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Dear Sir/Madam,

RE: Treasury Laws Amendment (Self Managed Super Funds) Bill 2020

I am pleased to make an invited submission to the Senate Economics Legislation Committee in relation to a bill to amend the maximum number of allowable members in SMSFs from four to six.

My submission is primarily based on research findings from two peer-reviewed articles published by the Australian Journal of Management:

Susan Thorp, Ron Bird, Doug Foster, Jack Gray, Adrian Raftery, and Danny Yeung (2020) Experiences of current and former members of self-managed superannuation funds, https://journals.sagepub.com/doi/pdf/10.1177/0312896220936338.

Ron Bird, Doug Foster, Jack Gray, Adrian Raftery, Susan Thorp and Danny Yeung (2018) Who starts a self-managed superannuation fund and why? https://journals.sagepub.com/doi/pdf/10.1177/0312896217747331

Is raising the maximum number of members likely to change the net establishment rate of SMSFs?

Although the number of SMSFs has continued to grow, the net establishment rate of SMSFs has been slowing from over 30,000 in 2011-12 to fewer than 1,500 in 2017-18.[1] Is this slowing in growth caused by the limit on membership, at least in part? In short, no. Although up to four members were allowed, by far the majority (93%) of SMSFs had two or fewer members in 2017-18 according to ATO member demographic data. This pattern of membership, where 7% of funds or fewer have more than two members, has been constant over at least the past four years. Further, the observation that fewer than 4% of funds at are the maximum four members indicates that while the current maximum

[1] ATO data accessed at https://www.ato.gov.au/About-ATO/Research-and-statistics/In-detail/Super-statistics/SMSF/Self-managed-super-fund-quarterly-statistical-report---March-2020/?anchor=SMSFpopulationtableannualdata#SMSFpopulationtableannualdata

could be limiting to some current or potential members, it appears not to be a constraint on the overwhelming majority. Net establishments are not likely to increase rapidly with a relaxation to six members unless other factors come into play.

Who is likely to favour a higher maximum member limit for SMSFs?

Over 50% of surveyed current and former members of SMSFs say that a financial professional such as an accountant or financial planner first started them thinking about setting up or joining an SMSF (Bird et al. 2018; Thorp et al. 2020). Only around 22% said the fund was their own idea. Further, most SMSF members report relying on financial professional for support in the operation of their fund, frequently for tasks such as tax compliance, investment strategy formulation and administration. Thus financial professionals who serve the SMSF sector may benefit from 1) in increase in the number of SMSFs; and 2) from serving SMSFs with a higher asset value where delegation of planning and operation to financial professionals is more likely. To the extent that raising the maximum members allows more, larger SMSFs, financial advisers are likely to benefit from, and favour, the change.

Potential members with lower accumulations may find a larger membership makes their SMSF more efficient and less burdensome. To the extent that SMSFs with more members also have higher asset values but do not incur additional costs, expense ratios could fall for funds with more members. It is important to recognise that more members alone does not reduce inefficiency except where more members results in increased scale. A key reason for the closure of SMSFs is that members find the administrative and compliance burden outweighs the benefits. Spreading the work could reduce that load (Thorp et al. 2020).

Estate-planning in family-based SMSFs could be helped by a change to more members especially since a majority of Australians bequeath their estates to immediate family. Along the same lines, a larger membership can provide self-insurance against some risks. Younger family members can help with fund administration when older members experience reduced capacity. As the population ages, the problem of cognitive decline with age may well mean that older SMSF trustee-members will need help to manage their financial circumstances. Older people tend to be less risk tolerant but also more

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vulnerable to positivity bias and consequently to fraud.[2] Younger members can help manage these risks.

Then again, some risks are increased as members of the same family join a fund. SMSFs are vulnerable to all kinds of household-level shocks, including divorce, ill health and death of partners. The more members, the more probable it is that a fund experiences such shocks. Around one in four surveyed ex-SMSF members report change in personal circumstances or ill health as the reason for closing or leaving their SMSF (Thorp et al. 2020).

Is it beneficial to house more superannuation assets in SMSFs?

The large-fund sector of the Australian superannuation system is prudentially supervised by APRA, which is consistent with the mandatory features of the Superannuation Guarantee that create an obligation for public agencies to protect members. By contrast, the SMSF sector is compliance-regulated by the ATO and presents different systemic risks. Growth in the number of superannuation members in a sector that is not prudentially regulated should be considered with systemic risks in mind. SMSF member-trustees are not generally more capable than large-fund members. Academic research shows that 1) SMSF members are not more financially sophisticated than the general population of superannuation fund members; 2) do not carefully monitor the performance of their funds relative to other superannuation vehicles; and 3) tend to both over-confidence in their own abilities and over-optimism in their funds' performances (Bird et al. 2018; Thorp et al. 2020). Changes in the rules that allow more people to enter the sector warrant close consideration.

Yours faithfully

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Susan Thorp

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[2] 50. Keane, Michael and Susan Thorp, (2016) Complex Decision Making: The Roles of Cognitive Limitations, Cognitive Decline and Ageing, in J. Piggott and A. Woodland, (eds) Handbook of the Economics of Population Ageing, volume 1B, Elsevier, 661-702