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THE SELF MANAGED SUPER SPECIALISTS

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SUBMISSION – CP 216

Background – Lime Super

Lime Super specialises in SMSF's. We provide financial advice and administration services. As such, we are speaking to trustees of SMSF's every day, and in particular to people deciding whether to commence SMSF's. Therefore we have a good understanding of their decision making process.

Our Director, Greg Einfeld, is an actuary with over 20 years' experience in the Australian superannuation and financial services industry.

Executive Summary

Response to C1Q1 - In summary, I believe you have overestimated the balances at which SMSF's become financially viable. More reasonable estimates would be:

- $150,000 - $260,000 – Can provide equivalent value with APRA-regulated funds provided the trustees undertake some of the administration.
- $260,000 or more - Can provide equivalent value to APRA-regulated funds on a full service basis.

Rationale for these ranges is provided below.

Response to section B1 – The proposals have some merit. However you are missing the most important point here. People should not be allowed to establish SMSF's without obtaining financial advice.

Drivers for commencing SMSF's

Clause 2 of the paper refers to 2 drivers for establishing SMSF's, being fees and control over investments. In my experience, these are important drivers. However your report has overlooked 2 other important drivers:

<u>Investment earnings on fixed income</u>

On average, super funds invest around 30% of their balances in fixed income assets.

For public offer funds this is typically invested into government bonds and bank bills. Depending on the duration of the asset the expected gross return is likely to be around 2.5-4.0% p.a. based on current market interest rates.

SMSF's are able to invest into term deposits. The expected return is around 3.5-5.0% p.a. based on current market interest rates. For example, ANZ, Macquarie and ING are currently paying 3.7% p.a. on a 3 month term deposit, while Bank of Queensland and Rabobank are paying nearly 5% for 5 year term deposits.

SMSF's can earn around 1% p.a. higher investment returns than public offer funds on the fixed income in their portfolios, being 0.3% p.a. when averaged across the portfolio.

Tax

SMSF's are better able to manage their tax position than public offer funds. This can be achieved in different ways. Firstly, they can defer the realisation of capital gains until the fund commences in the pension phase. Secondly, they can manage the sale of asset parcels to further improve their tax position.

It is difficult to quantify this benefit. 0.1% p.a would be a reasonable estimate of the benefit.

In total, these 2 drivers result in a benefit of 0.4% p.a.

Fees

Fees vary greatly for both SMSF's and public offer funds. It is reasonable to assume that on average, fees are around $2,500 p.a. to operate an SMSF (including the amortised cost of setup and windup), compared with 1.3% of assets for public offer funds.

It is also reasonable to assume that the cost of advice is 0.75% of assets p.a.

Comparison

When including the fees and benefits above, the breakeven points for SMSF's versus public offer funds are:

- With no advice: $2,500/(1.3% + 0.4%) = $147,000
- With advice: $2,500/(1.3% + 0.4% - 0.75%) = 263,000

As such, the thresholds should be adjusted to:

- $150,000 - $260,000 – Can provide equivalent value with APRA-regulated funds provided the trustees undertake some of the administration.
- $260,000 or more - Can provide equivalent value to APRA-regulated funds on a full service basis.

The need for advice

The consultation paper misses an extremely important point. Most of the people not suited to SMSF's are proceeding without receiving personal advice. For example they are attending sales oriented seminars or speaking to their friends.

So the proposed disclosure will never be seen by the people who need to see it most.

A better (or perhaps parallel) solution is to make it compulsory to receive personal advice in order to establish a SMSF.

This should be introduced in conjunction with a requirement that the financial adviser doesn't receive any commissions in relation to the SMSF (including commissions in relation to property).

I can be contacted to discuss any of the points above.

Yours sincerely

Greg Einfeld

Director