Statement to Productivity Commission

Jordan George, Head of Policy, SMSF Association

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First of all, I would like to thank the Productivity Commission for the opportunity to appear today at this hearing and for previously engaging with the SMSF Association as part of the Commission's work.

The SMSF Association is the peak body representing the SMSF sector which is comprised of over 1.1 million SMSF members who have $712 billion of funds under management and a diverse range of financial professionals servicing SMSFs.

Today, I will focus my comments on SMSF issues that the Commission addressed in the draft report but before I do that I will make some high-level comments on the Commission's report.

Without making specific comments on the individual recommendations, we broadly support:

- Preventing account duplication and savings erosion by ensuring that people are only ever allocated one default account.
- Enhancing choice in the superannuation system by empowering individuals to choose their own superannuation product. This includes maintaining the role of SMSFs as a choice superannuation vehicle and preserving the ability, and in some instances opening up the choice, to have an SMSF as a retirement savings vehicle.
- Ensuring insurance premiums do not erode low account balances or those of younger fund members.
- Improving superannuation data for improved policy analysis.

We are also pleased that the Commission recognised the role that SMSFs play in providing a competitive force within the superannuation sector and the effect this has had on fees across the sector.

I will now address the specific areas concerning SMSFs that the Commission focussed on in the draft report, starting with draft finding 2.2 regarding SMSF returns.

SMSF returns

We are pleased that the Commission's assessment of SMSF investment returns showed that returns in the sector are broadly equivalent to that of large funds. This is an important draft finding and supports the rationale for many people establishing SMSFs.

However, we are concerned by the draft finding that SMSFs with balances below $1 million deliver lower returns than large superannuation funds. We believe it is important all SMSF trustees consider the costeffectiveness of their SMSF and the long-term viability of having an SMSF compared to other superannuation options.

While this point is important, caution must be taken regarding the Commission's analysis of SMSF returns. I note that the Commission caveated the difference between APRA-fund and SMSF data and the issues this creates in comparing the sectors. This is especially relevant to how return on assets (ROA) is calculated, with the Commission's Technical Supplement 4 illustrating that the difference between APRA's and the ATO's methodology for calculating ROA can create a 0.6% difference.

In addition, the ATO's ROA methodology which uses a crude average assets basis can distort net returns for funds when they are established. This is because new funds may be established earlier in a financial year but contributions/roll-overs are made towards the end of the year. This larger end of year balance can increase the average assets figure, reducing the overall ROA calculation, while the true amount of assets exposed to risk/return has been far lower for much of the year.

Accordingly, further work and analysis is needed to make better judgement of the returns of SMSFs under $1 million.

Finally, on this issue, we would be concerned that a $1 million balance was seen as a required balance to establish an SMSF. A $1 million balance is a good aspirational goal for SMSF trustees to achieve to ensure their fund has appropriate scale and is efficient. Considering that this would represent $500,000 per member in a two-member SMSF, we do not believe that this is an unattainable or unrealistic figure.

SMSF costs

Again, in regards to SMSF costs the Commission pointed out the difficulties in comparable data across the sector yet made the draft finding that costs for low balance SMSFs are particularly high. SMSF trustees should be aware of how costs affect their retirement savings, particularly when deciding on whether they should establish an SMSF.

Similar to our views on returns, we are concerned by the implications that poor data and different reporting methods across sectors may have on the Commission's draft findings.

In regards to costs, establishment costs of a capital nature can grossly distort net returns and cost ratios for SMSFs with small balances when established. These costs distort comparisons with large funds, especially for lower balance SMSFs which may have been recently setup. Similarly, advice costs for SMSFs are of a different nature to those incurred by APRA-fund members, further distorting comparisons on cost.

How costs are accounted for also affects comparison between SMSFs and large funds. For instance, costs of maintaining a direct property investment are recorded as investment costs to the SMSF but where a large fund invests in a property trust, costs of that trust are more likely to be accounted through reduced returns.

In regards to costs, the Commission noted that, “It is unclear to what extent the presence of small SMSFs in the system is necessarily a problem.” We believe that these smaller funds do not represent a problem and cite the research undertaken by Class Ltd, an SMSF software provider in 2016. Analysing the funds that use their software Class found:

- For the 2015 financial year around 50% of funds with less than $50,000 were either newly established in the year or entered this bracket due to drawdowns or rollovers during the year.
- Class’ findings point to the dynamics of funds with balances of less than $50,000 being similar to “that of an airport transit lounge, with constant arrivals and departures”. On average these funds stay in this bracket for around 2 years.

We also note ATO data which showed that in 2012, of SMSFs that lodged for the first time, 51% reported total assets of $1 to $200,000. Comparatively, this asset range made up only 20% of funds still active in 2016.

SMSF advice

Finally, I will address the Commission’s draft finding on financial advice.

Part of the SMSF Association’s mission is raise the standards and professionalism of financial advice provided to SMSF trustees. Given the draft finding of the Commission, revelations at the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry and recent comments from ASIC, it is clear that more is needed to raise the standards of financial advice.

In regards to SMSF advice we believe it is critical that those providing advice to SMSF trustees have undertaken specific SMSF education or qualifications. SMSF advice should not be seen as part of superannuation or retirement advice but a specialist advice area. This is necessary given the unique aspects of being an SMSF trustee and the complexities of superannuation and related laws. While general standards of financial advice are being raised to a minimum bachelor degree level, at the moment there is no additional requirement for specialist education in SMSF advice. We strongly recommend that completing specialised SMSF education or accreditation be a requirement to provide this type of advice.