



ASIC

Australian Securities & Investments Commission

CONSULTATION PAPER 216

Advice on self-managed superannuation funds: Specific disclosure requirements and SMSF costs

September 2013

About this paper

This consultation paper sets out ASIC's proposal to require Australian financial services (AFS) licensees and their authorised representatives who give personal advice to retail clients on establishing or switching to a self-managed superannuation fund (SMSF) to:

- warn clients that compensation arrangements under Pt 23 of the *Superannuation Industry (Supervision) Act 1993* (SIS Act) in the event of fraud or theft do not apply to SMSFs; and
- explain other matters that may influence a client's decision about whether to set up an SMSF.

We also propose to examine the costs associated with setting up, running and winding up an SMSF, and to develop guidance to improve the quality of advice about SMSFs.

We are seeking the views of retail clients, AFS licensees, authorised representatives, individual advice providers, other advisers (including recognised accountants) and other interested parties on our proposals.

About ASIC regulatory documents

In administering legislation ASIC issues the following types of regulatory documents.

Consultation papers: seek feedback from stakeholders on matters ASIC is considering, such as proposed relief or proposed regulatory guidance.

Regulatory guides: give guidance to regulated entities by:

- explaining when and how ASIC will exercise specific powers under legislation (primarily the Corporations Act)
- explaining how ASIC interprets the law
- describing the principles underlying ASIC's approach
- giving practical guidance (e.g. describing the steps of a process such as applying for a licence or giving practical examples of how regulated entities may decide to meet their obligations).

Information sheets: provide concise guidance on a specific process or compliance issue or an overview of detailed guidance.

Reports: describe ASIC compliance or relief activity or the results of a research project.

Document history

This paper was issued on 16 September 2013 and is based on the *Superannuation Industry (Supervision) Act 1993* (SIS Act) and the *Corporations Act 2001* (Corporations Act) as at the date of issue.

Disclaimer

The proposals and explanations in this paper do not constitute legal advice. They are also at a preliminary stage only. Our conclusions and views may change as a result of the comments we receive or as other circumstances change.

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The consultation process

You are invited to comment on the proposals in this paper, which are only an indication of the approach we may take and are not our final policy.

As well as responding to the specific proposals and questions, we also ask you to describe any alternative approaches you think would achieve our objectives.

We are keen to fully understand and assess the financial and other impacts of our proposals and any alternative approaches. Therefore, we ask you to comment on:

- the likely compliance costs;
- the likely effect on competition; and
- other impacts, costs and benefits.

Where possible, we are seeking both quantitative and qualitative information. We are also keen to hear from you on any other issues you consider important.

Your comments will help us develop our policy on improving the quality of advice given to SMSF investors. In particular, any information about compliance costs, impacts on competition and other impacts, costs and benefits will be taken into account if we prepare a Regulation Impact Statement: see Section D, 'Regulatory and financial impact'.

Making a submission

We will not treat your submission as confidential unless you specifically request that we treat the whole or part of it (such as any financial information) as confidential.

Comments should be sent by 11 November 2013 to:

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What will happen next?

Stage 1	16 September 2013	ASIC consultation paper released
Stage 2	11 November 2013	Comments due on the consultation paper
Stage 3	February 2014	Class order and regulatory guide released

A Background to the proposals

Key points

Becoming a trustee of a self-managed superannuation fund (SMSF) is an important decision that carries certain duties and responsibilities, including the need to manage the fund for the benefit of members in their retirement.

SMSFs are an important part of Australia's superannuation system, and are proving popular and effective for a growing number of retail investors. ASIC wants to help ensure that investors choose to set up an SMSF for the right reasons, that they understand the risks as well as the benefits, and that they can obtain good quality advice.

Unlike members of superannuation funds regulated by the Australian Prudential Regulation Authority (APRA), SMSF investors are not entitled to receive compensation under the *Superannuation Industry (Supervision) Act 1993* (SIS Act) in the event of fraud or theft.

The inquiry of the Parliamentary Joint Committee on Corporations and Financial Services (PJC) into the collapse of Trio Capital Limited (Trio) found that most SMSF investors in Trio were unaware of this and other risks associated with SMSFs. It also found that many SMSF investors in Trio lacked basic knowledge of their responsibilities as SMSF trustees.

Our recent review of SMSF advice also demonstrated a need to improve the quality of advice given to retail clients on SMSFs.

The costs of establishing, running and winding up an SMSF are also an important consideration for clients when deciding whether an SMSF structure is right for them. Industry views vary widely on SMSF costs, and in particular, on the point at which an SMSF will be cost-effective compared with an APRA-regulated fund.

In a report commissioned by ASIC, Rice Warner Actuaries (Rice Warner) found that the cost-effectiveness of an SMSF depends largely on the amount of work the trustee does themselves in administering the fund. As such, there is a range of fund balances at which an SMSF will be cost-effective compared with an APRA-regulated fund.

This paper covers two broad issues. It sets out our proposals to:

- require Australian financial services (AFS) licensees and their authorised representatives who give personal advice to retail clients on establishing or switching to an SMSF to make specific disclosures to these clients; and
- give guidance on cost issues to improve the quality of advice on SMSFs.

Overview of the SMSF sector

- 1 Since their introduction, SMSFs have grown rapidly from a niche product to the largest component of the superannuation system, in terms of total assets. There are \$439 billion of total superannuation assets held by SMSFs.¹ As at

¹ APRA, *Annual superannuation bulletin*, June 2012, issued 9 January 2013, p. 5 and Table 9, p. 40.

30 June 2012, there were approximately 478,263 SMSFs in Australia—an increase of 127% since 30 June 2001.²

- 2 There are two key drivers for investors to establish an SMSF—the desire to have greater control over their investments and the desire to save money on fees charged by other superannuation funds. Other motivations for establishing an SMSF include the advice and influence of a third party, such as an accountant or financial adviser, and estate planning.
- 3 For many Australians, the decision to set up an SMSF is one of the most significant steps they can take in relation to their retirement savings.
- 4 If investors are considering setting up an SMSF, it is important that they research and understand the risks and obligations associated with these funds.
- 5 We consider that gatekeepers—such as financial planners and accountants—provide a critical entry point on the establishment of SMSFs. They have a key role in influencing an investor’s decision to set up an SMSF, developing and implementing the fund’s investment strategy, and ensuring that the fund’s trustee complies with their legal obligations.
- 6 Our role in relation to SMSFs is to regulate the gatekeepers who provide advice and services to SMSF trustees, and to regulate many (but not all) of the financial products that funds invest in.
- 7 In our view, it is important that investors, through their financial planner or accountant, have access to good quality financial advice and information before they decide to set up an SMSF. From that perspective, we are very keen to ensure that investors are better informed about the obligations and risks associated with SMSFs so that they are more equipped to decide whether holding their superannuation investment in an SMSF structure is appropriate in light of their individual circumstances.

Impact of the collapse of Trio on SMSF investors

- 8 On 16 May 2012, the PJC released its final report on the *Inquiry into the collapse of Trio Capital* (Trio report).
- 9 The PJC found that nearly 6,090 Australians invested in Trio and lost their money. Investors who had invested in Trio through an SMSF were not eligible to receive compensation under Pt 23 of the SIS Act.
- 10 Many SMSFs suffered substantial losses because they were largely limited to pursuing compensation through their adviser’s professional indemnity insurance, which in many cases was found to be inadequate.

² APRA, *Annual superannuation bulletin*, June 2012, issued 9 January 2013, p. 5 and Table 1, p. 32.

- 11 The PJC concluded that most investors in Trio were not aware of the risks associated with investing in SMSFs. The PJC expressed concern about the quality of advice that investors in Trio received from these gatekeepers, commenting, at paragraph 7.16 of its Trio report, that:
- [M]any Trio investors were not aware they were not entitled to compensation. This poses the fundamental question of what advice, if any, was provided by planners and accountants. The committee is particularly interested in establishing what advice was given to SMSF investors in Trio Capital by financial planners and advisers.
- 12 The PJC also found that many SMSF investors lacked a basic knowledge of their responsibilities as SMSF trustees. The PJC commented, at paragraph 7.58 of its Trio report, that:
- Clearly, many SMSF investors in Trio Capital lacked basic knowledge of their responsibilities and the different regulatory settings between SMSF and APRA-regulated funds ... [T]he financial advice they received did not draw their attention to either the detail of their investment or the operating environment of SMSFs.
- 13 The PJC recommended (see Recommendation 5 at paragraph 7.17) that:
- ASIC conduct a specific and detailed investigation of both planners' and accountants' advice to SMSF investors in Trio Capital. This investigation must examine what information was provided to SMSF investors regarding their duties and responsibilities, and whether they were informed—either verbally or in writing—that they are not entitled to compensation in the event of theft and fraud.
- 14 As a consequence of the Trio collapse, we conducted a comprehensive surveillance of financial advisers providing advice on Trio, and took enforcement action against a number of advisers who recommended Trio to investors where we found breaches of the law. We also took enforcement action against the directors of Trio, its investment manager and auditors.
- 15 In the course of our investigations, we found no evidence that SMSF investors in Trio received appropriate warnings that they would not be entitled to receive compensation under the SIS Act in the event of fraud or theft, which they might be if investing through an eligible APRA-regulated superannuation fund.

Government response to the PJC's Trio report and the St John report

- 16 On 26 April 2013, the Australian Government released its formal response to the PJC's Trio report, and to the report by Richard St John on *Compensation arrangements for consumers of financial services* (St John report).

Note: In April 2010, the Australian Government announced that it had engaged Richard St John to undertake a review of the need for a statutory compensation scheme in Australia for financial services. This review was in response to the final report of the PJC *Inquiry into financial products and services in Australia*, which recommended that the Government investigate the costs and benefits of a statutory compensation scheme.

- 17 The Government accepted the vast majority of the recommendations in both reports, noting that its response, together with the recent Future of Financial Advice (FOFA) reforms and Stronger Super reforms, would help to improve the trust and confidence of investors and enhance investor protection.

Note: The Government's response to the PJC's Trio report and the St John report is set out in the following media release: The Hon Bill Shorten MP, Minister for Financial Services and Superannuation, Media Release No. 028, *Comprehensive response to combating superannuation investment fraud*, 26 April 2013, <http://ministers.treasury.gov.au/DisplayDocs.aspx?doc=pressreleases/2013/028.htm&pageID=005&min=brs&Year=&DocType=0>

- 18 In particular, the Government accepted the PJC's recommendation that ASIC should conduct a detailed investigation of advice provided to SMSF investors in Trio, noting in its response to Recommendation 5 in the PJC's Trio report that:

ASIC has already undertaken a detailed and specific risk based investigation of people who provided financial advice relating to Trio.

- 19 As part of the investigation, ASIC identified inadequate disclosure, including on the relationship between Trio/Astarra, by financial advisers. ASIC has undertaken a range of actions on various financial advisers who advised on Trio, including banning and cancelling their licences. The Government also highlighted in its response to Recommendation 4 in the PJC's Trio report that ASIC would consult on a proposal to require advisers who advise on the establishment of SMSFs to advise retail clients that they do not have access to compensation arrangements under the SIS Act.

Note: In this document, references to 'client' mean 'retail client' as defined in s761G of the Corporations Act and Div 2 of Pt 7.1 of Ch 7 of the Corporations Regulations.

Personal advice to retail clients on SMSFs

- 20 The provision of personal advice to retail clients is regulated under the Corporations Act. This includes advice provided to retail clients in relation to establishing or switching to an SMSF.
- 21 Subject to some limited exclusions (see paragraphs 22–24), a person who provides SMSF advice to retail clients must hold an AFS licence and comply with the conduct and disclosure obligations in Pt 7.7 and Pt 7.7A of the Corporations Act. These obligations are designed to ensure that retail clients receive appropriate personal advice that is in their best interests and that should enable them to make an informed decision about whether to establish or switch to an SMSF.
- 22 As part of the FOFA reforms, the existing exemption under reg 7.1.29A of the Corporations Regulations 2001 (Corporations Regulations), which allows recognised accountants to give advice about SMSFs without holding

an AFS licence, will be repealed on 1 July 2016. This means that recognised accountants who wish to continue giving advice to their clients about SMSFs will need to obtain an AFS licence.

- 23 To facilitate accountants moving into the AFS licensing regime, the Government has amended the Corporations Regulations to create a new form of AFS licence, which is referred to as a ‘limited’ AFS licence.
- 24 Recognised accountants who are granted a limited AFS licence will need to comply with the financial services laws, which includes complying with the best interests duty and related obligations, and providing clients with a Statement of Advice (SOA), where required.

Best interests duty and related obligations

- 25 The best interests duty and related obligations in Div 2 of Pt 7.7A of the Corporations Act require advice providers, when providing personal advice to retail clients, to:
- (a) act in the best interests of their clients (s961B);
 - (b) provide appropriate personal advice (s961G);
 - (c) warn the client if advice is based on incomplete or inaccurate information (s961H); and
 - (d) prioritise the interests of the client (s961J).
- 26 The best interests duty and related obligations generally apply to the individual advice provider providing the personal advice. However, if there is no individual that provides the advice, the legal person that provides the advice must comply with the obligations in Div 2 of Pt 7.7A (e.g. the AFS licensee or authorised representative).
- 27 AFS licensees also have an obligation to take reasonable steps to ensure that their representatives comply with the best interests duty and related obligations.

Note: For guidance on an advice provider’s obligations to act in the best interests of the client and related obligations, see Section E of Regulatory Guide 175 *Licensing: Financial product advisers—Conduct and disclosure* (RG 175).

Statements of advice

- 28 The conduct and disclosure obligations in Pt 7.7 and Pt 7.7A generally require AFS licensees and their authorised representatives to give clients an SOA when personal advice is provided. If the SOA is not the means by which personal advice is provided, the SOA must be given as soon as practicable after the advice has been provided but, in any event, before the client acts on the advice: see s946C of the Corporations Act.
- 29 When an AFS licensee or its authorised representatives recommend that a client establish or switch to an SMSF, the SOA must, among other things,

set out the advice and the reasoning that led to the advice. The SOA must include as much detail as a person would reasonably require to decide whether they should act on the advice received. This includes information about the costs, loss of benefits, risks and other significant consequences that the AFS licensee or its authorised representatives know, or ought to know, are likely to result from the client taking the recommended action.

Note: Sections 947A, 947B and 947C of the Corporations Act set out the main requirements for the content of an SOA given by an AFS licensee or its authorised representatives. See Section D of RG 175 for our detailed guidance on preparing and providing SOAs to retail clients.

Switching from an APRA-regulated superannuation fund

30 Section 947D of the Corporations Act outlines the additional requirements that must be included in an SOA when the advice recommends replacing one product with another.

31 Where an AFS licensee or its authorised representatives recommend to a client that they switch from an APRA-regulated superannuation fund to an SMSF, the following additional information must be included in the SOA:

- (a) information about the exit fees or any other charges applying to the withdrawal from the APRA-regulated superannuation fund;
- (b) the loss of access to rights or benefits (e.g. insurance cover and compensation);
- (c) the loss of other opportunities, including incidental opportunities associated with the existing product (e.g. rights or opportunities not presently available to the investor, but which may become available in the future);
- (d) the set-up costs and ongoing fees for the SMSF; and
- (e) any other significant consequences for the investor in changing their superannuation to an SMSF: see RG 175.160.

Note: See Information Sheet 182 *Super switching advice: Complying with your obligations* (INFO 182), which provides general information and compliance tips for financial advisers who provide ‘super switching advice’, and replaces Regulatory Guide 84 *Super switching advice: Questions and answers* (RG 84).

Other legal obligations

32 A person who provides advice to retail clients about an SMSF may also need to comply with:

- (a) the *Australian Securities and Investments Commission Act 2001* (ASIC Act) (e.g. s12DA, which prohibits misleading or deceptive conduct). When financial services (including financial product advice) are provided to consumers, there is an implied warranty under the ASIC Act that:

- (i) the financial services will be rendered with due care and skill; and
 - (ii) if the purpose for which the financial services are being obtained is made known, the financial services will be reasonably fit for that purpose (s12ED of the ASIC Act); and
- (b) the common law obligations that apply to the provision of advice. Depending on the context in which the advice is given, these obligations may include:
- (i) a duty to disclose any conflicts of interest that may affect the advice they provide;
- Note: AFS licensees are subject to a statutory obligation to manage conflicts of interest under s912A(1)(aa) of the Corporations Act. For guidance on complying with this obligation, see Regulatory Guide 181 *Licensing: Managing conflicts of interest* (RG 181).
- (ii) a duty to adopt due care, diligence and competence in preparing advice; and
 - (iii) fiduciary duties.

Quality of advice given to SMSF investors

- 33 On 18 April 2013, we released Report 337 *SMSFs: Improving the quality of advice given to investors* (REP 337), which sets out the results of our 2012 review into the quality of advice provided by financial planners and accountants to some lower-balance SMSFs (i.e. funds with a balance of \$150,000 or less).
- 34 While REP 337 found that the majority of advice provided to SMSF clients as part of our file review was of an adequate quality, the report did highlight that 28% of the advice examples were poor.
- 35 Our report demonstrated that there was significant room for improvement in the quality of SMSF advice that clients receive. The problems we identified in the advice-giving process tended to involve areas where:
- (a) the advice was not sufficiently tailored to the investor's circumstances (i.e. the advice provider was not able to demonstrate that they prioritised the goals and objectives of the investor);
 - (b) insurance recommendations were absent or inadequate;
 - (c) an inappropriate single asset class was recommended to clients;
 - (d) disclosure about product replacement was absent or inadequate;
 - (e) suitable alternatives to an SMSF were not considered; and
 - (f) there was inadequate consideration of the investor's long-term retirement planning objectives.

- 36 As part of our surveillance activity, we found—among other things—that in some of the files reviewed:
- (a) the duties and obligations of an SMSF trustee were discussed by advice providers to varying degrees—for example, some clients were not told that:
 - (i) trustees are required to develop, implement and regularly review an investment strategy for the fund; and
 - (ii) trustees remain responsible for managing the fund even if they outsource some or all of their responsibilities;
 - (b) the risks associated with an SMSF were discussed by advice providers to varying degrees—for example, some clients were not warned that, compared with members of an APRA-regulated superannuation fund:
 - (i) an SMSF has limited access to external dispute resolution (EDR) schemes;
 - (ii) an SMSF does not have access to statutory compensation under the SIS Act in the event of fraud or theft; and
 - (iii) managing an SMSF requires time, commitment and skills;
 - (c) insurance issues were either inappropriately included or excluded from the scope of the advice provided; and
 - (d) when the advice provider recommended that a client switch from an APRA-regulated superannuation fund to an SMSF, there was a significant lack of disclosure about product replacement, or disclosure was found to be inadequate.
- 37 To improve the quality of advice provided to clients, REP 337 identifies some practical tips for giving advice to clients on SMSFs. These practical tips have been developed based on the problems we identified as part of our file reviews.
- 38 More generally, ASIC is also experiencing an increase in reports of misconduct about aggressive marketing of investments, notably direct property, through SMSFs. These reports have come both from retail investors and from professional associations. We are concerned to highlight the risks of inappropriate advice to SMSF trustees or investors who may be considering an SMSF, and we will work with industry participants to improve advice quality.

SMSF costs

- 39 Whether there should be a minimum fund balance size for SMSFs has long been an issue of debate. Many industry participants question whether an SMSF with assets of less than \$200,000 can be cost-effective when compared with an APRA-regulated fund. Within industry, there is also a lack of consensus on the costs associated with setting up, running and eventually winding up an SMSF.

40 While there may be benefits for some investors in establishing an SMSF, the costs associated with an SMSF can be significant. It is important to discuss these costs with clients before making a recommendation to establish or switch to an SMSF.

41 Providing accurate information on SMSF costs will help clients to make an informed decision about whether an SMSF structure is right for them.

42 Direct financial cost is only one of the many factors that need to be considered when deciding whether an SMSF is an appropriate retirement savings vehicle for an investor. Other factors that are equally relevant include whether the investor is comfortable with taking on the responsibility, time commitment and risks associated with managing their own superannuation.

43 For many investors, including those with high superannuation balances, an APRA-regulated superannuation fund may be a more appropriate superannuation vehicle than an SMSF.

Rice Warner's research

44 In late 2012, ASIC commissioned Rice Warner to examine the minimum cost-effective balance for SMSFs compared with APRA-regulated superannuation funds: see Section C for a summary of Rice Warner's findings.

45 A full copy of Rice Warner's report, *Costs of operating SMSFs—May 2013* (Rice Warner report), is attached to this consultation paper.

Our proposed disclosure requirements

46 Given the significance of the decision to establish an SMSF, and the growth of this sector, we think there is a need to improve the quality of advice given to clients when establishing or switching to an SMSF. Furthermore, the findings of the PJC inquiry into the collapse of Trio, together with the Government's response and our own review of the quality of advice provided about SMSFs, suggest that clearer disclosure benchmarks will help to reduce risks for retail investors considering an SMSF.

47 We propose to do this by imposing specific disclosure obligations on those who provide advice on SMSFs, to assist clients in making a decision about whether to establish or switch to an SMSF. These disclosures largely reflect the advice on establishing an SMSF that advisers should already be giving to clients.

Compensation arrangements for SMSFs

- 48 We propose to modify the law to require AFS licensees and their authorised representatives to warn clients that SMSF investors are not entitled to receive compensation under Pt 23 of the SIS Act for a loss suffered as a result of fraud or theft: see Section B.
- 49 Part 23 of the SIS Act provides that the trustee of an APRA-regulated superannuation fund, or approved deposit fund, may apply to the Minister for financial assistance if the fund suffers loss because of fraudulent conduct or theft, and the loss has resulted in a substantial reduction of the fund which makes it difficult for the fund to pay its members' benefits: see s229 of the SIS Act. Any financial assistance paid under Pt 23 of the SIS Act is funded through a levy imposed on APRA-regulated superannuation funds and approved deposit funds by the *Superannuation (Financial Assistance Funding) Levy Act 1993*.
- 50 SMSFs are not eligible to receive compensation under Pt 23 of the SIS Act. An SMSF that suffers loss as a result of fraud or theft may still, for example, claim compensation through a professional indemnity insurance claim against the AFS licensee on whose advice it relied. However, there is no guarantee that the SMSF will be compensated for the loss suffered. Depending on the circumstances, the SMSF may receive no compensation or limited compensation.
- Note: Section 912B of the Corporations Act requires AFS licensees providing financial services to retail clients to have arrangements to compensate clients for loss or damage suffered as a result of a breach of a Ch 7 obligation. Regulatory Guide 126 *Compensation and insurance arrangements for AFS licensees* (RG 126) states that the requirement to have sufficient compensation arrangements in place is met by an AFS licensee having adequate professional indemnity insurance cover.
- 51 As part of its inquiry, the PJC found that many SMSF investors in Trio were unaware of the lack of compensation available to SMSFs in situations where there is fraud or theft, and recommended that ASIC should undertake a detailed investigation of advice received by SMSF investors in Trio: see paragraphs 11 and 13.
- 52 The Government agreed with the PJC's recommendation and noted in its response that ASIC would consult on a proposal to require advice providers to warn SMSF trustees that they do not have access to compensation under the SIS Act: see paragraphs 18–19.
- 53 We aim to ensure that clients understand that compensation under the SIS Act is not available to SMSFs in the event of fraud or theft. Therefore, we are seeking in this consultation paper feedback on whether clients should be required to sign a document, acknowledging that they understand this risk before they decide to set up or switch to an SMSF.

Disclosure requirements

- 54 We propose to modify the law to impose specific disclosure requirements on AFS licensees and their authorised representatives who give personal advice to clients on SMSFs to explain certain matters that may influence a client's decision to set up an SMSF. These include:
- (a) the duties and obligations associated with running an SMSF, including that trustees remain responsible for managing the fund even if they outsource some or all of their responsibilities;
 - (b) the risks associated with running an SMSF;
 - (c) the need to develop and implement an appropriate investment strategy for an SMSF;
 - (d) the time commitment and skills needed to run an SMSF effectively;
 - (e) the costs associated with setting up, running and winding up an SMSF;
 - (f) the need to consider and develop an exit strategy for an SMSF; and
 - (g) the possibility that the laws and policies that affect SMSFs may change: see Table 2 in Section B.
- 55 These specific disclosure requirements are in addition to the product replacement disclosure requirements set out in s947D of the Corporations Act: see paragraphs 30–31.
- 56 As noted above, the PJC found that many SMSF investors in Trio lacked a basic knowledge of their responsibilities as SMSF trustees, and the advice they received did not adequately draw their attention to these responsibilities. The PJC also expressed some concern about the quality of advice received by investors in Trio: see paragraphs 11–12.
- 57 Our recent review of advice provided also highlighted a need to improve the quality of advice given to clients on establishing or switching to an SMSF. In particular, our surveillance work found that there was room to improve:
- (a) disclosure to clients about the risks and responsibilities associated with establishing and operating an SMSF; and
 - (b) disclosure about product replacement when an advice provider recommends that a client switch to an SMSF.
- 58 These proposals build on the key findings of our surveillance activity and should be considered in conjunction with the practical tips that we have set out in Section C of REP 337.

When disclosures should be given

- 59 We propose to require AFS licensees and their authorised representatives to provide these disclosures to clients:

- (a) where an SOA is the means by which the advice is given—in the SOA itself; and
- (b) where an SOA is not the means by which the advice is given—at the time the advice is provided, and in the SOA when it is later given to clients: see Section B.

60 As a matter of best practice, we think that AFS licensees and their authorised representatives should give the disclosures in person at the time the advice is provided, regardless of whether the advice is (or will be) set out in the SOA.

61 As a condition of their AFS licence, we note that AFS licensees are required to keep a copy of every SOA provided by the AFS licensee or its representatives to a retail client for at least seven years from the date that the SOA is provided to the client.

Note: For details of these record-keeping AFS licence conditions, see condition 57 of PF 209, and RG 175.191–RG 175.192.

Proposed transition period

62 We propose that AFS licensees and their authorised representatives who provide personal advice to clients on establishing or switching to an SMSF should be required to make the specific disclosures six months after our class order is made: see Section B.

Our proposed guidance on SMSF costs

63 As discussed in paragraphs 39–42, we consider that the costs associated with managing an SMSF are potentially significant. These costs include:

- (a) the costs of setting up an SMSF;
- (b) the ongoing costs associated with running an SMSF;
- (c) the costs of winding up an SMSF;
- (d) the time costs associated with managing an SMSF; and
- (e) the insurance costs.

64 In our view, it is important to consider these costs when making a recommendation to establish or switch to an SMSF.

65 We therefore propose to provide guidance on this issue. We think this will include an assessment of whether an SMSF is a cost-effective option for the client: see Section C.

Your feedback

- 66 We are seeking your feedback on our proposals:
- (a) to improve the quality of advice clients receive by requiring AFS licensees and their authorised representatives to provide specific disclosures that may influence an investor's decision to establish or switch to an SMSF; and
 - (b) to provide guidance on the importance of considering cost issues when recommending that a client establish or switch to an SMSF.
- 67 We will take into account your comments before we release our class order on the specific disclosure requirements and the accompanying regulatory guidance.
- 68 We will also take into account your feedback when giving guidance on SMSF costs.
- 69 Following this consultation paper, we propose to hold some round-table discussions with industry and investor representatives to further explore the issue of SMSF costs.

B Our proposed disclosure requirements

Key points

We propose to modify the law, by way of class order, to impose disclosure requirements on AFS licensees and their authorised representatives who give personal advice to clients on establishing or switching to an SMSF. They include the need to:

- warn clients that SMSFs do not have access to the compensation arrangements under the SIS Act in the event of fraud or theft; and
- explain other matters that may influence the client's decision to set up an SMSF.

We also propose that AFS licensees and their authorised representatives should be required to make these disclosures to clients six months after the class order is made.

Warning clients about lack of statutory compensation for SMSFs

Proposal

B1 We propose to modify Pt 7.7 of the Corporations Act, by way of class order, to require AFS licensees and their authorised representatives who provide personal advice to clients on establishing or switching to an SMSF:

- (a) to warn clients that SMSFs do not have access to the compensation arrangements under Pt 23 of the SIS Act in the event of fraud or theft (see Table 1); and
- (b) to give clients the warning at the same time, and by the same means, as the advice is provided. If the advice is provided in an SOA, the warning can be given by including it in the SOA. If the advice is not provided in an SOA, we expect the warning to be recorded in the SOA when it is later given to clients.

Your feedback

B1Q1 Do you agree with our proposed disclosure requirement in Table 1? If not, why not?

B1Q2 Do you think that the proposed warning will benefit clients who are considering setting up or switching to an SMSF? If not, what other warnings would help clients decide whether it is appropriate in their circumstances to establish or switch to an SMSF?

B1Q3 Do you think the proposed warning should be given to clients in a prescribed format? For example, should the warning be given in a stand-alone document, or should it feature more prominently in the SOA? If you do not think the warning should be given in a prescribed format, please explain why.

- B1Q4 Do you think that clients should be asked to sign a document acknowledging that they understand that SMSFs are not entitled to receive compensation under the SIS Act? Are there any alternatives to obtaining client acknowledgement that will help to ensure that investors understand the lack of compensation available to SMSFs? If so, please provide details.
- B1Q5 Are our proposed disclosure requirements likely to result in additional compliance costs for AFS licensees and their authorised representatives? Please give details, including figures and reasons.
- B1Q6 Are there any practical problems with the implementation of this proposal? Please give details.

Table 1: Proposed requirement to warn clients about lack of statutory compensation for SMSFs

Disclosure requirement	Explanation
<p>Lack of compensation under the SIS Act for SMSF investors</p> <p>Advisers must warn clients that an SMSF is not entitled to receive compensation under Pt 23 of the SIS Act for any loss suffered as a result of fraud or theft.</p>	<p>SMSFs are not eligible to receive compensation under the SIS Act for any loss suffered as a result of fraud or theft.</p> <p>In contrast, members of an APRA-regulated superannuation fund may apply to the Minister for financial assistance under Pt 23 of the SIS Act if the fund suffers loss because of fraud or theft, and the loss has resulted in a substantial reduction of the fund which makes it difficult for the fund to pay its members' benefits.</p> <p>Clients need to consider this risk when determining whether or not an SMSF is the right superannuation structure for them.</p>

Rationale

- 70 Given the significance of the decision to invest in an SMSF, we consider it is important for investors to be warned about the lack of compensation available to SMSFs under Pt 23 of the SIS Act for any loss suffered as a result of fraud or theft.
- 71 As part of its formal response to the PJC's Trio report, the Government accepted the PJC's recommendation that ASIC investigate the advice provided to SMSF investors in Trio and whether these investors were informed that they were not entitled to receive compensation in the event of fraud or theft. The Government also highlighted that ASIC would consult on a proposal to require advisers to give retail clients a warning about this issue.
- 72 Our investigations into the advice provided to SMSF investors in Trio and, more recently, the findings of our review of SMSF advice in REP 337, highlighted that it is not current industry practice to warn clients that SMSF investors are not entitled to receive statutory compensation under the SIS Act.
- 73 If advice is given verbally to clients, advisers should discuss the effect of the lack of compensation for SMSF investors under the SIS Act with their clients before recommending that they establish or switch to an SMSF.

Disclosure requirements

Proposal

- B2** We propose to modify Pt 7.7 of the Corporations Act, by way of class order, to require AFS licensees and their authorised representatives who provide personal advice to clients on establishing or switching to an SMSF:
- (a) to disclose to clients the matters set out in Table 2. The level of detail about a matter that is required is such as a client would reasonably require to decide whether it is appropriate in their circumstances to establish or switch to an SMSF; and
 - (b) to give clients the disclosures at the same time, and by the same means, as the advice is provided. If the advice is provided in an SOA, the disclosures can be given by including them in the SOA. If the advice is not provided in an SOA, we expect the disclosures to be recorded in the SOA when it is later given to clients.

Your feedback

- B2Q1 Do you agree with our proposed disclosure requirements in Table 2? If not, why not?
- B2Q2 Do you think the proposed disclosure requirements will benefit clients who are considering setting up or switching to an SMSF? If not, what other disclosures do you think would help clients decide whether it is appropriate in their circumstances to establish or switch to an SMSF?
- B2Q3 Do you think that the proposed disclosure requirements in Table 2 should be given to clients in a prescribed format? If not, why not?
- B2Q4 Do you think that clients should also be asked to sign a document acknowledging the responsibilities and risks associated with running an SMSF? Are there any alternatives to obtaining client acknowledgement that will help to ensure that clients understand the risks associated with SMSFs? If so, please provide details.
- B2Q5 Are our proposed disclosure requirements likely to result in additional compliance costs for AFS licensees and their authorised representatives? Please give details, including figures and reasons.
- B2Q6 Are there any practical problems with the implementation of this proposal? Please give details.
- B2Q7 Do you think we should provide further guidance on the disclosure obligations? If so, please provide details.

74 The first column in Table 2 sets out the proposed disclosure requirements for AFS licensees and their authorised representatives when giving advice to clients about establishing or switching to an SMSF. The second column in Table 2 sets out additional background and explanation. The level of detail

in which these matters need to be explained to clients will depend on the client's relevant circumstances.

Table 2: Proposed disclosure requirements

Disclosure requirement	Background and explanation
<p>1 Responsibilities and obligations for SMSF trustees associated with running an SMSF</p> <p>Advisers must explain the role, responsibilities and obligations of an SMSF trustee in running an SMSF.</p>	<p>SMSF trustees need to comply with a number of obligations under the superannuation and taxation laws, as well as the trust deed. There may be various consequences—for example, loss of taxation concessions—if an SMSF trustee fails to comply with their obligations. Even if one trustee is less actively involved, all trustees are equally liable for the fund's compliance with the superannuation and tax laws.</p> <p>The Australian Taxation Office (ATO) requires new trustees to make a declaration that they understand their responsibilities and obligations as an SMSF trustee, including to:</p> <ul style="list-style-type: none"> • ensure that the SMSF is managed in compliance with the relevant laws and be responsible for and control the SMSF; • maintain the fund for the sole purpose of providing retirement benefits to SMSF members, or to their dependants if a member dies before retirement; • accept contributions and pay benefits (pension or lump sums) to members and their beneficiaries in accordance with superannuation and taxation laws and the SMSF trust deed; • value the fund's assets at market value for the purposes of preparing financial accounts and statements; • have the financial accounts and statements for the SMSF audited each year by an approved SMSF auditor; and • meet the reporting and administration obligations imposed by the ATO. <p>It is important that clients understand that they remain responsible for managing the fund even if they outsource some or all of their responsibilities to external service providers.</p>
<p>2 Risks associated with an SMSF</p> <p><i>Lack of insurance for SMSFs</i></p> <p>Advisers must discuss insurance issues with clients because this may influence an investor's decision to establish or switch to an SMSF.</p> <p><i>Other risks associated with an SMSF structure</i></p> <p>There may be additional risks that advisers need to discuss with the investor, depending on their individual circumstances.</p>	<p>Unlike APRA-regulated funds, SMSFs do not come with insurance. The potential loss of insurance benefits as a result of switching from an APRA-regulated fund to an SMSF is an important issue that advisers should discuss with their clients. SMSF trustees should consider whether it is appropriate to take out separate life insurance for members, including income and total and permanent disability cover, as part of the fund's investment strategy. Although taking out this insurance will be at an additional cost to the SMSF, the risk of not having appropriate insurance is that it may leave members worse off in retirement.</p> <p>Note: REP 337 sets out some practical tips for advisers on the types of insurance issues they should raise with clients: see C17–C18.</p> <p>There may be risks, for example, associated with:</p> <ul style="list-style-type: none"> • a lack of access to the Superannuation Complaints Tribunal to resolve SMSF complaints; • using individual trustees as opposed to a corporate trustee; and • a breakdown in the relationship of fund members, especially in circumstances where the membership structure of the SMSF is unusual. <p>Note: REP 337 sets out some practical tips for advisers on the other risks associated with an SMSF structure: see C13–C16.</p>

Disclosure requirement	Background and explanation
<p>3 The need to develop and implement an appropriate investment strategy for an SMSF</p> <p>Advisers must explain that SMSF trustees must set and follow an investment strategy that ensures the fund is likely to meet the members' retirement needs (e.g. deliver an adequate level of income) with respect to superannuation and taxation laws.</p> <p>Trustees must also conduct a regular review of the fund's investment strategy.</p>	<p>Developing and implementing an appropriate investment strategy is a serious responsibility for SMSF trustees. The trustee will ultimately remain responsible for the fund's investment strategy even if they seek investment advice from an adviser.</p> <p>It is important that clients understand:</p> <ul style="list-style-type: none"> • the benefits associated with asset diversification and investing across a number of asset classes (e.g. shares, real property and fixed interest products) in a long-term investment strategy, such as improving the risk and return profile of an SMSF fund; • there are some restrictions on SMSF investments and, as part of their obligations, trustees are prohibited from entering into certain transactions, such as lending the fund's money, or providing financial assistance to a member of the fund or their relatives; and • they should conduct a regular review of the SMSF's investment strategy to ensure that the investment strategy continues to reflect the purpose and circumstances of the fund and its members. <p>Note: REP 337 sets out some practical tips for advisers on developing an investment strategy and investment diversification: see C19–C26.</p>
<p>4 The time commitment and skills needed to run an SMSF effectively</p> <p>Advisers must explain to clients that, to run an SMSF effectively, clients should consider whether they have enough time and the appropriate skills and financial experience to make the best investment decisions for the fund and to meet all of their obligations as an SMSF trustee.</p>	<p>Trustees can use external research or advice to develop their financial knowledge over time, but they remain ultimately responsible for ensuring that investment decisions are made and implemented according to the SMSF's investment strategy.</p> <p>Note: REP 337 sets out some practical tips for advisers in determining whether an SMSF is a suitable retirement savings structure for clients: see C7–C9. See also INFO 182.</p>
<p>5 The costs of managing an SMSF</p> <p>Advisers must explain to clients the costs associated with managing an SMSF, and also provide clients with an estimate of these costs.</p>	<p>The costs associated with managing an SMSF are potentially significant, and it is important that advisers explain these costs to clients before making a recommendation to establish or switch to an SMSF. This will help to ensure that clients are able to make an informed decision about whether an SMSF structure is a suitable superannuation vehicle for them.</p> <p>The costs of managing an SMSF include:</p> <ul style="list-style-type: none"> • establishment costs (e.g. preparation of a trust deed and development of an investment strategy); and • ongoing costs associated with operating an SMSF (e.g. annual administration and investment costs, the cost of outsourcing the trustee's compliance obligations and statutory charges). <p>Note: See REP 337 (at paragraphs 86–90) for a discussion of some of the costs of setting up and running an SMSF. REP 337 also provides a practical tip for advisers on discussing the likely costs of operating an SMSF: see C7. See also INFO 182.</p>
<p>6 The need to consider and develop an exit strategy for an SMSF</p> <p>Advisers must provide clients with information about a possible exit strategy for the SMSF.</p>	<p>Clients should be made aware that they need to consider and develop an exit strategy for the SMSF in situations, for example, where the compliance requirements become too onerous or costly for the SMSF trustee.</p> <p>It is important that clients are aware of the process for winding up an SMSF and the likely costs associated with that process.</p>

Disclosure requirement	Background and explanation
<p>7 The laws and policies that affect SMSFs are subject to change</p> <p>Advisers must explain to clients that it is the responsibility of SMSF trustees to update their knowledge on any changes to the law and their compliance obligations.</p>	<p>The taxation and superannuation laws and policies that apply to SMSFs may be subject to continual change, including changes to legislation, and regulatory policies and standards.</p>

Rationale

- 75 As discussed in paragraphs 20–32, when providing personal advice to clients on whether to set up or switch to an SMSF, AFS licensees and their authorised representatives are already required to comply with the conduct and disclosure obligations in Pt 7.7 and Pt 7.7A of the Corporations Act.
- 76 Depending on the circumstances, this includes:
- (a) for advice about establishing or switching to an SMSF—a requirement that AFS licensees or their authorised representatives set out their advice in an SOA, including information about the basis on which the advice is given, together with as much detail as a person would reasonably require to decide whether they should act on the advice (see s947B and 947C); and
 - (b) for switching advice—an additional requirement that AFS licensees or their authorised representatives give clients information about the costs, loss of benefits and other significant consequences for the client in making the decision to switch to an SMSF in accordance with the product replacement disclosure obligations in s947D.
- 77 However, our recent review of a sample of SMSF advice provided found that there was significant room for improvement in the quality of advice received by clients. In particular, our surveillance work found that there was a need to improve disclosure to clients about:
- (a) the responsibilities associated with establishing and operating an SMSF;
 - (b) the risks associated with investing in an SMSF, such as the lack of access to EDR schemes; and
 - (c) product replacement when an advice provider recommends a client switch their retirement savings to an SMSF.
- 78 The findings of our surveillance activity also showed that the quality of advice varied significantly. For example, some of the advice samples we reviewed did not clearly set out the disclosures, or the disclosures were buried deep in the SOA.

- 79 Requiring AFS licensees and their authorised representatives to explain to clients the matters set out in Table 2 should ensure that clients are made aware of the risks and responsibilities associated with SMSFs, and allow them to make a more fully informed assessment as to whether they should hold their superannuation investments in this way. The level of detail in which these matters need to be explained to clients will depend on the client's relevant circumstances. We consider this is particularly important given the significance of the decision to invest in an SMSF.
- 80 The specific disclosures we have set out in Table 2 should be considered in conjunction with the practical tips for giving advice on SMSFs that we have outlined in Section C of REP 337 and in INFO 182. Depending on the individual circumstances of the client, other disclosures may be required in addition to those set out in this consultation paper.
- 81 The proposed disclosures we have set out in items 1 and 3 of Table 2 are consistent with the obligations and duties set out in the ATO *Trustee declaration*, which SMSF trustees must sign within 21 days of becoming a trustee or a director of a corporate trustee. Given that many trustees sign this declaration after they have received advice about establishing or switching to an SMSF, we think it is important that AFS licensees and their authorised representatives ensure that trustees understand the information contained in the declaration before they set up an SMSF.
- 82 If advice is given verbally to clients, advisers should discuss the specific disclosures with their clients before recommending that they establish or switch to an SMSF.

Transition period

Proposal

- B3** We propose that an AFS licensee or its authorised representatives that provide personal advice to a client on establishing or switching to an SMSF should be required to make the disclosures in proposals B1 and B2 six months after we release our class order on the disclosure requirements.

Your feedback

- B3Q1 Do you agree with the proposed timeframe for the implementation of proposals B1 and B2? If you think that a transition period of longer or shorter than six months is required, please explain why.

Rationale

- 83 We consider it is important to ensure that clients who are thinking about establishing or switching to an SMSF are fully aware of the risks and responsibilities associated with holding their superannuation investments in an SMSF structure. As such, we think that our proposed requirements should be implemented as soon as practicable.
- 84 We recognise, however, that AFS licensees and their authorised representatives may need time to implement these specific disclosures. In some cases, AFS licensees and their authorised representatives may need time to update their systems to take account of the specific disclosures in Table 1 and Table 2. We consider that a transitional period of six months is appropriate. The proposed transitional period will allow an adequate period of time for AFS licensees and their authorised representatives to meet the disclosure requirements.
- 85 We plan to implement the proposed disclosure requirements by modifying the law by way of class order.

C Our proposed guidance on SMSF costs

Key points

ASIC commissioned Rice Warner to examine the minimum cost-effective balance for SMSFs compared with APRA-regulated superannuation funds.

We have decided to publish the Rice Warner report and seek feedback on Rice Warner's findings.

We propose to give guidance, informed by Rice Warner's work and the feedback we receive from stakeholders on the report, to improve the quality of advice which recommends that a client establish or switch to an SMSF.

Our proposed guidance includes both direct financial costs, such as those involved in setting up an SMSF, as well as issues around the time that investors devote to running an SMSF. These would include guidance about the need to consider:

- the costs associated with setting up an SMSF;
- the ongoing costs associated with running an SMSF;
- the winding up costs of an SMSF;
- the point at which an SMSF structure is likely to be cost-effective with an APRA-regulated fund for the individual investor;
- any other SMSF costs; and
- whether an SMSF is a cost-effective option.

Background

86 The question of whether there should be a minimum fund balance size for setting up an SMSF is a contentious issue. Many industry participants question whether an SMSF with assets of less than \$200,000 could be cost-effective compared with an APRA-regulated fund. ASIC is not proposing a mandated minimum balance, but rather is looking to provide clearer guidance on this issue based on research and on industry and investor views.

87 ASIC has previously stated in RG 84 (at page 8) that:

It is generally accepted that for a fund balance below around \$200,000, an SMSF is usually not cost-competitive with other available super options.

Note: RG 84 was published in 2005. It has now been replaced by INFO 182.

Rice Warner's research

88 ASIC commissioned Rice Warner in late 2012 to examine the minimum cost-effective balance for SMSFs when compared with APRA-regulated superannuation funds.

- 89 As part of our brief, we asked Rice Warner to specifically consider:
- (a) the comparable costs of holding superannuation in an SMSF or an APRA-regulated fund;
 - (b) the various products issued by APRA-regulated funds, including default options and likely MySuper costs;
 - (c) the situation where there is more than one member in an SMSF, which would result in multiple accounts in an APRA-approved product; and
 - (d) the opportunity cost of the time spent by an SMSF trustee in managing the fund.
- 90 Rice Warner delivered its report *Costs of operating SMSFs* in May 2013. We have decided to release the Rice Warner report and seek industry feedback on it. The purpose of this is to encourage further debate and explore the issues relating to SMSF costs.
- 91 In assessing the minimum balance size of an SMSF, Rice Warner considered a number of factors, including:
- (a) the likely pattern of future contributions (nil once all members are in the pension phase), including any large non-concessional amounts;
 - (b) the current size of the fund and future cash flows (earnings plus contributions less expenses, tax and withdrawals);
 - (c) the asset allocation—and whether this can be replicated more cost-effectively in an APRA-regulated fund; and
 - (d) whether the trustee(s) is self-directed or will rely on external advice (which will add to costs).
- 92 Rice Warner separated the SMSF segment into funds of different types, including separating funds by:
- (a) the number of members;
 - (b) the accumulation phase and/or pension phase; and
 - (c) the size of investments.
- 93 Rice Warner estimated the range of costs for setting up and running SMSFs through the marketing material of and interviews with a number of SMSF administration services suppliers, accountants and auditors. Rice Warner found that there was a range of costs that reflected the range of complexity of the SMSFs themselves:
- Costs for simple funds with little complexity and the trustee seeking only transactional services will generally be at the low end of the range. Funds with more complexity and/or where the trustee required more assistance will generally be at the high end of the range.³

³ Rice Warner, *Costs of operating SMSFs*, May 2013, p. 18.

94 Rice Warner’s report *Superannuation fees research—June 2012*, prepared for and published by the Financial Services Council, provided a detailed overview of the level of fees charged by APRA-regulated funds. Rice Warner relied on this report to provide a comparison of these costs with the costs of operating SMSFs.

95 Rice Warner found that, as there was a range of costs for all fund types, the costs for each type overlapped with the costs of the others. Rice Warner therefore presented the range of costs for SMSFs of various size balances and determined whether the fee is:

- (a) above the range of fees for equivalent balances held in APRA-regulated funds—that is, above the high fee for that account balance;
- (b) within the range of fees for equivalent balances held in APRA-regulated funds—that is, between the low and high fee for that account balance; or
- (c) below the range of fees for equivalent balances held in APRA-regulated funds—that is, below the low fee for that account balance.

96 Table 3 sets out a summary of Rice Warner’s findings comparing the cost of SMSFs with the cost of APRA-regulated funds.

Table 3: Summary of Rice Warner’s findings comparing the cost of SMSFs with the cost of APRA-regulated funds

SMSF balances	Findings
Less than \$100,000	Are not competitive in comparison to APRA-regulated funds. SMSFs of this size would only be appropriate if they are expected to grow to a competitive size within a reasonable time.
\$100,000 to \$200,000	Can be competitive with more expensive APRA-regulated funds if the trustees undertake the broader investment and administration functions. For example, SMSFs of this size may be competitive with more expensive APRA-regulated funds if the trustees outsource transactional services, but undertake other investment and administration functions themselves.
\$200,000 to \$500,000	Can provide equivalent value with APRA-regulated funds provided the trustees undertake some of the administration.
\$500,000 or more	Can provide equivalent value to APRA-regulated funds on a full service basis.

Source: Rice Warner report.

97 The Rice Warner report also discusses:

- (a) the costs of establishing an SMSF;
- (b) the annual compliance costs associated with running an SMSF;
- (c) the costs associated with non-standard assets;

- (d) the costs associated with full administration of an SMSF; and
- (e) the costs of winding up an SMSF.

Guidance on costs

Proposal

- c1** We propose to provide guidance that, when giving advice to clients on establishing or switching to an SMSF, advisers must consider and be able to show that they have informed clients of each of the SMSF cost issues set out in Table 4.

Our proposed guidance will take into account Rice Warner's findings and the feedback received in response to it.

Your feedback

- C1Q1** Do you agree with Rice Warner's findings? In particular, do you agree with:
- (a) the way that Rice Warner has described SMSF costs in its report? If not, why not?
 - (b) Rice Warner's analysis about the points at which an SMSF becomes cost-effective compared with an APRA-regulated fund? If not, why not?
- C1Q2** Do you agree that we should provide guidance on the costs associated with setting up, managing and winding up an SMSF? If not, why not? If yes:
- (a) what are the costs associated with setting up, running and winding up an SMSF?
 - (b) is insurance purchased through an SMSF cost-effective compared with insurance through an APRA-regulated fund? If not, why not?
 - (c) do you think we should provide actual dollar costs (or a range of dollar costs) for the following SMSF costs? If not, why not?
 - (i) the costs associated with setting up, running and winding up an SMSF;
 - (ii) the time cost associated with managing an SMSF;
 - (iii) the cost of an SMSF not having access to compensation under the SIS Act; and
 - (iv) the cost of obtaining insurance; and
 - (d) what are the costs or benefits of SMSF structures compared with other superannuation vehicles? Please provide details.
- C1Q3** Should advisers be required to consider and inform clients of the costs in Table 4 before establishing an SMSF? If not, why not?

- C1Q4 Are there any other SMSF costs that need to be disclosed to clients? If so, should they be disclosed in actual dollar costs (or a range of costs)? Please provide details.
- C1Q5 Do you think that any other disclosures about the costs of setting up, running and winding up an SMSF need to be made to clients before establishing an SMSF? If not, why not?
- C1Q6 Is our proposed guidance likely to result in additional compliance costs for advisers? Please give details, including figures and reasons.
- C1Q7 Are there any practical problems with the implementation of this proposal? Please give details.

Table 4: SMSF costs that we propose advisers should explain to clients

Cost type	Explanation
1 Costs associated with setting up an SMSF	There are a number of costs associated with setting up an SMSF. Some of these costs are unavoidable (e.g. having a trust deed), while other costs may not be incurred in all situations (e.g. having a corporate trustee).
2 Ongoing costs associated with running an SMSF	There are a number of ongoing costs associated with the running of an SMSF. Some of these costs are unavoidable (e.g. having the SMSF audited annually), while other costs may not be incurred in all situations (e.g. fees for professional investment advice).
3 Costs associated with winding up an SMSF	An SMSF may be wound up in a number of situations.
4 Point at which an SMSF becomes cost-effective compared with an APRA-regulated fund	There has been considerable debate within industry about whether there should be a minimum balance for SMSFs.
5 Time cost associated with managing an SMSF	The time associated with managing an SMSF is often overlooked as one of the costs associated with an SMSF structure.
6 Insurance costs	<p>An employer's default fund must offer a minimum level of life insurance so that most investors will have some insurance cover through their APRA-regulated superannuation fund.</p> <p>Because of their size, most APRA-regulated superannuation funds are able to access competitive insurance premium rates, such as group insurance policies and discounts. These rates may be unavailable to members of an SMSF and may mean that each SMSF member needs to be individually assessed for insurance purposes. This may lead to potentially higher premiums, loadings, exclusions or refusals of insurance for investors.</p>

Rationale

- 98 As discussed in paragraphs 20–32, when providing personal advice to retail clients on whether to set up an SMSF, AFS licensees and their representatives are already required to comply with the conduct and disclosure obligations in Pt 7.7 and Pt 7.7A of the Corporations Act.
- 99 We think that, when considering whether to recommend that a client establish an SMSF, AFS licensees and their representatives should consider whether an SMSF is a cost-effective option for the client.
- 100 This includes considering the costs associated with setting up, running and winding up an SMSF, and whether the SMSF will be cost-effective for the client when compared with an APRA-regulated superannuation fund.
- 101 We will hold round-table discussions with industry and investor representatives to consider Rice Warner’s findings.
- 102 We propose to give guidance, informed by the Rice Warner report and the feedback in response to it at round-table discussions and in the submissions we receive on this consultation paper.

D Regulatory and financial impact

103 In developing the proposals in this paper, we have carefully considered their regulatory and financial impact. On the information currently available to us we think they will strike an appropriate balance between:

- (a) ensuring that clients who are thinking about establishing or switching to an SMSF are aware of the responsibilities and key risks of holding their superannuation investments in an SMSF structure; and
- (b) not causing AFS licensees and their authorised representatives to incur unreasonable costs in ensuring that these matters are explained to clients.

104 Before settling on a final policy, we will comply with the Australian Government's regulatory impact analysis (RIA) requirements by:

- (a) considering all feasible options, including examining the likely impacts of the range of alternative options which could meet our policy objectives;
- (b) if regulatory options are under consideration, notifying the Office of Best Practice Regulation (OBPR); and
- (c) if our proposed option has more than minor or machinery impact on business or the not-for-profit sector, preparing a Regulation Impact Statement (RIS).

105 All RISs are submitted to the OBPR for approval before we make any final decision. Without an approved RIS, ASIC is unable to give relief or make any other form of regulation, including issuing a regulatory guide that contains regulation.

106 To ensure that we are in a position to properly complete any required RIS, please give us as much information as you can about our proposals or any alternative approaches, including:

- (a) the likely compliance costs;
- (b) the likely effect on competition; and
- (c) other impacts, costs and benefits.

See 'The consultation process', p. 4.

Key terms

Term	Meaning in this document
advice providers	A person to whom the obligations in Div 2 of Pt 7.7A of the Corporations Act apply when providing personal advice to a client. This is generally the individual who provides the personal advice. However, if there is no individual that provides the advice, which may be the case if advice is provided through a computer program, the obligations in Div 2 of Pt 7.7A apply to the legal person that provides the advice (e.g. a corporate licensee or authorised representative)
AFS licence	An Australian financial services licence under s913B of the Corporations Act that authorises a person who carries on a financial services business to provide financial services Note: This is a definition contained in s761A.
AFS licensee	A person who holds an AFS licence under s913B of the Corporations Act Note: This is a definition contained in s761A.
approved SMSF auditor	Has the meaning given in s10(1) of the SIS Act
APRA	Australian Prudential Regulation Authority
ASIC	Australian Securities and Investments Commission
ASIC Act	<i>Australian Securities and Investments Commission Act 2001</i> , including regulations made for the purpose of that Act
ATO	Australian Taxation Office
ATO <i>Trustee declaration</i>	ATO's <i>Trustee declaration</i> , published in December 2012 (NAT 71089-12.2012). The trustee declaration must be: <ul style="list-style-type: none"> • completed by new trustees (or directors of corporate trustees) of a new SMSF or an existing SMSF; and • signed within 21 days of becoming a trustee (or director of a corporate trustee) of an SMSF
authorised representative	A person authorised by an AFS licensee, in accordance with s916A or 916B of the Corporations Act, to provide a financial service or services on behalf of the licensee Note: This is a definition contained in s761A.
client	A retail client
Corporations Act	<i>Corporations Act 2001</i> , including regulations made for the purposes of that Act
Corporations Regulations	Corporations Regulations 2001

Term	Meaning in this document
EDR	External dispute resolution
financial product	<p>A facility through which, or through the acquisition of which, a person does one or more of the following:</p> <ul style="list-style-type: none"> • makes a financial investment (see s763B); • manages financial risk (see s763C); • makes non-cash payments (see s763D) <p>Note: This is a definition contained in s763A of the Corporations Act: see also s763B–765A.</p>
financial product advice	<p>A recommendation or a statement of opinion, or a report of either of these things, that:</p> <ul style="list-style-type: none"> • is intended to influence a person or persons in making a decision about a particular financial product or class of financial product, or an interest in a particular financial product or class of financial product; or • could reasonably be regarded as being intended to have such an influence. <p>This does not include anything in an exempt document</p> <p>Note: This is a definition contained in s766B of the Corporations Act.</p>
FOFA	Future of Financial Advice
gatekeepers	Advisers, approved SMSF auditors, and providers of products to SMSFs
investor	Has the same meaning as client
personal advice	<p>Financial product advice given or directed to a person (including by electronic means) in circumstances where:</p> <ul style="list-style-type: none"> • the provider of the advice has considered one or more of the client's objectives, financial situation and needs; or • a reasonable person might expect the provider to have considered one or more of these matters <p>Note: This is a definition contained in s766B(3) of the Corporations Act.</p>
PJC	Parliamentary Joint Committee on Corporations and Financial Services
recognised accountant	<p>A member of the Institute of Chartered Accountants in Australia, CPA Australia or the Institute of Public Accountants who complies with the professional education requirements of their membership</p> <p>Note: See reg 7.1.29A(2) of the Corporations Regulations for the exact definition.</p>
REP 337 (for example)	An ASIC report (in this example numbered 337)

Term	Meaning in this document
representative of an AFS licensee	Means: <ul style="list-style-type: none"> • an authorised representative of the licensee; • an employee or director of the licensee; • an employee or director of a related body corporate of the licensee; or • any other person acting on behalf of the licensee <p>Note: This is a definition contained in s910A of the Corporations Act.</p>
retail client	A client as defined in s761G of the Corporations Act and Div 2 of Pt 7.1 of Ch 7 of the Corporations Regulations
RG 175 (for example)	An ASIC regulatory guide (in this example numbered 175)
Rice Warner	Rice Warner Actuaries
Rice Warner report	Report by Rice Warner Actuaries on the <i>Costs of operating SMSFs—May 2013</i>
s913B (for example)	A section of the Corporations Act (in this example numbered 913B), unless otherwise specified
SIS Act	<i>Superannuation Industry (Supervision) Act 1993</i> , including regulations made for the purposes of that Act
SMSF	Self-managed superannuation fund
SOA	Statement of Advice
St John report	Report by Richard St John on <i>Compensation arrangements for consumers of financial services</i>
Stronger Super reforms	Proposed changes to the SIS Act, in response to the Super System Review
Super System Review	A review of the superannuation system in Australia, initiated by the Australian Government
Trio	Trio Capital Limited
Trio report	Final report by the PJC on the <i>Inquiry into the collapse of Trio Capital</i> , released 16 May 2012

List of proposals and questions

Proposal	Your feedback
<p>B1 We propose to modify Pt 7.7 of the Corporations Act, by way of class order, to require AFS licensees and their authorised representatives who provide personal advice to clients on establishing or switching to an SMSF:</p> <p>(a) to warn clients that SMSFs do not have access to the compensation arrangements under Pt 23 of the SIS Act in the event of fraud or theft (see Table 1); and</p> <p>(b) to give clients the warning at the same time, and by the same means, as the advice is provided. If the advice is provided in an SOA, the warning can be given by including it in the SOA. If the advice is not provided in an SOA, we expect the warning to be recorded in the SOA when it is later given to clients.</p>	<p>B1Q1 Do you agree with our proposed disclosure requirement in Table 1? If not, why not?</p> <p>B1Q2 Do you think that the proposed warning will benefit clients who are considering setting up or switching to an SMSF? If not, what other warnings would help clients decide whether it is appropriate in their circumstances to establish or switch to an SMSF?</p> <p>B1Q3 Do you think the proposed warning should be given to clients in a prescribed format? For example, should the warning be given in a stand-alone document, or should it feature more prominently in the SOA? If you do not think the warning should be given in a prescribed format, please explain why.</p> <p>B1Q4 Do you think that clients should be asked to sign a document acknowledging that they understand that SMSFs are not entitled to receive compensation under the SIS Act? Are there any alternatives to obtaining client acknowledgement that will help to ensure that investors understand the lack of compensation available to SMSFs? If so, please provide details.</p> <p>B1Q5 Are our proposed disclosure requirements likely to result in additional compliance costs for AFS licensees and their authorised representatives? Please give details, including figures and reasons.</p> <p>B1Q6 Are there any practical problems with the implementation of this proposal? Please give details.</p>
<p>B2 We propose to modify Pt 7.7 of the Corporations Act, by way of class order, to require AFS licensees and their authorised representatives who provide personal advice to clients on establishing or switching to an SMSF:</p> <p>(a) to disclose to clients the matters set out in Table 2. The level of detail about a matter that is required is such as a client would reasonably require to decide whether it is appropriate in their circumstances to establish or switch to an SMSF; and</p> <p>(b) to give clients the disclosures at the same time, and by the same means, as the advice is provided. If the advice is provided in an SOA, the disclosures can be given by including them in the SOA. If the advice is not provided in an SOA, we expect the disclosures to be recorded in the SOA when it is later given to clients.</p>	<p>B2Q1 Do you agree with our proposed disclosure requirements in Table 2? If not, why not?</p> <p>B2Q2 Do you think the proposed disclosure requirements will benefit clients who are considering setting up or switching to an SMSF? If not, what other disclosures do you think would help clients decide whether it is appropriate in their circumstances to establish or switch to an SMSF?</p> <p>B2Q3 Do you think that the proposed disclosure requirements in Table 2 should be given to clients in a prescribed format? If not, why not?</p> <p>B2Q4 Do you think that clients should also be asked to sign a document acknowledging the responsibilities and risks associated with running an SMSF? Are there any alternatives to obtaining client acknowledgement that will help to ensure that clients understand the risks associated with SMSFs? If so, please provide details.</p> <p>B2Q5 Are our proposed disclosure requirements likely to result in additional compliance costs for AFS licensees and their authorised representatives? Please give details, including figures and reasons.</p>

Proposal	Your feedback
	<p>B2Q6 Are there any practical problems with the implementation of this proposal? Please give details.</p> <p>B2Q7 Do you think we should provide further guidance on the disclosure obligations? If so, please provide details.</p>
<p>B3 We propose that an AFS licensee or its authorised representatives that provide personal advice to a client on establishing or switching to an SMSF should be required to make the disclosures in proposals B1 and B2 six months after we release our class order on the disclosure requirements.</p>	<p>B3Q1 Do you agree with the proposed timeframe for the implementation of proposals B1 and B2? If you think that a transition period of longer or shorter than six months is required, please explain why.</p>
<p>C1 We propose to provide guidance that, when giving advice to clients on establishing or switching to an SMSF, advisers must consider and be able to show that they have informed clients of each of the SMSF cost issues set out in Table 4.</p> <p>Our proposed guidance will take into account Rice Warner's findings and the feedback received in response to it.</p>	<p>C1Q1 Do you agree with Rice Warner's findings? In particular, do you agree with:</p> <ul style="list-style-type: none"> (a) the way that Rice Warner has described SMSF costs in its report? If not, why not? (b) Rice Warner's analysis about the points at which an SMSF becomes cost-effective compared with an APRA-regulated fund? If not, why not? <p>C1Q2 Do you agree that we should provide guidance on the costs associated with setting up, managing and winding up an SMSF? If not, why not? If yes:</p> <ul style="list-style-type: none"> (a) what are the costs associated with setting up, running and winding up an SMSF? (b) is insurance purchased through an SMSF cost-effective compared with insurance through an APRA-regulated fund? If not, why not? (c) do you think we should provide actual dollar costs (or a range of dollar costs) for the following SMSF costs? If not, why not? <ul style="list-style-type: none"> (i) the costs associated with setting up, running and winding up an SMSF; (ii) the time cost associated with managing an SMSF; (iii) the cost of an SMSF not having access to compensation under the SIS Act; and (iv) the cost of obtaining insurance; and (d) what are the costs or benefits of SMSF structures compared with other superannuation vehicles? Please provide details. <p>C1Q3 Should advisers be required to consider and inform clients of the costs in Table 4 before establishing an SMSF? If not, why not?</p>

Proposal	Your feedback
	<p>C1Q4 Are there any other SMSF costs that need to be disclosed to clients? If so, should they be disclosed in actual dollar costs (or a range of costs)? Please provide details.</p> <p>C1Q5 Do you think that any other disclosures about the costs of setting up, running and winding up an SMSF need to be made to clients before establishing an SMSF? If not, why not?</p> <p>C1Q6 Is our proposed guidance likely to result in additional compliance costs for advisers? Please give details, including figures and reasons.</p> <p>C1Q7 Are there any practical problems with the implementation of this proposal? Please give details.</p>