Self-managed superannuation funds – Markets trends and regulatory focus

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CHECK AGAINST DELIVERY

Introduction

Good morning and thank you for inviting me to speak today. I'm delighted to be at the annual CPA Australia National SMSF Conference.

The self-managed superannuation (SMSF) sector continues to expand. With around 550,000 SMSFs, over a million members, and assets totalling more than $550 billion, this is a hugely significant sector of Australian investors.

This morning I will:

- give a snapshot of where the superannuation industry is at and the importance of the SMSF sector as a competitive force within the industry
- provide an update on the limited Australian Financial Services (AFS) licensing and SMSF auditor registration regimes, and
- touch on recent ASIC action in the sector.

ASIC's focus

Before I begin on those topics, let me give a broader overview of ASIC's priorities.

Ensuring Australians have trust and confidence in our markets is at the heart of everything that we do and is reflected in our strategic priorities of:

- promoting investor and financial consumer trust and confidence
- ensuring fair, orderly, transparent and efficient markets, and
- efficient and accessible business registration.

Building and maintaining consumer trust and confidence in the superannuation system is vitally important for the welfare of all Australians. Gatekeepers such as financial advisers, accountants and auditors play a crucial role in achieving this objective.

We are also particularly focused on culture as a driver of gatekeeper behaviour. Poor culture, whether it be within organisations, professions or whole industries, influences conduct and non-compliant behaviour. It can lead to poor outcomes for investors and consumers, impacts on the integrity of Australian financial markets, and can erode investor and financial consumer trust and confidence.

The superannuation system

A new phase

The Australian superannuation system is integral to our economy. It forms an important part of household and national savings and has become the largest asset for Australians outside the family home. The size of the industry has grown exponentially. In the five years to 30 June 2015, total superannuation assets grew by 51% or $686 billion.[1]

However, this high growth phase may be stabilising. According to the APRA statistics for the quarter ending 31 March 2016, total superannuation assets were down by -.6%, although SMSFs had growth of +.2%.[2]

It looks as though the proportion of fund members drawing an income stream or lump sum, or some other form of benefit, from their superannuation account is increasing and the proportion in the accumulation phase is falling. In the March 2016 quarter, $16 billion in total benefit payments was paid out, an increase of 11.1 % from the March 2015 quarter ($14.4 billion), which included an increase in both lump sum and pension benefit payments.[3]

[1] ATO, *Self-managed funds – A statistical overview 2013–14*.
[2] APRA, *Quarterly superannuation performance*, March 2016.
[3] APRA, *Quarterly superannuation performance*, March 2016.

The SMSF sector

The SMSF sector has also continued to grow. In the five years to 30 June 2015, SMSF assets grew by $180.9 billion or 44%.[4] Of the $2 trillion assets in the Australian superannuation industry, SMSFs now account for 29%.[5]

In the same time period, the number of SMSFs grew from around 440,000 to 550,000, as shown in Table 1.

Table 1: Number of SMSF funds and members, from June 2011 and June 2015[6]

Year	Total number of SMSFs	Total members of SMSFs
June 2011	440,121	836,645
June 2012	473,463	899,384
June 2013	502,249	950,311
June 2014	524,341	992,868
June 2015	549,747	1,041,087

This growth continues to steadily increase. Of SMSFs established in the 10 years to 2014, 90% are still in existence[7].

Demographics

So who is establishing these SMSFs?

Age

Table 2 shows the break-down of SMSF members by age.

[4] ATO, *Self-managed funds – A statistical overview 2013–14*.
[5] ATO, *Self-managed funds – A statistical overview 2013–14*.
[6] ATO, Self-managed super fund statistical report March 2016
[7] ATO, *Self-managed funds – A statistical overview 2013–14*.

Table 2: Approximate age distribution of individuals who were members of SMSFs as at the end of June 2015[8]

Age ranges	Male	Female	Total
<25	0.8%	0.8%	0.8%
25-34	3.4%	3.5%	3.4%
35-44	10.6%	12.0%	11.3%
45-54	20.8%	23.2%	21.9%
55-64	28.9%	30.7%	29.8%
65-74	25.1%	22.8%	24.0%
>74	10.4%	7.0%	8.8%
Unknown	-	-	-
Total	100%	100%	100%
All ages	52.7%	47.3%	100%

As we can see, SMSFs are most popular with those aged between 55 and 74. In 2014, 40% of these members were fully or partially in the pension phase.[9]

This makes sense. SMSFs appeal to those consumers who want to have direct control over their superannuation investments and are actively engaged in management of their assets. As a person gets older and closer to retirement and their balance increases, an SMSF fund may seem an increasingly popular option.

Performance

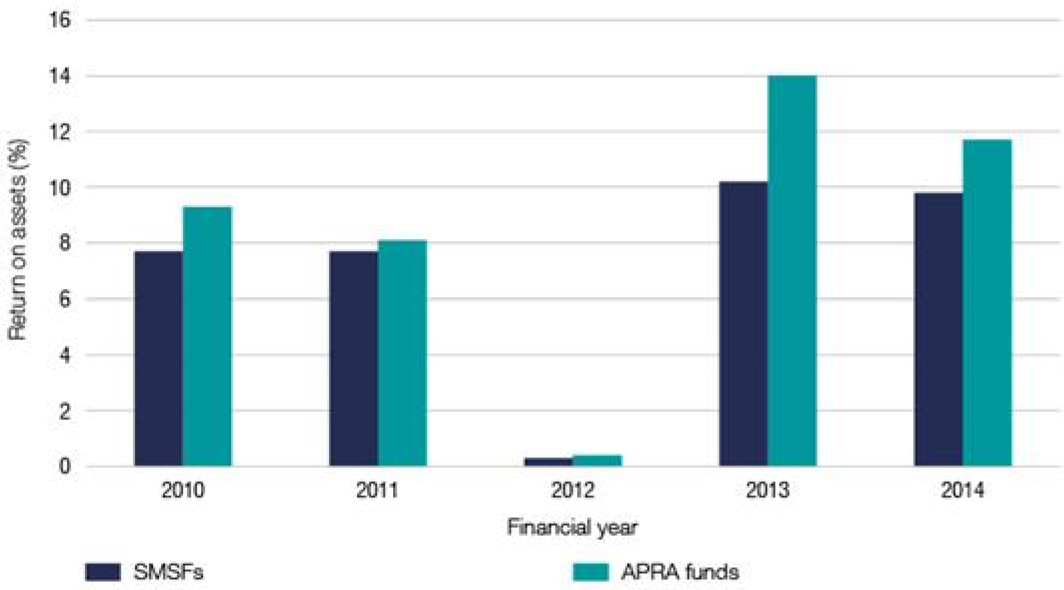
How do SMSFs perform in comparison to the APRA-regulated sector?

Return on assets (ROA)

In 2013–14, SMSFs also experienced a positive return on assets of 9.8%,[10] the fifth consecutive year of positive returns. This is in line with the trend of positive returns on investment also achieved by APRA funds of more than four members, as demonstrated by Graph 1.

[8] ATO, *Self-managed super fund statistical report*, March 2016.
[9] ATO, *Self-managed superannuation funds – A statistical overview 2013–14*.
[10] ATO, *Self-managed superannuation funds – A statistical overview 2013–14*.

Graph 1: Average return on assets for SMSFs and APRA funds[11].



Please note, this graph is taken from the most current data the ATO have, which is for the 2013–14 year.

You will see that the graph also shows that the average ROA for SMSFs is slightly lower than for the APRA-regulated funds.

Table 3 breaks down the ROA of SMSFs by fund size.

Table 3: Average ROA of SMSFs by fund size12

Fund size	2010	2011	2012	2013	2014
$1 - $50k	-9.33%	-8.46%	-18.70%	-17.13%	-11.79%
>$50k - $100k	-1.69%	-1.49%	-9.92%	-5.02%	-2.27%
>$100k - $200k	2.15%	2.11%	-5.90%	0.96%	1.89%
>$200k - $500k	4.95%	4.86%	-2.53%	6.46%	6.14%
>$500k - $1m	6.66%	6.35%	-0.41%	9.35%	8.44%
>$1m - $2m	7.65%	7.25%	0.69%	10.69%	9.70%
>$2m	9.33%	9.44%	1.48%	11.65%	11.32%

We can see that ROA improves dramatically with the size of the fund and that small account balances may be losing their trustee's money.

[11] ATO, *Self-managed superannuation funds – A statistical overview 2013–14.*
[12] ATO, *Self-managed superannuation funds – A statistical overview 2013–14.*

Accountants and advisers

Investment Trends research published in April 2016[13] show that accountants expect their practice revenue from SMSF clients to increase from 23%, where it currently is, to 31% in three years time. The research also shows that there are many opportunities for accountants in the SMSF space, with 255,000 SMSFs reporting unmet advice needs.

And finally, over the next 12 months, 44% of SMSF accountants plan to increase the range of areas they advise SMSF clients on.

It is clear that there is scope and need for the SMSF advice sector to expand in the upcoming years.

As advisers, you need to think carefully when recommending SMSFs to clients.

To be really successful, trustees must have skills in understanding financial and legal matters and be willing to take on the responsibility that comes with managing their own super. They need to understand the risks and responsibilities associated with running an SMSF and also the relationship between the balance of the fund and the likely expected returns. ASIC has published guidance to assist advisers when making recommendations to clients about SMSFs (see Information Sheet 205 *Advice on self-managed superannuation funds: Disclosure of risks* and Information Sheet 206 *Advice on self-managed superannuation funds: Disclosure of costs*).

The ATO and ASIC (via MoneySmart) have also published useful educational material for SMSF trustees to help them understand whether an SMSF is right for them and also the obligations involved in running one.

One of the factors that needs to be considered is the balance that the client has to invest and how they will build it. The statistics I have discussed this morning highlight the fact that SMSFs work best in terms of net returns when they have sufficient funds – put simply, if you have a low balance in your SMSF the fixed costs you will pay will eat up a lot of your return. We don't and won't prescribe a specific minimum dollar figure. We understand that there are many reasons for setting up an SMSF with a low balance – for example, some people may establish an SMSF because they know that they will shortly receive an inheritance. However, ASIC is likely to look more closely at advice to establish an SMSF to see if it is in the client's best interests if the starting balance is below $200,000, because independent research shows that the costs of running a fund with such a balance is likely to be higher in an SMSF than in an APRA regulated fund.

Competition

As the population ages, the popularity of SMSFs looks likely to continue and may well increase. SMSFs provide consumers with choice and have increased Australians' engagement with their retirement savings. In fact, this popularity is driving behaviour in

[13] Investment Trends, *Self-Managed Super Fund: Accountant Report*, February 2016.

the other sectors of the industry, as we referred to in our May submission to the Productivity Commission on superannuation efficiency and competiveness.

We have already seen a number of APRA-regulated funds starting to compete with the SMSF sector on product features. For example, some APRA-regulated funds now offer member directed investment options, which aim to provide some of the flexibility in investment choice of the SMSF sector, without the member having to move their superannuation assets to an SMSF.

ASIC maintains an even-handed approach to regulation – we want the competition to be fair. While we have achieved a number of regulatory outcomes in the SMSF space ranging from actions against people for operating without a licence, particularly in the property spruiking area, providing poor quality advice or making misleading or deceptive statements about performance, we have also taken action in the APRA-regulated sector.

For example, in 2015 we conducted a proactive surveillance of responsible entities and superannuation trustees that are also holders of an AFS licence. We identified that that some trustees promoted ‘self-managed’ investment options, which, on occasion, gave the impression that they provided members with the same level of choice and control as SMSFs. This was incorrect as investing in the self-managed option did not afford members the same rights and responsibilities for the fund’s management as an SMSF and often the range of assets in which the members could invest in was restricted. We required the relevant trustees to amend or withdraw these statements.

We will continue to conduct reviews of responsible entities and superannuation trustees with a focus on remedying any defective and or misleading disclosure and advertising material and improve overall industry standards in compliance.

Regulation of SMSFs

Let me move now to the topic of regulation and SMSFs.

ASIC’s primary role in relation to SMSFs is to regulate the gatekeepers – the financial advisers (some of whom are accountants as well), SMSF auditors and providers of products and services to SMSFs. Today I will discuss the limited AFS licence regime and, in particular, the important obligations associated with being licensed. I will also give an update on ASIC action since the introduction of the SMSF auditor registration regime.

Limited AFS licence

As you are aware, the exemption which allowed accountants to make a recommendation that a person acquire or dispose of an SMSF without the need for an AFS licence ceased on 1 July and the new limited AFS licence regime is in full swing.

Since the commencement of the transitional period on 1 July 2013, ASIC received 1,159 applications for a limited AFS licence. Of these:

- 366 have been granted a licence or have been offered a draft licence
- 284 applications have been withdrawn or returned to applicants because they were incomplete, deficient or missed mandatory information
- 507 applications are pending assessment, and
- two applications were refused by an ASIC Hearing's Delegate.

A very large number of these applications were received in June and understandably assessments have not been completed. That means that those applicants cannot give SMSF advice until their application is determined. While we're working hard to process those applications as soon as we can, I should say that we and the accounting associations had made very clear that applications needed to be received by 1 March this year if the applicant expected to get their limited licence by 1 July.

Depending on what authorisations have been selected, a limited licensee can provide financial product advice in relation to:

- SMSFs
- a person's existing superannuation fund, to recommend that they establish an SMSF or provide advice on contributions or pensions, and
- 'class of product advice' on the types of financial products clients are likely to hold through their SMSFs, such as securities, simple managed investment schemes and basic deposit products .

'Class of product advice' means financial product advice about a class of products that does not include a recommendation about a specific product.

For those who are now licensed or are a representative of a licensee, it is important to understand that your licence is limited in scope but not obligations. You are subject to all the same ongoing conduct and disclosure obligations that apply to other AFS licensees and representatives. Importantly, this includes the Future of Financial Advice (FOFA) measures, such as the duty to act in the best interests of clients, the obligation to give priority to the interests of the client, the ban on receiving conflicted remuneration and providing clients with a Statement of Advice where required, as well as membership of an external dispute resolution scheme. These requirements are directed at ensuring that consumers receive quality advice that is in their best interests. .

The only exception is that holders of a limited AFS licence can lodge a compliance certificate rather than undertake an annual external audit of their financial statements and internal controls. This exemption from the annual external audit requirement will be available to limited AFS licensees who do not handle any client money in connection with the provision of financial advice.

During the next 12 months, we will be conducting a range of surveillance activities on accountants. We will:

- visit a small number of licenced accountants in each state to understand how they are operating

- conduct targeted surveillance on some licensed accountants to assess whether they are meeting their ongoing obligations when giving financial product advice in relation to SMSFs, and
- seek to identify unlicensed conduct and take appropriate action.

Some people tell me that they think there are many accountants who will continue to give SMSF advice without a licence, despite the exemption having expired. I don’t think that’s necessarily true, because I just can’t imagine that any professional would want to join the ‘unlicensed advisers’ club’ and join the company of property spruikers, cold callers and boiler room operators.

Our ongoing work in the SMSF space

The SMSF sector remains a high priority for ASIC. In 2012, we established a dedicated SMSF Taskforce to examine high-risk and emerging SMSF issues. Since then, we have achieved a number of regulatory outcomes.

The Taskforce has a particular focus on property spruiking. As a general rule, ASIC does not regulate advice on property or the sale of property because property, in itself, is not a financial product and therefore does not fall within our jurisdiction. However, advice to a person to establish an SMSF or use an existing SMSF to purchase property is financial product advice and is something we regulate.

I want to highlight two important cases for ASIC in this space; the action we took against Park Trent Properties Group Pty Ltd, and the action we took against Queensland-based ActiveSuper and Royale Capital.

Park Trent’s business promoted the use of SMSFs to purchase investment property. By the time of the trial in June 2015, Park Trent had advised over 860 members of the public to establish and switch funds into an SMSF. In November 2015, we obtained final orders declaring that Park Trent was carrying on an unlicensed financial services business. Park Trent must now refrain from providing unlicensed advice and post a notice on its website outlining the order made against it.

This judgement was important for ASIC because it confirmed our view of the law that those who promote and make recommendations to investors about establishing an SMSF (or using an existing one) and recommend, facilitate or arrange for the investors to acquire or dispose of superannuation assets to invest in property, are carrying on a financial services business for which they must have an AFS licence.

In the matter of ActiveSuper and Royale Capital, we were particularly concerned about the practice of cold calling consumers and encouraging them to set up SMSFs. Consumers were then encouraged to make investments in, among other things, distressed properties in the United States. The companies had raised $4.75 million from more than 200 SMSF investors and the scheme aimed to raise at least $20 million before ASIC intervened.

In 2015, the Federal Court found that the Corporations Act had been breached. In particular, the judgement found Gold Coast businessman Craig Gore's conduct to be particularly egregious as he established the share scheme offshore to avoid compliance with Australian laws. Orders were made banning a number of people involved from providing financial services.

Misleading and deceptive advertising

Another focus of the Taskforce has been misleading advertising of SMSFs. We want to ensure that consumers receive clear and accurate information.

The themes we have seen in recent matters of misleading and deceptive advertising on SMSFs include:

- providers claiming that SMSFs can be established 'free' of charge
- the risks, benefits and costs of SMSFs compared with funds regulated by APRA
- the performance of SMSFs compared with APRA-regulated funds, and
- the performance of certain investments with SMSFs (e.g. property).

Particular problems identified include misleading or deceptive statements about SMSF fees, returns and risks.

We recently expanded this work to include a review of online SMSF advertising through social media. With the growing popularity of social media sites including Facebook, Twitter and YouTube, social media has become an increasingly important channel for the promotion of financial products and services, including SMSFs. We have achieved several outcomes in this space. Following ASIC raising concerns, Urban Seed Project Marketing Pty Ltd, Skybridge Portfolios and Tatnell DLS Pty Ltd have taken steps to remove or amend material from their Facebook and YouTube sites that provided exaggerated or unqualified representations about SMSFS and that were potentially misleading.

In July 2015, Onmiwealth paid a $10,200 penalty to comply with an ASIC infringement notice after producing potentially misleading advertisements. Omniwealth's website included a page on the advantages of investing in property within an SMSF. This page compared the performance of a geared property investment within an SMSF to an ungeared equity investment within an SMSF. The webpage was also promoted on social media with a statement that investing in property in an SMSF has taxation, leverage and diversification advantages. We were concerned that the webpage did not give a balanced message about the returns, benefits and risks of investing in property in an SMSF and, in particular that the uncertainty of forecasts was not made clear.

Auditors of SMSFs

Let me turn now to the auditing side of SMSFs.

As you know, ASIC has been registering approved SMSF auditors since January 2013. The introduction of this registration regime has played a critical role in raising the minimum standards for SMSF auditors. Under the watchful eyes of both ASIC and the ATO, SMSF auditing has become a more specialised activity requiring a greater commitment to meeting standards.

The number of auditors is now fairly stable with new auditors each year largely matching those choosing to exit. Nearly 6,700 SMSF auditors are currently registered with us – ATO information shows around 6,300 are active in auditing funds. This is significantly less than the 11,500 professionals that were auditing SMSFs prior to the registration requirement.

SMSF auditors are obliged to lodge annual compliance statements with ASIC. Annual statements are a critical part of the regulatory framework providing information needed by both ASIC and the ATO.

Recently, ASIC notified 811 auditors that they had not met their annual statement requirement and faced cancellation of their registration. Of these, 626 heeded our warning and complied. A final warning was sent to 185 auditors giving them until 22 July to comply or have their registration cancelled. 133 auditors failed to comply and have now had their registrations cancelled. The program also highlighted the importance of auditors meeting their ongoing obligation to provide up to date contact details – changes to details have to be updated within 21 days of the change occurring.

I note that many of these cancelled auditors were in that small minority of auditors that had not issued any audit reports in the last couple of years and had less at stake. This perhaps illustrates the specialisation and commitment to standards I mentioned earlier. We have fewer but more active auditors with more to lose from non-compliance.

For all of you involved in this field, ASIC recognises that very important role you play in providing assurance that SMSFs are operating within the law. This is very important to the health of the sector and to the financial wellbeing of the more than one million members of SMSFs. I strongly encourage you to continue to develop your professional skills, especially by engaging in continuing professional education.

Working with the ATO

We work very closely with the ATO as co-regulator in the SMSF auditor sphere. While ASIC was made responsible for determining eligibility requirements, setting competency standards and taking enforcement action where appropriate, the ATO has continued to police SMSF auditor compliance and refer non-compliant auditors to ASIC.

In the last 12 months, the ATO has referred eight SMSF auditors to ASIC for further action. These referrals contributed to the 17 misconduct actions taken by ASIC against SMSF auditors in 2015–16, including:

- three registration disqualification orders
- one suspension order
- four instances of additional conditions being imposed on SMSF auditor registrations
- three instances where ASIC initiated a registration cancellation, and

- six voluntary cancellation requests accepted by ASIC.

The ATO helps us maintain and further develop the SMSF auditor competency exam question bank. We also exchange valuable information, including information from the ATO that has assisted us directly with individual registration assessments – identifying, confirming or allaying concerns with the applicants.

This is not the only area where we work closely with the ATO. We meet, at senior and officer level, to discuss current and emerging issues in the SMSF space.

We also work closely with the ATO in other areas such as financial literacy and consumer education. We support each other’s campaigns and initiatives through website links, social media and our engagement with professional associations. You may have seen that we have embedded the ATO’s SMSF education videos on ASIC’s MoneySmart website. ASIC’s financial literacy team meet regularly with the superannuation communications area at the ATO.

We have also shared information that has informed ASIC surveillances and investigations. For example, since 2015 ASIC has been engaged in an ongoing investigation into the conduct of a group of people and companies related to the company formally called Heritage Financial Solutions Pty Ltd – Freedom & Security Pty Ltd. The conduct relates to unlicensed advice given to investors to establish SMSFs for investment in real estate in Queensland and arranging finance for those investments. ASIC has concerns about the way loans and property ownership have been structured.

We worked with the ATO to understand what the structuring requirements were for SMSFs to borrow money and own property and together developed a plan to identify and remediate the 400 or so non-compliant SMSFs. We were also able to draw on the ATO’s data to identify affected consumers.

So far, in relation to this investigation, we have cancelled the Australian credit licences of:

- Heritage Financial Solutions
- Sunpac Finance Pty Ltd, and
- Smithson & Baye Pty Ltd.

Conclusion

The SMSF sector is an important sector of the superannuation industry and this sector is anticipated to grow. It is important that those thinking about an SMSF and those who already have one, receive good quality advice, accounting and audit services.

The professional accounting bodies have a long-established practice of maintaining high standards of conduct in their members. The limited AFS licence regimes brings this group into the ASIC regulated adviser population. We look forward to working with the CPA in overseeing those members who are now also regulated by ASIC.

Which brings me to my final point for this morning. Every profession requires a level of self-policing – so if poor practice is identified, it is challenged and steps are taken to rectify or expose those risking the reputation of the rest of the group. This is what drives good culture. Where poor conduct is witnessed, please don't turn a blind eye. Report it – to ASIC or to your professional body.