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Ansett's Superannuation Fund: A Case Study in Insolvency

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Part 1: Introduction

How safe is our superannuation?

Many Australians rely on their superannuation savings to provide financial security in retirement. But when it comes time to retire, can we be sure that the money will be there? Does our superannuation legislation provide adequate protection for members' benefits?

The collapse of Ansett Airlines indicates that there are some loopholes in our legislation.

Ansett Airlines was one of the two largest domestic airlines operating in Australia, with about 16,000 employees. The employees belonged to one of five staff superannuation funds; some funds offered accumulation benefits, some offered defined benefits.

In 2001, the company fell into financial difficulties. As the situation deteriorated, it became clear that the defined benefit superannuation funds did not have sufficient assets to provide the benefits promised to the employees. The shortfall is estimated to be between $150 million and $200 million.

At the time of writing, members of one Ansett fund have received just 70% of their resignation benefit. Many of them were entitled to retrenchment benefits which were considerably higher than the resignation benefit, increasing the magnitude of the shortfall.

It is possible that they will receive additional payments in the future date – the benefit will ultimately depend on the outcome of a court case which is currently under appeal.

How could this problem arise? Shouldn't the legislation protect members from such losses? Is Ansett an isolated incident, or could the same problems affect other defined benefit funds?

It is worth noting that at present, many defined benefit funds are underfunded (Deloitte, 2002; Lampe 2003). During the 1990s, many employers reduced contributions (and even took contribution holidays) and allowed funding levels to fall. Then funds were hit by a downturn in financial markets. Many funds had negative returns on investments in the financial year ending 30 June 2002, and returns are still poor in the current financial year. APRA has recently expressed concern about the levels of funding, urging trustees and actuaries to monitor the situation closely and take action to increase funding levels (APRA, 2002).

This aim of this case study is to describe:

- the legislative background in relation to solvency of defined benefit funds
- Ansett's superannuation arrangements
- the deterioration of the financial status of the fund in 2001/2002
- the issues arising from the court case, whereby the trustees sought to claim additional funds from the administrator

and then to assess the effectiveness of our legislation in protecting members' benefits.

Part 2 : Legislative Background

2.1 Introduction to Solvency Standards

Ansett's superannuation funds are regulated under the Superannuation Industry (Supervision) Act 1993 (known as SIS). What are the SIS rules in relation to the solvency of a defined benefit fund?

The SIS legislation has a multi-level solvency approach.[1]

Firstly, the fund must have enough assets to cover the payment of the Minimum Requisite Benefits (MRBs). The MRB is the minimum benefit which must be provided by the employer under the SIS legislation. A fund which has enough assets to cover these minimum benefits is called *technically solvent*, and details are given in Section 2.1 below. Funds must strive to maintain technical solvency: if the fund fails this test, the trustees might be required to wind up the fund.

Secondly, the fund should have enough money to pay the benefits specified in the Trust Deed, assuming that everyone voluntarily resigned from the fund tomorrow. This is known as the **Vested Benefit**. It is the resignation benefit for younger members, or the early retirement benefit for older members (who have attained the minimum age for early retirement defined in the Trust Deed).

The benefits promised in the Trust Deed may well be higher than the minimum amount required by law. That is, Vested Benefits may exceed MRBs. The employers may provide these additional benefits voluntarily (in order to attract and retain staff); alternatively they might result from negotiation with employees. In either case they may be regarded as part of the employee's remuneration package.

Under the SIS regulation, if a fund does not have enough money to cover Vested Benefits, then the fund is in *an unsatisfactory financial position.* Section 2.2 explains the consequences for a fund which is in an unsatisfactory financial condition.

Thirdly, we might check to see whether the fund has enough money to cover the benefits payable under the Trust Deed, assuming that all members were retrenched tomorrow. In some funds, the benefit payable on retrenchment is higher than the resignation benefit, so a fund might be in a satisfactory financial position[2] (according to SIS) but still be unable to pay its retrenchment benefits. Section 2.3 explains the consequences for a fund which does not cover its retrenchment benefits.

[1] Note that the rules are rather technical. This is a simplified explanation.

[2] We shall use the term "satisfactory financial position" to mean that a fund is not in an unsatisfactory financial position as defined in the SIS legislation.

Finally, we can look at the long-term prospects for the fund. Suppose that all the employees continue to work for the company until retirement age. Would the fund have enough money to pay their retirement benefits? The proportion of the retirement benefit "earned" by service up to the present is called the A*ccrued Retirement Benefits.* For example, suppose that the retirement benefit is calculated as 15% of Final Average Salary for each year of service up to age 65. The accrued retirement benefit might be calculated as 15% of salary at present, multiplied by the number of years of service which have already been completed (Professional Standard 402 of the Institute of Actuaries of Australia explains how to calculate the Accrued Retirement Benefit).

Under SIS, the trustees must obtain an actuarial review at least once every three years. The actuary's report will contain a valuation of the Accrued Retirement Benefits. The actuary will usually recommend contribution rates sufficient to ensure that retirement benefits are fully funded before retirement (as required by IAAust Professional Standard 400).

Funds often provide death and disability benefits as well as resignation and retirement benefits. These are often provided by group insurance policies. In the triennial review, the actuary will usually comment on the adequacy of insurance arrangements.

2.2 Minimum Requisite Benefits and Technical Solvency

In order to understand these rules, we must look back to 1992, when the government introduced the Superannuation Guarantee Charge (SGC). Under the SGC rules, employers must make superannuation contributions to a complying fund on behalf of most of their employees[3]. An employer who does not make contributions at the required level is required to pay additional taxes.

If the employer chooses to pay the SG contributions into an accumulation fund, then the required contribution is 9% of earnings[4]. This benefit must be fully vested. That is, when a member leaves the fund for any reason, he/she must be paid an amount which is not less than the legally-defined *minimum benefit*. This minimum benefit is equal to the member's own contributions plus the employer's compulsory contributions, accumulated with interest, less tax, insurance costs, and expense charges.

Alternatively, the employer can pay the SG contributions into a defined benefit fund. In this case, the determination of the SG contribution rate is more complex.

[3] There are some exceptions, e.g. part time workers under age 18, workers earning less than $450 per month, etc.

[4] The SG system was phased in over a decade from 1992 to 2002. The contribution rate was initially set at 3% for small employers and 4% for large employers, but the rate increased over the years. The current rate is 9%. The SIS legislation also defines the notional earnings base for calculation of the contributions.

Firstly, the defined benefit fund must specify a *Minimum Requisite Benefit* (MRB) which is the minimum amount payable when any member exits the fund for any reason. For a member who joined after 1/7/92, this benefit should be approximately equal to the minimum benefit in an accumulation fund (as defined above)[5]. However there is some flexibility in the method of calculation: for example the benefit may be calculated as x% of final average salary multiplied by years of service, as long as this gives roughly the same value.[6] This flexible approach made it much easier for defined benefit funds which were established before 1992 to adapt their existing rules to meet SG requirements.

The actuary then calculates the *Notional Employer Contribution Rate* (NECR). This is the average expected long term cost to the employer of providing the Minimum Requisite Benefit. If the Notional Employer Contribution Rate is greater than or equal to 9% of earnings, then this satisfies the SG requirements and the employer does not have to pay any additional taxes. The actuary produces a *Benefit Certificate* which defines the MRB and certifies the NECR.

Under the SIS Regulations, a fund is considered to be *technically solvent* if the value of the assets available to pay members' benefits[7] exceeds the total value of the Funded Minimum Requisite Benefits.

Is this a satisfactory standard for solvency?

There are a number of weaknesses in this standard.

Firstly, most members would expect to get an amount at least equal to the resignation benefits described in the Trust Deed. This is the amount shown on the annual member benefit statement, and it is the benefit described in the members' booklet. But the MRB may be much lower than the vested benefits.

This discrepancy may result from the phased-in introduction of the Superannuation Guarantee Charge. Initially, in 1992, the SG contribution rate was set at a very low level, only 3% (for small employers) or 4% (for large employers). The rate has gradually increased over time. So the Minimum Requisite Benefit also started at a low level, and is gradually increasing.

As an example, consider a member who started on 1 July 1992 on a salary of $20,000. Assuming an interest rate of 5% per annum, their MRB would be approximately $16,200 as at 1 July 2003.

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[5] Transitional rules apply to employees who started work before 1/7/92

[6] The Superannuation Guarantee (Administration) Regulations set out the rules for determining MRBs and NECRs. The IAAust gives guidance to actuaries to help determine the MRB, see IAAUST Guidance Note 456.

[7] The value of available assets is the market value of assets, less the costs of realisation, less assets set aside to pay benefits for former members of the fund (e.g. employees who have left service but have not yet been paid their benefits). (SIS Regulations 9.15)

If the employer was contributing at 9% per annum throughout, and these contributions were fully vested, then the Vested Benefit would be approximately $25,570 as at 1 July 2003.

In this case the MRB is only about 63% of the Vested Benefit. Of course the numbers would vary from one fund to the next, depending on fund rules, membership turnover, etc.

Comparison of MRB and Vested Benefit for a Hypothetical Employee starting 1 July 1992 with a salary of $20,000 per annum

Period	SG Contribution				Employer 9% Accrual			
ending	Rate	Contribution	Accumulation		Rate	Contribution	Accumulation	
30 June 1993	3%	$ 600	$	600	9%	$ 1,800	$	1,800
30 June 1994	3%	$ 600	$	1,230	9%	$ 1,800	$	3,690
30 June 1995	4%	$ 800	$	2,092	9%	$ 1,800	$	5,675
30 June 1996	5%	$ 1,000	$	3,196	9%	$ 1,800	$	7,758
30 June 1997	6%	$ 1,200	$	4,556	9%	$ 1,800	$	9,946
30 June 1998	6%	$ 1,200	$	5,984	9%	$ 1,800	$	12,243
30 June 1999	7%	$ 1,400	$	7,683	9%	$ 1,800	$	14,656
30 June 2000	7%	$ 1,400	$	9,467	9%	$ 1,800	$	17,188
30 June 2001	8%	$ 1,600	$	11,540	9%	$ 1,800	$	19,848
30 June 2002	8%	$ 1,600	$	13,717	9%	$ 1,800	$	22,640
30 June 2003	9%	$ 1,800	$	16,203	9%	$ 1,800	$	25,572

The SIS solvency standards require the fund to have enough money to cover the Minimum Requisite Benefits, i.e. $16,200. A fund which meets this standard is "solvent" according to the SIS rules.

Even if a fund is "solvent", this does NOT guarantee that the fund could pay the resignation benefits promised in the Trust Deed. If the entire workforce resigned, then the fund would not have enough money to cover the total resignation benefits due to members.

This is, to some extent, a transitional problem. The SG minimum contribution is now 9%, and will remain at this level. So the MRBs will gradually increase over time. Hence the difference between the MRB and the Vested Benefit should gradually reduce (although it may never disappear, if the fund offers benefits which exceed the minimum SG requirements).

As we shall see, in the Ansett Fund, the MRB was considerably below the level of Vested Benefits. The level of assets was more than enough to cover the MRBs at all times, and hence it was technically solvent under SIS – even though the assets were, at times, below the level of Vested Benefits.

Secondly, some funds may be considered to be technically solvent, even if they do not have enough money to cover the MRB. When the solvency standards were first introduced in 1992, some defined benefit funds had a deficit. The government decided to allow the funds some time to catch up on the shortfall. Therefore the legislation has some transitional provisions. However, with the passage of time, these deficiencies should disappear.

Thirdly, the standards do not require the superannuation funds to be solvent **at all times**. Even if a fund is technically solvent now, there is no guarantee that it will remain solvent in the future.

The future solvency of the fund depends on the adequacy of the contributions paid by the employer in the future. Consider a fund which is "just solvent". In order to ensure that the fund assets remain above the level of the MRBs, the contributions during the next period must cover

- the benefits which will accrue in the next period,
- the excess value of benefits paid, where these exceed the minimum benefits,
- **and** any shortfalls which may arise as a result of adverse experience (such as investment losses).

In order to determine the appropriate contribution rate, the fund must obtain actuarial advice. Under SIS, the trustees of the fund are required to obtain a *Funding and Solvency Certificate* from an actuary. [8]

In the Funding and Solvency Certificate, the actuary must state:

- Whether the fund is technically solvent at the calculation date
- The minimum level of employer contributions reasonably expected to be required to secure the solvency of the fund on the expiry date of the certificate
- Any events which may occur during the period of the certificate which would have a significantly adverse effect on the fund's solvency (*Notifiable Events*).

The Funding and Solvency Certificate specifies a minimum contribution rate for the employer. Under the SIS regulations, the employer must pay contributions not less than the minimum amount specified. (SIS Reg 9.08(2))

Note that the SIS legislation does NOT require that the fund should remain solvent <u>at all times.</u> The aim is to secure the solvency of the fund "*at the expiry date of the certificate*". The expiry date may be anywhere from one year to five years in the future, at the discretion of the actuary. Usually, if the actuary is concerned about the solvency of the fund, he would issue a one year certificate – this would ensure that the fund is reviewed annually. A fund which has a large surplus might get a five-year certificate.

The solvency of the fund may vary up and down over the intervening period; from time to time assets might fall below the total value of the MRBs.

This was a matter of some controversy when the SIS standards were introduced. (Duval, 1992; IAAust SPC 1992; IAAust SPC 1993). The government wanted a "continuously solvent" requirement; however the IAAust argued that this would be too onerous. If the actuary was required to certify that the fund would be continuously solvent, then the fund would be required to keep a "buffer" of extra assets to cover any temporary fluctuations in market value. This would cause difficulties for some defined benefit funds which were underfunded. It would impose extra costs on the employer. Over the longer term, it might discourage employers from investing in more volatile assets (such as shares) – this was also considered to be undesirable.

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[8] Part 9 of the SIS regulations describes the rules in respect of Funding and Solvency Certificates.

So the legislation does NOT require funds to keep a buffer of assets to cover the possibility of adverse investment returns.

Similarly, the actuary is NOT required to set contributions on the basis of conservative or worst-case assumptions about future experience. When the experience of the fund is worse than expected by the actuary, the fund may easily become insolvent.

The following description is a simplified example of the process of setting the minimum contribution rate for a Funding and Solvency Certificate. (Actuaries can tell you that it is much more complicated than this in practice, but we aim here to explain the basic concept, not the intricacies that may arise in professional practice. The Institute of Actuaries of Australia has issued a Guidance Note, GN461, which describes the principles that should be adopted).

Firstly the actuary will project the assets of the fund up to the date of expiry of the certificate (we will assume a one-year certificate is to be issued)

Assets at the start of the year
\+ expected investment income
\+ expected contribution income from members and employers
\- expected benefit payments
\- administration expenses
\- taxes
\- insurance premiums for death and disability costs
\+ insurance claims for deaths and disablements
= Expected assets at the end of the year

Then the actuary would estimate the total Minimum Requisite Benefits as at the expiry date. Depending on the formula used to calculate the MRBs, this might require estimates of future salary increases and staff turnover rates.

The actuary would then work out the contributions required to ensure that the Expected Value of Assets exceeds the Expected Value of total MRBs. This would be the minimum rate of contribution which the actuary might recommend.

Clearly, the level of contributions depends on the assumptions made by the actuary, as to future investment returns, number of exits, salary increases and so on. Although actuaries are generally considered to be conservative by nature, there is no requirement for the actuary to adopt conservative assumptions for these purposes: the actuary is not required to "allow for the worst". The SIS legislation specifically states that the minimum contribution should be based on "*reasonable expectations*".

The IAAust Guidance Note suggests that actuaries should usually use "best estimate assumptions". They suggest that:

> *"This reflects the need to provide proper estimation of the required contributions, rather than make overly conservative assumptions which may result in overfunding by the employer." (IAAust GN 461, 1994)*

The actuary can make more conservative assumptions, as long as he has discussed this with the employer and the employer is prepared to make additional contributions (and indeed this was discussed in relation to the Ansett fund, as explained below).

Even when the actuary makes perfectly reasonable assumptions, there is no guarantee that the recommended contribution will be adequate to maintain solvency.

To understand what happened at Ansett, let's do a simplified example.

Suppose that the MRB is \$1000 for each employee, and there are ten members in the fund, so that the total MRB is \$10,000. Suppose that the fund is just solvent, i.e. assets are \$10,000.

Suppose that actuary believes that investment returns will be 6% per annum and the MRBs will increase by 10% in the next year, to \$1100 per member. He expects that two members will leave during the year and take their resignation benefits of \$1200 each (Note that the vested benefit is slightly higher than the MRB)

The calculation will be

Assets at start of year = 10,000
Investment income = 600
Benefits Paid = 2,400
Assets at end of period (ignoring contribution income) = \$8,200

Total MRBs for eight members at \$1100 each = \$8,800

This would suggest that the minimum contribution is \$600.

If all goes as planned, and the employer pays the minimum contribution of \$600, the fund will still be solvent at year-end.

Now suppose that things don't work out exactly as expected. Suppose that the investment income is 0% and four members resign.

The calculation will be

Assets at start of year = 10,000
Investment income = 0
Benefits Paid = 4,800
Assets at end of period (ignoring contribution income) = \$5,200

Total MRBs for six members at \$1100 each = \$6,600

If the employer pays the minimum contribution calculated previously, i.e. \$600, the fund will still have a severe shortfall at year-end, amounting to \$800. The fund will be technically insolvent. If the fund is wound up, the remaining members would get less than 90% of their MRB (and only about 80% of their vested resignation benefit).

Of course, when the SIS legislation was first developed, the regulators realised that the fund's experience might not match the actuary's assumptions, and adverse experience might endanger the solvency of the fund. They allowed for this problem by introducing the concept of *Notifiable Events.*

Notifiable Events

Basically, a Notifiable Event is an event which might "have a significant adverse effect on the fund's financial position" (IAAuut GN 461, para 1.6.1). When completing the Funding and Solvency Certificate, the actuary must specify a list of Notifiable Events. If such an event occurs, the Funding and Solvency Certificate is automatically cancelled, and the actuary must review the solvency of the fund.

The IAAust Guidance Note (IAAust GN 461) lists a number of events which the actuary should consider when preparing his list of Notifiable Events, including

- significant numbers of early retirements;
- significant numbers of retrenchments;
- significant numbers of withdrawals in a fund where the assets are less than the vested benefits;
- significant salary increases (which might increase the MRBs);
- a significant investment loss;
- an increase in benefits.

Even if none of the listed events have occurred, the actuary can withdraw his Certificate at any time.

The Funding and Solvency Certificate will also lapse if the employer fails to pay the minimum contributions specified by the actuary.

When a Notifiable Event occurs, the trustees must ask the actuary to review the financial status of the fund and issue a new Funding and Solvency Certificate within three months. Of course, the new Funding and Solvency Certificate might specify a higher rate of employer contributions to cover the deterioration in the financial position of the fund.

As we shall see, this is exactly what happened to an Ansett superannuation fund in 2001/ 2002. In 2001, the Ansett Ground Staff Superannuation Fund had both investment losses and a significant number of retrenchments. The actuary subsequently withdrew his certificate and issued a new Funding and Solvency Certificate requiring a higher level of contributions. Unfortunately, the administrators of Ansett declined to pay the extra contributions.

2.3 Vested Benefits and an Unsatisfactory Financial Condition

Under the SIS rules, a fund is considered to be solvent as long as the fund assets cover the minimum benefits required under the SIS legislation. However, the Trust Deed might specify benefits which are higher than the SIS minimum. The Vested Benefit is the benefit payable under the rules of the Trust Deed, to a member who voluntarily leaves service.

Why would an employer provide benefits that exceed the legal minimum? The employers may provide these additional benefits voluntarily (in order to attract and retain staff); alternatively they might result from industrial relations negotiations with employees. In either case they may be regarded as part of the employee's remuneration package.

Since the Vested Benefits often exceed the MRBs, a fund may be technically solvent, even when it does not have enough money to cover the Vested Benefits.

The SIS legislation does recognise that this is an undesirable situation. Using the SIS terminology, the fund is in "*an unsatisfactory financial condition*".

If an actuary or auditor discovers that a fund is in an unsatisfactory financial condition, then he/she must inform the trustees in writing (S130 of SIS).[9] [10] The trustees must provide a written report to the actuary, describing the action which the trustee intends to take to deal with the matter. If the trustee does not respond, or actuary or auditor is not satisfied with the trustee's response, then the actuary or auditor must report the matter to APRA.

Note that this gives considerable discretion to the actuary, to determine what action is satisfactory under the circumstances. The Institute of Actuaries of Australia has published a Guidance Note (IAAust GN 460) to help actuaries interpret this requirement.

The Guidance Note states that:

> *"Provided that the trustees have acknowledged the actuary's advice in the specified period, the lack of any other action by the trustees does not necessarily mean that the actuary must report the matter to the Commissioner. There may be circumstances, left to the actuary's professional judgement, where the absence of any action by the trustees, other than acknowledging the actuary's advice, is acceptable. For example, the legislation does not specify a period over which a satisfactory financial position must be achieved. In any case a program to return the fund to a satisfactory financial position over an acceptable period may be already in place." (para 9.4)*

> *"However, while the legislation and this Guidance Note do not require action to be taken to return the fund to a "satisfactory financial position" (as defined) over a particular period of time, in usual circumstances the actuary would take action to improve the financial position over a period of time reasonable to the fund's and, where appropriate, the employer's circumstances." (Para 9.5)*

Different actuaries have different views on what is "reasonable". Some actuaries might strongly encourage the employer-sponsor to make additional contributions in order to cover the deficiency as quickly as possible (e.g. within one year). Others may be more lenient and allow a longer period – 3 years or 5 years - to make up any shortfall.

[9] The actuary must inform the trustees if he thinks that the fund is currently in an unsatisfactory financial position, OR the financial position of the fund is likely to become unsatisfactory (S130). When performing an actuarial review of the fund, the actuary will usually make financial projections three years ahead, as per SIS regulation 9.31.

[10] S130 only applies if the actuary or auditor forms an opinion while performing an actuarial or audit function under the Act. See IAAust Guidance Note 460 for interpretation of this requirement.

The situation is exacerbated if the employer is in financial difficulties. On the one hand, this increases the risk to the employees: if the employer becomes insolvent, and the employees lose their jobs, it is quite likely that the notional shortfall will be crystallised. On the other hand, if the employer is forced to make additional contributions, then it may put the company under increased financial pressure, and may even precipitate insolvency. Of course, this might not be in the best interests of the members.

According to a recent article in Superfunds (Davis, 2003):

> *While the regulator will not necessarily allow five years for a sponsor to fix a funding problems, precise guidelines are difficult to establish. "We need to do it sensitively and to recognise that not everyone will be paid tomorrow," (APRA's general manager) Vankatrami says.*
>
> *Although understandable, the lack of precision causes difficulties for DB fund actuaries and auditors in interpreting their obligation to inform APRA is they were not satisfied the sponsoring employer has an adequate funding plan in place......*
>
> *The DB issue is creating real dilemmas for actuaries and auditors. According to [Mercer executive director of consulting] John Newman, APRA is arguing that if the actuary and auditor take the view that the fund can be restored over a period of more than 12 months, they are taking a view about the long term solvency of the fund sponsor. If the sponsor fails leaving a deficiency in the fund, this would create possible liabilities for the auditor and actuary. Newman says that Mercer's rejects APRA's view in this issue.*

However, the actuary cannot compel the employer to make any contributions: he merely recommends. If the employer chooses to ignore this advice, the actuary might "blow the whistle" and report the matter to APRA.

But even if the actuary reports the fund to APRA, it is not clear what action APRA could take to rectify the matter. APRA does not have the power to force the employer to make additional contributions to a fund which is "technically solvent".

How widespread is the problem?

How many funds are in an unsatisfactory financial position? And how large are the deficits?

This can be quite difficult to determine.

Financial market analysts are concerned about the level of deficits in superannuation funds, because of the effect on the employer-sponsor. If the employer-sponsor is required to make extra contributions to cover the deficit, this may drain profits and depress the share price (Oldfield, 2002). But according to newspaper reports, analysts are finding it difficult to assess the risks:

- some companies do not disclose enough information
- some companies use optimistic forecasts in valuing their liabilities; and
- some of the actuarial reviews are out-of-date (up to three years old).

(Oldfield and Buffini, 2002)

According to a recent survey by APRA, many superannuation funds are underfunded. APRA surveyed 370 funds, and found only one fund which was technically insolvent. But they found that many funds were in an unsatisfactory financial position. A survey by Deloitte Touche Tomatsu also revealed that about 20% of funds surveyed had assets below the level of vested benefits (Deloitte Touche Tomatsu, 2002).

Although APRA can (and does) *encourage* employers to improve the level of funding, the employers are not *required* to take action.

In September 2002, APRA issued a guidance not to auditors, actuaries, and trustess (APRA, 2002), which said that:

> *APRA does not expect a knee-jerk reaction from trustees/actuaries based solely on recent market volatility, as investment is a long term process and actuarial assumptions should take into account the long term sustainable earnings. On the other hand, action will be required to be fast tracked where individual fund / employer situations warrant.*
>
> *Where solvency deficits are identified, employers should be willing and able to increase contributions – especially where funding margins are tight. APRA believes that fund that took advantage of good times to minimise contributions should recognise that the reverse applies when markets downturn."*

But APRA does not have the power to compel employers to make additional contributions. As the Sydney Morning Herald reported (Lampe, March 28, 2003)

> *"APRA can regulate for provision of only minimum benefits, which roughly include employer and employee contributions, plus earnings, plus rollovers, less taxes and expenses. On that measurement, all but one fund were fully covered by assets.*
>
> *But if discretionary higher benefits due to members are taken into account – where the employer contributes more than 9% of pay to boost minimum legislated benefits – a significant number of funds were found not to have sufficient assets to pay out expected benefits to all. In some cases the Vested Benefit Index was down to 60%.*
>
> *Mr Venkatramani (APRA's general manager) stressed that APRA has the power only to ensure that there is adequate solvency for the minimum benefit requirement.*
>
> *Discussions have been conducted with employers providing higher benefits whose solvency levels are running low, to encourage them to contribute more....The affected funds have been told by APRA that they are under a heightened level of supervision until their asset position improves.*
>
> *But while it encourages fund trustees and employers to pursue full restoration funding to more appropriate levels, it has no statutory power to enforce this."*

Is this acceptable? For most companies, the fact that the fund is in an "unsatisfactory financial position" may never cause a problem. As long as the company remains in business, as long as the employees keep their jobs, the notional shortfall does not crystallise. Over the next few years, investment returns may improve, and employers may make additional contributions – the shortfalls may well disappear.

Problems will only arise when the company becomes insolvent, the fund winds up, and benefits become payable.

Clearly, the SIS definition of solvency is a fairly weak definition, since it only protects the SIS minimum benefits, not the benefits promised in the Trust Deed. A number of alternative (stronger) definitions of solvency were considered when the SIS legislation was proposed, but the government decided against requiring a higher level of protection. Some argued that benefits above the SIS minimum were voluntarily provided by the employers – if the solvency standards were too strict, then the employers would be reluctant to offer these additional benefits.

When the solvency standards were first proposed, the Government Actuary affirmed that:

> *"The solvency certificate relates only to the compulsorily provided superannuation benefits. It is appropriate that these be given a higher degree of protection than that assured to the voluntarily provided benefits." (Duval, 1992)*

2.4 Retrenchment Benefits and Actuarial Reviews

In many cases, superannuation funds provide additional benefits for retrenched members. The Retrenchment Benefit might be even higher than the Vested Benefit.

If the MRB is much lower than the retrenchment benefit, and the employer sponsor retrenches a large number of members, this could produce a very dismal outcome. If the entire workforce was retrenched and the fund was closed, a fund which was technically solvent would not have enough money to pay the retrenchment benefits which members are expecting.

If the retrenchments occur slowly, over an extended period, the fund might face the "last man out" problem. Returning to our example above: suppose that the investment income is 0% and six members are retrenched. Suppose that retrenchment benefit is $1300 per person, compared to the vested benefit of $1200 and the MRB of $1100.

The calculation will be

Assets at start of year = 10,000
Investment income = 0
Benefits Paid = 7,800
Assets at end of period (ignoring contribution income) = $2,200

Total MRBs for four members at $1100 each = $4,400

If the employer pays the minimum contribution calculated previously, i.e. $600, the fund still have a severe shortfall at year-end. The fund will be technically insolvent. If the fund is wound up, the remaining members would get just 50% of their MRB, which is equivalent to just 42% of the retrenchment benefit which they expected to receive. In contrast, the members who were retrenched early would have received their full retrenchment benefit. Clearly, the last members to be retrenched are severely disadvantaged.

If the trustees pay the full retrenchment benefits to those who are the first to be retrenched, then the solvency position will deteriorate rapidly. There may be very little – or nothing – left when the last few members are retrenched. This is very unfair, since the shortfall falls most heavily on just a few unfortunate employees. The trustees may try to ensure that the shortfall is distributed more evenly, by reducing benefits for all members, as soon as it appears likely that the fund will be unable to pay the full benefits. This may, or may not, be possible under the Trust Deed.

The SIS Act does not require any action to be taken to ensure that the fund has enough money to pay retrenchment benefits.

Under IAAust professional standards, the actuary must report on the ratio of assets to total retrenchment benefits (IAAust PS400 paragraph 38). However, this report is sent to the trustees, not the members. The members of the fund might never see this actuarial report, and remain unaware of the shortfall. (SIS disclosure requirements are discussed in more detail below).

In the June 2000 review of the Ansett Ground Staff Superannuation Fund, the actuary noted that the assets were about $84 million less than the total of the retrenchment benefits. It is doubtful whether the members were aware of this fact at the time.

Part 3: Ansett's Superannuation Arrangements

Ansett ran five different superannuation plans for its employees:
- the Ground Staff Plan;
- the Pilot Management Plan;
- the Ansett Australia Flight Attendants Benefit Plan ;
- the Ansett Australia Pilots Accumulation Plan;
- and the Ansett Australia Flight Engineers Superannuation Plan.

All employees were required to belong to one or more of these funds – employees who were not eligible to join any of the other plans were required to join the Ground Staff Plan.

The case study deals only with the Ground Staff Plan, which was the subject of the court case described below. Some of the other funds also have a deficit.

Ansett's Obligations According to the Trust Deed of the Ground Staff Plan

For most members, the Ground Staff Plan provided defined benefits. [11]

The fund provided benefits on retirement, resignation, death, disability, or retrenchment. The details of the rules are rather complicated, resulting from transitional provisions designed to allow for transfers in from an earlier scheme which existed prior to 1987.

For the purposes of this case study, the details of the benefits are not important. We simply note that:
- The Vested Benefits were always greater than or equal to the MRBs;
- The Retrenchment Benefits were always greater than or equal to the Vested Benefits.

Based on the actuarial data as at 30 June 2000, the retrenchment benefits were about 17% higher than the vested benefits:

Total Vested Benefits	$584 million
Total Retrenchment Benefits	$683 million

The benefits were to be funded by both employer and employee contributions.

The members paid contributions at the rate of 5% of salary. [12] Ansett was required to pay the contributions as specified under the Trust Deed.

[11] There was also an accumulation section of the scheme. This covered a small number of members from a pre-existing scheme, who had elected to remain in their accumulation scheme instead of transferring into the defined benefit scheme. Casuals and temporary employees were also covered by the accumulation scheme. Any member was entitled to make additional voluntary contributions or to roll over benefits from another fund – these were invested in the accumulation section.

[12] They were entitled to make additional voluntary contributions as well. The voluntary contributions and rollovers into the fund were simply held in an accumulation account and the balance was paid out at exit

How were Ansett's contributions to be determined?

According to the Trust Deed, the employer contribution rate was based on the actuary's recommendations. The trustees were required by SIS to obtain an actuarial review at regular intervals not exceeding three years; in practice these reviews were carried out every two years. The actuary would then provide a report to the employer and the trustee, with a recommended contribution rate. The employer would then contribute at the rate specified by the actuary.

After the SIS legal minimum solvency rules were introduced, the Trust Deed was amended to ensure compliance with the law. Hence the Trust Deed states that "*Contributions by the Employer ...will not be less than is required by the solvency requirements under the Act"*. (Clause 4(4)). That is, the contributions would not be less than the amount specified in the most recent Funding and Solvency Certificate.

According to the Trust Deed, Ansett has the right to terminate its contributions to the Plan. The fund would then be closed to new members, and the trustees would allocate the assets among the members "*in such shares and proportions and in such manner as [the trustees] shall determine to be fair and equitable after considering the advice of the Actuary*" (Clause 20(1)).

Ansett's Obligations according to the Member Information Booklets

When new employees joined the fund, they were given a copy of the member booklet, which set out the fund rules in plain English. These booklets became very important later on, when deciding the extent of Ansett's obligation to cover any deficiencies in the superannuation fund. Ansett made a lot of promises in these booklets – the question was later raised: did the company have any legal obligation to keep the promises made in these booklets?

There were various versions of these rules.

In the pre-1995 versions, the booklet stated that

> *Ansett will pay the balance of the costs of providing the benefits [i.e. after the member pays 5% of Benefit Salary into the Plan].*

In the 1995 version, the booklet said:

> *How Much Does Ansett Pay Towards Your Superannuation ?...This will vary from time to time, but will always be an amount sufficient to provide you with the benefits promised by the plan.*

The 1995 version also included the following statement:

> *The Plan is a joint commitment between you and Ansett. Each year you pay the five percent we mentioned earlier and Ansett pays whatever amount is necessary to ensure that you receive the benefit promised to you.*

In the court case that followed, the judge stated that:

> *Given that membership of the Plan was a condition of employment for those employees of Ansett eligible to join the Plan, and that Booklets were issued, with the obvious approval of Ansett, containing a description of the benefits available under the Plan and promises by Ansett in relation to the provision of those benefits, the promises clearly formed part of the members' contract of employment with Ansett.*

The Fund's Obligation to Pay Retrenchment Benefits

The superannuation fund provided retrenchment benefits which exceeded the normal vested benefits.

Under the Trust Deed, "retrenchment" was defined as *"a reduction of staff declared by the employer for the purposes of these rules"*. This seems to imply that the employer had to make a formal "declaration" to the trustees. But as a matter of practice, whenever people were made redundant, the retrenchment benefit was paid, without any formal declaration.

The usual procedure was for Ansett to provide a "payroll termination advice" to the superannuation department. This would state the reason for the termination, e.g. resignation or retrenchment. The superannuation department would then fill in a form for the superannuation fund administrator, and the administrator would calculate the appropriate benefit and provide a cheque to the superannuation department. The cheque would then be forwarded to the member. This system had been in place for a number of years.

This arrangement was confirmed by the introduction of a "business recovery redundancy program" in November 1998. Ansett negotiated with the union to determine the terms and conditions of this redundancy program, and the results were included in a certified collective bargaining agreement. The agreement said that employees who were made redundant under this program would receive retrenchment benefits from the superannuation fund.

This system apparently remained in place until the administrators took over – but as we shall see the administrators attempted to change the process in order to limit the fund's liability. They wanted to pay the resignation benefit, instead of the retrenchment benefit, to the members who lost their jobs after the collapse of Ansett.

Part 4: What Happened at Ansett?

In this part we provide a chronological history of the events affecting the Ansett Ground Staff Superannuation Fund. The primary source of this information is the evidence presented to the Supreme Court of Victoria (Ansett Australia Ground Staff Superannuation Plan Pty Ltd and Another v Ansett Australia Ltd and Others [2002], VSC 576), the newsletters from trustees to members, and annual reports of the fund.

Actuarial reviews were conducted every two years. The most recent actuarial review (prior to the collapse) was conducted as at 30 June 2000. At that time the fund had 8,829 members, and the employer was contributing at 9% of salaries. The actuary sent the report to the trustees on 3 April 2001.[13]

The actuary's covering letter included the following statement:

> *The report recommends a continuation of current employer contributions. The Plan's assets covered its Vested Benefit liability (the amount payable on the voluntary withdrawal of all members) with a margin of 3% as at 30 June 2002, and covered its actuarial liability in respect of accrued benefits with a margin of 8%. Each of these shows a Plan in a sound financial condition....*

Clearly the fund was both technically solvent and in a satisfactory financial condition (as per the SIS definitions).

At about this time, there were concerns about Ansett's financial performance. The company was struggling in a very competitive market; the company was reporting major losses. In April 2001, some of the company's planes were grounded because of concerns about poor maintenance and inadequate compliance with safety standards. This attracted a great deal of adverse publicity.

Shortly afterwards, on 23 April 2001, the actuary wrote to the trustees, pointing out that the fund assets were insufficient to cover the total retrenchment benefits – the shortfall was about $84 million.

> *The total liability in respect of retrenchment benefits is, based on data supplied to me, $683.333M. This exceeds the amount of assets by $84.44M. This position is not unexpected, and need not be a matter of concern unless there is a reasonable prospect of the contingency arising where a significant retrenchment program will occur and the employer is unwilling or unable to finance the additional benefit liability. I suggest that the Trustee seek assurance from the employer, whenever a retrenchment program is initiated, that additional contributions will be made to cover the difference between (say) retrenchment benefits and Vested Withdrawal benefits for the affected members, unless actuarial advice indicates that such additional financing is not required.*

[13] Note that it may take several months to complete an actuarial review, so the delay is not out of the ordinary – the legislation allows 12 months (SIS 9.30(2))].

The actuary also provided a Funding and Solvency Certificate effective from 1 July 2001, expiring on 30 June 2005, verifying that the fund was technically solvent, and recommending a contribution rate of 9% of salaries.

By June 2001, the press was reporting that Ansett was facing formidable difficulties. There were warnings that Ansett might collapse, unless the company could raise additional capital. (Boyle, Sandilands, Koutsoukis, 2001)

The members were given the following information about solvency in the fund's annual report to members as at 30 June 2001.

> *The Plan Actuary carries out a review every two years to check the financial position of the Plan. At the last review (1 July 2000), the Actuary reported that the Plan was in a sound financial position and that members' current benefit entitlements were covered by the Plan's assets. The next review is due effective 1 July 2002.*

The annual report to members did not mention that the fund assets were about $84 million below the total value of retrenchment benefits. Under the SIS regulations, the members would have been entitled to request a full copy of the actuary's report, along with any subsequent written advice by the actuary which would be relevant to the overall financial condition of the fund (SIS Regulation 2.41 (1)). However, such requests are not very common (see discussion of disclosure issues below).

Ansett's financial position deteriorated, and was exacerbated by the terrorist attacks on the Twin Towers in New York on September 11, 2001. The first group of administrators took over the airline on 12 September, 2001; and on 16 September the plan trustees wrote to the administrators to inform them of the potential shortfall, estimated at $84 million. Following the actuary's suggestion, the trustees asked for additional funding to cover any retrenchments.

For unrelated reasons, the original Ansett administrators were replaced after just a few days. The new administrators took over on September 17.

On 18 September 2001 the actuary wrote to the trustees to explain the situation more fully. He pointed out that the trustees were already aware of the shortfall of $84 million as at 30 June 2000. He explained that the current level of contributions did not allow for the payment of retrenchment benefits.

> *"Recommended contributions [in the 30 June 2000 actuarial report] did not include any allowance for funding of any shortfall against the Plan's retrenchment benefits. Had there been any basis, at the time that the 2000 valuation was undertaken, to expect that retrenchment benefits were going to become payable for the absolute majority of the Plan's members, then the contributions recommended would have been higher to the degree required to cover an expected excess of benefit payments over normal resignation/retirement benefits."*

He then updated the estimates of assets and liabilities.

The news was not good. During the months of July, August, and September 2001, the market value of assets had fallen by about 10%. The value of assets was now just $516 million. The total retrenchment benefits were estimated at $633 million, giving a shortfall of $117 million. Since the employer contributions are taxed at 15%, this means that the employer would have to contribute about $137 million to cover the shortfall. This was based on the assumption that all employees would be retrenched.

The shortfall was exacerbated because Ansett had not paid the usual employer contributions for the months of August and September 2001. The trustees wrote to the administrators to request urgent payment.

The members of the fund were naturally concerned about the security of their benefits. It seems that their Union was very helpful in providing what little information was available.

The National Union of Workers issued a special report for Ansett members on 20 September 2001, which stated that:

> *"The ACTU has been informed that the defined benefit funds are fully funded to pay retirement and resignation benefits, which means that members should receive these benefits on exiting the fund. In the case of the Ground Staff Superannuation Plan, there is a retrenchment benefit which is higher than the resignation benefit. The Plan is not funded for payment of the retrenchment benefit for all members at the one time as it was not expected that all Plan members would be retrenched at once."*

In retrospect, this newsletter was perhaps rather optimistic.

The actuary wrote to the trustees again on 20 September 2001, raising a question about the wording of the Trust Deed. Under the Trust Deed, "retrenchment" was defined as *"a reduction of staff declared by the employer for the purposes of these rules"*. The actuary noted that the retrenchment benefits would not be payable unless the employer made a declaration of retrenchment. If a person was made redundant, and the administrators refrained from making such a declaration, perhaps the member's entitlement would be restricted to the much lower resignation benefit?

On 27 September 2001, this issue was raised at a meeting between the trustees and representatives of the administrators. The representatives of the administrators would not comment, other than to say that they were seeking legal advice on this matter.

Shortly afterwards, the administrators made an offer of voluntary redundancy to 8,663 members of the Ground Staff. The offer of voluntary redundancy did not specify the superannuation benefits which would be payable – instead it suggested that employees should ask the trustees of the superannuation plan to provide information about benefits which would become payable. Thousands of members accepted the offer and were subsequently made redundant. (By May 2002, the administrators had made 7,768 members redundant).

Soon after, on 17 October 2001, the trustee's solicitors wrote to the administrators, asking them to confirm that anyone who accepted an offer of redundancy would be eligible for the retrenchment benefit under the superannuation rules. The administrators did not reply.

The administrators subsequently gave evidence in court, stating that they had decided (on legal advice) not to make any declaration of retrenchment. One of the administrators stated that

> *... he believed that to make a declaration would be contrary to the interests of Ansett and to the interests of its creditors as a whole because of the risk that such a declaration might increase the liabilities of Ansett in circumstances where it was already insolvent.*

On 18 October the trustees issued a newsletter to members. The newsletter included the following information:

> *Based on advice received to date, the Trustees have decided to make your retrenchment benefit available in two stages. The first stage will be made within the next week and will be for an amount equivalent to your ordinary resignation benefit or early retirement benefit. All payments are subject to the usual preservation requirements.*
>
> *The second stage involves the consideration of any available balance. This may involve the Trustee seeking directions from the Court as to appropriate amounts payable.*
>
> *The main reason for this course of action is to determine the proper level of benefits that members will be entitled to should the Plan be wound up. In this case, Defined Benefit Plan Members should be aware if large scale redundancies / retrenchments occur that fall within the definition of "retrenchment" for the Defined Benefit Fund Rules, then the Plan may have a large shortfall of assets in order to meet full retrenchment benefits.*
>
> *The employer has previously made contributions in accordance with the actuary's recommendations. As such, the Plan has previously been funded in accordance with commonly accepted actuarial practice which does not fund for 100% member retrenchment. Under normal circumstances, the Trustees would expect in a redundancy program that the employer would fund the Plan's solvency requirement as provided for under the Trust Deed. The size of the shortfall cannot at this stage be determined and the Trustee is not confident that the shortfall could be met by either Ansett Australia Limited or the Voluntary Administrators. The downturn in the investment markets following the New York tragedy has impacted this situation.*
>
> *There are a number of events that could act to wind up the Plan which may affect the way your end benefit is calculated. These events may occur soon, but depend on a number of factors. The Trustees may have to approach the Court for guidance in respect to benefit determinations in these situations....*
>
> *The Trustees are obligated to act in the best interests and in a fair and equitable manner on behalf of all members.... Please be aware that we are taking every action possible to seek the best possible outcome for you."*

The trustees reported that they were consulting with APRA, ASIC, and the SCT to work out all the ramifications of the situation.

On 23 October 2001 the actuary wrote to the trustees advising that the recent poor investment performance of the fund meant that the previous Funding and Solvency Certificate (effective 1 July 2001) would cease to have effect. This meant that the actuary would have to re-examine the solvency of the fund prior to issuing a new Funding and Solvency certificate. The actuary commenced a new investigation of the fund.

Soon afterwards, the trustees froze all payments from the fund (Wood & Paxinos, 2001).

During November 2001, the trustees had managed to obtain some money from the administrators. The administrators agreed that Ansett was legally obliged to make the payments of 9% of salary for the period up to the date when the company was put under administration (i.e. up to September 13); this amount was paid on 12 November 2001.

The actuary completed his review of the fund's solvency, and reported back on 3 December 2001. Once again, the news was not good. The actuary advised that:

- The net assets were less than the Vested Benefits – the amount of the shortfall was estimated at $76 million;
- The net assets were less than the retrenchment benefits;
- There was some uncertainty as to how much more the employer would be able to pay in contributions;
- There were "potential concerns" if the members who had been made redundant were paid retrenchment benefits.

On 23 January, 2002, the actuary issued a new Funding and Solvency Certificate (in the court case which followed, this was known as FSC4). The actuary stated that the fund was technically solvent at present – even though the assets were much less than the Vested Benefits, they still covered the MRBs. He noted that payment of retrenchment benefits would jeopardise the security of benefits for continuing members, unless the employer paid additional contributions. The actuary recommended a two-tier contribution rate. For members still in employment, Ansett should pay 9%. But for each retrenched member, the employer contribution should be a lump sum equal to the amount of the member's retrenchment benefit less the amount of the resignation benefit (increased to allow for tax on contributions).

During this period, the administrators were trying to put together a plan to rescue the airline. The airline had stopped flying in September, but the administrators had set up "Ansett Mark II", flying a limited number of planes on the most important routes. In November 2001 they also entered into an agreement to sell the airline to TESNA. But in late February 2002, these plans fell through. All flights ceased on March 4, 2002.

By this time most employees had been retrenched, but some people were still working for the administrators. Under the SG legislation, these members were still entitled to SG contributions. But there were concerns that this money would simply be swallowed up in paying the retrenchment benefits for those who had already gone. So the trustees decided to try to "quarantine" these contributions – effectively these contributions would be put into a separate accumulation amount for each member who was still employed. Members were notified of this arrangement in the December 2001 newsletter from the trustees.

By mid December, 2001, the trustees had decided to lift the "hold" on payment of benefits – many retrenched workers were facing financial difficulties and needed the money. But by this stage, the fund assets were less than the total Vested Benefits – it would not be wise to pay the full amount of the benefit. The trustees decided to pay a reduced amount as a "stage one" payment. Based on the actuary's advice, retrenched members would receive a maximum of 70% of their resignation benefit or early retirement benefit. (December 2001 trustee newsletter).

Many members would not be able to take the full amount in cash, because their benefits were subject to preservation requirements.[14] Usually, members with preservable benefits would be able to roll the benefit over to another fund – but the trustees decided (based on legal advice) to forbid such rollovers. The fund would only provide non-preservable cash payments. This meant that for the fund would not release any benefits at all for some members (especially those with shorter service periods).

By March 2002, this rule was relaxed and retrenched members were allowed to roll over the preservable part of their benefits to another fund (subject to the limit of 70% of the vested benefit).

On April 24, 2002 a *Notifiable Event* occurred, i.e. the employer failed to make the contributions specified in the certificate. As explained above, this meant that the old Funding and Solvency Certificate automatically lapsed. The actuary had to conduct a new investigation of the fund and provide a new Funding and Solvency Certificate (this new Certificate was known as FSC5 in the court case which followed). The actuary certified that the fund was still solvent, and set out the same minimum contributions as the previous certificate, i.e. the employer was still required to pay extra contributions for retrenched members.

It is worth noting that the fund was still clearly technically solvent, since the assets million comfortably exceeded the MRBs (estimated at approximately $424 million at March 2002). However the higher contributions were necessary to meet the SIS standards, i.e. so that the fund could be "reasonably expected to secure the solvency of the fund on the expiry date of the certificate" (i.e. 30 June 2005).

By the end of the financial year, the situation had again deteriorated, due to poor investment returns. The returns for the financial year ended 30 June 2002 were negative (-3.2%). This was consistent with the poor returns earned by many other funds over the same period – in fact Ansett's performance was slightly better than average.

On July 12, 2002 the actuary advised the trustees that the shortfall (i.e. the difference between retrenchment benefits and assets) was of the order of $150 million to $200 million. This amount will continue to fluctuate up and down depending on future investment performance.

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[14] Under the SIS legislation, members must preserve some or all of the superannuation benefits. Preservable benefits may not be taken in cash, but must be rolled over to another superannuation fund or approved deposit fund until the member meets a condition of release (such as retirement after age 55, death, permanent disability etc). The preservation rules were introduced in 1987, and have been progressively tightened. Under transitional provisions, benefits accruing prior to the introduction of the new rules are not preservable (i.e. they may be taken in cash). The rules are quite complex. Long-serving members are more likely to have access to non-preservable benefits.

The actuary gave evidence as to his belief that the fund had enough money to cover vested benefits, but it did not have enough to cover any part of the difference between vested benefits and retrenchment benefits.

The trustees decided to go to court to obtain additional money from the Ansett administrators, and the court case commenced on July 16, 2002.

The trustees realised that they could not represent all the members, because there was a conflict of interest between the retrenched members and the continuing members. If the retrenched members were given full benefits, this would reduce the amount available to pay benefits for those remaining in service. Therefore it was necessary to have separate legal representation for the two groups.

The court case lasted several months – the judge's decision (described below) was not handed down until December 20, 2002.

In the meantime, the trustees had a number of other difficult issues to deal with, including insurance of death and disability benefits. For retrenched members, insurance cover would cease 60 days after ceasing employment. The trustees arranged for these members to obtain death cover under automatic acceptance arrangements with group premium rates.

The trustees were also preparing for the fund wind-up. They decided to set up an accumulation-type successor fund. Once the amount of the benefits was finalised, members would be able to take their lump sums and roll the money over into the new fund. All five Ansett funds would be combined into one successor fund. The trustees described the advantages of this arrangement:

- Allow members to retain their benefits in the Plan;
- Mitigate wind up costs;
- Increase the time frame for decision making;
- Permit future contributions to the Plan.

The trustees were incurring significant expenses in administering the fund – and in particular, the trustees were incurring significant legal costs in pursuing their claim against the Ansett administrators, in trying to extract the outstanding contributions.

Some were critical of the trustees. For example the Australian Services Union newsletter dated September 2002 said:

> *These cases are not only delaying payments but also costing money as they are being funded from the Superannuation Fund. The Administrators must appear so their legal costs are from the Ansett sale proceeds. Whatever happens the lawyers are the winners and the Ansett staff pay the costs through reduced super or reduced returns. Whether the whole saga is going to benefit ASU members who want payments now is certainly not clear as all members are experiencing now is delays.*

In summary, as at the end of 2002, the members of the Ansett Ground Staff Superannuation Plan faced a significant loss. They would not be able to obtain their full benefits unless the trustees were successful in obtaining additional funds from the Ansett administrators. This was a matter to be determined by the Supreme Court of Victoria.

Part 5: The Court Case - Issues and Outcomes

The trustees of the Ground Staff Superannuation Plan went to court. The following account is based on the judgement published by Supreme Court of Victoria in December 2002. (Ansett Australia Ground Staff Superannuation Plan Pty Ltd and Another v Ansett Australia Ltd and Others [2002], VSC 576).

There were three issues to resolve:
(1) Were the retrenched members of Ansett entitled to redundancy benefits under the Trust Deed?
(2) If there was a shortfall in the fund, should Ansett be required to make additional contributions to fund these benefits?
(3) If so, then what priority would the superannuation fund have, among the other creditors of the airline, under the Corporations Act 2001?

Issue 1 : Are the members entitled to retrenchment benefits?

Were the members of the fund entitled to retrenchment benefits?

To answer this question, the judge had to look at the Trust Deed. The Trust Deed gave a definition of retrenchment: *"a reduction of staff declared by the employer for the purposes of these rules". (Rule 1.1)*

The administrator argued that retrenched members did not have an automatic entitlement to the higher level of benefits. They argued that the Trust Deed gave the employer some discretion: the employer could decide whether or not to make a declaration. If the employer did not make a declaration for the purposes of the rules, then the members were not entitled to the higher benefits.

Members of the fund argued that this interpretation of the Trust Deed was incorrect. They said that the rules merely required the company to provide information to the trustees, so that they could determine whether or not the member had been retrenched. They argued that the Trust Deed did not give the company the right to have any discretion over the payment of the benefit, once an employee had been retrenched. They pointed to the past practice of the company (as outlined above): all retrenched employees had been paid the retrenchment benefit, and there had never been any official company declaration especially for the purposes of the Trust Deed.

Which interpretation of the Trust Deed was preferred?

In making her decision, the judge referred to a number of precedents for the interpretation of Trust Deeds. (The following is a layman's summary, and those who are interested in the intricacies of legal decision-making should read the judgement.)

Firstly she noted that the basic approach should be '*practical and purposive*', that is the rules of the scheme should be interpreted to give reasonable and practical effect to the scheme.

Secondly she noted the approach suggested by a previous judge, who stated that the interpretation of the Trust Deed should take into account the background facts and surrounding circumstances. All of the past practice suggested that the retrenched members were entitled to the retrenchment benefits without any special declaration. The member booklets suggested that retrenchment benefits would be paid to retrenched members. The members were never told that the benefit would depend on the discretion of the employer. In fact this issue was never raised by anyone until the actuary sent a letter to the trustee in September 2001, after the collapse of Ansett.

The administrators suggested that the judge should not rely on these facts when interpreting the Trust Deed, but the judge indicated that the facts could not be ignored.

According to the administrators, the retrenchment benefits are, in effect, conferred as part of the bounty of the employer. Although this type of bounty may be a reasonable assumption in other types of trust, the judge decided that this did not seem appropriate for a modern superannuation scheme, which is part of the employer-employee relationship. She refers to a judgement from the English courts

> *By reason of their employment, the beneficiaries of a scheme (the members) give valuable consideration for the benefits they enjoy under the scheme. The consideration they give is of two kinds. In all cases (including non-contributory schemes) they are working in the terms of a contract of employment which treats the provision of pension rights as part of the pay for which they receive their services. In many schemes, employees are compelled to join the scheme. Second, in contributory schemes the members are bound to pay into the fund out of their salaries. Therefore, the concept of a settlor acting out of bounty, which underlies much of trust law, has no application. In my view, the most realistic analysis is that there is no settlor of a superannuation fund. Both the employers and employees provide the trust fund in discharge of contractual obligations between them. Neither side is being generous.*

In the Ansett case, the judge decided that members who had been made redundant by the administrators were entitled to the retrenchment benefits under Rule 1.13.

Note that this decision rested on the interpretation of the Trust Deed - it does not necessarily mean that any member of another superannuation fund would be entitled to a retrenchment benefit when a company collapses, since the wording of each Trust Deed is different.

Issue 2: Was Ansett obliged to make contributions to cover the cost of the retrenchment benefits?

Next, the judge had to consider Ansett's obligations under the SIS legislation and Trust Deed. As described previously, the SIS Act requires employers to make contributions no less than the amount specified in the Funding and Solvency Certificate. And the Trust Deed of the fund stated that the employer would make contributions required to comply with the Act.

So the conclusion was quite clear. Ansett did have an obligation, under SIS and the Trust Deed, to pay the contributions specified in the Funding and Solvency Certificates.

The judge also looked at Ansett's contractual obligations to the employees. After considering all the assurances which were given in the member booklets (as described in Part 3 above), the judge decided that Ansett had an obligation to pay contributions; this obligation arose from the contract between employer and employees.

The most recent Funding and Solvency Certificates (FSC4 and FSC5, described above) required Ansett to pay an additional lump sum for each member who was retrenched, to cover the deficit. There was some argument about whether the FSC's had been calculated properly, in accordance with the legislation - but the judge decided that the actuary's approach was acceptable. (Another actuary had given evidence in support of the method of calculation.)

This decision was, in principle, good news for the fund members. But it merely added the fund trustees to the long list of Ansett's creditors. Based on the testimony of the administrators, Ansett certainly had nowhere near enough assets to pay all of its debts. Only the creditors with high priority would actually receive any money.

So this leads to the third question to be decided by the court: did the superannuation fund have priority over the other creditors? If not, then the fund would probably be unable to obtain any money from the creditors.

Issue 3: Does the superannuation fund have priority over other debtors, in claiming money from the fund administrators?

Section 556 of the Corporations Act sets out the order of payment of debts, when a company is wound up.

The top priority is given to expenses incurred by the administrator. Sections 556(1)(a) to S556(1)(df) describe different types of expenses which may be incurred.

The next highest priority is given to certain employee entitlements, as described in Sections 556(1)(e) to 556(1)(h). These sections refer to wages, superannuation contributions, unpaid leave, and retrenchment benefits.

The trustees wanted the judge to answer these questions

(1) Did the superannuation contributions fall under S556(1)(a), as an expense incurred by the administrator in the carrying on the company's business during the period of administration?
(2) If not, did the superannuation contributions fall under S556(1)(dd), as any other type of expense properly incurred by the administrator?
(3) If not, did the superannuation contributions fall under S556(1)(e), which gives higher priority to certain employee entitlements?

If the superannuation contributions fell under S556(1)(a) or 556(1)(dd), then the fund would have high priority in the queue of creditors. The fund would probably obtain the full amount owing, and hence be able to pay members the full retrenchment benefits.

This would not be an unmixed blessing for all Ansett employees. If Ansett's meagre assets were used to pay the superannuation fund contributions, then there would not be enough money left over to pay some of the other employee entitlements which had lower priority (such as redundancy benefits which were payable by Ansett in accordance with industrial relations arrangements).

It would also create a loss for the Commonwealth government. When Ansett went into administration, the government agreed to provide a loan to Ansett to cover unpaid wages, unpaid leave, unpaid long service leave, entitlements for pay in lieu of notice, and redundancy entitlements up to a period of eight weeks. Part of this money came from general revenue, and part came from a levy on all airline tickets. The government expected to be able to reclaim this money from Ansett during the winding-up process. And under the law, anyone who lends money for the payment of employee benefits has the same priority for payment as those employees would have had themselves. In effect, this means that the Commonwealth had priority to certain sums under S556(1)(e) to S556(1)(h). But if the superannuation plan had higher priority, the Commonwealth would probably not recover the full amount outstanding.

If the superannuation contributions fell under S556(1)(e), then the situation became more complicated. The administrators had entered into a deed of arrangement with the creditors of Ansett, which promised payments to certain creditors. If this agreement was binding, then other creditors would receive their payments, but there would not be enough left to cover the amount owed to the superannuation fund. The superannuation fund would then have to go to court again, to try to overturn this deed of arrangement.

If the superannuation fund did not have any priority under S556(1)(a), S556(1)(dd), or Section 556(1)(e), then the fund would simply have to line up with all the other unsecured creditors. Since all the money would be used up to pay the high priority creditors, there would be nothing left for the superannuation fund.

ISSUE 3 Question (1)
Did the superannuation contributions fall under S556(1)(a), i.e. were the superannuation contributions expenses incurred by the administrator in carrying on the company's business?

Initially, the trustees argued that the superannuation contributions should be included under S556(1)(a).

S556(1) gives priority to expenses incurred by the administrator in "*preserving, realising, or getting in the property of the company, or in carrying on the company's business*".

As an example, when the administrators are winding up the company, they might decide that part of the business is still profitable (e.g. one particular product line). They can maximise the payments to the creditors by continuing to produce this product - and they may use the company's money to do so.

As another example, the administrators will need some assistance from the company's employees in selling off the assets of the company. The administrator is entitled to pay the salaries of the staff who are employed for this purpose.

Do the superannuation shortfall contributions fall under this definition?

After the administrators took over, they had the right to discontinue contributions and close down the superannuation fund. They decided not to do this – as noted above, for some time, they were trying to maintain the business as a going concern, and then sell it to another company. The trustees argued that as long as the administrators kept the fund open, then they had a legal obligation to pay the contributions specified in the Funding and Solvency Certificate; hence the contributions were an expense of administration.

This led to some very long and involved legal arguments, with much discussion of other cases where winding-up expenses were disputed.

Justice Warren decided that some of the contributions should be included under this heading – but this applies only to the 9% contributions in respect of employees who continued in service after the administration took over.

Justice Warren decided that the contributions for retrenched employees did not fall under this heading. These liabilities arose from the decision to retrench employees, and the retrenchment of employees did not form part of the "continuation of the business" of Ansett.

ISSUE 3 Question (2)
If not, did the superannuation contributions fall under S556(1)(dd), i.e. were the superannuation contributions "expenses properly incurred by the administrator"?

Next, the trustees argued that the superannuation contributions should be included under S556(1)(dd). S556(1)(dd) gives high priority to "any other expenses properly incurred" by the administrator.

If they were successful in convincing the judge that this was the correct interpretation of the law, the superannuation fund would have been able to obtain enough money to pay out benefits in full.

The judge considered this question: Were the superannuation liabilities *incurred by the administrators* during their period of administration of the company ? If so, then the shortfall contributions might come under S556(1)(dd).

Alternatively, were the superannuation liabilities *incurred by the Ansett company before the administrators took over* ? If so, then the shortfall expenses should be included along with all the other debts incurred by Ansett before the administrators took over.

This was clearly a tricky problem. Even the administrators acknowledged that "*a difficult area arises where liabilities occur during winding up that relate to activities involving the liquidator but which also relate to obligations undertaken by the company prior to winding up*".

Justice Warren consulted a number of authorities and concluded that the liabilities were actually incurred by Ansett before 12 September 2001. Ansett had a contingent liability; the amount of the liability would depend on the occurrence of certain events (i.e. retrenchments). Therefore the liability was not "incurred by the administrators", it already existed when they took over on September 12.

Consequently, the superannuation fund was not eligible for priority under S556(1)(dd).

ISSUE 3 Question (3)
If not, did the superannuation contributions fall under S556(1)(e), i.e. were the superannuation contributions payable by Ansett in respect of services rendered to the company before 12 September 2001?

Next, the trustees argued that the superannuation shortfall contributions should fall under S556(1)(e).

S556(1) (e) gives high priority to wages and superannuation contributions payable by the company in respect of services rendered to the company by employees before the relation date (in this case, the relation date is the date the administrators took over the company, which was September 12, 2001).

This raises the question: should retrenchment benefits paid after 12 September be counted as benefits "in respect of" services rendered before 12 September? If so then they would appear to fall under S556(1)(e).

Justice Warren decided that the shortfall contributions should **not** be given priority under S556(1)(e). The reasons for this decision were not made entirely clear in the judgment; this decision is now the basis of an appeal (see below).

Outcomes And Appeals

The trustees reported the outcome of the case the members, in a newsletter dated December 2002.

> *The decision unfortunately represents a pyrrhic victory as it confirms that members made redundant since 12 September 2001 are entitled to Retrenchment Benefits (and that Ansett is required to fund the shortfall to meet this benefit) BUT this obligation does not attract a priority. Effectively any funding will only occur after Priority Creditors have been paid from the sale of Ansett assets – at which point the Plan will share equally with other creditors. We also understand (from the Administrators' report to the Third Creditors' Meeting) that there is little likelihood of any funds being available once Priority Creditors have been paid.*

Using conservative figures, there is a shortfall of at least $150 million, in a fund which had about 8,800 members. This would be an average loss of about $17,000. If the shortfall increases due to adverse experience, the average loss could be more than $22,000 per member. Of course, the losses are not distributed evenly across the membership – some individuals will suffer even larger losses.

It is interesting to observe that one newspaper reported the decision under the headline *"Win for Ansett Workers*" (Elias, 2002). The journalist pointed out that there are 15,000 Ansett workers waiting for their redundancy benefits - these are benefits payable directly from Ansett to redundant workers, in accordance with industrial relations agreements. If Ansett's assets are allocated to pay the superannuation fund retrenchment benefits first, then there would not be enough left over to cover the redundancy benefits. On the other hand, if the superannuation fund is given lower priority, then those millions of dollars will be available to pay the redundancy benefits of all the other workers. Essentially, there is some conflict of interest between the Ansett workers who are in the Ground Staff Superannuation Plan and those who are not.

The trustees have not given up yet. They are intending to appeal against the decision, and ask for the superannuation plan to be given a higher priority in the queue of creditors. That is, they would like the superannuation contributions to be included as debts under S556(1)(e) (Tingle, Koutsoukis, and Allen, 2003)

If the appeal is successful, then the Commonwealth will not be able to obtain a full recovery of the amount it lent to Ansett last year (the debt exceeds $300 million). As a result, the Commonwealth government has decided to continue the levy on airline tickets. If the government cannot obtain repayment from Ansett, the levy will help to cover the losses. (Riley, 2003). [It is not entirely clear what the government will do with the proceeds of the levy, if they do manage to obtain full payment from the Ansett administrators].

Part 6: The effectiveness of the SIS legislation

The Ansett saga raises a number of issues about our solvency legislation.

Does the current standard provide an appropriate level of protection for worker's entitlements?

As noted above, the SIS solvency standards are designed to provide a high level of protection for a relatively low level of benefits. That is, a fund must strive to maintain technical solvency, but this only secures the Minimum Requisite Benefits (which may be much lower than the resignation benefits and retrenchment benefits promised under the Trust Deed).

If we accept this standard, then the legislation has been successful in this case: it is quite probable that all the Ansett members will, eventually, receive their Minimum Requisite Benefit.

But should the standards be higher? Should employers be required to provide funding which is adequate to cover the full value of the benefits promised under the Trust Deed, with a high level of probability?

The government has apparently decided that benefits arising from compulsory superannuation deserve a high level of protection; but benefits arising from the employer's "voluntary" superannuation contributions do not deserve such a high level of protection.

However, as suggested by Justice Warren's comments (given above), these additional superannuation contributions are not really "voluntary"; they are not provided by employers as an act of benevolence. They form a component of the remuneration of the employee in return for services rendered, as agreed between employers and employees. Shouldn't these benefits be protected? Or should we just leave it up to the employers to behave responsibly?

This following view was expressed by the chair of the Goode Committee, which was responsible for the review of UK pension fund legislation after some shocking losses in the 1990s.[15]

> *"Those who favour the retention of the laissez-faire principle in all its vigour argue that the establishment of a pension scheme is a voluntary act on the part of the employer. Since the employer does not have to provide a scheme at all, surely it must have complete freedom to set the terms of any scheme it chooses to provide. Though such a proposition still has its advocates, it is not dictated by either policy or logic. It is perfectly legitimate to insist that if the employer does choose to set up a scheme, the bundle of benefits offered to the employees as an integral part of the remuneration package should be legally protected and financially secure." (Goode, 1994)*

On the other hand, some are opposed to any strengthening of standards. They argue that a high level of security for employees will undoubtedly increase the costs for the employers, and this may have some adverse consequences. If the costs are too high, then employers will

[15] The most shocking losses were incurred by funds associated with the late Mr Robert Maxwell. After the death of Mr Maxwell, it became apparent that he had diverted the assets of the superannuation funds of his employees to prop up his sagging business empire.

be unwilling to offer any defined benefits over and above the level of the Minimum Requisite Benefits; and it may exacerbate the trend away from defined benefits, in favor of lower-risk accumulation funds. It may force superannuation funds to invest in low-risk, low return investments in order to reduce volatility of fund surpluses.

If the legislation does not provide adequate protection of any benefits over and above the MRBs, then the security of benefits depends on the trustees, the actuaries, and the employer. The actuary can recommend a higher level of funding (with a buffer of additional assets to cover the possibility of adverse experience); and indeed, actuarial textbooks often advise actuaries to do just that. However, in most cases, the ultimate decision about the level of additional funding may be made by the employer, who may be quite reluctant to adopt the actuary's recommendation. In recent years, we have seen that many employers have chosen to reduce the level of funding, by taking contribution holidays. The effect, i.e. the erosion of security for members, has now become apparent.

This problem is by no means confined to Australian superannuation funds; other countries are also finding it difficult to find the appropriate balance between the security of employee benefits and costs to the employer. The American and British approaches to this problem are discussed in *Solvency of Superannuation Funds* (Ferris, 2003).

Should there be a guarantee fund for to cover the shortfall when the employer becomes insolvent?

When an employer becomes insolvent, workers may be entitled to a variety of benefits, including unused holiday pay, long service leave, and redundancy benefits (payable by the company), as well as superannuation benefits. All of these may be put at risk when the employer has failed to make adequate provision.

After a number of such insolvencies (including National Textiles), the government set up the General Employee Entitlements Redundancy Scheme, which provides compensation for loss of certain employee entitlements (up to specified limits). However, this scheme does not cover defined benefit superannuation shortfalls.

Should the government guarantees be extended to cover superannuation?

In the United States, defined benefits are protected by a guarantee fund, the Pension Benefit Guaranty Corporation (PBGC). The PBGC is funded by a levy on all insured defined benefit funds. This has increased security for members (subject to certain limitations). But the PBGC is currently facing a massive deficit, as a result of major insolvencies in the airline industry and in the steel industry. Some of these companies have consistently underfunded their pension funds for many years – leaving the losses to be covered by other, more responsible employers. To reduce the potential for such moral hazards, the PBGC has, over time, introduced more stringent funding requirements – but employers have often resisted such changes.

The government recently reviewed the prudential standards for superannuation funds, and they considered the introduction of a more comprehensive guarantee system for superannuation funds. However, most of the submissions to the enquiry were opposed to this proposal – on the basis that it would create an unacceptable moral hazard.

Should superannuation benefits have priority over other creditors, when an employer-sponsor becomes insolvent?

As we have seen, the law is not entirely clear about the priority of employee entitlements such as superannuation, when an employer becomes insolvent. This uncertainty has certainly contributed to the distress of Ansett employees, as they wait for the legal issues to be resolved – and this is inevitably a slow process.

After the Ansett collapse, the government indicated that there would be a review of the Corporations Law, to consider giving certain employee entitlements higher priority (even ahead of secured creditors). However, there has been strong opposition to this proposal from the banks, some accountants, and the legal profession. If employee entitlements get higher priority, other creditors (such as banks) would face greater risks in lending to employers. Hence, they would be forced to charge higher interest rates to corporate customers; some companies might face difficulty in borrowing. (Oldfield, April 2003; Dwyer, Jan 2002)

Similar problems are likely to arise if superannuation shortfalls are treated as high-priority debts in the event of insolvency. Potential lenders would want to have much more information about the level of the shortfall in the superannuation fund; they would also want to assess the risks that the deficit might increase. The superannuation fund's asset mix might have a direct bearing on the employer-sponsor's ability to borrow.

Despite these problems, some other countries do make explicit provision for defined benefit shortfalls to be counted as liabilities when the employer becomes insolvent (up to specified limits). These laws specify both the method of calculation of the shortfall, and the priority of the debt relative to other creditors (Refer to Ferris, 2003, for further details).

Should members be given more information?

Did the members of the Ansett Ground Staff Superannuation Plan have adequate information about the financial condition of the fund? Based on the information provided in the annual reports at 30 June 2000 and 30 June 2001, members would probably not have been aware of any problems in the solvency of the fund. The annual report was quite reassuring, i.e. the actuary stated that the fund was in a "sound financial position" at the last review.

It is true that the fund met the minimum solvency requirements under the SIS legislation as at 30 June 2000: that is, vested benefits were covered. However it did not reveal that the assets were $84 million below the total retrenchment benefits as at 30 June 2000 – a fact which was certainly of some significance to the members, given that it was well-known that Ansett was facing major financial challenges.

The members could have discovered the shortfall if they had requested a copy of the actuarial report. The SIS Regulations require trustees to provide such information on request. However it is doubtful if many members would have made such a request:

- The annual report was reassuring, so they might not consider it necessary to make further enquiries;
- Most members would have been unaware of their right to read the actuary's report.
- Even if they did read the report, they might not have understood the significance of some of the figures.

Under the SIS legislation, trustees are required to tell members about significant adverse events. The members were duly notified about the potential problems in the Newsletter to members dated 18 October 2001. However the information provided was not very precise – members were simply told that *"the Plan may have a large shortfall of assets in order to meet full retrenchment benefits"*.

It is clear that members were very worried about their benefits, and they wanted more information. The trustee newsletter said that the member's Service Centre had been inundated with calls – 4,161 calls were received in one month (October 2001), compared to the normal level of about 520 calls per month.

Conclusion

In summary, the collapse of Ansett has revealed some of the weaknesses of our existing solvency legislation - thousands of employees are likely to receive benefits which are significantly less than the amounts they had been led to expect, based on the promises of their employer. There are a number of alternatives which may provide greater security for members - but each solution carries significant costs to the employers or the community.

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