ATO SELF MANAGED SUPERANNUATION FUNDS:

A STATISTICAL OVERVIEW 2017-2018

The Australian Taxation Office's 2017-18 statistical overview of SMSFs provides the industry a first look at the impact of the significant superannuation changes that took effect on 1 July 2017.

Plus, granular expense data!

SMSF ASSOCIATION

The SMSF Association's key takeaways

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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 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.

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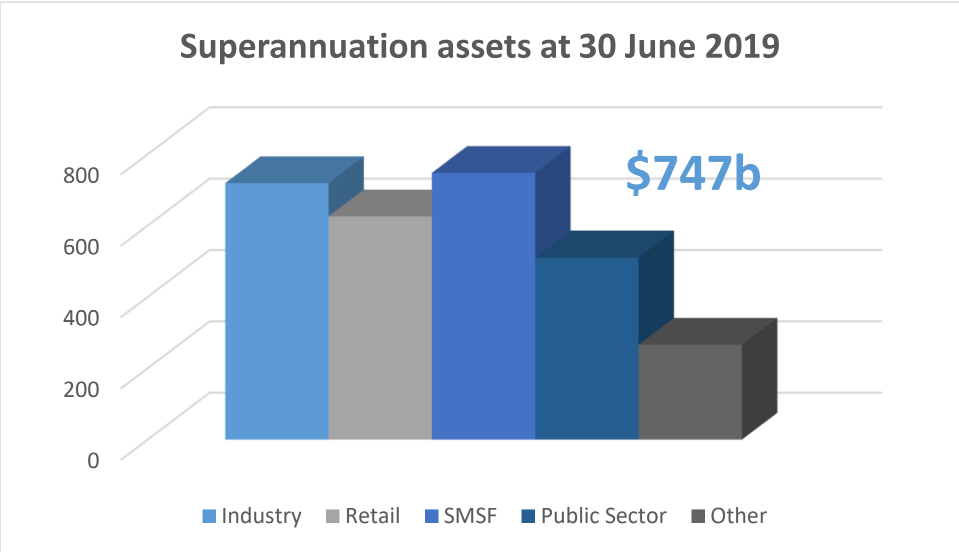
So, what are the key takeaways for SMSFs?

- SMSFs are continuing to grow,
- A reversion to normal for contributions and benefit payments, and
- A greater understanding of actual operating costs of SMSFs.

The 2017-18 financial year was the first financial year after the extensive 1 July 2017 superannuation changes which included the $1.6 million transfer balance cap coming into effect. Accordingly, the statistics provide interesting analysis of the behavioural changes of SMSF trustees after these measures took effect, particularly in relation to contribution levels and benefit payments.

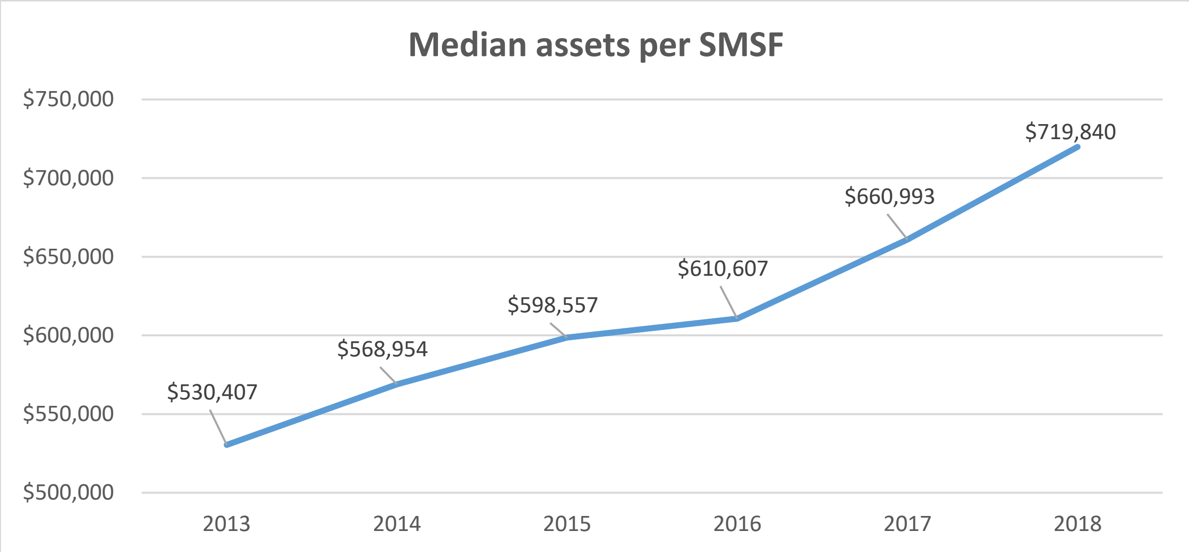
In addition, more granular expense data which breaks down how expenses are apportioned within an SMSF and for different sizes of SMSFs provides a clearer picture of the actual costs of running SMSFs. A clearer argument that the typical operating costs are below $5,000 per annum for most newly established SMSFs is now evident from the ATO data.

SMSFs accounted for 99.7% of all super funds in Australia and collectively held 26% of the $2.9 trillion in super assets under management. SMSFs therefore, continue to be an integral and significant part of the superannuation system.



There are 1.125 million Australians in nearly 600,000 SMSFs with an average fund balance of $1.3 million and a median fund balance of $720,000 (the median value is more reflective of the typical SMSF as a small minority of very large SMSFs distort the average figure).

SMSFs are typically made up of a couple with an average of 1.9 people in an SMSF and 43% of SMSFs are in some form of pension phase; two crucial factors that are typically glossed over when analysing SMSFs. Median assets have grown by 36% over the 5 years to 2018.



Expenses

The biggest change to the ATO's statistics is a welcome update of the reporting of expenses for SMSFs. As many in the industry would be aware, recent expense data has made it difficult to objectively examine the operating expenses of an SMSF. This was recently highlighted in an ASIC SMSF fact sheet that we believe was well intended to help people consider whether an SMSF was a suitable choice for them but lacked balance and would benefit from more context regarding different expense components.

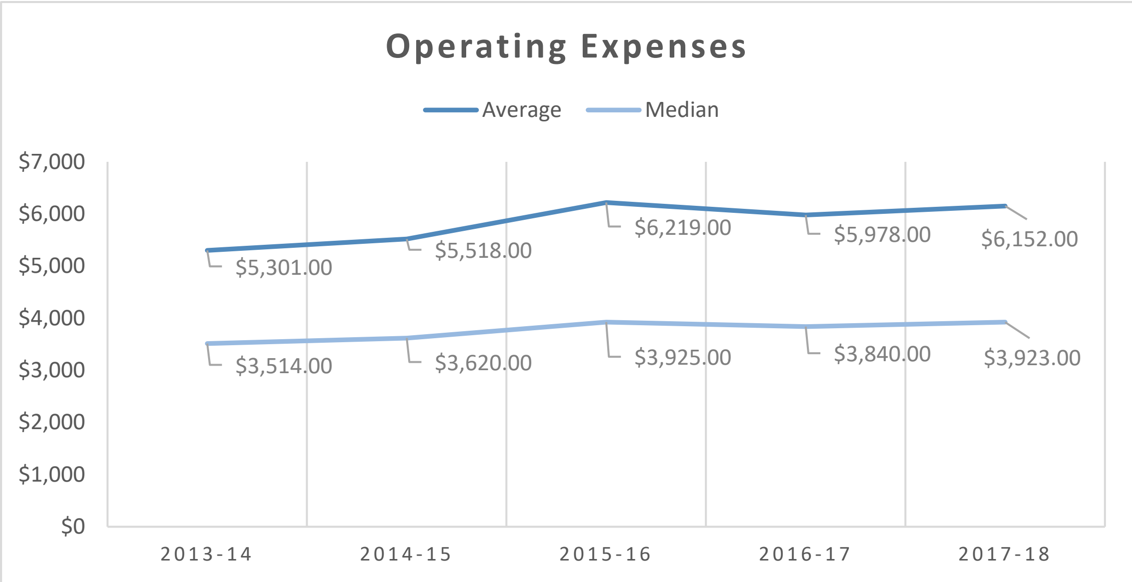
Previous analysis has relied on the use of averages which ignores distortions from very large SMSFs and included SMSFs which have chosen to use extensive administration, insurance, and investment services.

The SMSF Association has been encouraging the ATO to publish more granular expense data and we are extremely supportive of the updated data that has now been released.

So, what is new?

1. New tables which break down median and average expenses by type and asset size.
2. 'Administrative and operating expense' has been renamed 'Operating expense'. Its components of approved auditor fee, management and administration expenses, other amounts and SMSF supervisory levy remain unchanged.
3. 'Management and administrative expenses' therefore now only refer to amounts entered into management and administrative expenses in the SMSF annual return.
4. 'Investment expense' now only refers to amounts entered into investment expenses in the SMSF annual return.

With this new breakdown, the median 'operating expense' of an SMSF is $3,923. As highlighted above at point 2, this includes the typical expenses an SMSF would need to incur.

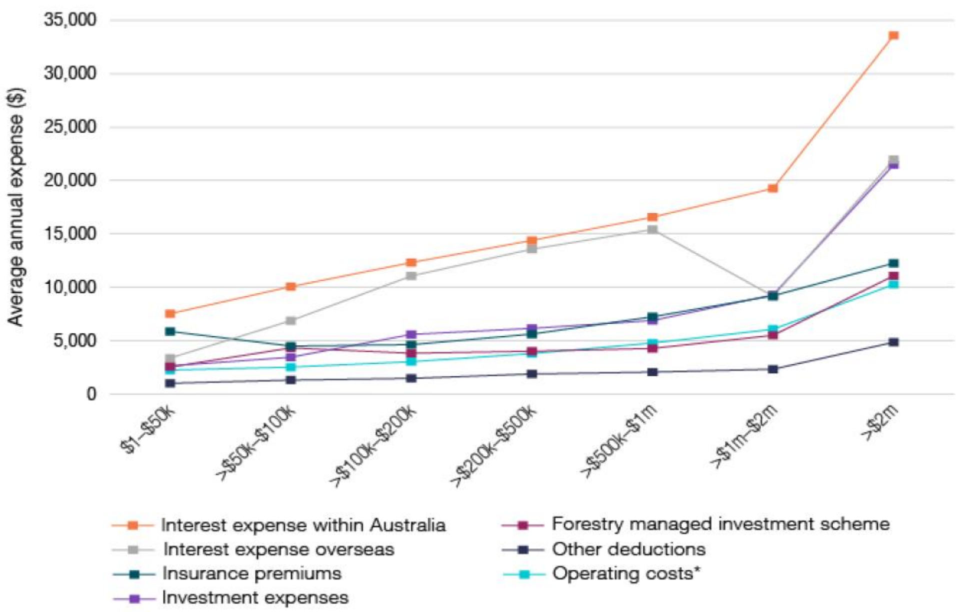


The breakdowns also allow us to determine how much the average and median expenses have been affected by those funds which undertake optional services or incur less common expenses.

The SMSF sector may be wondering how the total average expense cost of $14,879 was calculated for the 2017-18 financial year. Graph 7a (below) supplied by the ATO provides a visual determination (the table can also be found in the full release).

As is clearly highlighted, funds with over $2 million had a significant impact on the weighting of the costs allocated to an average figure. In addition, expenses such as investment expenses, insurance and interest were attributed to the average when many SMSFs did not use these services. The spike in these amounts is also quite evident for funds on the higher end of the scale. In particular, interest expense relating to borrowings is an expense aimed at achieving higher investment returns and not an operating expense.

Graph 7a: Average expense by expense type and asset range, 2017–18



(* For transparency, Other deductions have been excluded from Operating costs in the graph. Operating costs includes SMSF auditor fee, management and administration expenses and supervisory levy.)

Greater information can be taken from the following table on median expenses. It details the number of funds which are reporting an expense, as well as a clear breakdown for asset sizes.

Median expenses	$1-$50k	>$50k-$100k	>$100k-$200k	>$200k-$500k	>$500k-$1m	>$1m-$2m	>$2m	All funds	No. of funds reporting this expense
Interest expense within Australia	$764	$10,459	$12,515	$13,401	$13,403	$12,406	$7,394	$12,881	61,652
Interest expense overseas	$48	$4,717	$11,794	$12,407	$9,048	$3,059	$818	$9,453	351
Insurance premiums	$3,271	$3,001	$3,363	$4,175	$5,252	$6,413	$7,909	$4,532	98,821
SMSF auditor fee	$450	$473	$495	$548	$550	$574	$659	$550	347,739
Investment expenses	$149	$711	$3,877	$4,399	$4,880	$6,371	$10,734	$5,311	240,691
Management and admin expenses	$1,107	$1,331	$1,804	$2,341	$2,824	$3,437	$5,048	$2,808	444,961
Forestry MIS	$633	$2,309	$1,848	$2,869	$2,238	$2,889	$3,467	$2,538	353
Supervisory levy	$259	$259	$259	$259	$259	$259	$259	$259	470,415
Other deductions	$285	$386	$513	$473	$277	$259	$259	$317	217,770
Total expenses	$1,871	$2,645	$4,613	$6,855	$7,787	$9,588	$15,814	$7,710	470,415

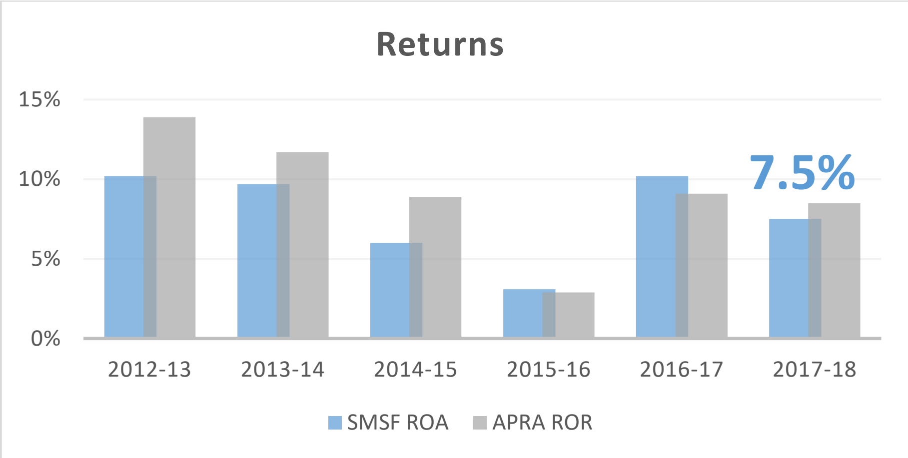
If we take a fund with a typical establishment balance of between $200,000 and $500,000, only including the typical operating expenses, removing those with investment expenses, insurance, interest, and forestry MIS we can roughly estimate the median operating expense as $3,400 for these SMSFs.

The updated expense data shines a light on the many optional expenses an SMSF could incur. With these breakdowns, it is clear that previous analysis included expenses such as insurance premiums and interest expenses that were not operational expenses. We are now able to see a clearer picture of where SMSFs choose to voluntarily incur expenses that members believe provide value to their fund.

Returns and asset allocation

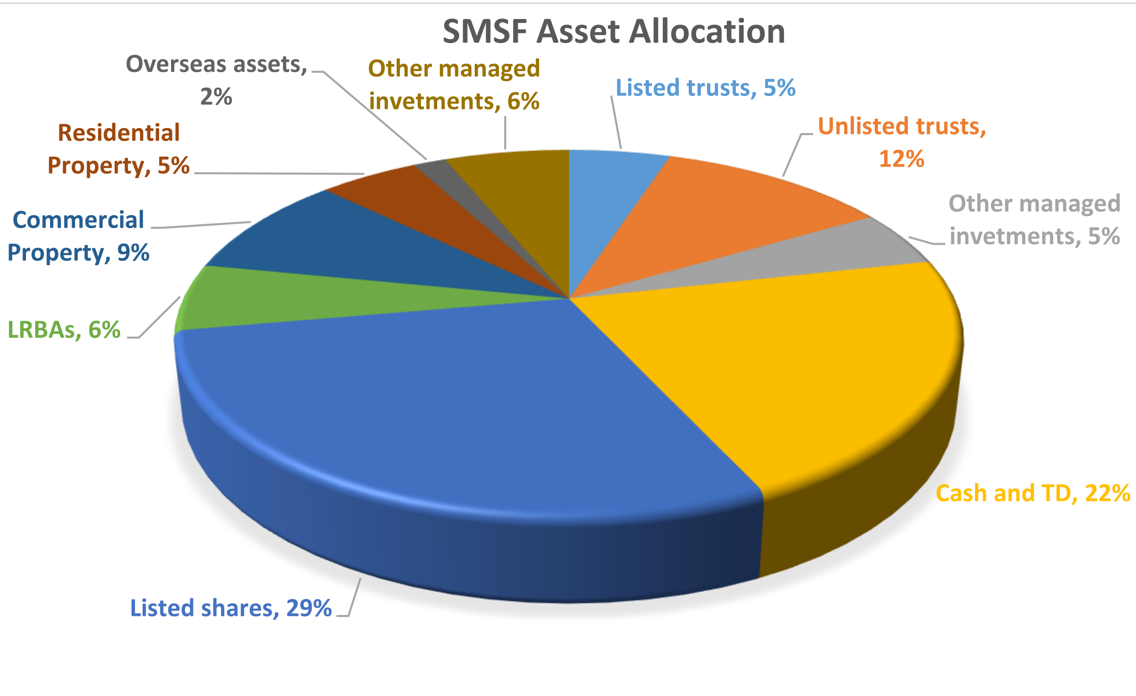
In the 2017-18 financial year, **SMSFs made an average return of 7.5%** compared to the 8.5% return for Australian Prudential Regulatory Authority (APRA)-regulated funds.

This continues the strong run of positive returns SMSFs and continued comparable performance to APRA-regulated funds.



The SMSF Association has been clear on highlighting the difficulties in comparing return data with APRA- regulated funds, particularly due to definitions and member cohorts; but we are pleased with the positive outcomes SMSF members are obtaining.

The impact of COVID-19 will also be extremely interesting over the coming reporting years. The below graph details the asset allocation of SMSFs at 30 June 2018.



Now this is quite some time before the COVID-19 pandemic of 2020, but our understanding is that the asset allocation of SMSFs has not changed significantly between 2018 and 2020.

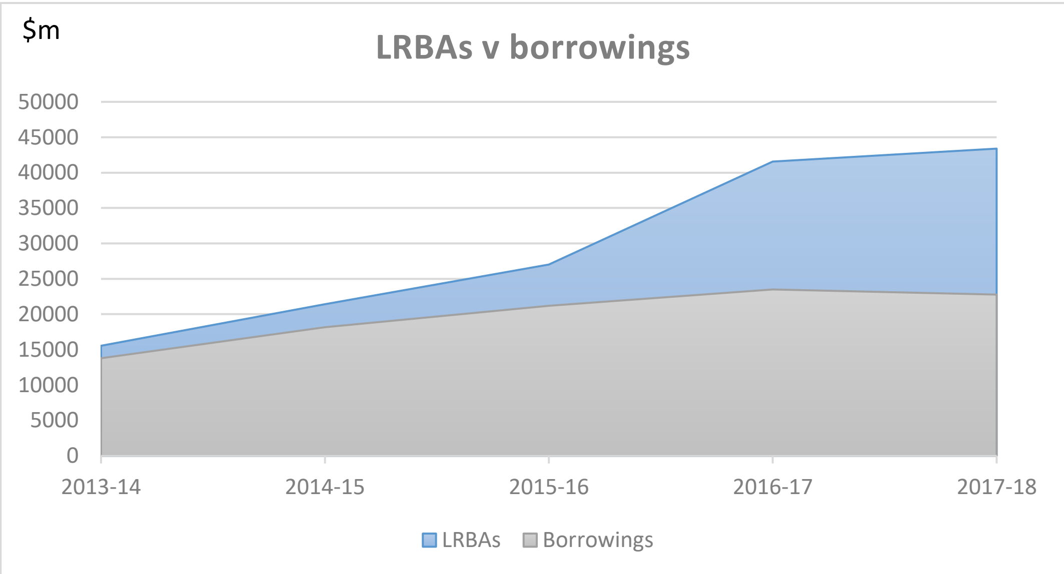
Therefore, going into the pandemic, SMSF asset allocation remained steady with a significant proportion of assets invested in listed shares and cash investments. The key drivers for this asset allocation include:

- Tax preferences for domestic equities – fully refundable franking credits increase the after-tax return for domestic equities for SMSFs, especially for those in retirement phase.
- A desire for liquidity to pay pensions in retirement – this is especially relevant to the SMSF sector where 42% of funds are in retirement phase.
- Cognitive biases that drive allocation to assets trustees understand, especially blue-chip ASX shares.

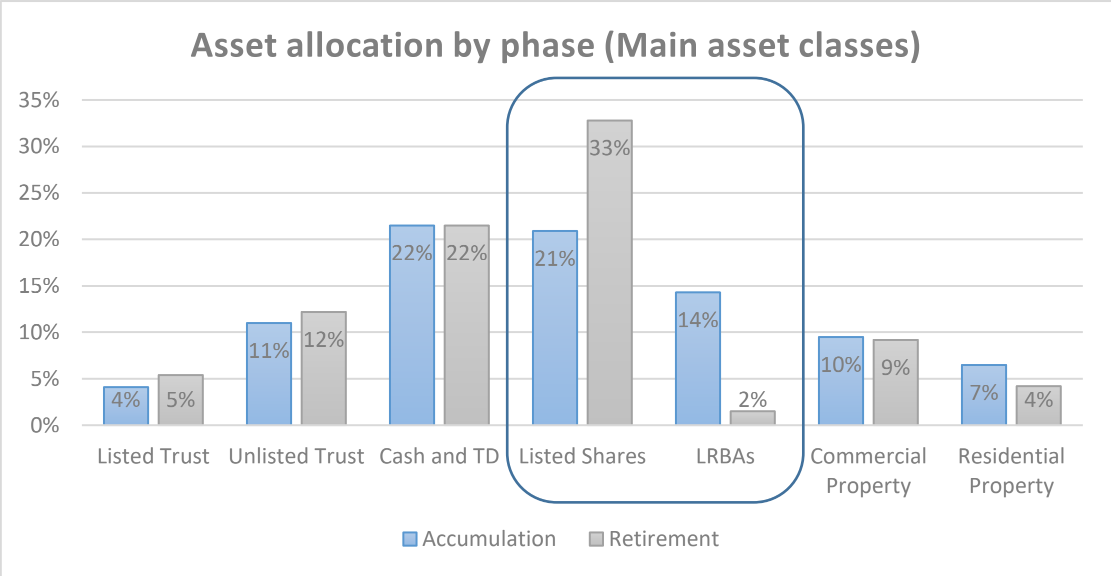
A positive for the sector is that many SMSFs should be able to navigate through this pandemic from a better starting point than some of their counterparts.

This is an outcome of a generally older cohort of investors requiring more liquid assets to service their retirement living expenses. The benefits of the financial adage about holding two years of income in cash should bear fruit for many SMSF trustees.

A risk commonly raised in discussions on SMSFs is limited recourse borrowing arrangements (LRBAs). There is no doubt that in the current economic climate, where rental incomes may be reduced or suspended, some SMSFs with property may be facing unexpected risks. However, from a broader picture, the 2017-18 statistics highlight a flattening of LRBA growth and an acceptable level of LRBAs to borrowing.



In addition, the risk profile of SMSFs is quite reasonable, especially with respect to LRBAs. The below graph details the asset allocation of SMSFs by fund phase. What is most evident is that when SMSFs enter the retirement phase, they are generally doing so without LRBAs and moving to more liquid assets.

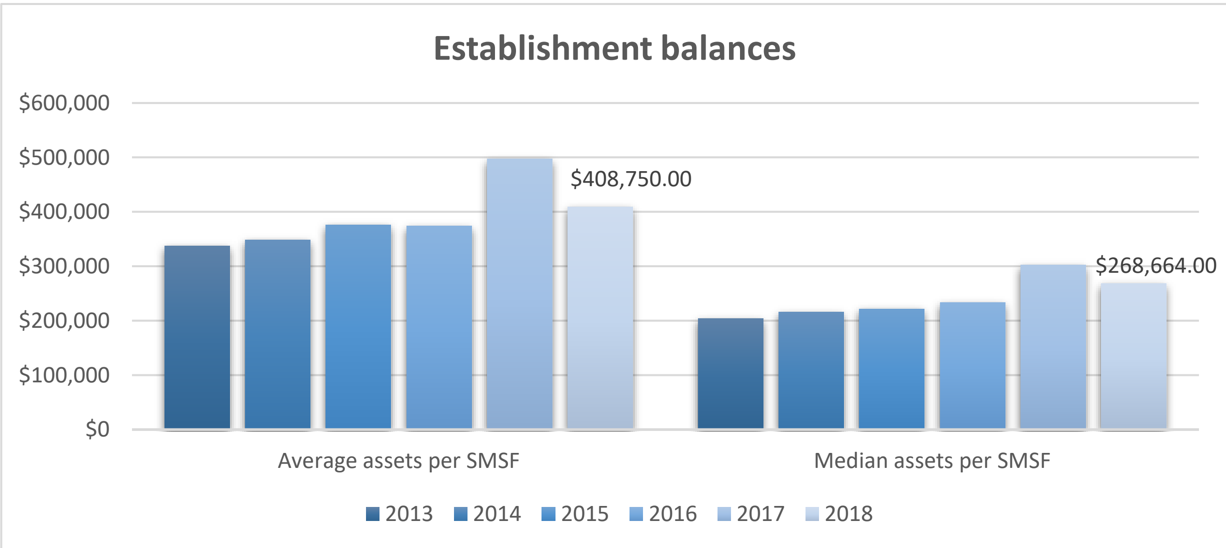


Growth, establishment and wind-ups

The most significant takeaway in last year's ATO statistics was the increase in establishment balances for SMSFs. It highlighted that that the majority of SMSFs were being set up with an appropriate balance which indicated that SMSF trustees were receiving quality advice.

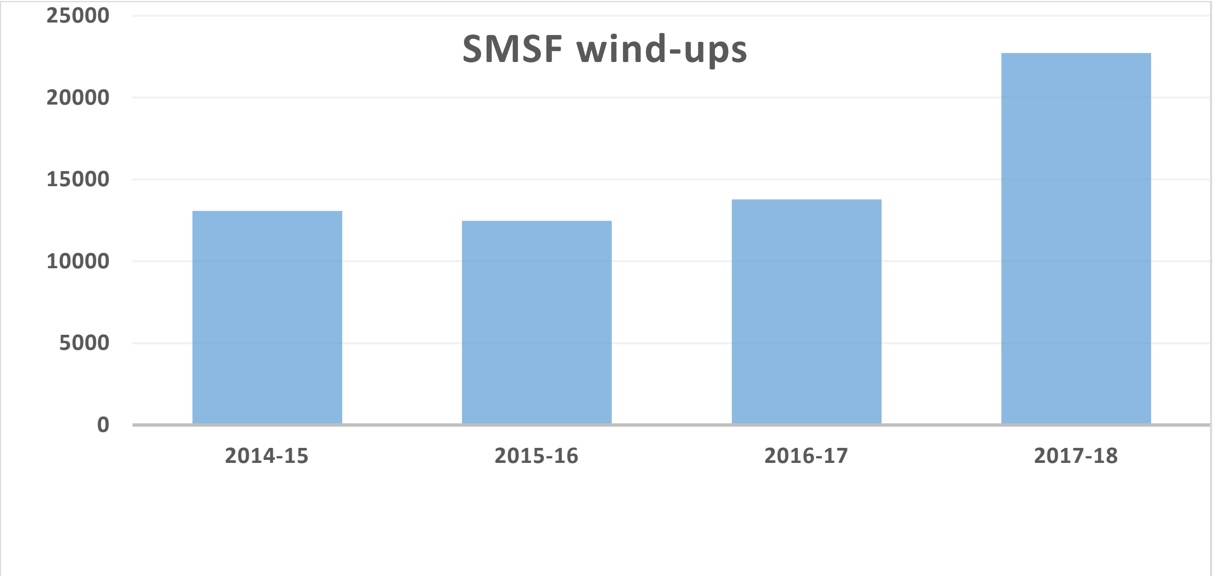
The SMSF Association did however attribute some of this increase to the behavioural changes resulting in individuals establishing SMSFs with larger amounts due to the expected lower contribution caps taking effect on 1 July 2017.

Promisingly, the 2017-18 statistics do not show a significant fall in fund establishment size and continue to demonstrate that the majority of SMSFs are being set up with a balance in excess of $200,000. Some SMSFs have been established with lower balances while expecting future contributions and roll-ins to be received within a short time frame.



The number and size of SMSFs continue to grow. In the five years to 2018-19, the number of SMSFs grew by an annual average of 2.9%. On average 28,490 new funds were established annually.

There has been a declining trend in the number of new SMSFs established and the 2017-2018 statistics detail that it was the highest year on record for wind-ups.



Interestingly, early indicators suggest that the number of SMSF registrations has been increasing. The number of SMSF registrations received between July and December 2019 was 11,558. This compares to 10,954 SMSF registrations received for the same period last year, representing an increase of 5.5%.

SMSF registrations for January and February 2020 were 3,246 compared to 2,807 SMSFs registered during the same period last year. That is an increase of 15.6%.

This confirms there has been growth in registrations over the past year and this is expected to continue due to the economic impacts of COVID-19, as some members choose to establish SMSFs to enable greater control of their retirement savings.

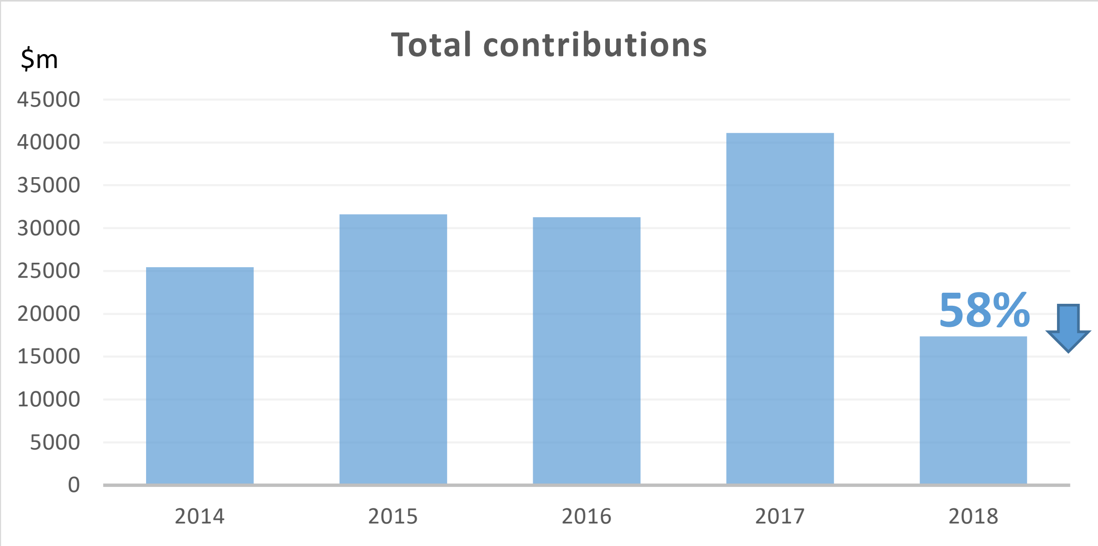
The 1 July 2017 changes

In 2016–17, total contributions to SMSFs were $41.8 billion up from $31.6 billion, an increase of 32%. In the 2016-17 financial year, totally SMSF benefit payments increased by 31% from $35 billion to $46 billion.

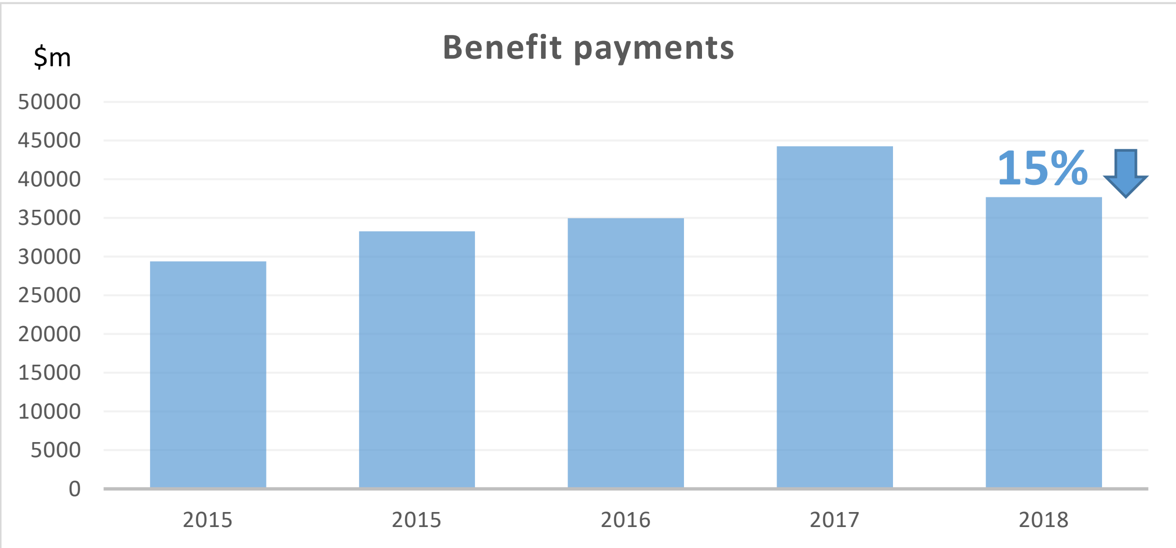
These were significant increases over the previous financial years, most of which can be attributed to a behavioural change resulting from the introduction of the superannuation reforms taking effect on 1 July 2017.

With the release of the 2017-18 statistics, we now have a reversion to the norm.

- Total contributions to SMSFs peaked at $41.1 billion in 2016–17 before dropping 58% to $17.4 billion in 2017–18.
- The decline in contributions was most pronounced for member contributions, which peaked at $33.9 billion in 2016–17 before dropping 66% to $11.6 billion the following year.
- Total SMSF benefit payments decreased by 15% from $44.3 billion in 2016–17 to $37.7 billion in 2017–18.

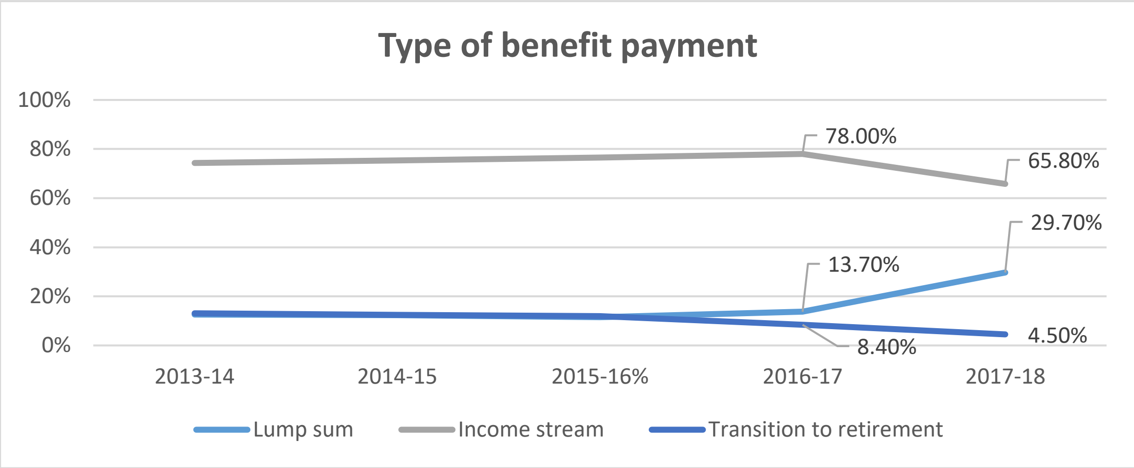


The decline in contributions was most pronounced for member contributions which contributed to the majority of the fall. This is likely due to the fact many SMSFs would have used their three yearly contribution bring forward rule in the previous financial year.



Unfortunately, the statistics don't detail the amount of money that moved from retirement phase into accumulation phase because of the transfer balance cap (TBC). The data relating to being in retirement phase is recorded once all members of the fund receive at least one pension payment.

However, we can see some of the impact in the type of benefit payment taken by SMSF trustees, as lump sums more than doubled in the financial year.



In the 2017-18 financial year, there was a significant increase in lump sum withdrawals from SMSFs. As SMSFs moved money into accumulation phase and the TBC took effect, they took the opportunity to withdraw funds as a lump sum to keep a larger amount in retirement phase. If lump sums were taken from the retirement phase this would create debits to their TBC.

Transition to retirement income streams were also out of fashion in the 2017-2018 financial year. This can be attributed to the loss of tax exemption status for these income streams.

In the 2016-17 year, $31 billion was paid out in income stream payments. In the 2017-18 year, this fell to $20 billion.