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Sunday, 29 August 2004

The Minister for Revenue and Assistant Treasurer
Department of the Treasury
Parkes Place
PARKES ACT 2600

General Manager
Superannuation, Retirement and Savings Division
The Treasury
Langton Crescent
PARKES ACT 2600

By email to: superannuation@treasury.gov.au

Dear Sir

Re: **REVIEW INTO DIY SUPER**

I refer to the recent request of Minister for Revenue and Assistant Treasurer, Mal Brough, that all interested parties make a submission to the review into the provision of defined benefit pensions by DIY and other small superannuation funds, to ensure that all viewpoints can be properly considered.

I seek to make such a submission.

I am opposed to the recent regulatory changes preventing do it yourself superannuation funds providing complying pensions.

Unfair Preferential Treatment for Branded Funds

I suspect that the motivation behind the recent regulation change (which the ALP seek to reverse) was not to fix a rort, as now claimed by Treasury, but to give branded publicly sold retail superannuation funds an unfair advantage at the expense of do it yourself mom and pop superannuation funds.

The regulations of which the ALP, and others, complain only affect small do it yourself funds.

Bizarrely large branded funds are specifically exempted. That is, the large branded funds remain free to provide the alleged “rort” products to their customers; small funds cannot.

Despite extensive complaints and requests Treasury has still not addressed the basic unfairness question. They seem instead to have advanced the rather strange notion that the customers of, and the promoters of, large branded funds would not be involved in buying and selling “rorts” so they need not be restricted in relation to the sale or supply of “rorts”.

Treasury has so far refused to provide specific details on the extent of the "rort". Lack of specific evidence can cast doubt on their true motive for sponsoring regulatory change.

The new regulations prevent small DIY superannuation funds from providing the same pensions that can be provided by large commercial branded providers.

These amendments, SIS Amendment Regulation No. 2, were gazetted on 12 May 2004 and have immediate effect. The regulations prohibit the establishment of defined benefit funds with less than 50 members after 12/5/04.

It is unfair of Treasury to seek to tilt the competitive playing field and give the "big end of town" a free kick at the expense of small private DIY funds.

If any provider can provide particular pensions, then fairness dictates that the same criteria should apply to all providers, not just a favoured few.

IFSA Against Competition From DIY Superannuation

It is common knowledge that DIY funds with now over $135bn of investments are depriving the relatively few branded funds of $3bn-$8bn p.a. of annual management fees; as well as exit fees, which are sometimes in excess of 50% of a fund balance.

It is unfair of Governments to seek to re-channel those commissions back to branded investment providers at the expense of those who seek to do it themselves.

Competition will tend to reduce high branded fund fees. Reduction in competition will tend to increase fees.

The IFSA is often quoted as being in favour of the new regulations. This in itself proves little, but one can question the motivation. The IFSA is the industry body for those adversely affected by the competition engendered by self-managed do it yourself superannuation funds. In other words they are the lobby group for branded funds.

In their 22 July 2003 submission to the Senate Select Committee on Superannuation and Financial Services, the IFSA said: *The Investment and Financial Services Association represents Australia's leading investment managers and life insurance companies who are responsible for investing approximately $620 billion on behalf of over 9 million Australians.*

It is hard to imagine they might have any other point of view, than to be in favour of the new competition reducing regulations.

Their sudden concern for superannuants did not seem evident in their recent successful attempts to water down disclosure of the fees their members charge consumers.

I am not aware that they, or Treasury, or ASIC, or the Taxation Office made any comment on sad "rorts" such as that encountered in *Rhodes V Tower Superannuation Fund* [2004] FCA 510 (reported at 2004 WTB 17 [654] where a school teacher unsuccessfully complained about an "exit fee" of $13,226 imposed on her super fund balance of $29,000.

I am not aware that they have responded critically to the *Sydney Morning Herald* report that AMP has charged exit penalties as high as 50 per cent on some accounts, quoted in a CPSA Media Release of 12 July 2004 (David Skidmore)

I am also not aware of any call for penalty action or comment of theirs on ASIC Commissioner Prof Berna Collier's speech to the Australian Investors' Association Annual Conference, 12 June 2003 advising that the recent ASIC/CHOICE survey showed that an investment consumer had only a 21% chance of getting good or better advice from those selling their members products.

Captive Regulatory Authorities Unfairly Biased Against DIY Superannuation

I do not suggest any conscious corruption on the part of public servants. Indeed I suspect they perceive they are acting from the highest of motives. However the superannuation regulatory bodies, Treasury, ASIC and the Australian Taxation Office exhibit characteristics of what economists term "captive regulatory authorities".

As you are probably aware, this is a very common and universally occurring anti-competitive phenomenon. Virtually the only industry participants with whom a regulator has significant ongoing high level contact, are those whom they regulate. Any suggestion to the regulator that "standards" need to be improved within an industry by higher entry levels and tighter regulation so as to "protect the public from rorts" is usually eagerly, and understandably, embraced by a regulator, anxious to both protect the public, and protect themselves from criticism.

Unfortunately the higher industry promoted "standards" usually involve competition barriers such as industry dominated licensing boards, industry instigated regulation change, and other similar barriers to new entrants; or even actual competition prohibition as Treasury's new regulation proposes. They rarely include a simple, efficient and easily enforced penalty regime centred around mandatory ongoing industry participant competency checks.

The reduction in competition from new entrants can mean those on the "inside" are in the happy position of having more freedom to set their own fees and charges as they control supply.

Industry participants, through their trade associations, must however maintain constant vigilance to maintain and strengthen the barriers against competition from new suppliers. The adverse effect on profits could be devastating.

A simple example might illustrate this. For example, a Barbers Society anxious to enhance its members income and protect them from the chill winds of competition might seek to ensure that regulation exists to ensure only licence holders cut hair. They might seek to ensure that it is not a criminal offence for a "licensed" barber to produce a substandard haircut. If a consumer claims they have been let down they must initiate their own action against the barber.

If however hair was cut by a barber without a "licence" the cutter is subject to substantial criminal penalties, irrespective of how competently the hair was cut.

Similarly a Pharmacy Board might seek to prevent the involvement of Woolworths and Coles, or a Liquor Licensing Board might seek to restrict the number of Hotels. The public servants behind such actions are acting purely in the interests of protecting consumers you understand, indeed not even the existing industry participants ever mention to anyone the happy profit enhancing bi-product, flowing from reduced competition. Any economist who does, can be quickly denigrated beyond redemption by being branded a "rational economist" acting against the high social objectives of the existing industry participants, and of course there is usually some high social objective to act as a diversion.

This kind of lobbying ensures that when a superannuant like Ms. Rhodes (see above) encounters a cunning rort compelling her to pay an "exit fee" of $13,226 on a super fund balance of $29,000, then she must bear the full cost of a Federal Court action to complain, and ultimately be unsuccessful. It also ensures that if a latter day Ms Rhodes consulted a public accountant on such a shoddy Tower super product, the accountant risks criminal penalties in advising against it. (Corporations Act 2001 Reg 7.1.29)

It is natural to suspect substantial cosying up by large branded funds with their regulators. Industry lobbyists acting in a profit enhancing manner for their sponsors might be expected to spend substantial effort pointing out to regulators follies and rorts, by non-sponsors, which neither consumers nor regulators previously knew existed. The end result being anti self managed super fund legislation and regulation designed by the public service from the highest of motives and with the loftiest of objectives. Rules designed to protect consumers from their own folly, and reduce 'rorts" but which actually have the effect of seeking to prevent people from making their own investment decisions, and compel them to pay excessive fees to branded funds in an environment of reduced competition.

These latest regulatory changes seem part of larger on going 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 have the knowledge to operate funds penalty free.

Examples of Anti-DIY Captive Regulatory Authority Action

1. 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) were introduced which applied if this unique and discriminatory fee was accidentally paid from the wrong bank account. The Australian Taxation Office was recently forced to back down, the fee can now be paid, penalty free from another bank account (MT 2004/D2)

2. The only entity in the whole of Australia required by law to have a business plan is a superannuation fund. Should a mom and pop 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 entity dropping billions of superannuation dollars in dud overseas ventures.

3. 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. 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. That is what clients come to them for. However, independent accountants tend to suggest that 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. In its current amended form independent accountants can discuss do it yourself superannuation funds, they can still face criminal penalties however, for discussing branded superannuation products.

   However if the accountant is not independent, that is also a commission earning sales rep for a branded fund, discussing superannuation with a client is penalty free.

   The regulation contains a bizarre industry-beneficial twist, reminiscent of asking a barber for impartial advice on whether you needed a haircut. If, despite the independent accountant's best endeavours, a client insisted on talking about superannuation with an "unlicensed" independent accountant, that accountant is obliged to make no recommendation but instead provide the client with a written instruction to discuss the matter with a branded superannuation fund sales rep or similar.

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

4. 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. Audits are very expensive and add no value. 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 otherwise 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 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 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 substantially lard up the costs and hence reduce the benefits of doing it your self.

5. 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 business person is the only fund member.

   That regulation was swiftly changed to exempt business real property when it was realised that branded superannuation managers often rent their premises from the superannuation funds they control.

6. For a short period, a few years ago, do it yourself superannuation was effectively banned by the cunning device of requiring all superannuation funds trustees including self managed ones, to have a personal net worth of at least $5million. While this amount would be a uselessly small triviality for the trustee of a billion dollar branded fund, free to charge the fund any level of fees, it was an insurmountable barrier to most do-it yourselfers.

   Again informed public ridicule swiftly reversed the regulation.

7. The Australian Taxation Office is currently mounting a campaign which will compel do it yourself superannuants to further lard up their costs. They have

said do it yourself superannuants, unlike all other taxpayers, should employ two separate firms of professionals 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. 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.

Excessive Branded Fund Fees as the True Cause of the DIY Super Boom

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 to be the 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 providing a superior product at a lower cost.

A cheap efficient, competitive and professionally run superannuation industry, able to harness significant economies of scale, should have long ago confined do it yourself superannuation to the same dustbin to which do it your self car manufacturing, clothing, banking, medicine manufacture, haircuts and so on long since disappeared.

Competition in most industries has lowered costs to a point where "do it yourself" becomes totally impractical for all but a few dyed-in the-wool hobbyists. It is an appalling indictment of the superannuation industry that their high costs have caused a boom in individual amateur do it yourselfers perceiving themselves able to produce superior net returns to seasoned, but unfortunately rapacious, industry professionals. Their perception is reinforced by the recent APRA survey comparing long term net results of both. The Apra survey indicated do it yourselfers tended to do as well or better than branded fund professionals. Inexplicably the Apra survey excluded the exit fees charged by branded funds. Perhaps industry lobbyists were at work. Certainly the inclusion of 50% style exit fees on branded products (***Rhodes V Tower Superannuation Fund** – see above)* would have changed the results substantially further in favour of DIY.

It is sad that instead of fostering competition, innovation and responsibility by encouraging do it yourself superannuation, government departments should act as captive regulatory bodies and seek to stifle competition so as to give a free kick to an inefficient, high cost (but politically well organised) industry, at the expense of independent do it yourself retirees.

Yours faithfully

Richard T M Jacobs.