Submission to Productivity Commission inquiry into the efficiency and competitiveness of Australia's superannuation system.

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SMSFs and Trustees as Fiduciaries

Virtually anyone can start an SMSF, and can then operate it (directly or via a corporate) as Trustee. There is no formal requirement or training required to become an SMSF trustee. There are no specified minimum amounts or guidelines on when an SMSF is or is not appropriate. The prevalence of service providers around the SMSF space means that; trust deeds, accounting, audit and the entire framework for managing an SMSF can quickly and easily be setup. SMSFs can be setup by stakeholders with small balances, and/or with little or no reason for setting up an SMSF, other than that they can (or maybe were advised by someone with a vested interest in their setting it up (perhaps there should be an enquiry into this)). Such stakeholders will invariably end up running sub scale SMSFs, which will result in high fees, undisciplined investment and little focus on risk management. If these fail to perform (at least in line with the industry), it will create additional burden on the government.

The whole framework around the "do it yourself" segment of the SMSF industry relies on readymade documentation (supplied by various third party providers) and easy access to platforms and investments (again the latter may be linked to the same or different third party providers). How these providers are remunerated, and whether their interests are aligned with the beneficiaries of the resulting SMSFs is unclear. The ready-made documentation sets up a robust framework for managing an SMSF. It defines the objectives of the fund, allowable investments, and trustee obligations. It makes accounting, audit and all regulatory and administrative functions easy. It is pitched to a wide audience, and it is tailored for trustees with little or no investment experience or expertise. To my reading, the primary aim of much ready-made documentation and easily accessible structures is to protect the trustee. The secondary aim is the investment and retirement outcomes for the beneficiaries (namely ensuring that the SMSF accumulates and provides adequately for them when they reach retirement). As such, there is no focus on asset allocation, diversification, risk and risk management, other than very general statements. There is no requirement for benchmarking and no focus on returns. There is no guidance on responsible investment. To reiterate: The real aim of the SMSF – namely ensuring that the beneficiaries funds generate good returns and can become effective as a source of income during retirement – is completely ignored (or only paid lip service).

Solving this is complex. Most important is that trustees need to be aware that they have a fiduciary duty. They must be equipped for this and understand that it is a real responsibility, perhaps even with consequences if they fail. This requires education for trustees about their duty and about investing. Regulation and scrutiny around the service providers and industry which makes setting up and managing an SMSF easy is lacking. Are there conflicts of interest between these service providers and the SMSF stakeholders who become beholden to them.

Because the role of SMSF trustee should entail real fiduciary responsibility, it requires real understanding and commitment. It is not just a construct. The "anyone can do it" approach that currently abounds needs to be modified to "anyone can do it, if they are appropriately qualified", with a possible addendum "with performance monitored, benchmarked and attributed". Furthermore, SMSFs should be required to adhere to basic risk management principles, and to explain if they move away from them. Perhaps (loose) limits should be imposed which specify a minimum amount of diversification, allowable investments and other factors should be imposed as a default. If a trustee decides on a different approach then they should be required to specifically opt out from the default. They should knowingly be doing this, rather than the current approach, which doesn't require this level of responsibility.

I attach a tongue in cheek article which I wrote some time ago "**Retirement Planning 101, or: How I Learned to Stop Worrying and Love the SMSF**". In this, I emphasise that within segments of the SMSF industry, everything is setup to protect the trustees, not the beneficiaries. Documentation is robust, allowable investments are comprehensive (often extending to complex derivatives and exotic asset classes, without qualification). It begs many questions about suitability, appropriateness and more. The focus is to make it virtually impossible for a trustee to violate their role, irrespective of how they invest, regardless of the needs of the beneficiaries, and ultimately of how their SMSF performs.

Whilst I do not favour making the system more complex, introducing unnecessary ruled or administrative burdens, there are serious flaws as it stands. Some final thoughts and in summary:

- Should there be specific requirements before an SMSF can be set up
- Trustees must be educated and understand that they are fiduciaries
- SMSF documentation should look after the beneficiaries ahead of the trustee
- A basic investment framework (with a sensible risk based approach) should be the default. Trustees who wish to take a different approach should specifically opt out
- More scrutiny and possible conflict of interest around SMSF service providers (platform operators, suppliers of documentation and professional services etc.) is needed
- Analysis of total costs should be required and benchmarked against all super funds

If this is useful, I welcome the opportunity to discuss further and make more detailed submission/contributions.

Roger Cohen (May 30, 2018).