21 September 2017

Supplementary submission to the Productivity Commission's Review of Efficiency and Competition in Superannuation – Stage 3

Submissions to the Productivity Commission's review of efficiency and competition in superannuation reflect the opinions and biases of their authors. Their views are part of the public policy debate and there is nothing wrong with expressing self-interest.

However, the claims made by the Australian Institute of Superannuation Trustees in their submission to the Productivity Commission are so prejudiced against self-managed superannuation funds they cannot go unchallenged.

SISFA comments on AIST submission to Productivity Commission

AIST submission: "It is at least arguable that the collective investment profile of SMSFs represents an inefficient misallocation of capital at the national level. In particular, the heavy weighting to cash and term deposits deprives SMSF members of potential returns…"

Generally, SMSF trustees take a more conservative approach to managing their own money than professional fund managers do in managing their clients' money.

SMSFs generally hold a larger proportion of their assets in cash and term deposits than APRA-regulated funds. SMSFs also have a higher weighting towards Australian shares. In contrast, APRA funds hold less in cash and invest more in overseas shares and other financial instruments, with associated currency and other risks.

The $622 billion held in SMSFs is invested productively and predominantly in the Australian economy.

The relatively conservative approach of SMSF trustees stood them in good stead during the GFC when they lost less value than the APRA funds. As the global and Australian economies have improved since then, APRA funds have performed better than SMSFs but the performance trend over five years is similar.

	2011	2012	2013	2014	2015
SMSFs	7.7%	0.3%	10.2%	9.7%	6.2%
APRA funds	8.1%	0.4%	14.0%	11.7%	8.9%

Average return on assets (ROA) - ATO SMSF Statistics – Annual Report 2014-15

It's important to note that the investment performance of SMSFs reported by the ATO is the average return on assets for half a million self-managed funds. This masks a spectrum of performance. In contrast to the large APRA funds where investments and returns are pooled, each self-managed fund has its own investment strategy and asset allocation depending on the risk appetite of the trustees and the changing circumstances of its members as they move through the work and retirement cycle. Trustees and members may well be prepared to accept a lower return for lower risk and greater certainty that their superannuation will deliver a retirement income sufficient for their needs, which they are best placed to judge. The responsibility placed on SMSF trustees is to act in the best interest of their members (generally one and the same) and not to achieve some economic efficiency target set by others.

AIST assumes that a lower investment return is economically inefficient. This may be so if efficiency is measured solely by return on assets. But there are other economic elements. For example, retirement savings held by SMSFs in cash – some $157 billion at end 2016 – support the capitalisation and stability of banks and provide funds for bank lending to business and families.

Savings invested in Australian companies support the local share market where they are not exposed to currency risk.

A lower than average return on superannuation savings is not necessarily an overall loss to the economy if other sectors of the economy benefit from it.

Are SMSFs really inflaming the property market?

AIST submission: "…the weighting of $97.9 billion to direct property (when combined with the government's policy of permitting borrowings by SMSFs through limited recourse vehicles) has helped inflame the property market and reduced housing affordability for younger Australians."

The property market can be influenced by many factors; the condition of the economy, employment levels, real wages, population growth, immigration, foreign buyer demand, supply of land and housing stock, demographic changes, availability of finance and, not least, interest rates.

A Reserve Bank research paper 'Long-run Trends in House Price Growth' identifies monetary policy and population growth fuelled by immigration as the significant drivers of housing prices. It does not mention SMSFs. Source: Reserve Bank of Australia Quarterly Bulletin – September 2015.

CoreLogic estimated the total value of the Australian residential property market at end 2016 at $6.7 trillion. The ATO Statistics for the December quarter 2016 estimated residential property assets held by SMSFs were $26.66 billion. So SMSF residential investments amounted to 0.39% of the total value of residential property.

AIST's claim that SMSF investment is inflaming the property market is a wild exaggeration.

Tax minimisation

AIST submission: "…the SMSF holding of $61.7 billion in unlisted trusts represents a clear risk to Government revenue, given the opportunity to channel trust earnings through to a super fund with a nominal tax rate of either 15% or 0%, depending on whether the member is in the accumulation or pension phase."

There are strict rules, backed by law, governing contributions to superannuation funds and the taxation of earnings derived from fund assets. Trust earnings derived on a non-arm's length basis are in fact subject to tax at the top marginal tax rate (currently 47%) resulting in no loss to the revenue. SMSF financial accounts are subject to audit and the ATO has effective powers to investigate and impose serious penalties for any breaches of the rules.

The ATO's SMSF statistics indicate that only 2% of self-managed fund financial accounts are qualified by their auditor and half of these are rectified before the accounts are lodged. This does not suggest an endemic risk to the revenue from SMSFs.

Mental capacity of SMSF trustees

AIST submission: "AIST notes economic research indicating that individual capacity to navigate complex financial decision-making declines with age. 17.7% of SMSF members were aged over 70 at 30 June 2016.The great majority of SMSFs are structured as having individual rather than corporate trustees. To the extent that the capacity of SMSF trustees declines with age, it would be expected that either the SMSF must be liquidated and assets rolled in to an APRA regulated fund, or the economic performance of the SMSFs will decline with a consequent loss of efficiency for the sector, and further losses to the economy overall.

Of course, the capacity to navigate anything declines with age. However most people over the age of 70 remain quite competent to make financial decisions or do any number of things that require perception, thought and judgement. If people lose mental acuity as they age, they are usually assisted by their families and by professional advisers to make appropriate decisions about the management of their financial affairs and other aspects of their lives. In addition the superannuation laws provide a safeguard in the form of a 'director enduring power of attorney' for a legal personal representative to act where the member/director is under a legal disability.

It would be quite arbitrary and somewhat discriminatory to decree that people over 70, or even older, are unable to make sensible decisions about their finances and so their SMSF accounts should be "liquidated and assets rolled in to an APRA regulated fund" as AIST suggests.

Excessive choice

AIST submission: "Large numbers of investment choices correlates strongly with substandard fund-level investment performance."

It seems AIST's comments are directed towards for-profit retail funds, a source of competition for the industry funds AIST represents.

The range of choice of product offered by both retail and industry funds is a commercial decision for each fund. In time, the market will sort out the optimal range of investment products.

It seems AIST resents competition whether it comes from retail funds or from self-managed funds.

When product providers lose a large share of the market to competitors (30% of the superannuation market is held by self-managed funds) they generally need to look at their own product offering. Perhaps, instead of criticising SMSFs, AIST would do better to look at the reasons why, given the choice, people prefer other options when it comes to managing their retirement savings. Or does AIST believe all compulsory and voluntary superannuation contributions should be a monopoly market to their benefit?

Contact:

Duncan Fairweather
Director
Self-managed Independent Superannuation Funds Association (SISFA)