SEDLEY KOSCHEL

FINANCIAL GROUP

SMSF Association review of the Australian Taxation Office's SMSF Statistical Overview 2016-2017

Self Managed Super Fund Association

The Australian Taxation Office's 2016-17 statistical overview of SMSFs reveals an SMSF sector that has not only performed well but provides a positive outlook for its future growth and strong performance.

SMSF Association - 6 key takeaways

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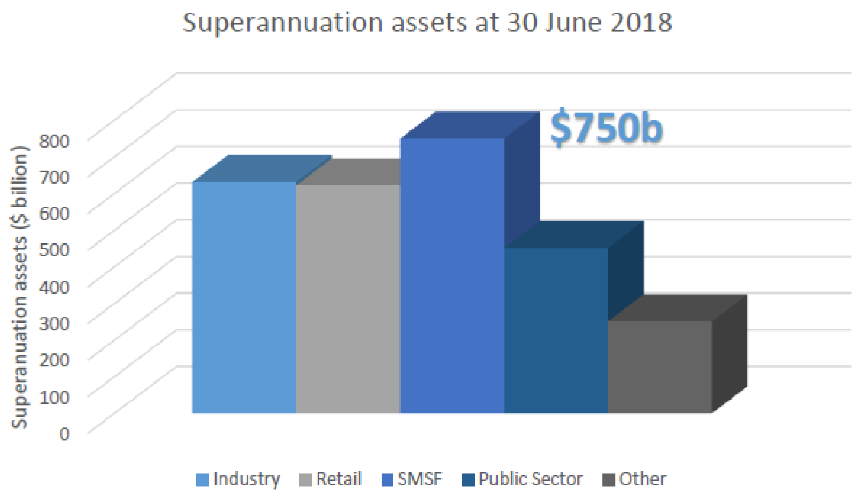
So what are the key takeaways for SMSFs?

Returns are up, expenses are down and advice is improving. Notably, the establishment balances for SMSFs has risen significantly.

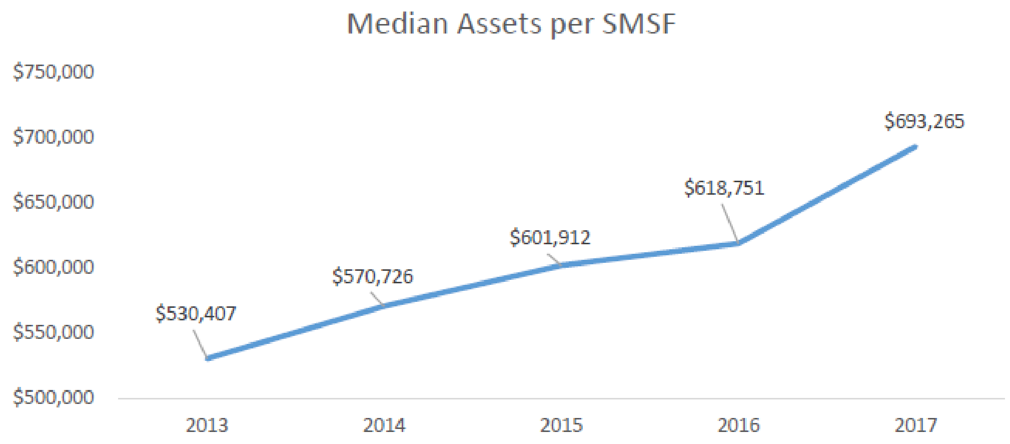
The 2016-17 financial year was also the last financial year before the extensive 1 July 2017 superannuation changes which included the $1.6 million transfer balance cap took effect. Accordingly, the statistics provide an interesting analysis of behavioural changes and SMSF trustee decisions before the impending legislation took effect. SMSF trustees clearly acted to contribute more to superannuation before more restrictive measures were placed on the system.

SMSFs accounted for 99.6% of the total number of superannuation funds in Australia and 28% of the $2.7 trillion in total superannuation assets at 30 June 2018. SMSFs therefore, are clearly an integral and significant part of the superannuation system.



There are approximately 1.1 million Australians in 596,000 SMSFs with an average fund balance of $1.2 million or median fund balance of $690,000 (the median value is more reflective of the normal SMSF as a minority of very large SMSFs distort the average figure). The median balance has continued to grow and now comfortably exceeds the Productivity Commission's recommended $500,000 cost-effective balance for SMSFs.

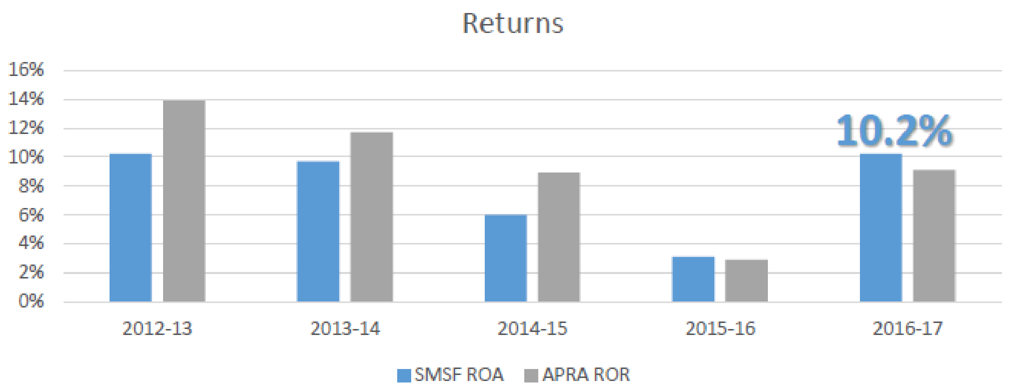
SMSFs are typically made up of a couple with an average of 1.9 people in an SMSF and 42% of SMSFs are in some form of pension phase, two crucial factors that are typically glossed over when analysing SMSFs.



RETURNS

In the 2016-17 financial year, **SMSFs made an average return of 10.2%** compared to the 9.1% return for Australian Prudential Regulatory Authority (APRA)-regulated funds.

This now marks a strong continual run of positive returns SMSFs and continued comparable performance to APRA-regulated funds.



We believe this is quite a significant result for SMSFs, as differences in ATO and APRA investment return methodologies have typically seen SMSF investment returns understated compared to those for APRA funds. This is predominantly due to the differing datasets available to the ATO and APRA which limit the comparability of the investment returns reported by each. Aligning the methodologies may require the ATO to impose additional reporting burdens on SMSF trustees.

Furthermore, another significant issue in comparing investment returns, especially at a sector level, is that SMSFs have a significant proportion of members in retirement phase compared to APRA-regulated funds which can distort comparisons.

The different costs that are included in SMSF ROA compared to APRA-regulated fund ROR also make it difficult to compare investment returns across the sector and come to a conclusion on what level of assets are required by SMSFs to achieve similar returns to APRA -regulated funds.

As stated above, the result of these problems is that typically SMSF returns are undervalued when compared to APRA-regulated funds. Therefore, the positive performance of SMSF funds in the 2016-17 is a testament to the ability of the SMSF sector to deliver positive investment outcomes for SMSF members.

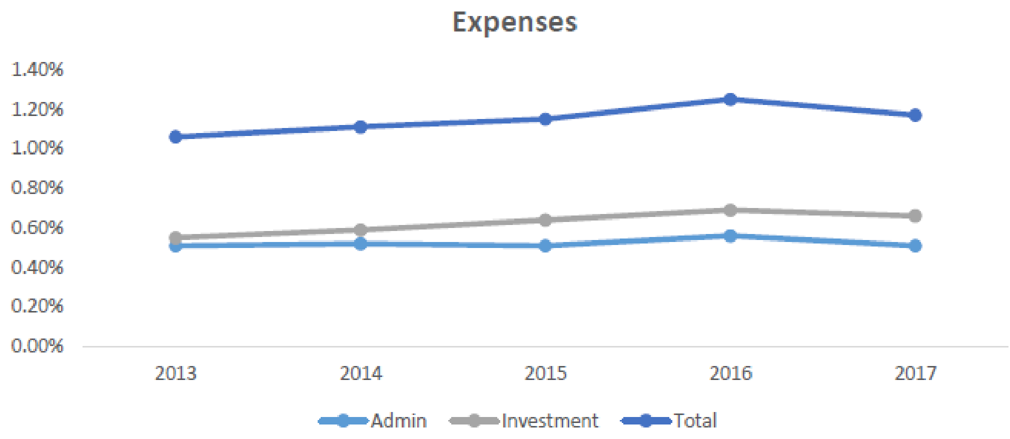
However, it must be remembered that analysis must look further than a discussion of comparable returns and look towards individual retirement goals and income needs. It is entirely appropriate for an SMSF member (typically older and more risk averse) to aim for a level of retirement income that allows them to achieve all their financial goals and lead a comfortable lifestyle through a lower investment return than another riskier fund.

EXPENSES

In conjunction with returns rising, expenses fell for SMSFs for the 2016-17 financial year.

This is based on the total expense ratio for SMSFs which includes administration and operating expenses and investment expenses, which are the two key outgoings for SMSF members. Overall, these fell by eight basis points in the 2016-17 financial year.

The average expense ratio for APRA-regulated funds was 0.8% as at June 2017 compared to 1.17% in SMSFs.



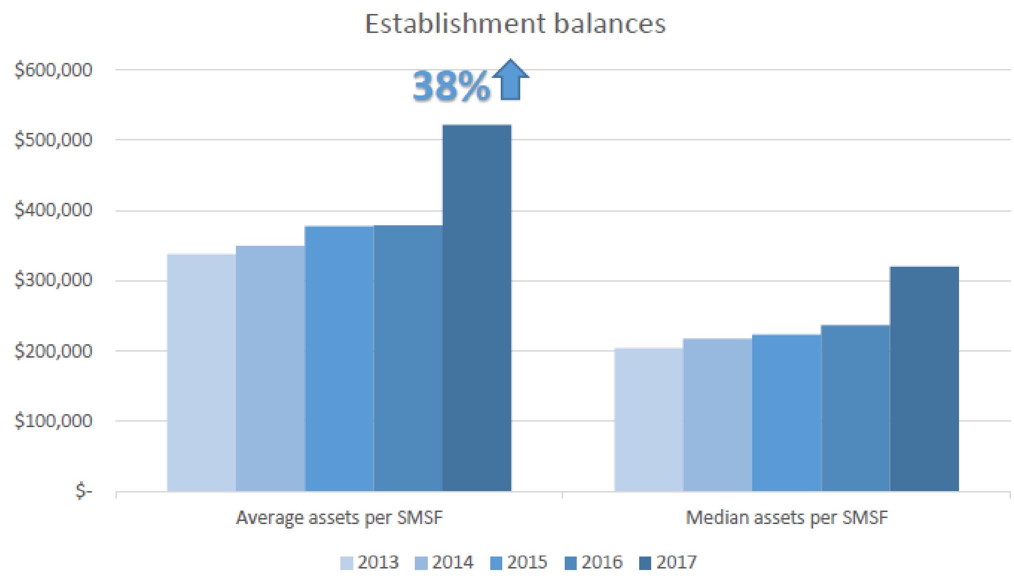
Administration and operating expenses fell by five basis points. An almost **9% reduction** from the year prior. This category of expenses encompasses the accounting work and documentation required by an SMSF.

We believe this can be attributed to the increased use of technology and software in SMSF administration services. The SMSF industry has always been at the forefront of financial technology and innovation and this is now starting to reduce fees for members.
Investment expenses fell by three basis points in the financial year. This category typically includes any investment advice commissioned by the SMSF members or brokerage for investment assets. It’s promising to see these expenses also falling for SMSF members.

ESTABLISHMENT

The most significant takeaway in the ATO statistics was the increase in establishment balances for SMSFs for the 2016-17 year. As clearly shown in the graph below, the average assets when an SMSF was established in 2016-17 rose to $521,000 compared with the relatively stable levels of $370,000 in previous years, **a 38% increase.**

The median assets when an SMSF was established also rose substantially to $320,000 from the low $200,000 levels in the previous four years.



From the Association's perspective, this demonstrates that SMSF trustees are receiving quality SMSF advice. SMSF trustees and their advisers are understanding that they need an appropriately sized SMSF to ensure they receive the full benefits an SMSF can provide. This coincides with the introduction of the limited licence regime on 1 July 2016 which ensured that any individual who provides SMSF establishment advice must have an Australian Financial Services Licence or be an authorised representative of a licensee.

The key to ensuring that SMSFs are established appropriately is high quality and professional financial advice which incorporates size and scale considerations into the decision to establish an SMSF. The provision of quality financial advice can ensure that members are only placed into SMSFs when that is in the client's best interests and appropriate for their circumstances.

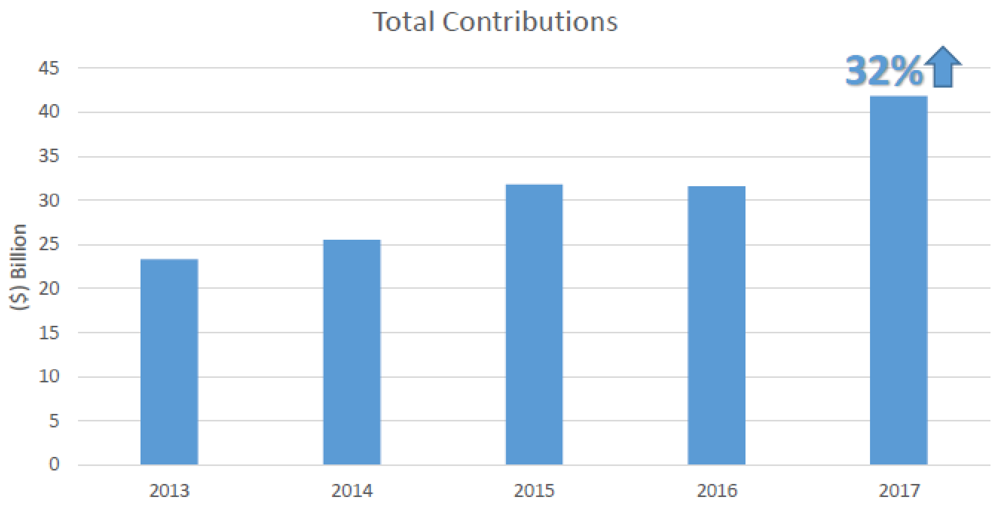
This strengthens the Association's push to ensure that all advisers who provide advice to individuals about SMSFs should have specific SMSF education and qualifications that underpin their advice. Not only will the benefits be seen with more appropriate establishment balances but quality advice provided to SMSFs will materially improve member outcomes, positively affect retirement savings and protect individuals from inappropriate advice.

Additionally, the increase in establishment balances would also be affected by the increased growth of SMSF establishments from the 35-44 year old age demographic. These new SMSF trustees have had careers under a full superannuation guarantee system and are likely to bring larger balances to establish an SMSF, especially as a couple. The increase in establishment assets in 2016-17 could also have been driven by behavioural changes resulting in individuals establishing SMSFs with larger amounts due to the expected lower contribution caps taking effect on 1 July 2017.

The SMSFA believes that these figures illustrate that the majority of SMSFs are being setup with an appropriate balance. It should also be noted that some SMSFs may be established with low balances with further contributions and roll-ins to be received in a short time period later.

CONTRIBUTIONS

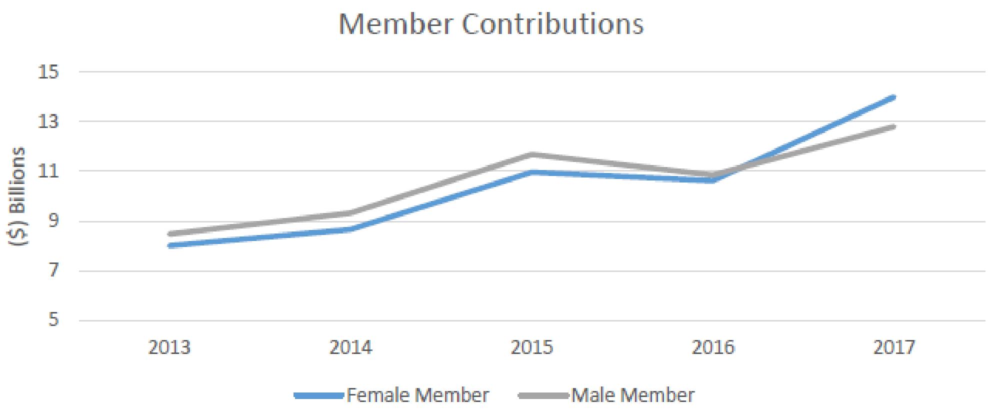
In 2016–17, total contributions to SMSFs were $41.8 billion up from $31.6 billion and **an increase of32%** over 2016.



This is a significant increase over the previous financial years, most of which can be attributed to a behavioural change resulting from the introduction of the superannuation changes taking effect on 1 July 2017. One of these changes was a reduced non-concessional cap of $100,000. Individuals prior to 1 July 2017 had the opportunity to contribute up to $540,000 post-tax into their superannuation through the three-year bring forward rule and clearly many took this opportunity up. This is further highlighted by a **42% increase** in member (voluntary) contributions in the 2016-17 year.

While on the topic of member contributions, SMSF member contributions accounted for over half of all member contributions across all superannuation funds in the 2016-17. This is a startling result, indicating that SMSF engagement is clearly at an all-time high, especially when compared to the rest of the superannuation system, highlighting how SMSFs are providing positive member outcomes.

Another interesting outcome is the fact that 2016-17 was the first financial year where SMSF member contributions were higher for females than males.

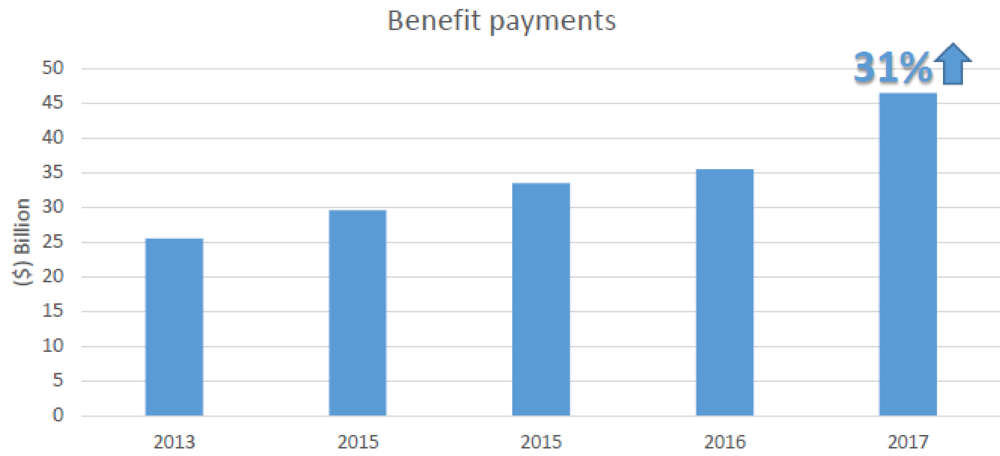


This is due to two reasons. One of these is the importance of spouse equalisation strategies given the introduction of the 1 July 2017 changes mentioned earlier. The transfer balance cap implemented a $1.6 million cap on the amount of assets an individual could have in superannuation on a tax-free earning rate. This meant couples took the opportunity to re-balance their accounts and transfer money from one member to the other (by withdrawing and recontributing superannuation money), increasing the amount of money couples could keep in superannuation tax-free in retirement.

Secondly, increasing awareness of the superannuation gender gap may have played a part in the increase of superannuation to female accounts. This could include rebalancing strategies, as mentioned, spousal contribution measures and greater engagement with women's retirement issues.

BENEFITS

As with the increase in contributions for individuals looking to make the most of larger non-concessional caps, the behavioural impact of 1 July 2017 changes can equally be seen on the benefits side.



In the 2016-17 financial year, totally SMSF benefit payments **increased by 31%** from $35 billion to $46 billion. This is largely because of the introduction of the transfer balance cap mentioned earlier. SMSF trustees could have either removed money from superannuation above the $1.6 million retirement account limit or moved this money into the accumulation phase to be taxed at 15%. While it is expected that many would have moved money into accumulation, there is no doubt some individuals took the opportunity to cash benefits out of the system.

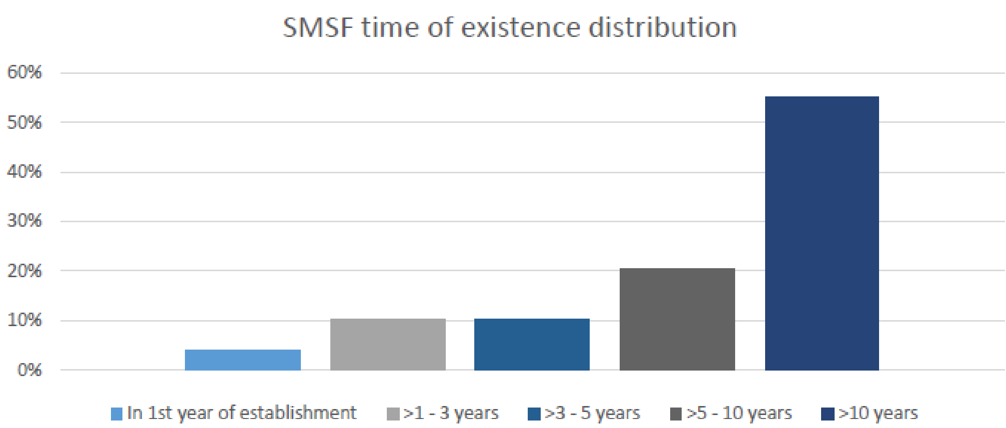
The other impact on the benefit figure comes from the equalisation strategies mentioned earlier. The money that was re-contributed to a spouse's account is sourced from one of the member's own accounts as a benefit payment.

SATISFACTION

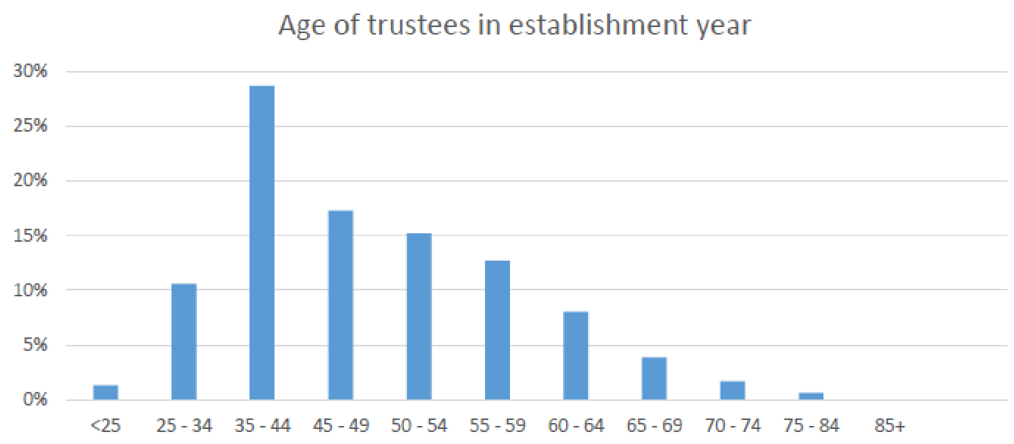
Finally, the ATO SMSF statistics tell a story of satisfaction from SMSF members. Of SMSFs established in the 10 years prior to 30 June 2017, **88% were still in existence** at that date. This is a significant indication of the satisfaction that SMSF members experience with their SMSF.

It highlights that there is only small subset of people that are entering the SMSF sector and shortly exiting due to it being inappropriate for their circumstances.

Additionally, the age distribution of funds indicates that SMSFs are in it for the long haul and are generally satisfied with keeping their SMSF. The median and average age of an SMSF is 10 years. The ATO stats also highlight that the **older the fund is, the greater their SMSF return**.



It is also worth noting that the median age of SMSF members of newly established funds in 2016-17 was 48 years.



As the graph above demonstrates, the average age brackets of members who are establishing SMSFs is clearly skewed to younger demographics. We believe this highlights how SMSFs are able to deliver long term outcomes for individuals who wish to take control, especially drawdown outcomes. SMSFs provide a level of flexibility and strategy, that simply is hard to obtain in an APRA-regulated fund especially as members age, retire and drawdown on their benefits.

Source: SMSF Association

Please do not hesitate to contact the team at Sedley Koschel should you have any questions on 1300 00 11 08 or admin@sedleykoschel.com.au