



Superannuation Guarantee non-compliance

Cbus

September 2015

Agenda

1. Key findings

2. SG non-compliance summary

3. Detailed insights

4. Methodology

Key findings

1. **Superannuation guarantee (SG) non-compliance continues to be a significant and growing problem, now affecting 690,000 Australians (nearly 7% of the workforce).**
2. **Total estimated SG losses are \$2.6bn in 2013 and have grown at 5% per annum over three years**
3. **Solvent employers failing to meet their SG contributions are the biggest contributor to SG losses.**
4. **Australians affected by non-compliance lose an average of \$3,800 pa in SG contributions – 9 months' worth for someone on average weekly earnings**
5. **This amounts to an annual loss in the future retirement incomes of Australian workers of \$280m (in real terms)**

Agenda

1. Key findings

2. SG non-compliance summary

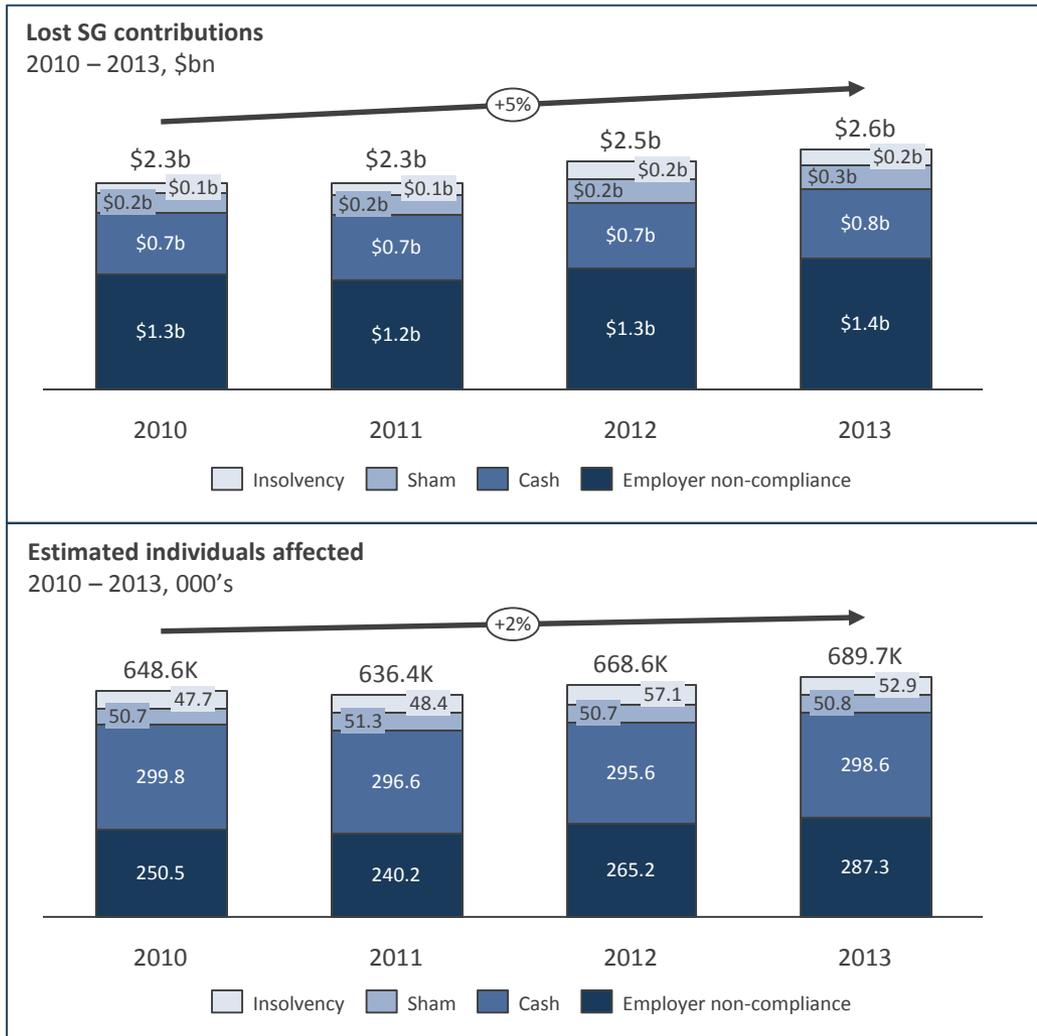
3. Detailed insights

4. Methodology

Superannuation Guarantee non-compliance

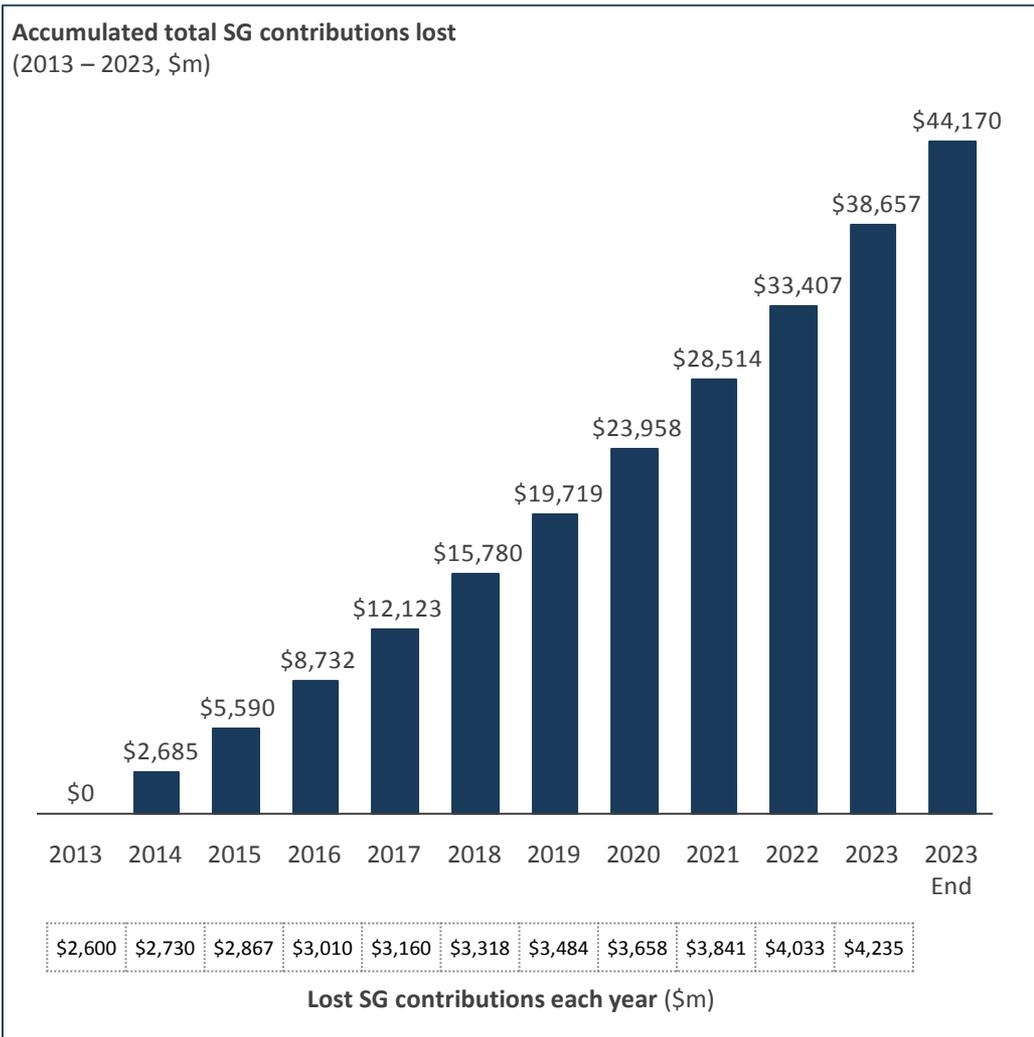
1. **We estimate non-compliance with superannuation guarantee (SG) obligations costs employees ~\$2.6bn pa, or 4.4% of total SG contributions**
2. **At current growth rates, total losses to the superannuation system resulting from SG non-compliance will be \$44b over the ten years to 2023**
3. **Construction is the most affected industry; other industries with elevated non-compliance include property services, mining, hospitality, and manufacturing**
4. **SG non-compliance has four main sources, in order of importance:**
 - Employer non-compliance (SG contributions are not made at all, or only in part); \$1.4bn
 - Cash economy (SG is part of avoidance of PAYG and other employment obligations); \$0.8bn
 - Sham contracting; \$0.3bn
 - Employer insolvency; \$0.2bn
5. **SG non-compliance affects the superannuation of 7% of the workforce every year:**
 - While calculations vary widely, we estimate that ~700,000 miss out on some or all of their super contributions
 - Given the total amount of non-compliance, this is an average of ~\$3,800 pa missing for each person affected
 - Relative to average weekly earnings, the average SG loss is equivalent 9 months of super contributions;
 - These are conservative estimates; the actual contributions lost and individuals affected may be significantly higher
6. **The biggest change has been Employer non-compliance, indicated by the significant increase in SG related complaints (19,500, up from 18,000 in 2012)**
 - Employer non-compliance has grown by 5% per annum on average, increasing from \$1.3b to \$1.4b in the year to 2013

Lost SG contributions total \$2.6b and affect 7% of working Australians



- Estimated lost SG contributions have increased by 5% p.a. over the three years since 2010 to a total figure of \$2.6b per year in 2013
- This is equivalent to 4.4% of all SG contributions, up from 3.9% in 2012
- The number of individuals affected has continued to increase to just under 700,000, or 6.8% of the workforce
- The biggest change has been Employer non-compliance, indicated by the significant increase in SG related complaints (19,500, up from 18,000 in 2012)
- An increased SG rate (9.25% in 2013 compared to 9.0% in 2012) has driven small increases in SG losses through sham contracting and the cash economy
- Insolvencies were down in 2013 indicating an associated small drop in SG losses to \$166m (2012: \$200m)
- Employer non-compliance remains the largest contributor to SG non-compliance, but SG losses due to the cash economy affects the most individuals.

If lost SG contributions continue to grow at it's current rate, it can result in a total loss of over \$44b in 10 years



Cumulative system losses and impact on Australians' retirement incomes

- If the issues of SG non-compliance persists and continues to grow at its current rate of 5% per annum, lost SG contributions from now to 2023 will total over \$44b
- Each dollar coming into the system will be there for 15.3 years until a members' retirement (on average). This year's \$2.6b loss will grow to \$4.7b over that time.
- Assuming a 6% drawdown rate, this indicates a loss of \$280m in Australians' retirement incomes as a result of the 2013 lost SG contributions alone (in today's dollars).

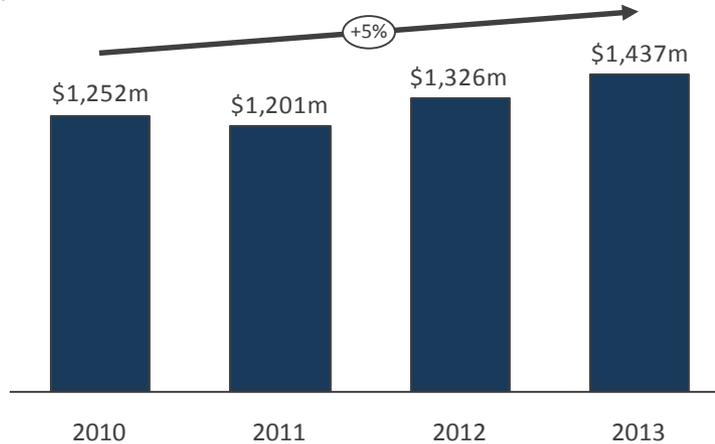
Assumptions: asset growth 6.5% pa; Increase in lost SG contributions 5% pa. All figures in today's dollars

Agenda

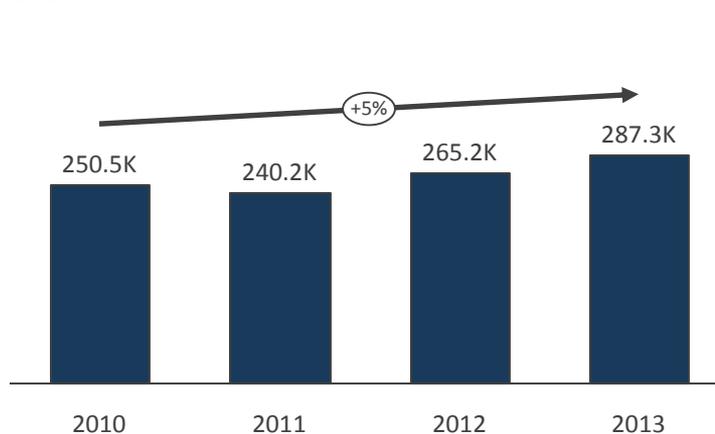
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Employer non-compliance

Lost SG contributions
2010 – 2013, \$m



Estimated individuals affected
2010 – 2013, 000's

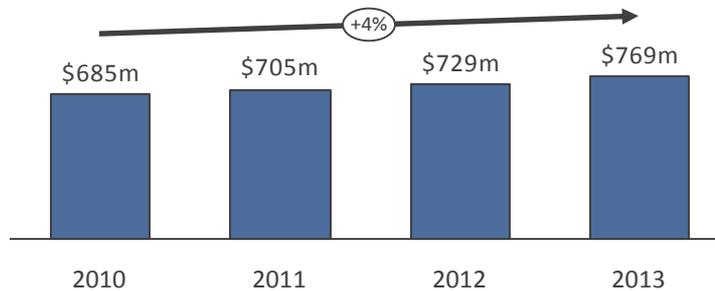


Employers not meeting with their SG obligations, whilst the employee is compliant and lodges a tax return

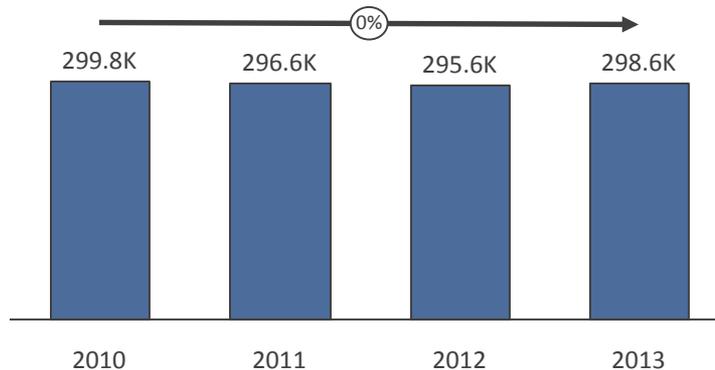
- Employer non-compliance has continued to worsen, with both losses in SG contributions and the number of individuals affected increasing by 5% per annum since 2010
- This most recent increase is driven primarily by the significant jump in SG reported complaints from 18,000 in 2012 to 19,500 in 2013. Unless driven by increased compliance or education efforts, this increase suggests a parallel jump in unreported complaints and incidents where employees are not aware of the issue
- 65-70% of these complaints are confirmed by the ATO to have some degree of employer non-compliance, suggesting a total of ~57,000 separate issues
- An average of \$25,000 per validated complaint indicates a total of \$1,437m lost in SG contributions for 2013
- Each validated complaint is unlikely to be isolated to a single employee; it is assumed that an average of 5 employees are affected per validated complaint, reaching a total of almost 290,000 individuals affected

Cash economy

Lost SG contributions
2010 – 2013, \$m



Estimated individuals affected
2010 – 2013, 000's

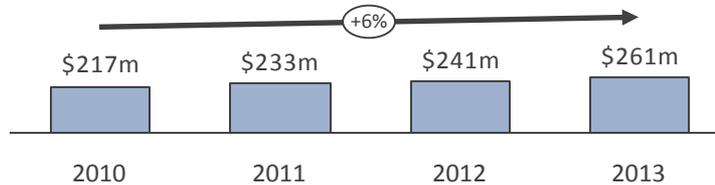


Employer and employee both non-compliant with their SG obligations, failing to declare salary and wage income (but excluding criminal activity such as narcotics)

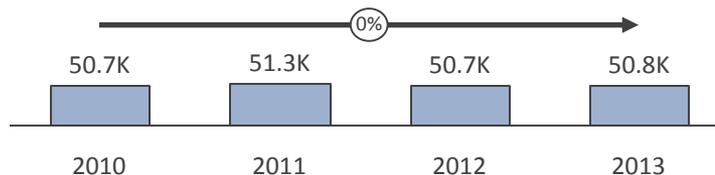
- SG contributions lost from the cash economy have grown by 4% per annum since 2010, however the number of affected individuals remains relatively stable
- Of the four categories of non-compliance, the cash economy affects the most individuals, with Employer non-compliance a close second
- The ABS has estimated the cash economy to be 1.5% of GDP
- Non-compliance due to the cash economy does not solely involve SG, it also includes PAYG, payroll tax, workers' compensation and other employee entitlements
- Missing PAYG salary and wages is estimated to be ~\$8,300m, and at the SG rate of 9.25%, implies missing contributions of \$769m

Sham contracting

Lost SG contributions
2010 – 2013, \$m



Estimated individuals affected
2010 – 2013, 000's

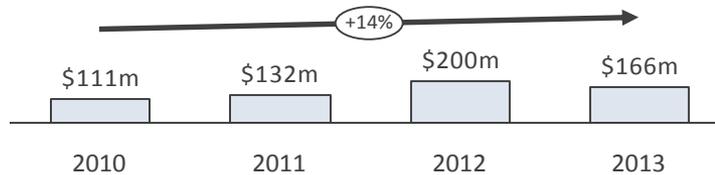


Individuals incorrectly identifying as (or being categorised as) a contractor rather than an employee, to avoid a range of employee obligations including SG

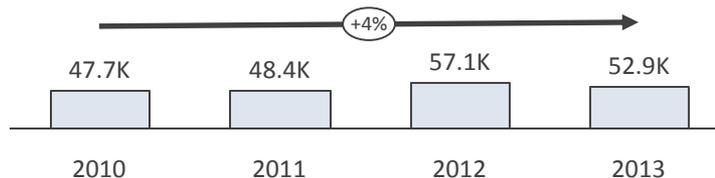
- Lost SG contributions due to sham contracting has continued to worsen, increasing by 6% per annum since 2010
- However, the number of individuals affected by sham contracting remains largely unchanged
- This increase in lost SG can be mostly explained by the increase in the SG rate (to 9.25%) and an increase in average weekly earnings
- Despite this being widely perceived as a problem, particularly in the construction industry, there is very little hard data on the issue
- Independent contractors represent ~10% of salary & wage earners in the PAYG system; it is assumed that 5% of these contractors should have been classified as employees
- Implying a leakage rate of 0.5% of salary and wage income, along with a 9.25% SG rate, delivers an estimate of lost SG contributions at \$261m
- This 0.5% leakage rate is also applied to salary and wage earners reaching the estimate of ~50,000 workers affected

Insolvency

Lost SG contributions
2010 – 2013, \$m



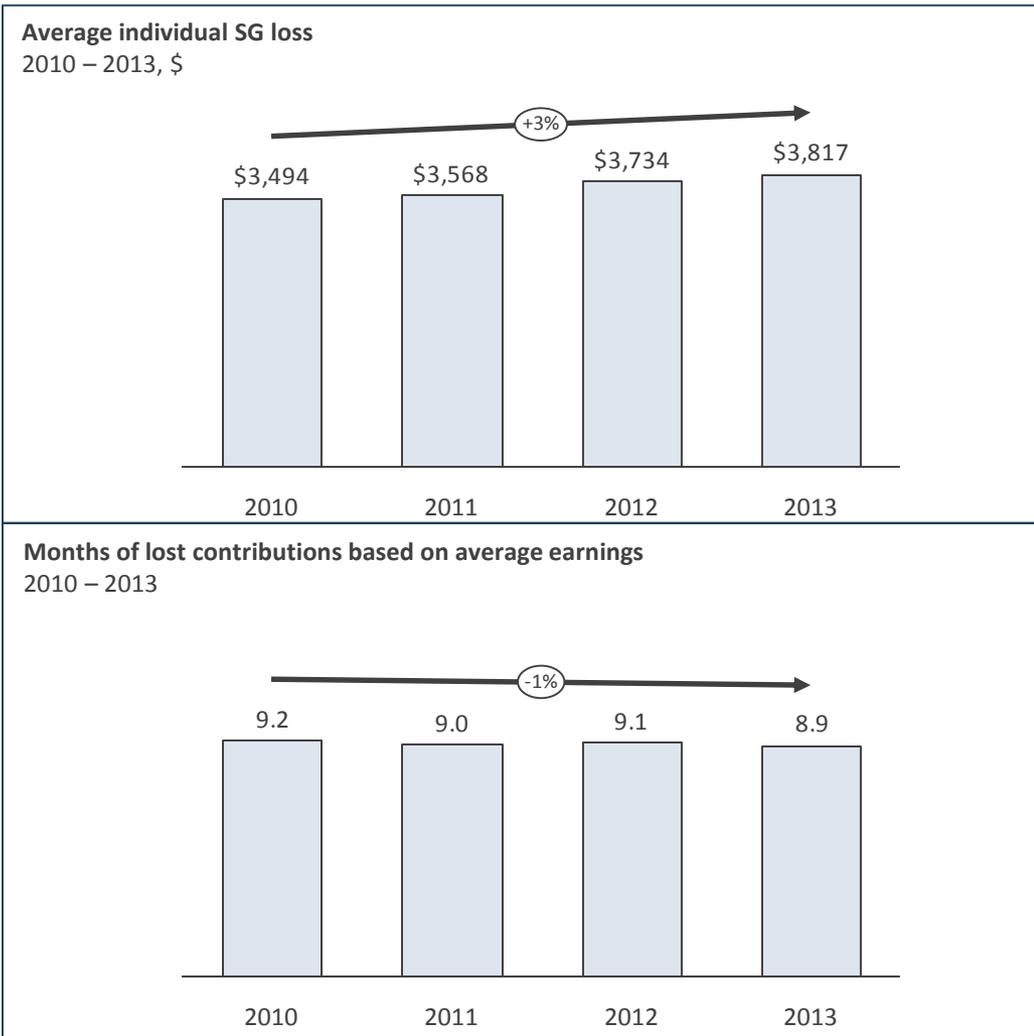
Estimated individuals affected
2010 – 2013, 000's



When employers fail to meet SG obligations due to a lack of funds

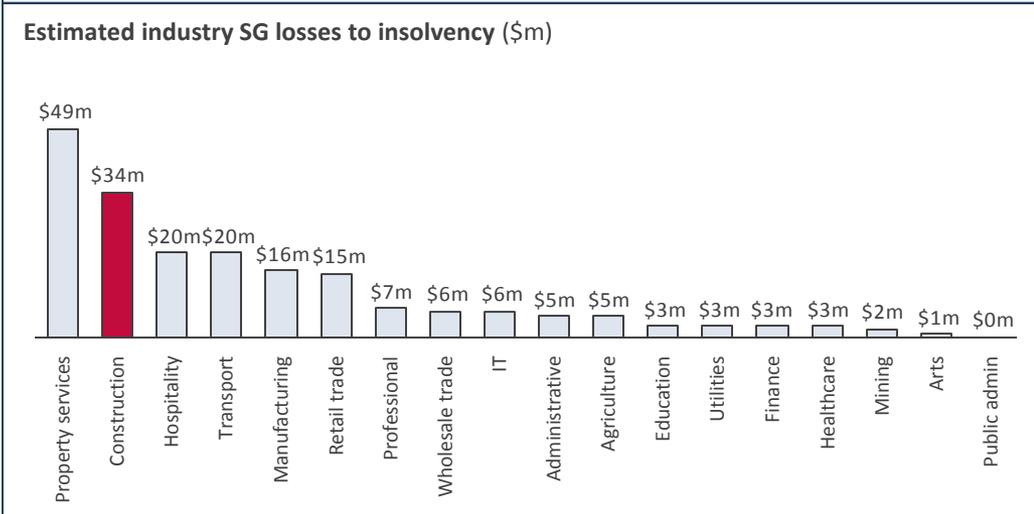
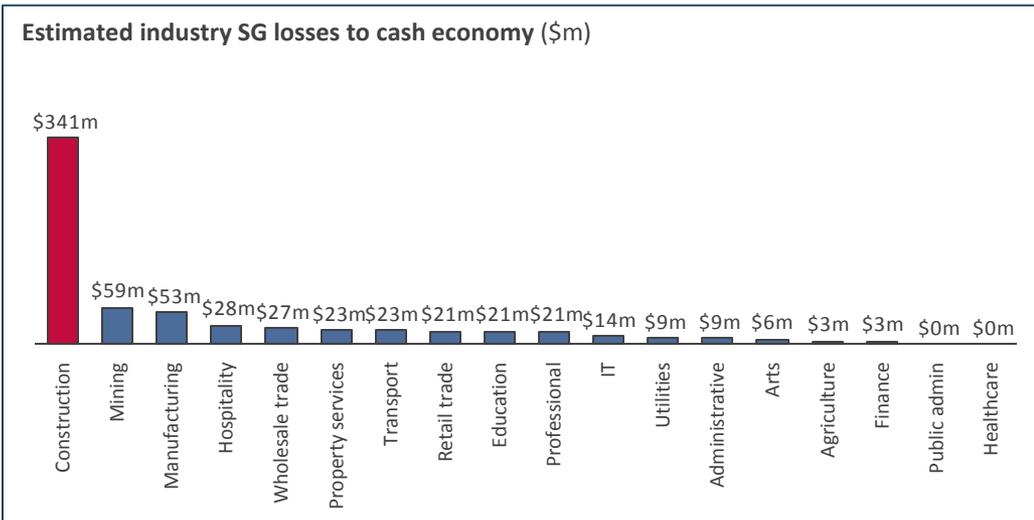
- Following sharp growth in 2011 and 2012, insolvency numbers are down, driving a drop in associated SG losses
- Insolvency remains the smallest source of SG losses
- The recent decrease in both lost SG contributions and individuals affected is solely attributable to the decrease in number of insolvency incidents reported by ASIC
- ASIC groups entitlement losses into relatively broad bands (\$1-100,000; \$100-250,000; \$250,000-\$1m; \$1m+); we make estimates of average losses at lower end of the bands (\$10,000; \$150,000; \$500,000; \$1m respectively) to arrive at our estimate of lost SG contributions of \$166m
- Employees affected by entitlement losses are similarly grouped into wide bands – averages are similarly assumed to be at the lower end to reach our estimate of ~53,000 individuals affected

While individual experience may vary enormously, average impact of SG non-compliance is the loss of 9 months of contributions (or more)



- Individuals' experience of SG non-compliance can vary. One may experience a single occasion of lost SG contributions, whilst others may be subject to multiple years of non-payment
- The average impact of SG non-compliance on an individual has steadily risen over time, increasing by 3% per annum since 2010 to \$3,817 for 2013
- For an individual earning the average wage, this is equivalent to 9 months of lost contributions (since 2010).
- However, most people affected by SG non-compliance tend to have lower incomes, which further exaggerates this effect (i.e. more months of lost contributions)

SG non-compliance occurs in most private sector industries, but is heavily focused in construction



- Data supporting industry attribution of SG non-compliance is limited, but points to common themes of elevated non-compliance activity
- ABS estimates that the construction industry is by far the biggest contributor to the cash economy, and also prominent in SG losses arising from insolvency
- Industry data is not available for employer non-compliance and sham contracting, which means caution should be exercised in attributing the entire \$2.6bn SG losses by industry
- Other industries with elevated levels of cash economy activity include property services, hospitality, mining, and manufacturing
- The outlier nature of the construction industry is also supported by employee SG complaint analysis, which indicates an elevated level of non-compliance in construction (also engineering / mechanical, only outliers reported) and a high level of failure to complain

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Methodology

Factor	Sources / approach
Overview	<p>The overall approach was critiqued by Ross Clare, Director of Research, ASFA, the importance of whose input is acknowledged.</p> <p>The four sources of SG non-compliance were drawn from the 2010 report of the Inspector-General of Taxation into the ATO's administration of the SGC</p>
SG rate	<p>For the period of the analysis (2010-12), the SG rate was 9%. The rate has been increased to 9.25% for 2013.</p>
Total SG losses after 10 years and Impact on Retirement Incomes	<p>The average duration of each dollar was calculated by weighting the change in balance of the super account as a percentage of the balance at start of retirement. This was multiplied by the number of years each contribution remained in the system. The sum of this gives an average dollar duration of 15.26 years. Assuming this grows by a real return rate of 4% per annum this amounts to \$4.7b after 15 years. At 6% drawdown this represents \$280m in retirement income at that point. All figures are quoted in today's dollars (real terms)</p>
Cash economy	<p>We used the ABS approach to estimating the cash economy, which is 1.5% of GDP. This is at the bottom end of global estimates. ~60% of this figure is allocated by the ABS to gross mixed income, and we allocated 60% of this figure to missing employee earnings (\$8.3bn in 2013), based on ABS share of employee earnings vs returns to capital. Estimated individuals affected was derived by spreading the missing employee earnings figure across half weekly average earnings, based on the evidence that low income earners are disproportionately represented in the cash economy.</p>
Employer non-compliance	<p>This includes both deliberate and inadvertent non-compliance. The ATO Compliance Program reports ~19,500 complaints. A research report by GFK Research for the ATO indicates a slightly higher rate of complaints which go unreported. There is no data for employees who remain unaware that they have an SG issue; we assumed a 50% complaint unawareness rate for a total of ~84,500 pa underlying SG complaints. The IGT report referred to above notes a complaint validation rate of ~68%. The ATO's 2011-12 Compliance Program noted an average SG assessment of \$25,000, indicating multiple employees affected; we assumed 5 on average.</p>

Methodology

Factor	Sources / approach
Sham contracting	<p>Primary source is Fair Work Ombudsman Sham Contracting study November 2011. This was a limited study of high risk industries which found 20% misclassification and potential 7% shams in independent contractor sample population. Independent contractors represent ~10% of employees, and we assumed 5% leakage; this implies leakage of 0.5% of salary & wage income</p>
Insolvency	<p>Primary source is ASIC Insolvency Statistics, External Administrators Reports. This details the loss of super entitlements by industry, grouped in bands of lost amounts and company FTE size. We made the following assumptions:</p> <p>Average assumed unpaid super \$1-\$100,000 band: \$10,000 Average assumed unpaid super \$100K - \$250K band: \$150,000 Average assumed unpaid super \$250K - \$1m band: \$500,000 Average assumed unpaid super >\$1m band: \$1m</p> <p>Assume FTE Companies <5 FTE band: 2 FTE Assume FTE Companies 5-19 FTE band: 10 FTE Assume FTE Companies 20-199 FTE band: 50 FTE Assume FTE Companies 200+ FTE band: 200 FTE</p>