cbus
Construction & Building Industry Super

3rd May, 2002

Senate Select Committee on Superannuation
Parliament House
CANBERRA ACT 2600

Dear Sir/Madam,

Cbus, as the Industry Fund for the Building Industry felt that it was important that it respond to the Senate Select Committee's invitation with the enclosed submission to the Superannuation Inquiry into Superannuation and Standards of Living in Retirement.

Cbus' submission attempts to address some of the anomalies of the Building and Construction Industry as well as some of the more general issues relevant to all.

Cbus, established in 1984 was the first industry superannuation fund. Today it is one of the largest industry funds with $3.7 billion in assets, 330,000 members and almost 30,000 participating employers. Cbus has a high level of inactive accounts and small accounts due to the nature of the industry which is widely sub contracted and experiences high mobility.

Should you have any queries in regard to the submission please contact our office on (03) 9657 4200.

Yours Sincerely,

Helen Hewett
FUND SECRETARY
CBUS

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Senate Superannuation Committee

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SUBMISSION TO THE SENATE SELECT COMMITTEE ON SUPERANNUATION INQUIRY INTO SUPERANNUATION AND STANDARDS OF LIVING IN RETIREMENT

APRIL 2002

SUMMARY

Cbus welcomes the opportunity to contribute to the Senate Select Committee on Superannuation Inquiry into Superannuation and Standards of Living in Retirement.

There is no doubt that the decisions that are made today in respect to the provision of superannuation contributions and the taxation of superannuation assets will be critical in determining whether in the future all Australians are able to enjoy an adequate standard of living throughout their retirement.

The combination of the ageing of the baby boomer generation, increased life expectancy, reduced birth rates and steady levels of immigration will mean that over the next 40 years a larger percentage of the population will not be working.

The growing imbalance in the ratio between old and young Australians will mean that should our current generation not be able to finance its own retirement needs then the next generation of Australians will be forced to allocate scarce resources from Government budget revenues to provide for our pensions.

The dual objectives of Australia's retirement income system must be to ensure that the portion of Government revenues that are allocated to pensions are sustainable and that Australians are able to receive an adequate retirement income.

An adequate retirement income is one, which allows a reasonable standard of living while allowing a sum of surplus capital to be set aside for the replacement of domestic goods, clothes and to effect minor domestic repairs.

In calculating the level of contribution that will deliver an adequate level of retirement income assumptions need to be used that will reflect the working experiences of ordinary Australians.

In particular it must be assumed that a worker may have periods of unbroken service which may be caused by unemployment, rearing children, workplace injury, ill health.

Cbus believes that there is an argument that in reforming our retirement income system priority should be given to improving the adequacy of superannuation contributions for low-income earners.

It is proposed that low-income earners with limited superannuation assets be able to claim a superannuation tax rebate, which would be paid into their nominated superannuation fund.

The rebate should be delivered through the taxation system to reduce the administration costs for superannuation funds, which may otherwise be required to develop administrative systems to deliver different rates of superannuation contribution taxation.

The Federal Government should consider establishing benchmark standards for superannuation funds that wish to accept compulsory superannuation contributions.

Such benchmarks could be based upon those established recently by the UK Government and could also include standards for administration costs.

Cbus believes that given that superannuation contributions are compulsory commission should be banned from rollovers into superannuation funds.

CBUS AND THE BUILDING AND CONSTRUCTION INDUSTRY

Cbus is the national industry superannuation fund for the building, construction and allied industries.

With around 324,000 members and $3.7 billion in funds under management Cbus is one of the largest industry superannuation funds. As an industry fund, Cbus is a public offer fund existing solely for the benefit of its members – all profits belong to the members. There are no shareholders to receive dividends and no sales representatives or agents to receive commissions.

Cbus superannuation was formed as a result of a campaign by unions and the ACTU for superannuation (pension) rights for construction workers in 1984.

Originally known as BUSS (Building Unions Superannuation Scheme), Cbus was formed in 1994 from an amalgamation of BUSS and AUST (Allied Unions Superannuation Trust).

The building and construction industry is one of the major drivers of the economy. Employing over 600,000 people, the industry accounts for 6% of GDP.[1] As at May 2001, 667,600 workers were employed in the industry.

The industry operates in three major sectors:

- residential construction
- non residential (commercial) building
- engineering construction

Residential building is the major sector of the industry representing about 50% of construction activity with non- residential building comprising 22% of activity and engineering 28%.[2]

Total construction expenditure reached its highest level ever at $71.8 billion in 2000.[3]

Activity within the industry reflects is subject to short-term business cycles, and is influenced by interest rates, demographic trends, the available stock of housing and commercial office space, and public sector investment in infrastructure.

The industry is project focused. Projects can bring together a range of employees from different occupations. The finite nature of projects means that it is common for workers to move from one project to another, often experiencing gaps between projects.

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[1] Productivity Commission, *Work Arrangements on Large Capital City Projects*, August 1999

[2] Australian Procurement and Construction Council, *Construct Australia: Forecasts of Construction Industry Activity Australia States and Territories*, January 2002, P4

[3] Ibid, P4

OBJECTIVES OF AUSTRALIA'S RETIREMENT INCOME SYSTEM

It has been well documented that Australia's population is ageing. The combination of the ageing of the baby boomer generation, increased life expectancy, reduced birth rates and steady levels of immigration will mean that over the next 40 years a larger percentage of the population will not be working.

According to the United Nations, Australia had an Elderly / Youth Ratio for 1990-1995 of 0.37. By 2020-2025 this ratio is expected to increase to 0.77 and will ultimately increase to 0.97 by 2040-2045.

The growing imbalance in the ratio between old and young Australians will mean that should our current generation not be able to finance its own retirement needs then the next generation of Australians will be forced to allocate scarce resources from Government budget revenues to provide for our pensions.

With Australians expected to live longer over the next fifty years the burden that will be placed on future generations would simply be unsustainable. While Australians can currently expect to live for 77.60 years, by 2025 Australians will live to 80.67 years and by 2045 will live to 82.29 years.[4]

It is unlikely in such circumstances that governments could afford to increase the amount of the pension in real terms. Indeed it is more likely that over coming years budget pressures would result in a reduction in the real value of the pension. Those who depend upon the pension for retirement income may find that they increasingly live on the fringe of poverty.

The prime objectives of Australia's retirement income system must be to ensure that the portion of Government revenues that are allocated to pensions are sustainable and that Australians are able to look forward to an adequate income in retirement.

If we accept that there is a need to ensure that Australians are able to finance their own retirement the question is how can we achieve this?

ADEQUACY OF SUPERANNUATION CONTRIBUTIONS

Cbus believes that the current Superannuation Guarantee Charge of 8%, increasing to 9% in July 2002, will not provide the vast majority of Australians with sufficient income to retire in comfort.

The question as to what level of retirement income is 'adequate' has been the subject of a great deal of debate.

There are a number of factors that should be considered in determining what level of retirement income will be adequate in the future.

One benchmark is the old age pension.

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[4] United Nations: World Population Prospects 1950-2050 (1998 Revision)

The old age pension is currently $421.80 per fortnight for singles or $352.10 each for a couple.

As a comparison, for a couple to purchase an annuity that would deliver an equivalent annual income to the old age pension of $18,354.84, a lump sum of $223,000 would be required.[5]

This is based upon the assumption that the annuity was for a male, would commence at the age of 65 and would terminate at the age of 81. It should be noted that the purchasing power of a lump sum will vary and is influenced by factors such as interest rates.

There is however a question as to whether a retirement equivalent to the old age pension will be sufficient in the future.

It is already questionable whether the current level of old age pension is sufficient or whether pensioners who solely rely on the old age pension for income are already living on the verge of poverty.

According to a report by the National Centre for Social and Economic Modelling (NATSEM), 11.2% of Australians over the age of 65 are currently living in poverty.[6] It is significant that since 1990 poverty rates amongst the aged have increased from 7.3%.

Whether the current old age pension is sufficient or not it is clear that pensioners currently do not have a great deal of discretionary spending.

This means that when basic household items such as refrigerators, washing machines and television break down, pensioners can find it difficult to replace these items.

It is also difficult for pensioners to afford to make small domestic repairs such as replacing fences or painting houses.

The inadequacy of the pension can be seen from the fact that the vast majority of Australians have an expectation that they will retire on significantly higher incomes. According to a recent survey by Rod Cameron from ANOP, 70% of respondents believed that they would require an income of $30,000 in retirement.[7]

In deciding what level of retirement income is adequate it is considered that a basic objective of Australia's retirement income system must be to deliver a level of retirement income that enables Australians to live in a level of comfort, not in poverty.

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[5] Assumptions: male, pension commence at age 65, annuity to be provided for 16.21 years or until the age of 81 which is current life expectancy. Pension would cease at age 81. Indexation of benefit of 3% per year.

[6] Ann Harding, Rachel Lloyd and Harry Greenwell, Financial Disadvantage in Australia 1990 to 2000: The persistence of poverty in a decade of growth, National Centre for Social and Economic Modelling, P17

[7] Rod Cameron ANOP, *It's Time For a Retirement Reality Check: Presented to ASFA 2001 National Conference*, September 20 2001, P9

An adequate retirement income is one which would enable a couple to maintain a reasonable standard of living while allowing a sum of surplus capital to be set aside for the replacement of domestic goods, clothes and to effect minor domestic repairs.

In calculating the level of contribution that will deliver an adequate level of retirement income assumptions need to be used that will reflect the working experiences of ordinary Australians.

Many statements on the adequacy of superannuation contributions are based on the assumption that a worker is able to work for 40 years in the workforce with unbroken service.

There are a number of reasons why an employee is unlikely to have unbroken service during their working lives.

Many women are likely to have broken service due to taking time out from the work force to have children.

Over the course of working life, the economy will go through many economic cycles that can result in reduced employment opportunities.

In the building and construction industry the nature of employment means that many employees experience periods of broken employment service.

Many workers are employed on a project basis and may face a gap in employment between one project finishing and another starting.

A survey conducted by Wallis Consulting Group in 1999 revealed that the average duration of employment in building and construction was well below the economy wide average.[8]

The building and construction industry is also subject to fluctuations in economic cycles, which can have a major impact on employment levels.

An indication of the fluctuating nature of employment in the building and construction industry can be seen from the employer contributions that are made on behalf of employers to Cbus on a monthly basis.

While employer contributions have been steadily increasing over the last number of years, reflecting strong activity in the building construction industry and a strong acceptance of Cbus as the industry's superannuation fund, the fund did experience a strong in increase in contributions of almost 30,000 in the December 1999 quarter, followed by a reduction of contributions of over 16,000 in the following quarter. It is likely that such fluctuations resulted from consumers seeking to bring forward construction activity to avoid the GST.

Fluctuations in building and construction activity can impact on the ability of workers to make regular superannuation contributions, which can ultimately influence the

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[8] Productivity Commission, P19

amount of superannuation assets that can be accumulated over a lifetime in the workforce.

Another factor that influences the rate of accumulation of superannuation assets by building and construction employees is the high number of self employed workers in the industry.

According to the ABS in 1997-98, self employed workers consisted of 27% of the building and construction industry workforce compared to an economy wide average of 10%. [9]

Many employees in the building and construction industry move between periods of self-employment and paid employment and may not necessarily make sufficient superannuation contributions while self-employed.

There is a greater likelihood of suffering injury or fatality working in the building and construction industry than many other industries. According to Worksafe Australia the fatality rate between 1993-94 and 1995-96 for building and construction workers was 15.2 fatalities per 100,000 workers compared to an all industries average of 5.6 fatalities per 100,000 workers.[10]

According to the National Occupational Health and Safety Commission there were 32 fatal injuries and 13,929 non-fatal injuries in the construction industry in 1999-2000.[11]

Cbus has been able to offer its members access to excellent life insurance benefits.

However the benefits that can be delivered to building and construction industry workers are less than the benefits that employees in clerical professions are able to access for the same premium rates. This potentially impacts on the accumulation of superannuation assets of building and construction industry workers or the level of benefits a spouse receives in the event of death.

Many injuries in the building and construction industries are cumulative. Workers over the age of 55 are almost three times more likely to suffer an injury resulting in a claim than workers under the age of 24. [12]

The dangerous nature of many occupations in the building and construction industry means that workers face greater risks that at some stage during their working lives that they will be injured.

Where a worker receives workers compensation benefits and does not attend work, no superannuation payments are made.

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[9] Productivity Commission, P19

[10] Worksafe Australia 1998, quoted in Productivity Commission *Work Arrangements on Large Capital City Projects*, August 1999, P73

[11] www.nohsc.info.au.com

[12] Worksafe Australia 1998, quoted in Productivity Commission *Work Arrangements on Large Capital City Projects*, August 1999, P74

Periods of absence from work due to workplace injury can therefore impact on a worker's ability to accumulate superannuation assets.

While for workers in other industries retirement at the age of 65 may be possible, for workers in the building industries the ability to work in a manual occupation over the age of 60 may be questionable.

The cumulative impact of back injuries, hearing loss and other injuries may force workers to consider retiring earlier than they otherwise would if they worked in a less arduous occupation.

In calculating the level of contribution that will be sufficient to deliver an adequate level of retirement income it is important that an assumption is made that a worker may have periods of unbroken service.

Broken service may be cause by unemployment, rearing children, workplace injury, ill health or simply gaps between one project and another.

For low income earners if the level of superannuation contributions are then the result will be continued reliance on the old age pension – which many commentators already regard as insufficient.

The issue for high income earners is not whether they will be able to retire with an adequate level of retirement income, but whether that retirement income meets their expectations.

There is clearly an argument that in reforming Australia's retirement income system priority be given to improving the adequacy of superannuation contributions for low income earners.

INFLUENCES ON ACCUMULATION OF SUPERANNUATION ASSETS

A number of factors, such as investment returns, costs and taxation can influence the rate at which a superannuation fund member is able to accumulate assets.

<u>INVESTMENT RETURNS</u>

In recent years superannuation funds have had strong investment returns. According to APRA, between the June 1996 and June 2001 an average annual return of 9% was achieved on superannuation assets.

Over this same period the average annual return for Cbus members was 10.54%.

The ability of superannuation funds to achieve consistently strong investment returns over the next 20 –25 years will have a great impact on the adequacy of retirement incomes.

It is not possible to predict with any degree of certainty what the likely level of investment return over the next decades will be.

In building a retirement income system for the future Cbus believes that we need to make conservative assumptions on the level of investment returns that may be achieved.

The level of investment returns that superannuation fund members achieve will vary according to the performance of their superannuation funds and according to the investment choices that an individual has made while accumulating superannuation assets.

Cbus members are offered five investment choices; Cbus Super (default option), Cbus Super Stable, Cbus Super Saver, Cbus Super Plus, Cbus Super Shares.

The vast majority of Cbus members have either made no investment choice or have chosen Cbus Super – the balance investment option.

COSTS

While investment returns can greatly influence the accumulation of superannuation fund balances, costs that are charged to superannuation members can also influence the accumulation of balances and ultimately retirement incomes.

Hazel Batemen in her report Disclosure of Superannuation Fees and Charges (August 2001) states:

Suppose a superannuation fund member contributes 9% of earnings for 40 years and receives a 5% real rate of return on these contributions. A charge of 1% of assets would reduce the accumulation at retirement by around 22%, while a charge of 2% of assets would reduce the accumulation at retirement by nearly 40%.[13]

According to a report by the Association of Superannuation Funds of Australia, the cost for administration of Industry Funds is $54 per year compared to $164 per year for a retail fund.

Additionally, iInvestment costs as a percentage of assets are 1.35% for Industry Funds while the average investment cost for retail funds is 2.4%.[14]

It should also be noted that industry funds do not charge commission or entry and exit fees while many retail funds do.

Cbus believes that the level of costs charged by some organisations will reduce the ability of many superannuation fund members to accumulate superannuation assets.

Cbus believes that there is an argument that since superannuation contributions are compulsory that the fees that are charged by providers of superannuation funds should be subject to regulation.

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[13] Hazel Batemen, *Disclosure of Superannuation Fees and Charges* (August 2001),

[14] Ross Clare Association of Superannuation Funds of Australia, *Are administration and investment costs in the Australian superannuation industry too high?* November 2001

The UK Government introduced a new type of 'stakeholder' pension in April 2001. Providers of Stakeholder Pensions must meet certain standards, including;

- Management charges are capped at 1% of fund assets.
- Penalty free transfers
- Low minimum payments

The Australian Federal Government should consider establishing benchmark standards for superannuation funds that wish to accept compulsory superannuation contributions. Such benchmarks could be based upon those established recently by the UK Government and could also include standards to for administration costs.

Should choice of superannuation legislation be introduced in the future without a ban on commission on superannuation rollovers Australia may easily experience the kinds of selling practices that resulted in the UK 'Mis-selling of Pensions Scandal' in the 1990s.

Cbus believes that given that superannuation contributions are compulsory commission should be banned from rollovers into superannuation funds.

TAXATION OF SUPERANNUATION

Currently superannuation funds are taxed at three stages, a 15% tax on the level of contributions, 15% tax on investment income and varying taxation of between 0-30% at the time of departure from a superannuation fund according to timing of contributions.

One way of increasing the accumulation stage of superannuation assets is to reduce the taxation of assets when contributions are made or when investment returns are made.

Cbus accepts that any reduction in the taxation of superannuation contributions or investment returns will reduce the revenues that are available to the Government.

It is clear that one result of reduced taxation, in the absence of increased taxation in other areas, is that Federal Government's will have fewer resources to allocate to other government priorities such as education and health.

While acknowledging the competing priorities for Government expenditure Cbus believes that the Federal Government's objective should be to reduce the reliance on the taxation of superannuation assets.

Cbus accepts that there may be a need for a transitional process in moving to the ultimate goal of reducing the taxation of superannuation assets.

Low income earners who have limited superannuation assets are more likely to retire with inadequate superannuation and are more likely to rely on the old age pension in retirement.

Low income earners are also less likely to have other assets that they can rely upon. According to a report by NATSEM, for 20% of the population, superannuation represents 90% of their assets.[15]

The priority of the Federal Government should be to reduce the taxation of superannuation fund members who are low-income earners and who have limited superannuation assets.

Cbus proposes that low income earners with limited superannuation assets be able to claim a superannuation tax rebate which would be paid into their nominated superannuation fund.

Delivering a rebate through the taxation system would reduce the administration costs for superannuation funds, which may otherwise be required to develop costly administrative systems to deliver different rates of superannuation contribution taxation.

It would also ensure that employees would only be able to claim a rebate where their combined superannuation assets were limited rather than where a balance in a particular superannuation fund was small.

[15] Simon Kelly, National Centre for Social and Economic Modelling, Wealth on Retirement – Latest Estimates for Australia, Paper presented to Ninth Annual Colloquium of Superannuation Researchers, 9-10 July 2001, P14

RECOMMENDATIONS

1. **The dual objective of Australia's retirement income system must be to ensure that the portion of Government revenues that are allocated to pensions are sustainable and that Australians are able to receive an adequate retirement income.**

2. **In calculating the level of contribution that will deliver an adequate level of retirement income assumptions need to be used that will reflect the working experiences of ordinary Australians.**

3. **In reforming Australia's Retirement Income System, priority should be given to improving the adequacy of retirement savings, particularly for low income earners and people with broken work patterns.**

   The Age Pension is to be retained.

   Increase the minimum compulsory superannuation contributions from the 9% (from 1 July 2002) SG level to 12 – 15%. This increase is to be funded by employee contributions, employer contributions and government contributions.

   That low income earners be able to claim a tax deduction for employee contributions.

   That low income earners with limited superannuation assets (small accounts) be able to claim a rebate of the superannuation contributions tax which would be paid into their nominated superannuation fund.

   The rebate should be delivered through the taxation system to reduce the administration costs for superannuation funds and to avoid double dipping or abuse.

4. **The Federal Government should consider establishing benchmark standards for superannuation funds that wish to accept compulsory superannuation contributions. Such benchmarks could be based upon those established recently by the UK Government and could also include standards for administration costs.**

5. **Commission should be banned from rollovers into superannuation funds and on compulsory superannuation contributions.**