

G A R N A U T

11 November 2013

Ai-Lin Lee
Policy Guidance Officer
Australian Securities and Investments Commission
GPO Box 9827
MELBOURNE VIC 3001
By e-mail: policy.submissions@asic.gov.au

Head Office
Level 10
499 St Kilda Road
Melbourne Vic. 3004

T: (03) 9856 4500
F: (03) 9820 8485

Canberra Office
Level 7
1 Hobart Place
Canberra City ACT. 2600
Mailing Address
GPO Box 2707
Canberra City ACT. 2601

T: (02) 6230 5566
F: (02) 6230 7733

E: gpw@garnaut.com.au

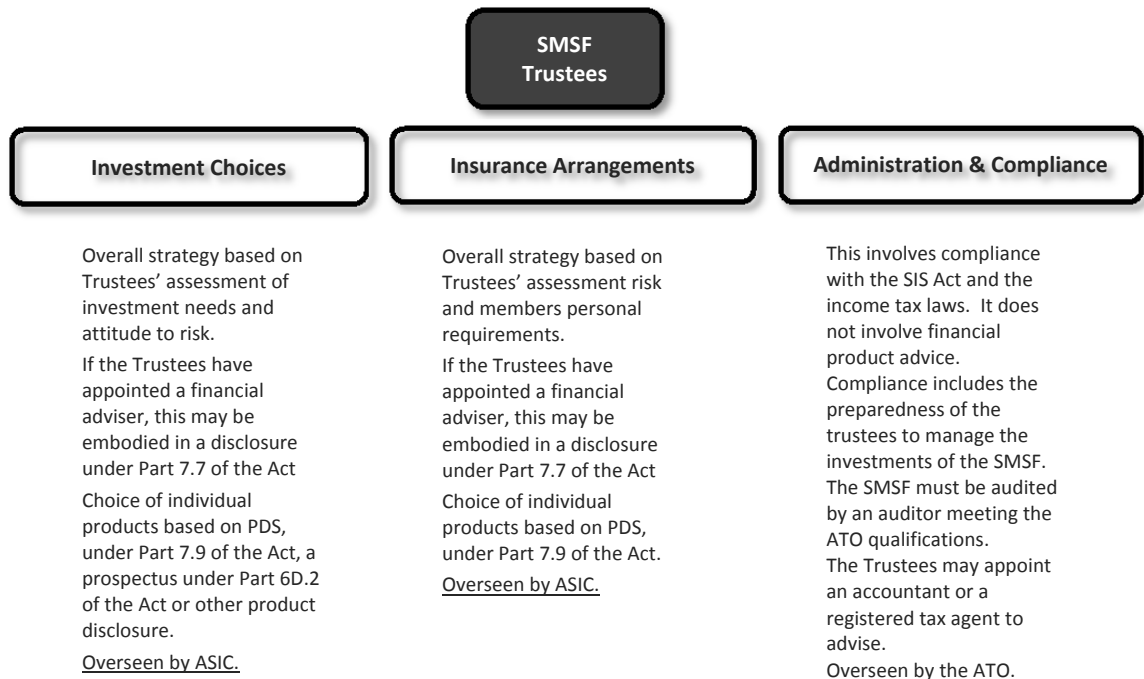
W: www.garnaut.com.au

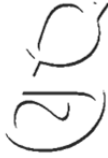
Associate Offices
Sydney, Brisbane,
Adelaide, Perth Hobart

Dear Sir

CP 216 Submission

1. This is a submission in response to ASIC CP 216 regarding financial product advice to trustees of self-managed superannuation funds (SMSFs).
2. By way of introduction, this firm is a licensed financial adviser to the trustees of several hundred SMSFs but none that invested in the Trio Capital funds.
3. It is important to understand the role of the financial adviser and the regulatory bodies in the governance of SMSFs. The following is a diagrammatic summary of the responsibilities of trustees of a complying SMSF, as we explain it to our clients:





4. Importantly, the trustees of the SMSF do not have to appoint a financial adviser at all and many SMSFs have no financial adviser. On the other hand, all SMSFs are required to appoint a suitably qualified auditor and make annual returns to the ATO.
5. In the SMSFs that are advised by this firm, many do not require advice on all investments. Many trustees are self-confident and do not believe that they require financial product advice across the board.
6. The Trio Capital case was a case of fraud in relation to a registered managed investment scheme. If there was a problem with regulation, it relates to the regulation of managed investment schemes, not SMSFs. The fraud was very difficult to detect and was not discovered by ASIC, until it was too late.

The fraud continued throughout the life of the MIS. In mid-2009 ASIC undertook a review of hedge-funds and identified (sic) a hedge-fund involved with the ASF for further investigation. Following a tip-off from a market participant, ASIC believed they had sufficient credible evidence that ASF required more intensive investigation. ASIC communicated this information to APRA in September 2009. (Review of Trio Capital Fraud, Department of Treasury, 2013, page 11)

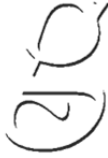
In circumstances where ASIC and APRA did not detect the fraud, it is highly unlikely that the trustees of an individual SMSF, no matter how well informed or advised and no matter how compliant with relevant laws, could have uncovered the problem.

7. That is, there is nothing in the failure to detect the problems with 2 out of 28 managed investment schemes operated by Trio Capital that would indicate a failure on behalf of the SMSF trustees. After all, there were APRA regulated superannuation funds that invested in one of the troublesome Trio managed investment schemes:

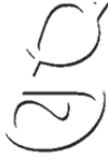
There are around 6,000 people in APRA regulated funds who were affected by the impact of Trio. Six thousand people and around \$55 million. There are 600 people in non APRA regulated funds for about the equivalent amount. (Opening Statement to the Senate Standing Committee on Economics, APRA, 29 May 2012, page 3)¹

8. As explained in the footnote, these figures actually suggest that APRA funds fared worse, on average, than SMSFs.
9. Importantly, only 600 individuals in SMSFs were affected by the Trio fraud. That number is **just 0.14%** of the 442,200 SMSF investors as at 30 June 2008 (SMSF Statistical Report – June 2013, ATO) and not all of this miniscule sample was unaware of their inability to have recourse under the SIS Act. Nor is there any indication that this tiny sample was representative of the remaining 99.86% of members of SMSFs to any statistical level of confidence whatsoever.

¹ In addition to the numbers, the Deputy Chairman of APRA is attempting to make the point that APRA regulated funds have more diversified investments. However, as at 30 June 2008, the average member account balance in a SMSF was \$442,200 (SMSF Statistical Report – June 2013, ATO), while the average member account balance in APRA regulated funds was \$25,900 (APRA Annual Superannuation Bulletin June 2012, issued 9 January 2013). From the figures quoted above by the Deputy Chairman, the average loss in APRA regulated funds was \$9,167, or 35% of the average account balance, while the average loss in the SMSFs was \$91,667, or only 21% of the average account balance. Thus, the losses were comparable, in any sense in which portfolio diversification was relevant. If anything, the SMSF losses were less.

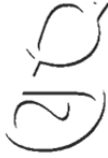


10. The costs of running and winding up an SMSF are matters of administration and compliance. The expertise of SMSF trustees and their consciousness of statutory obligations is also a matter of administration and compliance for the trustees. None of this relates to financial product advice given to the SMSF trustees.
11. The financial product advice given to SMSF trustees relates to investment products and risk products as illustrated above. It is up to the trustees to operate the SMSF according to their own assessment of their abilities. Some trustees may prefer to outsource to the maximum, running the SMSF at above average cost but lower personal involvement, while others may be very hands-on, minimising running costs. There is nothing in the level of operating costs of a particular SMSF as such to indicate that the fund is being either well run or not well run.
12. Furthermore, The costs of operating SMSFs in the Rice Warner report covers less than half of self-managed superannuation funds. As at 30 June 2013, the average (mean) SMSF net assets was \$971,845, while, as at 30 June 2012, only 48.8% of SMSFs had net assets of less than \$500,000 (*Self-managed super funds statistical report – June 2013, ATO*). The Rice Warner report applies only to funds with net assets up to \$500,000.
13. In addition, the Rice Warner report compares the costs in SMSFs with APRA regulated superannuation funds. The Rice Warner report does not compare the return after fees between these classes of funds, which is the only number that is relevant to the members of either class of fund. This is highly relevant when the industry-wide rate of return for APRA regulated funds was 0.5% for the year to 30 June 2012 (Annual Superannuation Bulletin June 2012, APRA, issued 9 January 2013, page 6), less than the interest on a bank term deposit.
14. Even so, the Rice Warner report (page 29) states:
“SMSFs with \$100,000 to \$150,000 are competitive with traditional retail personal superannuation plans provided the trustees undertake some of the administration ...”.
Only 12.2% of SMSFs had net assets of \$100,000 or less at 30 June 2012 (*Self-managed super funds statistical report – June 2013, ATO*) and only 11.1% had net assets of more than \$100,000 but not more than \$200,000. The Rice Warner report states (page 30):
“SMSFs with \$200,000 or more are competitive with both industry funds and retail funds provided the trustees undertake some of the administration ...”.
As stated above, it is the choice of the trustees of the SMSF to run at higher fee levels with lower personal involvement, a choice which is not available to members of APRA regulated funds.
15. Finally, on the matter of costs, it is not within the training or expertise of a financial adviser to estimate the fees and costs which might be incurred by the trustees in operating an SMSF. This is much more likely to be within the training of an accountant. A financial adviser could not rely on the Rice Warner report, for the reasons set out.
16. Whether or not the trustees of an SMSF are aware of their statutory obligations is not a matter for the financial adviser giving financial product advice to the trustees. This is a matter between the trustees and the regulator – the ATO. As a result, there are many



informative, up-to-date ATO publications setting out these obligations in plain words, which can be downloaded for free from the ATO website, such as:

- a. *Thinking about self-manager super: Introduction for people considering an SMSF* (NAT 72579-03, March 2013);
 - b. *How your self-managed super fund is regulated: Overview for SMSF trustees* (NAT 711454-03, March 2013);
 - c. *Self-managed super funds – key messages for trustees: Fact sheet for trustees* (NAT 71128-12, December 2012);
 - d. *Setting up a self-managed super fund: Introduction for people setting up an SMSF* (NAT 71923-04, April 2013);
 - e. *Running a self-managed super fund: Introduction for SMSF trustees* (NAT 11032-04, April 2013); and
 - f. *Paying benefits from a self-managed super fund: Introduction for paying benefits from an SMSF* (NAT 74124-04, April 2013).
17. That is, there is no evidence of a shortage of information available for SMSF trustees about their statutory duties.
18. Further, all SMSF trustees have to sign a Trustee Declaration, within 21 days of becoming a trustee. A copy of this declaration is enclosed. Importantly, the last declaration immediately above the signature of the trustee is as follows:
- I do not have access to the government's financial assistance program that is available to trustees of Australian Prudential Regulation Authority (APRA) regulated funds in the case of financial loss due to fraudulent conduct or theft.*
- The declaration was introduced in 2007 but the form of declaration above was introduced in late 2012. That is, the ATO, as a responsible regulator, has already taken into account the findings in the Trio capital case and made sure that all new SMSF trustees are aware of their responsibilities.
19. If there is a perceived problem at the policy level that SMSF trustees may not be aware of all of their obligations, the only proper course is to have all trustees sign a declaration in the current form prescribed by the ATO. Any intervention via financial advisers may not reach all SMSF trustees, since many funds do not have a financial adviser. The only sure way is to intervene via the trustees' regulator, the ATO, where the intervention can be backed by an audit of the SMSF or by an annual return to the ATO.
20. Finally, it should be stressed that the above discussion relates only to the SMSF trustees in their role as trustees. There are questions relevant to the same people as members of the fund, which are not addressed. For example, the proportion of savings that a person should accumulate inside and outside the superannuation régime, the timing of contributions and pension withdrawals, the amount and type of life and trauma insurance and whether the insurance should be held within the SMSF and so on. These matters are also irrelevant to the subject matter of CP216.
21. In conclusion, for the reasons set out above:



- a. **(B1)** the assumption underlying this proposal is that trustees are ignorant of the lack the access to the SIS Act compensation régime but:
 - i. this assumption is based on a miniscule and unrepresentative sample of trustees, being the 600 involved in the Trio Capital failure out of the 713,000 trustees as at 30 June 2008; and
 - ii. if there is a problem, is a matter between the regulator, the ATO, and is covered in the ATO declaration, which all SMSF trustees must sign and, if there is doubt that trustees are aware of this, all trustees should be required to sign the latest version of the form, perhaps with the next regulatory return to the ATO, since proposal B1 will not reach trustees of established funds nor all trustees of new funds, since not all funds have a financial adviser;
- b. **(B2)** all of the matters set out in the table are more than adequately covered by ATO information publications and:
 - i. the financial adviser is not expert in many of the matters set out, which are not in the realm of financial product advice; and
 - ii. a financial adviser is constrained to give advice precisely commensurate with the available advice from the ATO, since the ATO is the regulator of SMSF trustees and the giving of contrary advice by a financial adviser would be incompetent;
- c. **(B3)** this does not achieve the objective, since not all SMSF trustees have a financial adviser and the objective would be much more certainly achieved by the ATO requiring all trustees to sign the Trustee Declaration in the current form published by the ATO;
- d. **(C1)** financial advisers cannot give advice on the costs of establishing an SMSF and the cost of operating an SMSF, since:
 - i. the costs of operation and establishment depend on the choices made by the trustees, in relation to management and administration of the SMSF, as acknowledged in the Rice Warner report;
 - ii. financial advisers are rarely involved in the establishment of the SMSF, which is most often the sphere of the accountant (in this firm this is always the case); and
 - iii. in any case, financial advisers have no professional expertise in the costs of establishing and operating an SMSF, which is not financial product advice.

In conclusion, the proposals by ASIC could easily be misinterpreted as an attempt to make available the professional indemnity insurance of financial advisers to trustees of SMSFs who plead *ex post facto* ignorance of their legal obligations when a loss occurs in their fund.

22

ASIC should also be aware that the members of SMSFs will pay for all increased costs, as they now pay for all existing costs. There should be no doubt that these proposals will come at a significant extra cost to retail clients.

Thank you for the opportunity to make a submission on these matters.

Yours faithfully

Chris Garnaut
Managing Director
Enc

Trustee declaration

To be completed by new trustees and directors of corporate trustees of self-managed super funds.



Read this declaration in conjunction with *Self-managed super funds – key messages for trustees* (NAT 71128).



WHO SHOULD COMPLETE THIS DECLARATION?

You must complete this declaration if you become a **new** trustee (or director of a corporate trustee) of:

- a **new** self-managed super fund (SMSF)
- an **existing** SMSF.

You must sign this declaration within 21 days of becoming a trustee or director of a corporate trustee of an SMSF.

A separate declaration is required to be completed and signed by each and every new trustee (or director of a corporate trustee).

You must also complete the declaration if you are a legal personal representative who has been appointed as trustee (or director of a corporate trustee) on behalf of a:

- member who is under a legal disability (usually a member under 18 years old)
- member for whom you hold an enduring power of attorney
- deceased member.

INFORMATION YOU NEED TO READ

Make sure you read *Self-managed super funds – key messages for trustees* (NAT 71128). It highlights some of the key points from the declaration and some important messages for you.

BEFORE COMPLETING THIS DECLARATION

Before you complete and sign this declaration, make sure you:

- read each section
- understand all the information it contains.

➤ If you have any difficulties completing this declaration or you do not fully understand the information it contains:

- speak to a professional adviser
- visit www.ato.gov.au/smsf
- phone us on **13 10 20**.

If you are not familiar with some of the terms used in this declaration or you need more information, refer to *Running a self-managed super fund* (NAT 11032).

WHEN COMPLETING THIS DECLARATION

When you complete this declaration, remember to:

- insert the full name of the fund at the beginning
- sign and date it
- ensure it is signed and dated by a witness (anyone 18 years old or over).

WHAT SHOULD YOU DO WITH THE DECLARATION?

You must keep your completed declaration for at least 10 years and make it available to us if we request it.

We recommend that you keep a copy of your completed declaration and refer to it and *Self-managed super funds – key messages for trustees* (NAT 71128), which is available on the ATO website, when making important decisions, such as those relating to choosing investments, accepting contributions and paying benefits.



Do not send your completed declaration to us.



Self-managed super fund trustee declaration

I understand that as an individual trustee or director of the corporate trustee of

Fund name

I am responsible for ensuring that the fund complies with the *Superannuation Industry (Supervision) Act 1993* (SISA) and other relevant legislation. The Commissioner of Taxation (the Commissioner) has the authority and responsibility for administering the legislation and enforcing the fund's compliance with the law.

I must keep myself informed of changes to the legislation relevant to the operation of my fund and ensure the trust deed is kept up to date in accordance with the law and the needs of the members.

If I do not comply with the legislation, the Commissioner may take the following actions:

- impose administrative penalties on me
- enter into agreements with me to rectify any contraventions of the legislation
- disqualify me from being a trustee or director of a corporate trustee of any superannuation fund in the future
- remove the fund's complying status, which may result in significant adverse tax consequences for the fund
- prosecute me under the law, which may result in fines or imprisonment.

SOLE PURPOSE

I understand it is my responsibility to ensure the fund is only maintained for the purpose of providing benefits to the members upon their retirement (or attainment of a certain age) or their beneficiaries if a member dies. I understand that I should regularly evaluate whether the fund continues to be the appropriate vehicle to meet this purpose.

TRUSTEE DUTIES

I understand that by law I must at all times:

- act honestly in all matters concerning the fund
- exercise skill, care and diligence in managing the fund
- act in the best interests of all the members of the fund
- ensure that members only access their super benefits if they have met a legitimate condition of release
- refrain from entering into transactions that circumvent restrictions on the payment of benefits
- ensure that my money and other assets are kept separate from the money and other assets of the fund
- take appropriate action to protect the fund's assets (for example, have sufficient evidence of the ownership of fund assets)
- refrain from entering into any contract or do anything that would prevent me from, or hinder me in, properly performing or exercising my functions or powers as a trustee or director of the corporate trustee of the fund
- allow all members of the fund to have access to information and documents as required, including details about
 - the financial situation of the fund
 - the investments of the fund
 - the members' benefit entitlements.

I also understand that by law I must prepare, implement and regularly review an investment strategy having regard to all the circumstances of the fund, which include, but are not limited to:

- the risks associated with the fund's investments
- the likely return from investments, taking into account the fund's objectives and expected cash flow requirements
- investment diversity and the fund's exposure to risk due to inadequate diversification
- the liquidity of the fund's investments having regard to the fund's expected cash flow requirements in discharging its existing and prospective liabilities (including benefit payments)
- whether the trustees of the fund should hold insurance cover for one or more members of the fund.

Investment restrictions

I understand that, as a trustee or director of the corporate trustee of the fund, subject to certain limited exceptions specified in the law, I am prohibited from:

- lending money of the fund to, or providing financial assistance to, a member of the fund or a member's relative (financial assistance means any assistance that improves the financial position of a person directly or indirectly, including the provision of credit)
- acquiring assets (other than business real property, listed securities, certain in-house assets and acquisitions made under mergers allowed by special determinations or acquisitions as a result of a breakdown of a relationship) for the fund from members or other related parties of the fund
- borrowing money (or maintaining an existing borrowing) on behalf of the fund except in certain limited circumstances (while limited recourse borrowing arrangements are permitted, they can be complex and particular conditions must be met to ensure that legal requirements are not breached)

- having more than 5% of the market value of the fund's total assets at the end of the income year as in-house assets (these are loans to, or investments in, related parties of the fund – including trusts – or assets subject to a lease or lease arrangement between the trustee and a member, relative or other related party)
- entering into investments on behalf of the fund that are not made or maintained on an arm's length (commercial) basis (this ensures the purchase or sale price of the fund's assets and any earnings from those assets reflects their market value).

Accepting contributions and paying benefits

I understand that I can only accept contributions and pay benefits (income streams or lump sums) to members or their beneficiaries when the conditions specified in the law and the fund trust deed have been met.

Administration

I understand that the trustees of the fund must:

- keep and retain for at least 10 years
 - minutes of all trustee meetings at which matters affecting the fund were considered (this includes investment decisions and decisions to appoint members and trustees)
 - records of all changes of trustees, including directors of the corporate trustee
 - each trustee's consent to be appointed as a trustee of the fund or a director of the corporate trustee
 - all trustee declarations
 - copies of all reports given to members
- ensure that the following are prepared and retained for at least five years
 - an annual statement of the financial position of the fund
 - an annual operating statement
 - copies of all annual returns lodged
 - accounts and statements that accurately record and explain the transactions and financial position of the fund
- ensure that an approved auditor is appointed within the prescribed period (currently this is no later than 31 days before the due date for lodgment of the fund's annual return but this may change to 45 days) to audit the fund for each income year, and provide that auditor with documents as requested
- lodge the fund's annual return, completed in its entirety, by the due date
- notify the ATO within 28 days of any changes to the
 - membership of the fund, or trustees or directors of the corporate trustee
 - name of the fund
 - contact person and their contact details
 - postal address, registered address or address for service of notices for the fund
- notify the ATO in writing within 28 days of the fund being wound up or after becoming aware that the fund has ceased to be an SMSF.

DECLARATION

By signing this declaration I acknowledge that I understand my duties and responsibilities as a trustee or director of the corporate trustee of the self-managed superannuation fund named on this declaration (or if the fund's name changes, that name). I understand that:

- *I must ensure this document is retained for at least 10 years or while I remain a trustee or director of the corporate trustee (whichever is longer) and, if I fail to do this, penalties may apply.*
- *I may have to make this document available for inspection by a member of staff of the ATO and, if I fail to do this, penalties may apply.*
- *I do not have access to the government's financial assistance program that is available to trustees of Australian Prudential Regulation Authority (APRA) regulated funds in the case of financial loss due to fraudulent conduct or theft.*

Trustee's or director's name

Trustee's or director's signature

Date

Day Month Year
 / /

Witness' name (witness must be 18 years old or over)

Witness' signature

Date

Day Month Year
 / /