The Smarter SMSF Podcast – Transcript

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Speaker 1: Welcome to The Smarter SMSF Podcast, the show where we discuss the latest insights, ideas and strategies with self-managed super funds. All designed to help make smarter decisions and equip you to be at the top of your game. Now, here's your host, Aaron Dunn.

Aaron Dunn: Welcome everybody to this week's edition of The Smarter SMSF Podcast. My name is Aaron Dunn and today we're going to be looking at the release of the June 2018 SMSF Benchmark Report, issued recently by Class Limited. The report, this quarter, is looking at the 'great pension squeeze'. Importantly what we see is, out of this Class Benchmark Report, the ability to get some really valuable insights into things like how SMSFs invest and what the implications are APRAss various reform measures on more than 160,000 funds that are currently administrated through the Class software. And today I'm again joined by Kevin Bungard, CEO of Class Limited, who will be discussing with me, the latest report on the great pension squeeze. So thank you Kevin for joining me today in this week's podcast.

Kevin Bungard: Thank you Aaron, always a pleasure.

Aaron Dunn: Okay, let's get to the very heart of this quarterly report. We all knew that the Super reforms were going to have an impact on the level of taxation within SMSFs. But just how profound, we are now only starting to see being highlighted. So to you, I'm interested in seeing and understanding what the insights found in this quarterly report around the taxation of assets, in particular, TRIS is probably one of the most obvious ones?

Kevin Bungard: Yeah, I think you're right. We were talking about the scale of the changes with the Super reform and those are biggest in 10 years, but I think in the midst of dealing with all those changes and working out who had to talk to the trustees, explain what was happening and so forth. I don't really think ... Certainly I didn't have enough time to reflect on the scale on the amount of dollars involved. And so when we looked into what the washout was from the Super reforms, we were pretty surprised at the scale of the numbers. I guess you think about the scale of the numbers in self-managed Super Funds, it makes sense, but a billion dollars really due to the Super reform changes in tax extra, just in this year in the 2018 year, it's pretty significant. And you mentioned the taxable assets, there's an increase of $200 billion in taxable assets in self-managed Super funds. So pretty significant number.

Aaron Dunn: The revenue has come through the change of TRIS accounts, they also come back through the recalibration of the $1.6 million transfer balance cap.

Kevin Bungard: Yeah. In the report we break down basically what the taxable baseline was and then what the tax that we would calculate from that first FY17. And then we looked at that in terms of with the changes, with the move of that $200 billion into taxable. And the gross increase, is $1.5 billion is tax,

and that's just assuming, because obviously we don't know what the return is APRAss the industry. So this is a conservative assumption of five percent, what would that mean? So it could be more. That half a billion of that is due to organic growth in self-managed Super Funds. There's more money flowing in obviously means more taxable money anyway. Some of that might have gone into pension in earlier years, so I think some of that is automatically being captured due to the Super reforms, because it can't go into pension phase. But then that $200 million is due to the change in the status of the transition to retirement income stream.

Kevin Bungard: And then there's another $800 million that is due to money that was in pension phase that has been moved back into accumulation phase because of the $1.6 million cap.

Aaron Dunn: Yeah, and it's interesting that we have seen in most or in a lot of instances, the majority with the practitioners that I've spoken to and you'd probably be the same, that those that are over $1.6m, in many instances we've seen the roll back to the accumulation rather that large sums of money actually exit the system. Would that be a fair assessment?

Kevin Bungard: Yeah that is a fair assessment. When we look at the asset base and where the money had grown, the bulk of the organic growth, and it was about, of the top of my head, about $64 million in growth in total. Most of that was accumulation. There was a small growth in pension assets, but obviously pension assets have a downward pressure because it withdraws anyway.

Kevin Bungard: Normally you would expect new pensions to be started and some more growth in there, so it's possible that some money was taken out of the system as well. We didn't do an analysis of that, but it's very clear that the majority of that money had just been moved back into the accumulation phase. I guess in a lot of cases, even if you move back into accumulation it's being taxed at 15%, that's going to be better than taking it out, investing it outside Super and potentially paying some marginal tax rate.

Aaron Dunn: Yeah absolutely. We've spoken in the past about new strategies, ideas with whether it's been rebalancing benefits between spouses, because we have the $1.6 million cap, APRAss both spouses. We've spoken previously about the way in which benefits might be taken out of the fund. Again, you've looked in this report this quarter and noticed the impact of some of these new strategies and unexpected benefits as a result of the changes from last year. So can I get you to highlight some of those? In particular the gender imbalance and what you found in respect to that particular topic?

Kevin Bungard: Yeah, it was again, unintended consequence, but for the first time we saw that gender imbalance. We saw the female balance up over 80% of that, that's in the male balances. And in particular, there's been a slight increase in it, so it has been evening up slowly. But there was a just

around the March, June period, and what we think that was related to, was quite a number of people looking at contribution splitting. So I'm sure most of the contribution splitting occur generally at the end of the financial year, when the adjustments are made. The contributions that came in during the year was split, 85% of those have been allocated APRAss to the spouse. And the other thing that we think was occurring, was people doing re-contributions. So somebody had a $1.9 million member balance, to get under the one point six, they might have taking out 300,000. They could have been giving that to their spouse to contribute using the bring forward as non-concessional contribution into their account.

Kevin Bungard: So if they had a lower account. And even those potentially have both accounts under the $1.6m. We think there was a fair bit of that evening up as well. And that strategy of evening up the balances obviously works whether you're at the $1.6m or not, so even if you are currently at a lower balance, it's obviously good policy or good strategy to look to even those up. Because at some point there might be other policies that will impact you. I thinks it's as low as 500,000 before some of the total super balance based triggers start to click in. So I think it makes sense that in general, you want to try and even those up. So yeah, I don't think we expected to see that impact for gender balance, but it's good to see it. I don't know if it was the government policy, but it's good to see it having that effect.

Aaron Dunn: Yeah, and I think conceptually we're going to see that continue. The more we have engaged self-managed super members and the fact that they start to further understand the implications of having disproportion in member balances, there'll be continued focus on getting that calibration right as much as possible. So for advisors and accountants, it's about really managing that risk for your client and really looking at not only what the law is saying now, but also then of course managing legislative risk well into the future. And I already go back ... When the changes went back in 2007, managing legislative risk is always something that you need to come APRAss, which leads in really nicely into the next question I wanted to ask you Kevin. And this is actually around future policy, because we do of course have a whole range of policies, hanging over our heads at the moment. Raising a lot of discussion and debate within Superannuation, in particular self-managed Super. And I'm thinking here, specifically at Labor's proposed policy to ban franking credit refunds.

Aaron Dunn: If elected in the government, we of course have a ... I think it was called The Pensioner Guarantee, if I can recall what that correct terminology was, but these risks are inherent and we need to factor in as we look to go forward and manage that legislative risk. We have of course seen the coalition provide a response in some ways to Labor's policy by actually looking to increase the number of members in an SMSF from four to six. But you make a comment in this report that talks about the fact that our pension based SMSFs shouldn't be hit again. Why do you see that as so important? I guess we're also trying to understand here, that maybe what Labor's thinking has been in the tax grab that they were looking to achieve, has actually started to fall through now. And therefore, what

they're expecting to get is nowhere near what they may have initially projected.

Kevin Bungard: I think there's a couple of good points in there Aaron. I think first of all, why did we make that comment? The thing about the Super reforms, and when they came out and everybody was figuring out what they all meant and what the scale of them were. We knew obviously it was going to make a big difference to the taxation in the self-managed Super Funds, but I don't recall talking to anybody who said, "This is unfair." In fact, I remember speaking to some [inaudible 00:11:54] that had quite large funds who went, "Yeah, we knew it was coming, we knew that that kind of generosity that Peter Costello handed out in 2007 wasn't going to last forever."

Kevin Bungard: And the thing about the changes were, they affected APRA funds and SMSFs equally. But the policy was even handed, it was promoted as being about fairness and sustainability. And I think people generally accepted that for how it was presented. I think the challenge with the Labor party policy is the lack of fairness. The fact that it essentially penalises people who have chosen to manage their own Superannuation and self-managed Super Funds. It disproportionally compared to the equal ... Basically had no impact on big banks and their Super funds. So you're talking about a policy where it is potentially going to mean that if people are getting good advice, and this policy comes in, if Labor's gets in and implements this policy, you're going to see people taking their share portfolio out of their SMSF and moving it into an AMP Super, where they will get the franking credits because of the difference in the structures and the fact that they will always get their franking credits because of the inflows they get into the large funds.

Kevin Bungard: So, why Labor would have policy that favours the big banks, either the people who are working in saving for their own retirement, managing their own retirement money, I find hard to understand.

Aaron Dunn: Yeah, I'd agree entirely with that and if we ... You only have to think about the fact that the refunds that come in are adding to ... It might be adding one, maybe even two percent to a portfolio return, which of course is leaving many of those people out of the social security system, for them to have to rely on some supplement through age pension. So they'll be taking out of one hand and giving it back in the other. I'm totally supportive of you around what you said there and again, the coalition's response personally, was nothing but a blanket decision to enable children to be coming into some of those larger funds to start to washout the tax. Going way back to the Cooper review back in 2009/10, when it was finalised, those discussions around a number of members in a fund. There was no real rational to do so (increase membership), there hasn't really been any policy setting or discussion that warranted an increase to that number. And then surely enough, after the discussion happens around Labor's proposed policy, we see this immediate response to look to increase it to six, funnily enough.

Aaron Dunn: So it all smacks of being not policy on the run I guess, but certainly in respect to the franking credits issue itself, from my point of view, like you said, it seems to be very prejudicial to a specific sector of the industry, rather than when we see change, like we have with the transfer balance cap. Or even what Labor's proposed rules were going to be around the $75,000 earnings threshold to apply tax and those sorts of things. By and large, when it has a fair and reasonable impact APRAss the sector, we might not necessarily like it, but we work within the realms of what that legislation therefore enforces us to do.

Kevin Bungard: Correct, yeah. Couldn't agree more.

Aaron Dunn: So the other thing, whilst we're on policy, and the fact that we're seeing a lot of discussion and debate at the moment happening around the Productivity Commission and the work that they're doing in the efficiency and competitiveness of the Super system. We have seen in some of the draft findings, the Productivity Commission raising some very interesting numbers when it comes to size and suitability of SMSFs. And quite clearly we've seen parts of the Superannuation sector really take this $1 million dollar number to the market, and really amplify that out there. And again, it's this mud slinging that's going on. I was really pleased in the response that you provided to the Productivity Commission, because it was really pointed and told the important story that needs to be told. Because now more than ever, we have data that is available that talks about what is happening in funds, each and every day.

Aaron Dunn: We have of course had historical information, and that's really from the ATO, what the Productivity Commission has relied upon, and trying to compare apples with oranges, rather than apples with apples. And your response went to the very heart of trying to get apple and apple comparisons. So can I get you to shed some insights into what your response was about and why you see it as so important in the ongoing debate with self-managed Super Funds?

Kevin Bungard: The reason we responded, when we looked at the draft report and we saw some of the findings in there, and also some of the material that they had used to effectively make those decisions. It was very clear that if we didn't counter some of these, if we didn't actually [inaudible 00:17:37] shed some light on [inaudible 00:17:39] with more accurate data, that some of the data than on face value looked quite ridiculous. To have data that says over 10 years, a $50,000 fund has been losing 17% of its assets every year. It just seemed crazy. And I know in the past when we've seen this kind of numbers, people were just going, "Well that's crazy. Somebody has done something wrong. We'll ignore that and we'll move on." And obviously in this case, given the potential for the recommendations that may come out of the final report, we thought, "Well, we have to get into this. We have to figure out what's going on here." Rather than just go, "Well that's silly." We also should thank that the ATO ... We approached them to actually say how some of these numbers were produced, and the actually did help us in answering our

questions, so that we could actually do some of the analysis that we did.

Kevin Bungard: So I think, let's be clear here and I think the ATO is working with data they have, they're somewhat constrained in that they're working of the tax return data only. That they still don't have the visibility of data that we have.

Aaron Dunn: Okay.

Kevin Bungard: And so, we were able to take the information they had, we were able to use some of the information that the Productivity Commission used about how the APRA funds were reporting and also looking at the APRA fund guidelines. And effectively, broadly there are two different reporting mechanisms that the ATO and [inaudible 00:19:12] used. Distinctly in the Productivity Commission in their report basically said you shouldn't compare apples with oranges and then they went ahead and did so. And as you said, unfortunately there were plenty of people willing to just pile in, and just take those comparisons and ignore the caveats that the Productivity Commission had added. So from our point of view, we looked into that, we worked out that the basic differences were, if you look at the two different formulas, there's some fundamental differences in the maps.

Kevin Bungard: But then the big difference is inclusion of contribution tax and inclusion of insurance premiums, and most people would know, insurance premiums, particularly given the average age of a self-managed Super Fund trustee are a significant expense. But they're obviously not an investment expense of the fund and there's a good reason that [inaudible 00:20:08] excludes those. And likely his contribution tax is not a tax on earnings, it's nothing to do with the returns of the fund. It's effectively income tax that's being collected on the way in, rather than it being anything to do with the performance of the fund.

Aaron Dunn: Correct.

Kevin Bungard: So that was actually worked to. It took quite a bit of work, the team here put in some long hours to dig through the analysis. There was an interview with the Productivity Commission, with Karen Chester from the Productivity Commission and talked about the nearly killing three staff to do the analysis based on the quality of the data that they had available to them. It really is quite hard work sifting through the data, so certainly commend Adam and the rest of the team here, in the work that they did.

Aaron Dunn: It's [crosstalk 00:21:00] worth taking unfortunately, so I think the work that you've done has been fantastic and much needed at a policy level for the industry, we don't have necessarily the luxury of people sitting in Canberra and doing the lobbying and trying to shape and influence as a sector, we have such a fragmented sector. But the work that gets done through these reports and being able to collaborate with the member bodies and so forth, to really drill down and make sure that we are comparing apples with apples. And there fore recommendations that do

go to government, actually are totally informed of where the settings actually are, inside our industry are absolutely paramount. So to you and the rest of the team, you should certainly be commended for punching out those hard hours.

Kevin Bungard: Thank you.

Aaron Dunn: All right, so where can people find out a little bit more in respect to the June 2018 Benchmark Report?

Kevin Bungard: So the Benchmark reports, they can go to our website, so if they go to class.com.au, and right there on the front page, there's a link to download the latest SMSF Benchmark Report. So they can grab that from there.

Kevin Bungard: And if they're interested in reading the Productivity Commission report ...

Aaron Dunn: Yes?

Kevin Bungard: Probably the easiest place to find that is actually on the Productivity Commission's site (www.pc.gov.au),so it's a little bit hard to dig through to the submissions page, but they're publicly available then you can read our submission and other submissions, if that's [inaudible 00:22:39] to you.

Aaron Dunn: Yep, and of course we have in September, the Class Connect Conference coming up, and I'm looking forward to being a part of that again this year. So where can people find out a little bit more about the agenda and what's going on at this year's conference?

Kevin Bungard: Yeah absolutely, you can go to the class.com.au again. If you look on the menu there you'll see Class Event, and on there you can see Class Connect 2018, 16 to 18 September.

Aaron Dunn: Excellent. All right, thank you once again Kevin. It's been great to chat. I always really enjoy these. I enjoy the read of the Benchmark Report, it gives me plenty ideas and questions, so I always like the opportunity to come back and grill you about them as well. So, thank you once again for your time today, and very much look forward to having a chat to you again for the September Benchmark Report.

Kevin Bungard: It's a pleasure, thank you for your time.

Aaron Dunn: All right, thank you everyone for joining me in this week's SMSF podcast. I look forward to you joining in next week. Take care, have a great rest of the day, and bye for now.

Speaker 1: Thanks for joining us today on The Smarter SMSF Podcast. That was a smart move. If you wanna find out more about today's topic, you can add a comment either at our website, smartersmsf.com, via our Facebook page or using our Twitter handle @smartersmsf.