Submission to:

Productivity Commission report

How to assess the competitiveness and efficiency of the superannuation system – draft report

About us

Dixon Advisory

Dixon Advisory was founded in 1986 by Daryl Dixon, now widely recognised as one of Australia's leading superannuation advisors. Since inception, Dixon Advisory has assisted individuals navigate the superannuation system by providing easy to understand advice on a fee-for-service basis. We hold Australian Financial Services Licence number 231143.

Dixon Advisory and its team are very familiar with all aspects of the superannuation system through the advice they provide to individuals within all four key sectors: public sector superannuation, industry funds, retail funds and SMSFs.

Dixon Advisory assists more than 20,000 families with their superannuation decisions including over 4,500 families who use SMSFs, for which Dixon Advisory provides a complete administration service.

Dixon Advisory estimates that this makes it the fourth largest administrator in the $600 billion SMSF market.

Dixon Advisory employs more than 350 people in its 5 offices: Sydney, Melbourne, Canberra, Brisbane and New York (USA).

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Executive summary

Dixon Advisory welcomes the opportunity to respond to the Productivity Commission's ('the Commission') draft report on the competitiveness and efficiency of the superannuation system. We were pleased to be invited to participate in the roundtable hosted by the Productivity Commission on the 6th of September 2016. We found the discussions informative, constructive and well facilitated.

Noting that the review aims to measure Self Managed Super Funds (SMSFs), we have focused particularly on the SMSF sector, including our experiences from assisting more than 20,000 families with their superannuation decisions and over 4,500 families with SMSFs. Given our experience, and our unique position as a privately owned financial advice business that has operated under a fee-for-service model since inception 30 years ago, we have also extended our submission points, in some sections, to the non-SMSF sector.

SMSFs are an important sector in the superannuation industry. In the five years to 2014/15 the number of SMSFs has increased by 27 per cent to 557,000. As at March 2015, there are 1.08 million members in SMSF funds[1]. The 2010 Super System Review confirmed that the SMSF sector is largely a successful and well-functioning part of Australia's superannuation system[2]. Further, data from the Super System Review's 'A Statistical Summary of Self-Managed Superannuation Funds' confirm that the SMSF sector has continued to respond to changing economic circumstances, evident from positive shifts in SMSF numbers, total assets and member account balances over the five years to 2013[3].

SMSFs are critical to the health of the wider superannuation system and support individual responsibility and self-reliance in retirement saving. They provide essential competition to the major retail and industry funds and encourage saving through the unique choice and control they deliver. These strong catalysts are why SMSFs should remain a choice easily accessible to all Australians.

As SMSF specialists, we are in a unique and qualified position to give a substantiated assessment of the industry, and how the areas of competitiveness and efficiency impact the SMSF system. In our submission report, we also seek to raise awareness of claims made by SMSF competitors that are not accurate but continue to be put forward and, at times, are used as a basis for advocating for the restriction of the operation of SMSFs.

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1 Australian Taxation Office, Tables, <https://www.ato.gov.au/Super/Self-managed-super-funds/In-detail/Statistics/Quarterly-reports/Self-managed-super-fund-statistical-report-March-2016/?anchor=SMSFannualdata#SMSFannualdata>

2 The Australian Government The Treasury, 2010, *Super System Review*, Canberra, p. 221

3 Australian Taxation Office, 2014, 'Self-managed superannuation funds: A statistical overview 2012-2013', viewed 20 April 2016, <https://www.ato.gov.au/About-ATO/Research-and-statistics/In-detail/Super-statistics/SMSF/Self-managed-superannuation-funds--A-statistical-overview-2012-2013/?page=3#Executive_summary>

Dixon Advisory's key recommendations

Considerations for assessing competition – assessing demand side

1. Barriers to entry to SMSFs for consumers should not be increased.
2. Regulations governing SMSF establishment should not be made more complex or time-consuming. Restrictions would create anti-competitive barriers to entry and further reduce the incentives for efficiency across the APRA regulated sector. There is no substantiated evidence of significant failure or damage to the integrity of the Australian superannuation system that would justify such changes.
3. The following, which would impose severe barriers to entry to SMSFs, should not be introduced:
    a. A minimum balance for SMSFs.
    b. Mandatory compliance education for SMSF trustees.
    c. A mandatory professional custodian for SMSFs – new or existing. Custodian rules would unnecessarily increase SMSF costs and drive users away.
4. In general, existing rules are sufficient to make would-be SMSF trustees aware of their responsibilities and to dissuade them from setting up SMSFs without due consideration. Fund establishment rules should be clear and simple so that SMSF choice remains a financially viable, easily understandable option for consumers.
5. Exit fees should be removed from all legacy superannuation products to allow consumers to easily leave these products and seek better choices that suit their needs.

Considerations for assessing efficiency – net returns

6. Assessing the efficiency of the superannuation system via a net return metric at a system-wide level will be ineffective due to the high level of variations across the many variables at play, including asset class definitions, investment approach, investment structure, gearing, life stage of member, draw-down rates and savings levels.
7. Incorporating a measurement for risk-adjusted returns is an important balance to a single net return figure. However, the proposed assessment methodology of comparing returns within the same asset classes at a system-wide level is highly problematic because of the variations within asset classes (such as gearing levels and investment structures).
8. Direct comparison between the SMSF and non-SMSF sectors is also not yet possible due to variations in regulatory data reporting standards, particularly with regard to asset classes.
9. All measurements must be split out according to the superannuation phase of the member, namely, accumulation phase members, members in transition to retirement and members in full retirement phase. Efficiency measures, which amalgamate all phases, will not be able to recognise the significantly different approach to managing an investment portfolio in the decumulation phase.
10. Investments in technology may not result in fee efficiencies being passed on to members, but may result in better services, more features, more compliant funds and shorter processing times.

Considerations for assessing efficiency – member’s preferences

11. Measurement of members’ preferences must incorporate how trustees in APRA regulated funds make decisions about the services, including investment into administration and IT systems for the benefit of members. SMSFs use the administrative system in order to improve the trustees’ retirement position.
12. Fee-for-service/Intra-fund embedded fees: Dixon Advisory is a strong advocate of a fee-for-service model for all recipients of financial advice and believes this is the way forward for all financial advisory professionals.

Considerations for assessing efficiency – insurance

13. Portability of insurance policies should be assessed.
14. Assessing the efficiency of insurance within the superannuation sector needs to be undertaken with a broad qualitative survey of members that captures their holistic financial situation including debt levels, details of all dependants, minimum living expenses, assets and non-super insurance.
15. Incorporating the assessment of insurance levels held within SMSFs, as a comparative measure to APRA regulated funds, which offer default insurance, will overlook the demographics of the SMSF, which, for rational reasons include factors like capacity to self-insure, costs, quality of terms offered, and effectiveness of holding insurance inside their SMSFs.

Considerations for assessing efficiency – system stability

16. SMSFs already have good support in accessing upstream capital markets across multiple asset classes and the support for this group of investors continues to grow.
17. The balance between regulatory protection of SMSF savings to ensure that funds are lawfully used, and the ability to complete the annual requirements in a timely, cost-effective manner, is working well in the vast majority of cases. It should not become more difficult for SMSF trustees to complete their annual regulatory requirements.
18. Restoring a general prohibition on direct leverage in superannuation funds is unnecessary as the regulations, existing lender requirements and limited tax benefits of gearing sufficiently protect lenders and customers.

We thank you for allowing the opportunity to provide comments on this important issue. Improving the efficiency and competitiveness of the superannuation system is core to providing retirement incomes for Australia’s ageing population. If you have any questions regarding Dixon Advisory’s submission, please do not hesitate to contact me .

Kind regards,

Nerida Cole

Managing Director- Head of Advice

Dixon Advisory

Key issues – overview

Ineffective competition results in higher fees for consumers

In recent years, major superannuation industry lobby groups have been advocating for the increased regulation of SMSFs.

The ever growing presence of SMSFs is a direct result of people seeking greater control of their own superannuation accounts, better alignment of interests and more flexibility. The retail and industry sectors lose large amounts of money that roll out of their funds to SMSFs (as reported by the Australian Taxation Office (ATO) over the five years to 30 June 2014, $77.8 billion was rolled into SMSFs[4]). Therefore, the constant push by some superannuation lobby groups to increase regulation is an attempt at improving their own competitiveness in the industry rather than articulating an objective industry reform opinion.

Therefore, it is critical that the Productivity Commission considers the submissions of industry leaders and experts in the SMSF area (like Dixon Advisory) in order to gain an objective and insightful vision of the industry and the SMSF sector in particular.

From Dixon Advisory's experience in the marketplace, competition inside the APRA regulated retail and industry fund sector is far lower than is generally perceived by consumers.

Unfortunately, the lack of real internal competition in this sector is resulting in very slow or no reduction in the fees paid by fund members – particularly default fund members.

Consumer differentiation in the APRA regulated sector is divided between industry and retail funds. As a group, industry funds have chosen to band together and adopt a universal brand symbol in order to advertise as though all industry funds are equal, just as prosperous and safe for consumers. This has benefited the industry fund sector materially. For the consumer, however, the reality is starkly different with material performance differences between the highest quality industry funds and the lowest quality and most expensive industry funds. By having a universal brand symbol and advertising support there is not enough incentive for expensive and poor performing industry funds to improve because they enjoy the positive effect of the whole sector. This is even further the case if the fund has a significant amount of default employer support providing guaranteed fund flows. For the better industry funds, there is little need to improve as they are already significantly cheaper than retail funds.

Retail funds are tarnished with a high fee reputation, despite efforts with the launch of MySuper to provide some competitive and quality offerings. The last decade has seen a constant wave of consolidation across retail and industry funds where the top providers dominate the employment of financial advisors in the sector. As such, if barriers to entry to SMSFs were increased, the reduction in overall industry competition would further compound the problem and consumers would suffer even further. The end result could be that government and taxpayers in general would have greater Commonwealth pension burdens to manage in the future than would otherwise be the case.

4 Australian Taxation Office, *SMSF Rollovers,* <https://www.ato.gov.au/Super/Self-managed-super-funds/In-detail/Statistics/Annual-reports/Self-managed-superannuation-funds--A-statistical-overview-2013-14/?page=7#SMSF_rollovers>

Dixon Advisory's submissions:

Chapter 1: Addressing Section 'G – SMSF' of the Productivity Commission report

Part A: How do SMSFs differ from other types of funds?

Institutional structure

SMSFs are structured as trusts, with the members also taking on the role of the trustees. It is this closely linked relationship between members and SMSFs that makes it an attractive superannuation choice for over 1.08 million Australians[5]. From a regulatory perspective, the ATO is the primary regulator of SMSFs, while ASIC is still responsible for the licensing and supervising of SMSFs and the related parties, such as, financial advisors and auditors.

Irrespective of the type of superannuation fund selected by an individual to house their retirement savings, the ultimate objective of members does not change – they are hoping to build wealth in the system sufficient to provide for their retirement. As such, it is critical that all superannuation funds operate according to the same rules and boundaries.

In the current environment, it is difficult for a superannuation member to confidently choose between different fund types by comparing major differentiating characteristics such as investment performance, control, flexibility, fees and service levels.

Regulatory landscape

There is no evidence to suggest ATO compliance activity is inadequate in the SMSF sector. In the year ending 30 June 2015, only 8,200 SMSFs had auditor contravention reports (ACR) lodged against them. As stated by the ATO, 'the percentage of the SMSF population with ACRs remains relatively stable at approximately 2 per cent of all SMSFs each year'[6]. It must also be noted that this is a 7 per cent decrease from the number of ACR lodgements in 2014. These improvements are expected to continue as a result of increased standards for SMSF auditors, increased education standards for financial advisors and targeted education materials for trustees via the ATO website. It should also be noted that ASIC closely monitors the SMSF sector. In July 2015, ASIC provided the sector with guidance via Information Sheet 205 and 206. The release of these important sheets was designed to clarify what the regulator considers an advisor should consider, discuss and then disclose to clients when providing advice on establishing or switching to an SMSF. The information sheet 206s also deals with the cost-effectiveness of an SMSF. This includes ASIC's view that an SMSF with a starting balance of $200,000 or less is unlikely to be in the client's best interests and that advice to establish one below that threshold is more likely to be scrutinised by ASIC. The information sheet 206 also notes some of the circumstances where an SMSF with a starting balance of less than $200,000 may be in the client's best interests.

Further, from 1 July 2016, ASIC removed the accountants' exemption that allowed accountants to provide certain advice on SMSFs and their establishment outside of the normal AFSL regulatory environment. This is expected to improve the alignment of appropriate trustees with the SMSF structure. Further, ASIC has announced it will undertake compliance of the accounting sector to ensure compliance with this tighter regulatory framework.

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5 Australian Taxation Office, *Tables* <https://www.ato.gov.au/Super/Self-managed-super-funds/In-detail/Statistics/Quarterly-reports/Self-managed-super-fund-statistical-report-March-2016/?anchor=SMSFannualdata#SMSFannualdata>

6 Australian Taxation Office, *Compliance* <https://www.ato.gov.au/Super/Self-managed-super-funds/In-detail/Statistics/Annual-reports/Self-managed-superannuation-funds--A-statistical-overview-2013-14/?page=26#fn34>

Given current compliance activities have not revealed broad or significant non-compliance in the SMSF sector, but rather revealed a striking level of compliance, there appears to be no reason to increase the level of compliance activity beyond the already high levels.

Why people set up SMSFs

There are usually a number of reasons why people set up SMSF funds. We seek to use our expertise in this area to further shed light on some of the key advantages attracting people to start their own SMSF. The general feedback we get from our clients is that having greater visibility over their retirement savings has led to a deeper understanding of how their overall wealth is tracking, and given them more confidence in their investment and lifestyle decisions.

Below we underline some of the reasons why people set up SMSFs:

- Investment choice
  - SMSFs provide more investment options than any other super fund. Trustees can access direct shares, high-yielding cash accounts, term deposits, income investments, direct residential property, business real property, unlisted assets, international markets, commodities and more.
- Flexibility
  - SMSFs allow couples to facilitate their retirement planning choices together even if at different superannuation stages. Members can run a mixture of accumulation and pension accounts within one fund. The structure and investments can be adapted quickly and efficiently as required by changes like the work status of the members or legislative change.
- Transparency
  - SMSFs offer significant transparencies that allow trustees to align their personal goals with their investment decisions. Whether they are passionate about property, shares or sustainable and ethical investing, SMSFs allow their members to better track and understand where and how their money is invested. This is particularly important during times of market volatility or decline, when understanding the exposure to specific sectors, regions or investments can inform the actions that may need to be taken.
- Cost
  - SMSF trustees must lodge an annual tax return, and audit and pay a supervisory levy to the ATO. Generally, the more an SMSF grows, the more cost-effective it becomes, but the total cost of running an SMSF will depend on the related investments and the costs associated with engaging professional support.
- Consolidation of superannuation
  - An SMSF allows a trustee to combine their super assets with up to three other members (such as spouse or other family members). Consolidating of super accounts immediately creates larger fund balances, which increases the fund assets and investment opportunities. From a family perspective this also allows parents to encourage their children to take an interest in finances and investments, building lifelong good habits. Many young adult children at the early stages of their working life are likely to benefit from a better fee arrangement than holding multiple default accounts with minimum flat account keeping fees.
- Administrative efficiency through alignment of member and trustee interests
  - Although tax benefits are often held up as a feature of SMSFs, SMSFs do not have access to tax benefits that are not also available to APRA regulated funds. SMSFs are governed by the same legislation that covers APRA regulated funds: the *Superannuation Industry (Supervision) Act.*
  - It would be more appropriate to consider that the real benefit members gain from an SMSF is an alignment of their individual interests with the features offered by the fund. With APRA

regulated funds largely focused on accumulation members, in the large part they do not offer their members access to the administrative systems support that would allow them to obtain the full benefits of the super system.

Part B: What trends are evident?

Fund size and members

Dixon submits that in these competitive market conditions, SMSFs are performing very strongly. We believe that their positive growth and strong presence in the superannuation market is due to the advantages that it offers to its new members. Below, we outline some of the key findings that have been published by the ATO[7]:

- In the five years to 30 June 2015, SMSF assets grew by $180.9 Billion or 44 per cent. As stated by the ATO in A Statistical Overview 2013-14, 'SMSFs continue to have a significant influence in the overall growth of the $2 trillion Australian superannuation industry.'
- Between the years of 2011 and 2015, the number of SMSFs grew from 440,000 to 557,000.
- Total members within SMSFs has increased significantly from 836,645 in June 2011 to 1,085,286 in March 2016. This equates to approximately 4.3 per cent of Australia's population.
- SMSFs are continuing to cater for sustainable retirements in the future as the increase in the average assets per member changes from $486,585 in the 2010/11 financial year to $564,086 in the 2013/14 financial year.
- There is also a clear developing pattern of younger people establishing SMSFs. The ATO has confirmed that, 'There were generally younger members in more recently established funds'. Of SMSFs established in 2014, 71 per cent of members were under 55 years old, compared to just 65 per cent of members of SMSFs established in 2013 and 51 per cent of members of SMSFs established in 2010.
- In 2016, 11.8 per cent of new SMSFs were established by people in the 25-34 age bracket. Whereas, 29.8 per cent of new SMSFs were established by investors in the 35-44 age bracket.

Member profile

Our experience is that SMSF owners are very diverse but most often include business owners, managers and senior executives in the public and private sectors.

SMSF trustees are usually well educated, and well aware of the superannuation system in general as well as their own SMSF. As underlined by Rice Warner in their 2012 report about SMSF needs and concerns[8], 81 per cent of trustee respondents held a tertiary qualification. Income levels are also an area of contrast. Research by the ATO indicated that the average income earned by SMSF trustees is $109,000, while the median taxable income was $57,000[9]. SMSF trustees also have longer living expectancies. Accurium, a leading actuarial group, calculated that SMSF trustees live about three years longer than the average Australian[10]. All of these statistics indicate that SMSF members are wealthier, healthier and more educated than the average Australian. These factors all contribute to the argument that SMSF trustees have a positive bias to engage with their superannuation and retirement planning.

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7 Australian Taxation Office: SMSF Statistics, <https://www.ato.gov.au/About-ATO/Research-and-statistics/In-detail/Super-statistics/SMSF/>

8 Rice Warner, '*Survey of financial needs and concerns of SMSF members (October, 2012)',* page 2, <http://www.smsfassociation.com/media/93653/121127_spaa-vanguard_research_report.pdf>

9 ATO, SMSF Statistics – Income, <https://www.ato.gov.au/Super/Self-managed-super-funds/In-detail/Statistics/Annual-reports/Self-managed-superannuation-funds--A-statistical-overview-2013-2014/?page=14#fn22>

10 Doug McBirnie and Jim Hennington, '*SMSF Trustees - Healthier, Wealthier and Living Longer',* The Journal of Superannuation Management (March 2016) pg 102 "http://www.fssuper.com.au/media/library/FS_Super/FS_Super_-SMSF_Trustees_-_healthier_wealthier_and_living_longer_-_D_Mc.pdf

Due to the hands-on nature of SMSFs, it is unlikely that Australians without these characteristics even consider setting up an SMSF. Those trustees who are less experienced are almost certainly receiving advice from a Chartered Accountant, CPA, financial advisor or SMSF specialist advisor. In fact, a majority of SMSF trustees engage a professional advisor in the management of their fund.

Asset allocation

The issue of SMSF asset allocation remains a topic of discussion by a number of industry commentators and participants. Dixon Advisory believes some of the commentary is intended to divert attention from the fact that SMSF investment returns are generally outperforming other fund types.

A commissioned study in 2013 by Rice Warner underlined that 7-year returns (between 2005-2011) for SMSFs was 8.8 per cent p.a. with the return on asset ending 30 June 2014 being 9.8 per cent. APRA funds, in contrast, had returns of 5.4 per cent over the same period[11] (we address performance comparison issues later in the report). These figures suggest that SMSF trustees are capable of managing their assets appropriately and do not highlight any weaknesses in their understanding of fundamental investment concepts such as asset allocation.

Further, SMSF trustees can, and mostly do, engage an investment or finance professional to assist with the management of their investments. Statistics reveal that 35 per cent of SMSF trustees use professional services in relation to the preparation of their fund's investment strategy, while 32 per cent seek financial advice regarding fund investments. A total of 73.5 per cent use professional services when preparing their SMSF annual return[12].

The most distinguishing characteristic of an SMSF compared to APRA regulated funds is the ability for members, in their capacity as trustees of their fund, to retain full control over all investment decisions. Dixon Advisory submits that all superannuation fund types, including SMSFs, should have fair and equal access to invest in assets that the trustee believes will increase the retirement benefits of members (subject to the existing investment restrictions contained in the SIS Act). It is this desire for control that leads an overwhelming 95 per cent of new trustees to establish an SMSF[13]. Any move by policy makers to limit or restrict an SMSF trustee's ability to make fully informed investment decisions will defeat the purpose of having an SMSF.

Dixon Advisory does not view the high allocation to cash within SMSFs as a negative. Given the proportion of SMSF members that are in a retirement or transition-to-retirement phase, it is prudent to have an allocation to cash that covers at least 2-3 years of pension payments as well as lump sum requirements. It is also important to note that because many SMSF members are also small business owners or have other complex financial arrangements, they may make a fully informed and rational decision to keep a larger proportion of their SMSF in cash to reduce the risk across the entire position.

Other comments that SMSF trustees have low allocations to international investments do not appear to take account of the high number of ASX listed investments that focus on non-Australian equity investments. This includes well known ETFs and LICs. Our research indicates at least 149 different investments are available to buy on the ASX but that do not invest in Australian equities or

[11] Rice Warner Actuaries, Submission to ASIC, *Costs of Operating SMSF's*, 3 September, 2013, page 17 (of 32), <http://download.asic.gov.au/media/1336058/cp216-RiceWarner-cost-of-operating-smsfs.pdf>

[12] Australian Government, *Review into the Governance, Efficiency, Structure and Operation of Australia's Superannuation System: A Statistical Summary of Self Managed Super Funds*, 10 December 2009, page 23, <http://www.treasury.gov.au/~/media/Treasury/Consultations per cent20and per cent20Reviews/Reviews per cent20and per cent20Inquiries/2009/supersystem/Documents/Statistical per cent20Summary per cent20SMSF/PDF/SMSF_statistical_summary_report.ashx>

[13] Productivity Commission Report: *How to Assess the Competitiveness and Efficiency of the Superannuation System: Draft Report* (August, 2016), page 253

Australian fixed income. (Refer Appendix A). Currently, the tax reporting requirements mean that as these investments are listed on the ASX, they are included as 'listed shares' in regulator data even though the underlying asset class may be emerging market equities, Australian fixed income, US property or Asian investments.

In any event, an SMSF's asset allocation is generally a direct result of each member's tolerance for investment risk. Risk tolerance can vary based on a number of factors, including but not limited to, the member's financial literacy and investment experience. Mandating or restricting a trustee's ability to construct an appropriate asset allocation in the context of the member's personal circumstances, is counterproductive and counter to the logic of having an SMSF.

Performance comparison issues

Dixon Advisory submits that the measurement of performance across SMSF and non-SMSF funds is likely to be inconclusive and misleading. Due to the different reporting requirements and categories between APRA and the ATO, any comparison may be parallel to comparing 'apples and oranges'. Previous studies, such as one by Rice Warner, have stated that, 'It is not possible to provide detailed statistics on the performance of individual SMSFs because there is no reporting requirement.'[14] Further, the Cooper Review also submitted that data between APRA and ATO is, 'largely incomparable.'[15] We are strongly of the opinion that SMSF and non-SMSF funds can not be compared on fees, performance, risk levels, asset allocation and other measurement categories until there is a synchronisation in the reporting requirements between APRA and the ATO, and the different phases of super are separated for reporting purposes. We believe that any relativisation of these two sectors may mislead the end users/consumers who will base their decisions around the results of these studies.

[14] Rice Warner Actuaries, Submission to ASIC, Costs of Operating SMSFs, 3 September 2013, page 16 (of 32)

[15] Australian Government, *Super System Review: Final Report: Chapter 8: Self Managed Super Fund Solutions*, 2008, page 248, <http://www.treasury.gov.au/~/media/Treasury/Consultations per cent20and per cent20Reviews/Reviews per cent20and per cent20Inquiries/2009/supersystem/Documents/Final per cent20Report/PDF/Final_Report_Part_2_Chapter_8.ashx> page 248

Chapter 2: Dixon Advisory submission on competitiveness

SMSF growth is an indicator of competition

When compared to its major competitors of retail and industry funds, the SMSF sector, if used correctly, gives greater flexibility to implement financial planning strategies to match individual needs and, particularly where the balance is high, has achieved higher returns for members. Research conducted by Rice Warner in 2013[16] affirmed that SMSFs with funds above $500,000 may be the cheapest alternative when compared to APRA funds. However, not only do SMSFs cater for an efficient fund, at the same time they can accommodate for complex superannuation arrangements that cannot be used in the non-SMSF sector. For example, as stated in the previous section regarding asset allocations, the overall performance for SMSFs in the 7-year period from 2005 to 2011 was 3.4 per cent per annum stronger than the APRA funds[17].

SMSFs are also rapidly growing into the fund of choice. Consumers are noticing the appeal of SMSFs, especially the freedom of investments available, flexibility and control. From 2011 to 2015 there has been a steady increase of active SMSFs from 440,000 to 557,000, representing a growth of 27 per cent[18].

Economies of scale

Across the SMSF sector as a whole an average SMSF has assets of $1,066,080[19]. Although some concerns about accessing economies of scale have been raised, data suggests that a typical SMSF does not have any trouble 'defraying fixed costs' when compared to its APRA regulated counterparts. In our view, this would suggest severe inefficiencies combined with significant profit margins to major players in the other sectors. For example, the ATO has reported the operating expense ratio across all SMSFs was 1.06 per cent[20], however, for larger funds the cost is lower. Whereas, due to the flat fees that generally apply in SMSFs, very small SMSFs may pay much more as a percentage of their overall assets. In our experience, the management expense ratio charged by the popular APRA regulated superannuation funds ranges from around of 0.4 per cent to 3.44 per cent. Further, these funds may either have additional fees for taking up some flexibilities or not offer the full range of features to members. For example, some funds charge a fee to implement a spouse splitting transaction or charge higher fees to access direct investment options.

Setting a minimum SMSF balance rule will result in reduced competitive pressure on the APRA regulated sector for consumers with balances below $200,000–$250,000. In Dixon Advisory's view, it has been the significant competition from SMSFs that has driven the efforts of retail and industry funds to reduce fees and increase service and flexibility from their funds.

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16 Rice Warner Actuaries, Submission to ASIC, *Costs of Operating SMSFs*, 3 September 2013, page 10 (of 32)

17 Rice Warner Actuaries, Submission to ASIC, *Costs of Operating SMSFs*, 3 September 2013, page 17 (of 32), <http://download.asic.gov.au/media/1336058/cp216-RiceWarner-cost-of-operating-smsfs.pdf>

18 ATO, SMSF Statistics 2013-14, <https://www.ato.gov.au/About-ATO/Research-and-statistics/In-detail/Super-statistics/SMSF/Self-managed-superannuation-funds--A-statistical-overview-2013-14/?page=5#Growth_in_numbers_of_SMSFs>

19 ATO: Annual SMSF population analysis table, <https://www.ato.gov.au/about-ato/research-and-statistics/in-detail/super-statistics/smsf/self-managed-super-fund-statistical-report-march-2016/?anchor=Assetallocationbyassetvalue#Membershipsizes>

20 Productivity Commission Report: *How to Assess the Competitiveness and Efficiency of the Superannuation System: Draft Report*, August 2016, page 259

Further, where SMSFs commence with relatively low balances (say $150,000 to $200,000) there are often other factors, such as a timing gap in receipt of all funds, a client's desire for involvement in a very unique investment class, including business real property that, when placed in context, outweighs any short-term disadvantage created by a smaller scale. An SMSF may be established on the grounds of complex superannuation arrangements that are not offered by retail/APRA funds. Rather than a minimum SMSF balance or a concern for scale, it should be up to the industry and retail funds to make their offers of better value and more compelling to members with smaller balances than they currently are.

Legacy products

Dixon Advisory suggests the review should consider measuring the exit fees which remain on legacy superannuation products. We believe these fees should be banned and removed from any products in which members joined at a past date that could be set by the government in the near future. Our reasoning is that under old legislation it was much easier to hide exit fees and sales practices of advisors were of a far lower standard than today. We have met many consumers who tell us that they never knew nor were they informed about these exit fees and are locked into a product that is not efficient or does not meet their needs.

Removing the exit fees would encourage consumers to leave and hence allow the products to be closed earlier.

Key Points:

- Barriers to entry to SMSFs for consumers should not be increased.
- Regulations governing SMSF establishment should not be made more complex or time-consuming. Restrictions would create anti-competitive barriers to entry and further reduce the incentives for efficiency across the APRA regulated sector. There is no substantiated evidence of significant failure or damage to the integrity of the Australian superannuation system that would justify such changes.
- The following, which would impose severe barriers to entry to SMSFs, should not be introduced:
    - A minimum balance for SMSFs.
    - Mandatory compliance education for SMSF trustees.
    - A mandatory professional custodian for SMSFs – new or existing. Custodian rules would unnecessarily increase SMSF costs and drive users away.
- In general, existing rules are sufficient to make would-be SMSF trustees aware of their responsibilities and to dissuade them from setting up SMSFs without due consideration. Fund establishment rules should be clear and simple so that SMSF choice remains a financially viable, easily-understandable option for consumers.
- Exit fees should be removed from all legacy superannuation products to allow consumers to easily leave these products and seek better choices that suit their needs.

Chapter 3: Dixon Advisory submission on efficiency

Maximising net returns on member balances over the long term

Dixon Advisory submits that the focus on historical returns as a measure of efficiency overly emphasises past performance, which is a significant conflict with the maxim: past performance is not an indicator of future performance. We have concerns that a strong focus on historical returns as a measure of efficiency may have misleading and negative consequences. Further, this may inappropriately emphasise to consumers that performance is a key factor in how they make investment or super choice decisions.

Another problem encountered by Dixon Advisory is the issue of measurement. If net return is one of the main criteria of efficiency, then, as echoed by the FPA in its draft submission[21], how will the commission differentiate between whether the super system is efficient as a result of the superannuation reforms or merely due to an increase in net return which is caused by improved market movement? Will there be a metric in place that differentiates impacts from legislative reform as opposed to market movement?

New super funds and new investment products will be disadvantaged on the basis of historical performance creating an additional barrier for entry. It is uncontentious that newly created funds will not be in the same position, nor have the same appeal as funds that have had a longer history of returns.

Super funds and investment products that have adopted a contrarian approach to the market for their medium- to long-term strategy are also likely to be disadvantaged. Namely, a fund that bought into an asset class when it was low (in order to sell later at an expected high) may be considered as a poor rating fund without acknowledging its future strategy or plan. Similarly, a fund that seeks to move out of an asset class because it believes it has become too overvalued may find that it’s performance in affected in the short term, but long-term results may produce excellent returns.

The grouping of different asset classes according to their asset allocation, to measure performance benchmarks, also raises concerns of accuracy and data integrity.

Firstly, no two investments are the same – even within the same asset class. At an investment fund level, although a performance category may incorporate only Australian shares, it is still problematic as different investment approaches are diversified across and within the asset class and may have different weightings to cash or hedges allowed within the fund mandate. As a practical example of the issue, Dixon highlights the Perpetual Equity Investment Company Limited (ASX: PIC). Although it is classified as an Australian equity exposure and is benchmarked to the ASX 300 Accumulation Index, it's mandate allows it to hold up to 25% in global listed equities, up to 25% in cash/deposit products and up to 10% in unlisted securities. It must be noted that this is clearly a different exposure to a number of traditional Australian share options that are usually limited to 5-10% exposure in cash and then the rest being in Australian shares only with no ability to invest globally. This option would therefore cause problems in terms of what asset class should the product be included within for assessment; its skewed diversification can lead to different performance patterns in comparison to its “traditional” Australian share option competitors. Further, variations such as gearing levels and the structure of the investment entity are all points of contrast that will need to be accounted for if the grouping of asset classes is to be used to compare risk or performance. The Commission has also underlined that it will group the unlisted assets into this study which will further complicate the compatibility of industry-wide returns as this sector in particular is incredibly diverse.

21 Financial Planning Association of Australia: Submission to the Productivity Commission - Re Study of Superannuation efficiency and competitiveness (21 April 2016), page 12 of 13, http://www.pc.gov.au/__data/assets/pdf_file/0009/198144/sub028-superannuation-competitiveness-efficiency.pdf

The Commission should also carefully consider the potential implications from the use (or misuse) of the published results. Specifically, data may be used to promote particular funds or investment approaches as superior, this is highly risky if the fund or asset class has been misclassified or is not directly comparable to the sample universe.

Key points:

- Assessing the efficiency of the superannuation system via a net return metric at a system-wide level will be ineffective due to the high level of variations across the many variables at play, including asset class definitions, investment approach, investment structure, gearing, life stage of member, draw-down rates and savings levels.
- Incorporating a measurement for risk-adjusted returns is an important balance to a single net return figure. However, the proposed assessment methodology of comparing returns within the same asset classes at a system-wide level is highly problematic because of the variations within asset classes.
- Direct comparison between the SMSF and non-SMSF sectors is also not yet possible due to variations in regulatory data reporting standards, particularly with regard to asset classes.

Efficiency and fees

Many Australians are not fully aware of the fees that they pay for their superannuation funds. A report published by the Grattan Institute in 2014 stated that about half of account holders do not know the fees they pay, while three quarters of Australians did not know their investment returns[22]. Further, the broad choice of products just complicates comparisons for Australians with only 2 per cent of Australians switching funds for reasons other than their employer switching default funds[23]. As articulated by the Grattan Institute, 'Such broad choice can benefit active and engaged account holders [...] some look for and find lower superannuation fees. Others – typically those with larger balances – may find it beneficial to set up a SMSF.'[24]

Dixon Advisory submits that the measurement of efficiency on the basis of fees, or rather the lowering of fees, raises problems that, similar to the measurement of net returns, may lead to inaccurate and unsubstantiated data.

One of our main concerns about efficiency and whether fees are being minimised is the issue of fee elasticity. It must be noted that, for SMSFs, fees such as compliance and auditing fees are a legal requirement. Therefore, these types of fees are not a sign of inefficiency, but rather a regulatory requirement that keeps changing. The Commission must acknowledge and distinguish which fees are mandatory and which fees are a sign of inefficiency or, rather, open to reform. It is our concern that relativising all fees may be misleading from a consumers' perspective without distinguishing which fees are mandatory and which are at the discretion of the providers.

[22] Grattan Institute, "*Super sting: how to stop Australians paying too much for superannuation*" (27 April 2014), pg 16.

[23] Above n21.

[24] Above n21.

Another key area concern for Dixon Advisory is the comparison of fees between different entities, and the SMSF and non-SMSF sector. Namely, the commission will need to be aware of the different categories of fees for each of the providers and what services these fees account for. For example, a provider may incorporate their administration and management fee into a single overall management fee, whereas, other providers will divide different fees into categories (i.e. management fee, investment fee, administrative fee). The inconsistency between the fee labels may mislead consumers in believing that one fund is cheaper from another without considering the different fee structures that are in place. Furthermore- complexity in obtaining full and accurate disclosure from funds about fees is highly concerning and acts as a barrier to competition in the sector. Further, as stated previously, we underline that the comparison of fee data between the SMSF and non-SMSF sector is not possible in the current regulatory structure.

A fund may also be in the high fee category based on the fact that it is an active research fund, whereby the investment analysts/fund managers are required to actively seek information in order to stay 'above the curve'. As a practical example, the Aberdeen Emerging Opportunities Fund (APIR: ETL0032AU) could be considered an example of an investment with high fees but at the same time strong returns. The Aberdeen Emerging Opportunities Fund is an emerging market equity fund with a 5 year performance of 7.6% pa (benchmark being 5.05%, outperformance of 2.55%). Aberdeen charges a flat 1.5% management fee which is classed as slightly expensive in comparison to its peers. Another example is the Magellan infrastructure Fund (APIR: MGE002AU), which has a fee of 1.06% plus a performance fee of 10.1%. The total cost of the fund is 1.51% (the highest in the global listed infrastructure universe according to Morningstar[25]). At the same time the fund has had a 5 year performance of 16.12% p.a. (benchmark at 12.16%), which is just outside the top quartile of performance against competitors despite the higher fees. Risk on the aforementioned fund has been labelled low relative to its peers by Morningstar[26], suggesting returns have been strong on a risk adjusted basis. The Commission therefore must ensure that the publication of data is balanced and reasonable by transparently accounting for the many dynamics that are inherent with any fund.

Furthermore, the Commission will need to focus on fairly acknowledging the value that comes from the provision of superannuation fees. It is critical that fees are weighted fairly with the value that they bring. If a superannuation provider offers an over-the-phone advice service that is highly regarded, then it is reasonable to presume that this provider will have higher overall fees than a provider who offers this type of service that is not used by members due to poor quality of the service. It is therefore critical that expensive funds are not automatically labelled inefficient, but rather that expensive funds are proportionately evaluated to what benefits they bring. We discuss further some of these aspects of what features are offered to members by a fund in the next section 'Taxation Advantages'.

However, it must be noted that this approach has a number of inherent problems that the Commission will need to weigh up:

– There might not necessarily be a relationship between good service and fees.
– A fund may increase costs without proportionately improving the customers' access to service and information.
– As these fees are covered by all of the fund members, is it fair to charge these fees across all members when only a portion of them use it?

[25] Morningstar, 'Global Fund Report' 30 June 2016 (page 7 of 9)

[26] Above n25, (page 4 of 9).

Another issue that the Commission will need to address is that of complex superannuation arrangements. Ultimately, fees of complex superannuation arrangements may be higher than a standard single member superannuation account. As stated in the Rice Warner report[27], 'SMSFs paying higher fees have more complex investment arrangements that are not possible within an APRA regulated fund.' Dixon Advisory submits that the Commission must consider the issue of complex superannuation structures and its likely high fee. The danger is that a certain segment of SMSFs will be classed as expensive without weighing in on the complexity of the superannuation structure, which is not available with APRA funds.

Innovation in the system

In the current market, the system is consistently required to innovate and update its technology, whether it is due to constant regulatory reform or market demand. Dixon Advisory submits that investment into technology will not always result in cost efficiencies that can be passed on to members. Over recent years the significant amount of regulatory reform and the pace of technological advancement has resulted in duplication of initial costs with replacement systems and further upgrades required in the short term.

Regulatory reforms and reporting changes should be proposed only if there is material benefit to consumers or the sector. Secondly, large system overhauls usually disadvantage smaller participants who find it harder to accommodate the change than bigger institutions. This too must be considered especially in a market that seeks to increase its competitiveness.

Key points:

- Investments in technology may not result in fee efficiencies being passed on to members, but may result in better services, more features, more compliant funds and shorter processing times.

Taxation advantages

The Productivity Commission in its draft report[28] points out that one of the major incentives for people to open up an SMSF is the ability to use tax management strategies. However, the notion, as suggested by certain lobby groups, that people entering the SMSF market to evade tax is an incorrect causal argument.

Although tax benefits are often held up as a feature of SMSFs, SMSFs do not have access to tax strategies that are not also available to APRA regulated funds.

It would be more appropriate to consider that the real benefit members gain from an SMSF is an alignment of the individual members' interests with features offered by the SMSF. Most APRA regulated funds are largely focused on accumulation members, and through a board of trustees make active decision about what services and systems they will invest in or offer their members. These trustees could choose to invest in administrative systems that would allow their members to obtain the full benefits of the super system. SMSF trustees should not be hobbled by unnecessary regulation or restrictions because they have chosen to provide superior features that suit their members.

[27] Rice Warner Actuaries, Submission to ASIC, Costs of Operating SMSF's, 3 September 2013, page 10 (of 32)

[28] Productivity Commission Report: *How to Assess the Competitiveness and Efficiency of the Superannuation System: Draft Report* (August 2016), page 253

Example 1: most APRA regulated funds require investments to be sold and then new investments purchased when a pension account is set up, even if it is within the same provider. This costs members administrative hassle, tax and increases investment risk.

Example 2: most APRA regulated funds do not separately report capital gains income from investment income within accumulation accounts. This results in their members paying an additional 5 per cent tax on capital gains. This is because the mandated tax rate for capital gains is 10 per cent if the investment is held for more than 12 months. Whereas, the tax rate applied to income earnings is 15 per cent.

Example 3: most APRA regulated funds do not offer couples the option of consolidated reporting that consider both spouses super account to assist couples plan their retirement together.

However, in each example listed above these options could be provided by APRA regulated funds. This is evidenced by the fact that some APRA regulated funds do offer these features to their members, and other less used features of the super system, but they are also more likely to have higher fees as a result of providing these additional benefits. WRAP accounts offer a high degree of investment control and transparency, and are often considered second or closely comparable to SMSFs in this regard. However, providing this advantage has systems and compliance costs to the WRAP that are passed on via a higher member fee. Further, some industry and retail funds have recently commenced offering their members direct investment options and options to manage tax through the transition-to-retirement phase. This progress to increase the range of features offered is a direct impact of competition from the SMSF sector.

Upstream capital markets

SMSFs already have good support in accessing upstream capital markets across multiple asset classes. This includes ETFs and listed investment vehicles that cover the domestic market as well as provide access to international exposure (refer to Appendix A).

In addition, support for this important group of investors continues to grow with fund managers considering in their design of products how to specifically address the needs of SMSF investors and retirees.

For example, in 2008 and 2009, in the post-GFC upheaval certain sectors of the fixed income market presented attractive buying opportunities, particularly for investors such as self-funded retirees who rely on income to cover their living expenses. The value appeared to be maximised by investing in the traditional way of selecting issues on the basis of extensive credit research, investing in those issues with a view to holding maturity, and passing interest payments and principal repayments directly back to investors. However, because the Australian fixed income markets are generally only accessible to wholesale investors, this research-driven buy-and-hold strategy was not available to most individual investors. However, specialist fund manager Walsh & Company established purpose-built fixed-income funds to address this issue and provide investors, predominantly SMSF trustees, with direct access to a diversified portfolio of regular income producing securities. Since establishing the Australian Corporate Bond series and Australian Yield Fund series, Walsh & Company has invested $750 million into the Australian corporate bond market across 10 funds on behalf of investors.

Other examples from Walsh & Company include:

The Australian Property Opportunity Fund (APOF) series aims to provide investors with attractive returns across market cycles through exposure to Australian commercial property assets that possess attractive and stable income, as well as the potential for capital growth.

The US Masters Residential Property Fund (URF) is an ASX listed Real Estate Investment Trust (REIT). The fund aims to provide investors with attractive returns across market cycles through exposure to a diversified portfolio of New York metropolitan area residential housing.

New Energy Solar invests in large-scale operating solar farms that generate power with zero emissions. New Energy Solar aims to generate positive social impact alongside distributions from producing solar assets and growth through solar and renewable sector acquisitions and developments.

In another example, the ASX listed BetaShares Australian Dividend Harvester Fund (managed fund) (HVST) reports that it was specifically designed to meet the investment challenges of SMSFs and retiree investors by aiming to provide exposure to large capitalisation Australian shares along with regular franked dividend income.

In addition, earlier examples of the institutional market responding to the demands of SMSF investors has occurred in the high yielding online cash account sector. SMSF trustees now have a range of high yielding cash account and term deposits from many of the major and online financial institutions.

Key point:

- SMSFs already have good access to upstream capital markets across multiple asset classes and the support for this group of investors continues to grow.

Managing Net-outflows

The government-mandated 9.5 per cent superannuation guarantee contribution has acted as a guaranteed cash inflow to many of the large default funds within the superannuation sector. However, with demographic shifts and an ageing population, we will eventually see a finer balance between inflows and outflows. This means that the amount of funds flowing out of superannuation funds could match, or even outweigh, the amount of cash flowing in. Given the lack of experience for many of the default funds in managing an underlying portfolio with a net-outflow position, this is a significant risk to the sector. The SMSF sector, on the other hand, has more experience with the retirement and transition-to-retirement phases. Due to the tailored investment strategy and the engaged approach, SMSF trustees are better prepared to accommodate outflows and preserve the capital for their individual retirement needs.

Academic research published in ‘How Safe are Safe Withdrawal Rates in Retirement? An Australian Perspective’ by Professor Michael Drew and Professor Adam Walk, is telling:

> ‘A recurrent theme throughout this study has been the role of cash flows. The biggest difference between the accumulation phase and the retirement income phase is that the cash flow profile moves from inflows (hence increasing liquidity) to outflows (hence decreasing liquidity). Importantly, as we move into retirement, time frames also shrink. Moreover, the amount of money available for long-term investments (and therefore strategies that might take a decade or more to work) also shrinks. The practical takeaways from this research are the dynamic nature of the problem, and strategies that are built on a philosophy of dynamism are key to putting the balance of probabilities in the retiree’s favour. The combination of cash outflows and shorter time horizons changes our perspective on the risk of investing in stocks. Equity risk becomes even more risky, with retirees exposed to the very real chance of a permanent loss of capital (particularly detrimental if this occurs within, say, the first seven years of the income phase).[29]’

[29] Drew, M, and Walk, A, (2014), How Safe are Safe Withdrawal Rates in Retirement? An Australian Perspective, Finsia (Financial Services Institute of Australasia), Sydney

Professor Michael Drew and Professor Adam Walk are internationally recognised experts in investment management and investing for retirement. In their work, they have pointed to the value of an investment approach that allows flexibility to adjust the asset allocation over time and market conditions and that allows an individual to match their upcoming liabilities with the investment time frame of the underlying investments they have selected. SMSFs are the most effective at offering these flexibilities to their members.

Dixon Advisory does not view the high allocation to cash within SMSFs as a negative. Given the proportion of SMSF members that are in retirement or a transition-to-retirement phase, it is prudent to have an allocation to cash that covers at least 2-3 years of pension payments as well as lump sum requirements. The minimum drawdown from retirement phase between the ages 65-74 years is 5 per cent, 6 per cent between the ages 75-84 years, and continues to increase to 14 per cent for individuals aged 95 years or older. As such, depending on the member's financial situation outside of super, an allocation of anywhere between 15-50 per cent of a portfolio to cash could be entirely appropriate. In addition, many SMSF members are also small business owners or they may have other complex financial arrangements, and, as such they may make a fully informed and rational decision to keep a larger proportion of their SMSF in cash to reduce the risk across the entire position.

Key points:

- All measurements must be split out according to the superannuation phase of the member, namely, accumulation phase members, members in transition to retirement and members in full retirement phase. Efficiency measures, which amalgamate all phases, will not be able to recognise the significantly different approach to managing an investment portfolio in the decumulation phase.

Leverage in SMSFs

Direct leverage of SMSFs is a very small part of the financial system, accounting for $2.3 billion of the $4.9 trillion in total lending for residential property. Lenders still retain control over borrowing conditions, and have the discretion to approve the borrowing.

The introduction of the best interests duty and tightened conflict of interest standards have increased the protection of consumers' interests in establishing this strategy.

A prohibition on lending inside SMSFs would also negatively impact small businesses, which use leverage within the SMSF to fund their real business premises. Self-employed individuals do not have compulsory superannuation and their business is generally their primary source of wealth creation. In many cases, self-employed people forego personal income for the benefit of building a sustainable business.

The economic consequence of a failed investment (future tax revenue and increased call on benefit payments) is just as likely to be borne by the government regardless of whether the investment was structured outside or inside super.

The low exposure to borrowing in an SMSF reflects how the tax benefits of gearing in an SMSF are relatively small compared to personal owner-occupied or investment property purchases and that lenders already impose significantly tighter lending conditions on SMSF borrowings, including:

- loans must be made on a non-recourse basis
- lenders must investigate both the viability of the SMSF borrower and fundamental merits of the investment
- a limited degree of leverage (usually between 60-80 per cent of the property)

- a requirement for SMSF trustees to obtain separate legal, tax and financial advice, making the application and documentation process more rigorous than a standard loan.

Further controls include restrictions on the improvement of property and its possible uses, as well as annual scrutiny by auditors to assess compliance with regulations.

Key point:

- Restoring a general prohibition on direct leverage in superannuation funds is unnecessary as the regulations, existing lender requirements and limited tax benefits of gearing, sufficiently protect lenders and customers.

Insurance

In 30 years of providing advice to thousands of Australian families, Dixon Advisory has witnessed the devastating effects of underinsurance. In light of this experience, it is extremely important that the insurance system within superannuation is efficient and provides an adequate safety net for members.

Unfortunately, insurance can act as a hurdle to efficiency in the superannuation system. It is a driver of people retaining old accounts for the sole purpose of retaining their insurance.

Dixon Advisory suggests that introducing insurance portability between superannuation funds would remove or reduce the most significant cost of leaving a fund, simplify the switch decision and drive further fee competition in the market. This could be achieved by allowing insurance policies to be transferred to the new super fund.

Regulatory bodies should also consider the implementation of reforms, whereby, insurance premiums and terms are consistent across super funds. The opportunity to mandate a core set of terms and conditions will also make it easier for clients to compare insurance policies on a relative basis. In this current climate, with different terms and conditions, meaningful comparison of insurances is otherwise extremely difficult.

These improvements would also enable advisors to provide more cost-effective and efficient advice to consumers with smaller balance accounts looking to consolidate.

An individual should also be able to easily opt out of insurance should they choose to do so. While potentially creating a situation of underinsurance, it is common for this choice to be exercised by those who are actively engaged in managing their financial affairs, that is, they have obtained a more suitable insurance solution outside the default option.

Dixon Advisory suggests that insurance policies should not cease if an employee ceases employer contributions or work. This is a common feature of insurance policies offered by many employer sponsored superannuation funds and commonly leaves members severely underinsured. This practice also short-changes employees for all the years they have contributed premiums.

In Dixon Advisory's opinion, the minimum level of insurance required in a default fund should be increased to reduce the financial burden imposed upon a family in the face of loss. Further, and most crucially, this insurance cover should not reduce simply because a member ages. The default insurance cover offered to members generally reduces as a member ages. This means insurance at age 45, 55 and 60 are all substantially lower than insurance cover at 35. This does not consider that a reasonable proportion of Default fund members continue to have high liabilities such as mortgages, raising children and other loans into their pre-retiree years and is not reflective of our experiences of the diverse financial needs of default members.

Introducing a tailored level of default insurance would likely increase the complexity of an otherwise simple and effective means of providing members with an insurance safety net. Once members are initially slotted into a particular category of insurance, the ongoing monitoring and administration required to ensure the desired effect is achieved (i.e. insurance levels change in accordance with changes in member circumstances) is likely to create a cumbersome and inefficient way of providing insurance.

The proactive nature of SMSF members, their more complex financial circumstances and their above average income levels means they are more likely to hold appropriate levels of life and disability insurance, often outside of their SMSF in their personal name, a business entity or through the retention of a policy held with a previous employer sponsored APRA fund.

Further, given that SMSF members have above average super balances and a median age of 59, it is also rational for large cohorts of SMSF members to self-insure against the risk of unexpected death or disability[30]. This logically weighs up that the cost of insuring, as individuals age, is significant. These factors would see the vast majority of SMSF members opt out of holding insurance within their SMSF.

Dixon Advisory believes that the SMSF sector does not require a system of default insurance. From a practical sense, we also do not see how such a scheme could be implemented or administered in an effective way.

Key Points:

- Portability of insurance policies should be assessed.
- Assessing the efficiency of insurance within the superannuation sector needs to be undertaken with a broad qualitative survey of members that captures their holistic financial situation including debt levels, details of all dependants, minimum living expenses, assets and non-super insurance.
- Incorporating the assessment of insurance levels held within SMSFs, as a comparative measure to APRA regulated funds, which offer default insurance, will overlook the demographics of the SMSF, which, for rational reasons include factors like capacity to self-insure, costs, quality of terms offered, and effectiveness of holding insurance inside their SMSFs.

[30] ATO, SMSF members by age < https://www.ato.gov.au/Super/Self-managed-super-funds/In-detail/Statistics/Annual-reports/Self-managed-superannuation-funds--A-statistical-overview-2013-2014/?page=13#SMSF_members_by_age>

Appendix A

Australian domiciled funds - ETFs excluding Australian equities

Count	TICKER	NAME	FUND TYPE
1	AAA AU Equity	BetaShares Australian High Interest Cash ETF	ETF
2	BBUS AU Equity	BetaShares US Equities Strong Bear Hedge Fund - Currency Hedged	ETF
3	BNKS AU Equity	BetaShares Global Banks ETF - Currency Hedged	ETF
4	BOND AU Equity	SPDR S&P/ASX Australian Bond Fund	ETF
5	DJRE AU Equity	SPDR Dow Jones Global Real Estate Fund	ETF
6	DMKT AU Equity	AMP Capital Dynamic Markets Fund Hedge Fund	ETF
7	DRUG AU Equity	BetaShares Global Healthcare ETF - Currency Hedged	ETF
8	EEU AU Equity	BetaShares Euro ETF	ETF
9	ESTX AU Equity	ANZ ETFS EURO STOXX 50 ETF	ETF
10	ETPMAG AU Equity	ETFS Metal Securities Australia Ltd - ETFS Physical Silver	ETC
11	ETPMPD AU Equity	ETFS Metal Securities Australia Ltd - ETFS Physical Palladium	ETC
12	ETPMPM AU Equity	ETFS Metal Securities Australia Ltd - ETFS Physical PM Basket	ETC
13	ETPMPT AU Equity	ETFS Metal Securities Australia Ltd - ETFS Physical Platinum	ETC
14	FOOD AU Equity	BetaShares Global Agriculture Companies ETF - Currency Hedged	ETF
15	FUEL AU Equity	BetaShares Global Energy Companies ETF - Currency Hedged	ETF
16	GGUS AU Equity	BetaShares Geared US Equity Fund - Currency Hedged	ETF
17	GOLD AU Equity	ETFS Metal Securities Australia Ltd - ETFS Physical Gold	ETC
18	GOVT AU Equity	SPDR S&P/ASX Australian Government Bond Fund	ETF
19	HACK AU Equity	BetaShares Global Cybersecurity ETF	ETF
20	HJPN AU Equity	BetaShares WisdomTree Japan ETF - Currency Hedged	ETF
21	IAF AU Equity	iShares CORE Composite Bond ETF	ETF
22	IFRA AU Equity	VanEck Vectors FTSE Global Infrastructure Hedged ETF	ETF
23	IGB AU Equity	iShares Treasury ETF	ETF
24	IHCB AU Equity	iShares Core Global Corporate Bond AUD Hedged ETF	ETF
25	IHEB AU Equity	iShares JP Morgan USD Emerging Markets Bond AUD Hedged ETF	ETF
26	IHHY AU Equity	iShares Global High Yield Bond AUD Hedged ETF	ETF
27	IHOO AU Equity	iShares Global 100 AUD Hedged ETF	ETF
28	IHVV AU Equity	iShares S&P 500 AUD Hedged ETF	ETF
29	IHWL AU Equity	iShares Core MSCI World All Cap AUD Hedged ETF	ETF
30	ILB AU Equity	iShares Government Inflation ETF	ETF
31	IWLD AU Equity	iShares Core MSCI World All Cap ETF	ETF
32	MNRS AU Equity	Betashares Global Gold Miners Etf-Currency Hedged	ETF
33	NDQ AU Equity	BetaShares NASDAQ 100 ETF	ETF
34	OOO AU Equity	BetaShares Crude Oil Index ETF - Currency Hedged Synthetic	ETF
35	POU AU Equity	BetaShares British Pound ETF	ETF
36	QAG AU Equity	BetaShares Agriculture ETF - Currency Hedged Synthetic	ETF
37	QAU AU Equity	BetaShares Gold Bullion ETF Currency Hedged	ETF
38	QCB AU Equity	BetaShares Commodities Basket ETF - Currency Hedged Synthetic	ETF
39	QMIX AU Equity	SPDR MSCI World Quality Mix Fund	ETF
40	QUAL AU Equity	Vaneck Vectors MSCI World ex Australia Quality ETF	ETF
41	QUS AU Equity	BetaShares FTSE RAFI U.S. 1000 ETF	ETF
42	RCB AU Equity	Russell Australian Select Corporate Bond ETF	ETF
43	RGB AU Equity	Russell Australian Government Bond ETF	ETF
44	RSM AU Equity	Russell Australian Semi-Government Bond ETF	ETF
45	UBE AU Equity	UBS IQ MSCI Europe Ethical ETF	ETF
46	UBJ AU Equity	UBS IQ MSCI Japan Ethical ETF	ETF
47	UBP AU Equity	UBS IQ MSCI Asia APEX 50 Ethical ETF	ETF
48	UBU AU Equity	UBS IQ MSCI USA Ethical ETF	ETF
49	UBW AU Equity	UBS IQ MSCI World ex Australia Ethical ETF	ETF
50	USD AU Equity	BetaShares US Dollar ETF	ETF
51	VACF AU Equity	Vanguard Australian Corporate Fixed Interest Index ETF	ETF
52	VAE AU Equity	Vanguard FTSE Asia ex-Japan Shares Index ETF	ETF
53	VAF AU Equity	Vanguard Australian Fixed Interest Index ETF	
54	VCF AU Equity	Vanguard International Credit Securities Index Hedged ETF	
55	VEQ AU Equity	Vanguard FTSE Europe Shares ETF	
56	VGAD AU Equity	Vanguard MSCI Index International Shares Hedged ETF	
57	VGB AU Equity	Vanguard Australian Government Bond Index ETF	
58	VGE AU Equity	Vanguard FTSE Emerging Markets ETF/Australia	
59	VGS AU Equity	Vanguard MSCI Index International Shares ETF	
60	VIF AU Equity	Vanguard International Fixed Interest Index Hedged ETF	
61	WDIV AU Equity	SPDR S&P Global Dividend Fund	
62	WEMG AU Equity	SPDR S&P Emerging Markets Fund	
63	WXHG AU Equity	SPDR S&P World ex Australia Hedged Fund	
64	WXOZ AU Equity	SPDR S&P World ex Australia Fund	
65	YTMAGL AU Equity	XTB Units AGL 5% Nov-21	
66	YTMAPA AU Equity	XTB Units APA 7.75% Jul-20	
67	YTMAST AU Equity	XTB Units AST 5.75% Jun-22	
68	YTMAWC AU Equity	XTB Units AWC 5.5% Nov-19	
69	YTMAZJ AU Equity	XTB Units AZJ 5.75% Oct-20	
70	YTMBH1 AU Equity	XTB Units BHP 3% Mar-20	
71	YTMBHP AU Equity	XTB Units BHP 3.75% Oct-17	
72	YTMBOQ AU Equity	XTB Units BOQ 4.00% Jun-18	
73	YTMCCA AU Equity	XTB Units CCA 4.25% Nov-19	
74	YTMCTX AU Equity	XTB Units CTX 7.25% Nov-18	
75	YTMCWN AU Equity	XTB Units CWN 5.75% Jul-17	
76	YTMDO1 AU Equity	XTB Units DOW 4.5% Mar-22	
77	YTMDOW AU Equity	XTB Units DOW 5.75% Nov-18	
78	YTMF01 AU Equity	XTB Units AMP BBSW+0.87% Jun18	
79	YTMF02 AU Equity	XTB Units BOQ BBSW+1.15% Nov-16	
80	YTMF03 AU Equity	XTB Units BOQ BBSW+1.00% Jun-18	
81	YTMF04 AU Equity	XTB Units NAB BBSW+0.88% Nov-18	
82	YTMF05 AU Equity	XTB Units NAB BBSW+0.85% May-19	
83	YTMF06 AU Equity	XTB Units SUN BBSW+1.10% Apr-19	
84	YTMIPL AU Equity	XTB Units IPL 5.75% Feb-19	
85	YTMLL1 AU Equity	XTB Units LLC 6% May-20	
86	YTMLLC AU Equity	XTB Units LLC 5.5% Nov-18	
87	YTMMG1 AU Equity	XTB Units MGR 5.50% Dec-17	
88	YTMMGR AU Equity	XTB Units MGR 5.75% Sep-20	
89	YTMQF1 AU Equity	XTB Units QAN 6.5% Apr-20	
90	YTMQF2 AU Equity	XTB Units QAN 7.5% Jun-21	
91	YTMQF3 AU Equity	XTB Units QAN 7.75% May-22	
92	YTMSCG AU Equity	XTB Units SCG 5% Oct-19	
93	YTMSG1 AU Equity	XTB Units SGP 8.25% Nov-20	
94	YTMSGP AU Equity	XTB Units SGP 5.5% Sep-19	
95	YTMSYD AU Equity	XTB Units SYD 7.75% Jul-18	
96	YTMTLS AU Equity	XTB Units TLS 7.75% Jul-20	
97	YTMWE1 AU Equity	XTB Units WES 4.75% Mar-20	
98	YTMWES AU Equity	XTB Units WES 6.25% Mar-19	
99	YTMWOW AU Equity	XTB Units WOW 6% Mar-19	
100	ZCNH AU Equity	ANZ ETFS Physical Renminbi ETF	
101	ZGOL AU Equity	ANZ ETFS Physical Gold ETF	
102	ZUSD AU Equity	ANZ ETFS Physical US Dollar ETF	
103	ZYUS AU Equity	ANZ ETFS S&P 500 High Yield Low Volatility ETF	

Australian domiciled funds - Closed end funds excluding Australian equities

Count	TICKER	NAME
1	AGF AU Equity	AMP Capital China Growth Fund
2	AIB AU Equity	Aurora Global Income Trust
3	AIK AU Equity	Armidale Investment Corp Ltd
4	AIQ AU Equity	Alternative Investment Trust
5	ALI AU Equity	Argo Global Listed Infrastructure Ltd
6	APW AU Equity	AIMS Property Securities Fund
7	AUF AU Equity	Asian Masters Fund Ltd
8	AWQ AU Equity	Arowana Australasian Value Opportunities Fund Ltd
9	AYD AU Equity	Australian Masters Yield Fund No 1 Ltd
10	AYF AU Equity	Australian Enhanced Income Fund
11	AYH AU Equity	Australian Masters Yield Fund No 2 Ltd
12	AYJ AU Equity	Australian Masters Yield Fund No 3 Ltd
13	AYK AU Equity	Australian Masters Yield Fund No 4
14	AYZ AU Equity	Australian Masters Yield Fund No 5 Ltd
15	BAF AU Equity	Blue Sky Alternatives Access Fund Ltd
16	BEL AU Equity	Bentley Capital Ltd
17	BTI AU Equity	Bailador Technology Investments Ltd
18	CDM AU Equity	Cadence Capital Ltd
19	EAI AU Equity	Ellerston Asian Investments Ltd
20	EGI AU Equity	Ellerston Global Investments Ltd
21	EMF AU Equity	Emerging Markets Master Fund
22	FGG AU Equity	Future Generation Global Investment Co Ltd
23	GFL AU Equity	Global Masters Fund Ltd/Fund
24	GVF AU Equity	Global Value Fund Ltd
25	HHV AU Equity	Hunter Hall Global Value Ltd
26	HHY AU Equity	Hastings High Yield Fund
27	HML AU Equity	Henry Morgan Ltd Fund
28	IPE AU Equity	IPE Ltd
29	KAT AU Equity	Katana Capital Ltd/Fund
30	LSX AU Equity	Lion Selection Group Ltd/Funds
31	MAX AU Equity	Millinium's Alternatives Plus
32	MFF AU Equity	Magellan Flagship Fund Ltd
33	MLT AU Equity	Milton Corp Ltd/fund
34	NAC AU Equity	Naos Absolute Opportunities Co Ltd
35	OCP AU Equity	Oceania Capital Partners Ltd/Fund
36	OEQ AU Equity	Orion Equities Ltd/fund
37	PAF AU Equity	PM Capital Asian Opportunities Fund Ltd
38	PAI AU Equity	Platinum Asia Investments Ltd
39	PGF AU Equity	PM Capital Global Opportunities Fund Ltd
40	PMC AU Equity	Platinum Capital Ltd
41	SVS AU Equity	Sunvest Corp Ltd/Fund
42	TGG AU Equity	Templeton Global Growth Fund Ltd
43	USF AU Equity	US Select Private Opportunities Fund
44	USG AU Equity	US Select Private Opportunities Fund II
45	USP AU Equity	US Select Private Opportunities Fund III
46	URF AU Equity	US Masters Residential Property Fund