18/11/2013

Ai-Lin Lee
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Dear Ms. Lee

SMSF Professionals' Association of Australia Submission on ASIC CP 216

The Self Managed Superannuation Funds Professionals' Association of Australia (SPAA) welcomes the opportunity to make a submission in relation to Australian Securities and Investments Commission (ASIC) Consultation Paper 216 "Advice on self-managed superannuation funds: Specific disclosure requirements and SMSF costs" ("CP 216").

SPAA welcomes ASIC's desire to improve the standard of advice given to prospective self managed superannuation fund (SMSF) trustees that are making the decision to either establish or switch to an SMSF. We believe that the general impetus to improve disclosure in order to reduce risks for consumers is merited and will strengthen the integrity of the SMSF sector.

While we believe this is an appropriate outcome to be pursued through financial advice requirements, we believe that some of the suggested disclosure requirements in CP 216 may not achieve their goals and are not appropriate. Further, while we support increased disclosure standards, we strongly believe it is also imperative that the standard of SMSF competency and knowledge of advisers be increased. An increase in SMSF competencies will result in better advice to consumers, including disclosures of the risks related to establishing or switching to an SMSF.

SPAA supports the disclosure of SMSF costs to potential SMSF trustees as part of the broad set of factors that should be considered in making the decision to establish an SMSF. However, we would not support the use of ASIC mandated breakeven points, such as those calculated in Rice Warner's SMSF cost report, to provide this advice on costs, on the basis that they can be misleading and overly simplistic.

Our detailed response to CP 216's proposals is in the attachment.

About SPAA

SPAA is the peak professional body representing the SMSF sector throughout Australia. SPAA represents professionals, irrespective of their personal membership and professional affiliations, who provide advice to individuals aspiring to higher levels of participation in the management of their superannuation savings. Membership of SPAA is principally accountants, auditors, lawyers, financial planners and other professionals such as actuaries.

SPAA is committed to raising the standard of professional advice and conduct in the SMSF sector by working proactively with Government and the industry. In doing so, SPAA has contributed to SMSF advisors providing a higher standard of advice to SMSF trustees. This in turn has enabled trustees to make more informed decisions addressing the adequacy, sustainability and longevity of their own retirement savings. SMSFs offer trustees greater control and flexibility and have become an integral part of the Australian Superannuation landscape by providing significant and viable options for managers, business owners, executives and retail operators alike.

We would be happy to provide further information or to discuss any questions you may have about this submission with you.

Yours sincerely,

Andrea Slattery

Managing Director/CEO

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Managing Director/CEO	Director, Technical and Professional Standards

PROPOSAL B1: PART 23 COMPENSATION DISCLOSURE REQUIREMENTS

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

We believe the proposed recommendation that advisers must warn clients an SMSF is not entitled to receive compensation under Part 23 of the Superannuation Industry (Supervision) Act 1993 for any loss caused by fraud or theft is an overly simplistic recommendation.

We agree that potential SMSF trustees should be warned that they will not be entitled to Part 23 compensation but this warning should not be given in isolation and should be given in the wider context of the risks associated with SMSFs. Providing this warning in isolation ignores the complex nature of compensation available to SMSFs in the event of fraud or theft. While SMSFs are not entitled to potential compensation under Part 23 they are able to seek compensation for fraud or theft via other avenues.

These avenues include the standard compensation arrangements that AFS licensees must maintain under section 912B of the *Corporations Act 2001*, approaching the Financial Ombudsman Service (FOS) if the trustee's adviser or other service provider involved in the fraudulent conduct, is a member of FOS, and the Financial Claims Scheme administered by the Australian Prudential Regulatory Authority (APRA) which includes a $250,000 guarantee for SMSF bank deposits with certain entities, as well as legal recourse for fraud or theft via civil legal actions. SPAA is aware that an SMSF investor in Trio Capital was able to recover substantial investment losses through a court action, with the damages funded by their financial adviser's professional indemnity insurance.

Also, the financial resources, corporate governance practices, and codes of conduct of many authorised deposit-taking institutions (including large reputable managed investment scheme operators) ensure that an SMSF would receive some compensation in the event of theft or fraud, especially where theft or fraud is carried out by an employee of the financial institution.

While these avenues do not guarantee that an SMSF trustee is able to recover a loss incurred by the SMSF due to fraud or theft, it is important that a potential SMSF trustee understands the entire range of compensation avenues that are available or unavailable to them in the event of theft or fraud. Not discussing these potential avenues of recourse in conjunction with warning a potential trustee about not having access to Part 23 compensation is likely to distort the understanding of the compensation available to SMSF trustees. The possible compensation needs for an SMSF trustee will be unique to their particular SMSF, and the investments it holds, and not as simple as not being able to access Part 23 compensation.

Furthermore, the compensation provided to APRA-regulated superannuation funds under Part 23 is not guaranteed for APRA-regulated funds that have suffered loss as a result of fraudulent conduct or theft. In order for an APRA-regulated fund to receive compensation under Part 23 they must:

- have suffered a loss due to fraudulent conduct or theft,
- the loss must result in “substantial diminution of the fund leading to difficulties in the payment of benefits”,
- the fund must apply to the relevant Minister for a grant of financial assistance, and

- the Minister must be satisfied that "the public interest requires that a grant of financial assistance should be made to a trustee of the fund for the purposes of restoring the loss".

In addition to satisfying these legal elements, there is no guarantee as to what percentage of the loss a Minister may choose to compensate. There is no guarantee that where a fund is chosen to be compensated by the Minister that it will have its total loss compensated for by a payment from the Government. It is within the Minister's discretion on a case-by-case basis to award between zero and 100 per cent of the loss from theft or fraud. This should be disclosed as part of any advice which addresses Part 23 compensation being available for APRA-regulated funds as it should materially affect a person's decision on whether Part 23 compensation is a significant incentive to remain in an APRA-regulated fund instead of establishing or switching to an SMSF.

Also, any disclosure regarding Part 23 compensation should recognise that there is no certainty a member's fund will receive compensation where there is a theft or fraud that affects their fund. We believe that it is a common misconception that APRA-regulated funds (and their members) will definitely receive compensation if the fund is a victim of fraud or theft, and this misconception seems to be embodied in the proposed requirement to disclose that SMSFs are not eligible for Part 23 compensation. Any warning about SMSFs not receiving Part 23 compensation should disclose that there is no guarantee an APRA-regulated fund will receive any compensation. It should be recognised that there are three key discretionary factors determining whether a member's fund will receive Part 23 compensation – whether the Minister is satisfied that the fund has suffered an eligible loss, the Minister's discretion as to whether compensation is in the public interest, and, whether the fund applies for compensation.

SPAA is aware that in the recent Trio failure there were funds that did not receive compensation for the fraud that had occurred in the Trio case because the Minister did not believe that compensating the funds was in the public interest. This led to members of APRA-regulated superannuation funds having their retirement savings depleted due to fraud. This is contrary to the type of disclosure that CP 216 indicates should be made to potential SMSF trustees.

Similarly, there is no certainty that an APRA-regulated fund will apply to the Minister for compensation under Part 23. Superannuation funds may perceive that applying for compensation from Government for theft or fraud that has affected their fund's ability to pay benefits would tarnish the fund's reputation and deter existing and future members. SPAA has anecdotal evidence of APRA-regulated superannuation funds having incurred significant losses from theft or fraud but not proceeded with a Part 23 application and instead have tried to recompense their loss through professional indemnity insurance or other legal avenues without disclosing the loss to members. These instances show that it is important that people considering a retirement income vehicle have a proper understanding that Part 23 compensation is not always granted to or pursued by APRA-regulated superannuation funds in addition to not being available to SMSFs.

Further to these factors are the complex funding arrangements that support Part 23 compensation. Members should be made aware that compensation to a superannuation fund made under Part 23 is subject to a cost recovery via an industry levy that applies to

APRA-regulated superannuation funds. This cost is passed on to members of APRA-regulated superannuation funds, possibly affecting their account balance. In the case of the APRA-regulated fund members who did not receive compensation for losses sustained by their fund in the Trio collapse (as discussed above), their fund was liable for the losses as well as paying the cost recovery levy. It is misleading to inform people that APRA-regulated funds can obtain compensation for theft or fraud but not disclose that any such compensation is funded by the broader APRA-regulated superannuation sector.

We believe that these complex factors surrounding Part 23 compensation should mean that a warning that SMSFs cannot access Part 23 compensation must be made in the broader context of SMSF compensation avenues and not in isolation. A potential SMSF trustee should be able to consider the absence of Part 23 compensation in context of how it applies to APRA-regulated funds and in light of other potential compensation avenues available to SMSF trustees.

Also, we believe that if Part 23 compensation is to be included as an issue which requires disclosure in regards to the decision to establish or switch to an SMSF, the issues we have discussed above need to be part of that disclosure. Accordingly, we believe these issues should be disclosed to all superannuation members – whether members of APRA-regulated funds or SMSFs – so that they are able to have a complete understanding of Part 23 compensation.

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?

As discussed above in B1Q1, we believe that a warning about the absence of the availability of Part 23 compensation will benefit SMSF trustees when it is made in the broader context of compensation available for SMSFs in the event of theft or fraud.

We believe in advising a client to establish or switch to an SMSF, and adviser should explain to their clients the broader framework for accessing compensation for theft or fraud for SMSFs, and that this disclosure would involve a warning that SMSF trustees are not able to access Part 23 compensation unlike APRA-regulated funds.

Warning a potential SMSF trustee that they will not be able to access Part 23 compensation in the broader context of disclosing the compensation avenues available for SMSFs compared to APRA-regulated superannuation funds would be the most appropriate way of making this disclosure. We believe this would give potential SMSF trustees the information on compensation in a context that would best position them to make the decision whether an SMSF is suitable for them.

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 warnings should be given in a prescribed format, please explain why.

On the basis of our recommendation that the warning about the absence of Part 23 compensation for SMSFs be made in the broader context of disclosing the compensation avenues available for SMSFs, any Part 23 warning would not need to be made in a stand-alone document.

As we believe a warning regarding access to Part 23 compensation should be made in the broader context of disclosing the compensation arrangements available for SMSFs, it would be most appropriate for the warning to be made in conjunction with a document detailing other SMSF risks and disclosures.

This document should be independent of SoAs. The relevant SoA for SMSF establishment or switching should be left to address the client's individual circumstances and needs rather than include generic advice on SMSF risks. However, this should not preclude the SoA from detailing specific risks that are relevant to the client's unique circumstances.

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 acknowledgment that will help to ensure that investors understand the lack of compensation available to SMSFs? If so, please provide details.

In line with our comments above that, a warning about Part 23 compensation not requiring a stand-alone document, we do not believe that potential SMSF trustees should be required to sign a separate document acknowledging they understand that SMSFs are not entitled to receive compensation under the SIS Act.

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.

We would expect any increased compliance costs to be relatively small for AFS licensees and their authorised representatives, especially if there is adequate time allowed to update relevant documentation and templates.

B1Q6: Are there any practical problems with the implementation of this proposal? Please give details.

No.

PROPOSAL B2: DISCLOSURE REQUIREMENTS

B2Q1: Do you agree with our proposed disclosure requirements in Table 2? If not, why not?

We generally agree with the disclosures listed in Table 2, however, it should be recognised that not of all the disclosures will be relevant to all potentially new SMSF trustees. Furthermore, as foreshadowed in our covering letter, we believe the most appropriate solution to advisers providing best practice advice on establishing or switching to an SMSF will be brought about by increasing SMSF competencies of advisers.

In our submission to ASIC CPs 212 and 215 we argued that the proposed update of RG 146 should be include a specialist SMSF topic if advisers wish to provide advice on SMSFs. We were surprised that ASIC had not suggested an additional specific SMSF topic in light of recent statements and research issued by ASIC that has shown concern for SMSF advice practices. Similarly, it is surprising ASIC has not sought specific SMSF competencies in the updated RG 146 when it has concerns regarding that the quality of disclosures made to potential SMSF trustees about the risks involved in being an SMSF trustee.

We believe that including an SMSF topic in RG 146, and recognising it as a specialist area of superannuation advice, will increase the level of professionalism and understanding of financial advisers who advise on the establishment and operation of SMSFs, leading to increased consumer protection. We think that improved SMSF competencies of those providing advice to potential SMSF trustees would be a significant factor in improving SMSF disclosures. As advisers have a greater knowledge of SMSFs, they would have a better ability to properly inform potential SMSF trustees on the risks involved in being an SMSF trustee.

Improving the quality of SMSF competencies of financial advisers that provide SMSF advice will offer a more holistic solution to ASIC's concerns around the quality of SMSF advice and risk disclosure. We encourage ASIC to pursue this avenue and would like to work further with ASIC to build requirements for an SMSF knowledge requirement that could be included in the updated RG 146 requirements moving forward.

We agree that Item 1, "Responsibilities and obligations for SMSF trustees associated with running an SMSF" should be disclosed by advisers to potential SMSF trustees. We believe that competent SMSF advisers are discussing these issues with clients and disclosing to them the obligations that come with being an SMSF trustee. Many advisers are providing this information through ATO SMSF trustee information documents or white-label materials developed by their licensee.

The risks associated with SMSFs should be disclosed to potential trustees, however, as SMSFs are unique to the individual trustees that establish them, not all risk factors will be relevant to all trustees. The risks described in Item 2 are good guidance for advisers advising on the risks associated with an SMSF, however, not all of the risks should be required to be disclosed if they are not relevant to a trustee.

We agree that the risks described Items 3 to 7 should be disclosed to potential SMSF trustees.

We believe that Items 1-7 should be disclosed to trustees, but believe that mandatory disclosure may not be the most effective mechanism for improving the information available to potential SMSF trustees. We believe that the most effective way to ensure that new trustees are aware of these issues is to ensure that SMSF advisers have high specialist SMSF competencies and knowledge so that they can adequately discuss with clients the risks associated with SMSFs. Mandatory disclosure may result in information being passed on to trustees via a standardised document (which already occurs with many advisers) but will not result in tailored advice and discussions that assist clients in making an educated decision on whether an SMSF is a suitable investment for them.

As discussed in B1Q1, we believe that any generic information provided on SMSF risks should be made in a stand-alone document separate for the relevant SoA for establishing or switching to an SMSF.

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?

As discussed above in B2Q1, mandatory disclosure may help facilitate a flow of relevant information to potential SMSF trustees, however, it will not necessarily ensure that trustees and advisers are having a constructive discussion as to whether an SMSF is suitable for the client's circumstances. Improving the SMSF competencies of advisers will help create better dialogue between potential trustees and advisers concerning the suitability of SMSFs for clients. We believe that this is more likely to achieve ASIC's goal of ensuring consumers are better informed when making a decision to establish or switch to an SMSF.

Also, as detailed above in B2Q2, ensuring that advisers who are advising on SMSF establishment or switching to an SMSF have specific SMSF competencies will improve the quality of SMSF risk disclosure.

B2Q3: 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.

As stated in B2Q1, the information on SMSF risks should be provided in a stand-alone document, with any specific risks relevant to a client's circumstances detailed in the SoA.

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 acknowledgment that will help to ensure that clients understand the risks associated with SMSFs? If so, please provide details.

No, this is not necessary in addition to the ATO trustee declaration new SMSF trustees must sign in accordance with section 104 of the SIS Act.

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.

We would expect any increased compliance costs to be relatively small for AFS licensees and their authorised representatives, especially if there is adequate time allowed to update relevant documentation and templates.

B2Q6: Are there any practical problems with the implementation of this proposal? Please give details.

No.

B2Q7: Do you think we should provide further guidance on the disclosure obligations? If so please provide details.

Regulatory guidance from ASIC may prove to be a useful addition to the current regulatory landscape where there is little guidance for advisers in providing disclosures regarding SMSF risks. This would assist advisers in providing SMSF risk disclosures to clients as well as tailor SoAs for specific risks affecting a client's decision to establish or switch to an SMSF.

PROPOSAL B3: SIX MONTH TRANSITION PERIOD

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.

Six months should be a sufficient time frame once the class order is issued by ASIC for licensees and their authorised representatives to adjust their practices to meet any new obligations. However, we believe that with the amount of recent changes confronting SMSF advisers, such as the Future of Financial Advice (FoFA) reforms, replacement of the accountants' exemption with a limited licence and numerous recent changes to the taxation and SIS laws, a longer time period of 12 months transition may be warranted so that advisers are not confronted with an overwhelming number of regulatory changes.

PROPOSAL C1: INFORMING CLIENTS OF SMSF COST ISSUES

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?

We agree generally with the description of SMSF costs in the Rice Warner report but are surprised at some of the report's findings in regards to when SMSFs are cost-competitive with retail or industry funds, especially high balance funds.

The administrative costs referenced in the reports seem to be generally in line with what we expect, however, the estimated operating expenses and the resulting breakeven points compared to APRA-regulated funds are higher than expected, especially for higher balance funds.

When compared to ATO SMSF statics in "Self-managed super funds: A statistical overview 2010-11" the Rice Warner report finds the operating expense ratio of SMSFs to be higher than expected. The ATO data showed that the majority of SMSFs had an estimated operating expense ratio of 1% or less (65.6% of SMSFs in 2011), the highest proportion (over 40%) of which had an estimated operating expense ratio of 0.25% or less. This is substantially different to the cooperating expenses for SMSFs calculated in the Rice Warner report.

The higher cost figure calculated by Rice Warner leads to higher balances in SMSFs being required to achieve a breakeven point against APRA-regulated fund costs for superannuation fund members. As these breakeven points are highly dependent on the operating costs estimated for SMSFs – which heavily depend on the underlying assumptions as to administrators' costs and fund asset holdings - the breakeven points should not be regarded as conclusive figures which potential SMSF trustees should make decisions on.

We believe that the individual nature of SMSFs and the diverse administration offerings and costs of SMSF administrators, as well as the different approaches of SMSF trustee to the degree of self-administration and outsourcing that they undertake for their SMSF makes it difficult to find meaningful average SMSF operating cost ratios and breakeven comparison points with APRA-regulated fund costs.

Accordingly, we do not believe that the figures in the Rice Warner Report should be used by advisers in discussing SMSF costs with potential SMSF trustees. The use of these breakeven points can be misleading and not relevant to trustees where the underlying assumptions of the breakeven points do not match the potential trustee's individual circumstances (i.e. investment approach, administrator, asset holdings, balance, etc.).

We believe that advisors should be able to have a meaningful discussion with potential SMSF trustee on the costs of running an SMSF where they have adequate SMSF knowledge and competencies without having to rely on predetermined breakeven comparisons with APRA-regulated funds. These cost factors should then be detailed in the client's SOA in a manner that is relevant to the client's individual circumstances. SPAA would expect that advisors would undertake such disclosures in their SoAs in order to

comply with the best interest duty and other existing *Corporations Act 2001* disclosure requirements.

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

As expressed in C1Q2, we believe that competent advisers should be disclosing SMSF costs to their clients and then including tailored advice on costs in their client's SoA. Guidance on what elements of SMSF costs should be discussed and advised on would assist advisers in meeting their disclosure obligations.

However, we would not support the use of ASIC mandated breakeven points to provide this advice on costs, on the basis that they can be misleading and overly simplistic.

C1Q3: **Should advisers be required to consider and inform clients of the costs in Table 4 before establishing an SMSF? If not, why not?**

We support advisers considering and informing clients of these factors in the context of overall balanced SMSF advice. Consideration of SMSF costs should be part of a broad consideration of the many factors that should be taken into account.

However, as discussed in the previous two questions, we do not support the use of breakeven cost-effective comparisons to APRA-regulated funds as a tool to consider costs. In particular, we do not support ASIC's justification in Table 4 that cost-effective breakeven comparisons with APRA-regulated funds should be used because "there has been considerable debate within industry about whether there should be a minimum balance for SMSFs." Industry speculation on future policy should not be the basis for a mandated disclosure.

C1Q4: Are there any other SMSF costs that need to be disclosed to client? If so, should they be disclosed in actual dollar costs (or a range of costs)? Please provide details.

It may be prudent for advisers to disclose where there will be increased administration costs for particular investment strategies (i.e. in-house assets, unlisted securities, etc.). Similarly, costs involved in administering pensions from SMSF should be disclosed.

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.

See our answer above to C1Q4.

C1Q6: Is our proposed guidance likely to result in additional compliance costs for advisers? Please give details, including figures and reasons.

We would expect any increased compliance costs to be relatively small for AFS licensees and their authorised representatives, especially if there is adequate time allowed to update relevant documentation and templates.

C1Q7: Are there any practical problems with the implementation of this proposal? Please give details.

The practical problems with this proposal relates to the issues in calculating a breakeven comparison point as described in our answers above.