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CP216 – Advice on self-managed superannuation funds: specific disclosure requirements and SMSF costs

The SMSF Owners' Alliance appreciates the opportunity to provide comment on ASIC's Consultation Paper CP216.

In brief:

We agree with ASIC's proposal that potential SMSF trustees should be explicitly warned by their adviser that SMSFs are not covered by the SIS Act compensation arrangements in the event of fraud or theft.

We agree that potential trustees should be advised of the obligations and responsibilities they will take on in setting up a self-managed fund and note that such advice is already provided by ASIC and the ATO.

We agree that potential trustees should be advised of the categories of costs that are involved in setting up, managing and winding up an SMSF.

We believe that an indicative range of costs for setting up, running and winding up an SMSF may be useful; however publishing actual dollar costs could be impractical.

Generally, we take the view that potential SMSF owners should be well informed before they embark on setting up an SMSF, noting that the information given needs to be relevant, useful and easily understood. Disclosure should not involve significant compliance costs for licensees which are passed on to clients.

We would be pleased to discuss our views further with ASIC at your convenience.

Yours sincerely,

Duncan Fairweather
Executive Director

B1Q1 – Do you agree with our proposed disclosure requirement in Table 1?

Yes. We believe it is relevant for potential SMSF owners to know they are not covered by compensation under the SIS Act in the event of fraud or theft.

We note that the ATO website and ASIC's 'MoneySmart' webpage warn people setting up SMSFs that they are not covered by compensation arrangements.

In the Trio case, both APRA-regulated and self-managed funds suffered losses. We suggest it would be appropriate for APRA-regulated funds to disclose that members of all APRA-regulated funds will bear the cost, reflected in their unit values, in the event that some funds suffer loss through fraud or theft and are compensated.

B1Q2 – Do you think that the proposed warning will benefit clients who are considering setting up or switching to an SMSF? What other warnings would help clients decide whether it is appropriate in their circumstances to establish or switch to an SMSF?

The proposed warning generally will be of benefit to potential SMSF owners.

We consider the information available on the ATO and ASIC websites sufficiently informs potential SMSF trustees of the responsibilities they must assume on setting up a self-managed fund.

B1Q3 – Do you think the proposed warning should be given to clients in a prescribed format? Should it be given in a stand-alone document or should it feature prominently in the Statement of Advice (SOA)?

So long as the warning is given some prominence, the adviser should have discretion as to whether the warning is part of the SOA or a stand-alone document. Cost and utility may be factors in this choice.

B1Q4 – Do you think that clients should be asked to sign a document acknowledging that they understand SMSFs are not entitled to receive compensation under the SIS Act?

No, so long as the warning is included in the SOA or a separate document. We note that new trustees are already required to make a declaration to the Australian Taxation Office that they understand their responsibilities and obligations (refer Table 2 – Point 1). If it is considered that a specific acknowledgement of the lack of compensation should be required, it would be practical and efficient for it to be incorporated in the ATO trustee declaration.

B1Q5 – Are the proposed disclosure requirements likely to result in additional compliance costs for AFS licensees and their authorised representatives?

SMSFOA is not able to comment on what compliance costs might be incurred for licensees but we assume there may be some. As a general observation, regulatory costs should be kept to a necessary minimum as these costs will be borne ultimately by the consumer.

B1Q6 – Are there any practical problems with the implementation of this proposal?

Not to our knowledge, apart from the comments made in response to other questions.

B2Q1 – Do you agree with our proposed disclosure requirements in Table 2?

Generally, yes. The proposed disclosure topics cover aspects of setting up and maintaining an SMSF that people need to know. Table 2 provides a useful framework for such disclosure.

B2Q2 – Do you think that the proposed warning will benefit clients who are considering setting up or switching to an SMSF? What other warnings would help clients decide whether it is appropriate in their circumstances to establish or switch to an SMSF?

The proposed warning generally will be of benefit to potential SMSF owners.

We consider the information available on the ATO and ASIC websites sufficiently informs potential SMSF trustees of the responsibilities they must assume on setting up a self-managed fund. Trustees of newly-established funds must make a declaration to the ATO that they are aware of their legal obligations.

B2Q3 – Do you think the proposed disclosure requirements in Table 2 should be given to clients in a prescribed format?

It would be appropriate for the disclosures to be made in the SOA.

B2Q4 – Do you think clients should be asked to sign a document acknowledging the responsibilities and risks of running an SMSF? Are there any alternatives to obtaining client acknowledgement that will help to ensure clients understand the risks associated with SMSFs?

Consistent with our response to B1Q4, we don't believe it is necessary for clients to sign a document of acknowledgement so long as the responsibilities and risks are clearly spelled out in the SOA. However, if ASIC believes that such a declaration is necessary, it would be more efficiently included in the trustee declaration already required by the ATO.

B2Q5 – Are ASIC's proposed disclosure requirements likely to result in additional compliance costs for AFS licensees and their authorised representatives?

As with B1Q5, we are not in a position to say what additional compliance costs might be entailed for licensees, however it is important for any such costs to be kept to a minimum as ultimately the client will pay.

C1Q1 – Do you agree with Rice Warner's findings, in particular with regard to:

- (a) The way Rice Warner has described SMSF costs in its report
- (b) Rice Warner's analysis of the points at which an SMSF becomes cost-effective compared with an APRA regulated fund?

We consider the Rice Warner report to be a useful point of reference for people considering establishing an SMSF and we have posted it to our website. To remain useful and current, the Rice Warner report or similar information would need to be updated from time to time.

The report gives estimated cost ranges for SMSFs of various asset sizes and degree of involvement by the trustees. Beyond these indicative cost estimates, it is difficult to be more precise given differences between SMSFs in asset sizes, asset allocation and the extent of research, investment execution and administration undertaken by the trustees. For example, an SMSF with a simple asset allocation of indexed share funds and cash, based on investment advice, will cost less to run than an SMSF with more complex asset allocation under an actively managed investment strategy which might include share trading and direct investment in property. The complexity of the fund will be reflected in advisory, administration, accountancy and audit costs.

We note that the provision of administration services to SMSFs is a competitive market with providers offering online SMSF administration tools at relatively low cost.

With regard to Point 4 in Table 4 – whether advice should be required on a minimum starting balance for SMSFs – we note that the Rice Warner report says the competitive threshold for SMSFs v APRA funds is \$200,000. While this accords with variously reported estimates from industry practitioners of around \$200-300,000, we note that the viable starting balance for an SMSF will depend on the age, saving capacity and degree of commitment of the members. For example, young people with good career prospects could viably start an SMSF with a lower initial balance than older people in the latter stage of their working lives. Any guidance by ASIC on an appropriate starting balance should be qualified by stating that the viability of a self-managed fund will depend on the capacity of its members to save and their commitment to achieve financial self-reliance.

Finally, we note that while costs are relevant, other factors are also important including satisfaction with the level of service provided and confidence in the quality of advice offered. SMSF owners may be willing to pay above the average rate for good service and advice and will make their own judgement in this regard. Rice Warner's report (A Survey of the Financial Needs and Concerns of SMSF Members - November 2012) showed that SMSF owners were less likely to be satisfied with advice that cost less than \$500 but more likely to be satisfied with advice that cost up to \$2,000.

C1Q2 – Do you agree ASIC should provide guidance on the costs associated with setting up, managing and winding up an SMSF?

(a) What are the costs associated with setting up, managing and winding up an SMSF?

The Rice Warner report lists these costs at 3.1. It would be helpful for ASIC to publish a list of the categories of costs involved in setting up and maintaining an SMSF. This list should also point out costs that are particular to SMSFs, such as insurance, the ATO supervisory levy and ASIC's fee for corporate trustees. For the reasons given in response to C1Q1 it may not be feasible for ASIC to give meaningful comparative costs beyond broad cost range indicators of the type contained in the Rice Warner report. We note that the ATO publishes general cost information, including the ratio of operating expenses to total assets and audit costs in its annual SMSF statistical overview, though these numbers are somewhat dated as the latest report available is for 2010-11. That report showed that in 2011, 65% of SMSFs had an operating expense ratio of less than 1% of assets and 40% had an operating expense ratio of less than 0.25%.

- a. **Is insurance purchased through an SMSF cost effective compared with insurance through an APRA regulated fund?** *We have not done a comparative analysis of insurance costs as we lack the resources to do so.*
- b. **Do you think ASIC should provide actual dollar costs (or a range of dollar costs) for the following SMSF costs?** *No. While relevant cost indications could be useful to SMSF trustees, it would be difficult for ASIC to establish actual dollar cost benchmarks as the cost of running a fund will vary according to the circumstances of the fund in terms of type and spread of investments, how actively trustees manage their funds and the tools and services they may source from a competitive marketplace. These factors and the associated costs will be continually changing. Apart from these practical considerations, we question whether it would be appropriate for ASIC to publish dollar costs which would then be taken as an indication of officially approved costs.*
- c. **The cost of setting up, managing and winding up an SMSF?**
As mentioned above, apart from giving an indicative range (as per the Rice Warner report), it will be difficult for ASIC to provide actual dollar costs given variations in the asset mix, degree of self-management by trustees and their use of the suite of products offered competitively by service providers. If these costs could be quantified accurately, they would need to be updated periodically. ASIC would need to consider whether publishing dollar costs would imply these to be officially approved.
- d. **The time cost associated with managing an SMSF?** *It would be difficult to assess this given variations in the mix of fund assets, the expertise of trustees and the degree to which they might seek professional advice and management. While we have no research insights on this question, we believe that most trustees would expect that in taking on the responsibility of a self-managed fund they should be prepared to spend some time attending to the good management of the fund and its compliance with the law. Whether this is an economic use of their time is for them to judge.*
- e. **The cost of an SMSF not having access to compensation under the SIS Act?** *Apart from pointing out that SMSFs are not covered by compensation in the event of fraud or theft, it would be difficult to give an indication of the cost since this would depend on the circumstances and extent of each instance of theft or fraud.*
- f. **The cost of obtaining insurance?** *ASIC should certainly point out that insurance is a specific cost that may be incurred by SMSFs. An indication of insurance costs would be helpful to potential (and existing) SMSF owners; however it may prove difficult to set meaningful cost benchmarks because the circumstances of the trustees of SMSFs, and their insurance risk, will differ.*

(b) What are the costs and benefits of SMSF structures compared with other superannuation vehicles?

The key benefit of SMSFs is that they allow people to take control of their own retirement savings and choose their own investment strategy – see Rice Warner’s November 2012 report: “A Survey of the Financial Needs and Concerns of SMSF Members”. This report listed the important benefits perceived by survey respondents as:

<i>Control over investing their fund's money</i>	<i>95.1%</i>
<i>Flexible investment choices</i>	<i>74.5%</i>
<i>Lower costs</i>	<i>61.5%</i>
<i>Better tax management</i>	<i>57.9%</i>
<i>Easier transition from accumulation to pension</i>	<i>47.8%</i>
<i>Estate planning</i>	<i>43.7%</i>
<i>Borrowing to invest</i>	<i>17.8%</i>

Source: Rice Warner – A Survey of the Financial Needs and Concerns of SMSF Members – November 2012

C1Q3 – Should advisers be required to consider and inform clients of the costs in Table 4 before establishing an SMSF?

Yes. It is reasonable to expect that advisers should provide clients of the categories of costs involved in setting up, managing and winding up an SMSF and the scale of these costs to extent they can reasonably be known. Costs to clients for specific services should be disclosed.

SMSF Owners' Alliance Limited

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