Financial System Inquiry

SUBMISSION 2014

SPAA

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Executive Summary

The SMSF Professionals' Association of Australia (SPAA) welcomes the opportunity to make a submission to the Financial System Inquiry ("the Inquiry"). As leaders of the self managed superannuation fund (SMSF) industry, we believe we are able to contribute to the Inquiry by offering insights into how the SMSF sector can best be an efficient and productive part of Australia's financial system and economy.

The SMSF sector has undergone substantial change and growth since the 1997 Wallis Report. Since the Wallis Report, the SMSF sector has grown from 138,000 "excluded funds" with $26 billion of assets to its current size of approximately 522,000 SMSFs with $543 billion of assets.

Holding close to one-third of Australia's retirement savings, SMSFs are an integral part of Australia's financial system. Accordingly, our submission focuses on how SMSFs can best contribute to the financial system and how to ensure the financial system can best deliver results for consumers.

The key points of our submission are:

- The growing SMSF capital pool can be unlocked to help fund productive Australian investment that benefits the real economy.
- The SMSF sector plays a significant role in diversifying assets held in the superannuation sector, reducing systemic risk in the Australia financial system.
- There is no systemic risk to the financial system posed by SMSF borrowing and property investment.
- The provision of independent and quality financial advice can be improved with some changes to the Australian Financial Services License regime.
- The existing regulatory settings, including the Australian Taxation Office's role, for SMSFs is appropriate and do not need to be changed.

We believe that the recommendations and suggestions we make in this submission will assist the Inquiry in forming a vision for Australia's financial system that can enhance investment in the real economy, improve retirement incomes and deliver better outcomes for consumers of financial services.

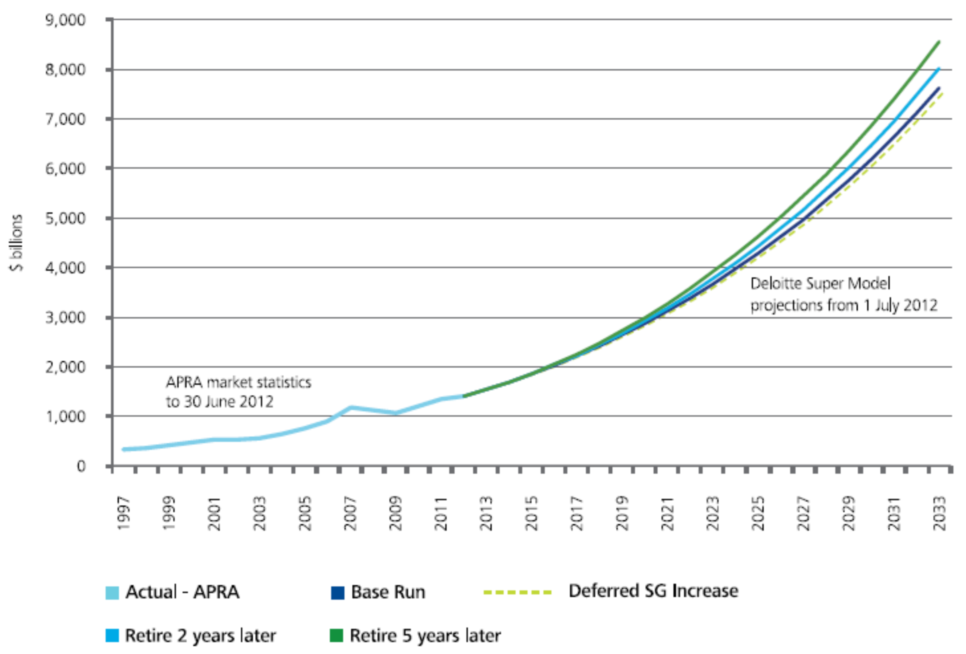
The SMSF Capital Pool

The superannuation system as of December 2013 holds $1.8 trillion in retirement savings and is predicted to grow to at least $7.6 trillion by 2033. It is expected that this growth in superannuation assets over the next 20 years will see superannuation assets exceed those of the banking sector and represent a significant component of GDP.

This requires the superannuation sector to be viewed as an important source of capital funding for future Australian investment – both public and private.

Predicted superannuation asset growth

Figure 2: Total superannuation assets (1997 to 2033) including impact of SG to 12%



Source: Deloitte Actuaries & Consultants, 2013

Of the current $1.8 trillion pool, SMSFs hold an estimated $543.4 billion of assets as of December 2013.[1] The $543.4 billion of assets are held by 522,328 SMSFs.[2] SMSFs already hold a significant sum of capital, with this amount to grow as the superannuation sector matures. With the superannuation sector forecast to have total superannuation assets increasing steadily to $7.6 trillion by 2033, SMSF asset holdings are projected to increase to $2.23 trillion over that time.[3]

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[1] APRA, Quarterly Superannuation Performance (interim edition) December 2013 http://www.apra.gov.au/Super/Publications/Documents/December%202013%20Quarterly%20Superannuation%20Performance.pdf

[2] Ibid

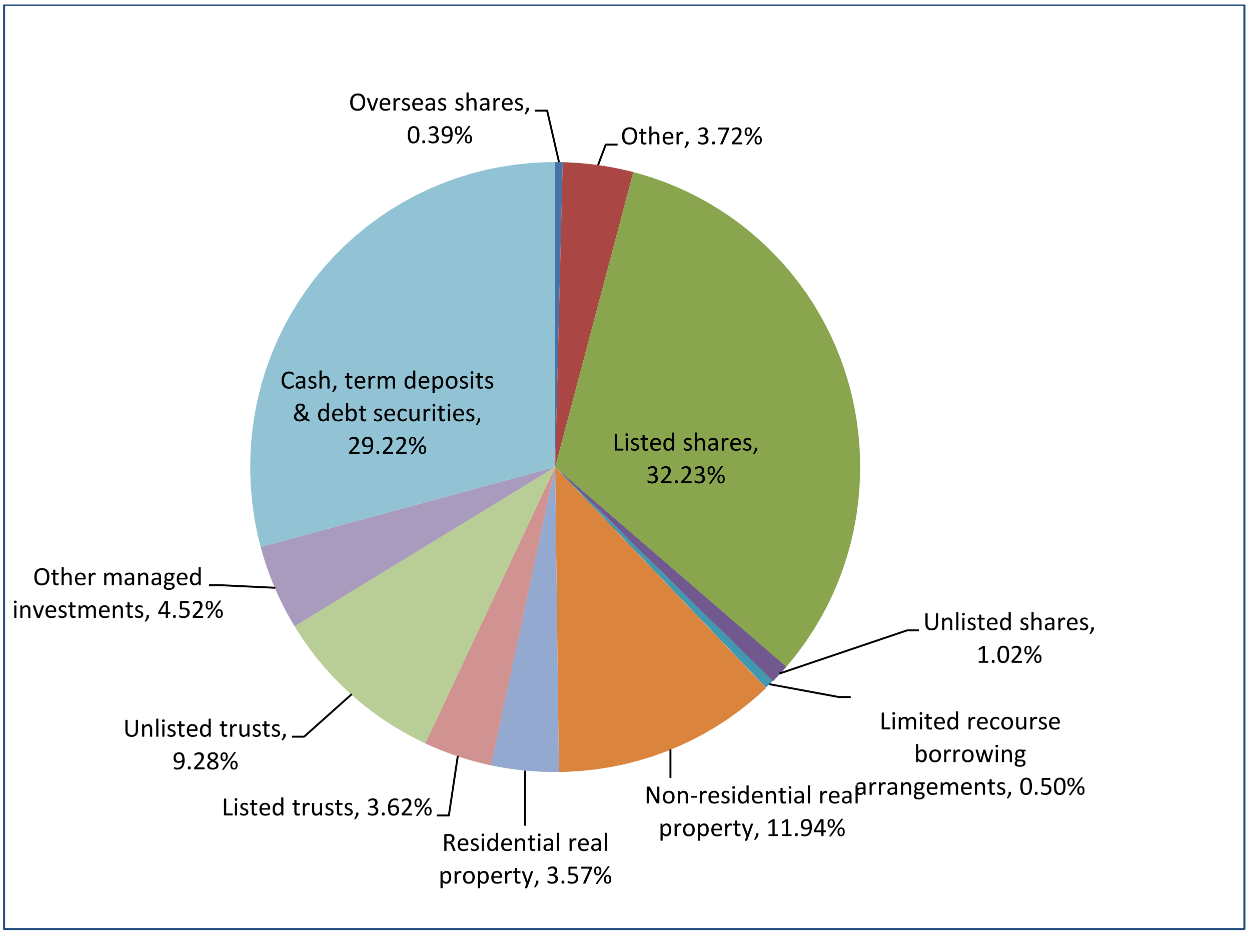
[3] Deloitte, Dynamics of the Australian Superannuation System: The next 20 years: 2013 – 2033 http://www.deloitte.com/assets/Dcom-Australia/Local%20Assets/Documents/Industries/Financial%20services/Deloitte_Dynamics_of_Superannuation_2013_report.pdf

The sheer size of assets currently held by SMSFs and the growth of these asset holdings over the next 20 years will mean that SMSFs will offer a viable funding source of capital to fund investment within the Australian economy. A $2.23 trillion capital pool is too large to ignore when considering solutions to funding Australia's future.

How is SMSF capital currently held?

ATO statistics show that SMSFs, in aggregate, have a well-diversified asset allocation. The following chart illustrates the diversification of SMSF assets:

SMSF Asset Allocation, December 2013



Source: ATO, Self-managed super fund statistical report – December 2013

SMSFs are currently significant investors in Australian capital markets as they represent about one-third of all superannuation assets. As of December 2013, SMSFs held $175.2 billion in listed Australian securities, around 11.5% of market capitalisation of listed domestic equities.[4] In comparison investments in foreign equities only make up 0.39% of total SMSF assets.[5]

SMSFs make a considerable contribution to Australia's investment pool as they invest in companies listed on the stock exchange, either directly or indirectly, provide loans to large public organisations, private companies and invest directly or indirectly in property. The cash holdings of SMSFs, just like all other funds, are used by banks and other financial institutions as a source of capital for investments in projects for Australia's future. Overall, the investment pool of self-managed funds is basically no different to those of the larger funds, a fact proven by statistics published by the ATO and APRA.

One of the reasons SMSFs invest in Australian equities is due to the tax preferences offered to trustees on Australian shares through franking credits and the low superannuation tax environment, especially in pension phase (see below). SPAA research has also shown that familiarity with investments is another key reason for SMSF trustees having a predisposition to investing in Australian companies.[6]

However, with a burgeoning number of exchange traded funds (ETFs) and listed investment companies (LICs) offering an international focus, SMSF trustees are more easily able to access international exposure. The development of ETFs and LICs with an international focus is offering greater diversification to SMSF trustees. SPAA/Vanguard research shows that over 40% of trustees are already investing in or are considering investing in ETFs.[7]

In addition to holding listed shares as a major asset class SMSFs on average hold 29.22% of their assets in cash, term deposit and debt securities products. 97.47% of SMSFs hold a proportion of their total investments in cash and term deposits, with a median value of $117,129 per SMSF.[8]

We believe that the composition of SMSF asset holdings, as well as SMSF trustees' preferences for domestic investments makes the growing SMSF capital pool an important element in funding future Australian investment. The efficient use of the SMSF capital pool as part of the broader superannuation capital pool should be a key objective of our financial system going forward.

Currently, SMSF capital is precluded from financing and participating in many areas of investment that would contribute to the wellbeing of Australia such as direct investment in large infrastructure projects and the corporate bond market. Opening up new productive investment opportunities to SMSFs would allow SMSF capital to be an efficient funding source for future Australian investment and offer increased diversification to SMSFs.

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[4] RBA Statistics" Australian Share Market -F7 http://www.rba.gov.au/statistics/tables/pdf/f07.pdf?accessed=2014-03-25-16-22-08

[5] ATO, Self-managed super fund statistical report – December 2013 http://www.ato.gov.au/Super/Self-managed-super-funds/In-detail/Statistics/Quarterly-reports/Self-managed-super-fund-statistical-report---December-2013/

[6] SPAA/Russell Investments, Intimate with Self Managed Superannuation 2013

[7] Rice Warner for SPAA/Vanguard, Survey of Financial Needs And Concerns of SMSF Members 2012, http://www.spaa.asn.au/media/93653/121127_spaa-vanguard_research_report.pdf

[8] ATO, Self managed Superannuation Funds: A Statistical Overview 2011-12 http://www.ato.gov.au/Super/Self-managed-super-funds/In-detail/Statistics/Annual-reports/Self-managed-superannuation-funds--A-statistical-overview-2011-2012/?anchor=t15#t15

Also, clarifying the definition of retail and wholesale investor for superannuation funds, especially SMSFs, would allow SMSFs greater access to these investment markets. The current Australian Securities and Investments Commission (ASIC) interpretation of the wholesale/retail test results in an SMSF being treated as retail unless the fund has $10 million in assets, even if the trustee passes the wholesale client tests. SPAA has advocated for an objective wholesale client test with a $1 million investable asset threshold which would exclude an individual's main residence dwelling and their non-SMSF superannuation assets. Further, SPAA believes that the law should be changed so that where a trustee of a superannuation fund passes the wholesale client test, they are able to elect to receive wholesale advice.

A productive use of SMSF capital

SMSFs have been criticised for an "overweighting" towards cash and term deposit investments. SPAA does not agree with this criticism and it should be noted that SMSFs have outperformed APRA-regulated funds as a general rule between 2008-2012.[9] Statistics published by the ATO indicate that due to the diversification of SMSF investments and a bias towards a more conservative portfolio approach in 'good' years where funds have positive rates of return, SMSFs produce rates of return equal to or better than APRA based funds. However, in years where funds generally have negative rates of return SMSFs have lower negative rates. As explained below, the weighting towards cash and term deposit investments is a natural consequence of the high proportion of SMSFs in pension phase or approaching pension phase.

The criticism that SMSFs are overweighted towards cash and fixed interest investments could also be directed to APRA-regulated funds where members are permitted to choose a range of asset categories. In some funds a member can place the whole of their account balance into one asset category such as cash, overseas shares or property for example. This takes on a potentially unacceptable level of risk, especially when the average APRA-regulated fund account balance is $117,000.[10] This concept may also lead to compliance issues with the *Superannuation Industry (Supervision) Act 1993* (SIS Act) and the formation of the relevant fund's investment strategy.

Opening up new investment opportunities and removing existing barriers can allow SMSF capital to finance productive investments rather than be invested in cash or term deposits. This would allow SMSFs to have a more productive and efficient influence on the real economy. We believe that the importance of efficiently and productively utilising SMSF capital will only increase as the sector grows from its current size of $532 billion to the projected $2.33 trillion by 2033.

Notwithstanding this, SPAA recognises that SMSF deposits are an important asset class and a stable source of funds for Australian banks, especially in meeting their Basel III required

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[9] ATO, Self managed Superannuation Funds: A Statistical Overview 2011-12

[10] APRA, Annual Superannuation Bulletin June 2013 (revised 5 February) 2014 http://www.apra.gov.au/Super/Publications/Documents/Revised%202013%20Annual%20Superannuation%20Bulletin%2005-02-14.pdf

liquidity coverage ratio because SMSF deposits are treated as retail deposits under the Basel III rules. SPAA considers that this should continue.

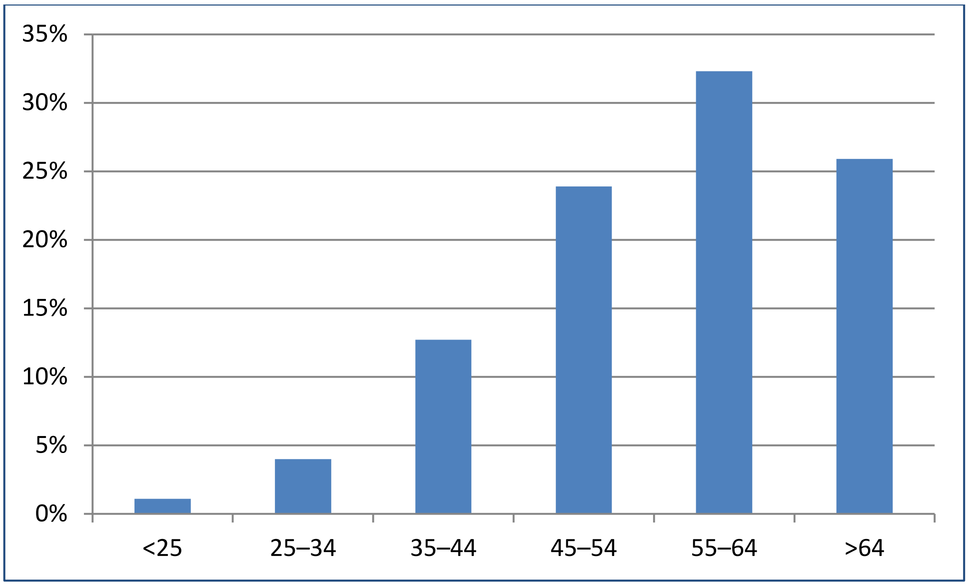
In order to allow the SMSF capital pool to be used as an efficient source of capital to fund productive investments, new investment options need to be opened up to SMSFs.

Demand for SMSF investment opportunities

SMSF trustees seek flexibility and control in the investment of their retirement savings, with most trustees preferring direct investment. The SPAA/Russell Investments 2013 Intimate with SMSFs Report showed that 77.8% of SMSF trustees prefer direct investment over managed funds.[11] Also, the Report showed that 10% of trustees with assets in cash and term deposits were looking to invest in higher quality low risk products.[12]

We believe that this predisposition for SMSFs to hold close to one-third of their assets, or a current aggregate of $172 billion, in low-risk assets is appropriate. In addition, the relevance of an SMSF holding that level of assets may take into account the personal investments of the fund members. It is estimated that members of SMSFs have the same proportion of investments in SMSFs as they hold in their personal name. This risk profile indicates that SMSFs would have an appetite for new types of low-risk, less volatile return investments. This will be especially important for SMSF trustees that are in or are approaching the pension phase so they can generate steady income streams to fund their superannuation benefits throughout retirement. This will be increasingly important as more SMSF members move into the pension phase with 58% of members age 55 or over.[13]

SMSF member age distribution



Source: ATO, Self-managed super fund statistical report – December 2013

[11] SPAA/Russell Investments, Intimate with SMSFs 2013
[12] Ibid
[13] ATO, Self-managed super fund statistical report – December 2013

Currently, over 50% of SMSF assets are held by funds that are in the retirement phase and this figure is projected to grow to over 60% by 2023.[14] These trustees are looking to manage longevity risk by accessing long term investment options with low volatility, moderate yield relative to inflation and moderate capital growth. By 2032, it is projected that there will be $800 billion of SMSF assets in the retirement phase, which will see an increasing demand for investment with stable returns over the next 20 years.[15]

Infrastructure investment

SPAA believes that opening up direct infrastructure investments to SMSFs would provide a new avenue for SMSF investment that could assist SMSFs in managing longevity while also funding Australia's future investment needs. The desire for control, direct investments, and alternatives to cash and term deposits will mean that SMSF trustees will view direct infrastructure investments as an attractive investment option. SMSF investors are also traditionally "sticky investors" that undertake investments with a long-term investment time frames in mind. This makes SMSFs suitable for investing in infrastructure.

Infrastructure investments act as an important investment class that offers a risk-return point between cash/fixed interest and equity investments. With SMSFs predicted to grow to asset holdings of $2.23 trillion by 2033,[16] this low risk capital pool will grow to approximately $725 billion. This large pool of low-risk preferred capital would be a viable source of infrastructure funding in years to come.

Currently SMSFs are extremely limited in investing directly in infrastructure due to the high dollar threshold for infrastructure investment and the illiquid nature of the required investment. SPAA believes that addressing these liquidity issues and removing administrative barriers will provide the most significant challenges in allowing SMSFs to have better opportunities to invest in infrastructure projects. Unitising investment in infrastructure projects to smaller investments for SMSFs (e.g. $25,000 units) would be one way to overcome current limitations, as would be issuing small-scale infrastructure bonds. Developing a secondary market in these products would allow SMSFs to manage liquidity risks, especially when they are in the retirement phase, so they can meet changing needs to realise their SMSF capital to generate income.

These administrative, threshold and liquidity issues also prohibit SMSFs from investing in other asset classes. Threshold issues are a problem for SMSF investing in public equity offerings, corporate debt offerings, bio-tech and venture capital investments. Opening these investment markets up to SMSFs would allow an untapped pool of capital to flow to these investments.

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[14] DEXX&R, Release of DEXX&R's Ground breaking Research into SMSF's, http://www.dexxr.com.au/news/2013Jun_Market%20Projections%20Media%20Release_vWeb.pdf
[15] Deloitte, Dynamics of the Australian Superannuation System: The next 20 years: 2013 – 2033
[16] Ibid

Corporate bond investments

Deepening of and access to the corporate bond market for SMSFs would allow SMSFs to diversify their low-risk holdings from cash and term deposits into other low-risk, steady-return products. As of December 2013, only 0.76% of SMSF assets were invested in debt securities compared to 28.45% in cash or term deposits. A deeper corporate bond market, with access for smaller investors, would allow Australian corporations access to Australian capital, reducing dependence on overseas debt funding. Allowing superannuation to provide more debt financing to Australian companies through corporate bonds will become increasingly important as superannuation assets grow to exceed those of the banking sector.

Housing finance

Another possible avenue to fund Australian investment is for superannuation funds, including SMSFs, to play a role in financing housing. Again, this will be important as the superannuation sector outgrows the banking sector. SMSFs could have a role in financing shared appreciation mortgages and shared equity arrangements. This would be an excellent opportunity for superannuation funds as investments in housing would offer an opportunity for an investment with low investment correlation to existing asset classes enhancing portfolio construction. It would also increase efficiency and competition in the home loan financing sector, benefiting Australian consumers.

In the context of providing investments that could assist with housing or other policy objectives such as health care or aged care, SPAA does not support amounts accumulated in superannuation (both SMSF and APRA-regulated funds) being used to assist a member directly in purchasing housing or payment of health care or aged care expenses. The mixing of health, housing, aged care policy with retirement income policy leads to confused outcomes and potential abuse as retirement savings are directed away from their sole purpose.

SPAA is wary of any calls to have percentages of superannuation balances compulsorily allocated to an investment type in order to meet funding shortfalls in an industry or investment area. Superannuation investments should be made with the fund members' retirement goals and aspirations as the motivating factor, not to meet non-retirement savings goals stipulated by governments and administrators. If governments wish for superannuation to fund publicly beneficial projects, they can encourage this through incentives, guarantees or the taxation system in order to make the investment attractive to superannuation funds generally.

Further Research

SPAA is currently undertaking research into what investment opportunities would be appropriate to ensure efficient use of SMSF capital and improve diversification in SMSFs and assist trustees in managing longevity challenges. When the research is complete we will relay our findings to the Inquiry.

SMSF risk to the financial sector

Diversification and asset allocation

As shown above, SMSFs are well diversified in regards to their asset allocation. This diversified asset allocation spread across over 500,000 funds is a strength of the SMSF sector and adds to the robustness of the Australian financial system by reducing the concentration of investment risk in the superannuation sector.

With the growth of larger superannuation funds in the retail and industry superannuation sectors, these larger superannuation funds hold an increasing proportion of retirement savings pool under their particular investment strategies. While SPAA is not concerned by this concentration where investment strategies and asset allocations are being managed prudently, we believe that the diversification amongst SMSFs maintains an important bulwark to concentration of superannuation investments.

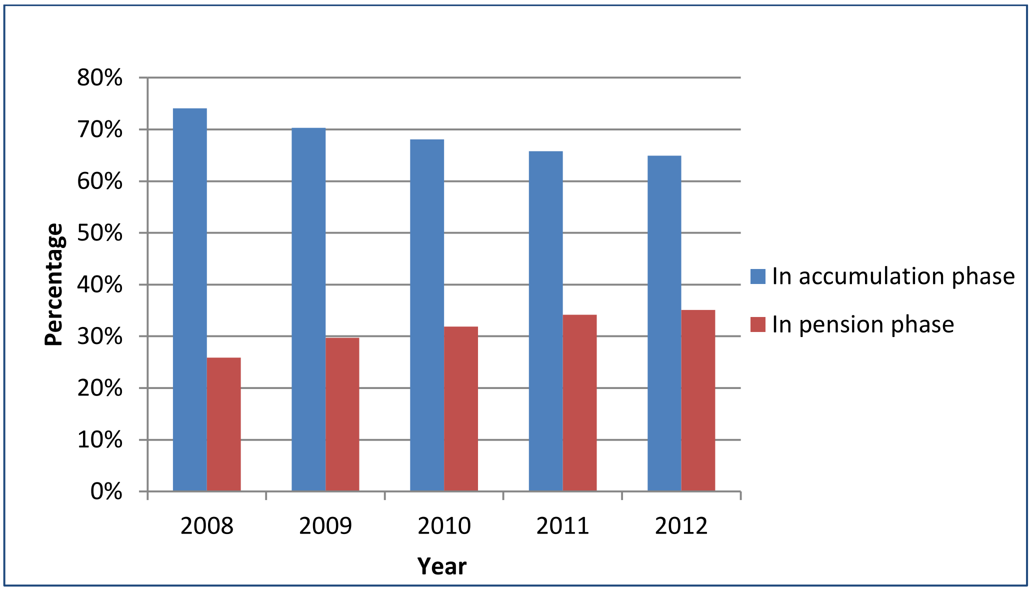
The responsibility of SMSF trustees for their fund's investment strategy, results in the SMSF sector being well diversified at an aggregate level but also at an individual fund level. The diversification across the SMSF sector and within each SMSF reduces systemic risk within the financial system as SMSFs across the sector do not concentrate their investments in a particular investment allocation or strategy. We believe this is a significant benefit of SMSF trustees being responsible for their own investment strategies.

While there may be some convergence in asset allocations across SMSFs (i.e. towards ASX200 equities, popular managed fund products and cash/term deposits), SMSFs still play an important role in diminishing the concentration of investment risk across superannuation.

Even though SMSFs have a heavy weighting towards Australian equities and cash or term deposit products, we believe it is a natural consequence of the higher proportion of SMSF trustees that are either in the retirement phase or are approaching retirement phase. ATO statistics show that over one-third of SMSFs are currently in the retirement phase, with this number increasing over the last five years.

One criticism about SMSF investments is the under-allocation of assets to overseas investments. The main reason for this can be gleaned from the lack of access to overseas markets and commodities, the price of entry being high and relatively lower rates of return due to taxation systems overseas. However, as mentioned above, this is being addressed by the increasing availability and falling costs of ETFs and LICs that allow SMSF trustees access to foreign equities and commodities markets.

SMSFs by payment phase

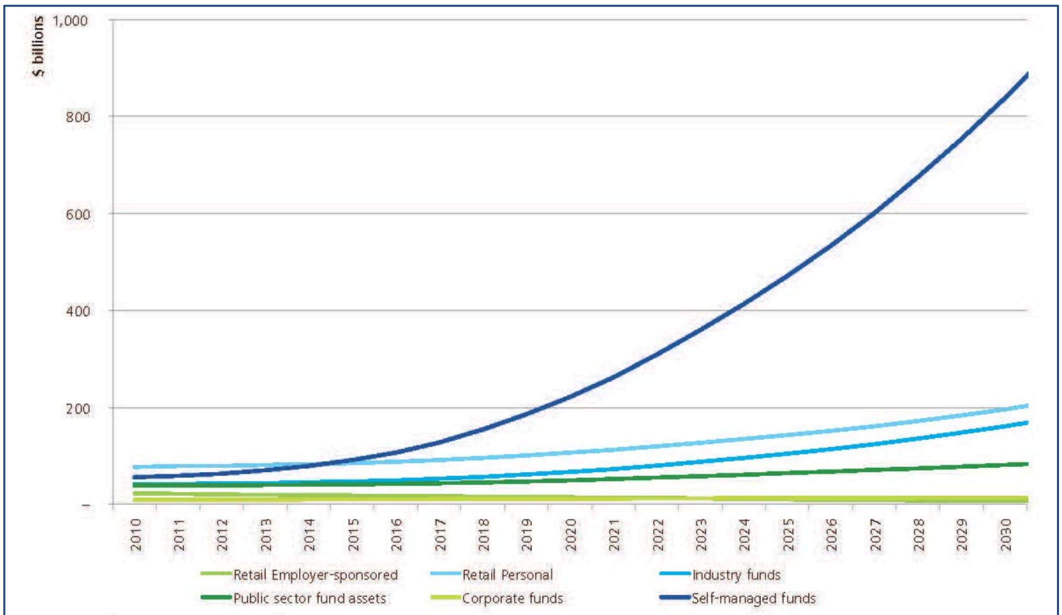


Source: ATO, SMSF: A statistical overview 2011-12

We expect the proportion of SMSFs in retirement phase to increase in the short to medium-term as ATO statistics show that in the SMSF sector, 69% of members were over 50 years old (compared to 26% of members in the non-SMSF sector).[17]

Research undertaken by Deloitte has indicated SMSFs will be dominant in the retirement income phase and drawing down income streams well into the future. This can be illustrated in the following chart:

Post Retirement Assets – projected market share



Source: Deloitte Actuaries & Consultants, 2011

[17] ATO, Self managed Superannuation Funds: A Statistical Overview 2011-12

The dividend imputation system provides a tax incentive for SMSF trustees in pension phase to invest in domestic equities, as franking credits are fully refundable to SMSF members in pension phase. It is natural that SMSF trustees in the pension phase seek the best after tax return for their investments, and dividend imputation maximises after tax return on domestic equities. Also, it is logical that SMSF trustees in pension phase or approaching it hold a large percentage of their retirement savings in cash or fixed interest products as they seek low-risk assets with non-volatile returns to provide cash flow for the payment of lump sums and income streams.

Greater diversification within SMSFs, especially to international equities, can be assisted by SMSF trustees receiving high quality advice from appropriately qualified advisors. The importance of high quality financial advice to the SMSF sectors is further outlined below. SPAA has developed professional standards and specialist accreditation models to support the building of appropriately qualified advisors that can ensure SMSFs are a well-functioning sector within the financial system.

SPAA is currently undertaking research into the asset allocations of SMSFs and will be providing the Inquiry with this research and results in the near future.

SMSF Property Investment and SMSF Borrowing

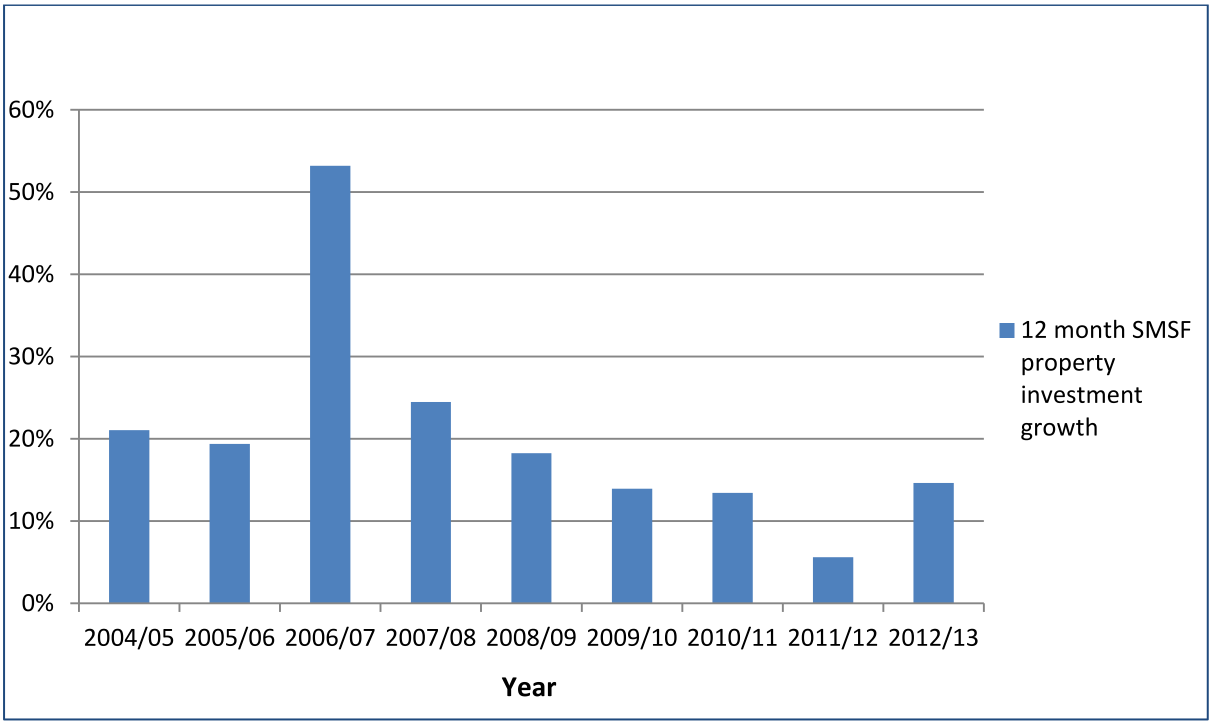
SPAA is aware that there have been concerns expressed that SMSF property investment, especially when borrowing is involved, is posing a risk to the Australian financial system. Concerns that have been expressed have included:

- SMSF property demand is creating "a vehicle for potentially speculative demand for property."[18]
- SMSFs could exaggerate the development of a property bubble.
- There is a rush of trustees into SMSF borrowing using Limited Recourse Borrowing Arrangements (LRBAs) for SMSF investments.
- There is improper spruiking of LRBAS to SMSF trustees.

SPAA has been surprised by a number of these concerns given the facts that exist in relation to SMSF investment in property. ATO SMSF statistics show that the year-on-year growth in the investment into SMSF property has been steady and in recent years been at the lower end of growth over the past decade. SMSF property investment in 2012-13 grew at a rate of 14.7%, which was less than recent SMSF property investment growth in 2007-08 (24.5%) and 2008-09 (18.3%). This shows that investment in property SMSFs has been generally steady over recent years (with the exception of 2006-07 which saw the one-off $1 million concessional contribution cap which gave scope to trustees to transfer their business property into their SMSF or undertake sizable property investment via their SMSF).

[18] RBA, Financial Stability Review: September 2013
http://www.rba.gov.au/publications/fsr/2013/sep/pdf/0913.pdf

12 month SMSF property investment growth



Source: ATO, SMSF: A statistical overview 2011-12

SPAA also believes the concerns relating to SMSFs increasing speculative demand and contributing to a housing price bubble are unfounded. Property investments by SMSFs make up a total of $80.9 billion of all SMSF investments or 15.22% of total SMSF assets. Of this, commercial property makes 11.72% of SMSF assets and residential property makes up 3.5% of total SMSF investments. The amount of residential property investments by SMSFs is small in the context of SMSF asset holdings. Commercial property is a more significant SMSF asset class, which reflects the ability of SMSF trustee to be able to transfer business real property from a related party into their SMSF in line with the contribution limits. This aligns with the SMSF trustee demographic which includes a large number of current or retired professionals, small business owners and self-employed.

More importantly, the $18.6 billion invested in residential property is a minute percentage (0.39%) of the total $4.752 trillion Australian residential housing market.[19] On the basis of these facts, we believe that there is no systemic risk posed by SMSF property investment for the Australian financial system. SPAA believes that systemic risk in the property market emanates from other factors at play in the economy such as property being purchased for negatively geared investments and land/housing supply constraints. The impact of price rises caused by these factors prevents first home buyers and other new entrants attempting to enter the housing market.

[19] RBA Statistic, Selected Assets And Liabilities Of The Private Non-Financial Sectors – B20 http://www.rba.gov.au/statistics/tables/xls/b20hist.xls?accessed=2014-03-27-15-35-20

Further, APRA-regulated superannuation funds also invest in unlisted property investments, with APRA statistics showing that the average default strategy has an allocation to unlisted property of 7%.[20]

SMSF Borrowing: limited recourse borrowing arrangements

SPAA is also aware of the concerns that exist in regards to SMSF borrowing for investment purposes.

SMSFs are not normally permitted to borrow under the SIS Act, however, there are some important exceptions to this rule. One such exception is LRBAs which allows a fund to borrow in a limited recourse nature.

An SMSF limited recourse borrowing arrangement typically involves an SMSF taking out a loan from a third party lender or from a related party, such as a member of the fund. The SMSF then uses the loan, together with its own available funds, to purchase a single asset (normally a residential or commercial property) that is then held in a separate trust.

The SMSF trustee acquires a beneficial interest in the asset with the trustee of the separate trust being the legal owner of the asset. The SMSF trustee has a right to acquire legal ownership of the asset by making one or more payments. Any investment income received from the asset goes to the SMSF and if the SMSF defaults on the loan, the lender's rights are limited to the asset held in the separate trust. This means there is no recourse to the other assets held in the SMSF.

SMSFs are most commonly used to invest in real property but can also be used to invest in other assets where the nature of the assets fits the SIS Act LRBA rules (i.e. to use an LRBA to invest in equities, all equities purchased under the arrangement must be identical so that the parcel of shares is considered a single, identifiable asset).

SMSF use of LRBAs

SPAA does not believe there is an excessive use of LRBAs by SMSFs. The most recent ATO statistics show that in December 2013 SMSFs had a total of $2.621 billion invested via the use of an LRBA. This represents 0.49% of all SMSF assets. This small level of investment vian LRBAs does not pose a systemic risk to the Australian financial system.

Further, SPAA's discussions with major lenders in the SMSF loan market show that the majority of loans made to SMSFs are being made with responsible lending practices. Banks have tighter lending policies and have experienced lower levels of default than loans made for other purposes.

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[20] 2013 APRA Annual Superannuation Report http://www.apra.gov.au/Super/Publications/Pages/annual-superannuation-publication.aspx

From a sample set of 14,783 LRBAs SPAA believes that the average loan to an SMSF is approximately $311,000 with an average loan-value ratio between 60% and 75%. We believe that this indicates that the vast majority of SMSF LRBAs are being made soundly and responsibly.

Also, the prevalence of SMSFs having only one asset which has been acquired through an LRBA is very low, which supports that LRBAs in general are being used appropriately by SMSFs. The ATO statistics indicate clearly that SMSFs investing predominately in a single asset does not occur.[21] Portfolios are relatively diverse with real estate investment forming part of the fund's overall asset allocation.

Asset concentration, by type, in 2012

Asset concentration, by type, in 2012 (% of all SMSFs with >50% asset allocation to an asset type)						
Asset type	**100%**	**>=90%**	**>=80%**	**>=70%**	**>=60%**	**>=50%**
Limited recourse borrowing arrangements	0.00%	0.20%	0.30%	0.40%	0.50%	0.50%
Non-residential real property	0.20%	2.50%	4.10%	5.60%	7.10%	8.50%
Residential real property	0.10%	1.10%	1.80%	2.30%	2.90%	3.50%

Source: ATO, SMSF: A statistical overview 2011-12

Concern over LRBA promotion

While SPAA is not concerned by the use of LRBAs by SMSFs, we do have concerns regarding the recent rapid growth in the promotion of LRBA strategies in SMSFs.

When used in the right circumstances and structured correctly, there should be little concern with SMSF trustees using an LRBA as part of an investment strategy for their SMSF. However, we are concerned that the recent increase in promotion of LRBAs by certain investment promoters has an undeserved and unrepresentative impact on the integrity of the SMSF sector. SPAA is aware of increased property spruiking targeting SMSF trustees through LRBA activities as well as increased product development by banks and other financial institutions to target SMSF lending through LRBA products.

While an LRBA used in the right circumstances can assist members to grow their retirement savings, there are also many risks and issues which investor funds should be aware of and considered before embarking on this strategy. Also, SMSF LRBAs which do not comply with the law can cause considerable problems for SMSFs and some SMSF trustees may not be aware of the serious consequences that may follow. For example, some of these arrangements, if structured incorrectly, cannot simply be restructured or rectified and can result in the SMSF needing to sell the property at a substantial loss to the SMSF.

[21] ATO, Self-managed super funds: A statistical overview 2011–12 Table 19: Asset concentration, by type.

SPAA believes that these risks inherent in LRBA investment strategies are not always properly being explained to SMSF trustees and that in some cases LRBAs are being promoted to trustees where the strategy is not suitable for the circumstances of the SMSF's members. For instance, we are aware of unlicensed LRBA promoters recommending for people to set up a SMSF with an initial $20,000 contribution and then acquire an investment property through an LRBA without the fund acquiring any other investments. This is evidenced by work ASIC has undertaken on inappropriate advice being provided to trustees.

Proposed solution – bring LRBA advice under the AFSL regime

SPAA believes that superannuation fund trustees should be protected by the *Corporations Act 2001 financial* consumer protection framework when they enter into an LRBA. SPAA considers that proposals to introduce a consumer protection framework should be expedited in consultation with relevant professional groups. Draft regulations produced have contained a number of shortcomings and in our view require further development by the previous government. In SPAA's view, consideration should be given to ensuring that structural advice on LRBAs should be provided by a licensed advisor.

We believe that inclusion of LRBAs in the AFSL regime will help to ensure that SMSF trustees are being properly advised on both the risks and the benefits of LRBAs and the suitability of the strategy for their fund. The licensing of these arrangements is also entirely consistent with the views expressed by the Super System Review Panel (the Cooper Review) which concluded such consumer protection measures were appropriate in light of the 2007 amendments to the borrowing provisions.

SMSF Failure

SPAA understands there is concern that SMSFs are perceived to pose a risk to the financial sector and the retirement savings system. However, this perceived risk that an SMSF might fail resulting in the loss of retirement savings is no different to that of APRA regulated funds sustaining substantial capital losses. While there have been some high profile financial collapses such as Trio and Storm Financial that have resulted in a small number of SMSFs suffering detrimental losses, generally there has been no problem with SMSF failures.

SPAA understands from discussions with policy makers that there are two key risks to the financial system and retirement income system from SMSF failure: systemic financial risk and risk to Government revenue due to reliance on the age pension after a failure when tax concessions have already been provided to the SMSF's members.

As explained above in regards to diversification and systemic risk, SMSFs should not be seen as a systemic risk to the financial system due to their individual nature and diversified asset holdings. Instead SMSFs should be seen as a bulwark against investment concentration in the retirement income system and broader financial system.

Similarly, SPAA believes that the risk of individual SMSF failures can be mitigated through better education which can be achieved by ensuring trustees have access to high quality financial advice, improving financial literacy, ensuring that financial advisors have adequate professional indemnity insurance and introducing a financial product-level compensation scheme.

High quality financial advice

Ensuring that SMSF trustees are able to access high quality financial advice to assist them in achieving their retirement savings goals would reduce the risk of SMSF failure. Increasing the financial literacy and awareness of SMSF trustees through financial advice will result in better decision making by SMSF trustees, leading to a lower risk of a SMSF sustaining significant investment losses.

Research undertaken by SPAA in 2012 and 2013 has shown that personal advice tailored to a consumer's personal circumstances results in the consumer having increased engagement with their financial future and retirement savings.[22] This also aligns with increased consumer satisfaction, knowledge and confidence. Additionally, our research has shown that consumers are increasingly demanding specialised financial advice to assist them in achieving their financial goals.

In order to ensure that consumers are able to access high quality financial advice SPAA believes there is a need to increase the standards of training for financial product advisors and encourage specialisation in the provision of SMSF advice. SPAA believes that a higher standard of education for the financial services professional is an integral driver to improve the quality of advice provided to consumers. The existing ASIC training requirements (RG 146) to provide retail financial advice are not sufficient in SPAA's opinion and need to be raised to ensure consumers are receiving quality advice. SPAA supported ASIC's goal to increase the standards of training for financial product advisors in ASIC Consultation Paper's 212 and 215 but believe that the approaches to financial advisor training and the approval and regulation of courses for RG 146 outlined in the papers were flawed and would not achieve the goal of improving the quality of financial advice.

SPAA is aware that the Government is currently undertaking consultation with financial advice sector stakeholders to improve the standard of competencies and education for financial advisors and supports this process. SPAA believes that a model where professional associations approved by a regulator (i.e. ASIC) are responsible for determining the competency, training and education requirements for financial advice professionals would best serve consumers and the industry. Such a model would promote professional ethical accountability of advice, raise professional standards and increase competencies within the financial services sector rather than meeting a "bottom-line" standard set by the regulator, such as the current RG 146 approach for financial advisors.

Promoting specialisation in SMSF advice is also integral to improving advice to trustees. We believe that advisors who operate in providing services to SMSF trustees should be required to undertake specialised SMSF education and training. This would help increase the level of professionalism and SMSF competencies of financial advisors who advise on the

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[22] SPAA/Russell Investments, Intimate with Self Managed Superannuation 2012; and, SPAA/Russell Investments, Intimate with Self Managed Superannuation 2013

establishment and operation of SMSFs, leading to greater confidence in the sector and increased consumer protection.

Last resort compensation scheme

SPAA has advocated and continues to advocate for a last resort compensation scheme for the financial services sector. SPAA previously outlined its position and its suggestion as to how a last resort compensation scheme would function in its submission to the Parliamentary Joint Committee on Corporations and Financial Services' Inquiry into the collapse of Trio Capital and any other related matters on 25 August 2011.

Also, SPAA does not support an SMSF compensation scheme based on an annual SMSF compensation levy. We believe that this would be an ineffective solution to SMSF failure as SMSF trustees should not be responsible for other trustees' decisions or the improper behaviour of financial services firms.

SPAA recommends that an industry based last resort compensation scheme should be introduced for the financial services sector with the following key features:

a) It should provide limited "last resort" financial compensation in situations where a client has suffered financial loss as a result of the misconduct or insolvency of a AFS licensee;
b) The compensation should be funded by a levy imposed on the industry sector which was the cause of the financial failure;
c) The characterisation of industry sectors should be sufficiently broad to include Managed Investment Scheme providers and manufacturers;
d) Compensation levies should be based primarily on past events;
e) The scheme should be sufficiently flexible to allow excessive compensation claims to be funded by a levy imposed on a linked industry sector.

SPAA is adamant that it is still important that a last resort compensation scheme be implemented to protect all consumers of financial advice and financial services. In SPAA's view there is inadequate protection against misconduct and insolvency of an Australian Financial Services (AFS) licensee for those who invest through SMSFs as opposed to other investment vehicles. SMSF members are mostly retail investors who are less able to absorb capital losses when compared with larger funds of the kind regulated by APRA. SMSF members are similar and aligned to ordinary investors in the marketplace and are not similar to APRA regulated fund members.

The exposure of consumers, in particular SMSF trustees, to fraud and dishonest conduct by AFS licensees and product providers has been illustrated by the recent failures in Trio Capital, Storm Financial, Opes Prime and Westpoint. These cases have illustrated the weaknesses of relying on external dispute resolution schemes and mandatory professional indemnity insurance for consumers, especially SMSFs trustees who are not eligible for Part 23 SIS Act compensation.

SPAA believes that the weaknesses of current compensation arrangements for investors that have incurred financial losses by no fault of their own due to a financial advisor or product provider acting fraudulently or dishonestly is not acceptable. The fairest and most appropriate method to remedy this problem is to introduce a last resort compensation scheme. In SPAA's view, if a last resort compensation scheme was in place prior to the Trio Capital collapse, it would have provided appropriate compensation to SMSF investors and other similar investors who under the current regime received little or no compensation.

SPAA does not agree with the findings of the Richard St John report, that the introduction of a last resort compensation scheme would be inappropriate and possibly counter-productive. However, SPAA does agree with the report's assertions that implementing a last resort compensation scheme could result in regulatory moral hazard and that the 'light-handed' regulation of financial advisors and other licensees – especially in regards to professional indemnity insurance – needs to be resolved. We believe that these issues can be dealt with appropriately and should not impede the introduction of a last resort compensation scheme. SPAA believes the core solution to resolving these issues is ensuring a better coverage and better regulation of professional indemnity insurance held by AFS licensees.

In relation to compensation schemes, many of the arrangements have involved a range of conflicts due to the commonality of links between parties involved from the manufacturer to the retail investor. These conflicts should be resolved so that each link in the chain operates objectively and independently.

Improved professional indemnity insurance

SPAA believes that ensuring that AFS licensees are holding proper and adequate professional indemnity insurance is an important step in resolving the inadequacy of the current compensation arrangements for investors that suffer a loss due to fraudulent behaviour or dishonesty. The financial losses of investors, especially SMSF trustees, incurred due to the dishonest behaviour of some financial advisors relating to advice on Trio Capital, revealed the problems of AFS licensees not having adequate professional indemnity insurance.

SPAA has advocated for more stringent enforcement of professional indemnity insurance in its submission to the Trio Inquiry. In this submission, SPAA noted that ASIC's general approach to insurance arrangements of AFS licensees relies on licensees self-assessing the adequacy of their professional indemnity cover taking into account the guidance in ASIC's RG 126. Licensees are required to provide ASIC with information about their insurance cover and a certificate of currency as part of their license application process but they are not required to provide ASIC with a copy of their professional indemnity insurance policy.

Furthermore, once a licence is granted, the licensee's insurance cover is not subject to annual or other periodic review (unless the licensee advises ASIC that they are no longer able to meet their licence obligations).

SPAA believes that a periodic and more systematic approach by ASIC in the monitoring and assessment of insurance policies held by licensees is necessary. At the very least, SPAA believes that licensees should be required on an annual basis to show how their insurance arrangements satisfy the requirements as set out in RG 126.

SPAA also supports the creation and promotion of standard professional indemnity insurance policies as a way of reducing the transaction costs and associated risks for licensees and consumers. Standard insurance policies would also encourage insurers to develop policies that can cover similarly situated licensees. Standard insurance policies may also address the general lack of run-off cover which exists in the financial services sector and which is a significant weakness in the reliance on professional indemnity insurance.

Ensuring an appropriate standard of professional indemnity insurance in the financial services sector and a more systemic regulatory approach by ASIC would resolve many of the issues experienced by investors who have suffered financial losses in the past due to the misconduct of their financial advisor. It would also pave the way for the introduction of a last resort compensation scheme for the sector as proposed above.

Assuming the last resort compensation scheme would be funded by an industry levy based primarily on past events, the requirement for AFS licensees to hold appropriate levels of insurance cover would ensure a last resort compensation levy for the sector would be minimised.

Increasing the regulation and oversight of AFS licensee professional indemnity insurance will ensure that if a last resort compensation scheme was in place, fewer claims would need to be compensated through the compensation scheme. This would result in lower industry levies needing to apply to the different sectors that would fall under a financial services last resort compensation scheme. Lower levies would most likely result in acceptance of a last resort compensation scheme by AFS licensees. SPAA believes that this would be a significant factor in being able to successfully introduce a last resort compensation scheme and also run it in a low-cost manner.

Similarly, the risk of regulatory moral hazard which was referred to in the final Richard St John report as a consequence of introducing a last resort compensation scheme would be reduced by the introduction of professional indemnity standards and a more heavy handed regulatory approach. By requiring AFS licensees to hold appropriate and adequate professional indemnity cover, proper regulation can reduce the risk that AFS licensees will not hold adequate insurance and instead rely on the existence of a last resort compensation scheme. We contend that ensuring that AFS licensees have appropriate insurance cover will reduce the chance of moral hazard occurring if a last resort compensation scheme were introduced. Also, there should be minimum levels of professional indemnity insurance which compulsorily cover certain events. We also contend that all avenues relating to an advisor's professional indemnity insurance are exhausted prior to referral to the Financial Ombudsman arrangements.

Requiring AFS licensees to hold appropriate professional indemnity insurance should be a major pillar in ensuring that investors have adequate protection from fraud and dishonesty. SPAA agrees with the Richard St John report's assertions that the current regulation and checking of AFS licensees professional indemnity insurance is lax and allows for irresponsible licensees to not have appropriate insurance arrangements.

We believe that if there was more regulatory scrutiny by ASIC of AFS licensees, the financial services industry would have greater professional indemnity insurance coverage resulting in more appropriate compensation outcomes for investors. Consequently, we believe that ASIC should be appropriately resourced to properly scrutinise whether AFS licensees are holding proper and adequate professional indemnity insurance.

Importance of independent financial advice

In our discussion above concerning the SMSF sector's influence on the systemic risk of the Australian financial system, we highlighted the need for SMSF trustees to be provided with high quality financial advice to minimise the risk associated of an SMSF failure. A fundamental feature of high quality financial advice is that it is provided on an independent basis to the consumer and takes into account the consumer's circumstances and needs.

The significance of independent advice has been embodied by the recent Future of Financial Advice (FOFA) reforms which have required financial advisors to act in the best interests of their client and remove the use of "conflicted remuneration" so that advisors move to a fee-for-service model which excludes commissions and volume based payments. These reforms were aimed at improving the quality of financial advice and ensure that consumers' best interests are protected.

While the best interests duty remains as a central element of the FOFA reforms and is reinforced by an advisor's common law fiduciary duty to their clients, recent amendments proposed by the Government intend on scaling back the ban on conflicted remuneration so that commissions can be paid to advisors providing general advice in certain circumstances, further challenging the independence of financial advice.

The financial advice industry has undergone significant consolidation over the previous decade with vertically integrated firms that both sell financial products and provide financial advice to consumers becoming the largest licensees in the AFSL system. The rise of these vertically integrated firms has caused a majority of advisors to be aligned with a financial institution that develops and sells financial products to consumers.

Vertical integration of selling financial products and the provision of financial advice can result in a firm's advice arm being used to distribute its financial products. While these products may be the best fit for a consumer, the comingling of the product distribution/sales and financial advice can impair the independence of advice being provided to consumers. It is because of this that vertical integration can pose a threat to the provision of independent financial advice.

The increase in vertical integration is not limited to large financial institutions, with smaller firms or conglomerates of smaller firms setting up their own product platforms and recommending clients invest in these platforms. These arrangements can be more difficult for consumers to recognise than larger institutions.

SPAA does not contend that vertical integration of financial services is inappropriate or should be prevented. However, we believe that there could be some improvements to the current financial advice environment to protect consumers and promote high quality, independent financial advice.

Increased disclosure

SPAA believes that improved disclosure requirements would assist consumers in understanding whether they are receiving advice which is provided on an independent basis or whether it is provided on the basis of an approved product list or through a vertically integrated firm.

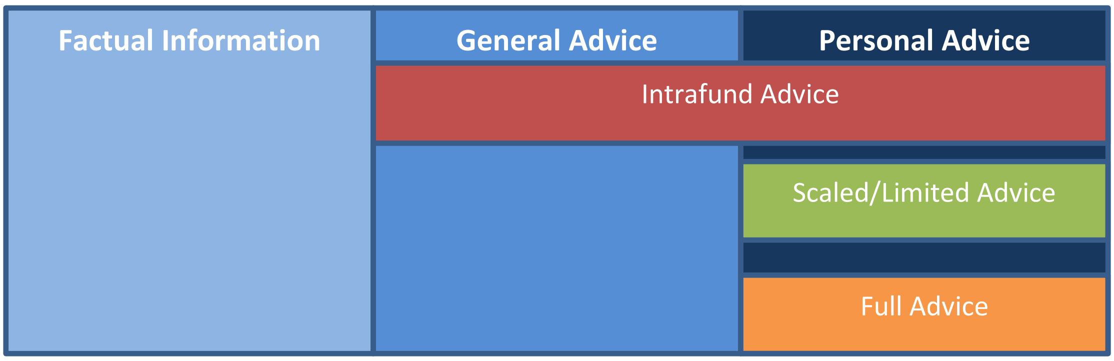
Mandatory disclosure as to whether advice is independent would allow consumers to be more informed in deciding whether the financial advice they are receiving is fit for purpose and offers them the best value. Providing consumers with this information will also allow them to judge whether the information or recommendations made to them are in their best interest and will assist them achieve their financial goals.

An improved distinction between sales and advice

In conjunction with improved disclosure requirements, we believe that there needs to be a clearer distinction between what is financial advice and what is factual or sales information. This would allow consumers to better understand the information they are being provided with by a financial advisor or employee of a financial services firm.

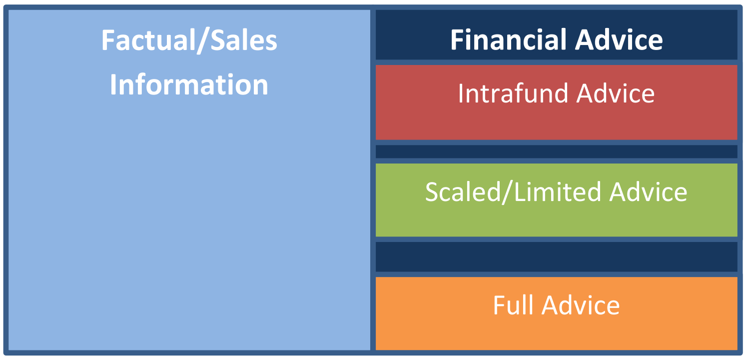
Currently, the licencing framework for financial advice divides financial advice into different categories which have different competency and compliance requirements. Financial advice can be categorised as factual information, general advice or personal advice. Within these categories, advice can be further stratified as intra-fund, scaled, limited or full advice. These distinctions are confusing for consumers and the lines between them are often blurred or unclear. Also, personal advice is the only type of advice in which a financial advisor must take a client’s personal circumstances into account and act in their best interests.

Current advice framework



We believe that a simpler split of financial advice activity into factual/sales information and financial advice would assist consumers in understanding the nature of the advice/information they are being provided with. Such a split would see current factual information or general advice fall under factual/sales information while personal advice would be considered as financial advice. This would lead to consumers having greater awareness of whether they are receiving financial advice that takes into account their personal circumstances and financial goals or whether they are being provided factual information or sales information which explains a product.

Proposed advice framework



Further, while reviewing the licencing system to make sure it better serves consumers, it would also be worthwhile to review what products are included under the *Corporations Act 2001* definition of financial product. This definition determines what products are regulated under the advice rules. With certain types of financial products being included (i.e. superannuation, equities, life insurance, managed investment products, etc.) and others being excluded (property, general insurance, LRBAs), the current settings can be confusing for consumers.

Improved licencing

The existing AFSL system has seen a move to consolidation and vertical integration as advisors benefit from the scale of larger licensees. Unfortunately, that has led to less competition and less independent advisors. We believe greater independence could be encouraged through changing Australia's licencing system to reward independence by creating a separate licensing category for independent advisors that have achieved higher competencies or specialisation than general authorised representatives. This type of licensing category could be similar to the Registered Investment Advisor (RIA) licence in the United States of America where RIAs are licensed under separate legislation with a full fiduciary responsibility to their clients and can only market themselves on a fee for service basis.

A separate licencing category that guarantees a consumer is receiving independent advice made in their best interests by a professional who has achieved a higher standard of competencies or specialisation would make it easier for consumers to seek and identify high quality, independent financial advice. Encouraging product differentiation in financial advice based on independence and competencies will allow consumers to more easily attain high quality advice that can prevent poor financial decision making. Also, if this differentiated category existed and was attractive to consumers we believe it would lift industry standards generally and encourage greater competition in the financial advice industry. This would consequently benefit all consumers of financial advice, not just those that seek advice from the independent/higher competency advisor.

SMSF and Superannuation Regulation

Regulatory Settings

SPAA believes that the current regulatory settings for the broader superannuation sector and SMSFs is correct and provides appropriate outcomes in relation to the character of SMSFs. The roles of APRA, ASIC and the ATO in regulating different superannuation entities is the right fit and should be maintained.

The continued prudential supervision by APRA of large superannuation funds that have trustees unconnected with members managing a member's retirement savings on their behalf is appropriate. Similarly, the compliance focussed regulation of SMSFs by the ATO is the correct approach for the regulation of SMSFs. SPAA believes there is no need to change compliance orientated regulation which was adopted as a result of the Wallis Inquiry recommendations in 1997.

There have been calls for SMSFs to be prudentially regulated as well as regulated from a compliance perspective in order to manage any systemic risk the sector poses. SPAA does not support the prudential regulation of SMSFs because it is incongruous to the nature of SMSFs where trustees as required under the SIS legislation to manage their own retirement savings. Prudential regulation is appropriate where money is being managed on behalf of another person that has little ability to influence the trustee responsible for managing their retirement savings.

SPAA acknowledges that the ATO's SMSF regulatory activities have been appropriate and are effective to the extent that SMSF trustees are complying with the taxation and superannuation laws. ATO statistics show that SMSF audit contravention reports (ACRs) (required when an SMSF has contravened a specified SIS Act provision) remain low with the ATO stating that "the percentage of the SMSF population with ACRs remains relatively stable at approximately 2% of all SMSFs each year."[23] Further the ATO reported that "just under half of all contraventions were reported as rectified."[24] This illustrates that the ATO are doing a good job and SMSFs are being administered responsible and within government policy objectives.

Furthermore, the level of serious non-compliance by SMSF trustees is low. In 2012-13 the ATO made 150 SMSFs non-complying, disqualified 440 people from being trustees, prevented 191 potential SMSFs from entering the system, wound up 70 funds as a result of audit action, entered 513 enforceable undertakings, and removed 438 SMSFs suspected of illegal early release from Super Fund Lookup while they were under investigation.[25] In a pool of over 500,000 SMSFs, this is a very low level of non-compliance.

We believe that the ATO's current approach to SMSF regulation is successful and will only be enhanced by the new SMSF administrative penalty regime commencing on 1 July 2014

[23] ATO, Self managed Superannuation Funds: A Statistical Overview 2011-12
[24] Ibid
[25] Alison Lendon, ATO, 'Regulating SMSFs: a cooperative exercise' http://www.ato.gov.au/Media-centre/Speeches/Other/Regulating-SMSFs--a-cooperative-exercise/

which will give the ATO a more complete suite of compliance measures to regulate SMSFs with.

More practically the ATO is an appropriate regulator of SMSFs due to their ability to undertake large scale processing to regulate over 500,000 individual SMSFs. Moving the SMSF regulatory function to another regulator would require building a knowledge base and developing technological capacities to be able to manage regulating over 500,000 entities.

SMSF size and costs

SPAA is aware of insinuation from conflicted special interest groups that there should be a minimum amount used to establish an SMSF. SPAA does not believe there is a need to regulate a minimum balance or cost-breakeven point for SMSFs, and that consumers should be free to make a choice whether an SMSF is suitable for their needs. In most situations a threshold is difficult to identify due to many factors applying and the time in which an SMSF will be able to accumulate the threshold amount.

Rather than a mandatory minimum balance we believe that SMSF advisors should be having a meaningful discussion with potential SMSF trustees on the costs of running an SMSF where they have adequate SMSF knowledge and competencies. These cost factors should then be detailed in the client's Statements of Advice in a manner that is relevant to the client's individual circumstances. SPAA would expect that advisors would undertake such disclosures in their Statements of Advice in order to comply with the best interest duty and other existing *Corporations Act 2001* disclosure requirements. Advisors will be in the best position to advise on SMSF costs when they are educated, trained and specialising in SMSF advice.

Superannuation and Longevity challenges

One of the key challenges facing the Australian financial system, especially the superannuation system, is how the system will fund the retirement income of an aging population. With Australia's demographic becoming older and people living longer, there are substantial challenges in regards to funding retirement in Australia. In this challenge, there has been a substantial focus on how retirees in the post-retirement phase best drawdown their superannuation savings and how they can manage longevity challenges.

This challenge has seen a focus on providing retirees with more products, such as annuities or deferred annuities, to manage their drawdown of retirement income. Two options often presented are to make retirees take a compulsory annuity product or provide taxation or social security incentives for the purchase of an annuity product.

We believe that this product focussed approach to the longevity challenge is flawed. The principle that particular types of annuity products should be incentivised or made compulsory for retirees implies that these products are the best way for retirees to drawdown on their superannuation benefits and manage longevity. SPAA believes that any focus on retirement income products should result in neutrality between different products so that retirees are able to choose a retirement product that best suits their needs.

One of SPAA's key concerns about making certain annuity type products compulsory or incentivised is that retirees will often have a lower income in retirement when using an annuity product. Annuity products result in the product provider accepting the investment risk in the product in exchange for a premium for the risk and providing a guaranteed income stream. Retirees lose out on increases in their income when investment returns exceed the guaranteed income they are entitled too.

A risk with pushing retirement savings into an annuity type product is that it can dislocate the allocation of superannuation capital as retirees are not motivated to seek returns which can fund their retirement income needs. Instead capital is allocated on a basis that covers the risk of an annuity product provider's obligations to retirees that have purchased one of their products. This may result in suboptimal allocation of capital, stymying the most efficient use of the superannuation capital pool.

Another concern with passing of investment risk from a retiree to a product provider is the exposure of the trustee to counter-party risk, especially over long-time horizons which would be involved in annuity of deferred annuity products. Any failure of product providers to meet their obligations to trustees over the term of their product would surely result in questions as to whether Governments will either guarantee products or bail product providers out. The political reality of this situation creates an implicit guarantee for annuity type retirement products. These are results which give rise to moral hazard and increase risk in the financial system.

Requiring a compulsory allocation of a retiree's superannuation to an annuity or deferred annuity product also reduces the flexibility that a retiree has in using their retirement savings to meet their needs. Fixed annuity products lock retirees into a defined income path, which implies a steady consumption path throughout retirement. This ignores the reality of a retiree's consumption needs which may see spikes in consumption for unexpected events such as healthcare needs, death of a spouse, family needs or changes in tax, superannuation and social security rules.

Providing incentives through the taxation and social security systems to encourage participation in these products is problematic in that it is likely to distort the decision making of investors. Any tax or social security concessions granted to encourage the take-up of retirement income products should maintain neutrality with superannuation settings to minimise the risk of distortion. Retirees should be selecting investment products on the basis of whether they meet their needs in retirement, not based on a tax or social security concession.

Finally, in assessing whether compulsion or incentives for annuity type products is required the role of the Age Pension in the retirement income system needs to be considered. The Age Pension effectively is a form of Government supported longevity insurance as if a retiree exhausts their superannuation savings during their lifetime, they are able to revert to the Age Pension to supply them with retirement income. While this is a simplistic view of the interaction between superannuation and the social security system, it raises the question of whether we need Government funded tax concessions for annuity type products, when the Government already provides the Age Pension.

Rather, than focussing on the provision and/or compulsion of annuity type products, we believe that underlying superannuation investment products should be focussed on when meeting the challenge of retirement income and longevity. Providing a broader range of investment options which allow retirees to address longevity and investment risk will substantially improve the abilities of retirees to manage their retirement income needs. This is especially relevant for SMSF trustees who take a greater role in self-managing their retirement income and addressing longevity risk.

Addressing the settings and availability of underlying investments which are suitable for managing longevity will also ensure that there is efficient allocation of superannuation capital. SMSF trustees and large fund trustees will be able to invest in suitable products that can generate income streams, manage investment risk and capital requirements for members rather than depend on product-focussed solutions to manage these risks.

As discussed above in this submission, we believe new investment products in infrastructure, corporate bonds and housing would assist trustees in generating steady returns which allow them to have a constant, non-volatile income stream. Similarly, the Government can play a role in providing investment options for retirees by establishing inflation indexed Government bonds which deliver steady, inflation proof returns to retirees over a medium to long-term horizon.