Monday, 17 July 2006

Committee Secretary
Parliamentary Joint Committee on Corporations and Financial Services
Department of the Senate
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Parliament House
Canberra ACT 2600
Australia

Email to: corporations.joint@aph.gov.au

Dear Sir/Madam

**Submission**

As an individual who runs my own DIY self managed superannuation fund I seek to make a submission.

1. **Whether uniform capital requirements should apply to trustees.**

   No, capital requirements should only be designed to share risk between the trustee/promoter and fund member, and tailored accordingly. They should not be uniform. Demand for high uniform requirements is an anti-competitive ploy designed to restrict the supply of superannuation products to the big end of town. Any suggestion that Mum and Dad DIY super trustees, risking only their own savings, should need or have the same capital requirements as promoters of large branded funds is clearly absurd.

   Unlike DIY Super Investors, Public super promoters risk the savings of thousands of unrelated members, at little risk to their own savings. A superior investment result by public promoters, not regulation, is the most consumer beneficial way to reduce the attractiveness of DIY investment.

2. **Whether all trustees should be required to be public companies.**

   No. My DIY fund involves only me. No body else's money is at risk. What benefit could my DIY super fund, or the community generally, possibly receive from such an absurdly onerous and expensive proposal? I do not need a public company to invest my own money in any other kind of endeavour, or run my own business involving many other stakeholders such as employees and creditors, or wind up an estate, or a million other endeavours. Why should my DIY super fund have to pay a load of already well remunerated hangers on for nothing? The only benefit would accrue to branded funds wanting to unfairly lard up their DIY competitors with overheads.

A public company is no guarantee of probity. People such as Christopher Skase, Laurie Connell, and a plethora of former state government bankers all ran public entities.

## 3. The relevance of Australian Prudential Regulation Authority standards.

DIY superannuation should only be subject to the same kind of regulation as my other DIY investment activities – apart from tax avoidance regulation, virtually none. My DIY fund involves only me. No body else's money is at risk. The active promotion by big end of town super promoters to lard up DIY costs by increasing DIY regulation is no benefit to the DIY fund, but an anti-competitive ploy to the benefit of branded fund promoters.

APRA standards are seriously deficient in some areas however:

- Unlike public company employees, Fund employees and promoters personal remuneration need not, and rarely is, disclosed to members.
- Unlike public company employees, Fund employees and promoters need not disclose publicly their own buy/sell arrangements. While public company officers must on pain of penalty, disclose all their conflict of interest dealings to shareholders, superannuation fund employees are free to put their own hidden buy and sell orders in ahead of their members interests.
- Unlike public companies, Funds promoters need not, and never do, hold annual general meetings to submit their actions and themselves to their investors.

## 4. The role of advice in superannuation.

Financial product sales staff ought to be identified to prospective purchasers as what they really are, sales staff. It is a fraud on consumers to suggest they are advisers, planners, consultants and the like.

Currently, sales advice available to consumers is unsatisfactory. Sales regulations are skewed by captive regulators to align with the profit enhancing interests of public promoters, not the protection of consumers.

Although highly lucrative for promoters, it is unfair on trusting and naïve consumers that tied commission based sales staff can falsely assume the trappings and appearance of expert, skilful and independent analysts.

Sales staff describe themselves as “financial advisers, consultants, planners” and anything else necessary to conceal their true salesperson status. They are also allowed to conceal the promoter's control, or even ownership of the salesperson's every action, by using misleading firm names that do not mention the promoter as principal.

With very few exceptions, consumers are unaware they are seeking advice from a barber as to whether, and by whom, they need their haircut.

It is unfair such financial salespeople are not clearly branded as financial product salespeople and hold financial product sales licences and not misleadingly titled "investment" (AFSL) licences.

It is a cruel deception on consumers for government to issue "investment" type licences for sales staff without any requirement for investment skills. Bizarre as it seems, there is no legal requirement whatsoever for a "financial planner" to actually have any skills or experience in, or ever be examined on, their ability to invest.

The incidence of conflict of interest "rorts" might be expected to substantially reduce if unsuspecting consumers were properly informed when they are discussing what to do with their money, that they are speaking to a tied salesman, only able to sell the limited range of products on the promoters list.

The car industry does not pretend its commission sales staff are skilled "transport advisers" able to analyse and select the best solution to our transport needs. They are clearly identified as partisan sales staff, and conflict of interest then becomes a non-issue. Tied Investment product salespeople should be similarly easily identifiable.

The current commission versus fee for service controversy is a furphy. It is another ploy by promoters to muddy the waters so as to deflect any move to have a promoter's sales force clearly identified as a partisan sales force. Promoters seek to confuse. They seek to retain the highly lucrative appearance of consumer friendly professional independence, so as to simplify sales closures with naïve consumers whose guard is down.

**5. The meaning of member investment choice.**

This has no practical relevance in a DIY situation because all members are trustees, and make all investment decisions. The current requirements larding up costs on DIY funds are wrong. Currently a single member DIY fund has to formally go through the charade of formally advising themself as member, in writing, what they are going to do with their own money. This is just one of many time wasting regulatory ploys, complete with substantial penalties for non compliance, designed to lard up DIY with costs and inconvenience so as to discourage DIY and help branded superannuation fund promoters. It does not help anyone. In contrast, entities ranging from public companies like AMP Ltd to private investors for example, are not legally required to have an investment plan, ridiculously a sole member super fund must.

**6. The responsibility of the trustee in a member investment choice situation.**

In a DIY fund the trustees and members responsibilities and benefits are perfectly correlated because they are identical, they are the same people. There is no higher responsibility because no one takes better care of my money than

myself because I bear all the costs of my errors and all the rewards of my skill. Unlike a branded fund, there are no managers extracting handsome rewards irrespective of performance.

**7. The reasons for the growth in self managed superannuation funds.**

Growth in self managed small superannuation funds, like growth in small business generally ought to be fostered, appreciated, and encouraged. Australia is the easiest place in the world to start a business. There are virtually no regulations discouraging commencement of a small business. Although some fail, consumers benefit from competition. Fresh competition introduces fresh ideas and makes cartels impossible. Consequently low life incumbents often try to encourage regulation to prevent competition from new players. The standard practice is to promote regulatory competition barriers, by suggesting self-managed DIY super somehow threatens the savings of widows, orphans and lunatics.

It is a sad example of the significant anti-competitive influence of big end of town super fund promoters that they are able to wrongly limit DIY superannuants by branding them as some kind of anti-social pariahs in need of discouragement and whose activities are generally negative and ought to be of concern to legislators.

A superior result by branded funds, not regulation is the most consumer beneficial way to reduce the attractiveness of DIY superannuation.

Vanguard (*Smart Investing 2006 page 1)* claim "*most professional money managers fail to outpace appropriate market indices"* and *"those that do rarely repeat in the future their success in the past"*

Some people like to do it themselves, often the same kind of people that competently and successfully run the many smaller businesses in Australia.

Contrary to branded retail superannuation fund publicity; satisfactory DIY investment performance is not hard. Unlike a public promoter a DIY fund with a few thousand to invest can select from any one of the approximately 1600 ASX listed public companies, many of which are highly profitable and successful, though smaller businesses. A large branded fund cannot. They must restrict themselves to the few big companies at the top and ignore the hundreds and hundreds of profitable, successful and growing mid-size and smaller ASX listed companies. The size of the branded funds buy and sell orders compared to the size of a smaller companies share register ensures they cannot buy or sell any meaningful quantity without substantial profit destroying price change. Unlike a DIY investor they cannot buy or sell quantities commensurate with the requirements of the funds at their disposal, without prices climbing through the roof or falling through the floor.

The size of a branded funds investment pool prevents them from participating in most Australian companies success and leads most of them to be merely closet index huggers, charging huge fees for indifferent performance.

Public investors like ARGO, Milton, Djerriwah. AFIC etc charge a fraction of one percent compared to up to 5% or more by branded funds promoters for worse performance.

Branded fund promoters have been successful in limiting DIY performance by ensuring DIY funds are larded up with meaningless, but profit reducing hindrances such as onerous ever changing regulation with huge disproportionate penalties for non compliance, compulsory audits, written investment plans, fees to lodge tax returns, limited investment areas, and limited kinds of benefits.

Why should a DIY super fund require any different regulation to an investment partnership? The risk to government revenue is the same. The answer is: one is seen to compete against big end of town interests, the other is not.

It is now appropriate to substantially reduce DIY regulation as the government has announced the abolition (May 06 Budget Announcements) of income tax from do it yourself superannuation funds paying pensions, and the recipients of those pensions, As such DIY super funds cannot lead to revenue loss, why regulate them at all.

**8. The demise of defined benefit funds and the use of accumulation funds as the industry standard fund.**

I have no submission to make.

**9. Cost of compliance.**

DIY funds compliance costs are excessive. Branded fund promoters seek to reduce DIY performance by continually clamouring to ensure DIY funds are larded up with meaningless, but profit reducing requirements such as onerous ever changing regulation, compulsory audits, written investment plans, fees to lodge tax returns, limited investment areas, and limited kinds of benefits.

Branded funds promoters continually suggest there is something sinister and anti-social about individuals who wish to manage their own retirement, for no charge, and proffer expensive and onerous solutions to non-existent but cleverly imagined possible problems. They seek merely to reduce competition, not solve problems.

DIY funds should only have to meet the same compliance regime that non-superannuation DIY investments do, apart from tax requirements, virtually none.

For example, there is no benefit to DIY members from the current requirement for a compulsory audit of their actions. No other similar private companies, partnerships, trusts, individuals and the like must have a compulsory audit. The Tax department check all other entities for compliance free of charge, including branded superannuation funds. Only DIY funds must pay for their

own tax compliance costs. This costs approximately $1,500pa on top of other normal tax return and financial preparation costs of approximately $500. This extra cost reduces the profitability of honestly run DIY funds only. It cannot stop errors or foolish or dishonest action. An audit can never prevent such action because it always takes place after the financial year has ended, when the foolish or dishonest action has already taken place.

**10. The appropriateness of the funding arrangements for prudential regulation.**

Prudential regulations funding should be charged to promoters, in proportion to the number of complaints against trustees that members make to regulators, in a similar manner that promoters charge premiums in their insurance businesses. Any other base is designed simply to enable branded funds promoters, who are the targets of most complaints, to free load on DIY funds.

DIY members and trustees are the same people. They are easily able to answer their own queries, and logically unable to swindle themselves.

**11. Whether promotional advertising should be a cost to a fund and, therefore, to its members.**

I have no submission to make.

**12. The meaning of the concepts "not for profit" and "all profits go to members."**

I have no submission to make.

**13. Benchmarking Australia against international practice and experience.**

British regulation, of their equivalent to DIY self managed superannuation is less onerous than Australian regulation. For example moderate borrowing by a British DIY superannuation fund so as to cautiously enhance the final result is permissible. It is analogous to borrowing to buy a home. This has only relatively recently become illegal in Australia following submissions by branded funds promoters concerned at the leakage of profit to small business, comfortable and experienced with borrowing and anxious to invest in their own premises and business as a morally legitimate retirement strategy.

On another matter, it is ridiculously misleading for superannuation promoters who have been investing money for decades, and sometimes centuries, to quote large returns for small time periods for individual small funds in their stable, instead of average returns for all funds since incorporation. The current misleading practice of continually starting and winding up funds enables true average investment returns to be masked. It seems that the same superannuation promoters are continually starting new funds that if they do well are promoted in a blaze of publicity and then quietly pulled from public view once performance flags, to be replaced by another new short-term skyrocket. There are more investment funds available to consumers than there are shares on the stock exchange, yet no superannuation fund promoter ever quotes average returns for all funds under their control, or the average return

for all their funds over the last few decades. Promoting a few short-term skyrockets as the kind of average performance consumers might expect, is purposely misleading, even when coupled with the usual weasel words in minute type about past performance not being indicative of the future.

ARGO, Milton, Djerriwah, AFIC, Souls etc quote total returns net of all charges over decades. No superannuation fund promoter does.

**14. Level of compensation in the event of theft, fraud and employer insolvency.**

Any compensation scheme can give rise to moral hazard, which ought not to be encouraged. A superannuation fund promoter able to access compensation has no incentive not to chase the highest return virtually irrespective of risk. If the gamble works, high returns and personal success to the promoter accrues. If the gamble fails compensation is available, and in the meantime high promoter remuneration can be paid while it worked. It is not illegal, though highly hazardous to long-term financial health, to chase risky high returns. Doing so is a risk free way for a dodgy substandard promoter to gain a short term edge over his more honest competitors. In other words the same logic that gave rise to cancellation of government guarantees for banks applies to super fund promoters.

Honest, cautious super fund promoters do not need guarantees; dishonest ones should not be able to freeload on them.

**General**

I am concerned at repeated attempts by big end of town branded superannuation fund promoters to successfully lard up the costs of do-it-yourself so as to nobble competition.

Regulators of superannuation funds appear to be an example of what economists call captive regulatory authorities. That is regulators that by cunning industry influence over many years, end up naively serving the interests of the industry they regulate, so as to limit profit eroding competition, rather than the interests of consumers they were originally formed to protect.

It seems amazing that in the 21st century, do it yourself superannuation has not gone the same way as most home-brew do it yourself tasks of the past. The reason seems high fees caused by lack of competition. The industry has successfully maintained barriers to competition and seems intent on seeing off the competition from do it your selfers by obtaining regulatory change, rather than the more consumer beneficial step of harnessing economies of scale to produce a superior product at a lower cost.

No doubt some do it yourself superannuation trustees are silly enough to think they can come out ahead robbing their own superannuation fund, but in absolute terms surely not enough idiots to justify the regulatory costs to all. In any event DIY funds are largely self-policing, if you rob yourself you clearly cannot avoid the loss.

Recent regulatory changes seem part of larger attempts to force self-managed superannuation assets out of the hands of their owners and into the hands of branded product salesmen by:

- larding up the costs of running a self managed super fund so as to attempt to reduce their cost competitiveness against branded funds.
- Disproportionately harsh punishment of even minor transgressions by a do it yourself superannuant.
- Limiting the kinds of superannuation fund pensions and activities that can be self managed.
- Subjecting the industry to constant regulatory change so that only industry insiders can operate funds penalty free.

For example:

a) The only entity in the whole of Australia that must pay a fee to lodge an income tax return is a small DIY super fund. The large branded funds do not pay fees to lodge their tax returns. Believe it or not, large penalties (50% of fund assets) have been introduced which apply if this unique and discriminatory fee is accidentally paid from the wrong bank account.

b) The only entity in the whole of Australia required by law to have a business plan is a superannuation fund. Should a self managed super fund not have an approved investment plan, then irrespective of how successful they have been, in investing their own money, they face severe penalties. There is however, no fine attached to a public branded superannuation fund promoter dropping billions of superannuants dollars in dud overseas ventures as one of our most prominent branded funds did in Britain recently. They never even had to formally notify their members of their disastrous endeavour.

c) Recently it became an offence for an independent public accountant to raise with a client the possibility of running their own superannuation fund, (Corporations Act 2001 Reg 7.1.29) or even discuss superannuation with a client. Most public accountants have tertiary degrees and years of experience in business, and are not beholden to any fund. They are ideally placed to discuss financial problems with clients. However, independent accountants tend to suggest clients ask awkward questions of salesmen, like fees charged, and performance achieved. The awkward question "problem" was solved by the above regulation. In its original form it successfully prevented independent fee for service public accountants from freely discussing superannuation with clients.

   However if the accountant was also a licensed commission earning sales representative of a branded fund, discussing superannuation with a client was penalty free.

   The regulation contained a bizarre twist. If, despite the accountants best endeavours, the client insisted on talking about self managed superannuation with an "unlicensed" though independent accountant, that accountant was obliged to refuse any recommendation and instead provide the client with a

written instruction to discuss the matter with a tied branded superannuation fund sales representative or similar.

Funnily, or perhaps sadly, if an accountant was not truly independent but instead had a verbal arrangement to gain a backhander for recommending a particular sales representative, there was no regulatory need to mention that in the written instruction to the client.

Fortunately public ridicule and efforts by Senator Murray largely but not fully, overturned these anti-competitive regulations.

d) It is compulsory for a self-managed super fund to have an expensive annual audit. Why? Fund members achieve no benefit having to pay to have their own actions checked. Such audits are very expensive and add no value to the fund. No other entity most people are ever involved in running is subject to expensive compulsory audit. Audits are otherwise the exclusive province of well-heeled public organisations that might rob their stakeholders.

A superannuation audit, under unique Tax Act regulation separate from Corporations Act audit regulation applying to other entities, is a uniquely complicated and therefore expensive kind of audit because unlike most other audits:

- all transgressions virtually irrespective of triviality must be reported to regulatory authorities
- the auditor must report on a range of non-financial criteria, as well as financial

A superannuant can work as employee, or be self-employed, or for his or her own company, or can even be executor of an estate or run a family trust or perform a thousand other commercial activities. In none of these capacities must their actions be expensively audited even though it is far more likely that temptation to swindle the tax department or others might strike long before the temptation to swindle themselves in their own superannuation fund.

Policing tax defaulters is a free of charge service provided by the tax department for all other taxpayers. Self managed superannuation funds however must annually pay for their own policing, irrespective of the veracity or past track record of their members.

Audits do however lard up the costs and reduce the benefits of doing it your self to the advantage of big end of town promoters

e) A few years ago regulation change made it illegal for a business to rent premises or lease plant from their own superannuation fund – even if the owner is the only fund member.

That regulation was swiftly changed to exempt business real property when branded superannuation promoters pointed out to their regulatory friends that they often rent their own premises from the superannuation funds they control.

f) For a short period, a few years ago, do it yourself superannuation was effectively banned by the cunning device of requiring all superannuation fund trustees including self managed ones, to have a personal net worth of at least $5million. While this amount would be uselessly trivial for the protection of billion dollar branded fund members, it was an insurmountable barrier to most do-it yourselfers.

   Again informed public ridicule swiftly reversed the regulation.

g) The Australian Taxation Office recently mounted a campaign to lard up do it yourself superannuants costs and help promoters. They said do it yourself superannuants, unlike all other taxpayers, should employ two separate firms of professional advisors to sign and approve separate sections of their tax returns.

   The Australian Taxation Office has made no such suggestion in respect of any other kind of taxpayer. They have advised that they believe that unlike all other entities in Australia the do it yourself superannuation fund tax agent cannot now perform an audit function. Again like Treasury, they have refused to provide statistics to back up the need for the change.

   Again informed public ridicule swiftly forced a retraction on this latest attempt. Unfortunately I do not believe it will be the last.

Yours faithfully
Richard Jacobs.

**Ps: Following the May 06 Budget announcement abolishing tax on pension paying funds and their pension recipients, why regulate such DIY self managed funds at all? Such DIY super funds, however foolishly run, cannot ever lead to revenue loss.**