22 AUG 2006

Heffron
consulting

Heffron Consulting Pty Ltd
ABN 88 084 734 261
AFS Licence No. 241739

1/50 Belmore Road
Lorn NSW 2320

Correspondence to:
PO Box 20
North Maitland NSW 2320

Phone: (02) 4930 2100
Fax: (02) 4930 2199
Email: heffron@heffron.com.au

18 August 2006

Committee Secretary
Parliamentary Joint Committee on Corporations & Financial Services
Dept of the Senate
PO Box 6100
PARLIAMENT HOUSE ACT 2600

Dear Sirs

Inquiry into the structure and operation of the superannuation industry

Thank you for the opportunity to contribute to the above inquiry.

The Inquiry has very broad terms of reference covering a great number of areas and issues within the superannuation industry. The purpose of this letter is to provide our comments in relation to item 7 of the terms of reference – "The reasons for the growth in self managed funds".

We have divided our submission into three key areas:

- Why is self managed fund membership growing?
- Is it likely to continue?
- Should the Committee be concerned about this and should any action be recommended to restrict / promote self managed fund growth in the interests of the community?

Why is the number of self managed funds growing?

Self managed funds meet some important needs that are not met elsewhere in the superannuation industry. In our view, these have contributed substantially to recent growth:

- **Avoiding asset based charges.** A self managed fund is virtually the only superannuation structure which allows individuals total protection from fees based on a percentage of fund assets. Asset based fees invariably penalise those with larger superannuation balances and subsidise those with smaller balances.

  Community pressure and changes in business thinking have prompted many financial advisers to move to a genuine fee for service basis (where the fee charged is not related to assets, contributions or transactions but is instead linked directly to the service provided). However, conventional superannuation

platforms make it virtually impossible for individuals to avoid "percentage of assets" fees completely at the "structural" level:

- Master trusts, wraps etc invariably incorporate asset based administration and investment fees;

- Industry funds invariably charge at least some of their fees (and often a significant component) by adjusting unit prices or credited interest rates. Both of these methods are simply another way of implementing an asset based fee.

It is perhaps curious that in the robust and extensive debate about how financial planners "should" charge, there has been little obvious pressure on the charging structures of superannuation providers themselves.

Self managed funds allow those with a sufficiently large superannuation asset base to remove their wealth from the "percentage of assets" environment entirely.

This does not mean that no self managed fund member ever pays asset based fees. Many choose to pay on this basis in relation to some or all of their portfolio if doing so is perceived to be a sensible means of purchasing a particular service. The existence of their self managed fund, however, gives them the ability to make their own choices.

- **Minimising costs.** A related point is that a self managed fund is simply less expensive for many individuals with larger balances than commercial platforms, master trusts and industry funds.

- **Distrust of institutions.** Rightly or wrongly there would appear to be widespread distrust of "large financial institutions" within the community. The precise definition of "large financial institution" will vary between individuals but those with sufficient concerns will certainly look for opportunities to manage their affairs more closely and limit their dealings with an industry they distrust. There are many factors which could have contributed to this lack of trust:

  - numerous unit pricing scandals in recent years;
  - the perception that conflicts of interest are rife (for example, most commercial master trusts and platforms include their sponsor's own products regardless of whether those products would ordinarily merit inclusion);
  - the perception that they are large, unwieldy bureaucracies that are difficult to deal with and are likely to hinder rather than help members with particular concerns.

- **Total flexibility of investment choices (subject to statutory constraints).** Only self managed funds provide access to the full range of investment opportunities available under the Superannuation Industry (Supervision) Act and associated Regulations. Common exclusions from most (if not all) non self managed funds are:

  - private equity opportunities;
  - direct property;

This problem would never have occurred within a self managed fund as these funds are subject only to legislative requirements and not the administrative convenience of the provider.

- **Ability to change suppliers without adverse tax or other consequences**. A self managed fund is essentially a "platform for life". Should the individual change financial advisers, for example, they are not also required to change superannuation funds. In contrast, some wraps / master trusts are tied to specific adviser groups and therefore only accessible via particular advisers.

  A change in the fund's accountant and auditor can be achieved by simply exchanging records.

  In contrast, moving from (say) one wrap / master trust to another potentially results in capital gains tax, exit fees, entry fees, buy/sell spreads etc.

- **A natural result of financial education.** Increased financial awareness results in individuals being more aware of their rights, responsibilities and opportunities. A natural reaction for those who are capable of doing so is to take more control over their affairs. Having a self managed fund is a natural result in this process. While all self managed fund trustees will inevitably outsource some of the work involved (quite possibly including advice on compliance) having their own fund allows each individual or family group to choose exactly the level of involvement that is right for them.

Is it likely to continue?

The Government's recent initiatives announced as part of the May 2006 Federal Budget will almost certainly increase the flow of funds into superannuation generally. This will simply accelerate the move towards self managed funds because the above factors become even more acute for particular individuals as their personal superannuation wealth grows.

There are already some 317,000 self managed funds and they account for over 23% of total superannuation assets[2]. We see the self managed fund sector growing substantially beyond these levels in the future.

Should the Committee be concerned about this? Should any action be taken to restrict or promote self managed fund growth?

We do not believe the Committee should be concerned about the growth in self managed funds.

In contrast, we believe the Committee should actively support self managed funds as a viable alternative within the broader superannuation industry. The presence of a vibrant self managed fund sector is entirely consistent with the apparent philosophy of this Government to give individuals choices.

Recent years have seen considerable development in the expertise of the financial advisers and accountants who advise on self managed funds. This has been helped by developments such as:

---

[2] "Quarterly Superannuation Performance" (March 2006) APRA, page 7

- the formation of the Self Managed Superannuation funds Professionals Association of Australia (SPAA) which imposes its own educational / experience criteria on those wishing to receive the Specialist Superannuation Adviser designation;

- the proliferation of technical conferences which focus exclusively on self managed funds and the rules which must be understood in order to advise clients who have them;

- increasing emphasis within the accounting profession on educating accountants who audit self managed funds.

Like every other part of the superannuation industry, the self managed fund sector is not perfect and all participants need to continually improve their expertise. However, the industry has now become a critical part of retirement planning for many Australians.

Steps we suggest the Committee considers in order to support the self managed fund sector are as follows:

- allowing self managed funds to have more than 4 members where all members are part of the same family group;

- allowing superannuation funds to borrow (perhaps with agreed prudential limits). Borrowing to invest is a legitimate and commonly used wealth creation strategy and the superannuation environment is clearly the optimal structure in which to grow retirement wealth. The long term nature of superannuation (ie, funds cannot normally be accessed until retirement) makes it an ideal structure in which to borrow to invest. Permitting some level of borrowing within a superannuation fund simply aids individuals to save for their retirement;

- developing specific rules to assist self managed funds that merge or de-merge when family circumstances change (eg adult children marry and wish to leave their parents' fund and establish a self managed fund with their new spouse). Under the current law, it is sometimes impossible for proportionate shares of the existing assets of the original fund to be transferred to the new fund; and

- continuing to develop appropriate controls over industry participants to ensure that the standard of legislative compliance is high. In conjunction with the relevant accounting bodies, issues such an appropriate level of audit independence from the tax and administration of each fund and specialist auditor qualifications for self managed funds should continue to be considered.

We would welcome the opportunity to discuss any of these matters with the Committee.

Yours sincerely

Meg Heffron
Principal