23 November 2018

Deputy Chair
Productivity Commission
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Melbourne VIC 8003

Email: super@pc.gov.au

Dear Commissioners,

SMSF ASSOCIATION SUBMISSION ON PRODUCTIVITY COMMISSION SUPPLEMENTARY ANALYSIS

The SMSF Association welcomes the opportunity to make a submission on the Productivity Commission's supplementary analysis on investment performance. We believe it is important that detailed and accurate analysis of superannuation data is conducted as it can significantly influence policy discussions.

We have addressed the specific SMSF questions the Commission referred to in their paper.

Are net return estimates for SMSFs biased by the way returns are calculated?

This issue was highlighted in the Association's submission to the Productivity Commission's draft report on superannuation.

We agree with the analysis conducted regarding biases for SMSF return calculations by the Commission in the supplementary report. We believe the Commission's final report will need to make the caveat that the data used for its analysis of SMSFs contains these deficiencies. We also maintain our position that the Commission should not be making recommendations regarding SMSF establishment balances based on data which has inherent weaknesses.

Do expenses for individual SMSFs fall over time and/or do net returns rise? If so, is this driven by growth in balances?

The SMSF Association believes that the data does show that age is a factor in SMSF cost-effectiveness. This is clearly highlighted in figure 33 of the supplementary report. Younger SMSFs had lower return on assets and higher expense ratios. We believe this should not be dismissed as a modest effect by the Commission.

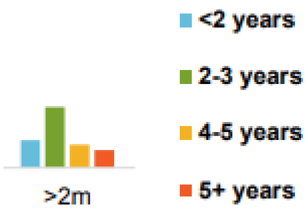
There is no doubt that SMSF expense ratios are much more clearly related to fund size than fund age, however, this does not mean that SMSF age is not important.

We believe further analysis is required on the interpretation of figure 34 where SMSFs were segmented by asset size and age.

The supplementary paper stated that *"the patterns are less clear cut in terms of returns, but SMSF age does not appear to be a strong predictor of investment performance or expense ratios within any* *size bracket*". The paper also stated "*in most size brackets, SMSFs aged between 2 and 5 years have similar or higher expenses on average compared to those that are under 2 years*."

However, we believe these inferences cannot be drawn from data that includes clear anomalies. For example, in most asset brackets, the 2016 expense ratio is significantly higher for funds that were established 2-3 years ago compared to funds established less than 2 years ago and funds established 4-5 years. Apart from the inclusion of non-deductible expenses in the 2012-13 year, which should not impact this data set, the SMSFA is unaware of reason why SMSF expenses are significantly higher for funds established in those specific year sets in 2016. This appears to be an aberration in the data.

The graphic below highlights this discrepancy for funds over $2 million which should be least affected by any such anomaly because their scale of size. In this section, funds that were established in the 2013-14 or 2012-13 year had over double the expense ratio than funds established in the 2011-12 and 2010-11 year in 2016.



This anomaly should not be interpreted as proof there is no trend in SMSFs becoming more cost effect with age. We believe inferences which can have significant impact on the Commission's findings should not be drawn until further analysis is conducted on this subset.

Putting aside that SMSFs that are over five years old and have less than $50k are a clear problem in their own right, all other SMSF brackets encountered a drop in SMSF expense ratios when comparing funds that were less than 2 years old to ones that were over 5 years old.

We strongly recommend the Productivity Commission considers this point in their final report and consider that SMSF expenses do fall with time due the effect of establishment expenses and growth of balances.

Longitudinal data

The SMSFA believes the use of longitudinal data is very valuable in the analysis of SMSFs and their growth rates. However, we have concerns with how some of the analysis was framed. This can be extremely important in policy discussions.

The Commission stated "*overall, about a quarter of funds with less than $500 000 in 2012 had grown to over $500 000 in 2016".*

This statement contains too large a sample size to draw meaningful inferences from. For example, an SMSF with $200,000 which is established cost-effectively making $25,000 concessional contributions would have needed to have returns of over 15% per annum to reach $500,000.

As stated in our submission to the Commission, *"ATO data showed that in 2012, 51% of the SMSFs in this dataset had assets of $1 to $200,000. Comparatively, this asset range made up only 20% of funds still active in 2016."*

Therefore, we believe it is important to note that 80% of funds established under $200,000 grew to exceed this size in five years, showing that growth is in fact occurring.

This goes to highlight that the statement from the Commission that '*in 2016, about 42 per cent (over 200 000) of SMSFs appear to be in this category (older than 2 years and balances less than $500 000)'* is not necessarily a problem if funds are growing.

The Commission also stated *'for the two smallest brackets in 2012 (under $50 000 and $50 000 to $100 000), about 20 and 15 per cent, respectively, remained in either of these categories by 2016. "*

Framed alternatively, this highlights that over 80% of SMSFs in 'red flag' territory were able to grow their SMSF to sizes over $50,000 or over $100,000.

If you have any questions about our submission please do not hesitate in contacting us.

Yours sincerely,

John L Maroney

John Maroney
CEO
SMSF Association

ABOUT THE SMSF ASSOCIATION

The SMSF Association is the peak professional body representing SMSF sector which is comprised of over 1.1 million SMSF members who have $750 billion of funds under management and a diverse range of financial professionals servicing SMSFs. The SMSF Association continues to build integrity through professional and education standards for advisors and education standards for trustees. The SMSF Association consists of professional members, principally accountants, auditors, lawyers, financial planners and other professionals such as tax professionals and actuaries. Additionally, the SMSF Association represents SMSF trustee members and provides them access to independent education materials to assist them in the running of their SMSF.