



Institute of Actuaries of Australia

Protection of Employee Entitlements in the Event of Employer Insolvency

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1 Introduction

1.1 Background

During recent years there have been a number of high profile cases where employees have lost part or all of their entitlements when companies have been wound up. This has led to increasing public debate on how these entitlements should be protected in the future.

The Institute of Actuaries of Australia ("IAAust") has an active interest in this issue for a number of reasons.

The actuarial profession with its skills has been seen as being needed in the development of a means of solving this problem. Submissions to the 1999 Ministerial Discussion Paper, a paper produced by the Department of Work Place Relations to discuss the protection of employee entitlements, refer to actuaries. Actuaries would be responsible for pricing insurance under a scheme proposed by the Federal Labor Party.

The actuarial profession's skills in this area have already been recognised in that accounting standard AASB1028 covers the disclosure in company accounts of long service leave and other employee entitlement liabilities and provides that the calculations can be based on actuarial techniques.

In fact, as most employee entitlements are salary based benefits, the techniques that actuaries use for advising on the management of defined benefit superannuation funds are readily applicable in this area.

In summary, the IAAust expects that any resolution of this issue will require the involvement of specialists. Actuaries are well placed as a result of our skills in the valuation and ongoing management of uncertain financial outcomes to provide relevant specialist knowledge and skills.

1.2 Objectives of paper

The starting point for any informed discussion and debate is a clear understanding of the current position. The IAAust therefore has undertaken an examination of the existing arrangements that apply to a range of employee entitlements. The IAAust has also briefly examined a number of approaches that have been proposed to secure entitlements.

The objective of this paper is to summarise the information obtained in that examination. This paper does not include any qualitative comments on the current situation or on any approaches that are considered in the paper. This paper does not provide social or political comment on the current situation, nor on the various approaches considered in the paper, as IAAust believes that these issues are beyond the scope of its area of expertise.

While mostly summary, this paper does provide some new information that we believe has not been previously published, including an estimate of the national employee entitlement liability and some statistics on those trusts currently being used to pre-fund some of the workforce's entitlements.

The IAAust intends to prepare a second paper that will consider various options that may provide increased protection for employees' entitlements. This will include detailed comments on existing arrangements and arrangements proposed by various organisations. Section 6 of this paper includes a discussion of the issues that may be considered in the second paper.

It is noted that this paper briefly addresses the issue of accrued superannuation entitlements. However, this area is not considered in any detail as the IAAust believes that this is a particularly complex area, and one which needs to be considered separately.

2 What do we mean by Employee Entitlements?

2.1 Criteria for protection

The entitlements described below apply to full time and permanent part time employees only. Casual employees are generally not entitled to these benefits.

In considering which entitlements should be protected, the following criteria were considered:

- The benefit must be payable on voluntary and/or involuntary termination of employment.
- Materiality, considering the size of individual and total benefits.
- Materiality, considering the number of employees affected.
- The benefit must not be an equity-based benefit.

2.2 Types of employee entitlement

2.2.1 Annual Leave

Annual Leave is a benefit specified in awards and other employment agreements (Certified Agreements, Australian Workplace Agreements). It generally accrues at a minimum rate of 4 weeks per annum (although employees in some industry sectors are provided with a greater level than this).

For employees not covered by an Award or Certified Agreement, the Commonwealth Workplace Relations Act 1996 specifies a minimum of 4 weeks paid annual leave.

Most Awards and Certified Agreements specify that annual leave must be given and taken within 6 months of the entitlement accruing. It is this mechanism by which employers can limit the amount of accrued annual leave liability.

2.2.2 Long Service Leave

Long Service Leave is a benefit unique to Australia & New Zealand¹ (and possibly some public servants in India) and relates to our colonial heritage.

Long Service Leave developed from the concept of furlough. Furlough is a Dutch word (meaning from leave) and its usage originates in leave granted from military service.

In the 19th century, furlough as a benefit as we know it, was a privilege granted by legislation to the Colonial and Indian Services. In Australia, the benefits were first granted to Victorian and South Australian Civil Servants. The nature of the leave allowed civil servants to sail “home” to England, safe in the knowledge that they were able to return to their positions upon their return to Australia.²

The concept spread beyond the public service over the period 1950 to 1975, mainly as a result of pressure from employees seeking comparability with the public service.

¹ McLaughlin (1998). Long Service Leave was common in industrial awards in New Zealand prior to the introduction of the Employment Contracts Act 1991. We have not examined more recent statistics about how widespread Long Service Leave is in the employment contracts.

² Transcript Public Service Arbitrator 1940 – “Claims re Furlough to temporary employees”, Minister for Defence, PMG, PSB and others. QIRC 1999

Nowadays, long service leave is ingrained in Australian culture and is specified by state based and some federal legislation. Interestingly, it is not often taken when it falls due. Appendix 1 summarises the arrangements in various states. There are some industries with portable Long Service Leave arrangements and these are discussed further in Section 4.5.5.

2.2.3 Severance / Redundancy Payments

These are payments made only on termination of employment for recognition of service with the employer.

The difficulty with these payments in the event of insolvency is that they represent a substantial expense, incurred at a time of financial stress – exacerbating the stress.

There are no severance pay conditions specified in the Commonwealth Workplace Relations Act 1996, as there are for notice. However, the Australian Industrial Relations Commission may, on application from an employee or union, make an order for severance pay.

States and Federal awards, Certified Agreements and Australian Workplace Agreements may contain redundancy provisions. Award provisions are most commonly in line with the provisions formulated in the Federal test case of Termination Change and Redundancy (1984).

In NSW, redundancy benefits may be specified by the NSW Employment Protection Act.

Typical levels of redundancy benefits are a base level of 4 to 5 weeks' pay after 1 year's service, ranging up to 8 weeks' pay after 4 or more years (Federal and Queensland minimum level). NSW levels are significantly higher than for other States, ranging up to 20 weeks' pay for older employees after 6 years' service.

Australian Workplace Agreements are not required to specify redundancy benefits. In the OneTel collapse in 2001, approximately 1500 employees had Australian Workplace Agreements which did not contain redundancy provisions³.

On the other hand some Awards and Certified Agreements have provisions for higher levels of redundancy payments than outlined above.

2.2.4 Payment in Lieu of Notice

As the name suggests, payments in lieu of notice are payments made only on termination of employment and are compensation for not being allowed to work the minimum period of notice of termination.

The Commonwealth Workplace Relations Act 1996 specifies a minimum period of notice or payment in lieu of notice. This minimum period varies with length of service. However, it is 4 weeks for employees with greater than 5 years' service.

This applies to all terminations of employment (including those under state awards). However, some limited exceptions exist, the most significant being non award employees with salaries exceeding \$81,500.

It is possible under Australian Workplace Agreements to negotiate to remove this benefit and be compensated elsewhere. On the other hand some Awards and Certified Agreements have provisions for higher levels of payment in lieu of notice.

³ O'Neill, Shepherd, (2002)

2.2.5 Unpaid salary / unpaid superannuation contributions

If a company becomes insolvent there may be some unpaid salary/wages and superannuation contributions. The extent of these will largely depend on the frequency of the company's payroll cycle, although companies in distress may often defer / renege on making salary and superannuation contribution payments.

2.2.6 Workers' compensation

All Australian employees are entitled to receive compensation for work-related injuries and, to varying degrees, for disease or illness which is deemed to be work-related. These entitlements are funded by employers.

For the majority of employers by number, their liabilities for workers' compensation are insured, either through the private sector or through government insurance entities. As such, the risk to employees' benefits is transferred from the employer to the insurer.

The solvency of private insurers is regulated by the Australian Prudential Regulatory Authority (APRA). The various Governments effectively guarantee the solvency of their own insurance entities.

However, many of Australia's largest employers elect to self-insure their workers' compensation liabilities. To do so, employers must satisfy certain conditions imposed by the relevant state workers' compensation regulator (often called a workcover authority).

These conditions are intended to minimise the risk to employees' entitlements should the employer fail. They include, inter alia, requirements to:

- annual actuarial reports on the extent of the liabilities;
- prudential margins in the employer's balance sheet provisions;
- bank guarantees of amounts exceeding the estimates of the liabilities (by 30% to 50%).

In practice, these conditions would be expected to be successful in preventing employer default on employees' workers' compensation benefits.

In summary, therefore, workers' compensation entitlements are not seen as presenting a major risk area for employees.

2.2.7 Sick Leave

This is a benefit payable in the event the employee is unable to work for reasons of illness or injury. Sick leave is not usually vested (ie it is a benefit only payable in the event of illness). Under some agreements / awards, vested sick leave may apply and operate in a similar way to annual leave.

The rate at which sick leave accrues and the maximum level of sick leave that can be accrued varies by state, industry and employer. Sick leave typically accrues at a rate of between 5 and 10 days per annum.

The entitlement is specified in awards, Certified Agreements or Australian Workplace Agreements. State based Industrial Relations Commissions are empowered by state legislation to insert sick leave provisions into awards. For Victoria, the Commonwealth Workplace Relations Act 1996 specifies that each employee is entitled to a minimum of one week paid sick leave during a year, with untaken sick leave accumulating.

In some Federal and State awards, the use of sick leave has been modified to include Family Leave or Personal / Carer's Leave which is leave that can be used not only for sickness but also bereavement and to provide care and support for family or household members.

Sick Leave is not generally payable on termination of employment and therefore shall not be considered further in this paper.

Other types of paid leave not considered include family/carer leave, paid parental leave (maternity/paternity/adoption), trade union training leave and jury service leave.

2.2.8 *Accrued superannuation benefits*

In Australia, private sector superannuation benefits are normally funded by contributions to trust funds which are independent of the sponsoring employer. This independence means that benefits are generally secure in the event of employer insolvency.

There are, however, some exceptions:

- Where a superannuation fund invests in the employer or property of the employer. The Superannuation Industry (Supervision) Act 1993 has limits in relation to the proportion of the fund invested in the employer (5% of the fund). However, different rules apply to DIY funds.
- There are some instances where a defined benefit fund has converted to an accumulation fund and the employer has agreed to provide a guarantee (outside the fund) that benefits will be no lower than the previous defined benefit.
- Funds in an unsatisfactory financial position at the time of employer insolvency (ie the assets of the fund are less than the benefits paid if everyone were to voluntarily leave the fund at a particular date).

There is an argument to say that unsatisfactory financial position is more likely to occur at a time of employer insolvency as contributions may have been reduced to low levels while the employer was in financial stress.

- Funds that have retrenchment benefits greater than the market value of fund assets.

The August 2001 demise of Ansett illustrates the impact of the last two points above.

While these issues are important and likely to be material (particularly at a time when investment markets have declined), we have not considered these issues in this paper as we believe they would be better dealt with in a separate paper.

2.2.9 *Employee Share-plans / Option Schemes*

Share schemes provide a facility for employees to purchase shares in their employer. These are plans that can attract some tax benefits (depending on how they are structured) and may provide a discount on the purchase price of the shares.

Option schemes provide employees with the right (but not the obligation) to purchase shares in their employer at a predetermined price. The design of option schemes can be quite complicated and involve vesting periods to be completed and performance hurdles to be achieved before options can be exercised.

These benefits are intentionally dependent on the fortunes of the company. When the company performs well, employees are rewarded through the increase in the share price. However the converse is also true.

For this reason we believe they should not be subject to protection in the event of employer insolvency.

2.2.10 Other packaged benefits

Other packaged benefits such as a motor vehicle are generally expenses paid by the employer as they are incurred (for instance lease payments). It would be unusual for an unpaid amount to accrue in a employer's balance sheet for such benefits.

2.3 Accounting Standards AASB1028/AAS30

The standard sets out the principles to be applied in accounting for employee entitlements.

These provisions do not have any bearing on the security of employee entitlements due to the low ranking of employees as creditors in the event of insolvency (see Section 3)

AASB 1028 was issued in March 1994 (and subsequently re-issued in June 2001). At the time of writing, there was discussion about implementation of international accounting standards by 2005.

Generally (under AASB1028), the amounts that companies are required to accrue are adjusted for the probability that they will be received and are measured at their present values, ie adjusted for future salary inflation and discounted with interest.

The requirement to use present value has seen the actuarial profession become involved with the valuation of employee liabilities (particularly long service leave), although the standard does not require actuarial involvement. However, the complexity of the task and the question about reliability of short-hand techniques has seen many large companies use actuaries to value their liabilities.

Benefit	Amounts Accrued under AASB1028
Annual Leave	Yes
Long Service Leave	Yes
Sick Leave	Yes (vested only ⁴)
Accrued Superannuation Benefits	No
Share Plans/Options	No
Other Packaged Benefits	No
Payment in Lieu & Severance Payments	No ⁵
Unpaid Salary /Superannuation Contributions	Yes

⁴ Vested sick leave accumulates and vests in a similar manner to annual leave. Non-vested sick leave is only paid upon a valid claim for sickness/injury by an employee. Typically non-vested sick leave is not considered material and a liability is not accrued.

⁵ Severance payments that are known at the balance date, need to be accrued.

3 What do we mean by Insolvency?

The following material has been summarised from Section 4 of the Productivity Commission Report “Business Failure and Change”.

3.1 Definitions

The main bodies of law relating to insolvency are Corporations Law (for businesses that are incorporated) and the Bankruptcy Act 1966 (for unincorporated entities).

Insolvency is the situation where an individual or a business is unable to pay debts as and when they fall due for payment.

A bankrupt is a person who is unable to meet his or her liabilities and has either presented a debtor's petition to the Official Receiver, or had a sequestration order made against their estate.

For incorporated businesses there are three main ways action may be taken in the event of insolvency:

- Voluntary Administration

The appointment of an administrator to take control of the affairs of a financially distressed company (with the aim of trading out of insolvency)

- Receivership

The process in which a receiver is appointed to a company to collect or protect property for the benefit either of the appointor or the persons ultimately held entitled to that property.

- Liquidation (winding up)

The process of terminating, or ‘winding-up’, an incorporated business. This involves ceasing business operations, realising its assets, discharging its liabilities and distributing any surplus assets among its members. This can be done by the appointment of an administrator by creditors or by court order.

The main differences relate to

- the parties that can initiate insolvency proceedings;
- events that can trigger proceedings;
- control rights over the business in the period between insolvency and winding up or reorganisation;
- the ability to finance continued operations;
- avenues for continued trading; and
- constraints on businesses continuing as going concerns.

3.2 Priorities in insolvency

The Government has made some comments on the possibility of changing the ranking of employees as creditors in relation to employee entitlements in the event of insolvency. This has not occurred.

The ranking of creditors in the event of insolvency (for an incorporated entity) depends on the action taken, as shown below.

Priority in declining order	Liquidation	Receivership
Highest Priority	Costs of winding-up reasonably incurred by the liquidator or provisional liquidator. Includes wages and salaries of employees during the administration period.	Any insurance liability owing to a third party where the company has already received the payment from the insurer.
Next Priority	Applicable in the case of compulsory winding up only: the cost of the application for winding-up order.	Reasonable fees and expenses of an auditor incurred before the appointment of the receiver.
Next Priority	Debts incurred by administrator during administration of the company and certain deferred expenses. Primary amongst these is the remuneration of the liquidator.	
Next Priority	Wages and superannuation contributions of employees. Under S 561 these debts have priority over floating charges but not other forms of security.	Employee wage and superannuation contributions. But see note below.
Next Priority		Employee leave entitlements (but see note below).
Next Priority	Employee retrenchment payments.	Employee retrenchment payments.
Next Priority	Dividends to unsecured creditors.	Payment of interest and principal to relevant debenture holder holders.
Next Priority	Any surplus to shareholders.	Distribution of any surplus to unsecured creditors.

Note: Assets covered by a property charge do not form part of the assets available for distribution. In this sense, creditors secured by a property charge can be said to have priority over all other stakeholders. In the case of a floating charge this may effectively entail all the present and future assets of the company (Keay 1999, p. 469). A partial exception to this, however, is that the employee wages and superannuation debts have priority

4 What is currently the situation?

4.1 Recent History

There have been some recent high profile company insolvencies that have led to losses in employee entitlements⁶:

- Gilberton Abattoir, Grafton (1997) – 250 employees lost around \$3 million in accrued entitlements.
- CSA Copper Mine, Cobar (1998) – 270 employees owed approximately \$9.0 million in accrued entitlements on closure (eventually recouped around 85%).
- Oakdale Colliery, Camden (1999) – 125 employees lost \$6.3 million in accrued entitlements.
- National Textiles, Rutherford (2000) – 340 employees owed approximately \$11.0 million in accrued entitlements.
- Ansett (2001) – 16,000 employees owed approximately \$500⁷ million in accrued entitlements.

The last case necessitated a special scheme be established by the government (outside its previously established arrangements) with the cost of the scheme funded by a levy on airline tickets.

4.2 GEERS

The Federal Government originally implemented a scheme known as the EESS (Employee Entitlement Support Scheme) which operated from 1 January 2000. The EESS provided limited payments by the Federal government to employees of failed companies in relation to their termination entitlements which were not met by the former employer (participating State governments provided matching payments).

The EESS was replaced on 12 September 2001 with the more generous GEERS (General Employees Entitlements Scheme). GEERS applies to all employees whose employment is terminated by reason of their employer's insolvency on or after 12 September 2001. A special (more generous) scheme applies to former Ansett employees.

Key Provisions of GEERS:

- Funded from taxpayer funds, but Government can then attempt to recoup some or all of cost from employer liquidation proceeds.
- Payment generally through insolvency practitioner, but individual employees must claim their entitlements within a year of termination.

⁶ Bickerdyke, Lattimore, Madge (2000). ACTU Media Release "Cabinet must improve Reith Scheme" (25 January 2000)

⁷ Media Reports, S. O'Neill, B. Shepherd, Parliamentary Library "E-brief"

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- Pays termination entitlements as follows, all based on the employee's actual wage up to a maximum of \$81,500 p.a. (indexed annually), to the extent that the employer is not able to meet the payments:
 - Unpaid wages including shift allowances & overtime.
 - Unpaid annual leave including leave loading if applicable, in relation to both taken and untaken leave.
 - Unpaid pay in lieu of notice.
 - Unpaid redundancy entitlements, based on the employee's employment conditions, up to a maximum of 8 weeks' pay.
 - Unpaid long service leave (both taken and untaken).
 - Payments are available to employees whose employment was terminated on or after 12 September 2001 due to the employer's insolvency or employees who resigned on or after that date due to non-payment or under-payment of wages. Contractors and shareholding executives are excluded.
 - GEERS is an administrative scheme run by the Department of Employment and Workplace Relations. There is no specific legislation covering the scheme.

The Government has also introduced changes to Corporations Law aimed at enhancing protection of employee entitlements. Specifically, these changes:

- Tighten the provisions designed to prevent insolvent trading, and
- Introduce new rules designed to stop companies from making arrangements which reduce the amount otherwise available to meet employee entitlements.

4.3 ALP Proposal

The ALP has tabled a private member's bill for its scheme to ensure employee entitlements are paid (Employee Protection (Employee Entitlements Guarantee) Bill 2002). At the date of writing this paper, the Bill has had a first reading only, with no debate in Parliament.

The ALP proposal's key features are:

- Employers with 20 or more employees, which have not guaranteed employee entitlements by other means (eg Trust fund, bank guarantee, insurance bond) must effect an approved insurance policy guaranteeing the payment of covered entitlements in the event of insolvency.
- Covered entitlements are not capped in any way, and comprise:
 - Unpaid wages (including all items payable under the employment contract).
 - Unpaid annual leave (including leave loading if applicable) in relation to both taken and untaken leave.
 - Unpaid pay in lieu of notice.
 - Unpaid redundancy entitlements, based on the employee's employment conditions.
 - Unpaid long service leave (both taken and untaken).
 - Unpaid repayment of training costs paid to the employer by the employee.
 - Unpaid employer superannuation contributions.
- Premiums to approved insurers would be capped by regulation. The proposal provides for cross-subsidies between insurers by regulation. The ALP estimates premiums would be around 0.1% of salaries.
- Employees of exempt employers (basically charities and those with less than 20 employees) would be covered by the government. Approved insurers may be

required by the government to contribute to the cost of this.

- Claims are administered by the relevant insurer, other than claims in relation to exempt employers, which are administered by the government.

The ALP proposes at the same time to “improve corporate behaviour” in particular in relation to related companies being liable for entitlements owed to ex-employees of failed subsidiaries.

4.4 Union initiative– NEST

The AMWU has been the main driving force behind the National Entitlement Security Trust (NEST), previously Manusafe, which is a trust fund for the provision of employee entitlements. NEST so far has a small number of participating employers.

The main features of NEST are:

- NEST is a trust fund which the AMWU intends to become a vehicle for funding all employee entitlements. Contributions towards funding employee entitlements through a trust arrangement are tax deductible to the employer.
- The entitlements funded through NEST are determined by the relevant employment agreement, and can include long service leave, annual leave (including loading), sick leave, severance payments (including but not restricted to redundancy), paid parental leave, and any other entitlements agreed to under employment agreements, for example study leave.
- The employment agreement would specify which entitlements are covered, the level of entitlements provided and the amount to be paid by the employer.
- Contributions are paid into an account for each employee. No interest is credited to the account in NEST.
- NEST does not remove the employer’s liability to pay an entitlement. Rather, the employer pays out the entitlement to the employee, and then claims reimbursement from NEST on provision of the required paperwork. Reimbursement is provided up to the amount of the employee’s account in NEST, the employer is liable for any additional amounts where the total contributions in NEST are not sufficient to pay for the actual entitlement paid.
- There is no provision for reversion of non-vested amounts on the lapse of entitlements. In fact, the AMWU has stated that through NEST, it wishes to make entitlements portable such as long service leave, sick leave etc that may currently lapse on changing employment.

4.5 Pre-funding through Trusts

Apart from the high profile NEST, there are many industry sectors where these trusts are already a reality, particularly where there is portability of entitlements.

The total amounts invested in these funds is not inconsiderable - \$1.4 billion, around 500,000 employees (or around 5% of the Australian workforce). See Section 4.5.6 below.

4.5.1 Long Service Leave Trusts

With the exception of NEST, the liabilities in these trusts are a salary based defined benefit and as a result require actuarial valuation and control.

Long Service Leave payments are made by the employer who is then reimbursed by the trust directly.

Refer to Section 4.5.6 for more detail.

4.5.2 Redundancy Trusts

Benefits in these trusts are usually accumulation in nature and so have little actuarial involvement. Benefits may either be paid directly to members or via employers.

Refer to Section 4.5.6 for more detail.

4.5.3 Regulatory Issues

The long service leave trusts are established by state government legislation, however many of the newer trusts (eg NEST) are not.

Disclosure and licensing through Corporations Law is an issue the trusts are currently dealing with following the Financial Service Reform Act⁸.

These trusts are not overseen by APRA and no prudential or disclosure legislation exists that regulates these trusts (other than State based legislation in some cases).

Indeed, there are several tax and regulatory issues that remain unresolved. It is not clear whether the Managed Investments Act applies, although several trusts have indicated they do not believe it applies.

4.5.4 Tax Issues

There has been considerable uncertainty about taxation of these trusts. A summary of the current arrangements (at the time of writing) is contained in the table below.

Deductibility of contributions by employer	Yes (no limit applies)
Fringe benefits tax on contributions	FBT exempt provided fund meets qualifying criteria (legislation yet to be drafted).
Tax on contributions	Nil
Tax on Investment Income	Nil, if income fully distributed.
Tax on benefits	Taxed as per normal rules applying to various benefits.

⁸ John Garnaut, The Age "Financial Advice? Give me a look at your licence", 16 March 2002

4.5.5 *Extent of portability of Long Service Leave*

The trusts listed in the table in Section 4.5.6 service industries with portable long service leave arrangements. The industries include:

- Building and Construction.
- Coal Mining.
- Manufacturing (subject of current industrial action by AMWU).
- Cleaning (in Victoria and ACT).

Other industry sectors that have portable long service leave arrangements not funded through trusts include⁹:

- Maritime Industry – previously employers contributed to a central funding arrangement through a company – the Australian Maritime Industry Pty Limited. This arrangement has recently been dissolved and portability of the accrued liability is achieved by a payment from one employer to another.
- Stevedoring – funding arrangement similar to the Maritime Industry.
- Australian Public Service – employees accrue continuous long service leave even if they move between departments and agencies in the Federal and State jurisdictions. There is no central pre-funding or transfer of assets between agencies when an employee transfers.
- Higher Education – similar to Australian Public Service.

Portable arrangements in the private sector have arisen in situations where the nature of employment is more likely to be short term, and thus accrual of benefits with one employer unlikely.

Portability within an industry increases the value of the benefits, as the probability the benefits are received increases (that is, the probability of working in an industry for the minimum period is greater than the probability of working for one employer).

Taken to its extreme, benefits which are completely portable (ie between any employer in any industry) would simply be deferred salary as there would be no risk the benefits would not be received at the expiry of a minimum period.

⁹ McLaughlin (1998)

4.5.6 Statistics on the Trusts

As these trusts are not overseen by APRA, no official statistics are available. The statistics contained in the tables below have been compiled from the annual reports of the various trusts.

Long Service Leave Trusts

Trust	Covers	No. employees covered/ No Accounts	Total Fund Assets (before liabilities)	LSL Liabilities	Employer Contribution	Year Commenced	Report Date
Construction							
ACT Construction Industry Long Service Leave Board (ACT)	Long Service Leave	16,628	\$42.0m	\$19.3m	1.0% of OTE	1981	30 June 2001
Long Service Payments Corporation (NSW)	Long Service Leave	218,719	\$394.0m	\$302.0m	No Employer – funded by levy 0.2% of cost of work on all building projects over \$25,000	1975	30 June 2001
Q Leave (QLD)	Long Service Leave	102,908	\$181.6m	\$80.5m	No Employer – funded by levy 0.2% of cost of work on all building projects over \$80,000	1992	30 June 2001
Construction Industry Long Service Board (SA)	Long Service Leave	15,865	\$25.8m	\$25.1m	1.6% OTE	1977	30 June 2001
TAS Build (TAS)	Long Service Leave	6,367	\$39.2m	\$17.7m	0.7% OTE	1971	30 June 2001
Coinvest (VIC)	Long Service Leave	117,313	\$369.2m	\$190.7m	Currently on contribution holiday – expected to be 1% of OTE from 1 July 2003	1976 (government) / 1997 Privatised	30 June 2001
Construction Industry Long Service Leave Board (WA)	Long Service Leave	37,222	\$86.0m	\$58.8m	0.1% of OTE	1985	30 June 2001

Mining							
Coal Mining Industry (Long Service Leave) Corporation (all states)	Long Service Leave	17,794	\$245.8m	\$358.8m	5% of eligible wages (previously funded through coal excise per ton of coal)	1949	30 June 2001
Manufacturing							
NEST (formerly Manusafe)	Long Service Leave and Severance (see above)	N/A	N/A	N/A	Fixed Dollar contributions for each employee.	July 2001	N/A
Other							
The A.C.T. Cleaning Industry Long Service Leave Scheme	Long Service Leave	2,917	\$0.3m	\$0.3m	N/A	2000	30 June 2001
Total		535,733	\$1,383.9m	\$1,053.2m			

Redundancy Trusts

Trust	Covers	No. employees covered/ No Accounts	Total Fund Assets (before liabilities)	Liabilities	Employer Contribution	Year Commenced	Report Date
Electrical Industry Severance Scheme (Protect)	Redundancy, income protection, dental, training assistance	6,511	\$56.2m	\$56.2m	typically \$51.40 per week, specified in Certified Agreements and awards	1998 (as ElecNet)	30 November 2002
Australian Construction Industry Redundancy Trust (ACIRT)	Redundancy Funeral	67,938	\$191.0m	\$178.9m	\$ per week specified in certified agreements and awards (minimum \$25pw)	1994	30 June 2002

Building Employees Redundancy Trust (QLD) (BERT)	Redundancy, Training, Trauma counselling	37,000	\$39.3m	\$39.3m	\$ per week determined by award	1989	30 June 2002
South Australia Building Industry Redundancy Scheme Trust (BIRST) (SA)	Redundancy, Emergency Ambulance, Funeral Cover, Journey Accident cover	N/A	\$13.6m	\$12.8m	typically \$40 per week	1989	30 June 2000
Contracting Industry Redundancy Trust (CIRT) (QLD) (Electrical)	Redundancy, Resignation, Emergency Transport	4,900	\$7.0m	\$7.0m	typically \$55 per week	1990	22 November 2002
Mechanical And Electrical Redundancy Trust (MERT)	Redundancy, Education, Training	16,139	\$46.1m	\$46.1m	Minimum \$25 per week	1988	30 June 2002
Total		> 132,488	\$353.2m	\$340.3m			

Notes:

1. In addition to these trusts above, we are aware of some company run trusts accepting “rollovers” and accruing entitlements. Not all of these are fully funded.
2. The total number of members should be considered with caution due to problems with reliability of data including inactive accounts and multiple accounts.

4.6 Insurance

Protection of some employee entitlements can be made through the use of insurance, whereby the employer pays a premium to transfer the risk to an insurer. The degree of protection is then determined by the security of the insurer.

Insurance bonds exist which will provide protection for employee entitlements in an event of an "insolvency event". Some of the rules which are part of the bonds are:

- specified expiry date (likely to be agreed with union/employees);
- the insolvency event must occur before the expiry date;
- the insurance proceeds will be determined after taking into account all recoverables;
- the insurance proceeds will be paid to a trustee who will be responsible for distributing the proceeds to the (former) employees.

The insurer concerned will only issue contracts of this type to very credit worthy applicants. Some less credit worthy applicants may be approved if the insurer can obtain security over the applicant's assets.

4.7 Bank Guarantees

Some companies have effected bank guarantees to secure employee entitlements in the event of company failure. A bank guarantee typically has the following features:

- The bank guarantees to pay cash up to a fixed dollar amount to a third party if the company effecting the guarantee is unable to pay the amount when required.
- The company pays an annual or six-monthly administration fee (less than 0.5% of the amount of the guarantee) to the bank for the guarantee.
- The guarantee is only granted by the bank when it can be fully secured by assets of the company.
- The guarantee is typically for a fixed period of time.

The main advantage of a bank guarantee is that it provides ready access to cash and this is available when needed. However:

- the dollar limits may mean a company is unable to secure all entitlements, and
- a company which is in difficulties would find it very difficult to renew a guarantee when its fixed term has expired.

5 What is magnitude of problem? / What is at risk?

5.1 Estimate of National Total Entitlements Liability

We are not aware of any national statistics being collected in relation to the value of employee entitlements, nor are we aware of any published estimates of the national entitlement liability.

There are, however, published estimates in relation to the amounts lost in the event of redundancy including those by the ACTU¹⁰, Benfield Greig¹¹, and the Productivity Commission¹².

We have estimated the national entitlements liability in order to:

- Establish the significance of the issue.
- Examine the magnitude of the assets required to pre-fund employee entitlements through trusts.
- Act as a starting estimate for estimating the premium and claim size if entitlements were secured through an insurance scheme.

Our estimates are set out in the table below.

Benefit	Amount (\$m)
<i>Currently Accrued Entitlements (not on termination)</i>	
Long Service Leave	\$16,480
Annual Leave (four weeks assumed)	\$18,878
Total Currently Accrued	\$35,358
<i>Additional Entitlements on Termination</i>	
Long Service Leave	\$183
Payment in lieu of notice	\$18,878
Severance Payments	\$42,282
Unpaid salary / superannuation contributions	\$9,439
Total Additional on Termination	\$70,782
TOTAL ON TERMINATION	\$106,140
PER ELIGIBLE EMPLOYEE (\$ APPROX)	\$18,400

Appendix 2 provides more detail on the above estimates.

¹⁰ ACTU 1998

¹¹ Benfield Greig 1999

¹² Bickerdyke, Lattimore, Madge 2000

A useful benchmark for comparison is the current level of accrued superannuation assets - \$528bn at 1 January 2002¹³. Indeed, superannuation was previously an employee entitlement that was funded on employers' balance sheets (just as other employee entitlements such as long service leave are currently liabilities on company balance sheets)

The entitlements have been grouped into currently accrued entitlements and those additional entitlements payable on termination.

The currently accrued entitlements (\$35.4bn) represent those payable under normal circumstances and this figure is the starting point for estimating the amount of assets that would need to be held in trust funds if that was the preferred method of protecting employee entitlements. This estimate has been determined using the principles in AASB1028 and includes adjustments for the probability that benefits are received and to measure the benefits at present value.

The additional entitlements on termination represent those additional amounts payable on redundancy (and in the event of company insolvency). They have not been adjusted for the probability that benefits are payable (Appendix 2 provides more detail of these calculations).

We have examined sensitivity of the results to a change in each of the major assumptions (by 10%) producing a variation of around +/- \$3bn for currently accrued entitlements and around +/- \$8bn for additional entitlements on termination.

5.2 Reasonableness based on ASX 300 reported liabilities.

The following table shows the main results from the survey listed companies.

Size Company	Sample size	Total Net Assets (\$bn)	Avg AASB 1028 Provision (% of net assets)	Std dev AASB 1028 Provision (% of net assets)
ASX 100	10	12,395	3.9%	3.4%
ASX100- 200	10	1871	5.0%	2.8%
ASX 200- 300	10 ¹⁴	497	4.4%	2.5%
Total	28	14,763	4.4%	2.9%

While the result is quite variable, the average AASB1028 provision as a percentage of the surveyed companies net assets is 4.4%. Extrapolating the results, the market capitalisation of companies listed on the Australian Stock Exchange is around \$1,400 bn.¹⁵

Assuming that the ratio of net assets to market capitalisation is around 70%¹⁶, an average AASB 1028 provision of 4.4% produces a total AASB1028 provision of around \$43bn. Obviously, the number only includes listed companies and so excludes governments, non listed companies, other organizations.

Therefore the estimate of \$35.4 bn for currently accrued liabilities would appear to be conservative.

¹³ APRA website (www.apra.gov.au)

¹⁴ 2 companies have no employees

¹⁵ ASX All Ords total captilisation May 2002

¹⁶ Data curtesy of Colonial First State (data excludes financial stocks)

6 Further Debate

The IAAust intends to prepare a second paper to further the debate on the issue of the protection of employee entitlements.

The objectives of the second paper will be to:

- Consider the different types of employee entitlements and comment on whether or not each type could be subject to a greater level of protection than currently applies.
- Analyse the implications of the different schemes currently in place or currently being proposed ie GEERS, the proposal put forward by the ALP and NEST.
- Analyse the implications of using separate trust arrangements.
- Analyse the implications of using insurance arrangements.
- Analyse the implications of using bank guarantees.
- Put forward and examine a range of other alternative approaches that could be used. These approaches will include:
 - The provision of the option for employees to cash out vested entitlements over a given level or after a period of time – either on a compulsory or voluntary basis .
 - The option of requiring part of the entitlements to be secured by assets of the employer.
 - The provision of the option for employees to transfer vested entitlements to appropriate third party vehicles.
 - The use of superannuation funds as vehicles to support the separate funding of entitlements.
 - The establishment of a national insurance scheme financed out of general government revenue.
- Review the approaches used by other countries to address this issue.

The paper will also consider the issue of the extent to which employers should be required to provide advice to their employees regarding the financial security of their entitlements – whether secured, held in trust or unsecured.

Appendix 1: Summary of Long Service Leave Provisions

	NSW	QLD	WA	SA	TAS	ACT	Federal Awards / VIC
WHEN LEAVE CAN BE TAKEN							
First Entitlement	10 Years	15 Years	15 Years	10 Years	15 years	10 years	15 Years
Next Entitlement	due every 5 years	due every 15 years	due next 10 years then can take proportionate entitlements	due every 10 years	due every additional 10 years	due every additional 5 years	due every 10 years
Service Counts After	1 April 1963	11 May 1964	1 October 1964	1 January 1972	17 December 1964	11 May 1964	1 April 1963
Payment in Lieu of Long Service Leave							
When do you first get entitled to payment in lieu if: resign retrenched* die disabled *excludes serious and wilful misconduct (full pro-rata payment [based on days] applies unless stated otherwise)	10 years 5 years 5 years 5 years Once entitled to leave, pro-rata on complete years of service	10 years 10 years 10 years 10 years	(3) 15 years 10 years 10 years not stated but treat as for retrenchment	(1) 7 years 7 years 7 years not stated but treat as for retrenchment Once entitled to leave, pro-rata on complete years of service	15 years 7 years 7 years 7 years	10 years 7 years 7 years 7 years	(2) 10 years 10 years 10 years 10 years
What amount at: 5 years 10 years 15 years	1 month 2 months 3 months	n/a 8 ² / ₃ weeks 13 weeks	n/a 8 ² / ₃ weeks 13 weeks	n/a 13 weeks 16.5 weeks	n/a 8 ² / ₃ weeks 13 weeks	n/a 2 months 3 months	n/a 8 ² / ₃ weeks 13 weeks
PAYROLL TAX	7%	7%	6%	7%			n/a

Appendix 2: Estimate of Total Entitlements Liability

National Earnings for those with Entitlements

Naturally, some broad assumptions are required to derive the estimate. The major assumption on which many of our estimates are based is the total earnings for those with entitlements.

While data is available on earnings from the Australian Bureau of Statistics, the data requires adjustment for those employees who are not eligible for employee entitlements. These adjustments are made below:

Total Earnings for all wage and salary earners ¹⁷	\$72,265.4m x 4	\$289,061.6m
Less		
Total Earnings for employees not entitled to annual leave and long service leave		
= Estimated number of casual employees x Estimated average casual earnings	1,900,920 x \$22,961	\$43,647.0m
Total Earnings for those with entitlements		\$245,414.6m

WHERE

Estimated number of casual employees = Total no. employees x proportion of casual employees ¹⁸	7,667,700 x 0.24791	1,900,900
Estimated average casual earnings = Average Weekly Earnings (AWE) ¹⁹ x 52 x Assumed casual earnings as % of AWE ²⁰	\$883.1 x 52 x 50%	\$22,961pa

¹⁷ ABS 6248.0 Wage and Salary Earners, Australia December Quarter 2001

¹⁸ ABS 6254.0 Career Experience, November 1998 (permanent v casual).

¹⁹ ABS 6302.0 Average Weekly Earnings November 2001

²⁰ General assumption being an adjustment for the fact that casual employees do not always work a full week.

Long Service Leave

To estimate the national long service leave liability we have adopted a first principles approach based on available national statistics on salary and length of service. The table below summarises the assumptions and calculations for the currently accrued long service leave liability and uses the "short hand techniques" set out in the working guide to AASB1028.

Duration of current job	% in cohort ²¹	Salary for cohort (\$m) ²²	Assumed service accrued for LSL ²³	Accrued LSL days ²⁴	Probability ²⁵	Discount ²⁶	Salary ²⁷ Inflation	Total (\$m)
< 1 year	23.7	58,163	0.5	3.0	0.28	0.55	1.45	108.48
1-2	12.7	31,168	1.5	9.1	0.32	0.59	1.40	204.10
2-3	9.7	23,805	2.5	15.2	0.37	0.62	1.34	304.06
3-5	13.1	32,149	4.0	24.3	0.45	0.69	1.27	831.84
5-10	16.4	40,248	7.5	45.5	0.72	0.85	1.10	3,386.04
10-20	16.1	39,512	10.0	60.7	1.00	1.00	1.00	6,567.25
20+	8.3	20,369	15.0	91.0	1.00	1.00	1.00	5,078.40
Total	100.0	245,415	5.16					16,480.16

The calculation for the total liability payable upon termination is set out below.

Duration of current job	% in cohort	Salary for cohort (\$m)	Assumed service accrued for LSL	Accrued LSL days	Probability	Discount	Salary Inflation	Total (\$m)
< 1 year	23.7	58,163	0.5	3.0	0.00	1.00	1.00	0.00
1-2	12.7	31,168	1.5	9.1	0.00	1.00	1.00	0.00
2-3	9.7	23,805	2.5	15.2	0.00	1.00	1.00	0.00
3-5	13.1	32,149	4.0	24.3	0.00	1.00	1.00	0.00
5-10	16.4	40,248	7.5	45.5	1.00	1.00	1.00	5,017.21
10-20	16.1	39,512	10.0	60.7	1.00	1.00	1.00	6,567.25
20+	8.3	20,369	15.0	91.0	1.00	1.00	1.00	5,078.40
Total	100.0	245,415						16,662.86

Paradoxically, the amount payable on termination is less than that currently accrued due to no payment being required for employees with less than 5 years service (although this varies by jurisdiction).

²¹ ABS Labour mobility 6209.0 Feb 2000

²² % in cohort multiplied by estimated National Earnings for those with entitlements. This method might produce a result which is too low, as it is possible that those employees with longer service have larger salaries.

²³ mid points except that for employees with more than 10 years' and less than 20 years' service, assume 50% of employees take their long service leave (ie 50% have only 5 years accrued, 50% have 15 years accrued), and for employees with more than 20 years service, assume 33 1/3% have 5 years accrued, 33 1/3% have 15 years accrued, 33 1/3% have 25 years accrued

²⁴ Assuming 13 weeks after 15 years, available after 10 years.

²⁵ General assumption of termination rate of 12.5%pa

²⁶ 10 year government bond rate of 6.5% as at June 2002

²⁷ 4% salary inflation rate, based on a long term typical "gap" between investment return and salary inflation of 2.5%.

Annual Leave

The accrued annual leave assumption is more difficult to determine. While there are statistics on length of service (and therefore the amount potentially accrued), an assumption is required as to the amount of annual leave actually taken. Another variable is different company policies in relation to maximum accrual of leave (before requiring it be taken).

The Benfield Greig²⁸ report used an assumption of 4 weeks accrued (and the reasonableness of their assumptions were considered by the NSW Department of Industrial Relations).

Using this assumption, the estimate is therefore 4/52 times the national earnings for those with entitlements.

Payment in Lieu of Notice

The amount of payment in lieu of notice is typically 4 weeks pay. The estimate is therefore 4/52 times the national earnings for those with entitlements.

Severance Pay

Using the scale of benefits applying in the NSW Employment Protection Act.

Duration of current job	% in cohort	Salary for cohort (\$m)	Assumed avg service	# weeks payment	Total (\$m)
< 1 year	23.7	58,163	0.5	0.0	0.00
1-2	12.7	31,168	1.5	4.0	2,397.51
2-3	9.7	23,805	2.5	7.0	3,204.55
3-5	13.1	32,149	4.0	12.0	7,419.07
5-10	16.4	40,248	7.5	14.0	10,836.00
10-20	16.1	39,512	15.0	16.0	12,157.46
20+	8.3	20,369	20.0	16.0	6,267.51
Total	100.0	245,415	6.4 ²⁹		42,282.09

However, not all employees entitled are automatically eligible to receive severance payments, in particular, those employees with Australian Workplace Agreements may not have provision for such payments. There are also employees whose Enterprise Bargaining Agreements or Awards give them higher levels of severance payments.

However only 1.2% of employees have Australian Workplace Agreements, and 75% of those agreements have severance provisions³⁰. Therefore on materiality grounds, it is assumed all employees have severance provisions.

²⁸ Benfield Greig (1999)

²⁹ Average - not used in calculations.

³⁰ Shergold, DEWRSB 2000

Unpaid Salary / Superannuation Contributions

Benfield Greig uses an assumption of 4 weeks salary (and no explicit assumption for superannuation).

We have maintained this assumption in the absence of any further information. We have not allowed for superannuation payable on unpaid salary.

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