

COMMENTARY

Self Managed is the Key

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There has been an immediate clamor for a protection scheme to be created for self managed super funds (SMSFs) following the Government's exclusion of SMSF investors from the compensation arrangements for losses due to the failure of Trio/Astarra. That decision is a good one, but does raise a number of issues worthy of consideration.

The Government decision was based on the provisions of part 23 of the SIS Act (1993) which provides discretion to compensate members of prudentially regulated funds for losses due to fraud, and levy other funds to finance such payments. In the review of Financial System Guarantees in 2004, the issue of protection of superannuation was considered, but viewed as being of a different nature to protection of bank depositors etc.

The reason was that (except for defined benefit funds) the fund does not make a promise of a defined amount reliant upon the balance sheet strength of the agent operating the fund, such that failure of that agent would mean that the promise was broken. Super fund members are collectively the owners of the assets of the fund and bear the market risk (both upside and downside) associated with the value of the assets.

The risk members face which does warrant prudential concern is that of possible fraud, including non-arms length investments by the fund trustees, which diminish the value of fund assets. Ideally, APRA oversight of regulated funds limits the likelihood of these outcomes, and the Treasurer's discretion to compensate for losses due to fraud etc. provides an adequate level of protection.

But SMSF come in all shapes and sizes, ranging from "really" self managed, where the member-trustee does virtually everything (although self-audit is not permitted), to virtual complete outsourcing. Stockbrokers and financial advisers provide platforms which provide accounting, advising, transactions, taxation, custody services and arrangements, such that the member-trustee's role is effectively that of a signatory acknowledging ultimate responsibility.

This variety of arrangements does produce potential risks, but a one sized approach to regulatory protection won't fit all. For the "really" self managed, the benefits of independent control and decision making come with (and should come with) the risk that those decisions might turn out to be pretty bad. There is no case for government compensation for investment losses, such as arising from fraud associated with issuers of securities or managed funds in which the SMSF has invested.

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Where such investors suffer losses, they are in the same position as other investors in those assets, and the appropriate policy is that of supervision and enforcement by ASIC to reduce the prevalence of such losses.

A prevalence of such losses among SMSFs may suggest that there may be an argument that those with inadequate financial expertise should not be allowed to self-manage retirement balances which receive substantial tax-concessions from government. But that is a proposition which would raise many hackles.

At the other end of the spectrum, there is the possibility that outsourcing of SMSF functions to a “full service” provider creates risks. These could include the risk that commission payments by manufacturers of financial products induce advisers to promote inappropriate products. Ideally reforms under the Future of Financial Advice legislation will reduce that risk.

But if such risks are viewed as substantial, the solution is not to develop a scheme applying to all SMSFs. It is a problem arising from the possibility that some providers of SMSF platforms may fail in a way which creates losses to their clients. Thus if a protection scheme is thought to be warranted, it would be some form of insurance scheme involving those providers, rather than SMSF’s directly.

Ultimately, those insurance costs would be passed on to members of SMSF’s using such services. The dilemma is that this relative pricing effect could induce some individuals to go the “really self managed” route, with its attendant risks.

Maybe there is some case for limiting the scope for individuals to go the “really self managed” route unless they can demonstrate the requisite expertise!

This Commentary is written by Professor Kevin Davis, Research Director of the Australian Centre for Financial Studies. Kevin is also a Professor of Finance at the University of Melbourne.

kevin.davis@australiancentre.com.au