SMSF Owners' Alliance
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SMSFOA Members' Newsletter

#1 /2014

Dear Members and Supporters

This is the first of regular newsletters to SMSFOA members and supporters during 2014 to keep you informed of our activities and the issues we are dealing with. We'll also post it on a members' only page on our website.

2014-15 Pre-Budget Submission

On 31 January we lodged with Treasury our 2014-15 Pre-Budget submission. Each year around this time the Government calls for submissions on what should be in the May Budget. You may recall that last year we made a substantial submission pointing out that the then Government did not have a revenue problem as tax revenues were higher than ever. Instead it had a spending problem because Government expenditure was rising even faster. There was no case to increase taxes on superannuation but subsequently the Government were rumoured to be considering a tax on withdrawals and later did try to impose a 15% earnings tax on fund earnings over $100,000 which would have targeted successful SMSFs. We fought strongly against the extra taxes and thankfully the new Government elected last September quickly dropped the idea.

At about this time last year, Treasury issued their Tax Expenditures Statement and incorrectly aggregated the cost of tax concessions from super to give a misleadingly high figure of $32bn. Some of the press – notably Robert Gottliebsen in *Business Spectator* – picked up and understood our criticism but Treasury declined to issue a correction, so these figures are still misquoted, most recently in the *Australian Financial Review* this week.

In this year's Pre-Budget submission we again argue the benefits of tax incentives to encourage superannuation savings, but focussing more on the importance of raising the contribution caps – especially for those over 50. Our computer model shows that most people's voluntary contributions will be constrained by the current caps but that, contrary to some stories, the Government would save in Age Pension costs many times the cost of extra tax concession if it raised the cap levels – in some cases 20 times over.

We again urge the Government to restore voluntary contribution caps to the levels set by the previous Coalition Government - $50,000 for under 50s and $100,000 for over 50s, while acknowledging that the Government is constrained by the size of the budget repair task it has inherited.

The broader context is that Australia's superannuation system is not accumulating enough savings to allow most Australians to retire on a reasonable income independent of the Age Pension.

We've attached the SMSFOA Pre-Budget Submission, and an accompanying media release, to this newsletter and you can also find it on the website under the 'Advocacy' tab.

Review of Governance and Transparency in APRA-regulated Funds

Our next submission will be to the Government's current review: *Better Regulation and governance, enhanced transparency and improved competition in superannuation*

This Treasury review is into the workings of the major industry and retail super funds to which most Australians entrust their superannuation savings.

Our submission will note that SMSFs have an interest in how industry and retail funds are conducted because some SMSFs invest in them. ATO figures show that some 60,000 SMSFs have invested $18.7 billion in the 'other managed investments' asset category which includes holdings in major industry and retail funds.

It is in their interests for APRA-regulated funds to conform to high standards of governance and transparency, not least because their financial advisers need access to as much information as possible about the performance and management of large funds.

We feel it is also important to point out the real reasons many savers decide to withdraw funds from such funds and start an SMSF. The lack of transparency and accountability – especially with reference to fees charged – are reasons often quoted.

We will also make the point that the trustees of industry and retail funds need to uphold high standards of governance because they hold billions in trust for millions of Australians. Such an issue of trust does not arise for SMSFs as the trustees and members are essentially the same people.

More about the review and a discussion paper on the issues to be examined can be found here:

http://www.treasury.gov.au/ConsultationsandReviews/Consultations/2013/Better-regulation-and-governance

SMSFs Draw Fire

The success of SMSFs seems to be encouraging some people to take pot shots at our sector. In recent weeks we've seen criticism of SMSFs from industry funds, fund managers, academics, investment banks and media commentators. Common themes are that SMSFs get an unfair tax break and put their own interests ahead of national development.

Recently, Credit Suisse claimed in a report that "SMSFs are retarding investment, employment and growth in Australia". How? Because SMSFs look to dividend yield from quality blue chip shares with franking credits rather than the capital needs of companies. Now that's a surprise…SMSF trustees favour reliable returns over capital risk. It would be a bigger surprise if they didn't.

In response, SMSFOA pointed out that, just like other investors, SMSFs are seeking good, reliable returns in a low interest rate environment. And also that it is the responsibility of company directors to make a judgement balancing the return to shareholders with the company's capital needs.

The story in The Weekend Australian 18-19 January is attached.

Reshaping Australia's Financial Architecture

Looming up is the Financial System Inquiry headed by David Murray, former Commonwealth Bank CEO and Future Fund chairman. It will be the most comprehensive review of Australia's financial system since the Wallis review of 1997 and has been given broad terms of reference by the Government.

Submissions are due by the end of March and SMSFOA will be working up our submission over the next few weeks. We'll be addressing superannuation's role as a pillar of the Australian economy and discussing options for how it might be made to work better to achieve the objective of enabling most Australians to retire with sufficient savings to give them financial independence throughout retirement without having to rely on the Age Pension.

We will also be making the point that SMSFs require less onerous regulation than pooled superannuation funds as the Cooper Review in 2010 acknowledged.

If you have thoughts on this topic, please drop us a line to: info@smsfoa.org.au

More on the membership and terms of reference for the Financial System Inquiry here:

http://jbh.ministers.treasury.gov.au/media-release/037-2013/

Who Minds the Custodians?

At the SMSFOA seminar held at the ASX last December, one of our members asked the ASX presenter on Exchange Traded Funds (ETFs) about the role and regulation of custodians.

A simple explanation from the ASX website:

"Assets held with a custodian are held in trust. This means that in the event that the ETF issuer ran into trouble, those assets are ring fenced for the benefit of the unit holders in the ETF. The nature of custodial businesses is to hold the assets in a secure environment. The custodian is appointed by the issuer of the ETF but is independent from the issuer."

Custodians in Australia hold over $1.85 trillion in financial assets, including shares, bonds and other financial assets. As well as holding financial assets in trust, they may also provide back-office administrative and compliance services. Their clients are superannuation funds, financial institutions and governments. Custodians include major Australian and international banks, including NAB, Macquarie, Citi, JP Morgan and State Street. As banks and financial service providers, they are regulated by APRA and ASIC.

More information is available from the Australian Custodial Services Association – see:

http://www.custodial.org.au/public_panel/index.php

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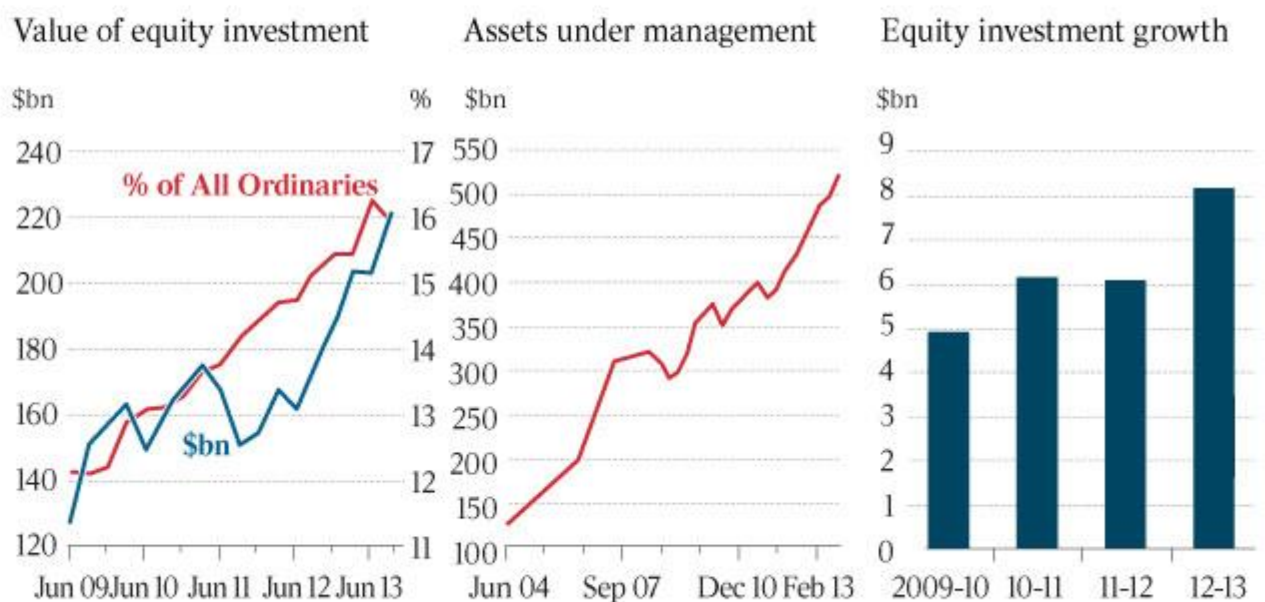
'Selfies' accused of distorting decisions on dividends, capital

ANDREW MAIN | THE AUSTRALIAN | JANUARY 18, 2014 12:00AM



Source: The Australian

SELF-MANAGED super funds are now so dominant in the Australian equity market that they are distorting the way big companies juggle decisions about dividends and capital investment, according to a Credit Suisse Australia report.

"SMSFs are retarding investment, employment and growth in Australia," the report by equity strategist Hasan Tevfik and analyst Damien Boey says.

It says SMSF trustees "hate dividend cuts and are not interested in capital expenditure by companies".

"Perversely, they control much of the equity that could be used for new investment but are demanding dividend increases instead."

The report says SMSFs account for 16 per cent of the equity market, representing about $220 billion of assets. They pump an additional $2bn net a quarter into the asset class and are likely to continue in the absence of other suitable venues such as a domestic market in corporate debt.

"Perhaps the development of an Australian credit market will help stop selfies (SMSFs) retarding growth," it says, referring to the limited market in high-yielding corporate bonds.

The report is not critical of SMSFs per se, noting that Australia has one of the most advanced pension systems in the world.

Mr Tevfik said yesterday: "Is this constraining capex good or bad for Australia? I'm not really sure. It's good for shareholders."

Duncan Fairweather, executive director of the SMSF Owners Association of Australia, said he was not surprised by the report but noted that the chase for yield and secure returns in the context of low interest rates was a driver for all investors, not just SMSFs.

"It's not the job of SMSF trustees to fund the capital markets. Some may choose to invest in low-cap growth stocks but it is an option and not an obligation," he said. "It is, of course, the responsibility of company directors to decide on dividend payments, taking the interests of shareholders and the company's need for capital into account."

David Prescott, a portfolio manager at value investor Lanyon Asset Management, said it was entirely correct that SMSF investors were distorting the Australian market, especially with respect to high dividend paying stocks.

He warned that "it appears SMSF investors are part of a growing army of investors pushing the prices of higher dividend stocks to extremely high levels".

"What SMSF investors should remember is there should always be a relationship between yield and the sustainability of the underlying company's earnings," Mr Prescott said.

"This relationship has become significantly skewed in the current market, and looks highly likely to cause great pain and many red faces when the music stops at some point in the future.

"SMSF investors may experience a dreaded compound issue where payout ratios start to retreat to long-term averages at the same time as the dividend yield expected by equity investors contracts. The potential for capital loss during a rush for the exits is very significant."

Mr Tevfik, who recently took up his role in Australia after spending 15 years in London, said it had given him a different perspective on Australia.

"Overseas investors miss just how big the pool of savings is in Australia and, what's more, they don't realise how limited the alternative investment options are," Mr Tevfik said.

SMSFs' main target are what the report calls tier-one stocks, for which, as it says, "Selfies hunt in packs".

Tier-one stocks are large companies that pay high dividends, have a history of dividend growth, distribute franking credits and are stocks SMSFs identify with, such as the big banks and Telstra.

In its advice to non-SMSF investors, Credit Suisse advises clients not to short-sell such stocks unless there is a dividend cut in the wind, for the unspoken reason that shorts will lose.

"Second, concentrate more on dividend yields and dividend per share growth and less on price-earnings ratios and earnings per share growth," it says.

"We have previously been short Westpac in our stock allocation.

"But given the bank is a tier-one stock, we have now come to our senses and stepped out of the way of these considerable flows," the report adds.

The analysts interviewed six SMSF advisers with a view to hearing what makes SMSF investors tick, the better to understand the new market paradigm. They quoted one adviser as saying that "the army of SMSFs will be happy buyers of CBA when the share price is 5 per cent lower, then 10 per cent, then 20 per cent lower, but if CBA cuts its dividend they will then dump their holdings".

The adviser says: "I am sure CBA sponsors the cricket to advertise its shares, not its banking services."

Another adviser said: "I have tried to get my clients to buy more Wesfarmers, but they do not identify with the company in the same way that they do with the banks and Telstra."

A reassurance for SMSF trustees is that the Credit Suisse analysts do not expect the situation to change soon.

They say that "at some point the big banks and Telstra may break their implicit contract with SMSFs and cut their dividend", adding that "we don't think this will be the case in the near term".

Graeme Colley, head of technical and professional Standards at SMSF Professionals Association of Australia, said that "reading between the lines shows the significant impact of SMSFs on investment markets which should not be taken lightly".

He said that average SMSFs had recently outperformed professionally managed funds, according to the ATO.

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