October 2020

Mr Mark Fitt
Committee Secretary
Senate Standing Committees on Economics
Department of the Senate
By email: Economics.Sen@aph.gov.au

Dear Mr Fitt,

Treasury Laws Amendment (Self Managed Superannuation Funds) Bill 2020

As the people's advocate in the superannuation sector, Super Consumers Australia supports reforms to improve member outcomes and has a track record of backing legislation when we are satisfied it will achieve this objective.[1] On this occasion, we don't believe the *Treasury Laws Amendment (Self Managed Superannuation Funds) Bill 2000* (the Bill) will make a meaningful contribution to delivering better member outcomes in an environment where barriers to accessing un-conflicted financial advice persist.

While the Bill is intended to improve 'choice and flexibility' for members,[2] the relationship between SMSF balance size and returns[3] and the significant administrative and compliance obligations associated with SMSFs means they are unlikely to be appropriate for the majority of people. SMSFs are also a complex product that expose people to a higher level of systemic risk. In consumer decision-making that involves weighing risks, research shows that most people judge risk intuitively and inaccurately, either over or under estimating it.[4] Having access to good quality, independent financial advice to help people decide if a SMSF is right for them is therefore imperative.[5]

However, the Productivity Commission has observed that there may be 'incentives for advisers to recommend setting up SMSFs to clients based on potential ongoing fee revenue to the adviser rather than because it is in the client's best interests.'[6] We are concerned that by effectively expanding access to SMSFs, the Bill may increase the potential for advisors to recommend an SMSF (or 'up-sell' to a current SMSF member) when it is not in a person's best interests, such as where they are unlikely to have a sufficiently large balance and/or are not equipped to fulfil the associated administration obligations. Our concern is amplified by research

[1] Including Protecting Your Super, Putting Members Interests First and Your Superannuation, Your Choice legislation.
[2] Treasury Laws Amendment (Self Managed Superannuation Funds) Bill 2020, Explanatory Memorandum, p5.
[3] Productivity Commission, *Superannuation: Assessing Efficiency and Competitiveness,* Inquiry Report, 2018. Finding 2.6 p151.
[4] ASIC and Dutch Authority for the Financial Markets, REP 632 *Disclosure: Why it shouldn't be the default*, 2019, p10.
[5] Productivity Commission, 2018, p599.
[6] Productivity Commission, 2018, p425.

about the extent to which financial professionals influence the decision to set up or join an SMSF.[7]

We also note there does not appear to be evidence of any demand to increase membership of SMSFs from four to six members. ATO data shows a steady five-year trend for the majority of funds to consist of two members, and a slight decrease over the same period in the proportion of funds with three or four members.[8]

For these reasons, which are further detailed below, we do not support the Bill at this time. We are happy to provide further information to the Committee on request, including by giving evidence at a public hearing.

About Super Consumers Australia

Super Consumers Australia (Super Consumers), formerly known as the Superannuation Consumers' Centre, is an independent, not-for-profit consumer organisation formed in 2013. First funded in 2018, we work to advance and protect the interests of low and middle income people in the Australian superannuation system. During its start up phase Super Consumers has partnered with CHOICE to deliver support services. CHOICE is the leading consumer advocate in Australia, established 60 years ago, it is an independent voice, ensuring consumers get a fair go.

Why Super Consumers does not support the Bill

Super Consumers does not support the *Treasury Laws Amendment (Self Managed Superannuation Funds) Bill 2020* for the reasons outlined below.

1. The majority of people do not belong to SMSFs and SMSFs are unlikely to be appropriate for most people

While the SMSF sector has grown over the past decade, the majority of Australians do not belong to SMSFs[9] and the evidence suggests that SMSFs are unlikely to be a good option for most people.

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[7] Ron Bird, Doug Foster, Jack Gray, Adrian Rafferty, Susan Thorp and Danny Yeung, 'Who starts a self-managed superannuation fund and why?', *Australian Journal of Management*, 2018; Susan Thorp, Ron Bird, Doug Foster, Jack Gray, Adrian Rafferty and Danny Yeung, 'Experiences of current and former members of self-managed superannuation funds', *Australian Journal of Management*, 2020.
[8] ATO, *Self-managed super fund quarterly statistical report*, June 2019. Membership sizes table.
[9] As at June 2019, SMSF members were 4% (1,125,000) of all super fund members (27,489,000) according to APRA, *Annual Superannuation Bulletin: June 2019*, Report, January 2020, p. 11.

[redacted]

Unlike MySuper and Choice funds, the SMSF sector is not prudentially regulated and members have significant administrative obligations. This creates exposure to a higher level of risk that not all individuals will be well equipped to manage.

There is also a link between SMSF balance size and outcomes. The Productivity Commission's inquiry into superannuation highlighted poorer outcomes for smaller SMSFs (those with assets under $500,000), with many delivering materially lower returns on average than larger SMSFs[10] and having significantly higher costs, on average, than APRA regulated funds.[11] It is only when SMSFs have over $1 million in assets that the costs become broadly comparable with APRA regulated funds.[12]

These findings are significant when considered alongside ATO data showing that in 2017-18, the modal age range of a member establishing an SMSF was 35-44[13] and the median asset size per SMSF in the establishment year was $268,664.[14] In addition, according to the Productivity Commission in 2018, the median balance size across all funds (excluding SMSFs) for those in the accumulation phase) did not exceed $100,000.[15]

The data suggests that most people will not have a sufficiently large balance to avoid the higher costs and lower returns associated, on average, with smaller SMSFs. The Productivity Commission found that 'a low fee product that, over a person's working life, exposes them to a mix of defensive and growth assets, is likely to meet the needs of most Australians during the accumulation phase.'[16] Commenting on its findings on scale and SMSF performance, the Commission said that 'advisers should be prepared to justify to ASIC why they are recommending any SMSF be established with the balance not expected to surpass $500,000 within a few years of establishment.'[17]

Reforming the default allocation system so that people default into one high performing fund in their lifetime (with the option to switch) will have a much greater tangible impact on improving member outcomes than tinkering with the SMSF system in the way the Bill seeks to do.

[10] Productivity Commission, 2018. Finding 2.6 p151
[11] Productivity Commission, 2018. Finding 3.8 p194
[12] Productivity Commission, 2018. Finding 3.8 p194
[13] ATO, *Self-managed super funds: a statistical overview, 2017-2018.* Table 19: Age ranges of SMSF members
[14] ATO, *Self-managed super funds: a statistical overview, 2017-2018.* Table 6: SMSF asset size in establishment year, 2013–14 to 2017–18.
[15] Productivity Commission, 2018. Technical Supplement 1: Members surveys.
[16] Productivity Commission, 2018. Finding 4.2 p 212
[17] Productivity Commission, 2018, p599.

[redacted]

2. Conflicts in financial advice persist and financial advisers stand to benefit from the expansion of SMSFs

Access to good quality, independent financial advice to help people decide if an SMSF is right for them is critical. SMSFs are a complex product that expose people to a higher level of systemic risk.

In consumer decision-making that involves weighing risks, research shows that most people judge risk intuitively and inaccurately, either over or under estimating it.[18] Far from the stereotype of SMSF owners as sophisticated investors, research cited by the Productivity Commission found that SMSF investors have no better financial literacy than other superannuation members, while its own members survey found that SMSF investors actually had lower average financial literacy.[19] The Commission also highlighted ASIC's 2018 finding that a sizable minority (between 30%-40%) of SMSF members 'lacked a basic understanding of their SMSF and their legal obligations as SMSF trustees'.[20]

In reality, conflicts in the financial advice market persist. We are concerned that the Bill may increase the potential for advisors to recommend SMSFs to people (or 'up-sell' to existing members of SMSFs) when it is not in their best interests, leaving them substantially more vulnerable to poor outcomes, particularly in the absence of the prudential safeguards that apply to MySuper and Choice funds. The Productivity Commission agreed, finding that there may be 'incentives for advisers to recommend setting up SMSFs to clients based on potential ongoing fee revenue to the adviser rather than because it is in the client's best interests.'[21] Expanding SMSF membership capacity may increase this incentive (eg. adviser suggests adding existing member's children to SMSF), especially given that SMSF owners are already major users of advice services.[22]

The Productivity Commission pointed to research by ASIC in 2018 which found that 86% of advisers had not demonstrated they had prioritised the client's interests, 91% had not complied with the requirement that advice be appropriate, and 62% of advice had not demonstrated compliance with the best interests duty and related obligations. In 10% of 250 randomly selected SMSF client files reviewed, ASIC found the client 'risked being significantly worse off'

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[18] ASIC and Dutch Authority for the Financial Markets, 2019, p10.

[19] "However, the share of SMSF members getting at least two out of the three questions on financial literacy correct was the same as other choice members, where a choice member is defined as a member not in a default fund plus members who made an active decision to stay in (or join) their current default fund." Productivity Commission, 2018, p208.

[20] Productivity Commission, 2018, p253.

[21] Productivity Commission, 2018, p425.

[22] Representing around one fifth of Australian financial advice industry's revenue in 2016-17. Productivity Commission, 2018, p282.

[redacted]

and a further 19% of clients were at an 'increased risk of suffering financial detriment'. The Commission also noted a sharp increase (albeit from a small base) in complaints to the Financial Ombudsman Service (now AFCA) about financial planning advice for SMSF owners.[23] In 2019-20, SMSF complaints accounted for 22% of complaints about financial advisers.[24]

These findings are even more concerning when considered alongside other research. For example, the Commission cited research suggesting that clients who form favourable views of advisers tend to maintain those views even when the quality of the advice does not justify their decision, and that current and former SMSF members were significantly more likely to trust their advisers and hold them in high esteem compared with non-SMSF members.[25] Research also shows the extent to which financial professionals, including financial planners, influence people's decision making about setting up or joining an SMSF. Over 50% of surveyed current and former members of SMSFs say that a financial professional first started them thinking about setting up or joining an SMSF, while only around 22% said the fund was their own idea.[26]

To strengthen SMSF advice safeguards, the Productivity Commission recommended that the government should:

- require specialist training for people providing advice to set up an SMSF
- require people providing advice to set up an SMSF to give prospective SMSF trustees a document, prepared by ASIC, outlining 'red flags' prior to establishment, and
- extend the proposed product design and distribution obligations to SMSF establishment.[27]

Conclusion

The Productivity Commission recommended that ASIC should undertake a thematic review in 2021 to assess whether the quality of advice provided to SMSF members has improved relative to the 2018 study.[28] If the Committee is genuinely concerned with providing better outcomes for fund members, it should recommend that the Bill be delayed until this review is completed and the findings considered.

In the meantime, the reforms recommended by the Productivity Commission to create stronger safeguards on SMSF advice should be fully implemented.[29] More broadly, systemic reform is

[23] Productivity Commission, 2018, p283.
[24] According to AFCA's datacube, in the 2019-2020 financial year, 130 of 590 complaints about financial advisers were related to SMSFs.
[25] Productivity Commission, 2018, p283.
[26] Bird et.al, 2018; Thorp et.al, 2020.
[27] Productivity Commission, Inquiry Report, 2018, Recommendation 12.
[28] Productivity Commission, 2018, p500.
[29] Productivity Commission, Inquiry Report, 2018, Recommendation 12.

needed to ensure people have access to independent, affordable financial advice.[30] We support Commissioner Hayne's recommendation that there should be a review of measures that have been implemented by the Government, regulators and financial services entities to improve the quality of financial advice by 30 June 2022.[31]

We appreciate the opportunity to provide this submission to the Committee and hope it is useful. Please do not hesitate to contact me if we can assist further.

Yours sincerely,

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Xavier O'Halloran
Director
Super Consumers Australia
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[30] Most recently in our submission to Inquiry into Future Directions for the Consumer Data Right (May 2020), submission to ASIC on advice fee consents and independence disclosures (April 2020), submission to the Retirement Income Review (February 2020), and submission to The Treasury on Enhancing Consumer Protections and Strengthening Regulators (February 2020). Submissions available at www.superconsumers.com.au
[31] Financial Services Royal Commission, Final report, Recommendation 2.3.

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