



# Into the SMSF future

As the number of SMSFs being established continues to grow, does the industry need to refocus and reshape itself to stem the tide, asks MICHAEL LAURENCE.

Trustees and senior executives of many large superannuation funds may have felt a little relief to read in the latest *Superannuation Market Projections* study by Rice Warner Actuaries that the spectacular growth of self-managed superannuation had peaked.

Indeed, Rice Warner projects that the market share of SMSFs will progressively slip from almost 31 per cent at the time of the study to 26 per cent within 15 years. This forecast for the future of SMSFs is largely based on expected changing demands of retirees as Australia's population rapidly ages and forecast shifts in the market share of other superannuation sectors.

Another superannuation researcher Chant West Financial Services agrees with Rice Warner that the growth in the market share for SMSFs has peaked. However, Chant West principal Warren Chant expects that the downturn in the SMSF market share will "be more severe and sooner".

But wait. There are some contrasting views within the superannuation industry about where the SMSF-sector is

heading in terms of market share. Alex Dunnin, research director for Rainmaker Information, says his group forecasts that the market share of self-managed funds will keep getting bigger at the cost of master trusts, reaching 39 per cent within a decade.

Predictions of the loss of market share by SMSFs in the absence of severe legislative restrictions on the sector "defies all evidence", Dunnin claims.

"Parts of the superannuation industry may not like SMSFs because they see them as a threat, but the problem for these people is that SMSFs keep getting more popular," he says.

Jason Clarke, chief executive of fund researcher SuperRatings, expects the growth in the market share of the self-managed sector to slow because of its sheer size – it is already the biggest sector in superannuation – but forecasts that it will keep expanding.

"Large funds will have to work harder to compete against SMSFs," says Clarke. But he suspects that they do not fully

understand what motivates so many people to establish their own funds.

Clarke bases his expectations that the market share of SMSFs will keep growing partly on research by SuperRatings showing that contributions to the average industry, public-sector and retail funds over the five years to June last year were only a little higher than outflows.

"[These] three sectors are fueling SMSFs more strongly than ever," he says.

Meanwhile Nicolette Rubinsztein, general manager of strategy for Colonial First State, comments that the growth of SMSFs has "blown everyone away". And she believes that the establishment numbers of SMSFs will remain high unless the Government takes any legislative actions that would slow their growth.

Rubinsztein describes Rice Warner's projected cut in market share of self-managed funds as a "big call".

Interestingly, Rubinsztein emphasises that her group has benefited from the remarkable growth of SMSFs because of the sector's investments in managed funds and





direct shares. (Commsec has a large share of the SMSF market for direct shares.)

No matter who turns out to be correct about the direction of the self-managed superannuation sector, it will remain a formidable force and provide intense competition for much of the superannuation industry.

Based on the Australian Prudential Regulation Authority's (APRA) latest available statistics to September 2008, the sector has assets totalling \$348 billion – up from \$72 billion less than eight years earlier.

The lead-up to the revamping of the superannuation system from July 2007 significantly boosted SMSFs establishment rates, which have since remained at an elevated level. APRA figures show that more than 30,000 SMSFs were established in the preceding 12 months to last September – taking the total to almost 400,000.

#### SHORT-TERM OUTLOOK

There is agreement among most fund researchers that SMSF establishment rates will remain high or even spike during the short-term at least in response to the severity of the bear market.

Given the large negative returns, many members of large funds are expected to reach the opinion that they can invest more successfully themselves with their own funds.

Alex Dunnin, for instance, comments that what he regards as any "very unfair criticism" that large funds had failed to anticipate the global financial crisis had "laid the groundwork" for an immediate jump in SMSF numbers.

Mark Johnston, principal of investment researcher Investment Trends says such a spike in the establishment numbers of SMSFs occurred after the average default portfolios of the large funds produced negative returns for 2001-02 followed by barely positive or barely negative return for 2002-03. (Paradoxically, the sharemarket had powerfully rebounded by the time many members had studied their member statements for 2002-03 and decided to setup an SMSF.)

SMSF specialist David Calvert is confident that the numbers of SMSFs being established will rise even higher from the current level in response to members of large funds studying their negative returns for the six months to December 2008.

Calvert is managing director of superannuation for Dixon Advisory and Superannuation Services, which administers more than 2,800 SMSFs and provides

SMSF establishment rates are likely to remain high in response to the severity of the bear market.

most with some financial planning and investment advice.

One of the factors that Calvert believes will drive members away from large superannuation funds in this bear market is the extent of the negative returns. With the magnitude of such negative returns, he cannot see that comfort gained by remaining a member of a large fund will outweigh the advantages of self-managed superannuation "where trustees have much greater control over investments and fees".

And Calvert does not foresee the SMSF sector losing market share over the long-term.

However Rice Warner director Michael Rice says that any short-term upturn in SMSF establishment numbers as some large fund members convince themselves that they can do a better job in the face of the bear market would disguise the true future of the sector.

Rice suspects that a significant proportion of those who establish SMSFs in response to the bear market will return again "to the comfort of big funds" after they find they can do no better themselves.

And Warren Chant of Chant West takes up a similar theme, saying that he suspects many people who establish SMSFs in 2008 and 2009 would later ask themselves the question: "Is this where I want to be?" And then many would switch again but this time to a good corporate master trust or industry fund after getting their fingers burnt with SMSFs.

#### RESHAPING SUPERANNUATION

Projections for the changing long-term SMSF market share, of course, also point to the expected refocusing and reshaping of the superannuation industry itself in response to the rapid ageing of the Australian population.

The Rice Warner report forecasts that the post-retirement dollars in superannuation will climb from 25 per cent today to 37 per cent within 15 years. And crucially, it expects that SMSFs will not manage to hold on to their current share of superannuation savings as members retire in burgeoning numbers, and begin to drawdown on existing savings.

And Michael Rice is convinced that many existing members of self-managed funds will question whether these are the right vehicles for their retirement.

Once couples with SMSFs retire, he says, they often lose contact with the accountants who might have encouraged them to initially establish the funds.

For example, the accountants would no longer do company tax returns for couples who had been in business together, and their personal tax affairs would, in most cases, have become much simpler.

And then Rice points out that another circumstance that will increasingly confront husband-and-wife SMSFs with the ageing of the population is when one spouse dies, leaving the other perhaps less willing or able to continue as a trustee.

Dixon Advisory and Superannuation Services has not experienced any pattern of some members switching from SMSFs back to large funds at the point of retirement.

"No one leaving a SMSF [among Dixon clients] gives retirement as the reason," David Calvert says. This was because SMSFs could easily adapt to the pension phase as well as provide a means for various retirement strategies.

While large superannuation funds have been improving their pension products, Calvert says that pensions provided through SMSF administration firms have been evolving at the same time.

Another factor that Rice believes will encourage members of SMSFs to return to large funds is that the Australian Taxation Office, in its role as regulator of self-managed funds, is continually toughening its stance against trustees who breach superannuation law. And Superannuation Minister Nick Sherry has been conducting a review for more than 12 months into the sector and how its standards can be improved.

"Many people in SMSFs will conclude that it's not worth the trouble," Rice predicts.

#### MARKET SHARE GAINS

One of the fundamental keys to Rice Warner's expectations that the market share of SMSFs will fall is its projected growth of



industry and corporate master trusts.

Michael Rice anticipates that industry and corporate master trusts will pick up most of the business forgone by standalone corporate funds – which are expected to all but disappear within 15 years – and from a forecast loss of market share by public-sector funds.

Further, Rice Warner is confident that industry funds and corporate master trusts will provide increasingly sophisticated and easy-to-use pensions – transition-to-retirement and retirement products – that will be highly successful in retaining existing members and in attracting new members throughout their retirements.

Meanwhile, Rice expects the market share of personal master trusts to considerably fall, in part, through difficulty in holding on to members from the accumulation phase into the retirement phase. He believes that retirement will serve as a trigger for many members of personal funds to look to low-cost industry funds and, where possible, corporate master trusts to provide their superannuation pensions.

Retirement, Rice says, will serve as a point for members of personal funds to re-evaluate how they want to hold their superannuation into retirement.

Despite his projected loss of market share for personal master trusts, he expects the overall market share of the retail sector to markedly rise. This is largely because of his firm's forecast of continuing growth of corporate master trusts in both the accumulation and retirement markets.

Some retail fund managers are, of course, well positioned to benefit through market shifts foreseen by Rice Warner. For instance, Nicolette Rubinsztein points out that Colonial First State, as a retail manager, will benefit from the growth in corporate master trusts, even if the personal superannuation market were to reduce.

#### PUBLIC-SECTOR COMEBACK

Warren Chant of Chant West says he agrees with Rice Warner's general expectations for the changing market shares in superannuation except in regard to public-sector funds.

While Rice Warner expects the sector to lose significant market share within the next 15 years, Chant expects it to at least hold its present market share, and to possibly increase it. And this would be a negative for both industry funds and SMSFs.

Chant says more public-sector funds are offering pensions and more are opening their memberships to the public.

"Public-sector funds are well-run, have solid returns and a cost advantage over [even] industry funds," he says. "And they are keen to protect their client base [of members with comparatively high average balances]."

#### IDEAS TO COUNTER SMSFS

Given that SMSFs will continue to provide intense competition for the big funds even if Rice Warner and Chant West are correct in forecasting that their market share will fall, what practical strategies can large funds adopt to counter them?

Suggestions put forward during interviews for this Superfunds article include that large funds should:

- Offer members many of the features that some people find highly attractive about SMSFs including the ability to choose from a range of fund managers and direct shares – within practical limits. One suggestion was for large funds to even provide some facility for members to hold direct property investments.
- Ensure accumulation products are as compelling as possible – in regard to such features as fees, investment options and performance – with the aim of holding on to members throughout their working lives and into retirement.
- Provide high-quality pension products which are sophisticated, easy-to-use and inexpensive in an attempt not to lose members at the point of retirement.
- Minimise the time taken between placing a request to switch between asset classes and the switch actually taking place.

Of course, depending largely on their sector, many large funds are already providing some or most of the features suggested during these interviews.

Another point is that one of the ways that industry funds, for example, minimise their costs is by minimising their investment options.

Nicolette Rubinsztein of Colonial First State believes that member education is an excellent way for large funds to respond to the competition of SMSFs. She suggests that such education could point out to existing members the costs of establishing a SMSF, the minimum balance needed for a new SMSF to be financially viable, and the obligations facing SMSF trustees.

Jason Clarke of SuperRatings doesn't believe it would be difficult for large funds to create a "virtual SMSF" within their structures – apart from adding to administration costs.

However, he says the large funds would still have to address the less-tangible reason why they lose members to SMSFs: the determination of people to gain what they perceive as control over their retirement savings.

Clarke says the direct share options provided by some large funds have not had a high take-up rate among their members. But he says that members are becoming more connected with their superannuation and the "unbundling" of preset investment options is likely to become increasingly popular.

Warren Chant believes that industry and public-sector funds would compete more successfully with the SMSF-sector by "engaging with the financial planning community". Many of their members would want the freedom to easily choose a financial planner to guide them with their superannuation, he says.

"About 500 advisers would support industry and public-sector funds yet there are 15,000-plus advisers," Chant points out. He says funds should make provision for a financial planner's fees for superannuation advice to be deducted from a member's balance if requested by the member.

David Whiteley, executive manager of Industry Super Network, suggests that large industry funds can respond to the competition of self-managed superannuation by always reinforcing the message to their members that they are gaining access to sophisticated and diversified portfolios at a low cost.

Alex Dunnin of Rainmaker Information advocates somewhat different approaches. "[Large] funds wanting to fight off SMSFs need to first recognise that people setting up SMSFs do it for independence, not because they have a desire to be the world's best fund manager," he says.

Dunnin suggests that big funds could go to the extent of offering SMSFs access to wholesale versions of their diversified investment options. "And what about letting SMSF members have access to the super funds' group insurance deals?"

He says that large funds that offer members the option of choosing individual shares should ensure that their service is of a high standard. "Given that SMSFs like direct access to equities, funds wanting to stem the tide need to start offering proper equity management platforms like managed accounts rather than budget, bulk order, share transaction services designed for the low-end.

"And being able to handle real property would also be a great tactic [for non-SMSFs]," Dunnin adds. **SF**