



**ASIC**

Australian Securities & Investments Commission

# **The regulator's perspective on the regulation of SMSFs**

*A speech by John Price, Commissioner,  
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## **CHECK AGAINST DELIVERY**

### **Introduction**

Good afternoon and thank you very much for inviting me to speak today. I'm delighted to be here at the Institute of Public Accountants (IPA) National Congress. Today I will be focusing on the recent work ASIC has undertaken in relation to self-managed superannuation funds (SMSFs) and our proposed work over the coming months.

By way of background, in September last year, Deputy Chairman Peter Kell and Commissioner Greg Tanzer became jointly responsible for heading up ASIC's SMSF taskforce.

The taskforce was set up in response to the growth in SMSFs, an increase in geared investment strategies, the collapse of Trio, and the Parliamentary Joint Committee on Corporations and Financial Services (PJC) Inquiry into that collapse. The taskforce's main purpose is to examine high-risk SMSF issues.

As I'm sure most of you will know, the SMSF sector is growing rapidly and more Australians than ever before are either considering or operating an SMSF. Today, however, I'd like to focus on three key things:

- the critically important role of gatekeepers in the SMSF sector
- ASIC's focus on SMSFs and our review of the quality of advice provided to SMSF investors
- ASIC's consultation paper on disclosure and costs relating to SMSFs.

### **SMSFs and the critically important role of gatekeepers**

SMSFs are the fastest growing sector of the superannuation industry.

ASIC's primary role in relation to SMSFs is to regulate gatekeepers – the accountants, financial planners, SMSF auditors and providers of products and services to SMSFs. ASIC also regulates many – but not all – of the financial products that SMSFs commonly invest in. From that perspective, we are very keen to ensure that SMSF trustees are adequately equipped to make good investment decisions by being fully informed about the risks and returns.

The decision to establish an SMSF is one of the most significant steps an investor can take in relation to their retirement savings, and many investors seek professional advice from an accountant or financial planner before taking this step. It is essential that investors have access to good quality, tailored advice that is in their best interests before making the decision to set up an SMSF.

The important role of accountants as gatekeepers has been recognised in recent legislation. Two key law reforms – the introduction of a new, limited Australian financial services (AFS) licence and the registration of SMSF auditors – highlight the trusted role accountants play in the SMSF sector.

### **New limited AFS licence**

As you will all be aware, since 1 July 2013, accountants have been able to apply for and be granted a limited AFS licence. This replaces the current accountants' exemption from licensing when giving advice about setting up an SMSF. A limited licence allows advice to be given on SMSFs and certain classes of product. Any person may apply for a limited licence. Recognised accountants<sup>1</sup> who apply between 1 July 2013 and 30 June 2016 will be able to take advantage of transitional arrangements for entry into the AFS licensing regime. Under the transitional arrangements, reduced requirements will apply where the responsible managers of the applicant are recognised accountants. Once the transitional period is over, all applicants will need to meet the full competence requirements under the *Corporations Act 2001* (Corporations Act).

In implementing this new regime we have been mindful to reduce red tape. We have taken advantage of the changes to our licensing process to also remove 46 licensing questions from our forms.

In addition, to help reduce the costs of operating within the AFS licensing regime, 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 licence holders who do not handle any client money in connection with the provision of financial advice.

However, it is important to note that, apart from the annual compliance certificate, holders of the limited AFS licence will need to meet the same ongoing requirements as other AFS licensees. This includes all other licensing conduct and advice requirements to which financial advisers are subject, such as providing clients with a Statement of Advice (SOA), where required, as well as membership of an external dispute resolution scheme and compliance with the Future of Financial Advice (FOFA) measures, such as the best interests duty.

ASIC has provided guidance in Information Sheet 179 *Applying for a limited AFS licence* (INFO 179), available on our website.

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<sup>1</sup> 'Recognised accountants' refers to members of the Institute of Chartered Accountants in Australia, Certified Practising Accountants (CPA) Australia and IPA who comply with their membership professional education requirements: see reg 7.1.29A(2) of the Corporations Regulations 2001.

Since 1 July 2013, we have received 24 applications and have issued seven limited AFS licences. Of the 24 applicants, four are members of the IPA.

### **Registration of SMSF auditors**

As part of the Stronger Super reforms initiative, ASIC became the registration body for approved SMSF auditors from 31 January 2013<sup>2</sup>. This reform recognises the key gatekeeper role that approved SMSF auditors play. The objective of SMSF auditor registration is to raise the standard of SMSF auditor competency and ensure there are minimum standards across the sector.

To audit an SMSF you must be registered with ASIC as an approved SMSF auditor. It is an offence under the *Superannuation Industry (Supervision) Act 1993* (SIS Act) for a person to hold themselves out as an approved SMSF auditor when they are in fact not an approved SMSF auditor.

ASIC released Regulatory Guide 243 *Registration of self-managed superannuation fund auditors* (RG 243) in January 2013 to provide further guidance to the industry regarding the registration requirements.

To be eligible for registration, you must have passed a competency exam within the 12-month period before you apply. If you were registered before 1 July 2013, during the transition period, then you may need to complete the exam before 1 July 2014 as a condition of your registration. Through our exam provider, Assessment Services Pty Ltd, ASIC has received approximately 450 exam bookings and delivered around 220 SMSF auditor competency exams, across 27 of the 44 exam venue locations. We are anticipating that over 1,800 exams will need to be delivered in the first year.

The required pass mark is 65% and so far about 80% of those sitting the exam have passed. Candidates are generally permitted two attempts at the exam, but very few second attempts have been taken. Around 10% of those that have failed their first attempt have made a second attempt. This may indicate that candidates are seeking further training before making their second attempt, to ensure they are up to the required standard.

Since the introduction of the SMSF auditor registration regime on 31 January 2013, as at 28 October 2013 ASIC has received 7,374 applications and we have registered and approved 7,051 SMSF auditors.

With the establishment of a public register, for the first time SMSF trustees are able to identify suitably qualified auditors to conduct an SMSF audit.

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<sup>2</sup> ASIC's responsibility in this area is to register SMSF auditors, set approved competency standards (which we have done working closely with industry) and impose administrative outcomes if the standards are not met. The ATO's responsibility is to monitor the conduct of SMSF auditors and refer any matters to ASIC for administrative action.

We also hope that, among those using the register, there are accountants who verify that the auditors they are referring to SMSFs are registered with ASIC to conduct SMSF audits. Our records show that as at 28 October 2013, 79,218 SMSF auditor searches have been conducted on ASIC Connect.

Being able to identify approved SMSF auditors is one of the key objectives of the regime. Having a publicly available register should promote a level of confidence that the sector meets minimum standards, and enables ASIC to get updates to auditors quickly and easily, if the need arises.

## **ASIC's focus on SMSFs and our review of advice**

Let me now turn to our work through the ASIC SMSF taskforce.

As mentioned earlier, the purpose of the SMSF taskforce is to examine high-risk SMSF issues. As its first major project, the taskforce looked at the quality of advice provided to SMSF investors, with ASIC's overarching aims in this area being to ensure that:

- only those investors for whom an SMSF is suitable are advised to establish an SMSF
- SMSF investors receive good-quality advice and services in relation to SMSFs from gatekeepers.

On 18 April 2013, we released Report 337 *SMSFs: Improving the quality of advice given to investors* (REP 337), which sets out the results of our 2012 review into the quality of advice provided by financial planners and accountants to some lower-balance SMSFs – funds with a balance of \$150,000 or less.

It is important to note that we deliberately targeted files that looked more likely to be higher risk for SMSF members. For example, investors who were older, or had lower incomes, or where the SMSF borrowed or had invested in a single class of asset only.

While REP 337 found that the majority of advice provided to SMSF clients as part of our file review was of an adequate quality, the report did highlight concerning pockets of poor advice. Much of this advice involved recommendations that investors set up an SMSF to gear into real property.

Through our file reviews, we found that there is room for significant improvement in aspects of the SMSF advice giving process. Where we found problems with the advice it tended to be in the following areas:

- the advice was not sufficiently tailored
- replacement product disclosure was absent or inadequate

- insurance recommendations were absent or inadequate
- an inappropriate single asset class was provided to investors
- suitable alternatives to an SMSF were not considered
- there was inadequate consideration of the investor's long-term retirement planning objectives.

Notably, we also found that investors were not warned about the real risk of not having access to a statutory compensation scheme in the event of theft or fraud.

## Consultation paper on additional disclosure and costs

As part of the next stage of taskforce work, in September of this year we released Consultation Paper 216 *Advice on self-managed superannuation funds: Specific disclosure requirements and SMSF costs* (CP 216). The consultation paper covers two broad issues.

### Disclosure requirements

We are proposing to modify the law, by way of class order, to set out specific disclosure requirements for AFS licensees and their authorised representatives who give personal advice to clients on establishing or switching to an SMSF. These include:

- the duties and obligations associated with running an SMSF, including that trustees remain responsible for managing the fund even if they outsource some or all of their responsibilities
- the risks associated with running an SMSF
- the need to develop and implement an appropriate investment strategy for an SMSF
- the time, commitment and skills needed to run an SMSF effectively
- the costs associated with setting up, running and winding up an SMSF
- the need to consider and develop an exit strategy for an SMSF
- the possibility that the laws and policies that affect SMSFs may change.

### Rice Warner's research and our proposed guidance on SMSF costs

I now turn to the second broad issue and our proposed guidance on SMSF costs.

Whether there should be a minimum fund balance size for SMSFs has long been an issue of debate. Many industry participants question whether an

SMSF with assets of less than \$200,000 can be cost-effective when compared with an APRA-regulated fund.

Within industry, there is also a lack of consensus on the costs associated with setting up, running and eventually winding up an SMSF. In our view, it is important to consider costs when making a recommendation to establish or switch to an SMSF.

In late 2012, ASIC commissioned Rice Warner Actuaries to examine the minimum cost-effective balance for SMSFs compared with APRA-regulated superannuation funds. We decided to publish the Rice Warner report as an attachment to CP 216 and seek feedback on Rice Warner's findings. The purpose of this is to encourage further debate and explore the issues relating to SMSF costs.

Rice Warner's research found that there was a range of costs that reflected the range of complexity of the SMSFs themselves. Rice Warner found that:

- SMSF fund balances with less than \$100,000 are not competitive in comparison to APRA-regulated funds.
- SMSF fund balances of \$100,000 to \$200,000 can be competitive with more expensive APRA-regulated funds if the trustees undertake the broader investment and administration functions.
- SMSF fund balances of \$200,000 to \$500,000 can provide equivalent value with APRA-regulated funds provided the trustees undertake some of the administration
- SMSF fund balances of \$500,000 or more can provide equivalent value to APRA-regulated funds on a full service basis.

To be very clear, ASIC is not proposing a mandated minimum balance, but rather, is looking to provide clearer guidance on this issue based on research and on industry and investor views.

We recently held two separate roundtable discussions in October for CP 216 – one for industry stakeholders and one for consumer representatives.

Overall, stakeholders supported the disclosure proposals in CP 216. A number of industry associations noted that their members already comply with the disclosure proposals. This is encouraging both in terms of consumer protection and because it means industry is able to implement the proposals with minimal cost and disruption.

One concern that was raised by industry was whether these proposals are a signal that ASIC is planning to introduce prescriptive disclosure requirements for advice about other financial products. As we said at the roundtable discussions, and I will say it again today, this is not on the cards.

Some stakeholders have noted that the proposals cover issues that are also contained in the trustee declaration that SMSF trustees give to the Australian Taxation Office (ATO). This isn't coincidental - ASIC looked closely at the trustee declaration in developing the proposals. A key difference is that trustees get the declaration *after* they have already set up their SMSF. Our proposals are designed to ensure that they get this information *before* then, so people can use the information to decide whether a SMSF is right for them.

We understand industry is busy coming to grips with a number of regulatory changes so we have provided an eight week consultation period with submissions being due on 11 November 2013. By early next year we want to finalise a decision on any next steps informed by our public consultation process.

We look forward to working with industry in the coming months to continue to improve SMSF advice.

## Conclusion

As I said before, ASIC is focused on encouraging gatekeepers to lift the standard of their advice so that investors can be confident and informed about this important sector.

I hope that today I've given you a sense of some of the work ASIC is doing in the SMSF sector and the important gatekeeper role your industry plays in helping us ensure that the SMSF sector remains vibrant, healthy and safe for investors.