying funds are subject to tax at the top personal marginal rate.

In 1993 the OSSA was superseded by the Superannuation Industry (Supervision) legislation (SIS) which increased the level of prudential supervision and required standards of the industry. SIS expanded the jurisdiction of the regulatory body, the ISC, providing it with greater enforcement powers,[61] clarified the duties and responsibilities of trustees and investment managers, and encouraged greater member participation. These changes are designed to enhance the security of superannuation savings.

One of the main innovations of the SIS has been to place the regulation of superannuation funds on a different legal basis under the constitution. Previously, the Australian Government's taxation power was used and eligibility for tax concessions was dependent upon a fund complying with the OSSA. A particular problem with this approach, however, was that the only sanction for

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59 This chapter draws on Senate (1988), Bateman and Piggott (1993), CCH (1993, 1994), Davis (1994), ISC (1994), ASFA (1995) and Willis (1995).

60 The term superannuation fund includes approved deposit funds.

61 Previously the ISC shared the responsibility with other regulators including the Reserve Bank, The Australian Securities Commission and the State Governments.

non-compliance was the withdrawal of a fund's tax concessions - which would hurt fund members rather than the trustees who were responsible for the breach.

To overcome this problem, the SIS is enacted under the Australian Government's corporations and pensions powers, in addition to the taxation power. This strengthens the ability of the Australian Government to legislate in the superannuation area and, in particular, allows the legislation to target individuals responsible for intentional or reckless non-compliance with the duties and standards contained in the SIS legislation.

The current regulatory framework covers three main areas - industry supervision, contributions and benefit standards, and member rights. These will be discussed in turn.

Industry Supervision

The SIS makes trustees solely responsible for the prudent operation of their funds. To enhance this, the SIS codifies the duties of trustees and investment managers. This approach allows them the maximum commercial autonomy in making their investment decisions.

Trustees are personally liable under both civil and criminal law for breaches of their obligations. Penalties range from disqualification and fines to prison terms. The regulatory framework also extends to other service providers such as investment managers, custodians, auditors and actuaries.

Investment standards

In the light of the obligations of trustees to formulate and implement an investment strategy, the SIS imposes a number of restrictions on the investment of superannuation fund assets[62]. These include:

- Investment in in-house assets must not exceed a statutory maximum. A reduction in the statutory maximum from 10 per cent of the cost to 5 per cent of the market value of assets is being phased in by the year 2000/2001.

- A prohibition on borrowing except on a short term basis to make benefit payments or to cover settlement of securities transactions.

- Funds must be maintained for the 'sole purpose' of providing retirement benefits so cannot be used as a means of conducting a business.

- All investment must be on an arm's length basis.

- Loans or financial assistance to, or acquisitions from, members (or their relatives) are prohibited.

Importantly, however, the investment restrictions do not extend to asset requirements or limitations or a required rate of return. Nor is there a Government guarantee of member benefits.

62 These requirements are less onerous for excluded funds.

Instead, the security and adequacy of superannuation benefits relies upon compliance with the supervisory regime established under the SIS. Of particular importance is the requirement that an investment policy be formulated and that it be implemented according to the prudent person principle.[63]

Reporting requirements

An essential theme of the SIS is to protect the interests of members. One way of enhancing this is to keep members fully informed. As such, the reporting requirements have been designed to facilitate members' understanding of their superannuation entitlements and the investment policy and performance of the superannuation fund. The SIS requires that trustees report regularly to fund members and to disclose certain information when requested. This includes both member specific and fund details[64].

Member specific reports are required to be sent to members on at least an annual basis, when they join or leave a fund and in the case of 'one off' special events. They are to include details of contributions, accrued benefits, earnings, fees and charges deducted and other benefits such as for death or disability. Fund information is generally sent to members in the form of an annual report. This must include details of the trustees and fund managers, the main accounting and financial data and the main investment information. Investment information must include the investment strategy of the fund and details of investments that exceed 5 per cent of assets, the earnings of the fund and the reserving policy.[65] Members are also allowed to obtain other relevant information on request.

Contribution and Benefit Standards

The contributions and benefits standards aim to ensure that the superannuation funds are used for genuine retirement income needs and not for other purposes such as the short term exploitation of the tax concessions.

The SIS attempts to address this by establishing rules relating to the contributions made to, and benefits received from superannuation funds. These include rules relating to the age limits for acceptance of contributions and payment of benefits, the employment status of fund contributors, the access to benefits by members (the preservation or *minimum payment standards*) and the *minimum benefits* owned by members (the vesting or *minimum benefit standards*).

Contributions

A fund may accept contributions, or in the case of a defined benefit scheme may grant benefit accruals, in limited circumstances only. The general rule is that contributions can be accepted

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63 Further, if trustees decide to keep reserves, they must implement a reserve management strategy consistent with the fund's investment strategy and the fund's ability to pay benefits and other debts as they fall due.

64 Some of these requirements do not apply to excluded funds.

65 Less detailed disclosure rules apply to excluded funds.

only until a member is age 65, and only if the member is, or was within the past two years, in the paid workforce or is no longer in the workforce because of ill health.[66]

Benefits

Prior to the introduction of mandatory employer contributions, vesting, preservation and portability generally only applied to employee contributions and the earnings thereon. Under the OSSA some compulsory vesting, preservation and portability was introduced and this has been extended under the SIS legislation.

The SIS contains minimum benefits standards which ensure that full vesting applies to all member contributions and mandatory employer contributions provided under awards or the Superannuation Guarantee and the investment earnings on these contributions.[67] Vesting is not required for non-mandatory employer contributions.

The minimum payment standards in the SIS require that superannuation benefits are fully preserved to the statutory preservation age. Since 1 July 1996, this has applied to all superannuation benefits which have been subject to concessional taxation.[68] The benefits are generally required to be preserved to the statutory preservation age. This is currently 55 but is being progressively increased to age 60 by the year 2025. Earlier withdrawals are available in the event of death, temporary or permanent disability, permanent departure from Australia and, with the discretion of the ISC, in cases of financial hardship.

Preserved benefits are also portable between funds. When a member leaves an employer, preserved benefits can be transferred to a new employer's superannuation fund, to a master trust, an approved deposit fund or an eligible rollover fund or used to buy a *deferred annuity* from a life insurance company.

Member Rights

The SIS provides for considerable member participation in the operation and management of superannuation funds. The trustees of superannuation funds with at least 5 members, must comprise at least 50 per cent member representation,[69] members of all funds are required to receive certain fund and member information on a regular basis and members have the right to bring civil and criminal action against trustees and investment managers who have failed in their duties. In addition, members have access to a comprehensive mechanism for dispute resolution, through the compulsory fund-based internal arrangements[70] and if these fail under the *Superannuation Complaints Tribunal.*[71]

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66 The August 1996 Budget includes a proposal to extend this to age 70 for persons working at least 10 hours per week.

67 Including those under a defined benefit plan which has a benefit certificate for superannuation guarantee purposes.

68 Previously it applied only to member contributions and mandatory employer contributions.

69 Unless the fund uses a corporate trustee, in which case equal representation is required for the policy committee.

70 These are not compulsory for excluded funds.

CHAPTER 6. HOW WELL DOES THE SUPERANNUATION GUARANTEE WORK?

Introduction

In the 1990s Australian private pensions as defined in Chapter 1 comprise both voluntary and mandatory elements. Both will be important in providing retirement income in coming decades. The mandatory component, in the form of the Superannuation Guarantee, however, is the most novel, and from an international perspective, the most interesting, of all the Australian retirement policy developments. With this in mind, we have focussed this concluding chapter on the Superannuation Guarantee and its implications.

The chapter attempts three tasks. First, we try to assess how well a mature Superannuation Guarantee might work in providing retirement income to future generations, in the context of retirement policy more generally, and in relation to conventional public policy criteria. Second, we reproduce official projections to indicate how the Superannuation Guarantee might impact upon the overall economy, and especially saving performance. Third, we draw together the problems and deficiencies with the Superannuation Guarantee in its present form, and this leads us to conclude with a policy agenda for the future.

The Superannuation Guarantee: A Normative Assessment

A recurring theme in this essay is that Australian private pension policy is in transition. It follows that any assessment of that policy must be contingent on the nature of future developments. Even with this caveat, however, assessment remains an extremely difficult task. This is mainly because while some policy components are developed to a high degree of sophistication, others remain in a more or less primitive state. It is a little like approaching a grand building, with an imposing edifice, which on further examination turns out to have a wall missing. How is such a structure to be assessed?

In the overall structure of Australian retirement income policy, the Superannuation Guarantee takes the role of a national employment related retirement income scheme. It follows that it should be judged on criteria appropriate to such arrangements. Standard normative public finance focuses on economic efficiency and equity, and these are clearly important. However, they do not adequately address the needs of the elderly which give rise to the formulation of a retirement income policy in the first place.

Standard criteria of this latter kind do not exist, but we have developed a set of requirements which seem reasonable. These focus on the needs of the elderly to be insured against various types of risk. We can then explore the extent to which the Superannuation Guarantee meets these criteria. In a strict sense, the Superannuation Guarantee scores poorly, because of the lack of an income stream requirement. However, it is possible to ask to what extent the policy would be able to deliver on these criteria, given current practice of retirees, and that is the approach followed here.

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71 Set up under the Superannuation (Resolution of Complaints) Act of 1993.

Criteria

As suggested above, criteria for assessing retirement income policy can be divided in two parts - those directly relevant to the retiring individual, and those addressing the allocation and distribution of resources in the economy as a whole.

From the point of view of the individual, it is convenient to think of these schemes as providing insurance. As Bodie (1990) has pointed out, there are many sources of income uncertainty that a risk averse individual confronting retirement would like to insure against. We list the most important in the Australian context:

- *Coverage Risk*: This is the statistical risk of a labour force participant falling outside the coverage of the Superannuation Guarantee.

- *Replacement Rate Risk*: Replacement rate risk is the possibility that the retiree will not have enough income to maintain the same standard of living after retiring as during his pre-retirement years.

- *Investment Risk:* Investment risk is the possibility that the amount saved for retirement will be inadequate because the assets in which money is invested perform poorly.

- *Longevity Risk:* Longevity risk is the risk that the retiree will live longer than expected, and thus exhaust the amount saved for retirement before he dies.

- *Inflation Risk:* Inflation risk is the risk of price increases which erode the purchasing power of the lifetime savings.

- *Political Risk:* This is the risk that changes in regulations may reduce expected retirement benefits.

The conventional criteria in an economy-wide context are efficiency and equity. In the present context, these may usefully be interpreted as follows:

Efficiency: Policies should be designed to offset intertemporal price distortion inherent in income taxation and social welfare safety net payments, and the resulting tendency for individuals or families to provide too little of their own resources for retirement. Action taken to correct market failure related to lifetime annuities can also increase the efficiency of retirement income arrangements.

Equity: Individuals in equivalent positions should be treated equally, and the treatment of those in unlike positions should relate to their relative economic position. Thus, policy should be designed to prevent superannuation arrangements from being used as a tax shelter for high income earners at the expense, in effect, of low income earners. In addition, intergenerational equity considerations suggest that over a period of demographic transition, policies should be introduced which ensure that the baby boomers do not place an undue burden on subsequent generations when they retire.

Assessment

We have previously [Bateman and Piggott (1993)] undertaken a detailed assessment of the quantitative impact of the Superannuation Guarantee on retirement provision. This study remains the only comprehensive assessment of the Superannuation Guarantee using the above criteria, and we therefore rely heavily on it in what follows. Their conclusions are summarised in Table 6.1.

Table 6.1: Assessment of the Australian Superannuation Guarantee

Coverage	• Adequate
Replacement Rate Risk	• Adequate for continuous contributions
Investment Risk	• Borne by retiree, but addressed through asset diversification and interaction with the age pension
Longevity Risk	• Not covered - no mandatory purchase of life annuities, ineffective incentives
Inflation Risk	• Not covered - ineffective incentives for indexed annuity purchase
Political Risk	• Superannuation Guarantee accumulations are well insulated from political risk, except for tax rate variations, but the public pension safety net remains exposed to government variation.
Efficiency	• Addresses myopia and price distortions by compelling saving but not failure of the annuities market
	• Enhances private saving
Equity	• Intergenerational neutrality is adequate
	• Low income earners forced to change intertemporal consumption stream

Coverage Risk: A mature Superannuation Guarantee will ensure that almost all employees will receive at least some superannuation benefit on retirement. The most important group in the labour force not covered by the Superannuation Guarantee is the self employed. Neither is this group otherwise required to provide for retirement. Further there is no special provision for those not in the paid labour force.

Replacement Risk: A standard index of retirement income adequacy is the replacement rate. This is supposed to capture the extent to which working life income is replaced by retirement provision. However, it is less clear what constitutes an adequate replacement rate, or how the replacement rate should vary across different personal circumstances. Actuaries often recommend a 70 per cent replacement rate, but how this should vary with family size, home ownership, and so on is not spelt out. As well, gross income is typically used in calculating replacement rates, although the implication of this ratio for actual replacement will depend upon the income tax regime which is operating.

Official estimates (Willis 1995, Table 1) use an expenditure replacement rate which takes account of pre-retirement superannuation contributions and taxation. Replacement rates have been calculated assuming that a CPI indexed life annuity has been purchased with Superannuation Guarantee accumulation. For workers with an unbroken employment history, replacement appears good, with a 9 per cent Superannuation Guarantee rate generating 78.6 per cent replacement (including both annuity and public pension income) for a male worker who has received average weekly earnings for 40 years and retires at 65. The corresponding figure for females is 75.4 per cent.

However, replacement rate estimates for those with a broken work history are much lower. Bateman *et al* (1994), using a similar approach, estimate that if a woman retires five years earlier, at 60, her replacement rate falls to about 63 per cent.

Investment Risk: The Superannuation Guarantee is of the accumulation type, so that in contrast to most social security schemes operating in comparable countries, and subject to transfers of reserves, investment risk rests squarely with the contributor, except insofar as taxation and the targeted age pension introduce government risk sharing. The means tested age pension acts as a shock absorber for investment risk for many employees. To illustrate how this helps, Bateman and Piggott (1993) calculate that a 1 per cent fall in the rate of return (from 4.5 per cent to 3.5 per cent) reduces the annuity replacement rate by almost 20 percentage points, but the overall replacement rate only falls by 10 percentage points.

Longevity Risk: Australian policy does not require retirees to spread their retirement consumption financed from their superannuation payout. Several undesirable consequences follow. The lack of mandated annuity purchase potentially generates adverse selection in the annuities market, and results in income inadequacy for some retirees in the later years of retirement. Furthermore, it combines with current age pension arrangements to induce the problem of double dipping.[72]

Inflation Risk: Even if superannuation regulations were changed to compel life annuity purchase, a non-indexed annuity flow would be subject to inflation risk. Inflation affects the profile of the real value of annuity payments. Because nominal interest rates are higher with (anticipated) inflation, early payments will be greater than under a zero inflation scenario.

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72 From a long term policy perspective, it is desirable to limit access to the age pension because of the upcoming demographic transition. Public retirement transfers will be costly to the next generation of taxpayers, both because the retired will constitute an increasing proportion of the population, and because the great political power of the elderly may lead to increases in real benefit entitlements.

As the price increases reduce the real purchasing power of these payments, however, the retiree is exposed to the risk of inadequate income replacement in the later years of retirement. The age pension, which is indexed to the CPI, again militates against extreme hardship.

Political Risk: Because Superannuation Guarantee accumulations rest in the private sector, and are therefore not part of the government budgetary process, they are well insulated against political risk. They are not, however, entirely immune: for example, it is open to any government to increase tax rates on accumulations and/or benefits.

On the other hand, the age pension has the same kind of exposure to political risk as the employment related paygo public pensions elsewhere in the OECD. Many of the risks that we have listed above are mitigated by the interaction of the age pension with private retirement income and assets. The political risk inherent in the age pension must be borne in mind in interpreting these impacts.

Efficiency and Saving Issues: Standard economic theory suggests that two types of market failure will be encountered in the broad policy area of retirement income provision. The first relates to saving incentives and is a consequence of the intertemporal price distortions induced by an income based tax system, along with a program of transfers to the aged. (In addition, myopia, seen by some as pervasive in this long term context, may exacerbate this misallocation of resources).[73]

The second relates to the annuities market. Because insurers cannot distinguish between annuity purchasers with respect to life expectancy, except on the basis of obvious discriminants such as gender, annuity price will be insensitive to this personal characteristic. Those purchasers who do not expect to live very long will find the price too high and will be driven from the market. This, in turn, leads to further price increases. This process, leading to adverse selection, is familiar from health insurance, where, in the absence of policy intervention, risk averse healthy people may not find it worthwhile to purchase insurance.

Current Superannuation Guarantee policy goes some way towards correcting the first of these market failures, by compelling some private saving. But the adverse selection problem in the life annuities market is not adequately addressed, because annuity purchase is not compulsory for the vast majority of retirees.

Equity Issues: The equity implications of mandating life cycle saving have not been much considered in the literature.[74] Equity issues are difficult to address in an intertemporal framework, even when "conventional" policies such as taxation are the object of analysis. Our remarks here must therefore be treated as preliminary and interpreted with caution.

The nature of the Superannuation Guarantee brings into focus the different groupings which must be distinguished in this kind of analysis. In particular, standard analysis of the redistributive effects of policy change uses economic data on economic units[75] classified by income range. The

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73 See Samuelson (1987).

74 Bateman *et al* (1994) and Atkinson and Creedy (1996) offer a preliminary analysis. Knox (1991, 1992), considers only the equity impacts of superannuation tax concessions to individuals facing different marginal tax rates.

75 These units may be households, families, "income units", or individuals. The type of unit chosen will depend on the purpose of the analysis.

unit's "age" is ignored. Redistribution between generations, and redistribution between the rich and poor within an age grouping, are conflated. Analysis of the Superannuation Guarantee however, requires that these two kinds of redistribution are separated.

This distinction has been emphasised by Kotlikoff (1992), among others.[76] He points out that analysis of a "tax system's progressivity based on annual income has misclassified as regressive some of the most progressive features of (a) fiscal system" (p.90). He also specifically separates "generational policy" (which addresses the question of how much each generation will pay in taxes or receive in transfers) and "distribution policy" (which addresses the question of how each generation's projected lifetime taxes and transfers are spread over its richer and poorer members). The argument in favour of making this distinction is not confined to the Superannuation Guarantee; it is quite general. But in most policy analysis the issue is finessed.

The Superannuation Guarantee compels those employees with the lifetime resources to do so to help fund their own retirement. Such compulsion is consistent with intergenerational neutrality, and is in this sense "equitable".

When within-generation distribution impacts of the Superannuation Guarantee are considered, concern over the negative equity effects arises on three counts. First, superannuation tax concessions offer more of a tax break, relative to comprehensive income tax, to the rich than to the poor. This is because the value of tax deductibility is determined by marginal tax rates, which increase with income. Second, if, as is variously assumed, claimed, and expected, the Superannuation Guarantee is to be largely absorbed through slower real wage growth, then the working poor may suffer more through reduced access to consumption today than they gain through increased retirement resources tomorrow. Third, women, who are highly represented in the group of so-called non-standard workers, are sometimes seen as disadvantaged by the Superannuation Guarantee.

Overall Economic Impacts. Present Evidence and Projections

Analysis of the economic impact of national pension policy in most developed economies focuses on two markets. Labour market behaviour, and particularly retirement, is seen as being altered through the impact of social security and particular provisions of defined benefit pension plans. The capital market is affected as saving behaviour is altered, especially through the transfers implicit in unfunded retirement provision.

In Australia, the Superannuation Guarantee is not generally thought to have major labour market consequences. This is because the accumulation and mandatory nature of the policy, while altering the time profile of labour payments, are not seen as having major impact on overall compensation. This is something of an over simplification, since once the scheme matures, age pension entitlements will be affected by Superannuation Guarantee accumulations. Further, short term wage rigidities may lead to increased labour costs resulting from the mandatory employer contribution. It is widely considered, however, that in the long term, these impacts are minor, although there is little evidence to support or refute this contention thus far.

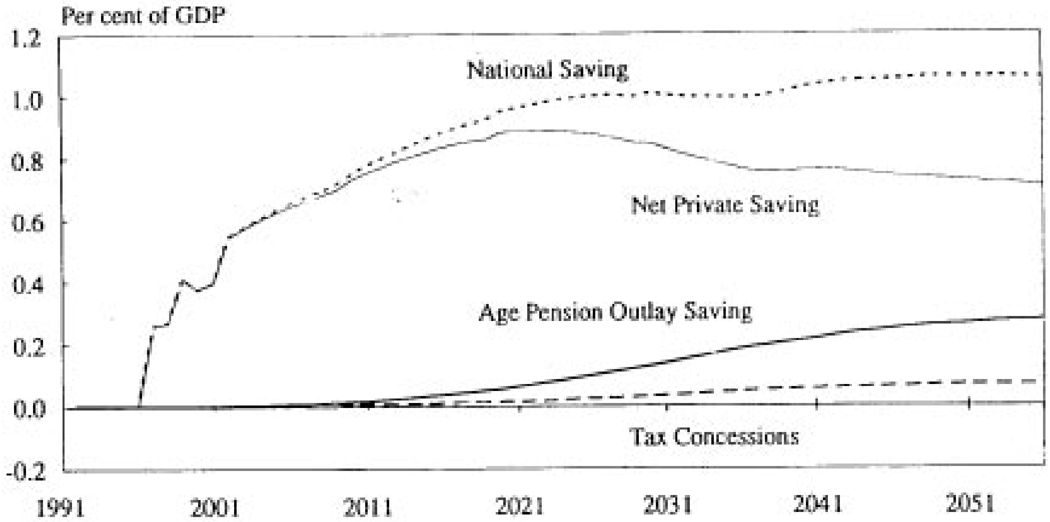
In Australia, therefore, attention has focussed primarily on national saving. This tendency has been exacerbated by concern with aggregate saving performance. The FitzGerald Report on

76 See, for example, Layard (1977); Davis *et al* (1984); Piggott (1987).

National Saving (FitzGerald 1993) devotes much space to the role of the Superannuation Guarantee in promoting saving performance.

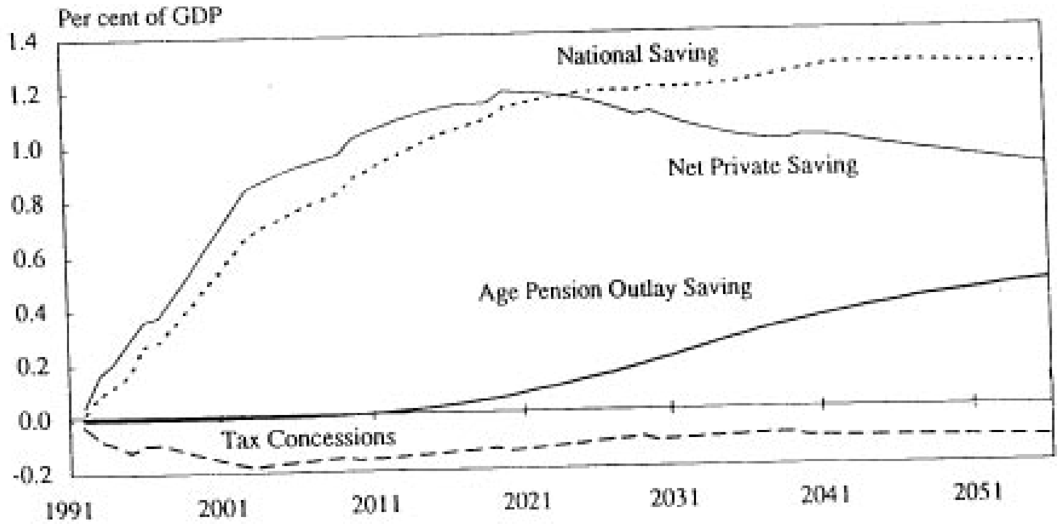
Charts 6.1 and 6.2, drawn from the FitzGerald Report, suggest significantly improved saving rates in the medium term from the introduction of the 9 per cent Superannuation Guarantee, and even greater improvement from the inclusion of the 3 per cent employee contribution. In these calculations, a 50 per cent saving substitution rate is assumed, that is, a dollar of mandatory saving leads to a 50¢ reduction in existing private saving. On this assumption, the combined effect of a 9 per cent Superannuation Guarantee and a 3 per cent employee contribution is projected to raise national saving by almost 1½ per cent of GDP within 10 years, and almost 2 per cent of GDP within 20 years.

Chart 6.1: The Superannuation Guarantee: Contribution to National Saving



Source: Retirement Income Modelling Task Force, unpublished, 1993

Chart 6.2: 3 Per Cent Employee Contribution: Additional Contribution to National Saving



Source: Retirement Income Modelling Task Force, unpublished, 1993

As the charts indicate, the saving comes from a variety of sources. Private saving improves because of the gradually increasing tax preferred mandatory contribution, and the earnings thereon, net of saving substitution. Public saving occurs because after some initial period, reductions in the expected age pension obligations exceed the value of tax preferences. (Initially, however, the year on year public saving rate decreases.)

If these projections are correct, they do indeed reflect a major improvement in saving performance. Net national saving currently stands at only 2 per cent of GDP, so a 1½ percentage point increase represents a 75 per cent acceleration in net saving. Since it is from net saving that new investment is funded, this is the relevant ratio to work with. However, it should be noted that the projections are very sensitive to changes in assumptions about rates of return, saving substitution, and growth rates.

Certainly, the composition of households' financial saving flows have altered dramatically in the last decade. Table 6.2 reports the net acquisition of financial assets for the 1970s, 1980s, and 1990s. Life office and superannuation contributions have increased from 20 per cent in the 70s to 50 per cent in the 90s.

Table 6.2: Households[(a)] - Net Acquisition of Financial Assets

	Bank deposits %	Life office, superannuation contributions %	Other [(b)] %
1970s	42	20	38
1980s	36	39	25
1990s	28	50	22

(a) Includes unincorporated enterprises
` (b) 'Other' includes building society and credit union deposits, government securities, debentures, shares, unit trusts, etc.

***Source*:** Reserve Bank (1996).

A final point on saving performance concerns the composition of saving and investment. There are two main channels of tax preferred saving in Australia - superannuation, and owner occupier housing. The latter of these is excluded from the age pension means test. While evidence is scarce, the structure of incentives is such that it must be expected that owner occupier housing would, in the absence of compulsion, be chosen as the preferred personal saving vehicle. It may therefore be that the Superannuation Guarantee contributes more to the efficient allocation of economic resources through its impact on the composition of saving and investment, than on aggregate saving performance.

A Partial Agenda for Policy

Four broad areas of policy can be identified where urgent attention is required from a social and economic perspective, or where there is impetus for change. These are the establishment of more effective retirement income streams; the reform of superannuation taxation; coverage of and provision for "non standard" workers; and the expansion of individual choice. They will be discussed in turn.

Retirement income streams

We have already alluded to the failure of Australian retirement policy to require or adequately encourage individuals to take their superannuation benefits as an income stream. Because the current preservation age is 55, while the pension eligibility age is either 60 or 65, superannuation benefits can be disposed so that means test requirements for the age pension are met, even when a large lump sum has been paid on retirement. One policy change that would go some way towards correcting this is to align the preservation age with the pension eligibility age. This would at least permit all superannuation benefits to be taken into account in assessing the means test eligibility for the age pension. Policy is currently moving in this direction, but very slowly and only partially. Much more urgent action is required.

Integration of the Superannuation Guarantee and the age pension through an alignment of age requirements is, however, only part of the story. In addition, it will be necessary, eventually, to require or provide massive incentives for individuals to take their superannuation benefits as an income stream. It seems most straightforward to mandate this; however, heavy taxation of lump sum benefits has also been advocated (Fitzgerald 1996).

This raises two further issues - setting the minimum annuity to be purchased with a benefit, and establishing what features the annuity must possess.

The minimum annuity value is a vexed policy issue. While we offer no view, it does seem reasonable to require or strongly encourage at least annuity purchase to a level which eliminates age pension eligibility, once a modest lump sum is paid.

If annuities are to be a well established form of retirement provision, they should provide longevity and inflation insurance. That is, they should be indexed or escalated to take account of changes in the price level and they should be life instruments. There is continuing debate over whether this is best achieved by gradually imposing more and more stringent conditions on income stream products, or by setting out the requirements at the outset. To the extent that annuity market failure is reduced by compulsory purchase of life instruments, the latter strategy is probably preferable.

Taxation

In Chapter 3, we described the tax treatment of superannuation saving in Australia. In particular, we pointed out that Australia is unusual in taxing contributions, benefits and fund earnings. This three stage arrangement is unnecessarily complicated and creates perverse incentives.

A benefit tax is perhaps the ideal way to tax superannuation saving. Tax liability then reflects differences in investment performance, and is payable at a time when the taxpayer has liquidity. The current Australian policy stance precludes this option as a feasible reform. It implies postponing tax collections until the current Superannuation Guarantee-covered generation of employees retires, and policy sensitivity to the annual government deficit is too great to allow such a reform.

In a world of certainty, however, benefits and contributions taxes are equivalent. A contributions tax is a good way to tax superannuation saving, and is attractive politically because, for the same present value of tax collections, a contribution tax will lead to reduced annual government deficits in the near term. Abolition of the remaining benefits taxation would simplify tax arrangements.

A second, and more important, policy change would be the reduction of the tax on fund earnings. This does not imply denial of the dividend imputation tax credit, which can still be set against contribution tax liability, providing that at least some earnings tax is collected. Reducing the tax on fund earnings improves the incentive structure of superannuation taxation. As individuals approach the preservation age, they face a number of choices with regard to their superannuation which were not available to them earlier in the life cycle. They can, for example, retire and take their superannuation; they can retire and preserve their superannuation for some period thereafter; or they can continue to work. One consideration that such individuals will take into account in making this decision is the expected increment to their accumulation if they are to stay and work, or to preserve their superannuation entitlements. High earnings taxation reduces the increments very substantially at this stage in the life cycle, because the bulk of the increment comes from earnings on previous accumulation rather than current contributions. Reducing the tax on earnings could therefore encourage workers to stay in the labour force longer, and encourage those who choose to retire to preserve their accumulated superannuation savings for longer. Both these effects will have the consequences of improving overall saving rates, and improving retirement income replacement.[77]

A further implication of significant earnings taxation is that it tends to distort the asset allocation decisions of fund managers. In the Australian case, this is most obvious in the case of domestic equities, which attract the dividend imputation tax credit - an effective comparative subsidy. This no doubt partly explains why such a small proportion of superannuation assets are invested internationally. According to Black and Litterman (1992), Australian investment funds have more to gain than most from international diversification, even though Australia exhibits less extreme “home bias” than other developed nations such as the United States. This is presumably because of the relatively specialised nature of Australian investment. This suggests that reduced earnings taxes may help to encourage a more efficient asset allocation.

At present, superannuation taxation discriminates against employee contributions. Employers may deduct contributions made on behalf of their employees, but employee contributions are not, in general, deductible. A sensible policy change would be the introduction of employee contribution deductibility. Therefore, it would not matter whether the employer or the employee contributes a dollar to superannuation, it receives the same tax treatment. Such an arrangement will also serve to encourage higher employee contributions and thus improve both saving and replacement rates. Contrary to widely held belief, this policy change need not be costly to revenue. In present

77 These issues are discussed further in Kingston and Piggott (1993).

value terms, and taking into account the future saving from reduced age pension liabilities, this concession may, in fact, generate a saving to the revenue.[78]

"Non standard" workers

The Superannuation Guarantee is reasonably expected to generate adequate accumulations for what might be termed "standard" workers - that is, people who work full time throughout their working lives. It is less certain whether it will do the same for what might be termed "non standard workers". These include the self employed, who do not fall within the Superannuation Guarantee net at all; people who are not in the paid labour force; low income workers; and workers who have broken work histories, including many women.

The self employed, and those not in the paid work force. The 15 per cent of the labour force classified as self employed are not covered. While a proportion of these could look to the sale of their businesses as a source of retirement income, many others will find that the value of their business resides largely in their personal involvement. Unless these workers have voluntarily participated in superannuation or other retirement saving, they will find it difficult to fund their own retirement, even though their lifetime resources may be quite adequate to cover this.

Some policy makers have already suggested that Superannuation Guarantee coverage be extended to the self employed, based on their income from exertion. This would reduce coverage risk to a low level for those who spend a substantial part of their lives in the labour force.

Other groups who may be seen to confront coverage risk include the unemployed and those not in the labour force. These groups are more difficult to include under the Superannuation Guarantee, and it may well be that reliance on the age pension is the best solution.

However, many working age people who are not in the labour force are partnered with a Superannuation Guarantee covered worker. It may be possible to change retirement benefit requirements to compel reversion, or to alter the property rights in Superannuation Guarantee accumulations, so that coverage is extended to at least some non labour force participants.

The Working Poor. The working poor can be thought of as employees who have no discretionary current income. They must spend all their available disposable income to survive.

When such employees are forced to change their intertemporal consumption stream as a result of the imposition of the Superannuation Guarantee, they may well suffer. They may rationally view the age pension as providing adequate income replacement in retirement, and have their welfare worsened by forced life cycle saving. Their current consumption is inadequate already - they would prefer higher wages now to higher retirement income.

For such people, the Superannuation Guarantee has a negative impact, and since they are among the poorer members of a generation, this is relevant in assessing the within generation impact of the Superannuation Guarantee. No evidence exists concerning the magnitude or proportion of this effect, however. Most people who fall into this category at any point in time are unlikely to remain there throughout their working lives so cross section analysis is therefore of little value in this context.

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78 See Bateman and Piggott (1992b), p.50.

Women. Women are seen as relatively disadvantaged by the Superannuation Guarantee because it is an earnings related accumulation scheme, and women on average earn less than men throughout their working lives. This is because they tend to be concentrated in relatively low paid occupations, and because they are more likely to have broken work histories. Further, they retire earlier and have a greater life expectancy, so that the (generally smaller) superannuation accumulation has to last longer. Finally, there is no requirement that, in the case of a couple, annuities with reversion be purchased with superannuation retirement benefits.

These facts combine to leave women with less of their own superannuation entitlement, and more vulnerable to economic loss in the event of marital or family breakdown, than men. It follows that the benefits of occupational superannuation will fall more heavily to men than to women. Further, while there tends to be a growing tendency for divorce courts to award the primary child carer a greater share of the assets insofar as the primary earner has a substantial superannuation accumulation, as yet this remains unsystematic.

It should, however, be noted that superannuation coverage for women has risen more dramatically than for any other group since the introduction of mandatory superannuation. Between 1987 and 1995 the superannuation coverage for female employees increased from 26 per cent to over 85 per cent. For many of these women, access to superannuation will benefit them, even if it does not benefit them as much as men.

A further point is that the age pension acts as a cushion to blunt the relative impact of the Superannuation Guarantee on the retirement income of the less well off. This mechanism is especially important for the economic welfare of retired women. For example, Bateman *et al* (1994) calculate that a single career female on average female earnings will be entitled to an Superannuation Guarantee annuity replacement rate of 44.4 per cent of earnings, compared with the corresponding figure for a male of 77 per cent. But under current means testing, the male is entitled to only 5 per cent of the age pension, while the female is entitled to 64 per cent. The replacement rate from combined public and private sources ends up at 78 per cent for the male and 63 per cent for women. While this still leaves the woman with less income, her relative deprivation has been substantially reduced by the way in which the Superannuation Guarantee interacts with the age pension. Similar calculations can be made for life events such as divorce.

The age pension cushion is, of course, not sufficient to level retirement incomes between men and women. Given the institutional and social factors discussed above, which operate throughout working life, this is not surprising. It is unlikely that any feasible retirement income policy could level male and female incomes in retirement, given the conditions which prevail in the labour market. In other words, it will require more general social and labour market reforms rather than simply superannuation reforms to address the gender-related equity issues.

There are, however, some steps which could be taken which seem to us to help. The first is the establishment of shared Superannuation Guarantee property rights. This would offer some protection for female divorcees who have devoted much of their married lives to nonmonetised activity.

The second is a requirement that annuities be joint with the retiree's spouse and should have a reversion clause. Whichever partner dies first, the survivor would be entitled to a substantial proportion of the annuity being paid when both partners were alive.

Choice

As we pointed out in Chapter 4, the choice available to employees as to where their Superannuation Guarantee accumulations are placed, and the portfolio in which they are invested, is extremely limited. The Superannuation Guarantee requires employers to make superannuation contributions to a complying fund of *their* choice. Under productivity award superannuation, unions have had some say into which fund or funds the mandatory employer contributions must be made but these have been restricted to industry funds.

Only about 20 per cent of funds provide for member choice of investments. Member investment choice is currently a political issue in Australia with quite diverse views among the major players. Industry funds have argued strongly against mandatory member investment choice, largely on the grounds of its impact on administrative costs, while a recent report of the Senate Select Committee on Superannuation (Senate (1995) came down in favour of it. The ISC has issued guidelines for the provision of member investment choice but the government has so far not included it in the supervisory legislation.

Member choice, with appropriately informed guidelines, would appear to be inevitable if the Superannuation Guarantee is to develop in the context of a private sector based competitive retirement provision industry. Policy should be directed towards ensuring that accurate and relevant information is available to employees to inform their decision making, and that trade practices are fair.

APPENDIX A. RETIREMENT INCOME POLICY PROPOSALS

The March 1996 Federal election saw the Australian Labor Party (ALP), which had been in government for 13 years, defeated by the Liberal/National Party coalition. Successive ALP governments were responsible for the recent reforms in Australian retirement income policy, including the introduction of the Superannuation Guarantee. The new coalition government has announced that it will continue with the main thrust of these reforms.

In May 1995, the previous government had announced proposals to expand both the amount and coverage of mandatory superannuation. These included an increase in mandatory contributions to close to 15 per cent of earnings and greater access to tax preferred retirement saving for the self employed. The additional mandatory contributions were to be in the form of a 3 per cent employee contribution and a government co-contribution of up to 3 per cent of earnings.[79] Unlike the Superannuation Guarantee the employee contribution was to be implemented through industrial agreements and awards rather than legislation.

The government co-contribution was to have a cap of 3 per cent of average earnings, phasing out for earnings in excess of 1.4 of average earnings to a co-contribution of zero for workers on twice average earnings.

The policy intentions of the current government can be gauged from the August 1996 Budget announcements as well as its pre-election policy proposals. The new government has stated that it also supports higher mandatory contributions, but not necessarily in the form proposed by the previous government. Its policy proposals includes a 3 per cent employee contribution but it is less specific on the government co-contribution. It has stated that it will "reserve the right to vary the delivery mechanism" (Short 1995).

These and other superannuation policies and proposals of the new coalition government are summarised in Table A1. The overall policy objective is to provide greater choice and flexibility for members and more competition between providers. It is emphasised that these are policy proposals only and have no legislative status.

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79 The motivation for the government co-contribution was largely political. Prior to its re-election in 1993 the ALP government had promised tax cuts. However, by 1995 it was clear that they would be untenable. The expected $A4.5 billion cost of the co-contribution mirrored the aggregate expected cost of the promised tax cuts.

Table A1: The Main Superannuation Policy Proposals of the Current Coalition Government

August 1996 Budget proposals include:

- A contributions tax surcharge of 15 per cent for individuals earning at least $A85,000 pa including tax deducted superannuation contributions.
- Allow persons earning between $A450 and $A900 per month to opt out of mandatory superannuation in favour of higher wages or salary.
- Allow financial institutions to offer retirement savings accounts (RSAs).
- Introduction of a tax rebate of 18 per cent for superannuation contributions made on behalf of a low income or nonworking spouse with an income below $A10,800 pa.
- Abolition of the standard contribution limits for tax deductibility and replacement with the currently optional age based limits.
- Allow contributions to be made up to age 70 (increased from age 65) if working more than 10 hours per week.

Other pre-election policies included:

- No change to the implementation schedule of the 9 per cent Superannuation Guarantee.
- Introduction of a mandatory 3 per cent employee contribution but not necessarily through industrial agreements and awards.
- The full benefit in dollar terms of the proposed government co-contributions, but not necessarily in the form proposed by the previous government.
- Award and enterprise agreements to provide a choice of up to five funds to receive employee contributions including employer or industry funds, personal superannuation or RSAs.
- Encourage accumulation funds to offer a choice of investment strategy and benefit design.
- Extend the “sole purpose” test to allow superannuation funds to provide life crisis cover and mortgage insurance in limited circumstances.
- All superannuation funds to provide minimum life insurance to members age 45 and less.
- Phase out the Australian Taxation Office holding reserve for small superannuation contributions.

APPENDIX B. CHRONOLOGY OF RETIREMENT PROVISION POLICY INITIATIVES

1908 Age pension introduced.

1913 Conservative parties proposed contributory national superannuation.

1915 Introduction of superannuation tax concessions - tax exemption of superannuation fund income, tax deductibility of superannuation contributions.

1922 Commonwealth employees superannuation fund established.

1928 Conservative government introduced National Insurance Bill - which provided for a national superannuation scheme.

1936 Service pension first paid. Introduction of tax concessions for lump sums.

1938 National Health and Pensions Insurance Bill passed - based on 1928 Bill.

1939 Legislation passed to indefinitely postpone the 1938 Act.

1943 Labor government establish National Welfare Fund to fund social services.

1945 Social services contribution introduced.

1950 Social services contribution merged with personal tax system.

1973 Means tests abolished for persons aged over 75.

1975 Means tests abolished for persons aged 70 to 74.

1976 Assets test abolished for all persons.

1978 Reintroduction of assets test for persons over age 70.

1983 Reduction of tax concessions for lump sums. Increased tax deductibility for superannuation contributions by uncovered employees and the self employed.

1984 Rollover funds established. Removal of tax on income underlying annuities.

1985 Assets test reintroduced for all persons. Labour government and ACTU finalise Accord Mark II.

1986 3 per cent productivity award superannuation endorsed by the Conciliation and Arbitration Commission.

1987 Commencement of operation of Occupational Superannuation Supervision Act. Establishment of the supervisory body, the Insurance and Superannuation Commission (ISC).

1988 Major reform of superannuation taxation - including 15 per cent tax on superannuation fund income, reduction of taxes on lump sums, introduction of a 15 per cent rebate on annuity and pension income, increase in tax deductibility for the self employed and uncovered workers and introduction of marginal RBL scales.

1990 Age pension income test amended to disregard the undeducted purchase price of pensions and annuities. Age pension assets test amended to include the purchase price of annuities. Introduction of tax rebates for low coverage employees.

1991 Industrial Relations Commission rejects further 3 per cent productivity award superannuation. Government announces introduction of 9 per cent Superannuation Guarantee to commence in July 1992.

1992 Superannuation Guarantee commences. Tax rebate for superannuation contributions extended to all employees but reduced in amount.

1993 Superannuation Industry Supervision Act passed.

1994 Flat rate RBLs replace marginal RBLs. Age determined employer contribution limits introduced. Improved preservation. Increased eligibility for 15 per cent pension and annuity rebate. Commencement of phased-in increase in preservation age to age 60.

1995 Commencement of phased-in increase in age pension age for women from 60 to 65. Commencement of member protection rules. Labour government proposes increase in mandatory contributions to 15 per cent.

1996 Financial investments to be subject to extended deeming under the age pension income test.

Change of government. New Liberal/National Party Coalition Government supports the broad direction of the previous government's superannuation policies. August 1996 Budget included changes to the tax treatment of superannuation contributions.

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GLOSSARY

Age pension
A pension provided by the Department of Social Security to eligible Australian men aged 65 years and older and women aged 60 and over. The age pension is subject to income and assets means tests and residency requirements. The eligibility age for women is being increased to 65 over a 20 year period from 1995. Similar payments are also provided to eligible war veterans.

Allocated pension/annuity
A pension/annuity where a member has their own account against which variable pension/annuity payments (within legislated limits) are debited and to which any investment earnings are credited. The pension/annuity continues until the death of the pensioner, or until the account is exhausted. Upon death, any balance remaining in the account is paid to a designated beneficiary as a lump sum or as pension payments.

Annuity
A regular periodic payment, usually purchased with a lump sum from a life office. The relationship between the size of the lump sum and the size of the regular payment depends on the expected future investment returns, the pattern of payments and the term of the annuity or for a life annuity, the expected life of the purchaser.

Approved deposit fund (ADF)
A retail trust fund that accepts superannuation payments made to a fund member after leaving employment, but before age 65. This allows rolled over lump sum superannuation payments to continue to receive concessional taxation treatment.

Approved trustee company
A trustee which must be a corporation, be approved by the Insurance and Superannuation Commission (which must be satisfied that it can be relied upon to perform the duties of a trustee in the proper manner) and fulfil other minimum liquidity/financial requirements.

Asset allocation
The distribution of investments among various asset classes. The major asset classes are shares, property, fixed interest and cash.

Complying superannuation fund
A superannuation fund which qualifies for concessional tax rates. Only a regulated fund which meets the legislated operational standards can be a complying fund. The standards relate to *inter alia* vesting, preservation and portability; reporting requirements; investments; trustee, investment manager, actuary and auditor standards. If a fund is not a regulated fund and is non complying, it is ineligible for the taxation concessions.

Corporate fund
A superannuation fund established for the benefit of employees of a particular company or group of companies.

Corporate trustee
Where the trustee of a superannuation fund is a company. A corporate trustee may be one of the professional trustee companies, a separate company established to take on the responsibilities of the fund or the employer-company sponsoring the plan.

Deeming rate
The deeming rates are: 5 per cent for the first $A30,000 of financial assets for a single person ($A50,000 for a couple) and 7 per cent for the remainder.

Deferred annuity
An annuity under which periodic payments do not commence until a future date.

Defined benefit fund
A superannuation fund which defines the benefits payable, usually in terms of salary near retirement and years of membership. The sponsor of a defined benefit fund carries the investment risk.

Defined contribution fund
A superannuation fund where the benefit received is the total of specifically defined contributions plus the earnings thereon. The members of defined contribution funds carry the investment risk. Defined contribution funds are also called accumulation funds.

Double dipping
The practice of dissipating tax preferred superannuation benefits in order to receive a full or part age pension.

Eligible roll over fund (ERF)
A superannuation fund or approved deposit fund which is eligible to receive benefits automatically rolled over from other funds.

Excluded funds
A superannuation fund with five or less members.

Extended deeming
For financial investments, rather than using the actual income from an investment, income for age pension means test purposes is imputed at a standard deeming rate based on the total value of a pensioner's assets. Assets covered by the deeming arrangements include: bank, credit union and building society accounts; cash, term deposits and cheque accounts; shares; friendly society bonds; other managed investments; loans and debentures. All annuities and pensions are currently excluded.

Franked dividends
A dividend paid out of a company's taxed profits.

Immediate annuity
An annuity where payments commence straight after purchase.

Imputation credit
The tax paid by the company on the gross profit that gave rise to the dividend.

Imputation system
The tax arrangement operating in Australia which eliminates the double taxation of Australian resident company profits. The payment of company tax is imputed, or notionally allocated, to the shareholder by means of imputation credits attaching to franked dividends.

Industry fund
A multi-employer superannuation fund. Usually covers a specific industry or range of industries and will accept contributions from any employers in those industries. Most commenced in the mid 1980s and were set up to accept contributions under PAS.

Insurance and Superannuation Commission (ISC)
A government body responsible for the regulation of the superannuation and insurance industries.

Investment manager
An individual or company who invests and manages the investments of others. Under the Superannuation Industry (Supervision) Act, investment managers must be incorporated bodies and have tangible assets of at least $5 million.

Low income rebate
Paid at a rate of $A150 to taxpayers earning less than $A24,450 pa. Phased out at a rate of 4 cents in the dollar for income above the threshold.

Lump sum
A retirement benefit taken as a single sum rather than a pension or annuity.

Lump sum mentality
The habit of taking retirement benefits as lump sums rather than annuities or pensions.

Mandatory retirement saving
Compulsory contributions to a superannuation fund which are fully vested and preserved until retirement.

Master trust
A trust arrangement which allows a single trustee operating under an 'umbrella' trust deed to administer and manage the superannuation funds of a number of employers or individuals.

Medicare levy
A levy on taxable income to partially finance the public health system. Currently applied at a rate of 1.5 per cent of taxable income above an income threshold.

Minimum benefit standards
Under the Superannuation Industry (Supervision) Act, the preservation requirements are referred to as minimum benefit standards. Since July 1994 all employer funded superannuation benefits provided pursuant to awards and the Superannuation Guarantee have been required to be fully vested in employees.

Minimum payment standards
Under the Superannuation Industry (Supervision) Act, the requirements for vesting are referred to as the minimum payment standards. Since July 1994 all employer funded superannuation benefits provided pursuant to awards and the Superannuation Guarantee have been required to be fully preserved to retirement at age 55 or beyond. This will extend to most other benefits which have received concessional taxation from July 1996.

Myopic loss aversion
Sensitivity to losses combined with frequent evaluation of long term investments.

Occupational superannuation
Superannuation provided by an employer as part of the terms and conditions of employment.

Ordinary annuity
An immediate or deferred annuity that has not been purchased with accrued retirement benefits.

Pensioner rebate
Eliminates tax liability for age pensioners with taxable income below the age pension plus the income test free amount. Withdrawn at a rate of 12.5 cents in the dollar for income above this threshold.

Pooled superannuation trust (PST)
A unit trust which can only accept investments from complying superannuation funds, complying ADFs and other pooled superannuation trusts. Pooled superannuation trusts receive concessional taxation treatment.

Portability
The ability for members to transfer their superannuation benefits from one scheme to another as employment changes.

Prescribed minimum standards
The required features of annuities and pensions to allow access to the higher pension/annuity reasonable benefit limit and the 15 per cent pension/annuity rebate. These include: payment for life, indexation to at least the lessor of 5 per cent pa or the annual CPI, no residual capital value and no commutation.

Preservation
The requirement that benefits remain in a superannuation fund until permanent retirement after the member reaches the preservation age. The benefit can be paid before this age if the member dies, becomes disabled, is leaving Australia permanently or, upon application to the ISC, in cases of financial hardship.

Preservation age
The age at which a member can access preserved benefits in a superannuation fund, provided the member has permanently retired from the workforce. The preservation age is gradually increasing from age 55 to 60 over the next 30 years.

Productivity Award Superannuation
Provision of superannuation by an employer under an industrial award in accordance with the decision of the 1986 National Wage Case decision.

Public offer fund
A superannuation fund which is open to members of the public (provided they are employed).

Public sector fund
A superannuation fund which provides benefits for government employees.

Reasonable benefit limits (RBL)
The maximum concessionally taxed superannuation benefit which a person can receive over a lifetime. Superannuation benefits greater than the RBL are taxed at the highest marginal tax rate. The RBL for lump sums of $A400,000 is less generous than the pension/annuity RBL of $A800,000 which applies when at least 50 per cent of the superannuation benefit is taken as a pension/annuity. The thresholds are both indexed annually to changes in average earnings.

Rebatable annuities/pensions
A superannuation pension/annuity which allows the recipient to receive the 15 per cent annuity/pension tax rebate.

Regulated fund
To be a regulated fund, a fund must comply with the SIS legislation; have either a corporate trustee or pay retirement benefits as pensions; and be a superannuation fund, corporate trustee, superannuation scheme/plan/fund that is indefinitely continuing.

Retail fund
A superannuation fund that is a publicly offered fund that members may join by purchasing investment units or policies. They are used for personal superannuation, by the self employed and by employers not wishing to establish their own superannuation fund.

Reversion
Where a benefit is payable to a person, usually a spouse, after the death of the primary beneficiary.

Reversionary annuity
An annuity payable to a person after the death of the primary beneficiary.

Rollover
The transfer of accrued retirement benefits to a rollover fund or other superannuation fund.

Rollover annuity
An immediate of deferred annuity purchased with accrued retirement benefits.

Rollover fund
A fund which can accept preserved benefits and which is eligible for the superannuation tax concessions.

Short termism
A preoccupation with performance over the short term - generally up to one year.

Small payments problem
The problem of relatively small superannuation contributions required to be made by employers under the Superannuation Guarantee being subsequently eroded by fund fees and charges.

Spouse rebate
Available where a taxpayer has a dependent spouse. The full rate in 1994-95 was $A1,211 pa, reduced by $1 for every $4 of dependent's income above a threshold of $A282 pa.

Standard employer fund
A superannuation fund which has been created by an employer for the benefit of its employees.

Superannuation
A long term savings arrangement which operates primarily to provide income for retirement.

Superannuation Complaints Tribunal
A forum established to deal with complaints about decisions of superannuation fund trustees.

Superannuation fund
An entity established primarily to provide benefits to members on their retirement (or on their resignation, death or disablement). Superannuation funds are generally trust funds governed by a trust deed and administered by trustees.

Superannuation Guarantee
A mandatory minimum level of employer superannuation contributions. The schedule of contributions is fixed in legislation, starting from 3 per cent of salary (for employers with payrolls under $1 million) and 5 per cent (for employers with payrolls over $1 million) in July 1992, and rising to 9 per cent for all employers by 2002.

Superannuation Guarantee Charge
A non deductible charge levied on employers who do not meet the minimum Superannuation Guarantee requirements for employers. The charge consists of the employee's entitlements, interest on those entitlements and an amount for administrative costs.

Superannuation pension
A pension payable by, or on behalf of, a superannuation fund and eligible for tax concessions.

Trust
A trust exists when a person or company (the trustee) holds assets for others (beneficiaries) who are intended to benefit from the assets and/or the income from the assets.

Trustee
A person or company appointed under the terms of a trust deed to hold the trust property for the beneficiaries and to make sure that the plan is operated in accordance with the trust deed.

Undeducted contribution
Component of a retirement benefit made up of a contribution for which no tax deductions were allowable. The undeducted contributions component of a retirement benefit is not taxable, and does not count towards a persons reasonable benefit limit. It is limited to post June 1983 contributions.

Undeducted purchase price (UPP)
That part of the purchase price of a pension or annuity which has not been claimed as a tax deduction. Applies to post June 1983 member contributions. The undeducted purchase price is used to calculate the tax free portion of the annual pension or annuity.

Vesting
An individual's entitlement to a superannuation benefit upon leaving a scheme (whether before or at retirement). Benefits are fully vested if the entitlement represents the individual's total accrual up to the time of leaving, from member contributions, employer contributions and any investment earnings on the contributions.

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