SMSF Association

Productivity Commission Draft Report Submission

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Adelaide SA 5000

ABOUT THE SMSF ASSOCIATION

The SMSF Association is the peak professional body representing the self managed superannuation fund (SMSF) sector which is comprised of over 1.1 million SMSF members who have $712 billion of funds under management and a diverse range of financial professionals servicing SMSFs. The SMSF Association continues to build integrity through professional and education standards for financial advisers and education standards for trustees. The SMSF Association is consisted of individual members, principally accountants, auditors, lawyers, financial planners and other professionals such as tax professionals and actuaries. Additionally, the SMSF Association offers SMSF members a membership category which allows them access to independent education materials to assist them in the running of their SMSF.

OUR BELIEFS

- We believe that every Australian has the right to a good quality of life in retirement.
- We believe that every Australian has the right to control their own destiny.
- We believe that how well we live in retirement is a function of how well we have managed our super and who has advised us.
- We believe that better outcomes arise when professional advisors and trustees are armed with the best and latest information, especially in the growing and sometimes complex world of SMSFs.
- We believe that insisting on tight controls, accrediting and educating advisors, and providing accurate and appropriate information to trustees is the best way to ensure that self-managed super funds continue to provide their promised benefits.
- We believe that a healthy SMSF sector contributes strongly to long term capital and national prosperity.
- We are here to improve the quality of advisors, the knowledge of trustees and the credibility and health of a vibrant SMSF community.
- **We are the SMSF Association.**

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EXECUTIVE SUMMARY

The SMSF Association (SMSFA) welcomes the opportunity to make a submission to the Productivity Commission (the Commission) on its draft report on the efficiency and competitiveness of the superannuation system. While the Commission's draft report has focused mainly on the APRA-regulated fund issues, the draft report evaluated a number of SMSF issues and made draft findings which this submission responds to. Most notably, the draft report asserts that SMSFs will only have comparable returns to APRA-regulated superannuation funds and comparable costs where the SMSF has at least $1 million in assets. The SMSFA rejects this finding on the basis that the evidence supporting it is not reliable and accordingly we do not believe any final recommendations should be based upon it.

SMSF DATA ISSUES

The SMSFA is concerned that the Commission has made draft findings regarding the cost-effectiveness of SMSFs using an evidence base which is fundamentally flawed and without taking into consideration broader motivations for members seeking an SMSF.

We believe that the Commission should not make these findings based on Australian Taxation Office (ATO) SMSF data as the quality of this data and the ATO SMSF statistics derived from it are questionable, especially in regards to costs and returns. Problems with this data is exacerbated by differences in ATO and Australian Prudential Regulatory Authority (APRA) statistical methodologies, such as the definition of net earnings and the treatment of contributions used to determine rate of return (ROR) for APRA-regulated fund and the return on assets (ROA) for SMSFs.

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

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

We believe that these data problems make it difficult for the Commission to appropriately make a finding that SMSFs are not cost-effective with a balance below $1 million and should not lead to a minimum balance for SMSFs being recommended.

ALTERNATIVE DATA ON SMSF INVESTMENT RETURNS AND COSTS

Given the issues with data provided through the ATO SMSF Annual Return process, the SMSFA believes it is important that the Commission considers other information and sources regarding investment returns and costs

for SMSFs. Accordingly, we have highlighted relevant sources of information that present a different perspective to the Commission on the view that SMSFs can be cost-effective below $1 million.

In particular, this view is founded on the fact that establishment costs are reflected in the ATO cost ratios and we believe that the figures reported through SMSF administration platforms by accountants are more accurate than ATO data due to more accurate and timely data entry.

OTHER FACTORS IN SMSF ESTABLISHMENT

The SMSFA believes the SMSF cost-effectiveness debate must also extend beyond an analysis of costs and returns to consider the different and varied motivations that SMSF members have in wanting to have their superannuation in an SMSF. For many SMSF members this may mean that the ability to take control of their retirement savings is more important to them than achieving a higher rate of return.

Inherent in the name of a ‘self-managed superannuation fund’, taking control is the predominant motivation which gives SMSF members the responsibility of managing their own retirement savings but also the ability to respond to other motivations such as transparency, engagement, retirement goals, investment choice, tax planning, flexibility, estate planning and achieving better returns and lower costs.

The SMSFA has also surveyed its professional membership base regarding the cost effectiveness of SMSFs which highlights that advisers believe that it is appropriate to establish an SMSF with a $200,000 balance because they believe they are directly comparable with alternative options.

SMSF ESTABLISHMENT LIMITS AS POLICY

The SMSFA does not support the introduction of arbitrary barriers to establishing an SMSF as they would inhibit consumer choice and flexibility within the superannuation system. We believe individuals must be given the ability to engage and manage their retirement savings in ways that suit their retirement goals.

The SMSFA is opposed to the introduction of any minimum mandated balance requirements before a member or members can establish an SMSF for a number of reasons highlighted in our submission.

SMSF ADVICE

The SMSFA acknowledges the questions regarding the quality of advice provided to members of SMSFs. In recognising the need to improve SMSF advice, particularly due to its importance to the sector, the SMSFA believes that advisers who provide advice to individuals about SMSFs should have specific SMSF education and qualifications that underpin their advice.

The SMSFA believes greater regulatory scrutiny is also required on property one-stop shops who spruik inappropriate properties and supports ASIC’s efforts to stamp out any unlicensed and unethical marketing behaviour.

RECOMMENDATIONS

RECOMMENDATION 1

We recommend that given the questionable quality of data that is used to compare SMSFs and APRA-regulated funds that the Commission reassess its draft findings that SMSFS with balances under $1 million not cost-effective and underperform.

RECOMMENDATION 2

We recommend that the Commission should seek and assess alternative data sources on SMSF costs an investment returns in order to have a more accurate representation of SMSF investment returns and cost operating ratios.

RECOMMENDATION 3

We recommend that the Commission considers the broader motivations of SMSF members, costs of switching to an SMSF later in life and the role that SMSFs play in the superannuation sector in formulating any final findings or recommendations on SMSFs and establishment balances.

RECOMMENDATION 4

We recommend that the Commission considers the impact on choice in superannuation that establishing a minimum balance requirement for SMSFs will have as well as the weakness inherent in such a policy.

RECOMMENDATION 5

We recommend that the Commission makes a final recommendation that any financial advisers that want to advise SMSF members should have undertaken specialist SMSF advice education or accreditation in order to lift the quality of SMSF advice.

SMSF DATA ISSUES

The SMSFA is concerned that the Commission has made draft findings regarding the cost-effectiveness of SMSFs using an evidence base which is fundamentally flawed and without taking into consideration broader motivations for members seeking an SMSF. The draft report asserts that SMSFs will only have comparable returns to APRA-regulated superannuation funds and comparable costs where the SMSF has at least $1 million in assets. The SMSFA rejects this finding and does not believe any final recommendations should be based upon it.

Within the draft report the Commission makes several caveats as to the quality of the SMSF data supplied by the Australian Taxation Office and the inability to use that data in comparison to APRA-regulated fund data.

In making this submission we recognise the difficulties the Commission faces in data collection and analysis and accordingly our submission responds throughout to the request in Technical Supplement 4 for feedback on data sources and methodology used to estimate net returns.

Despite these acknowledged data problems, the Commission still went on to make two significant findings regarding SMSF returns and costs which we believe cannot be substantiated.

In this section of our submission we argue that:

- The Commission should not make these findings based on a fundamentally flawed evidence base of ATO SMSF data.
- Alternative SMSF data shows that SMSF returns and costs are equivalent to APRA-regulated funds at lower asset levels.
- There are a number of other factors besides returns and costs that need to be considered when judging an SMSFs viability.
- A defined balance establishment limit is a blunt and inappropriate tool to regulate SMSFs.

ANALYSIS OF SMSF INVESTMENT RETURN AND COST DATA

INVESTMENT RETURNS

DIFFERENCE IN SMSF AND APRA-REGULATED FUND METHODOLOGIES

The Commission's draft report highlights the difference between the methodology used to estimate the rate of return (ROR) for APRA-regulated superannuation funds and return on assets (ROA) for SMSFs. In the draft report's Technical Supplement 4, the Commission specifies that the different methodology used can result in a 0.61% difference between return calculation for SMSFs and APRA-regulated funds. It also cites "that there are a number of other differences with the calculations that neither the Commission or ATO can test for, as the data collected by ATO and APRA are fundamentally different."

While caveats are placed in the report by the Commission, ultimately draft finding 2.2 still uses the long-term APRA annualised return of 5.7% as a benchmark to judge SMSF returns and scale. This seems incongruous with the methodology issues detailed in Technical Supplement 4, which shows the impact of the different APRA fund and SMSF return methodologies. We assume that if APRA fund returns were calculated with the same methodology as SMSFs, then this would result in a lower long-term investment performance for those funds and consequently would lower the amount of assets required by an SMSF to generate equivalent returns. However, this is not explored by the Commission.

Without this comparison, we believe it is problematic for the Commission to state that SMSFs need to have $1 million of assets to have similar performance to APRA-regulated funds. There is insufficient reliable evidence to support this conclusion.

NET EARNINGS CALCULATIONS

A fundamental problem in comparing APRA-regulated fund and SMSF investment returns is the different definitions of net earnings used by the ROR and ROA methodologies.

The ATO calculates net earnings by calculating:

$$Net\ closing\ balance + benefit\ payments + outward\ rollovers - contributions - inward\ rollovers - other\ income\ that\ is\ not\ earnings - net\ opening\ balance$$

The APRA calculates net earnings by calculating:

$$Net\ investment\ income + other\ income - operating\ expenses$$

There are three key differences in how the calculations determining net earnings for APRA-regulated funds and SMSFs:

1. The impact of contributions tax on the SMSF ROA calculations.

2. APRA-regulated funds do not take administration expenses into account.

3. APRA funds have “other income” included whereas SMSFs have “other income that is not earnings” excluded.

The treatment of contributions tax on the SMSF ROA calculations

As highlighted by the Commission in Technical Supplement 4, the different ROR and ROA formulas result in distortions in calculating investment returns for the SMSF and APRA-regulated fund sectors.

A key difference in how net earnings is reached is that APRA-regulated fund calculation uses a direct estimate of income generated by assets whereas the ATO uses differences in closing and opening balances for the year (adjusting for other flows) to estimate investment returns. By using this method, the ATO captures the reduction in earnings from both contributions and earnings taxes which are both paid from the fund’s gross assets. The APRA-regulated fund methodology only captures earnings tax in the net investment income element of the ROR calculation.

This results in a significant distortion between estimated investment returns for APRA-regulated funds and SMSFs as shown in the following example.

An example of this distortion is as follows:

> An SMSF has an opening financial year balance of $300,000 and aims to have an investment return of 6% over the income year. All contributions (all taxed at 15%) and investment earnings are taxed at 15%. The fund’s end of year balance after tax is $333,295.It has the following quarterly contributions and returns:

	Gross	Tax	Net
Taxable Contributions	$20,000	$3000	$17,000
Non-taxable contributions	-	-	-
Investment return	$19,710	$2,875.56	$16,295
TOTAL			$33,295

The APRA-regulated fund ROR methodology results in a ROR of 5.28%.

$$ROR = \frac{Net\ earnings\ after\ tax}{Cashflow\ adjusted\ net\ assets}$$

$$\frac{Net\ investment\ income + other\ income\ -\ operating\ expenses}{Net\ assets\ at\ start\ of\ year + \frac{1}{2}(Net\ member\ flows + Net\ insurance\ flows)}$$

$$\frac{\$16{,}295 + 0\ -\ 0}{\$300{,}000 + \frac{1}{2}(\$17{,}000 + 0)} = \frac{\$16{,}295}{\$308{,}500} = 5.28\%$$

The ATO methodology results in a ROA of 4.20%.

$$ROA = \frac{Net\ earnings\ after\ tax}{Average\ assets\ over\ the\ period}$$

$$\frac{Net\ closing\ balance + benefit\ payments + outward\ rollovers - contributions - inward\ rollovers - other\ income - net\ opening\ balance}{\frac{1}{2}(Opening\ balance + Closing\ balance)}$$

$$\frac{\$333{,}295 + 0 + \ 0 - \$20{,}000 - 0 - 0 - \$300{,}000}{\frac{1}{2}(\$300{,}000 + \$333{,}295)} = \frac{\$13{,}295}{\$316{,}647} = 4.20\%$$

The ATO methodology has a reduced investment return created by two factors. First, the investment returns are reduced by the $3,000 contributions tax which has a substantial impact on the overall investment return calculation. Secondly, the calculation has a larger denominator due to the use of opening and closing balances that include investment earnings generated throughout the year. The APRA-regulated fund ROR calculation, on the other hand, only includes member flows (e.g. contributions).

This distortion is exacerbated where a SMSF is newly established. Often a fund may be established during the income year but roll-overs or contributions may not occur until later that year (often due to delays in having the roll-over processed by APRA-regulated funds). For example:

The fund in this example is established on January 1 with a $10,000 contribution. Its assets are invested with a goal of a 6% return. The fund receives a roll-over of $150,000 just before the end of the financial year in late June meaning the amount invested is $10,150 for that quarter (the Quarter 3 contribution and earnings less tax).

	Quarter 1	Quarter 2	Quarter 3	Quarter 4
Contributions	$-	$-	$10,000	$150,000
Investment return	$-	$-	$150	$152

This gives the following outcomes:

	Gross	Tax	Net
Taxable Contributions	$10,000	$1500	$8,500
Non-taxable contributions	$150,000	-	$150,000
Investment return	$302	$45	$257
TOTAL			$158,757

The APRA-regulated fund ROR methodology results in a ROR of 0.32%.

$$\frac{Net\ investment\ income + other\ income\ -\ operating\ expenses}{Net\ assets\ at\ start\ of\ year + \frac{1}{2}(Net\ member\ flows + Net\ insurance\ flows)}$$

$$\frac{\$257 + 0\ -\ 0}{\$0 + \frac{1}{2}(\$158{,}500 + 0)} = \frac{\$257}{\$79{,}250} = 0.32\%$$

The ATO methodology results in a ROA of -1.57%.

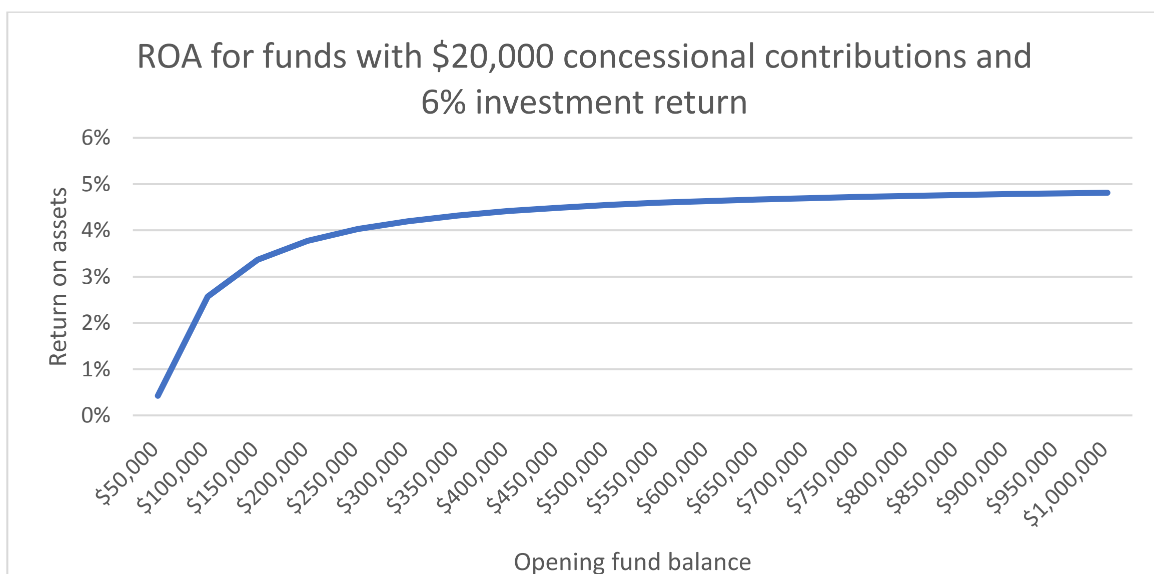
$$\frac{Net\ closing\ balance + benefit\ payments + outward\ rollovers - contributions - inward\ rollovers - other\ income - net\ opening\ balance}{\frac{1}{2}(Opening\ balance + Closing\ balance)}$$

$$\frac{\$158{,}757 + 0 +\ 0 - \$160{,}000 - 0 - 0 - \$0}{\frac{1}{2}(\$0 + \$158{,}757)} = \frac{-\$1{,}243}{\$79{,}378} = -1.57\%$$

Again, the key difference in this calculation is that the SMSF ROA net earnings number is reduced by the contributions tax amount of $1500 compared to the APRA-regulated fund method. Consequently, a fund in its establishment year will have a negative return whereas under the APRA method it does not.

Essentially, the APRA-regulated fund ROR methodology and the ATO ROA methodology have a different definition of after-tax earnings driven by the ATO capturing contributions tax in the ROA. This difference requires further analysis to understand how it impacts the different investment returns achieved by APRA-regulated funds and SMSFs and how this impacts on the Commission's views of SMSF viability.

Further, it should be noted that this difference has the most significant impact on SMSFs with small balances. This is because contribution tax is regressive in its flat tax nature. The regressive nature of the impact of contributions tax on the ATO ROA methodology can be seen in the following chart which shows ROA for funds with different opening balance but with $20,000 concessional contributions in a year with investment earnings of 6%.



All of these funds have achieved a return of 6% on assets invested. However, the $3,000 in contributions tax that they pay has a significant impact on the ROA calculation for funds with lower balances. This is significant given the Commission's concerns regarding SMSFs with low balances and the returns that they achieve.

APRA-regulated funds do not take administration expenses into account

The net earnings amount for APRA-regulated funds is potentially inflated compared to SMSFs due to the exclusion of certain administration costs from the APRA-regulated fund calculation whereas all expenses are included for SMSFs.[1] This is because the SMSF ROA calculation uses the difference in the financial year closing balance and opening balance to estimate returns for the year and in doing so captures all expenses paid by the SMSF. It is not clear as to what administration costs are included in the APRA-regulated fund ROR methodology and what are excluded.

Given that administration costs are a significant cost for both SMSFs and APRA-regulated funds, there is a significant issue in comparing ROR and ROA for the different funds. Also, advice costs and establishment costs for new funds are included in the calculation which can also reduce the net earnings amount for SMSFs, distorting their investment returns compared to APRA-regulated funds. Including these costs for SMSFs will have a material effect on returns compared to APRA-regulated funds. Again, advice costs and establishment costs have the biggest impact on the ROA calculations for smaller SMSFs.

APRA funds have "other income" included whereas SMSFs have "other income that is not earnings" excluded

The difference of how "other income" is treated for the net earnings calculations for the APRA-regulated funds are SMSFs is also a distortion between the investment return figures for the different funds. This is another issue which prevents direct comparability between SMSF and APRA funds.

AVERAGE ASSETS USED AS DENOMINATOR FOR ROA

As shown above in the ROA and ROR net earnings comparison the denominator used in the ATO ROA methodology uses average assets over the relevant year figure generated by taking the difference between opening balances and closing balances. This captures the investment earnings generated throughout the year and measures investment return in part against the earnings generated. Conversely, the APRA-regulated fund method does not include investment earnings generated in the relevant year in the denominator. In the first example of ROR and ROA calculations provided above, if the SMSF was to use the APRA cashflow adjusted denominator instead of the average assets approach its return would increase from 4.20% to 4.31%. This is another important difference in methodology that needs to be accounted for.

[1] The APRA Annual Superannuation Bulletin Glossary states: "Operating expenses represents expenses that relate to the operation of the fund by the RSE licensee. Includes: operating expenses for which administration fees are charged, such as expenses relating to advertising/marketing, commissions, director/individual trustee expenses, operating expenses associated with service provider and other operating expenses. Excludes: administration expenses."

This difference as well as the difference in net earnings means for the APRA ROR to be comparable to the ATO ROA methodology the ROR methodology should be amended to be:

$$\frac{Net\ investment\ income + other\ income\ -\ operating\ expenses - contributions\ tax}{Net\ assets\ at\ start\ of\ year + \frac{1}{2}(Net\ member\ flows + Net\ insurance\ flows + net\ investment\ income)}$$

This is a substantial difference in methodologies and accordingly makes it difficult to compare APRA-regulated fund investment returns with SMSF returns.

Given the inconsistencies between the different methodologies and the impact that contributions tax has on ROA calculations we believe the Commission should re-estimate APRA-regulated fund investment returns using this adjusted ROR formula to have a better comparison of investment returns across SMSFs and large superannuation funds.

SMSFS IN RETIREMENT PHASE

Another significant issue in comparing investment returns, especially at a sector level, is that SMSFs have a significant proportion of members in retirement phase compared to APRA-regulated funds. The SMSFA estimates that approximately 32% of SMSF members are in retirement phase and drawing account-based pensions, with 45.9% of SMSF assets supporting these pensions. Conversely, APRA superannuation statistics show that approximately under 4% of APRA-regulated fund accounts are paying superannuation pensions.

Members in retirement phase generally look for more stable income, meaning that they will forgo higher investment returns for reduced volatility and risk. These preferences lead to members in retirement phase having more liquid and less risky asset allocations and lower investment returns. We understand that the Commission did consider addressing this issue through creating a separate investment return benchmark for SMSFs but this was not pursued in the draft report.

Given that 45.9% of SMSF assets are invested to support pensions, this has a material effect on SMSF returns compared to the amount of APRA-regulated fund assets supporting pensions. Accordingly, the distribution of SMSF members in retirement phase makes it difficult to appropriately compare investment returns between APRA-regulated superannuation funds and SMSFs.

Consequently, this means that the Commission’s draft finding that SMSFs need $1 million on assets to have comparable returns to APRA-regulated fund members is likely to be inaccurate as the estimated investment returns for SMSFs should not be compared to APRA-regulated funds due to the different demographics of the two sectors.

SMSF RETURNS DISTORTED BY CERTAIN COSTS

Some costs incurred by SMSFs affect ROA calculations for the SMSF sector, distorting analysis of SMSF returns. The different costs that are included in SMSF ROA compared to APRA-regulated fund ROR make it difficult to

compare investment returns across the sector and come to a conclusion on what level of assets are required by SMSFs to achieve similar returns to APRA -regulated funds.

SMSF COSTS

There are a number of differences between SMSFs and APRA-regulated funds in regards to the costs incurred by the different funds as well as how data on costs are collected. These differences can cause two key problems for the Commission's analysis:

- As described above, overstatement of SMSF costs compared to APRA-regulated funds can cause SMSF investment returns to be understated in comparison to APRA-regulated fund returns.
- The overstatement of costs makes SMSFs appear less cost-effective than they genuinely are.

The following is an analysis of the costs issues which can distort analysis of the SMSF sector.

ESTABLISHMENT COSTS

A cost that is unique to SMSFs and makes the comparison between SMSFs and APRA-regulated funds difficult is the establishment costs of SMSFs.

When an SMSF is established there are a number of elements that must occur to bring the fund into being with a number of costs attached to these activities. Rice Warner's Report, "Costs of Operating SMSFs" published in 2013 and endorsed by ASIC in 2015, provided an in-depth analysis of SMSF establishments costs. The Report cited the following costs as being part of establishment:

- The legal and related costs of establishing and registering the superannuation trust including:
    - trust deed
    - ATO application forms
    - cash management account application
    - provision of binding death nomination forms
    - sample investment strategy
    - notice of election to become a regulated fund
    - general trust advice.
- The legal and related costs of establishing and registering the corporate trustee for those SMSFs that choose this route in preference to having individual trustees including:
    - searches and reservations of company names
    - preparation of company constitutions and Memoranda and Articles of association
    - incorporation and registration of the entity

- general Corporations Law advice.

The Report quantified SMSF establishment costs at ranging between $916 and $2,035. Costs can be more substantial where complex legal or financial advice is required to implement bespoke strategies for the SMSF members.

As noted by the Commission in the draft report and Technical Supplement 5, establishment costs are captured by the ATO data on SMSF costs, distorting analysis of SMSF cost-effectiveness. The ATO SMSF statistics capture these costs and attribute them to operating costs for a single income year when establishment costs are of a capital nature and should be amortised over time.

The impacts of establishment costs being treated this way has the largest impact on SMSFs setup with smaller balances. This has a large part in driving the reported high operating costs and low net returns for lower balance funds shown by the ATO statistics.

Data provided to the SMSFA by software provider BGL shows that the average SMSF establishment cost in the 2015, 2016 and 2017 income years was $2,129. For funds being established with a lower balance this cost can significantly distort investment returns and costs measures. Furthermore, we understand these expenses do not include financial advice costs associated with SMSF establishment, meaning that the one-off expense of establishing an SMSF is higher than this figure.

While these costs are material for SMSF members as they impact on the fund account balance, the approach of having establishment costs count as part of the annual cost is myopic and distorts SMSF cost and return data. A more appropriate assessment of these costs would be to evaluate their impact over the life of the SMSF and how they impact an SMSF member's balance at retirement. In our analysis below regarding tax planning and control, we show that establishment costs may result in a short-run reduction of superannuation savings but over the long-run SMSF members can be better off due to more efficient tax management when moving from accumulation phase to retirement phase and lower costs when their fund has sufficient scale.

This type of long-run analysis is more appropriate than the single year analysis offered by including establishments costs in annual operating costs for new funds. Without this assessment, the impact establishment costs can have on SMSF returns and operating costs ratios is a serious impediment to establishing a cost-effective SMSF balance that is comparable to performance of APRA-regulated funds. Given that between 2013 and 2017, there were 34,135 SMSF established per year on average, establishment costs require more careful analysis of how they impact SMSF metrics than afforded by the Commission in reaching the draft findings on SMSF cost-effectiveness.

WINDUP COSTS

While not as significant as establishment costs, wind-up costs can have a similar effect on SMSF cost ratios.

Wind-up costs are generated by the need to undertake final compliance activities in order to pay benefits out of the fund and bring its existence to a close. This generally requires financial advice, compliance work and a final audit and tax lodgement for the SMSF. Between 2013 and 2016, 9,465 SMSFs per year were wound up.

INVESTMENT AND ADVICE COSTS

A significant difference between SMSF and APRA-regulated fund cost data is how investment and financial advice costs are accounted for and effect operating cost ratios.

SMSF investment fees are unique in that many trustees are dependent on financial advisers to assist them with their investment strategies, asset allocation and broader strategy for their retirement savings (e.g. estate planning, small business succession, etc.), while this cost is not usually incurred by members of APRA-regulated funds.

Investment fees relating to APRA-regulated funds typically relate to direct management fees and 'indirect expenses' which comprise mainly of investment management fees which are not passed through fund financial statements as a direct fee paid to a manager, but which are indirectly incurred, generally via an adjustment to unit prices within a trust or bundled investment arrangement. This comparative investment fee relating to SMSFs is usually replicated in brokerage fees and wrap investment fees, which for ease of SMSF reporting is typically included in the cost base of investments.

From information provided to us by our members, we believe that when SMSF Annual Returns are being completed, financial advice costs are often included with investment costs (labels I1 and I2 in section D of the SMSF Annual Return). This means when the ATO produce SMSF statistics regarding costs, the investment costs statistics can erroneously include financial advice costs and omit true investment expenses. This is in contrast to APRA-regulated fund data that has a more clearly defined definition of investment costs and does not include financial advice costs. This makes it difficult to compare these different funds on this area of cost, particularly when financial investment advice is usually linked to assets under management, tailored and can be in the tens of thousands. Significantly, financial advice fees have been highlighted as a key concern in the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry and is an area the SMSFA has advocated reform so that fees reflect the value they provide.

Further, financial advice costs in APRA-regulated funds are of a very different nature to those for SMSFs. Most APRA-regulated funds offer intra-fund advice that is subsidised through administration fees and are accordingly excluded from operating expenses which affect cost and investment return figures. Also, where an APRA-regulated fund member seeks personal advice similar to that demanded by SMSF members, the fee is paid directly from the member's account. This means the costs is not attributed to the operating costs of the fund.

These differences in quality of data and how advice is demanded and paid for in the different funds present another obstacle to comparing the cost-effectiveness of SMSFs and APRA-regulated funds

ADMINISTRATION COSTS

Another significant difference in costs relate to the administration fees of an SMSF compared to an APRA-regulated fund. SMSF members have the option to effectively manage the administration services of their SMSF such as managing compliance responsibilities, ATO correspondence and paperwork, or they can outsource these services to a professional SMSF administrator.

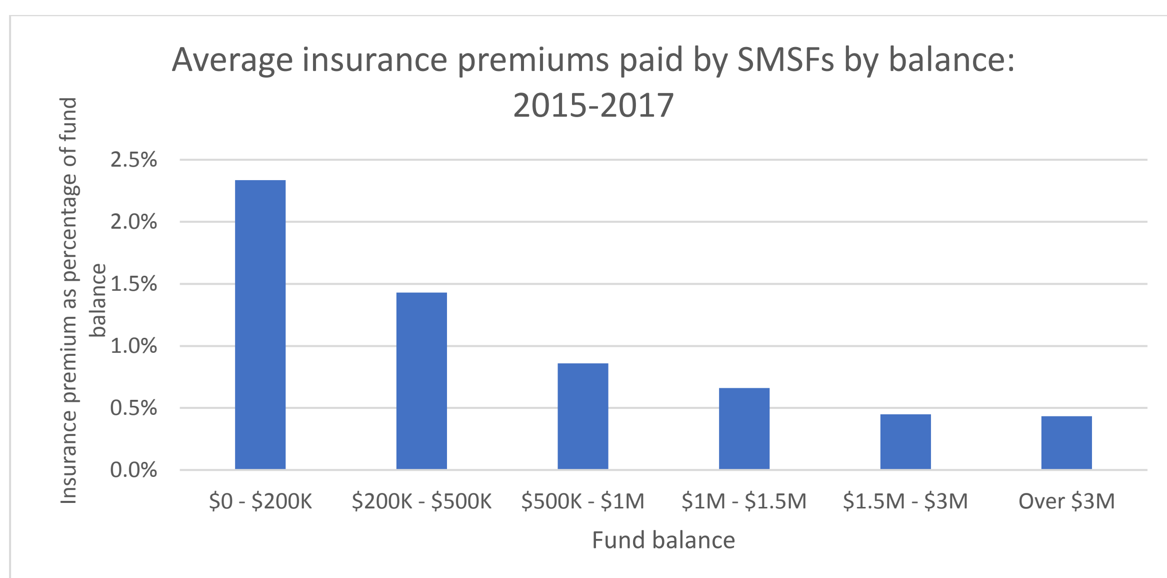
This option, which is available to SMSF members can distort the reporting of administration fees when some individuals choose to use a full or part administration service which may add $1,000 to $2,000 in fees but allows them to focus on other aspects of their SMSF or finances such as investment strategies and investments. When compared to APRA-regulated funds which typically charge administration fees of $1 to $2 a week, SMSF members who choose to utilise administration services can distort the comparison in fees.

INSURANCE COSTS

As the Commission stated in Technical Supplement 5 “[t]he annual return of SMSFs may include costs that would not be treated as operating expenses in APRA’s institutional fund data, such as insurance premiums[.]”

While use of insurance in an SMSF is not common (from the data provided to us by SMSF software company BGL and ATO data we estimate around 20% of funds have insurance), the inclusion of insurance premiums as operating costs for SMSFs will distort measures of cost-effectiveness and net returns.

Data provided by BGL shows that these costs, as a percentage of fund balances are most significant for SMSFs with lower balances.



As these costs are included as SMSF operating costs but not for APRA-regulated funds, then they can create a significant difference in the cost estimates for the different funds.

This is another example of how difficult it is to compare costs between SMSFs and APRA-regulated funds and why the Commission should be hesitant in relying upon the ATO data to establish that SMSFs are only cost effective with balances of $1 million and above.

DIRECT vs INDIRECT COSTS

Another potential area of discrepancy between SMSFs and APRA-regulated funds is the difference where SMSFs invest in assets directly but APRA-regulated funds are more likely to have indirect investments, such as in property. For the SMSF, the expenses of making and holding this investment will be reflected in the ATO's calculation of investment expenses. However, for an indirect investment held by an APRA-regulated fund, the net investment income distributed to them from an indirect investment (e.g. through a trust or corporate vehicle) will be include in their investment income without any corresponding cost added to investment expenses. While this does not impact overall ROR or ROA calculations, it does make comparing investment expenses between the different types of funds difficult.

INCORRECTLY LABELLED COSTS

As described above in regards to advice costs, as cost data is collected via the SMSF Annual Return the validity of the data collected through this method must be questioned. This is because the annual return is primarily a taxation and regulatory compliance task for SMSFs, the accurate placement of costs data under the ATO's labels may not affect taxation outcomes. For example, the SMSFA has been presented with anecdotal information that taxation costs and capital costs can be mistakenly reported as investment or operating costs of the fund. This can lead to the data being gathered by the ATO to be an inaccurate reflection of an SMSFs true costs.

RECOMMENDATION 1

We recommend that given the questionable quality of data that is used to compare SMSFs and APRA-regulated funds that the Commission reassess its draft findings that SMSFS with balances under $1 million not cost-effective and underperform.

ALTERNATIVE DATA ON SMSF INVESTMENT COSTS AND RETURNS

Given the issues with data provided through the ATO SMSF Annual Return process, the SMSFA believes it is important that the Commission considers other information and sources regarding investment returns and costs for SMSFs. In this section we present other sources of relevant information as well as data sourced from SMSF software providers.

RICE WARNER REPORT ON SMSF COSTS

In 2013, actuarial consulting firm Rice Warner prepared the report, "Cost of Operating SMSFs" for the Australian Securities and Investment Commission (ASIC). This report has been an important source of information regarding SMSF costs and establishments since it was published and was the basis of ASIC guidance in 2015 (15-192MR) that SMSFs should have a minimum balance of $200,000.

This report undertook a survey of SMSF costs across the sector including administration (including audit, compliance, tax lodgement costs), investment and regulatory levies. The costs were compared with fees of APRA-regulated funds.

The Rice Warner report found that SMSFs were cost competitive with APRA-regulated superannuation funds with a balance of between $200,000 and $500,000 depending on the level of fees and the amount of administration the trustee was willing to undertake. The depth of analysis in this report and its endorsement by ASIC has meant it has become an important guide regarding SMSF establishments.

The results in the report are also supported by the survey of SMSFA members on their views on what is an appropriate asset level for SMSF establishment. These are detailed below.

We recommend the Commission consider the analysis of the Rice Warner report in reassessing their draft findings on the cost-effectiveness of SMSFs.

SUPERCONCEPTS-UNIVERSITY OF ADELAIDE RESEARCH

SMSF administration firm, SuperConcepts, in conjunction with the University of Adelaide, produced a report analysing SMSF performance based on longitudinal data for 20,121 SMSFs in 2017. The "When Size Matters: A Closer Look at SMSF Performance" report looked at investment returns and diversification of funds by asset size cohorts.[2]

The report had two key findings which contrast with the draft finding of the Commission. Those were that:

> "[…] *the main difference that exists is between funds that are smaller than $200,000 and those which are larger than this amount. Although performance, diversification and expense ratio continue to*

[2] https://www.superconcepts.com.au/docs/default-source/teched/size-matters-smsf-performance.pdf?sfvrsn=55be161a_14

improve as a fund becomes larger, a significant deterioration in these traits occurs for funds that are below $200,000."

And:

"[…] *in general, funds which pass a threshold of $550,000 of funds under management, are comparable in performance, diversification and expense ratios to any of the larger funds.*"

These findings, based on detailed fund level data, indicate that SMSFs with far less than $1 million can be cost competitive with APRA-regulated funds and also endorses the industry practice that $200,000 is an appropriate establishment balance for SMSFs.

Notwithstanding this guidance, however, there will be cases where specialist SMSF advice may indicate that the establishment of an SMSF with a balance lower than $200,000 is appropriate. For example, if the trajectory of anticipated contributions is such that the fund will grow to this point within a short period, or if the intending SMSF trustee is faced with significant potential CGT costs when rolling an existing fund into an SMSF.

ALTERNATIVE DATA ON SMSF COSTS

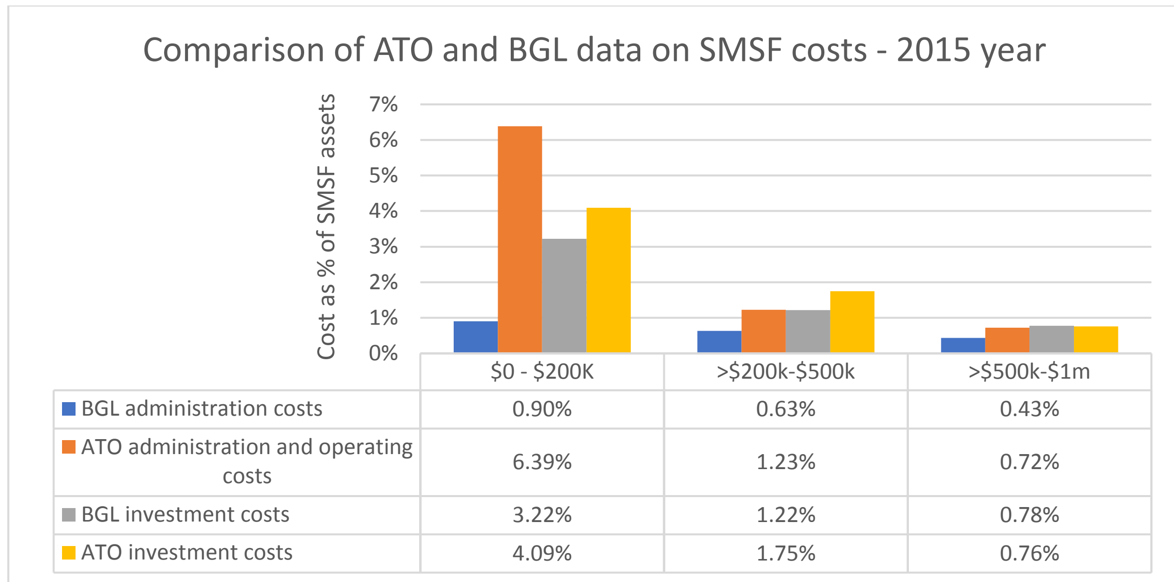
Data provided to the SMSFA by BGL Pty Ltd, a provider of SMSF administration software portrays a different view of SMSF costs than that provided by ATO data. The data collected from BGL's software used for SMSF administration was collected from 92,284 SMSFs who use BGL's cloud based SMSF software administration platform. We believe this data is more accurate than that gathered by the ATO through the SMSF annual return as it is used to generate financial statements which allow trustees to monitor their fund's financial performance whereas the ATO data is only used to assess the tax outcomes for the fund. This data showed median SMSF administration and investment costs lower than the ATO costs.

Median SMSF Administration expenses						
	$0 - $200K	**$200K - $500K**	**$500K - $1M**	**$1M - $1.5M**	**$1.5M - $3M**	**Over $3M**
2015	$1,404	$2,648	$3,314	$3,856	$4,300	$5,456
2016	$1,689	$2,508	$3,069	$3,439	$4,142	$5,008
2017	$1,887	$2,506	$2,925	$3,376	$4,002	$5,432

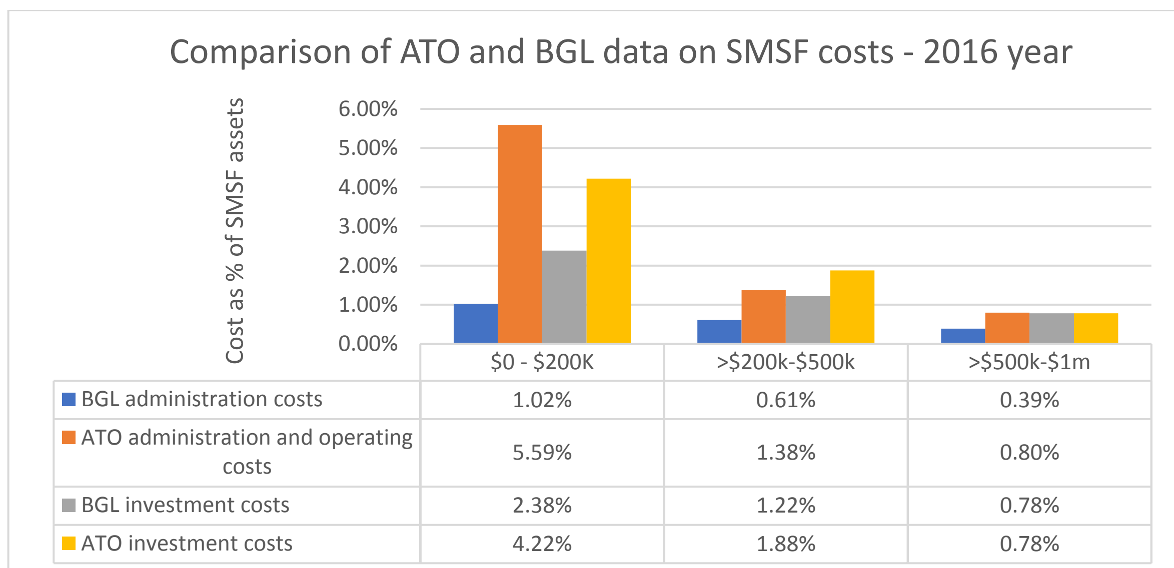
Median SMSF Investment expenses						
	$0 - $200K	**$200K - $500K**	**$500K - $1M**	**$1M - $1.5M**	**$1.5M - $3M**	**Over $3M**
2015	$1,694	$4,374	$5,992	$8,540	$11,192	$13,189
2016	$1,980	$4,636	$6,050	$7,775	$10,280	$16,585
2017	$2,642	$4,724	$6,186	$7,444	$9,844	$16,447

These amounts are significantly lower than what the ATO cost percentages reflect, especially for lower balance funds.

Comparing the 2015 and 2016 years of the BGL data and the ATO data on aggregate costs percentages for SMSFs shows that the costs calculated by BGL are significantly lower than the costs aggregates presented by the ATO, especially for SMSFs with lower balances:



	$0 - $200K	>$200k-$500k	>$500k-$1m
BGL administration costs	0.90%	0.63%	0.43%
ATO administration and operating costs	6.39%	1.23%	0.72%
BGL investment costs	3.22%	1.22%	0.78%
ATO investment costs	4.09%	1.75%	0.76%



	$0 - $200K	>$200k-$500k	>$500k-$1m
BGL administration costs	1.02%	0.61%	0.39%
ATO administration and operating costs	5.59%	1.38%	0.80%
BGL investment costs	2.38%	1.22%	0.78%
ATO investment costs	4.22%	1.88%	0.78%

This presents a very different perspective to the Commission's view on the viability of SMSFs as discussed in the draft report and lends credibility to the current industry belief that SMSFs can be cost-effective if established with a balance of around $200,000. The reasons for these large discrepancies can be attributed to some of the issues raised above. In particular, establishment costs are not reflected in these figures and we believe that the figures reported through SMSF administration platforms by accountants are more accurate than ATO data due to more accurate and timely data entry.

Given the variable results achieved from different data we believe the Commission should reassess its finding that SMSFs are only cost-effective when they have assets of $1 million.

ALTERNATIVE DATA ON SMSF RETURNS

At the time of lodging this submission to the Commission, we have not been able to source appropriately accurate and reliable alternative data on SMSF investment returns. The Association, will continue to work with our partners to source alternative data to the ATO data used to generate SMSF ROA calculations used by the Commission.

However, we refer to the analysis of Class Limited, the SMSF software provider, that showed a considerable uplift in SMSF returns when using the APRA-regulated fund ROA methodology (in effect adjusting SMSF returns for contributions tax and insurance flows captured in the ROA net earnings calculation).

SMSF Annual Returns

	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015
ATO reported ROA	12.6%	16.8%	-6.0%	-6.7%	7.7%	7.7%	0.4%	10.2%	9.7%	6.0%
estimated ROR	14.6%	19.9%	-4.9%	-5.8%	8.5%	8.5%	0.9%	11.1%	10.6%	6.6%

10 year annualised average 2006-2015

ATO reported ROA	5.58%
estimated ROR	6.71%

This analysis shows that SMSF returns may have been significantly underestimated compared to APRA-regulated fund returns, and to a greater magnitude than the 0.61% the Commission estimated in Technical Supplement 4.

RECOMMENDATION 2

We recommend that the Commission should seek and assess alternative data sources on SMSF costs an investment returns in order to have a more accurate representation of SMSF investment returns and cost operating ratios.

OTHER FACTORS IN SMSF ESTABLISHMENT

TRUSTEE MOTIVATIONS

CONTROL IS THE OVERARCHING MOTIVATION

The cost-effectiveness debate of SMSFs must also extend further than a pure quantitative argument to consider the many distinct and intangible motivations that an SMSF member may have. For many SMSF members this may mean that the ability to take control of their retirement savings is a stronger motivating factor to them than achieving a higher rate of return.

As the Commission's members survey found, the desire to gain greater control over superannuation assets and investments is the leading motivation for the establishment of SMSFs. This has also been reflected in research commissioned by the SMSFA and the Commonwealth Bank of Australia in 2017 in which 53% of individuals indicated that taking more control over their personal finances was one of the main reasons for establishing an SMSF.

Inherent in the name of a 'self-managed superannuation fund', taking control is the overarching motivation which gives individuals the significant responsibility of managing their own retirement savings but also the ability to put into action other motivations which are commonly reflected in SMSF surveys and discussed below. Furthermore, control provides the link to engagement in superannuation and retirement, a benefit which is hard to measure through return analysis but an essential matter to the long-term success of superannuation.

Control also lends itself to greater transparency which is provided by an SMSF and the 'ownership' of their funds compared to large APRA-regulated funds. For example, individuals who wish to manage their own superannuation have a clear understanding of the fees that they are paying because of the direct relationship and process between SMSFs and the service providers they use. This may mean that even though costs for some SMSF members are higher than in an APRA-regulated fund, they accept this trade-off in order to have greater control over their savings and visibility of their superannuation.

The Commission noted in their findings that seeking control was a paradox for members, that is control is only valuable when it provides higher returns or a clearer benefit than simple products provide. When looking at a holistic picture, this analysis is too simple. Analysis must look further than a discussion on comparable returns and look towards retirement goals and income. It is entirely appropriate for an SMSF member to aim for a level of retirement income that allows them to achieve all their financial goals and lead a comfortable lifestyle which can be achieved through a lower investment return than other superannuation funds achieve. Where this is a choice of an SMSF member, they are exercising control and their preferences for how their superannuation is invested to achieve their retirement goals. If the member chooses a certain level of retirement income that accords with lower returns, then this should be accepted as their choice to make.

Control is valuable in many senses, in many different ways, to many different retirement goals. It is the sense of comfort, confidence and security in managing your own affairs that cannot be measured. Furthermore, SMSFA members often provide us with the view that many of their clients would not make contributions to superannuation if they did not have an SMSF due to distrust of institutional funds. Blanket findings that SMSFs with assets below $1 million are uncompetitive unfairly discounts the benefits upwards of 80% of individuals who are accessing the intangible benefits of SMSFs that may allow them to achieve their retirement goals with their savings.

INVESTMENT CHOICE (INCLUDING BUSINESS REAL PROPERTY AND GEARING)

SMSFs provide the key ability to give ultimate investment choice to the trustees. Trustees are able to create an investment strategy and portfolio which appropriately reflects their financial circumstances and risk profile. This ability to create a diverse, specific portfolio is restricted in institutional superannuation structures and therefore an SMSF provides the ability for tailored strategies.

Despite the ability to be able to invest in specific direct shares and exchange traded funds (ETFs), which some large superannuation funds allow, SMSFs also provide more flexibility and more options in alternative and other assets. This includes residential and commercial property, collectibles, and unlisted investments.

One example of this flexibility involves business real properties which are owned by their SMSFs and then leased back to the business. Providing opportunities to utilise their SMSF with their business provides effective tax benefits, has positive cash flow impacts, bankruptcy protections and secure tenancy. It also allows small business owners to have what is often their most significant asset held in the concessional superannuation environment.

The SMSFA has long advocated for a lift in professional advice standards and while the quality of advice can certainly be improved in the area of gearing (see the section on SMSF Advice), the ability for individuals to borrow to invest in property is a valid wealth creation strategy for many SMSFs. An unconditional $1 million threshold would leave others with less money, less opportunities and reward only wealthier people.

Given the different investment strategies that can be employed by SMSFs, and the bespoke nature of these strategies, it is also important to consider how an SMSF fits with other assets owned by the fund members. Due to the different investment opportunities open to SMSFs, some trustees can use them as special purpose retirement savings vehicles where a specific strategy is deployed that forms part of a broader retirement savings strategy. Accordingly, this can make it difficult to assess SMSF returns compared to APRA-regulated funds where members do not have bespoke strategies that are part of a broader retirement strategy.

TAX PLANNING AND CONTROL

SMSFs also provide trustees an increased ability to manage the tax paid by their fund. The flexibility supplied by an SMSF allows individuals to time their contributions, allocate earnings, and time asset sales to each individual's unique situation to give the best retirement savings outcome for members. As the Commission noted, the fact that superannuation funds are taxed at the fund level supplies this opportunity.

One of the issues not quantified by the Commission in their analysis of SMSF returns and costs is the tax cost of switching from a large-fund to an SMSF.

If the Commission were to recommend that SMSFs should not be setup until a $1 million balance was available then this could result in a significant CGT cost imposed on the fund members when choosing to switch to an SMSF. This can result in an unnecessary erosion of retirement savings that can be reduced by switching to an SMSF earlier in life. In fact, establishing an SMSF earlier can result in lower superannuation costs over the lifecycle for its members due to tax efficiency.

The impact of CGT on retirement savings when switching to an SMSF later in life can be seen through the following simplified example:

> A couple both enter the workforce at age 23 with a $5000 balance in an APRA-regulated superannuation fund and begin with a $50,000 wage. They experience annual wage growth of 2.5%, only have superannuation guarantee contributions made at 9.5% of their wage and achieve an annual ROA of 5.5%. (For simplicity, we assume all their returns are capital gains and remain untaxed until they need to sell the underlying assets that support their superannuation account.)
>
> Under these circumstances the couple would achieve a joint superannuation balance of $1 million by age 55. To switch to an SMSF at this time, they would need their large superannuation fund to sell down their assets to roll-over cash to an SMSF.
>
> At this time, we estimate they would have accrued $638,105 in investment returns and would incur a $63,810 tax cost (assuming a 10% CGT rate) to switch to an SMSF. This is 6.07% of their retirement savings at this time. This tax impost has a more significant effect by the time the couple reaches retirement age. By age 65, the CGT cost incurred at 55 will cost them $103,315 in savings due to loss of investment earnings.
>
> In contrast, if the couple were to establish an SMSF when they had a $200,000 balance this would occur at age 36. At this time, they have accrued $71,854 in investment returns and switching to an SMSF would incur a capital gain cost of $7,185. This is 3.41% of their retirement savings at this time and only results in a $32,175 reduction of retirement savings at age 65.

Accumulation balance at 65			
	Stay	**Switch at 55: $1m balance**	**Switch at 36: $200,000 balance**
Balance	$2,067,641	$1,964,326	$2,035,466
Difference ($)	-	-$103,315	-$32,175
Difference (%)	0.00%	-5.00%	-1.56%

It can be seen from this analysis, that requiring superannuation fund members to wait until they have $1 million in assets to establish an SMSF will result in a reduction of their retirement savings through increased tax impost when switching to an SMSF.

This analysis changes if the large superannuation fund that the members belong to applies a taxing point when members shifts from accumulation phase to retirement phase. This taxing points is generated by the need for the fund to "sell" members out of their accumulation phase investment options and then "purchase" a retirement phase product.

In this example, applying CGT to the members' investment returns when shifting into retirement phase at age 65 in an APRA-regulated fund would impose a $145,168 reduction of the members' retirement savings at that time.

Conversely, SMSFs do not have to impose a tax point when a member moves from accumulation phase to retirement phase. This is because starting a pension in an SMSF is an administration point rather than a change in product or investments. Any assets sold to fund their pension after it is established are done in a tax-free environment (subject to the $1.6 million transfer balance cap).

This results in a positive outcome for SMSFs when they are established before shifting from accumulation to retirement phase. However, the benefit is reduced significantly by the CGT impost of switching later.

Pension balance at 65			
	Stay	**Switch at 55: $1m balance**	**Switch at 36: $200,000 balance**
Balance	$1,922,473	$1,964,326	$ 2,035,466
Difference ($)	-	$41,853	$112,993
Difference (%)	-	2.18%	5.88%

This again shows that it most effective to move to an SMSF earlier, especially where a taxing point occurs at retirement within large superannuation funds. While tax-effectiveness is not a key driver of SMSF establishments, it must be considered when evaluating the overall cost-effectiveness of SMSFs. It also shows it

is important to consider the cost-effectiveness of SMSFs over a lifecycle of the fund rather than looking at short-term or single year snapshot of the fund's returns and costs.

This analysis holds when costs are added in. To estimate costs for APRA-regulated funds we have used the Commission's average costs figure of 1.1% for APRA-regulated superannuation funds. For SMSFs, we have used the Rice Warner analysis of SMSF costs. Using these figures, we assume an SMSF establishment cost of $2500, ongoing annual administration costs of $4233 year and $800 per year investment costs.

For the same couple and circumstances described above the following outcomes are achieved with costs included:

The couple would switch to an SMSF at 58 when their combined superannuation balance reaches $1 million. (This occurs later due to the impact of costs on their balance). At this time, they incur a $64,828 CGT impost as well as a $2500 SMSF setup fee and ongoing SMSF costs of $5033 per year. When the couple reach age 65, they are slightly worse off ($11,209) from establishing an SMSF. This gap is narrowed from the original example, due to the lower costs they incur with an SMSF from the time they establish it (for example, in the year they turn 60, $5033 for their SMSF compared to 1.1% of their balance which is $12,111).

If the couple switches to an SMSF when they reach a $200,000 balance, they would incur a CGT impost of $7909 as well as a $2500 SMSF setup fee and ongoing SMSF costs of $5033 per year. When the couple reaches 65 under this scenario, they are slightly better off due to having lower costs than APRA funds from the time they are 46 onwards (at 46 they have a balance of approximately $417,000). The lower costs ameliorate the CGT impost when they switched.

Accumulation balance at 65			
	Stay	**Switch at 58: $1m balance**	**Switch at 37: $200,000 balance**
Balance	$1,549,530	$1,538,322	$1,592,798
Difference ($)	-	-$,209	$43,267
Difference (%)	0.00%	-0.72%	2.79%

Where the APRA-regulated fund has a taxing point when members shifts from accumulation phase to retirement phase the cost-effectiveness of establishing an SMSF is positive when taking costs into account. The increased benefit is due to the reduction in costs paid by the members (from establishment for the scenario at age 58 and from age 46 for the establishment at 37 scenario).

Pension balance at 65			
	Stay	**Switch at 58: $1m balance**	**Switch at 37: $200,000 balance**
Balance	$1,431,057	$1,538,322	$1,592,743
Difference ($)	-	$107,265	$161,686
Difference (%)	0.00%	7.50%	11.30%

This analysis challenges the rationale that an SMSF should not be established until it has $1 million on assets as it shows that earlier establishment of an SMSF may be positive over the longer-term for the SMSF. This highlights the problems with assessing SMSF viability by looking at costs and returns at a point in time rather than over the longer-term.

The absence of assessing the tax effectiveness of the decision to establish an SMSF also is another issue with the Commission's analysis of SMSF viability. The impact of APRA-regulated fund tax arrangements compared to those of SMSFs has a substantial impact on retirement savings outcomes.

Given these issues were not canvassed in the Commission's analysis, we believe these are further reasons that the Commission should not recommend that SMSFs only have appropriate scale when they have $1 million in assets.

FLEXIBILITY AND AGILITY WITH PORTFOLIO AND RETIREMENT STRATEGIES

SMSF members are able to instantly change their investment strategies and assets (as allowed by their trust deed) as they control the superannuation fund compared to APRA-regulated funds where they may be a lag between request and action. Furthermore, when retirement is nearing the ability to quickly and efficiently commence retirement and implement pension and investment strategies that align with cycle of life is also a benefit that is hard to replicate in a large superannuation fund.

ESTATE PLANNING

Estate planning is also easier to control when SMSF members are also the trustees of their retirement assets. Particularly for blended families and those with young children, an SMSF provides additionally flexibility and certainty regarding death benefit nominations and reversionary pension documentation when implemented then their counterparts.

ADMINISTRATIVE WEAKNESSES OF LARGE APRA FUNDS

Taking control of an SMSF also means that trustees have oversight of their funds at all times. Large superannuation funds deal with thousands of customers which can result in administrative errors, lag times and

the need to deal with customer service areas for information regarding their savings. Certain SMSF trustees also may not resonate and agree with how superannuation funds manage the retirement savings of Australians, the industry and retail 'battle' and the advertisement and board fees that are involved with APRA regulated funds. The comfort and peace of mind that SMSF trustees gain because of this is an intangible benefit.

ACHIEVING BETTER RETURNS AND HARNESSING LOWER COSTS

The 2017 SMSFA-Commonwealth Bank report also highlighted that achieving better returns and harnessing a lower cost structure were the largest and third largest reason respectively that individuals indicated as a reason to set up an SMSF. Despite the Commission's draft finding that SMSFs under $1 million fail to achieve returns commensurate with large superannuation funds, the SMSFA believes that this motivation is entirely legitimate for all SMSF trustees. This is particularly pertinent when the Commission's finding is not definitive for all SMSFs below that threshold.

With regards to better returns, SMSF trustees believe that they are able to achieve better net after-tax returns either by their own decision making or investing in partnership with a trusted professional adviser. Rice Warner analysis indicates that this belief is entirely possible with SMSFs outperforming large APRA superannuation funds in eight out of 12 individual years from 2005 to 2016. However, we also note that SMSF members may just seek a financial retirement goal that is not reflected in a benchmark investment annual return but in retirement assets or income.

Costs are also a clear and strong indicator for individuals choosing an SMSF, especially when compared to asset-based fees in large APRA funds. As stated earlier in our submission, annual costs for administration and accounting are typically fixed between $2,000 to $4,000 and become extremely cost effective the larger an SMSF fund is. Individuals are willing to incur establishment fees and investment advice fees knowing that they can 'afford' this expense in the aim to reach their retirement goals and achieve economies of scale in their SMSF.

ADVISER VIEWS ON SMSF ESTABLISHMENT

SMSF ESTABLISHMENT BALANCE

As we indicated at the Commission's public hearing in Sydney, the SMSFA has surveyed 131 of its professional member base regarding the cost effectiveness of SMSFs. We aimed to receive evidence on quantitative and qualitative factors that influence the decisions advisers make when providing SMSF advice.

Our member survey found that 64% of members believe $200,000 to $300,000 is an appropriate balance for a two-member SMSF to be established. Notably only 15.3% of members believe $100,000 or less is appropriate, and only 2.5% of members believe anything under $600,000 is not appropriate. Conclusively, it is overwhelmingly clear our members do not believe that a $1 million SMSF balance is needed to establish an SMSF.

On a pure quantitative basis, advisers highlighted to us that the fees charged for their SMSFs commonly equated to 1%-1.5% of the SMSFs balance. This means that advisers had no issues with balances of around $200,000 because they believe they are directly comparable with alternative options. When compared to the data received by BGL, the claims made to us by our members are entirely consistent.

Members also highlighted a common theme of factors that justified advisers making this judgement which were linked to their client's age and financial circumstances. This included the ability of clients to make future significant contributions allowing their SMSF to become even more cost effective. Members also reiterated the motivations listed in the previous section on trustee motivation, particularly in relation to control, holistic planning, estate planning and the ability to choose specific investments such as property and LRBAs.

A case study provided by an SMSFA member of where it is appropriate to establish an SMSF with a balance under $1 million is as follows:

A popular reason for starting an SMSF is for business owners who want to buy a business property in their SMSF and lease it back to their business - or transfer an existing business property into their SMSF. These clients all have well below $1m in super when they start their SMSF.

My most recent one (SMSF established this week) is a surgeon who is buying a medical suite and then leasing it back to his medical practice.

- *Total cost for property, GST, SMSF set-up costs, legal fees, ancillary expenses: $578,090*
- *Existing superfund balances: $365,831 (husband and wife)*
- *Shortfall: $230,000 (allowing for a small cash balance left after settlement; this will be augmented by a $50k GST refund after settlement)*

Most of my clients in this type of scenario get a SMSF mortgage to cover the shortfall. In this particular case, the clients are getting cash from the bank of 'Mum-and Dad' and putting it into the SMSF as a non-concessional contribution.

As the wife is also a doctor, both members can afford to make the maximum $25k each in concessional contributions into the SMSF. Annual rent on the property has been evaluated at $24,000.

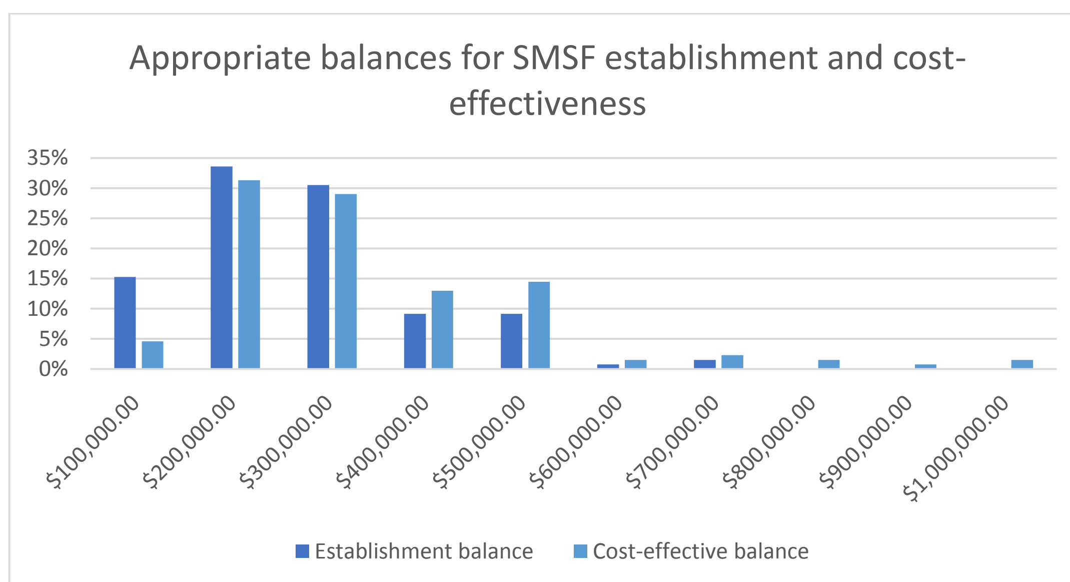
Even with a very modest 5% investment return on the cash generated from super contributions and rent (after expenses and tax), calculated in a very simple model on the opening cash balance for each year, the SMSF's net assets (excluding the property) grow from a starting position of $17k to $360k over five years. On top of that will be the commercial property purchased for $500k initially.

COST-EFFECTIVE BALANCE

When reframing the question to account for a balance that gives an SMSF enough scale to be cost-effective the results were quite similar. 60% of members still believe that $200,000 to $300,000 reaches this threshold which indicates that the majority of members believe this balance already provides a level of net return that is

beneficial to members. A minority of members believe balances between $400,000 and $500,000 are cost effective which is evident in the graph below.

Members reiterated similar points when discussing a cost-effective balance, noting that slightly higher balances indicate that further contributions have been received and SMSF fees would now reflect a cheaper ratio than APRA-regulated funds. When establishing a low balance SMSF, 70% of members believed that within three years the fund would reach a cost-effective balance.



WIND-UPS AND CHURN

Where older trustees are concerned, members overwhelmingly recommended closing an SMSF at a balance of $200,000 or less because it would no longer be cost effective or appropriate for their client. Member's caveated this by the fact SMSFs in this scenario normally have no more capacity for contributions, members have experienced cognitive decline or lack of engagement. However, when asked to provide evidence that SMSFs are not entering the system and leaving with low balances, our members had no or very low awareness of this occurring. In fact, members indicated that their accumulation funds were steadily growing and pension funds were generally stable to slightly decreasing.

Referencing the March 2018 APRA Superannuation Performance Statistics, SMSFs are still experiencing net rollovers from APRA-regulated funds. These quarterly results have been consistent dating back to September 2014 when the data series on rollovers to SMSFs began. The Commission also noted that, "It is unclear to what extent the presence of small SMSFs in the system is necessarily a problem." We believe that these smaller funds do not represent a problem and cite further research undertaken by Class Ltd in 2016. Analysing the funds that use their software, Class found that:

- for the 2015 financial year around 50% of funds with less than $50,000 were either newly established in the year or entered this bracket due to drawdowns or rollovers during the year.

- the dynamics of funds with balances of less than $50,000 are similar to "that of an airport transit lounge, with constant arrivals and departures". On average these funds stay in this bracket for around 2 years.

We also note ATO data which showed that in 2012, of SMSFs that lodged for the first time, 51% reported total assets of $1 to $200,000. Comparatively, this asset range made up only 20% of funds still active in 2016.

RECOMMENDATION 3

We recommend that the Commission considers the broader motivations of SMSF members, costs of switching to an SMSF later in life and the role that SMSFs play in the superannuation sector in formulating any final findings or recommendations on SMSFs and establishment balances.

SMSF ESTABLISHMENT LIMITS AS POLICY

The SMSFA does not support the introduction of arbitrary barriers to establishing an SMSF as they would inhibit consumer choice and flexibility within the superannuation system. We believe individuals must be given the ability to engage and manage their retirement savings in ways that suit their retirement goals. However, the SMSFA does acknowledge that the advice provided to SMSFs must improve to ensure trustees have a clear understanding of their responsibilities and that SMSFs require more significant involvement and engagement than being a member of an APRA-regulated fund.

A mandatory minimum balance for SMSFs is often discussed as a potential barrier to the establishment of SMSFs-primarily by parties seeking to stem the flow of industry or retail fund members to SMSFs.

The SMSFA has concerns the Commission's draft finding that SMSFs will only have comparable returns to APRA-regulated superannuation funds and comparable costs where the SMSF has at least $1 million in assets will be used in this regard.

The SMSFA is strongly opposed to the introduction of any minimum mandated balance requirements before a member or members can establish an SMSF for a number of reasons, many of which have been stated earlier.

We believe that any such restriction would unfairly discriminate against SMSFs, especially when SMSFs are established in order to maximise superannuation savings for retirement and must comply with the *Superannuation Industry (Supervision) Act 1993 (Cth)* (SIS Act) and tax provisions. The use of a defined balance establishment limit is a blunt and inappropriate tool to regulate SMSFs.

Preventing or deferring the member's ability to establish an SMSF would be counter to the fundamental principles of individual member choice underpinning superannuation. Noting that engagement is a significant problem for the superannuation industry, this type of action is likely to further disengage upwards of 80% of the expected SMSF population who would not be able to seek an SMSF as an alternative option and further discourage engagement and causing detriment to the system. With the Commission commending the benefits that SMSFs have provided to the superannuation system throughout their report, a $1 million barrier to entry effectively eradicates the crucial benefits of choice and competition that SMSFs have supplied over many years.

The imposition of minimum balances also introduces complications and unanswered questions around the following critical areas:

- How would regulatory controls and policing of minimum balances be achieved?
- A minimum balance fails to take into account the age, number and financial circumstances of the members, particularly when SMSFS can encompass to up to six members from next year.
- A minimum balance fails to take into account diversification outside of SMSFs and other superannuation accounts.

- A minimum balance fails to take into the account the actual fees of the SMSF, noting that SMSF members are able to negotiate and orchestrate their own fee structures regarding administration, accounting, audit, and investment advice. Likewise, this concern is replicated because the assets of the SMSF will also not be considered. For example, an SMSF with cash and shares will be administratively cheaper to manage then an SMSF with property, regardless of balance.

- A high minimum balance implies paternalistically that only the 'wealthy' know how to and are able to invest responsibly. Furthermore, even if a member does have a higher level of wealth it does not automatically mean that an SMSF is suitable for their circumstances. The recent ASIC report (RG575) on the quality of SMSF advice made this point strongly.

- Issues will arise with border line cases where a member satisfied the minimum balance at the time of establishing the fund, but due to adverse movements in investment markets, or delays occur occurring in roll-overs and Superannuation Guarantee contributions, less money being transferred into the fund.

- Setting minimum balances creates issues if the value of an existing fund falls below the minimum set balance due to members leaving the fund, payment of lump sums and pensions or caused by volatile investment markets, such as those experienced through the Global Financial Crisis.

- Government reduction of contribution caps has limited the ability to establish larger superannuation balances and members should not be disadvantaged or prevented from establishing an SMSF because of an inability to establish higher balances at the time of establishment.

The fact that there can be no definitive way to ensure that a minimum balance will mean that funds above or below that mark are administered appropriately or they will be better administered by transferring balances under the arbitrary limit to APRA-regulated funds, signifies that the SMSFA cannot support the setting of an arbitrary threshold. This has been supported by the Review into the Governance, Efficiency, Structure and Operation of Australia's Superannuation System (the "Cooper Review") and the Australian Securities and Investment Commission (ASIC).

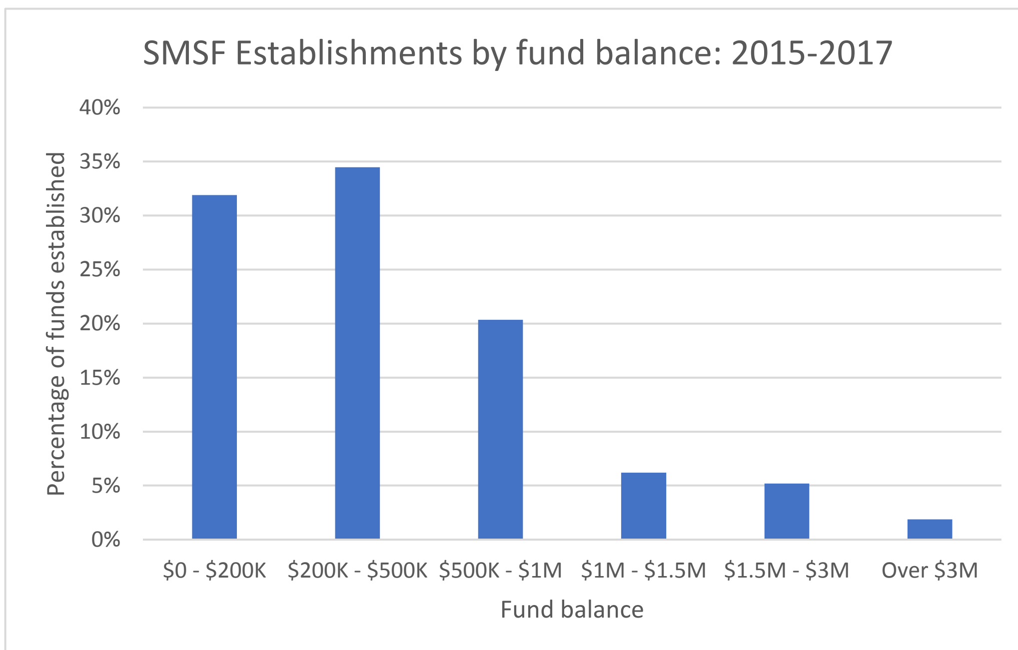
Despite these policy limitations and the fact that there is no correct minimum fund size that would ensure the costs of an SMSF would be less than the fees charged by an APRA-regulated fund, the SMSFA does acknowledge there may be a soft threshold where these concerns are mitigated.

ASIC information sheet 206 details that SMSF balances below $200,000 must undergo an important cost-effective analysis as it is unlikely that an SMSF will be in the client's best interests. This figure was arrived at as a result of the independent research from Rice Warner, which the SMSFA has referenced in discussion of alternative data sources. ASIC also go on to note that there are circumstances where an SMSF may be in the client's best interests regardless of balance, such as the SMSF members undertaking much of the administration

and where a large asset is being transferred into the SMSF within a short time frame. The SMSFA agrees with these circumstances.

Recent ATO statistics have also highlighted that the average SMSF establishment balance in 2015-2016 was $390,398 and the median establishment balance was $245,433. This is supported by data provided by BGL on SMSF establishment that shows from a sample of 6,385 SMSFs established between 2015 and 2017, 68% of SMSFs were established with balances of $200,000 or more.

SMSF Establishment numbers by fund balance - 2015-2017							
	$0 - $200K	**$200K - $500K**	**$500K - $1M**	**$1M - $1.5M**	**$1.5M - $3M**	**Over $3M**	**Total**
2015	780	741	394	110	115	38	2178
2016	800	930	551	169	136	58	2644
2017	457	531	355	116	81	23	1563



The SMSFA believes that these figures illustrate that the majority of SMSFs are being setup with an appropriate balance, particularly when based off evidence the SMSFA has supplied to the Commission in this paper. However, it must be noted that these statistics are hard to rely on when SMSFs may be established with low balances later in the financial year, with further contributions and roll-ins to be received in the next financial year.

As discussed in the section on SMSF advice below, the SMSFA believes the key to ensuring that SMSFs are established appropriately is high quality and professional financial advice which incorporates size and scale considerations into the decision to establish an SMSF. The provision of quality financial advice can ensure that members are only placed into SMSFs when they are in their best interests and appropriate for their

circumstances. The Government’s legislated changes to increase the education standards of financial advisers and the SMSFA’s support that specific SMSF education should be required is crucial to achieving this.

RECOMMENDATION 4

We recommend that the Commission considers the impact on choice in superannuation that establishing a minimum balance requirement for SMSFs will have as well as the weakness inherent in such a policy.

SMSF ADVICE

CURRENT ISSUES WITH SMSF ADVICE

The SMSFA acknowledges the questions regarding the quality of advice provided to members of SMSFs. Recently the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry, ASICs Report 575 SMSFs: *Improving the quality of advice and member experiences* and the Productivity Commission's Draft Report *Superannuation: Assessing Efficiency and Competitiveness* have highlighted certain significant areas of concern. We believe the SMSF industry and advisers should not treat this scrutiny of the sector as an opportunity to raise professional standards and strengthen advice practices to improve member outcomes.

Inappropriate advice provided by 'property one-stop shops' is an area of fundamental concern to the SMSFA. This advice model typically occurs when a company sources a property, provides financing services and completes a client's SMSF accounting and audit. These businesses have inherent conflicts of interest, lack of specialised advice and take advantage of customers with limited knowledge of SMSFs. It is therefore important that where SMSFs are advised to invest in property, it is considered in a broad retirement strategy.

ASIC's Report found that advice given in 10% of reviewed files was likely to result in clients being significantly worse off in retirement. But the high number of files ASIC classified as "non-compliant" did not indicate a risk of financial detriment but attracted scrutiny for not meeting record keeping and process requirements. The Association believes it is imperative that the industry be able to rectify these problems regarding advice standards, particularly relating to inappropriate lower balances and unjustified investment advice.

Nevertheless, the Association believes the large majority of SMSF advisers, especially those who have invested in specialist education, act in the best interests of their clients by providing justified, trusted and valuable advice.

WHY SMSF ADVICE IS IMPORTANT TO MEMBERS

The quality of financial advice provided to SMSF members is crucial to the integrity and performance of the sector. Given that the most significant complex changes to superannuation for a decade took effect on 1 July 2017, there has never been more importance placed on high quality specialised advice.

SMSFs are complex structures that are not for everyone and so SMSF members and potential SMSF members look to seek advice to understand the myriad legislative and regulatory conditions to determine if they are appropriate for their circumstances. Notably 63% of SMSFs were established on the suggestion of an advisor and 81% of SMSFs utilise some form of adviser, highlighting that the quality of advice can materially affect the retirement savings of the majority of SMSF members (SMSFA and Commbank 2017). Furthermore, as the Commission reported, evidence suggests that clients who form favourable views of advisers tend to maintain those views even when the quality of the advice does not justify their decision.

Recent research commissioned by the SMSFA (Commbank 2017 and Russell 2014) also emphasised the numerous and diverse areas members on which SMSFs seek advice. Compliance is the area members require

the most help with, closely followed by tax. If members and trustees do not understand their obligations and the time required to manage an SMSF, this can not only result in severe penalties and sanctions, but a lack of effective engagement and management causes significant financial detriment.

As stated earlier in our submission, tailored taxation and retirement planning can also provide substantial beneficial outcomes to members. This includes control over pension strategies, timing of asset sales, retirement and financial goals and exit strategies, the benefits of which are hard to measure by a simple return calculation.

When focusing on the areas which trustees value the most, it is investment advice which is most valued. The SMSFA believes that investment advice, which refers to investment strategy and asset allocation, rather than product or fund selection, is extremely important to the outcomes of members in SMSFs. Advisers have a key role to play in offering strategic holistic investment advice across a member's SMSF and individual assets to provide diversified portfolios, the benefits of which are well known. It is no surprise that advised client portfolios are much more diversified across asset classes than those of unadvised trustees (Russell 2014).

It is therefore clear that SMSF advice is necessary, and when provided, is relied upon heavily by members. This means the quality of the advice is extremely important to the SMSF sector. Despite only a small minority of members stating that the cost of advice was an important factor (Commbank 2017), the SMSFA believes it is still crucial that advisers exhibit transparency in the costs of advice provided. This includes clear disclosure regarding all fees, potential returns, obligations and compliance.

HOW TO IMPROVE SMSF ADVICE

SMSF EDUCATION REQUIREMENT FOR FINANCIAL ADVISERS

The SMSFA believes that advisers who provide advice to individuals about SMSFs should have specific SMSF education and qualifications that underpin their advice. SMSFs are now a major part of the advice framework making up almost one-third of all superannuation fund assets. As stated, they are complex vehicles that need to be accompanied by high quality and specialised advice, especially given they are only appropriate for certain types of individuals. This notion was also reflected in ASIC's Report 575 in regards to raising education and a specific SMSF qualification for advice providers wishing to provide SMSF advice.

Significantly, the Financial Adviser Standards and Ethics Authority (FASEA) is the new education standards-setting body which is currently determining the education and training requirements which will be required for advisers to give advice under a 'new' financial advice profession. We believe it would be unfortunate for new advisers to be able to reach a required FASEA threshold to give financial advice and then be able to give specific SMSF advice without specific SMSF knowledge being part of the required learning outcomes. This is especially pertinent when SMSF trustees, due to the self-directed nature and complexity of SMSFs, are susceptible to poor financial advice with potentially significant detrimental outcomes to individuals.

Therefore, given this inflection point and the creation of new professional standards, FASEA and the industry have the opportunity to help protect and grow the retirement savings of Australians through an appropriate and targeted increase in SMSF education and advice standards. If FASEA decides that learning outcomes only cover SMSFs on a high level as part of any superannuation and retirement learning outcomes, the Association will continue to advocate that SMSF advice should only be able to given if further specialist learning/training is undertaken by an adviser. Highlighted by the table below which compares the learning outcomes relating to superannuation in a graduate diploma of financial planning to a graduate certificate in SMSFs, advisers going forward must adequately understand SMSFs if they wish to advise on them. A broad high-level education approach does not give an adviser enough insight to reach this threshold. For example, complex SMSF limited recourse borrowing arrangements, business real properties and related party transaction issues are not discussed in any material detail in the current education standards for advisers. The opportunity to reform the industry, in a key area that requires higher standards for advisers could be missed under FASEA's proposed approach.

The following is a comparison in learning outcomes between a broader financial planning post-graduate qualification and an SMSF focussed qualification:

Graduate Diploma of Financial Planning	**Graduate Certificate in Self-Managed Super Funds**
• Analyse superannuation structures and strategies for various client situations. • Explain the taxation implications of superannuation strategies for contribution, withdrawal and insurance at the fund level. • Analyse superannuation retirement income stream strategies according to their benefits, tax implications and social security treatment as they relate to different client situations. • Formulate strategies to maximise superannuation benefits and clients' entitlements to social security benefits and aged care. • Discuss the advantages and disadvantages of equity release schemes as a source of retirement income. • Design superannuation strategies in respect of divorce, bankruptcy and death benefits. • Develop a compliant statement of advice (SOA).	• Evaluate the suitability of an SMSF based on the individual circumstances presented • Assess and apply best practice methodology to the operation of an SMSF • Integrate regulatory and legislative requirements into SMSF advice functions • Explain how the different SMSF-related occupations can contribute to the optimal operation of an SMSF. • Evaluate the application of behavioural finance to the interaction and engagement with SMSF trustees. • Explain factors resulting in measurable, systemic biases in investment decisions including difference between collective and individual decision making processes. • Analyse impact of behaviour biases on SMSF fund investment strategies • Develop a methodology for mentoring and guiding SMSF Trustees. • Distinguish SMSF strategic financial advice from comprehensive SMSF financial advice. • Identify a range of contemporary SMSF strategies and describe their strategic purpose. • Model a range of strategies to achieve fund/trustee objectives • Explain to trustees the identified strategy, the associated benefits, risks and restrictions and how it supports the SMSF strategic objective.

	• Outline the requirements for SMSF Auditor Registration • Illustrate the application of the Auditing Standards and the SIS compliance issues that may arise in auditing an SMSF. • Complete an SMSF audit that is compliant with both Australian Auditing Standards and SIS Regulations • Create the required Australian Taxation Office reports and Fund reports • Explain the legal regulations that apply to SMSFs. • Identify and describe the special taxation rules applicable to superannuation contributions, superannuation funds and superannuation benefits • Apply their SMSF strategy knowledge and skills and the treatment of regulation and tax to a series of complex SMSF case studies. • Identify a compliant trust deed, including all compulsory statutory provisions and those provisions that cannot or should not be included. • Explain the common triggers for SMSF Trust Deed review and amendment • Compare and contrast a range of public ally available SMSF trust deeds to determine suitability for use. • Create a SMSF Trust Deed using best practice principles.

Not only does raising the education standards of SMSF advisers increase their knowledge relating to specific and complex legislation, it also provides a barrier of entry for advisers who wish to give SMSF advice. For example, there will be many situations where financial advisers who are licensed to give advice may have not have many SMSFs in their portfolio of clients. These individuals may not have the required level of expertise and experience to deal with complex SMSF issues when they arise infrequently in their working life, yet they are not forced to seek expert advice and legislation deems them appropriate to give a full range of SMSF advice. A licence requirement to provide SMSF advice in this situation will then either force the adviser to complete requirements to advise on their SMSFs or force SMSF members to seek licensed advisers whom deal with SMSFs and the specialist issues involved on a regular basis.

Understandably, the SMSFA notes education cannot entirely prevent poor and misleading advice but it will provide a safeguard to those members who are inadvertently giving poor advice. Furthermore, a requirement to seek specialist SMSF advice would restrict the current practice we see in ‘one-stop property shops’ which the ASIC Report notes as a detrimental path to LRBAs.

PROPERTY ONE-STOP SHOPS AND LIMITED RECOURSE BORROWING ARRANGEMENTS

As stated, the SMSFA believes greater regulatory scrutiny is required on property one-stop shops who spruik inappropriate properties to susceptible individuals and fully supports ASIC's efforts to stamp out any unlicensed and unethical marketing behaviour. One measure the SMSFA believes will be effective, as previously discussed in our submission, is to limit property spruikers ability to establish SMSFs and sell properties by raising the specific SMSF education levels for licensed SMSF advisers.

Additionally, the strategy promoted by one-stop property shops to establish an SMSF and purchase a property through gearing, often off the plan properties located in a different state, is the most commonly used strategy and is most likely to cause financial detriment. It therefore may be worth exploring safeguards relating to the provision of limited recourse borrowing arrangements (LRBAs).

It must be noted that the SMSFA believes that gearing is an appropriate strategy for individuals to build their retirement savings and therefore should remain a legitimate investment option. As also highlighted by the Commission, we do not believe that use of LRBAs is occurring in an excessively risky manner– notwithstanding the potential risks in the one-stop property shop sector if that continues unchecked – and understand that SMSFs are required to consider diversification under the SIS Act.

We not do deny that LRBAs have become a more widely used financial instrument. Evidence from SMSF administrator Class shows that most of this debt is held in the accumulation phase, with SMSFs being 10 times more likely to have a geared investment in accumulation phase than in pension phase. We believe the sector is capable of using LRBAs responsibly to build their retirement savings.

Furthermore, recent tightening of lending standards by banks has made the provision of loans to SMSF increasingly difficult. Banks will now only lend on established properties, and SMSFS are now required to have substantial minimum balances, loan-to-value (LVR) ratios of no more than 70%, and strong evidence of loan serviceability.

Tightening licencing requirements around LRBA advice and increased scrutiny of this type of advice could assist in ensuring the integrity of LRBAs. Introducing an SMSF education requirement, as discussed above, would limit advisers who are licenced but have poor knowledge of SMSFs and LRBAs from advising on the product. It would also discourage property spruikers from entering the SMSF advice market as the education barrier to entry would be too high. Furthermore, we support and encourage further ASIC monitoring and enforcement of this type of advice.

Limiting the use of personal guarantees by SMSF members is another possible policy measure that could minimise possible systemic risk arising from leverage used by SMSFs. Personal guarantees given by SMSF trustees allow the SMSF to undertake larger borrowings with higher LVR ratios. While the SMSFA is comfortable that the vast majority of SMSF borrowing is being made within sensible LVR limits, prohibiting SMSF members from providing a personal guarantee for their SMSF's borrowings would make it more difficult for lenders to

make risky, high LVR borrowings to SMSFs. This would also limit the ability of property spruikers to use SMSF LRBAs as an investment vehicle for promoting speculative property investments and, in particular, would reduce the ability for property spruikers to encourage individuals to establish an SMSF with a small balance simply to purchase a property.

The SMSFA also expects to receive more granular detail about the prevalence of personal guarantees for LRBAs in the ATO's 2017 SMSF Annual Tax Return.

STATEMENT OF ADVICE TRANSPARENCY

Statement of advice (SOA) documents, which are legislated to be provided to individuals when receiving SMSF advice are a crucial aspect of the advice framework. SOAs, along with client interaction and meetings, are intended to help recipients assess the advice they receive and decide whether to act on it.

ASIC's Report 576 *Member experiences with self-managed superannuation funds* highlighted that members appeared confused about SOAs and revealed limited engagement and recollection with the contents of the document. Interviews from reviews conducted by ASIC to individuals recounted that they were 'token statements', were 'flicked through', and contained 'lots of numbers'.

Despite legislation stating an SOA must be worded and presented in a 'clear, concise and effective' manner, it is noticeable that SOAs are too long, too complicated and not effective. This problem partly lies with the mountainous amount of compliance that financial advisers must include in the document which does not materially affect the provision of advice but protects their liability. If advisers see the document as a compliance obligation and clients only glance and do not understand it, the SOA has failed in its ability to improve advice.

The SMSFA would support an educational and legislated push which increases the transparency and material effect of a SOA that is given to clients. Given the importance of advice, a transparent and understandable document will further improve the quality of advice and the decisions made by individuals seeking that advice.

We believe that a SOA document, particularly related to SMSF establishment advice, should clearly articulate all potential fees of the SMSF, expected returns of an SMSF based on the expected investment strategy, and the scale of growth for the SMSF. These clear indicators should be used to provide a one page benefit statement regarding the SMSF and its impact on an individual's retirement savings. This clear notion should then be utilised to demonstrate a comparison between an individual's existing superannuation fund and a potential SMSF, when SMSF advice is provided relating to establishment.

The Association believes reform in this area can use experience from the introduction of the MySuper dashboard legislation, which aimed to clearly articulate return targets, risks, fees and costs, to amend SOAs. A standardised SMSF dashboard or establishment advice template could be designed to incorporate the factors highlighted previously and achieve to materially increase the provision of financial SMSF advice.

RECOMMENDATION 5

We recommend that the Commission makes a final recommendation that any financial advisers that want to advise SMSF members should have undertaken specialist SMSF advice education or accreditation in order to lift the quality of SMSF advice.