31 August 2017

Superannuation
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Submission: Productivity Commission- Stage 3: Assessing Competitiveness and Efficiency

Thank you for the opportunity to contribute to the above Issues paper. The submission outlines our comments in relation to the criteria to assess the efficiency and competitiveness of our superannuation system.

We would also like to extend our sincere gratitude to Alex Maevsky, Yvette Goss and the Team for allowing an extension to our deadline.

About Dixon Advisory

By way of background, Dixon Advisory provides administration and advice services to 8,000 self managed superannuation fund (SMSF) trustees with a combined asset base in excess of $5 billion.

SMSF's are an important sector in the superannuation industry. In the five years to 2014-15 the number of SMSF's have increased by 27 per cent to 557,000[1], with total assets worth $590 billion. The latest ATO SMSF statistical report for March 2017, outlined that the total value of SMSF assets is $674.7 billion[2], with the total member base of SMSFs over 1.1 million members[3].

[1] Australian Taxation Office, 2015, 'ATO releases latest SMSF statistics', viewed on 30 August 2017 <https://www.ato.gov.au/media-centre/media-releases/ato-releases-latest-smsf-statistics/>

[2] ATO, SMSF statistical report- March 2017 (viewed on 30 August 2017) <https://www.ato.gov.au/Super/Self-managed-super-funds/In-detail/News/SMSF-statistical-report---March-2017/>

[3] Above n2.

Survey of SMSF trustees

Dixon Advisory understands that the Productivity Commission will be undertaking a survey of 200 SMSF trustees with a view to collate this feedback and data in preparation for conclusions and recommendations. We welcome engagement with SMSF trustees to collect and evaluate data. However, we suggest the proposed methodology is enhanced to ensure that conclusions derived from the survey results are accurate and balanced.

Broaden sample pool

The latest Australian Taxation Office statistics show that there are a total of 570,535 SMSFs and 1,080,370 total SMSF members[4]. The ATO data already collected backs up our experience that SMSF trustees are highly diverse. Surveying only 200 SMSFs makes up only 0.035% of all existing SMSFs and may lead to the formulation of conclusions that are not truly representative of the diverse backgrounds and priorities of the overall SMSF population.

To minimise risk of error and strengthen the overall integrity of the report, Dixon Advisory would like to see the survey sample pool increased to 2000 trustees. Although still only making up a fraction of all SMSF trustees, such a number would more closely align to a statistical significant survey. Namely, these numbers are used for SMSF research surveys like: Super Concepts[5] (quarterly SMSF client surveys of 2,750 funds) and the 2014 Investment Trends SMSF Investor Report based on a survey of 2,163 SMSF trustees[6].

Split survey results into appropriate age groups

Due to their individualistic nature, SMSF trustees substantially vary from each other on areas like investment strategy and risk profile. Specifically, SMSF trustees at different age groups have substantially different lifestyle needs, strategies for investment and cashflow profiles within their SMSF arrangement. For example, an SMSF trustee at age 40 is more likely to seek to maximise the accumulated capital to further strengthen their ultimate retirement outcome. While a trustee who is 60 years of age (i.e. pre-retirement stage) is more likely to prioritise stability and the need to ensure that the estate planning requirements are properly in place. However, even within these two age groups there will continue to be substantial variance.

We welcome the Commission's approach to dissecting net return surveys into accumulation and retirement segment categories, however for greater accuracy we suggest that the Commission dissect the SMSF survey process into two different, more appropriate, categories; trustees aged under 50 years of age and trustees aged 50 and over. These are the two groups where the profiles of members usually adapt to reflect the transitioning stage

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4 Australian Taxation Office, '*Population and asset allocation tables*' (viewed 30 August 2017) <https://www.ato.gov.au/Super/Self-managed-super-funds/In-detail/Statistics/Quarterly-reports/Self-managed-super-fund-statistical-report---March-2017/?page=3#Population_and_asset_allocation_tables>

5 Super Concepts- SMSF Investment Patterns Survey 2017 (April 2017) (viewed 30 August 2017), page 7 <https://www.superconcepts.com.au/docs/default-source/teched/smsf-investment-patterns-survey-mar-2017.pdf?sfvrsn=13d181a_4>

6 Investment Trends 2014, *SMSF Investor Report,* April. Note: Based on a survey of 2,163 SMSF trustees (sourced from <http://fsi.gov.au/publications/interim-report/04-superannuation/self-managed-super-funds/>) (viewed 30 August 2017)

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to retirement. This segmentation will ensure greater accuracy of results and accurately delineate the two main phases of superannuation members (accumulation and pre-retiree/retiree). Such categorisation will ultimately assist the Commission to make balanced and appropriate considerations.

Comparability of data

The Productivity Commission acknowledges (in its final stage 1 report) that there are data comparability issues with the SMSF and APRA sector. However, the differences extend beyond just statistical methodologies of data collection. The table below outlines a number of other characteristics that differentiate the average SMSF and APRA member. As outlined, these differences are substantial and warrant separately weighted considerations for the SMSF sector and APRA sector, especially in regards to the evaluation of risk, returns and investment strategy of funds.

Table 1: SMSF and APRA members

Category	SMSF sector	APRA
Percentage of members aged 50+[7]	72.30%[8]	30%[9]
Percentage of members aged 49 and under	27.70%	70%
Average member balance[10]	$589,636[11]	$45,924[12]

(E4) Tax flexibility of SMSFs

When assessing tax flexibility as a motivation to setting up an SMSF, the Commission needs to place a balanced accent on other motivations that incentivise individuals to establish SMSFs. The tax arrangements (as already outlined in our submission to the stage 1 draft report, pg. 17-18) that are offered by SMSFs are identical to the arrangements also available to APRA funds. Rather it is the alignment of the trustee to the interest of the SMSFs members that allows it the ability to utilise these existing legislative tax arrangements.

[7] Statistics as at June 2016
[8] ATO Statistics, *'Table 10: Age ranges of SMSF members'* (accessed 29 April 2017) <https://www.ato.gov.au/About-ATO/Research-and-statistics/In-detail/Super-statistics/SMSF/Self-managed-superannuation-funds--A-statistical-overview-2014-2015/?page=20#Table_10__Age_ranges_of_SMSF_members>
[9] 2016 APRA Superannuation Bulletin (accessed 29 April 2017) Table 12 <http://www.apra.gov.au/Super/Publications/Pages/annual-superannuation-publication.aspx>
[10] Statistics for 2015
[11] ATO Statistics, *Table 12: Average and median asset* sizes (accessed 29 April 2017) https://www.ato.gov.au/About-ATO/Research-and-statistics/In-detail/Super-statistics/SMSF/Self-managed-superannuation-funds--A-statistical-overview-2014-2015/?anchor=t12#t12
[12] (2016 figures) 2015 APRA Superannuation Bulletin. Courtesy of APRA for providing the materials.

To ensure a balanced assessment of competition across the system and genuine alignment to members' best outcomes, the Commission should extend the scope of Trustee surveys to consider why APRA funds do not allow their members to achieve tax outcomes that are already utilised by SMSFs (i.e. separation of capital gains income out from investment income would allow unitised funds to apply a 10% tax rate to capital gains, rather than applying an overall tax rate of 15% to all income). Further, some APRA funds have moved to adopt a whole of life investment approach which allows members to retain investments from accumulation all the way to the pension phase. This allows members to take a long-term investment approach and reduces unnecessary transactional costs, including in some instances tax, as well as risk.

In determining the reasons why trustees establish an SMSF, the Commission should consider the final wording of survey questions carefully. Notwithstanding the comments in the paragraph above, given one of the major benefits of superannuation is the tax concessions provided for saving towards your retirement, it would be unusual that individuals don't identify tax as a reason for using their particular super fund.

<u>(E1) Long-term net investment returns being maximised over members' lifetimes, taking account of risk?</u>

We remain concerned that the use of a *system-wide average net investment return* to measure and assess performance will not adequately consider risk and the range of returns that can occur due to intentional portfolio design.

<u>Use of reference portfolios for returns</u>

SMSFs members, in particular, have diverse economic and lifestyle factors (risk tolerance, income needs, investment strategy, estate planning considerations, other investments). They also have autonomy to invest their funds with the broadest choice afforded by the super legislation. The use of a reference portfolio may lead to considerations that are conceptually sound (such as what a model portfolio may look like) but may in fact differ from a large percentage of actual SMSF portfolios. Further, using the asset allocations as reported in the SMSF tax returns, does not allow a full look through to the true underlying asset class which may make it difficult to compare a reference portfolio with accuracy. This occurs as some SMSF investments are recorded for tax purposes as Australian equities (because they are listed on the ASX) but the actual exposure is to another asset class, such as bonds or Asian equities (we outline this issue in our submission to the Stage 1 draft paper- page 10 and 11).

If the Commission does decide to utilise reference portfolios for SMSFs, it should then provide a variety of models that incorporate different risk measures, age groups, as well as investment strategies, estate planning considerations and taxation arrangements that are reflective of the broader SMSF population.

<u>Relationship between risk and return</u>

The Productivity Commission notes in its final stage 1 report "*When the focus is system-wide (as it is here) and over a long enough time horizon, system-wide average net investment* *returns will collectively reflect the impact of diversification and average market volatility over the measured period*"[13]. Although a broader study, as undertaken in stage 3, will incorporate substantial data sets of diversification and volatility measures, as previously outlined in our submission in the Final Stage 1 report[14], variations like investment approaches and investment structures have a significant bearing on the funds performance and risk. We appreciate that the Commission will segmentise results in the retirement/accumulation stages and asset classes. However we suggest that the Commission also consider the inherent strategy and overall goal of funds as an integral measure to assessing the risk of a fund. We further outline the importance of the risk-return relationship, in the paragraph below (E2).

New funds

The Productivity Commission outlines that historical net returns will be based on funds that have performance indicators for 5-20 year time spans. As a result, this overlooks funds that have not existed for that time period and which, as a result, may skew the overall data and also lead to inappropriate comparisons of newer funds against the longer term returns.

(E2) Whether costs incurred by funds and fees charged to members being minimised

The SMSF sector has a number of fees that are regulatorily imposed, rather than set at the discretion of fund providers. For example, auditing fees and trust deed costs are all requirements to the establishment and maintenance of an SMSF. In its analysis, the Commission should separate fees that are regulatorily imposed and inelastic (like auditing fees) and fees that are set at the discretion of the fund/service provider. We suggest an additional sub-criteria be inserted to formalise these metrics. This will provide greater consistency and accuracy in the measurement of data.

It is suggested, as outlined above, that the Commission also consider the relationship between fees and the investment strategy of the fund. As outlined in our submission to the Stage 1 draft report (page 16), there is evidence of funds that have high fees but also exceed the average performance of their asset class.

Table 2- Evidence priorities

1. Member behaviour and knowledge

Our experience is that SMSF owners have very diverse professional backgrounds but most often include business owners, managers and senior executives in the public and private sector.

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[13] Productivity Commission, *How to Assess the Competitiveness and Efficiency of the Superannuation Industry,* (November 2016), page 117.

[14] Dixon Advisory, Submission to: Productivity Commission; How to assess the competitiveness and efficiency of the superannuation system- draft report, page 14. (<http://www.pc.gov.au/__data/assets/pdf_file/0007/207907/subdr103-superannuation-competitiveness-efficiency.pdf>)

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 on SMSF needs and concerns[15], 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 was $109,000, while the median taxable income was $57,000[16].

SMSF trustees also invest funds and use strategies that reflect their investment and risk profile- this also includes considerations of how actively they track their own portfolios. Some trustees use strategies that require them to monitor their fund on a regular basis with sophisticated tracking and monitoring systems in place akin to a professional firm. Other trustees develop well diversified portfolios that are structured to minimise the need for regular adjustments and only undertake a quarterly or annual review of their portfolio.

As will be outlined below in sections (a)-(e), SMSF trustees have a wide range of trustee obligations- which provide a consistent check and balance on trustees to ensure that they are acting within the obligations imposed on them. The thorough application of the laws and obligations relevant to SMSF trustees are comprehensive. Further, the reporting obligations, via the auditor and ATO provide a high level of account monitoring against these obligations.

(a) Overview of obligations for trustees

A trustee of an SMSF has a number of relevant legislative and administrative requirements to adhere to. As a trustee of an SMSF, one must act in accordance with[17]:

(i) The clauses of the fund trust deed
(ii) The provisions of the SISA and the *Superannuation Industry (Supervision) Regulations 1994 (Cth)*
(iii) If a director of the corporate trustee, the *Corporations Act 2001;* and
(iv) Other general rules, such as those imposed under tax and trust law.

(b) Trust deed

SMSF trustees require a trust deed to be created in order to set up an SMSF. A trust deed essentially provides guidance on how the superannuation fund can pay out a members' benefits[18] (whether as a lump sum, income stream or a hybrid). Further, a trust deed stipulates conditions, such as, what investments the fund can make, the reporting requirements of the fund, and when to remove trustees[19]. An SMSF trustee must ensure that all clauses of the

[15] Rice Warner, 'Survey of financial needs and concerns of SMSF members (October, 2012)', page 2, (accessed 29 August 2017) <https://www.smsfassociation.com/wp-content/uploads/2016/08/121127_spaa-vanguard_research_report.pdf>

[16] ATO, SMSF Statistics – Income (accessed 29 August 2017) < https://www.ato.gov.au/About-ATO/Research-and-statistics/In-detail/Super-statistics/SMSF/Self-managed-superannuation-funds--A-statistical-overview-2013-2014/?page=14#SMSF_members_by_income>

[17] Sanderson Jemma, '*SMSF Guide 2014: Current issues and strategies for the self-managed superannuation funds adviser*' (Tax Institute Publication, 6th edition, 2014) page 11.

[18] Above n15 (Sanderson), page 2.

[19] Above 15 (Sanderson), page 9.

deed do not breach any provisions of the Superannuation Industry (Supervision) Act 1993, Corporations Act 2001 (if a corporate trustee) as well as other general rules (ie. tax law).

(c) *Superannuation Industry (Supervision)* act

As outlined above, one of the primary mechanisms in codifying trustee obligations is found within the *Superannuation Industry (Supervision) Act* 1993 (SIS act). The Act imposes minimum requirements on trustees and are deemed to be included in the trust deed of every regulated fund[20]. As per the SIS act[21], the rule binds the trustees to:

(1) Act honestly in all matters concerning the fund;
(2) Exercise the same degree of care, skill and diligence as an ordinary prudent person in managing the fund;
(3) Act in the best interest of all fund beneficiaries;
(4) Keep the money and assets of the fund separate from other money and assets (e.g. personal assets);
(5) Retain control over the fund;
(6) Develop and implement an investment strategy;
(7) Not enter into contracts or behave in a way that hinders trustees from performing or exercising their functions or powers; and
(8) Allow members access to certain information.

As outlined, these provisions impose a wide array of responsibilities on trustees that need to be monitored and adhered to.

(d) Annual reporting requirements

SMSF trustees have significant annual reporting requirements. This regulatory obligation acts as a regular account monitoring mechanism to ensure that the trustees/members are complying with the regulatory requirements. The annual reporting requirements include:

- SMSF trustees completing an income tax and regulatory return with the ATO.
- The SMSF being audited by an independent ASIC registered auditor, to ensure that the trustee is complying with the SIS act and the SIS regulations (as outlined above).

(e) Trustee declaration

Since July 2007, the ATO has required that all SMSF trustees complete a declaration acknowledging their understanding of the duties and responsibilities for running an SMSF. The 'Trustee Declaration' specifies that the trustee, consistently with the SIS act obligations, acts honestly, in the best interests of the members of the fund, and exercises skill, care and diligence in the management of the fund. The declaration form further outlines information about the general trustee duties, investment restrictions, record keeping and reporting/lodgment obligations. Each trustee must sign the declaration within 21 days of becoming an individual trustee or the director of the corporate trustee. The declaration must

[20] Above n15 (Sanderson), page 11.
[21] Above n15 (Sanderson), page 12.

further be retained for at least 10 years and made available to the Commissioner of Taxation on request.

2. Insurance

SMSFs have full flexibility with their insurance- and can select arrangements to tailor their needs. This benefit has been a reason some people are further attracted to selecting an SMSF. Many SMSF trustees also make the informed decision to self-insure as it is rather simple to cancel insurance owned by the SMSF trustees. In our experience, the claims processed for SMSF trustees have generally been well supported by the insurance companies.

3. Fund Behaviour

Dixon Advisory, as a SMSF specialist has a high level of experience (over 30 years) dealing with the needs of retirees- a segment often underserviced or overlooked by the general super sector. Our services include offering tailored advice to clients, providing administrative solutions and services for their SMSFs as well as succession planning services. Being able to utilise Dixon Advisory as a central "hub" for their SMSF needs allows members to receive consistent service and advice that reflects their strategy and preference.

We also take a proactive approach in engaging with our clients. We have designed education services focused on increasing the financial capability and confidence of our clients, customised programs that cater for specific groups like baby boomer women as well as focus specific topics like succession planning events. These engagements not only increase our clients' overall financial capability but also promote a strong and regular dialogue with Dixon Advisory.

Should you have any questions please do not hesitate to contact me

Kind regards,

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