IACA - 1990 MEETING

NATIONAL REPORT FOR AUSTRALIA

by Edward J Jones

1. The Actuarial Profession

The last two years has seen a continuation of growth in numbers of actuaries practising in Australia, and of consulting actuaries. Comparative figures are:-

30 September	All Actuaries	Active Actuaries	Consulting Actuaries
1987	424+15	365+15	109+6
1988	454+33	394+33	126+12
1989*	481+40	420+40	139+20

* Provisional

Figures after the + sign are Accredited members of the Institute of Actuaries of Australia, being actuaries equivalent to FIAA and having six months residence. Thus, more than 10% of practising actuaries are recent immigrants.

The annual rate of increase in the active population of actuaries has averaged 10% over the 1987/9 period and 18% for consultants.

2. The Economy

The main factors in the economy influencing the work of actuaries are inflation, salary movements and interest rates. Keeping inflation down to low levels or at least

comparable with inflation rates of our trading partners has been one of the major focuses of the Government, and success in this area is largely attributed to an Accord struck between the Government and the ACTU (Australian Council of Trade Unions).

One of the most remarkable features of the Accord was the productivity/superannuation deal. Starting from late 1985 employers were required to contribute 3% of wages for employees covered by awards, in lieu of a national wage increase of 4% due to alleged productivity of the work-force. The importance of the continuance of the Accord is obvious from the length of the domestic airline pilots strike, in its eighth week at the time of writing; the Government thinks that to give in to the pilots would spell the end of the Accord.

Major economic indicators are as follows:

	Increase in	
Year	Consumer Price Index June/June	Average Weekly Earnings May/May
1987	9.3%	5.7%
1988	7.1%	6.3%
1989	7.6%	7.3%

At 31 May 1989 the average weekly total earnings for all employees were A$442.20.

Interest rates have moved up significantly this year and are currently 17% for short-dated paper and for home

mortgages, with an inverse yield curve down to 13.5% for long term bonds. These are politically unacceptable rates but there is no sign of relief.

Exchange rates are floating. The extent of the movement that can occur is indicated by the following rounded figures:

	Date in 1989	AUD/USD (A$/US$)	AUD/GBP (A$/£ Stg)
	1 January	0.86	0.47
	30 September	0.78	0.48
Highest	2 February	0.89	0.51
Lowest	30 May	0.74	
	31 July		0.45

Notable features of the above figures are the opposite directions of movements between currencies in the first nine months of this year, and the greater movement in the exchange rate relative to the US dollar. The margin between the highest and lowest exchange rates between sterling and the Australian dollar was 13% compared with a maximum swing of 21% for the greenback.

3. Australian Social Security

Flat rate pensions are payable from age 65 for men and 60 for women to those eligible. The full rates from June 1989 are A$129.20 per week for single persons and A$215.40 for a married couple. Residential qualifications apply as does a means test based on assets or income. The income and assets tests are applied separately and

whichever produces the lower level of pension is adopted. The pension ceases when weekly income exceeds A$298.40 (single) or A$500.80 (couple). A less stringent income test applies to those over 70. The pension also ceases when assets exceed A$160,600 for home owners or A$229,100 for non home owners (A$244,700 and A$313,200 respectively for married couples). Age 70 is not a determining factor for the assets test.

Pensioners with limited means are eligible for valuable fringe benefits such as concessionary fares on public transport and reductions in telephone charges, land tax and local council rates.

A pension is payable at the same rate as the age pension to a widow in certain circumstances - age over 50, or having a dependent child, for example - and subject to similar income and asset tests.

The same benefit and means tests apply to the Social Security invalidity pension.

The national health scheme is compulsory and financed through a tax levy of 1.25% of wages, unless the annual income is below A$10,300 (single person) or A$17,360 (married couples). The scheme, "Medicare", provides a rebate of 85% of scheduled fees for medical and surgical services, plus basic hospital accommodation. Supplementation by registered private health insurance funds is permitted.

4. Occupational Superannuation

The last National Report was written after the Treasurer's Economic Statement of 25 May 1988 and included its major announcements. In summary these were

* the introduction of a tax on investment earnings (including realised capital gains) of superannuation funds

* imputation credits on dividends from Australian shares

* a tax on deductible contributions going into a fund, with a corresponding reduction in tax on benefits

* and a revision of the requirements for limiting retirement benefits.

The proposals sounded simple, but to encompass them in legislation took more than a year. A special sitting of Federal Parliament was required to pass the legislation by the end of the financial year, 30 June 1989. However the Treasurer's Budget in August this year contained **further** significant changes to these provisions, and a concurrent paper was released by the Department of Social Security: "Better Incomes: Retirement Income Policy into the Next Century".

The Treasurer also announced in the Budget his support for an extension of award based superannuation as part of the wage system for the next financial year, i.e., another 3% contribution to superannuation funds in lieu of a pay rise, next year.

Benefit adjustments

The contribution tax imposed following the May 1988 Statement had an automatic effect on benefits emerging from defined contribution schemes. It was expected by superannuation professionals that defined benefit schemes would be amended to reduce the rate of benefit accrual by 17.6% of the employer-financed portion, because of the 15% tax on employer contributions. However, reductions have been rare. Two main reasons are given by plan sponsors: the current state of surplus of such schemes, and the industrial relations difficulty in reducing benefits, whatever the justification.

Reasonable benefit limits

Prescribed limits on benefits have been a feature of Australian superannuation for many years. In the seventies and early eighties there was a complex structure which incorporated monetary limits which declined in relative terms at the higher salary levels. The structure was simplified in 1983 to a single maximum of 7 times FAS(3) irrespective of salary or service. This maximum applied at age 65, for lump sum schemes, whether defined benefit or defined contribution. For pension schemes the maximum benefit was 75% of FAS(3). Lower limits applied at retirement ages below 65. It was forbidden to pay benefits above the limits, and benefits from all superannuation funds had to be taken into account.

The 1988 May Statement reintroduced a diminishing scale

for the higher paid. Those retiring on high salaries will have their limit calculated in three tranches: the multiple of 7 applies to the lowest tranche (up to about 1.6 times average earnings), a multiple of 5 applies to the intermediate tranche (between about 1.6 and 3 times average earnings), and 3 times applies at the top. The tranche levels are indexed to AWE (average weekly earnings) with annual adjustments. Contributions by a retiring member that were not deducted from income for tax purposes are payable in addition.

FAS(3) has been replaced by HAS(3) - the highest average salary in any three consecutive years prior to retirement.

Another fundamental principle of Australian superannuation legislation is non-retrospectivity. There is thus a transition from the 7× at all salary levels to the 3-tier structure, on a pro-rata basis related to service before and after 1 July 1988.

Benefits up to these limits enjoy concessional tax treatment, the top marginal rate on benefits being 16.25%, including the Medicare levy. Excess benefits may now be paid, but they will be taxed at the top personal marginal tax rate of 50.25% (48.25% from 1 January 1990), of which 1.25% is the Medicare levy. Benefits from concurrent and preceding funds are amalgamated for tax purposes, and the responsibility for advising the tax office of grouping rests with a new central registry that is about to be set up.

Maximum contributions

The benefit limit provisions have been accompanied by strictures on contributions. Until recently the rules have been complex. The August 1989 announcements included a significant simplification. The new maximum contribution involves first, calculating the pro-rata (based on service) "accrued" maximum benefit five years ahead. From this is deducted todays assets at market value, with an allowance for members contributions that have not been deducted for tax. The balance is then divided by five and grossed up by 1/0.85 for tax to arrive at the maximum annual deductible contribution. Additions are permitted for costs of insurance and administration. For defined benefit schemes the limit is applied to the membership as a whole; for defined contribution schemes it is applied to each member.

Employee contributions are by and large non-deductible. The maximum amount deductible from 1 July 1990 is A$3000 per annum, which applies only if the employer contribution rate is less than or equal to 4% of pay. The monetary limit decreases in even steps of A$500 for every 0.5% of employer subsidy above 4%, to reach zero for subsidies greater than 6.5%.

Trend to pensions?

Retirement benefits in Australia are predominantly lump sums. In the recent announcements there is financial encouragement towards pension benefits. The enticement applies if half or more of the total value of retirement

benefit is taken in pension form. The inducement may not be sufficient to cause a mass change-over to pensions. Nevertheless it is a pointer to the direction of thinking in Canberra.

Preservation

Productivity benefits and any increase in benefit provisions introduced after 22 December 1986 must be preserved to retirement on or after age 55. The Treasurer has announced new vesting and preservation requirements in respect of employer-financed benefits accruing from 1 July 1995. The rate of vesting is stated to be not less than 10% per annum to reach 100% after 10 years. Many aspects of this need to be clarified, e.g., what are employer-financed benefits? From 2005 it is proposed that faster vesting will be required and benefits preserved to age 60 rather than 55. The year 2005 is a long way away, and governments are bound to change. However it is another pointer to current thinking of politicians. The principle of preservation is not opposed by the superannuation lobby, and the labour movement has been (surprisingly?) accepting.

Coverage

Arising from the "productivity" schemes, superannuation is currently estimated to cover in excess of 65% of the work-force. By the end of 1989 it is thought coverage will be 80%, as more and more awards incorporate the 3% contribution requirement.

Surplus

It is expected that rules requiring refunds to employers of excessive surplus may be introduced some time in the future. The Institute of Actuaries of Australia has been addressing the problem of determining what methods should be employed to measure surplus for this purpose, so that a sensible policy can be suggested to the legislators at the appropriate time.

Surplus can now be refunded to an employer if the scheme deed permits. There are of course tax implications. Surplus repaid is added to the employers taxable income, and until 1995 any surplus repaid would be deductible to the scheme in the calculation of its contributions tax and earnings tax. However such deductions will cease to be applicable to superannuation schemes after 1995.

Next 3%

The "productivity" or award superannuation has been of undoubted benefit to those in the work-force who previously did not enjoy superannuation coverage. However, the level of contribution of 3% of pay is obviously insufficient to provide adequate retirement benefits. It is not surprising therefore that trade union leaders are saying that over time they hope to see the contribution level rise to 12% or more.

For employers with adequate superannuation arrangements, the first 3% award requirement was a nuisance. Either separate contributions had to go into a "union" fund or

into an accumulation section of their own plan, or else benefits in the round had to be improved to a level corresponding to 3% extra contributions. Various types of improvement were made: enhanced vesting of employer contributions, higher retirement accrual rates, better death benefits, reduced employee contributions, or combinations of these.

If further wage/superannuation trade-offs are going to occur as part of the national wage fixing system, there is some misgiving about the impact on occupational superannuation. However the Treasurer appears to accept that those with adequate superannuation should be treated differently next time round.

5. Retirement Incomes Policy

The recently published "Cass Report" discusses the aging of the Australian population and the ways in which old age benefits can be provided. The conclusion is reached that the private sector has a larger part to play in this area in the long run.

Necessarily, this requires greater emphasis on coverage, vesting, preservation, and pension benefits instead of or in addition to lump sums on retirement.

6. Life Insurance

As mentioned in the previous National Report for Australia, the May 1988 Economic Statement affected the tax basis of life insurance companies too. Although the

details have yet to be seen, it is clear that most expenses will be deductible in future.

Life companies have been active in marketing single premium policies and superannuation products. As a result they have maintained their market share of the savings dollar over the last seven years whereas in the prior five years their position had slipped.

A number of life companies have changed hands in the last two years. British and local companies have been the acquirers in general, whilst almost all the American companies have pulled out of this territory. There is a general view that the number of companies operating here (57) is far too many for a country with a population of 16 million and that more rationalisation is bound to occur.

The Life Insurance Act is badly out of date. The supervisory authorities have stated that the industry, including the Institute of Actuaries, will be consulted in regard to its revision. A start has been made by actuaries in considering what the profession would regard as suitable requirements.

7. General Insurance

Although our last report indicated that much of the "long-tailed" business of private insurance companies has been taken over by Government-run compensation schemes, there has been a resurgence in interest in self insurance by major employers in some States. The reason is that the

levies for workers compensation insurance have climbed steeply and it is thought that self-insurance would be a more efficient and cost effective arrangement. Naturally, the consulting actuarial firms have major roles to play in preparing submissions and providing appropriate annual certificates for the self insured schemes.

Another source of consulting work in general insurance will emerge when ED43 comes into force. ED43 is an exposure draft of the accounting profession. In it they say that annual actuarial certification of all general insurance company accounts will be required.