Self Managed Super Fund Association

ACCURIUM

SMSF Retirement Insights

SMSFs treading water

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Our latest check up on the financial health of SMSF trustees heading into retirement

For SMSF practitioner use only

Contents

Executive summary

- Despite small gains in balances an investment outlook of returns that will be lower for longer means many SMSFs are now further away from achieving their retirement goals than previously.
- Median SMSF balances were up 1.2% for FY16, based on a median investment return of 1.0%, however, a weaker investment outlook means retirees need to save more to afford their desired lifestyles in retirement.
- The amount needed for a 65-year-old couple to afford a comfortable retirement (as defined by ASFA)[1] has increased by 17% from $702,000 to $824,000.
- 66% of 65-year-old SMSF couples can be confident of affording a comfortable retirement, down 4% on our results from last year.
- 28% of 65-year-old SMSF couples can afford to spend $100,000 a year, which slightly up on last year.
- More than half of SMSF retirees cannot be reasonably confident (80% probability) of achieving their desired lifestyle in retirement while around one quarter can be very confident (95%).
- One in four are actually unlikely (less than 50% chance) to achieve their goals.

Background

About Accurium

Established in 1980 and now part of the Challenger Limited group, Accurium provides a range of services to self-managed superannuation funds (SMSFs) in, or transitioning to, retirement with the help of accountants and other SMSF practitioners.

Accurium leads the SMSF market for actuarial certificates, placing it in a unique position to provide analysis on SMSFs in the retirement phase. Accurium supports more than 65,000 SMSFs which are paying pensions and thus require an actuarial certificate, giving Accurium access to an unrivalled amount of information on which to undertake research to assist accountants and SMSF practitioners provide quality service to their clients.

As experts in SMSF retirement, we're committed to passing on the essential tools and information you need for success including our pioneering retirement healthcheck service which assists in making sure that your clients are on track to meet their retirement goals.

About SMSF Association

The SMSF Association is the leading and authoritative voice for the SMSF sector, established to improve the quality of advisors, the knowledge of trustees and the credibility and health of a vibrant SMSF community.
The Association's core beliefs embrace every Australian having the right to a good quality of life in retirement and having the right to control their own destiny. Representing professionals providing a range of strategic advice and services across various professional disciplines in the complex area of SMSFs, the Association also engages directly with trustees to assist them to become better educated and informed. The SMSF Association is an advocate for the highest professional standards to ensure SMSF trustees always receive the best advice and to continue to build the integrity of the SMSF sector as a major source for our nation's prosperity for today and our future.

1 ASFA Retirement Standard as at June 2017 – a comfortable lifestyle for a 65 year old couple requires spending of $60,063 p.a.

Changes in SMSF balances

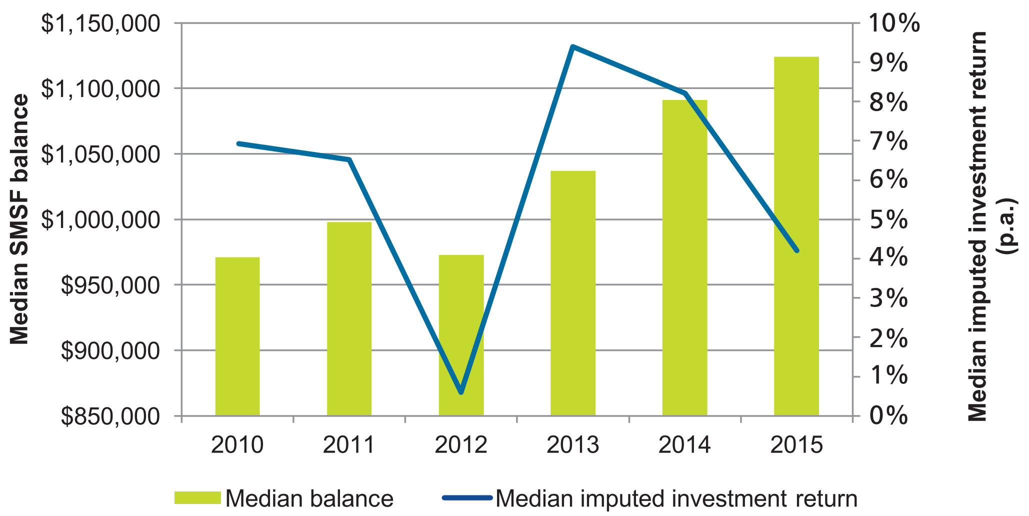
The median balance for a two-member SMSF in the Accurium database increased for 2016. Weak investment markets resulted in low returns and only a small increase in the balance of the typical SMSF. The rising trend over the past seven years can be seen in this table:

Table 1: History of median SMSF balances and imputed investment returns

Year ended	30 Jun 2010	30 Jun 2011	30 Jun 2012	30 Jun 2013	30 Jun 2014	30 Jun 2015	30 Jun 2016
Median balance for two member SMSFs	$971,000	$998,000	$973,000	$1,037,000	$1,091,000	$1,124,000	$1,137,000
Median imputed investment return	6.9%	6.5%	0.6%	9.4%	8.2%	4.2%	1.0%

Balances have continued to increase with lower returns in the past two years. This was in contrast to 2012 when low returns led to a fall in the median balance as benefit payments (drawdowns) from the SMSF were greater than the average contribution. The 1.0% p.a. imputed investment return for 2016 for SMSFs in our study compares to a 2.9% p.a. return for APRA regulated superannuation funds[2] over the same period. Direct comparisons between sectors are difficult, however, due to differences in methodology for calculating returns (see Appendix 2 for details).

Chart 1: Median SMSF balances and investment returns as at 30 June



Are SMSF trustees still on track for their desired lifestyle in retirement?

The increase in SMSF balances is good news for SMSF trustees, but the key question is – whether or not they are still on track to sustain their lifestyle in retirement. Over time the quality and cost of someone's desired lifestyle increases as reflected in the ASFA budget standards, meaning that they need more over time to meet their desired lifestyle.

Another factor in being able to meet a desired lifestyle is the ability to generate returns in the future. This depends on market conditions and there has been an adjustment to the return scenarios in the modelling. The investment scenarios reflect an increased probability of a 'lower for longer' situation where interest rates and equity returns remain low. This was reflected by the minutes of the Reserve Bank's July policy meeting where they noted that neutral nominal cash rates are around 3.5%[3]. They note that this is around 1.5% lower than previous views on neutral interest rates. Other asset class returns are also lower in the projections than they were in previous years.

The upshot for the average SMSF trustee approaching retirement is that their improving balance has not been able to keep up with the cost of meeting their desired lifestyle in retirement. As a result, fewer SMSF couples are able to afford the comfortable retirement lifestyle of $60,063 p.a., as defined by ASFA. The proportion of 65-year-old SMSF couples able to afford this lifestyle has fallen from 70% to 66% over the year.

2 APRA: Statistics – Annual Superannuation Bulletin June 2016.

3 Available at http://www.rba.gov.au/monetary-policy/rba-board-minutes/2017/2017-07-04.html.

It is worth noting here that we are comparing SMSF balances at a single point in time (30 June 2016) with estimates of the amount needed to fund spending needs over the whole of retirement, often extending over 30 years. Given the market based investments held by the typical SMSF, it is to be expected that balances will experience ups and downs.

Despite the weaker returns in 2016, our analysis shows that SMSF trustees still have a good chance of sustaining the typical $70,000 a year lifestyle in retirement. For example, the median balance for a 65-year-old SMSF couple is still sufficient to sustain the SMSF Typical lifestyle of $70,000 a year with 80% confidence. This can be seen in the charts to follow.

Chart 2: Savings required for different spending levels with 80% confidence vs. median SMSF balance

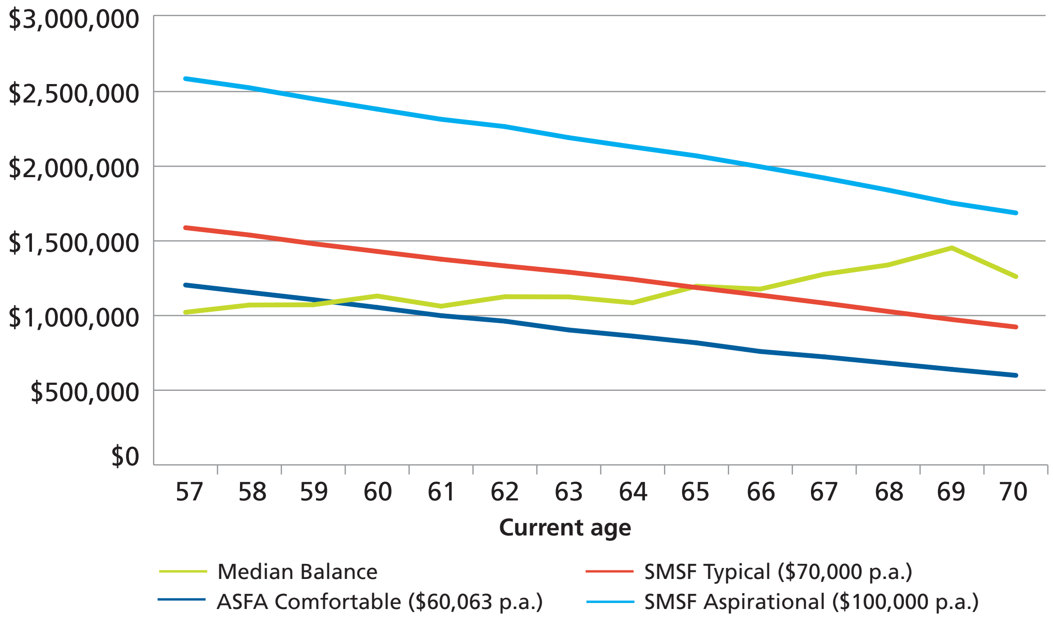
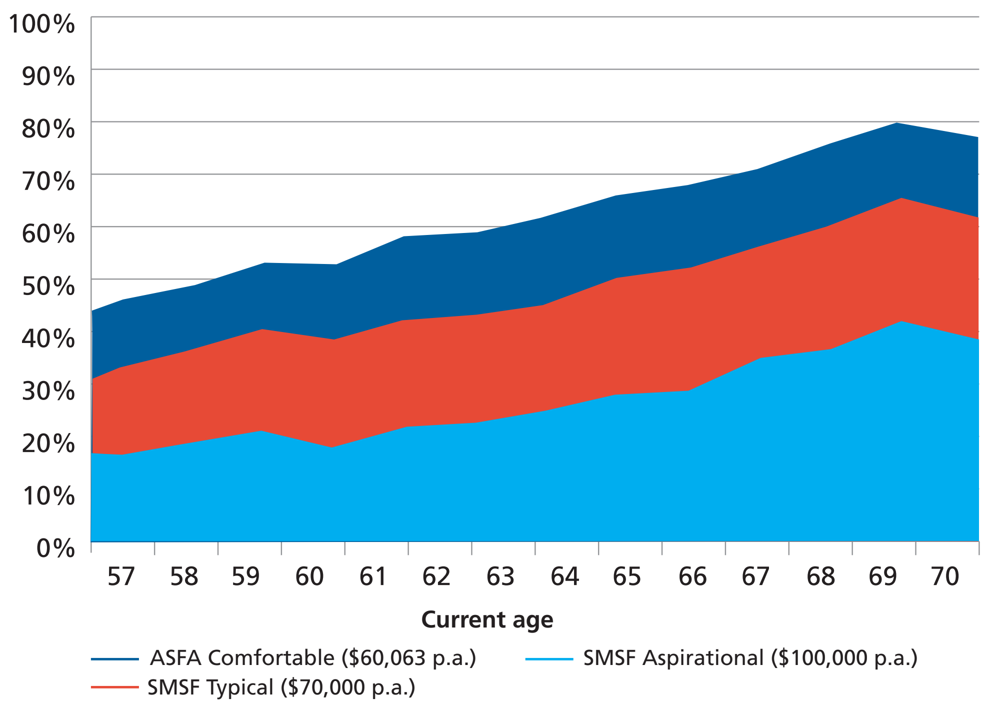


Chart 3: Proportion of SMSF couples reasonably confident (80%) of affording different spending levels in their retirement



When we use a high level of confidence, the charts below indicate the difficulty in being able to sustain the typical SMSF lifestyle for the median SMSF balance.

Chart 4: Savings required for different spending levels with 95% confidence vs. median SMSF balance

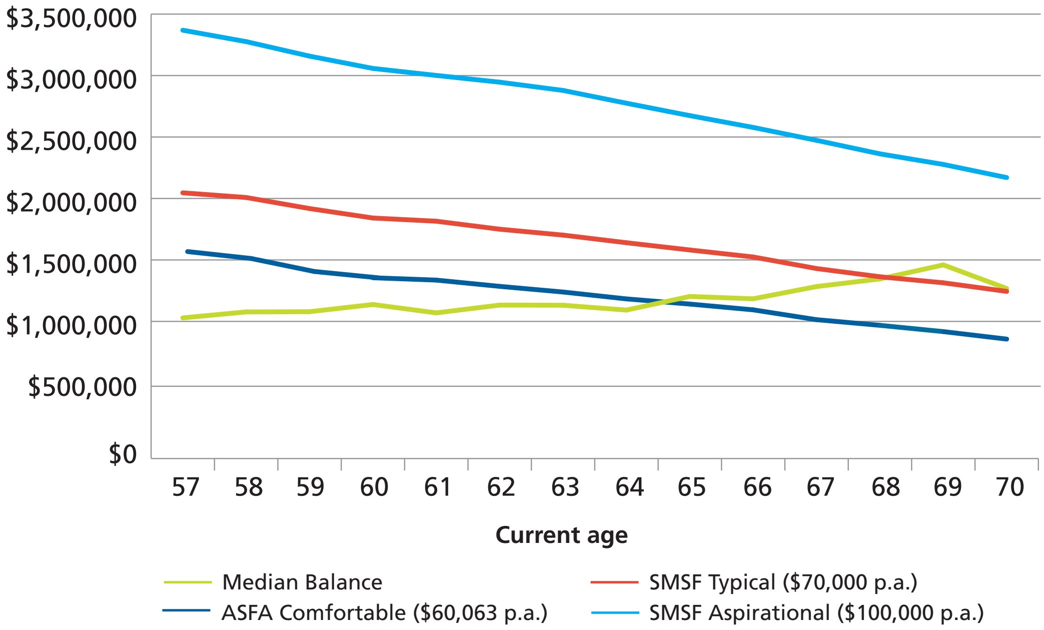
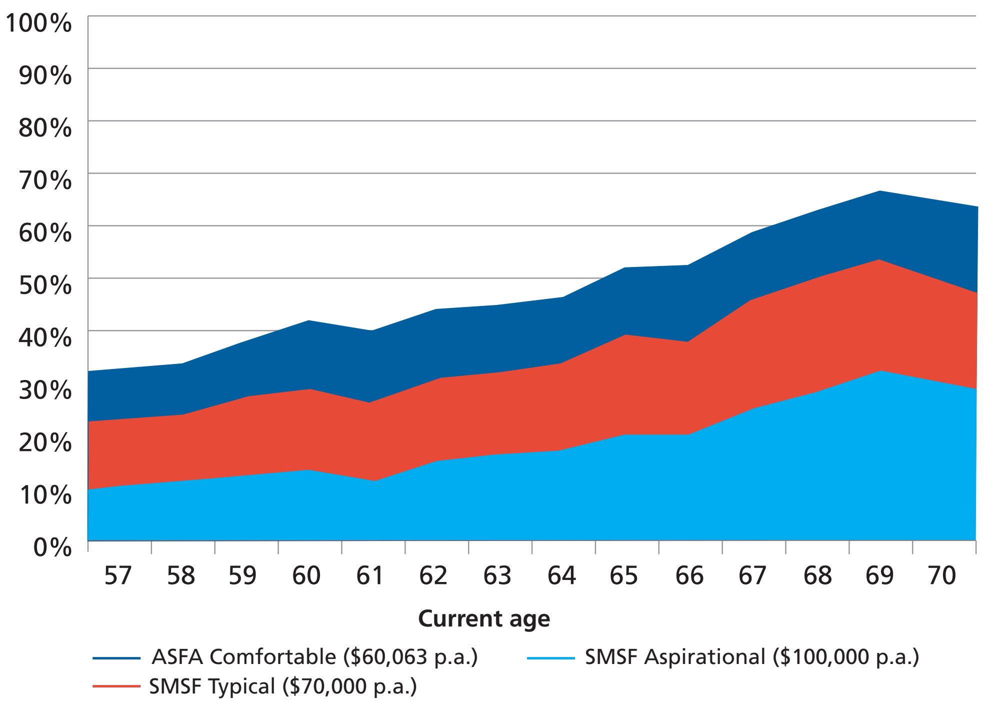


Chart 5: Proportion of SMSF couples very confident (95%) of affording different spending levels in their retirement



What lifestyles do SMSF trustees aspire to in retirement?

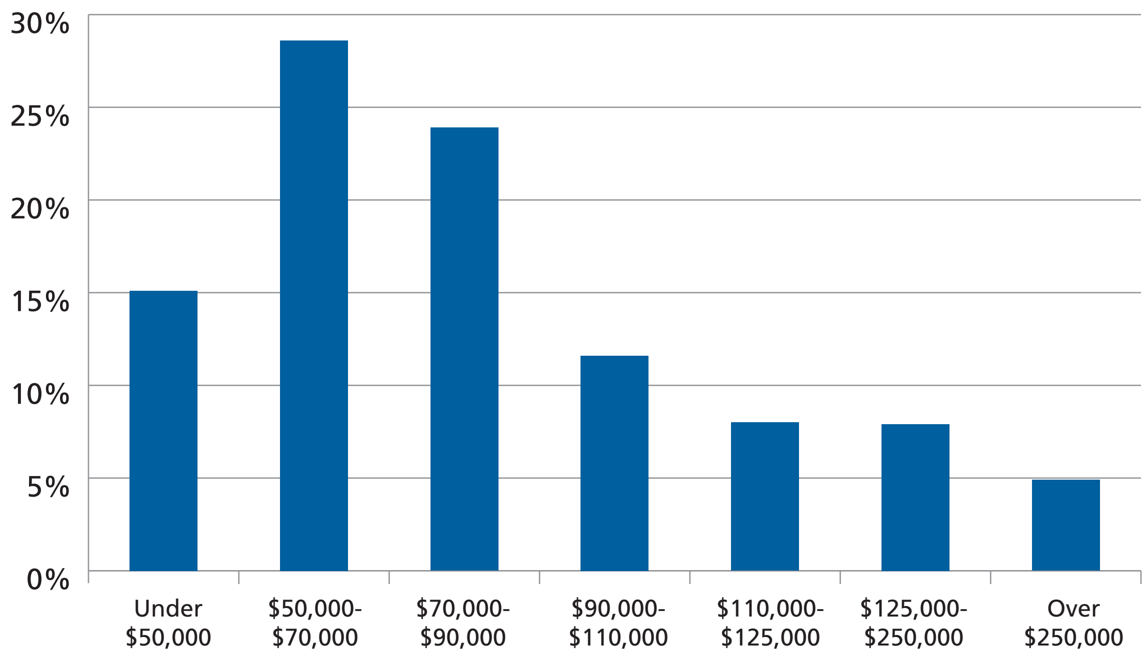
Annual budgets

Accurium's retirement health check is a retirement planning tool that assesses the likelihood of retired households being able to meet their retirement goals. Analysis of nearly 800 SMSF households' detailed retirement plans over the year to June 2017 shows a range of desired spending levels.

Table 2: Desired annual spending levels in retirement for SMSF trustees, based on retirement plans

	Couples	Singles	All households
Average	$92,300	$88,600	$91,000
Median	$80,000	$52,000	$72,000
Proportion of households aiming to spend over $100,000 p.a.	24%	13%	21%

Chart 6: Desired annual spending levels in retirement for SMSF trustees



Bequests

In introducing the limits on the amount that can be transferred into the pension phase in retirement, the government has highlighted a potential issue of retirees leaving their superannuation for the next generation. The government is concerned that the tax concessions from superannuation are not being used for the objective of providing income in retirement.

The information entered into Accurium's retirement health check suggests that most trustees don't have an explicit target to leave a bequest. From the completed plans, only 7% of SMSF households have included a specific target to leave an inheritance. The vast majority are looking to use their superannuation to fund spending in retirement. This result has also been found in other surveys of older Australians.[4]

We would not expect that only 7% of SMSF retirees will leave an inheritance. Some trustees won't live to life expectancy, leaving money unspent. Even those who live past life expectancy might not run through their money as the margin of safety (from a high confidence level) might not be needed when market conditions are favourable.

4 See National Seniors Australia, "Seniors more Savvy" NSA report, September 2017- (forthcoming).

For the SMSF trustees that have explicitly set a bequest, there has been a wide range of different levels. The average bequest was $780,000 and in most cases, the bequest was less than the balance of the SMSF, implying at least some spend down of capital in retirement.

Household wealth

Most SMSF trustees appear to maximise their exposure to the tax advantages of superannuation and have a majority of their wealth in their SMSF. The new $1.6 million limit on the transfer into the (untaxed) retirement phase of superannuation already provides a natural split for SMSF trustees. Those trustees with wealth in excess of $1.6 million have only 64% in their SMSF compared to those with less than $1.6 million who have 82% in their SMSF.

Chart 7: Proportion of assets inside and outside the SMSF, by total savings

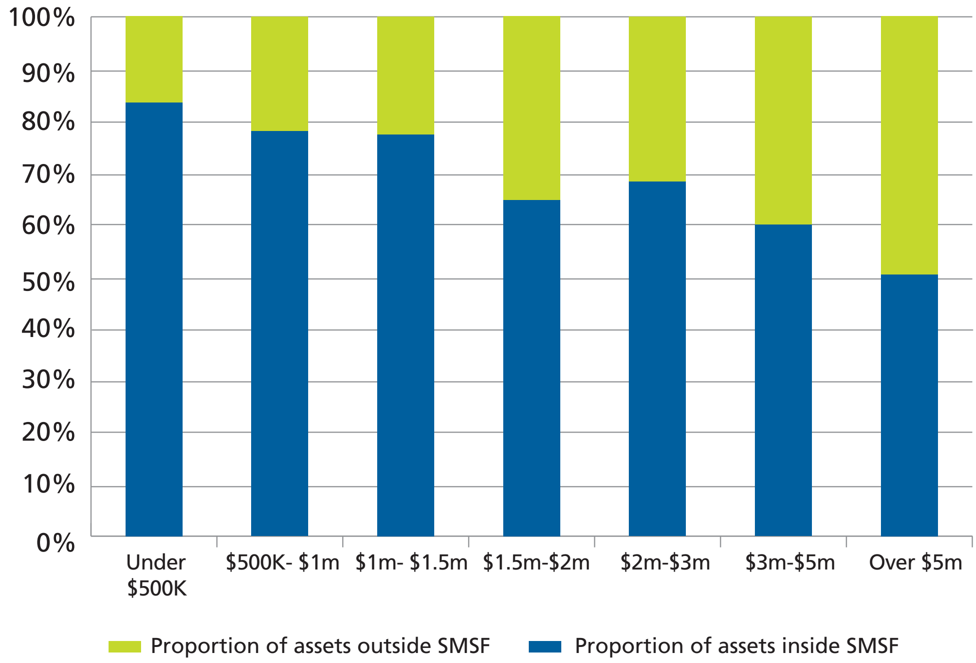


Chart 8: Overall asset allocation for retired SMSF households (excluding the family home)

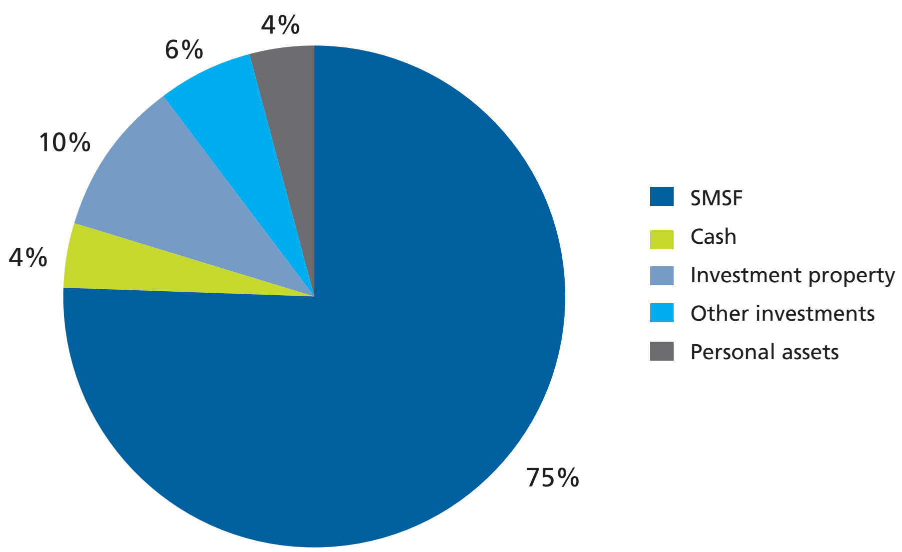


Chart 9: Average SMSF asset allocation – Accurium clients

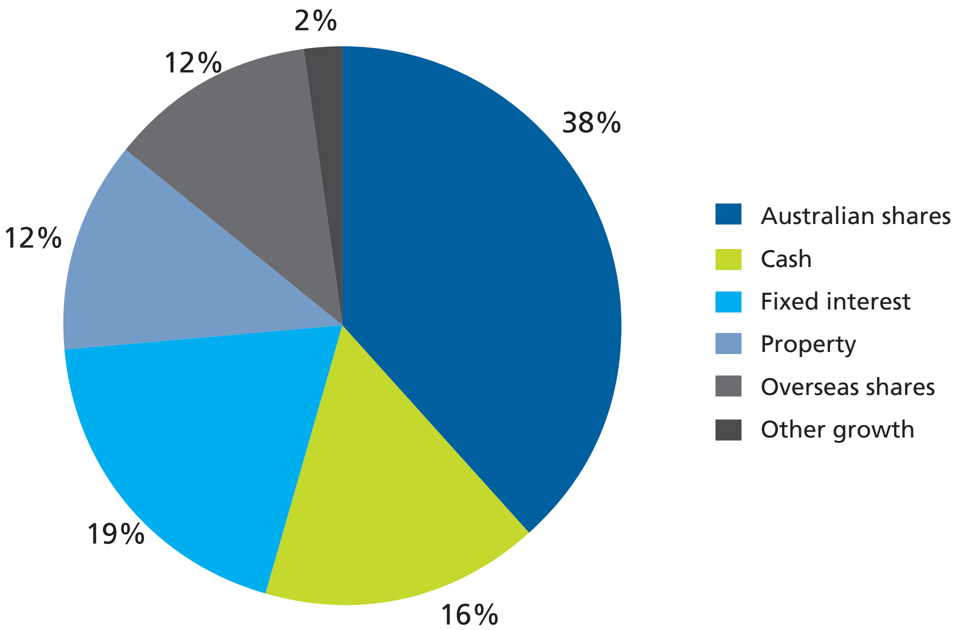
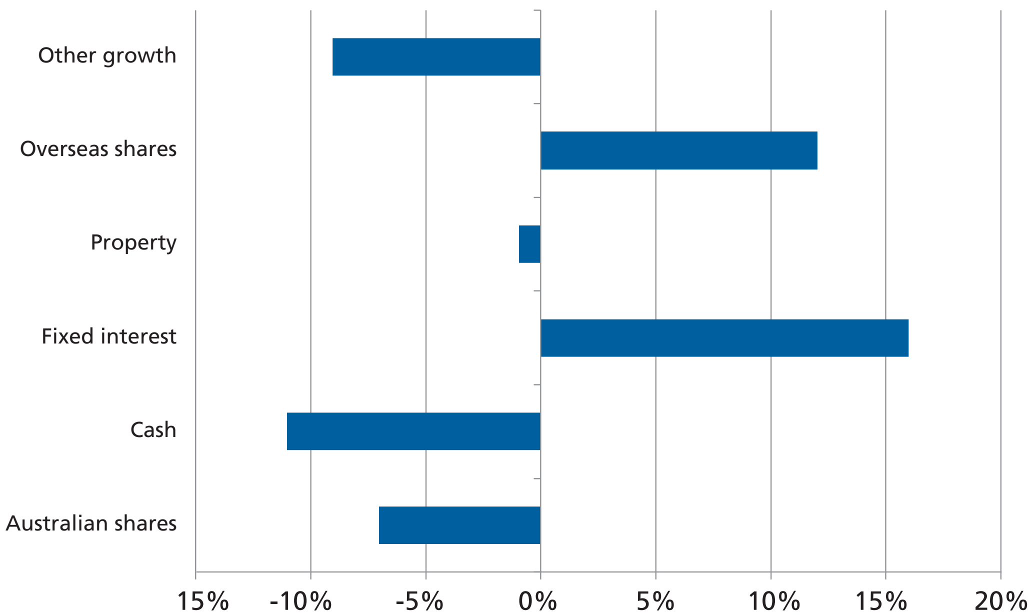


Table 3: Change in average asset allocation for Accurium clients

Asset Class	Accurium Average FY2017	Accurium Average FY2016
Australian shares	38%	40%
Cash	16%	15%
Fixed interest	19%	18%
Property	12%	13%
Overseas shares	12%	11%
Other growth	2%	3%

Chart 10: Difference between asset allocation in Accurium database and ATO pension phase average[5]



5 Compares asset allocation of SMSFs in Accurium's database with those found in the ATO's statistics, Self-managed super funds: A statistical overview 2014-15. Table 16 Asset allocations by fund phase (2015), pension phase.

SMSF household asset allocation

The asset allocation for SMSF households is shown above. On average, three-quarters the wealth of retirees is in the SMSF, with investment property the largest exposure outside the SMSF. The clients in the Accurium database hold less in cash, but more in fixed interest (although this could just reflect a different classification of the assets).

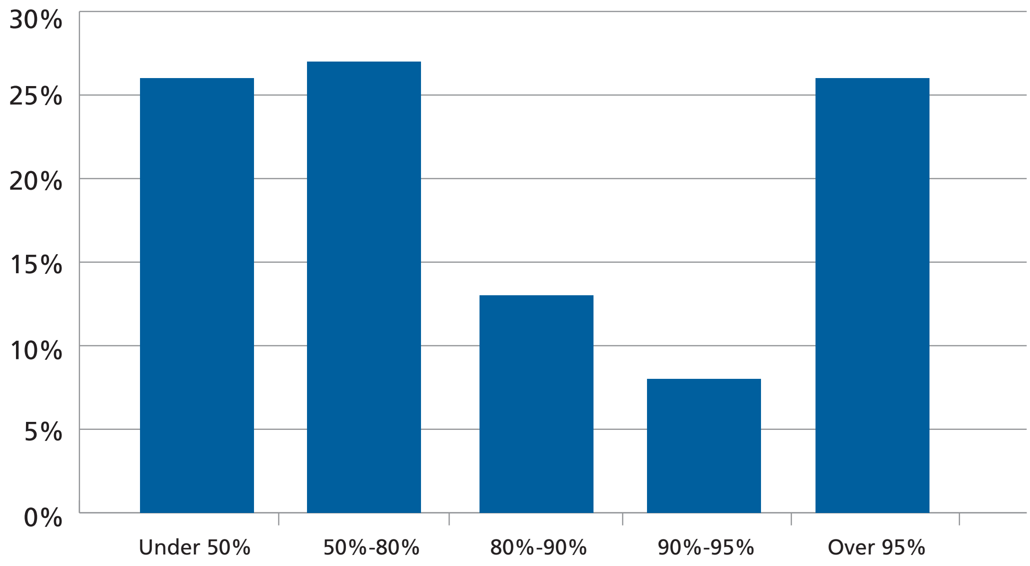
The Accurium asset allocation is also more useful as it looks through the managed funds and ETFs in the ATO data which does not provide any information on how the money is actually invested. Most of the higher international equity exposure (12% v 1%) will relate to ETFs not being allocated to the ultimate assets in the ATO data. This result is consistent with reports from SMSF custodians which indicate a larger exposure to international equities and fixed interest than what is in the ATO data.

Do SMSF trustees have the wealth to match their aspirations?

Accurium's retirement health check uses detailed actuarial modelling techniques to assess how sustainable SMSF retirees' spending plans are given the resources at their disposal. It would seem that there are many that are not there yet:

- Slightly over half of the SMSF retirees cannot be reasonably confident (80% probability) of achieving their desired lifestyle in retirement.
- One in four are actually unlikely (less than 50% chance) of achieving their goals.
- However, some are well prepared, around one quarter can be very confident (95%).

Chart 11: Sustainability of retired SMSF households' desired spending levels (confidence in achieving desired retirement lifestyle)



Achieving a sustainable lifestyle is always easier if you start with more wealth. And while the desired lifestyle might increase with wealth, there is a clear correlation that the greater the level of initial wealth, the more likely it is that an SMSF household will achieve their desired lifestyle. However, even some of the wealthiest households with more than $5 million are planning to spend more than what can be comfortably sustained throughout retirement.

Table 4: Sustainability of SMSF households' retirement plans by total savings

Total savings of SMSF household	Average probability that retirement plans will be sustainable
Under $500,000	48%
$500,000 – $1 million	63%
$1 million – $1.5 million	65%
$1.5 million – $2 million	72%
$2 million – $3 million	75%
$3 million – $5 million	80%
Over $5 million	83%

The high confidence levels shown for wealthier SMSF retirees suggests some may be able to enjoy more prosperous lifestyles than they are currently planning, without introducing a significant risk of outliving their savings.

Appendix 1 – Data tables

The figures behind many of the charts presented in this paper are provided below for reference.

Table 5: Savings needed to support ASFA Comfortable ($60,063) p.a. in retirement with differing levels of confidence vs. median balance

Couple's age	Median balances for two member SMSFs ($)	Savings required to support ASFA Comfortable ($60,063) p.a. for life ($)	
		with 80% confidence	with 95% confidence
57	1,028,574	1,211,000	1,568,000
58	1,077,044	1,162,000	1,512,000
59	1,078,928	1,113,000	1,406,000
60	1,137,429	1,061,000	1,355,000
61	1,069,204	1,006,000	1,336,000
62	1,132,726	969,000	1,285,000
63	1,131,387	910,000	1,239,000
64	1,092,102	869,000	1,183,000
65	1,202,906	824,000	1,141,000
66	1,183,926	766,000	1,094,000
67	1,283,631	730,000	1,014,000
68	1,345,513	688,000	968,000
69	1,459,564	646,000	917,000
70	1,267,709	606,000	856,000

Table 6: Savings needed to support $70,000 p.a. in retirement with differing levels of confidence vs. median balance

Couple's age	Median balances for two member SMSFs ($)	Savings required to support $70,000 p.a. for life ($)	
		with 80% confidence	with 95% confidence
57	1,028,574	1,595,000	2,046,000
58	1,077,044	1,546,000	2,008,000
59	1,078,928	1,488,000	1,918,000
60	1,137,429	1,436,000	1,841,000
61	1,069,204	1,384,000	1,815,000
62	1,132,726	1,339,000	1,750,000
63	1,131,387	1,297,000	1,702,000
64	1,092,102	1,249,000	1,640,000
65	1,202,906	1,194,000	1,581,000
66	1,183,926	1,143,000	1,524,000
67	1,283,631	1,090,000	1,430,000
68	1,345,513	1,034,000	1,363,000
69	1,459,564	980,000	1,314,000
70	1,267,709	930,000	1,244,000

Table 7: Savings needed to support $100,000 p.a. in retirement with differing levels of confidence vs. median balance

Couple's age	Median balances for two member SMSFs ($)	Savings required to support $100,000 p.a. for life ($)	
		with 80% confidence	with 95% confidence
57	1,028,574	2,593,000	3,369,000
58	1,077,044	2,532,000	3,276,000
59	1,078,928	2,458,000	3,158,000
60	1,137,429	2,389,000	3,058,000
61	1,069,204	2,321,000	3,001,000
62	1,132,726	2,272,000	2,946,000
63	1,131,387	2,198,000	2,879,000
64	1,092,102	2,136,000	2,775,000
65	1,202,906	2,076,000	2,674,000
66	1,183,926	2,003,000	2,578,000
67	1,283,631	1,928,000	2,473,000
68	1,345,513	1,847,000	2,363,000
69	1,459,564	1,760,000	2,277,000
70	1,267,709	1,694,000	2,170,000

Appendix 2 – Methodology and assumptions

Imputed investment return methodology

Imputed SMSF investment returns presented in this paper are based on financial information provided to Accurium with the application for an actuarial certificate. As such, the imputed investment return is calculated net of fund expenses, but before allowance for any income tax that may be payable (or tax refunds such as imputation credits). Member cash flows are allowed for in the return calculations to the extent that they have been included in the data provided to us. Fund expenses include administration costs and levies, professional fees and may also include life insurance premiums paid by the fund (which would not ordinarily be regarded as reducing investment returns). This means that the median imputed investment return might by very slightly lower than the actual investment return.

There are two other factors that should be taken into account in drawing conclusions from the imputed investment returns in this paper:

- the dataset of funds is restricted to SMSFs that need an actuarial certificate. This means they are partially in the retirement phase and might have a different asset allocation from a typical accumulation fund; and
- after-tax returns might actually be higher for SMSFs receiving substantial franking credits.

Note that care must be taken when using these imputed investment returns, particularly when making comparisons with other investment return data, particularly from other superannuation sectors. For example, both the data collected and the methodology used are different from that used by APRA to estimate returns on assets for APRA-regulated superannuation funds. Appendix 2 to the ATO's 'Self-managed super funds: A statistical overview 2014-2015' explains a number of the data limitations and differences in methodologies that affect comparisons of SMSFs with non-SMSF sectors.

It should also be noted that the 2013 financial year was the first year in which SMSFs were required to value all assets at market value in their accounts[6]. It is not known to what extent this will have affected SMSF balances in that year[7].

Modelling methodology

Accurium provides actuarial services for over 65,000 SMSFs. This uniquely positions us to develop insights into how well prepared SMSF trustees are for retirement.

The analysis is based on the outputs of Accurium's Retirement Adequacy Model, which uses stochastic modelling, instead of a deterministic modelling approach often used in retirement financial planning. Deterministic modelling is convenient and relatively simple because it assigns assumed, fixed values to random variables like expected share market returns and individual life expectancy. Deterministic models often employ mean or median values as 'averages' for reasons of intuitive appeal. However, this approach is inherently flawed, because by definition, the majority of outcomes will not reflect these assumptions. Surveys show[8] that retirees are left with understandable concerns around outliving their savings.

Stochastic (or probabilistic) modelling doesn't assume fixed values for key unknown variables. Instead, it accepts uncertainty and computes thousands of possible scenarios using a range of values for each variable, and in doing so can ascribe probabilities or confidence intervals to each outcome. Where a deterministic model will posit an 'average' output based on 'average' inputs, a stochastic model can calculate the probability of achieving a given output and therefore allows retirees to make informed decisions that take into account risk.

Accurium's Retirement Adequacy Model incorporates variables in investment returns, inflation rates, Age Pension payments and retiree lifespans. We have forecast typical SMSF trustee couples through 2,000 'what if' scenarios for each of these variables. Each scenario demonstrates a different series of possible market returns, inflation rates and lifespans. For the calculations in this paper, the assumed investment mix used is based on the average for SMSFs in pension phase published by the ATO.

6 Regulation 8.02B of the Superannuation Industry (Supervision) Regulations 1994.

7 For a more comprehensive discussion of the differences in investment performance reporting across the industry, see Appendix 1 to the 2010 report by Industry Super Network (now ISA) entitled: 'Towards full and transparent reporting of investment returns in super'.

8 Investment Trends: 2014 Retirement Income Report.

Modelling assumptions

Some of the key things to note about the calculations underlying the tables in this paper are:

- Spending is assumed to increase with inflation each year in retirement except:
  - When retirees reach age 85 spending is assumed to reduce by 10%. This reduction is in line with that found in the ASFA Retirement Standards that show that spending on travel and leisure reduces with age, partially offset by an increase in medical costs.
  - When the first spouse in the couple passes away spending is assumed to reduce by 30% to reflect lower living costs for single people.
- No explicit allowance is made for aged care costs. However, it is assumed that retirees do not sell or downsize their home. Anecdotally, the family home is often relied upon for meeting significant residential aged care costs that can sometimes arise in later life.
- When calculating the probability of being able to sustain a particular standard of living for life, we assume that all capital is available to be used to support that level of spending (there is no minimum bequest requirement).
- The statistics used to generate longevity scenarios are based on the 2010-12 Australian Life Tables published by the Australian Government Actuary. We also allow for the 25-year mortality improvement rates from the same publication.
- On the death of one spouse, all assets and superannuation are assumed to transfer to the surviving spouse.
- The investment returns and rates of inflation used to calculate the statistics have been generated by Willis Towers Watson using their Global Asset Model.
- The assumed investment mix is based on the average for SMSFs as published by the ATO. We assume the SMSF investment mix is regularly rebalanced throughout retirement and an allowance is made for fund expenses.
- Tax on non-superannuation investment returns is modelled; including the senior Australians tax offset (SATO) rules and Medicare Levy.
- The Age Pension is allowed for using Centrelink means testing rules i.e. we assume the person is eligible based on residency rules.

Other, more detailed, points to note include:

- The Minimum Pension Standards, as required under the Superannuation Industry (Supervision) Regulations, are allowed for. If the minimum pension payment in any particular year exceeds the household's spending, then this is added to the household's non-superannuation assets.
- SMSF pensions are assumed to be subject to the Centrelink deeming rules, rather than grandfathering rules (i.e. they are assumed to have commenced on or after 1 January 2015).
- All tax and Centrelink rates, bands and thresholds used are those current as at 1 July 2017. All future payment rates, bands and thresholds are assumed to change in line with inflation each year.
- We have allowed for the following asset mix in line with the ATO average for SMSFs in pension phase:
  - Cash 25.1%
  - Fixed interest 3.5%
  - Property 12.5%
  - Australian shares 44.4%
  - Overseas shares 0.6%
  - Other growth 13.9%

- We have allowed for the following fees and charges:
  - SMSF administrative fees of $2,500 per annum
  - Investment management charges within the SMSF of:

Cash	0% p.a.
Fixed interest	0.5% p.a.
Property	0.8% p.a.
Australian shares	0.5% p.a.
Overseas shares	1.0% p.a.
Other growth	0.5% p.a.

  - Investment management charges on non-superannuation assets of:

Cash	0% p.a.
Other assets	0.5% p.a.

Notes

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