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Ms Ruth Moore
Financial Services Reform Taskforce
The Treasury
Langton Crescent
Parkes ACT 2600

Dear Ms Moore,

Corporations Amendment (Design and Distribution Obligations) Regulations 2019

Industry Super Australia (**ISA**) appreciates the opportunity to provide feedback on the draft *Corporations Amendment (Design and Distribution Obligations) Regulations 2019*. The Regulations alter the products and persons in relation to which the Design and Distribution Obligations (DDO) apply.

Summary of ISA's position

ISA supports the proposed draft Regulations but considers that the coverage of the DDO should be extended to self-managed superannuation funds (SMSFs). Applying the DDO to SMSFs:

- Is consistent with the objective of the regime which is to promote the responsible distribution of financial products and can help prevent the sale of SMSFs to consumers for whom they are not and may never be appropriate
- Will help ensure that superannuation monies are used to save for retirement and not as a way to invest in a specific asset such as property or to save tax.

The Revised Explanatory Memorandum to the Bill states:

> *'These obligations are designed to assist consumers to obtain appropriate financial products by requiring issuers and distributors to have a customer-centric approach to designing, marketing and distributing financial products'*[1]

SMSFs are sold to people for whom they are not appropriate

The distribution of SMSFs to consumers for whom they are not appropriate has long been an area of concern for regulators, particularly ASIC which has undertaken considerable work in the area. For example, *Report 337 SMSFs: Improving the quality of advice given to investors*, *Report 575 SMSFs: Improving the quality of advice and member experiences* (REP 575) and *Report 576*

[1] *Treasury Laws Amendment (Design and Distribution Obligations and Product Intervention Powers) Bill 2019,* Revised Explanatory memorandum, paragraph 1.5

Member experiences with self-managed superannuation funds (REP 576). It is apparent from ASIC's current Corporate Plan that SMSFs remain an area of focus as it will be '*Developing a series of SMSF 'red flags' for consumers considering whether to establish an SMSF, so they can make informed decisions.*[2]'

As noted by ASIC in its submission on the revised exposure draft of the *Treasury Laws Amendment (Design and Distribution Obligations and Product Intervention Powers) Bill 2018* (Bill) and confirmed in its submission to the Senate Economic Legislation Committee on the Bill,

> *'Applying the design and distribution obligations to the establishment of SMSFs could have the potential to improve consumer outcomes, particularly in cases where consumers are encouraged or advised to open an SMSF when they only have a low balance and do not properly understand the risks and costs involved.*[3]'

As ASIC has stated on numerous occasions, the decision to set up an SMSF is one of the most significant steps a consumer can take in relation to their retirement savings. However, this decision is often made after attending a seminar or using an online establishment tool where no advice or perhaps general advice is given. Concerns around the prevalence of general advice has led ASIC to identify this as a priority in its current corporate plan[4].

Consumers are often encouraged to switch their superannuation from a MySuper product to an SMSF without regard to long-term net returns and where an SMSF is not appropriate because they only have a low balance[5] and do not understand the responsibilities, risks and costs involved in running an SMSF.

It is clear that the DDO provides an important consumer protection where general or no advice is given. Ensuring that SMSFs are only promoted to persons within the target determination will reduce the likelihood that consumers will open or switch to an SMSF when such action is detrimental to their retirement savings.

SMSFs sold for reasons other than saving for retirement

An SMSF must be run for the sole purpose of providing retirement benefits for the members of the SMSF or their dependants[6]. However, as ASIC notes in its submission, the way in which SMSFs are sold *'will often be focussed on promoting the use of superannuation as a way to reduce tax or invest in a particular asset (such as property), without broader consideration as to whether an SMSF is an appropriate retirement savings structure'.*

ASIC REP 576 identifies the motivations for setting up an SMSF noting:

[2] ASIC Corporate Plan, 2019-23, page 21
[3] Design and Distribution obligations and product intervention power: Revised exposure draft legislation – Submission by the Australian Securities and Investments Commission (ASIC submission), August 2018, paragraph 79
[4] ASIC Corporate Plan, 2019-23, page 15
[5] The Productivity Commission Inquiry Report - Superannuation: Assessing Efficiency and Competitiveness, 21 December 2018 suggested that balances below $500,000 may not be appropriate, page 39
[6] 62(1) of the *Superannuation Industry (Supervision) Act 1993*

'*For some members, 'control' meant investing their superannuation in property. However, for other members, an SMSF was primarily a vehicle for investing in property itself, with little regard for superannuation as a form of retirement income*.[7]'

REP 576 goes on to describe the ways in which consumers in their research sample sought advice about SMSFs identifying that:

'*Property one-stop shops were used by a number of members to set up an SMSF. Property one-stop-shops generally made contact by cold calling or by having already helped the member to buy a property before recommending that the member set up an SMSF to buy a second or third property. Trust was established through testimonials, referral programs or special events providing opportunities to network with 'like-minded' people*.[8]'

Investment by SMSFs is also of concern to the ATO. In August 2019 the ATO contacted approximately 17,700 SMSF trustees and their auditors because it considered SMSF diversification requirements were not met. ATO records showed that those SMSFs were selected because they are likely to hold more that 90% of funds in a single asset, or single asset class[9]. Often this single asset is property acquired through a limited recourse borrowing arrangement (LRBA).

Concerns over the use of LRBA's by SMSFs raised during the 2014 Financial System Inquiry prompted the government to ask the Council of Financial Regulators (CFR) to monitor leverage and risk in the superannuation system and report back. The report issued earlier this year by CFR and the ATO [10] found that although no systemic risk to the SMSF system was identified, '*LRBAs can represent a significant risk to some individuals' retirement savings, particularly where they have low-balance SMSFs with high asset concentration and/or personal guarantees*.'

Applying the DDO to SMSFs would help ensure that superannuation monies are used to save for retirement and not as a way to invest in a specific asset such as property with little regard to saving for retirement.

ISA's proposal

As noted above, promotion of SMSFs in a manner which complies with an appropriate target market determination will help prevent the distribution of SMSFs to people for whom they are not appropriate and reduce the risk that retirement savings are used for inappropriate and risky purposes.

ISA appreciates that applying the DDO regime to SMSFs is not straight forward because the issuer of the SMSF is also the trustee and therefore some adjustment to the regulatory settings may be required however this should not prevent its application. ASIC could be given the power, through instrument, to determine the target market for SMSFs as a 'class' of financial product. Given ASIC's work in this area, it is well placed to do this.

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[7] REP 576, paragraph 14
[8] REP 576, paragraph 18
[9] https://www.ato.gov.au/Tax-professionals/Newsroom/Superannuation/Investment-diversification-requirements-for-SMSF-strategies/
[10] https://www.cfr.gov.au/publications/policy-statements-and-other-reports/2019/leverage-and-risk-in-the-superannuation-system/#Executive-Summary

If you wish to discuss this submission, please contact Nick Coates at ncoates@industrysuper.com or 0409 033 901.

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