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SMSFs don't need two regulators

The Financial Services Council's reported proposal to the Financial System Inquiry that APRA should have regulatory oversight of SMSFs on top of ATO supervision is unnecessary and would just wrap the most successful segment of the superannuation system in more costly red tape.

It is unnecessary because SMSFs do not require prudential oversight. The retail funds that FSC represents hold Australians' superannuation savings in trust with an implied promise they will be safe guarded and nurtured. With SMSFs, there is no such issue as the trustees and beneficiaries of SMSFs are the same people. They can be relied upon to act in their own best interests.

This fundamental difference has been well recognised. Both Wallis and Cooper noted that SMSFs do not need to be prudentially regulated, as did the Treasury's recent submission to the FSI. Treasury's submission said that as SMSF risks were carried entirely by the beneficiaries, there should be no regulatory assurance for them and compliance oversight of self-managed funds should continue to reside with the ATO.

Treasury specifically said: "SMSFs should not be prudentially regulated."

Neither the RBA nor APRA raised any concerns in their FSI submissions about SMSFs being a risk to stability. APRA's submission had 13 pages on financial system stability and the prudential framework without mentioning SMSFs once.

There is no significant systemic risk posed by SMSFs. Indeed, it can be said that SMSFs support systemic stability by keeping $154.6 billion on deposit with the banks.

SMSFs invest 99% of their assets in Australia, avoiding exchange rate and sovereign risk, while APRA regulated funds invest 30% of their assets offshore.

SMSFs are inherently conservative and risk averse, holding 28% of their assets in cash and 32% invested in listed shares, mainly in blue chips that deliver reliable dividends.

The SMSF sector comprises over half a million separately managed funds with varying investment strategies so risk is widely dispersed. In contrast, APRA regulates 127 retail and 52 industry funds. The number of SMSFs is growing each year while the number of APRA-regulated funds is declining with fewer funds managing more of the super pool.

From time to time, commentators criticise SMSFs for being reluctant to take on risk and chase higher returns, yet their performance is consistently equal to or better than the professionally managed APRA funds.

It is claimed that SMSF investment in geared residential property may create systemic risk.

Yet SMSF investment in residential property has remained relatively low and unchanged at around 3.5% of total assets over the past 5 years. Only one in 100 SMSFs enters limited recourse borrowing arrangements and these equate to only 0.5% of total assets.

The RBA said seven months ago that it was keeping an eye on property borrowing by SMSFs but has said nothing since, so presumably the alarm bells are not ringing in Martin Place.

However, if the regulators should have concerns about SMSF investment in geared property, the remedy is already in their hands. APRA can instruct the banks to be more discerning in their lending and ASIC can target unlicensed 'advisers' and unscrupulous property spruikers. To the extent it exists, the problem should be attacked at source on the 'sell' side.

SMSFs already pay a supervisory levy to the ATO and their corporate trustees pay a fee to ASIC. Additional and unnecessary oversight of SMSFs by APRA would most probably entail extra charges for them under the government's cost recovery approach. Otherwise the cost would need to be carried in the budget at a time when the government is cutting spending.

In line with the government's deregulatory agenda, red tape needs to be reduced, not increased, as it is a significant drag on SMSF performance over time.

Instead of worrying about the regulation of SMSFs, FSC's bank-owned retail funds should be asking themselves why they are losing market share to SMSFs. An obvious answer is cost. As Treasury's FSI submission noted: "The Australian superannuation sector is characterised by high operating costs and limited product innovation."

The Grattan Institute reported recently that Australians are paying up to three times more than they should for superannuation, showing that 30 year olds would pay $250,000 in fees by the time they retire - about a quarter of their total superannuation savings. The Grattan Institute said that a fairer fee structure would see fees cut in half and account holders would then save $10 billion a year.

Superannuation savers are voting with their feet and setting up SMSFs to give themselves more control over the investment of their savings at less cost. They are doing this so well by themselves that another layer of costly regulation is unwarranted. The regulators and government policy advisers evidently agree.

Contact:
Duncan Fairweather
Executive Director
SMSF Owners' Alliance
dfairweather@smsfoa.org.au
0412 256 200
www.smsfoa.org.au