REPORT 337

SMSFs: Improving the quality of advice given to investors

April 2013

About this report

In 2012, ASIC set up an SMSF taskforce to look at risks in the SMSF sector. ASIC reviewed the quality of a sample of self-managed superannuation fund (SMSF) advice given to investors. While we found that the majority of advice provided was adequate, there was also room for improvement in aspects of the advice-giving process.

This report summarises the findings from our SMSF file reviews and identifies a number of practical tips that advice providers can use to improve the quality of SMSF advice they provide to investors.

This report also provides an update on some of the other work ASIC is currently undertaking in the SMSF sector.

About ASIC regulatory documents

In administering legislation ASIC issues the following types of regulatory documents.

Consultation papers: seek feedback from stakeholders on matters ASIC is considering, such as proposed relief or proposed regulatory guidance.

Regulatory guides: give guidance to regulated entities by:

- explaining when and how ASIC will exercise specific powers under legislation (primarily the Corporations Act);
- explaining how ASIC interprets the law;
- describing the principles underlying ASIC's approach; and
- giving practical guidance (e.g. describing the steps of a process such as applying for a licence or giving practical examples of how regulated entities may decide to meet their obligations).

Information sheets: provide concise guidance on a specific process or compliance issue or an overview of detailed guidance.

Reports: describe ASIC compliance or relief activity or the results of a research project.

Examples in this report

Where possible, industry examples in this report are based on real-life examples with details changed to protect privacy.

Examples in this report are purely for illustration; they are not exhaustive and are not intended to impose or imply particular rules or requirements.

Contents

Executive summary

SMSFs: The fastest growing superannuation sector

1 Self-managed superannuation funds (SMSFs) are the fastest growing sector of the superannuation industry. Since their official introduction in 1999, the number of SMSFs has grown strongly. According to the latest Australian Prudential Regulation Authority (APRA) figures, SMSFs now account for approximately a third of total superannuation assets in Australia, with $439 billion in funds under management.[1] As at 30 June 2012, there were over 478,000 SMSFs, with approximately 913,550 members.[2]

2 Compared with members of other types of superannuation funds, SMSF members tend to be older, earn a higher income and have larger superannuation balances.

3 The primary drivers for setting up an SMSF include a desire for control over investments and a wish to lower costs. Not surprisingly, the desire for control among SMSF members means that members tend to play an active role in their investment decisions. This is important because SMSF members have the ultimate responsibility for their own investments, and are not covered by the compensation scheme that applies to APRA-regulated funds.

4 The decision to establish an SMSF is one of the most significant steps an investor can take in relation to their retirement savings. It is therefore essential that, before making the decision to set up an SMSF, investors have access, through gatekeepers, to good quality, tailored advice that is not conflicted. At the very least, investors need to understand the time, resources, compliance obligations and risks associated with a do-it-yourself (DIY) superannuation option before deciding to move their superannuation savings out of an APRA-regulated environment.

ASIC's focus on SMSFs

5 Unlike larger superannuation funds, SMSFs are not prudentially regulated by APRA. SMSFs are regulated by the Australian Taxation Office (ATO). The ATO takes a compliance approach to SMSF regulation. The law requires all SMSFs to have their financial accounts and their compliance with the *Superannuation Industry (Supervision) Act 1993* (SIS Act) audited annually by an approved auditor.

[1] APRA, *Annual superannuation bulletin*, June 2012 (issued 9 January 2013) (APRA 2012 bulletin), p. 5 and Table 9, p. 40.
[2] ATO, *Self-managed super funds: A statistical overview 2010–11* (ATO 2010–11 overview), Table 1: Yearly SMSF population and asset size, http://www.ato.gov.au/superfunds/content.aspx?menuid=49150&doc=/content/00341497.htm&page=29&H29.

6 ASIC's role in relation to SMSFs is to regulate the gatekeepers—the advice providers, SMSF auditors, and providers of products and services to SMSFs.

7 In the past few years, ASIC has taken action against gatekeepers where they have failed to protect the interests of SMSF members. For example, as a consequence of Trio Capital's collapse, which affected 285 SMSFs and nearly 6,000 other superannuation members, ASIC took enforcement action against the directors of Trio, its investment manager, a number of financial planners who recommended Trio and Trio's auditors.

8 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 the collapse of Trio, ASIC established an SMSF taskforce in September 2012.

9 The purpose of the taskforce is to examine high-risk SMSF issues. As its first major project, the taskforce has been looking at the quality of advice provided to investors. ASIC's overarching aims in this area are to ensure that:

(a) only those investors for whom an SMSF is suitable are advised to establish an SMSF. ASIC does not want to see an influx of trustees who are ill-equipped to cope with the responsibilities and obligations inherent in running an SMSF; and

(b) SMSF investors receive good quality advice and services from gatekeepers in relation to SMSFs.

10 In a compulsory superannuation contribution environment, it is essential that investors can choose how to invest their superannuation savings, and a healthy and vibrant SMSF sector is a key conduit for exercising this choice. In the right hands, SMSFs can be very effective retirement savings vehicles. In the wrong hands, however, SMSFs can be high risk.

11 If there are widespread losses in the SMSF sector, it is likely that investor confidence will be seriously eroded, there will be increased scrutiny of gatekeepers, and there may be calls for greater regulation of SMSFs and the advice providers that work in this sector.

12 Gatekeepers therefore have a critically important role to play in ensuring:

(a) that only those investors for whom an SMSF is suitable go into the SMSF sector; and

(b) the ongoing viability of the SMSF sector.

13 If gatekeepers fail in their role, it is likely that the SMSF sector will look very different in the future.

Taskforce work

14 In 2012, as part of the first project undertaken by the taskforce, ASIC reviewed the quality of advice provided to some lower balance SMSFs (i.e. funds with a balance of $150,000 or less).

15 The purpose of our review was threefold. We wanted to:

(a) gain a better understanding of advice practices in the SMSF sector to enable us to more effectively target risky conduct and potentially problematic market practices;

(b) test whether gatekeepers were doing their job in ensuring that only investors for whom an SMSF was suitable were advised to set up an SMSF; and

(c) explore whether there were weaknesses in the advice-giving process in order to develop some practical tips for improving the quality of SMSF advice.

16 We reviewed over 100 investor files relating to establishing an SMSF. The majority of files we reviewed had a fund balance of $150,000 or less and included some, or all, of the following features:

(a) older members (i.e. members at, or close to, retirement age);

(b) members with a low income;

(c) borrowing; and

(d) investment in a single asset class (e.g. real property).

17 It is important to note that we did not select a random sample of files for review. Instead, as noted above, we targeted files that looked more likely to be higher risk for SMSF members.

18 We rated the personal advice we reviewed as good, adequate or poor. Overall, we concluded that the majority of investors received adequate advice.

19 While the majority of advice provided was adequate, we did find concerning pockets of poor advice. Much of this advice involved recommendations that investors set up an SMSF to gear into real property.[3] Where this advice was inappropriate for the individual investors, we will be following up on these and taking regulatory action.

20 Through our file reviews, we found that there was room for improvement in aspects of the SMSF advice-giving process. Given the risks associated with a DIY option, we think there are certain things advice providers and investors need to discuss and consider before setting up an SMSF.

[3] We did not look at business real property investments.

Considerations before setting up an SMSF

21 SMSFs will typically suit investors with greater resources and financial experience. However, they may not be suitable retirement savings vehicles for many Australians. This is because they are reasonably complex to run, require a hands-on approach and may be more expensive to participate in than other superannuation funds.

22 Table 1 contains a checklist of some of the issues that advice providers and investors need to consider and discuss before making the decision to set up an SMSF. Each item in Table 1 is discussed in more detail in this report.

Table 1: Issues to consider before setting up an SMSF

Issue	Considerations
Role and obligations of SMSF trustees: see paragraphs 72–76	Does the investor adequately understand what it means to set up and run an SMSF? Does the investor understand the role and responsibilities associated with being a trustee of an SMSF? Do they understand the consequences of getting it wrong?
Suitability of an SMSF structure: see paragraphs 77–98	Does the investor adequately understand the cost and time required to run an SMSF? Does the investor possess the financial literacy skills required to run, or be involved in running, an SMSF? Has the investor considered SMSF succession planning issues? This may be an issue for older investors.
Risks of an SMSF structure: see paragraphs 99–140	Does the investor understand the basic risks associated with having an SMSF? For example, does the investor understand: • their inability to access a Government compensation scheme; • their reduced access to dispute resolution bodies; • the risk of not having insurance, or having inadequate insurance; and • the risk of some SMSF membership structures?
Investment strategy: see paragraphs 141–160	Does the investor have the necessary skills and expertise to make the investment decisions for the SMSF? If not, does the investor have a plan to outsource these skills (e.g. by getting professional investment advice)? Does the investor understand the costs of importing these skills? Does the investor understand the benefits of investment diversification and the risks associated with investing all their superannuation in a single asset class (e.g. real property)? Will the investor's investment strategy deliver the returns required to adequately fund their retirement?
Switching from an APRA-regulated superannuation fund: see paragraphs 161–166	If the investor is moving from an APRA-regulated fund to an SMSF structure, do they understand the advantages and disadvantages of such a switch?
Alternatives to an SMSF structure: see paragraphs 167–169	Are there alternatives to an SMSF structure that would meet the investor's needs? If so, have these alternative structures been properly explained to the investor?

Other SMSF work ASIC is doing

23 In addition to looking at the quality of SMSF advice, ASIC is also:

(a) taking enforcement action to protect SMSF investors and stop unlicensed SMSF advice and misleading advertising;

(b) implementing a number of policy initiatives, including working with accountants on the removal of the accountants' exemption, registering SMSF auditors, and consulting on additional disclosure obligations for SMSF advice and on SMSF costs;

(c) working on education initiatives to help investors access reliable, accurate and trustworthy information about SMSFs.

24 This work is discussed further in Section D of this report.

A Overview of the SMSF sector

Key points

SMSFs have grown strongly from a niche product to the largest component of the superannuation sector (in both number and asset size). The global financial crisis (GFC) has had little impact on this rapid growth.

Compared with members of other types of superannuation funds, SMSF members tend to be older, have larger superannuation balances and are more involved in the management and investment decisions. SMSFs generally have two members and an individual trustee structure.

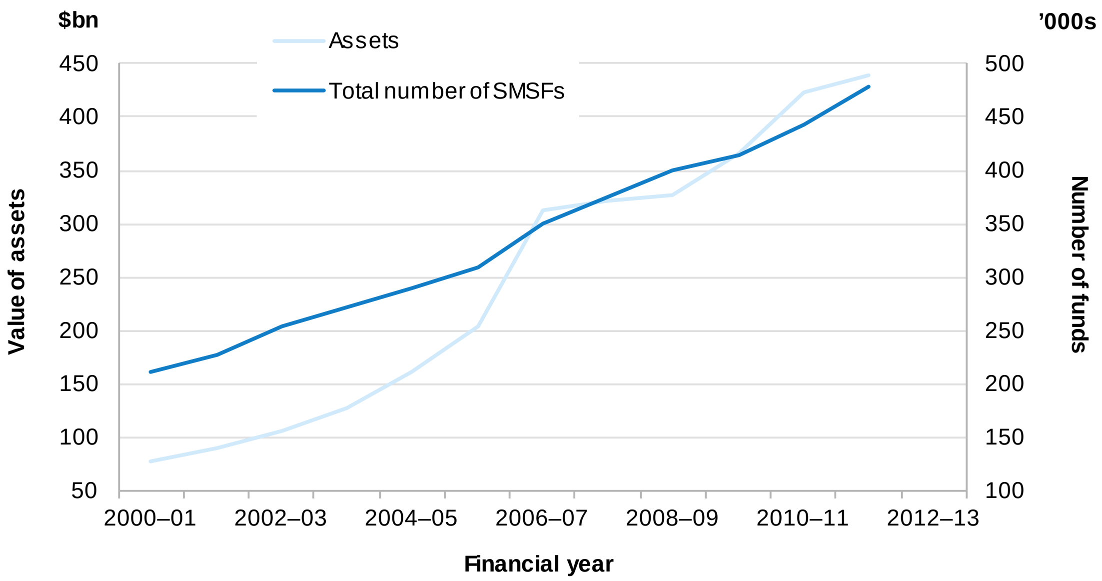
Control over investments is a key driver for setting up an SMSF.

While SMSF members are very active in managing their funds, the complexity and compliance obligations of running an SMSF mean that many members outsource to service providers various aspects of setting up and running their fund.

Growth of SMSFs

25 SMSFs are the fastest growing sector of the superannuation industry, both in terms of the share of assets under management and in the number of funds. SMSFs now account for nearly a third of total superannuation assets in Australia.[4] Since their official introduction in 1999, the number of SMSFs has grown rapidly. As at 30 June 2012, there were more than 478,000 SMSFs—an average growth of 7.7% per year over the preceding 10 years: see Figure 1.

Figure 1: Value of assets and number of SMSFs

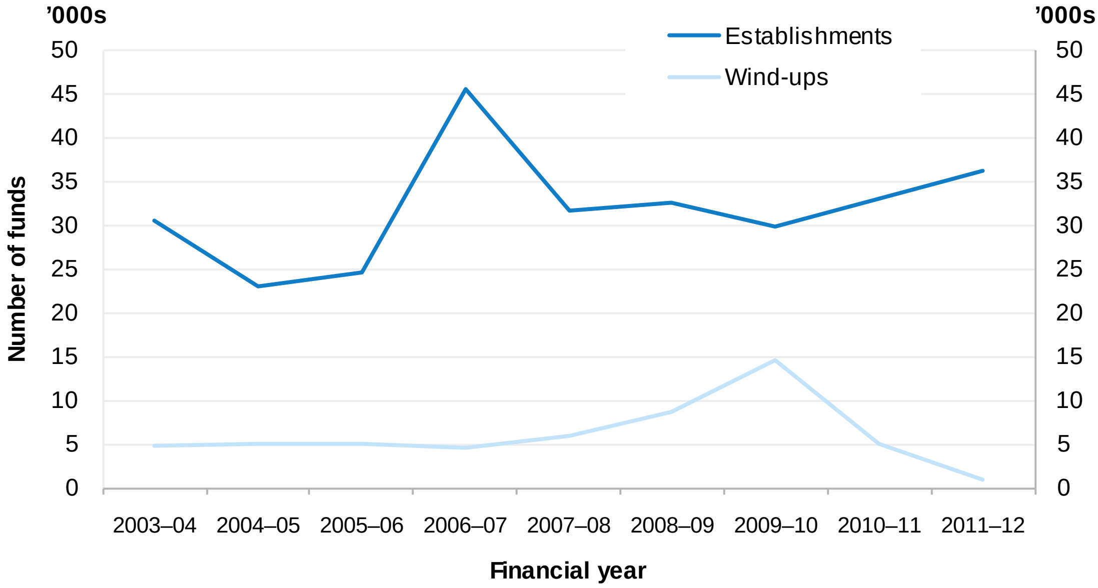


Source: APRA 2012 bulletin, Table 1 and Table 9.

[4] APRA 2012 bulletin, Table 9.

26 Perhaps surprisingly, the GFC had no noticeable effect on the establishment of SMSFs, with annual establishments remaining relatively constant from 2007–08 onwards. However, the impact of the GFC on SMSF wind-ups is uncertain. Although Figure 2 shows an increase in SMSF wind-ups in 2009–10, these figures were affected by the ATO's systems changes and data cleansing activity.[5]

Figure 2: SMSF establishments and wind-ups per year



Source: ATO, *Self-managed super fund statistical report*, December 2012, SMSF population table (annual).

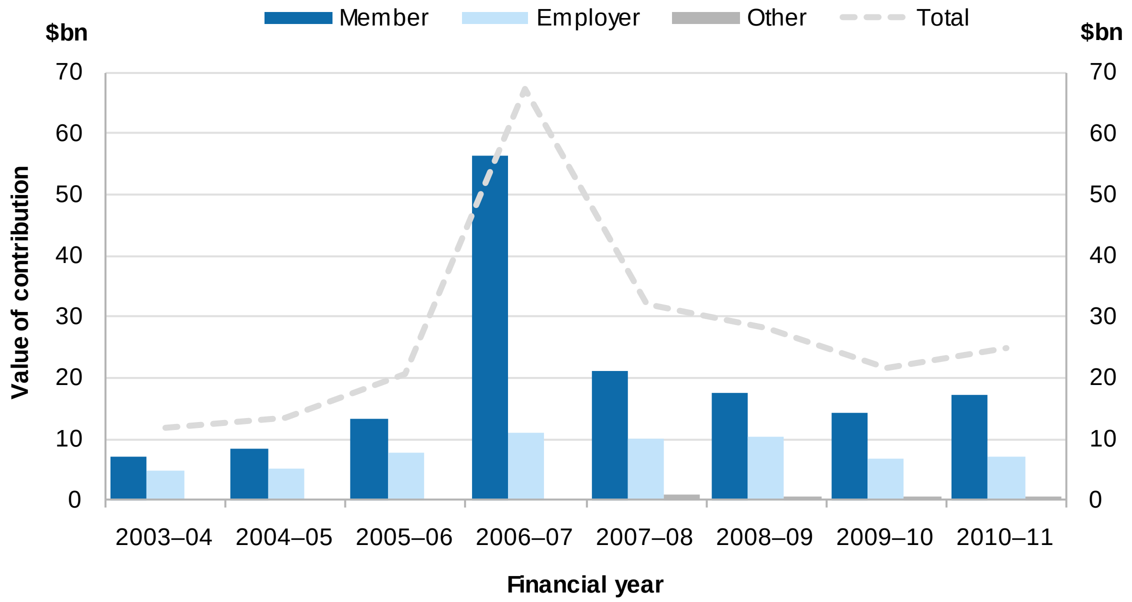
SMSF contributions

27 The GFC also affected SMSF contributions, as illustrated in Figure 3. The spike in 2006–07 is attributed to regulatory change that abolished reasonable benefit limits and introduced a $1 million transitional contribution limit. However, the continued decline in SMSF contributions between 2006–07 and 2009–10 appears to be a result of the GFC.

28 Despite this decline, SMSF member contributions still accounted for more than 50% of all member contributions as at 30 June 2011.[6]

[5] ATO, *Self-managed super fund statistical report*, December 2012, Additional information.
[6] In 2010–11, SMSF member contributions were $17,158 million, compared with total superannuation member contributions of $33,472 million: ATO, *Self-managed super fund statistical report*, December 2012; APRA 2012 bulletin, Table 7.

Figure 3: SMSF contributions per year by type of contribution

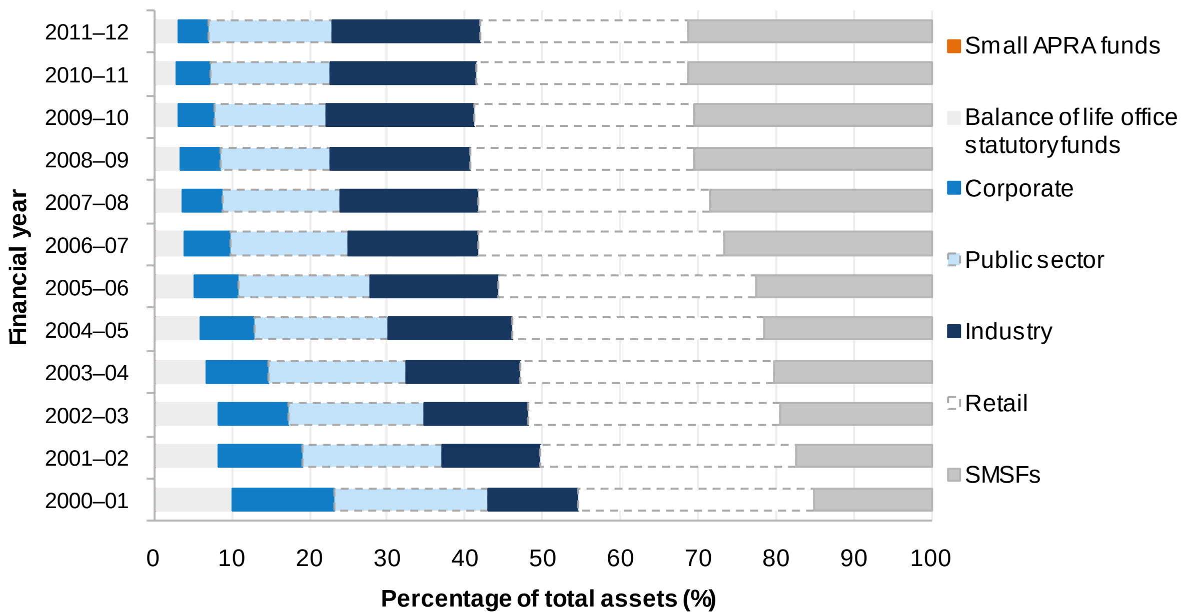


Source: ATO, *Self-managed super fund statistical report*, June 2012 and September 2012.

SMSF assets

29 SMSFs are now the largest fund type in terms of total assets held ($439 billion as at 30 June 2012).[7] Their increasing prominence in Australia is illustrated in Figure 4, with the proportion of assets held by SMSFs more than doubling: from 15% in 2000–01 to 31% in 2011–12.

Figure 4: Proportion of total assets by superannuation fund type



Source: APRA 2012 bulletin, Table 9.

[7] APRA 2012 bulletin, p. 5.

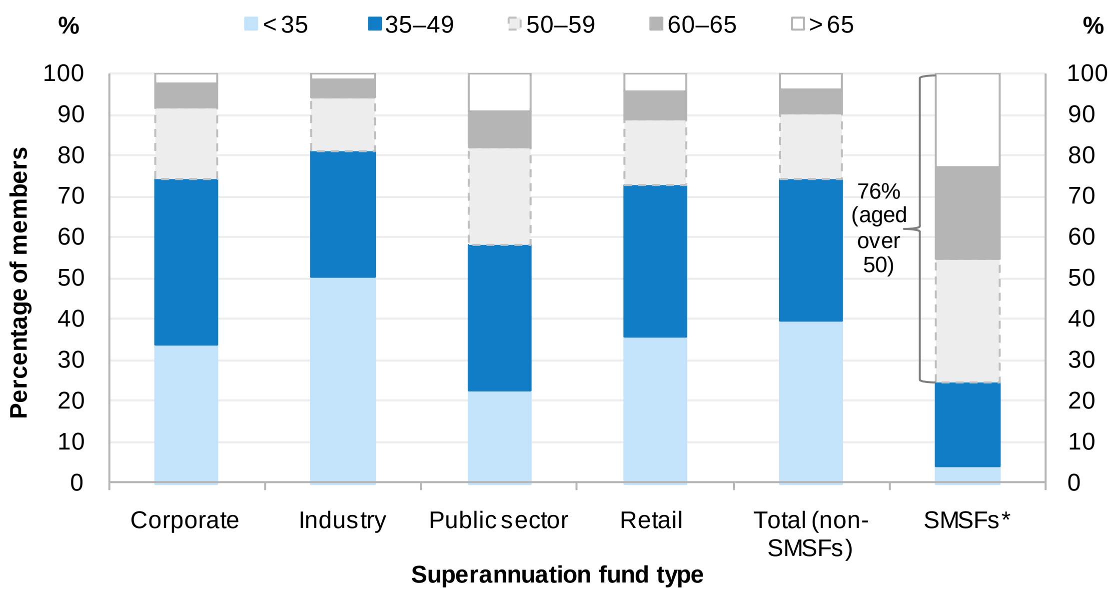
Profile of members

Age of members

30 The main factor influencing the large gap between the average account balance of SMSF members and members of other superannuation fund types is the much higher proportion of older members who have SMSFs. Older fund members have had more time to increase their assets compared with younger members.

31 This age disparity can be seen in Figure 5, which shows that 76% of SMSF members are over the age of 50. In comparison, those over the age of 50 account for only 42% of public sector funds, 28% of retail funds, 26% of corporate funds and 19% of industry member funds.

Figure 5: Age segmentation of members by superannuation fund type—as at 30 June 2012



* SMSF data refers to 30 June 2011.

Source: ATO 2010–11 overview, Table 11; APRA 2012 bulletin, Table 4.

Average number of members

32 Since June 2004, the composition of SMSFs, in terms of the number of members within each fund, has remained largely unchanged, with a two-member fund being the most common SMSF structure.[8] According to the latest ATO data, as at 30 June 2011, approximately:

(a) 22.5% of funds had one member;

(b) 69.1% had two members;

[8] ATO, *Self-managed super fund statistical report*, June 2012, Membership sizes tables.

(c) 4.1% had three members; and

(d) 4.3% had four members.[9]

Preferred trustee structure

33 According to ATO data, 75% of SMSFs have an individual trustee structure.[10] This preference is most likely a result of the increased costs and compliance burden associated with a corporate trustee structure. For example, in addition to complying with the company's constitution, a corporate trustee must also comply with the *Corporations Act 2001* (Corporations Act).

Motivation for setting up an SMSF

34 The desire to have 'control over investments' is the key driver for setting up an SMSF. This is supported by the Investment Trends report, *April 2012 self-managed super fund: Investor report* (Investment Trends 2012 report), issued in June 2012, where the most common 'control' related reasons for establishing an SMSF included:

(a) greater control over investments (59%);

(b) the ability to choose specific stocks to invest in (38%); and

(c) the ability to make better investments than superannuation funds (27%).[11]

35 Another commonly reported reason for setting up an SMSF is the advice or influence of a third party. According to the Investment Trends 2012 report, SMSF members said that their main reason for setting up their SMSF was:

(a) advice from their accountant (32%); and

(b) advice from their financial planner (18%).[12]

36 Word of mouth (from friends and colleagues) has played an increasingly important role in driving the establishment of SMSFs in recent years, while accountants have played a significant but diminishing role: see Figure 6 for more details.

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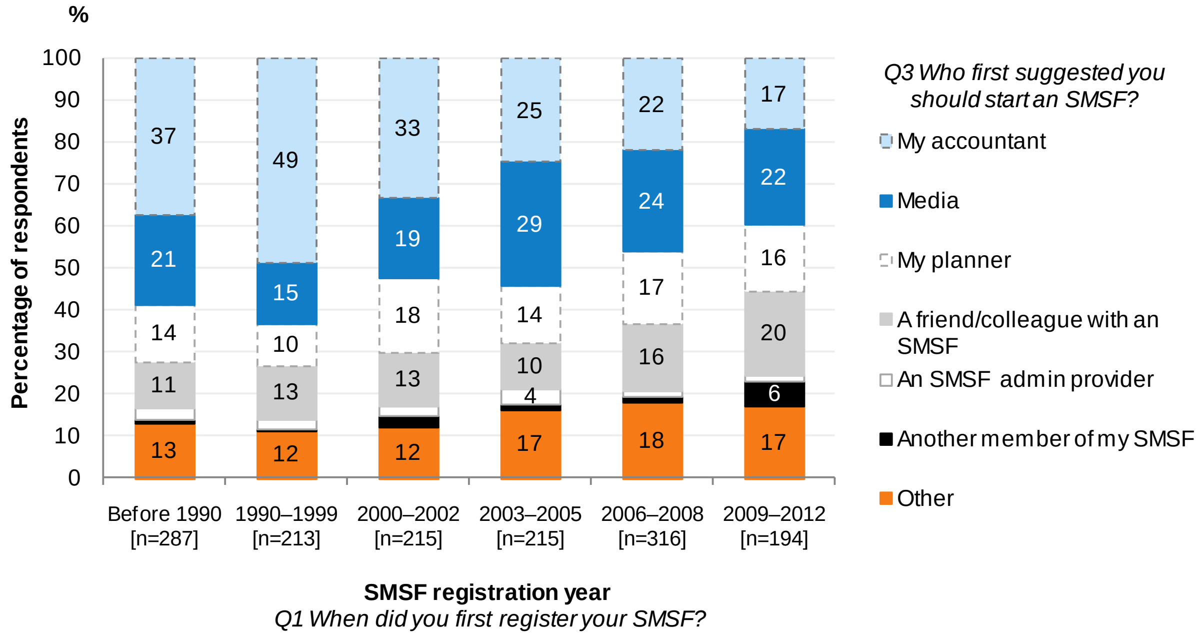
[9] ATO, *Self-managed super fund statistical report*, December 2012, Membership sizes tables.
[10] ATO 2010–11 overview, 'Trustee structure', http://www.ato.gov.au/superfunds/content.aspx?menuid=49150&doc=/content/00341497.htm&page=11&H11.
[11] Investment Trends 2012 report, volume 1 of 3, p. 20. Base sample: 1,575 SMSF members sourced via an online survey. This was a multiple response questionnaire (i.e. SMSF members were able to provide multiple reasons for setting up their SMSF).
[12] Investment Trends 2012 report, volume 2 of 3, p. 14. Base sample: 1,479.

Figure 6: Influences on SMSF members' decision to establish an SMSF



Note: Base sample: 1,479 SMSF members sourced via an online survey. Samples in the graph exclude those who responded 'don't know' to either of the two questions. Samples were sourced from a broad-based survey of the Australian population and further SMSF members were recruited via Investment Trends' institutional clients.

Source: Investment Trends 2012 report, volume 2 of 3, p. 14.

37 The reasons for setting up an SMSF vary between members and can be affected by factors such as the age of the SMSF member and when the SMSF was set up. Investment Trends found that, when members were asked why they set up their SMSF:

(a) the most common reason across all groups was wanting 'more control of my investments';

(b) older SMSF members were more likely to cite 'cost savings' and 'tax effectiveness';

(c) younger SMSF members were more likely to cite 'borrowing within super', 'investing in real property' and 'to consolidate multiple super funds';

(d) members of SMSFs established before 1999 were more likely to cite 'I was/became self-employed';

(e) members of SMSFs established in the 1990s were more likely to cite 'advice from my accountant'; and

(f) members of SMSFs established since 2009 were more likely to cite 'saw what super funds were charging', 'poor performance from super funds', 'to consolidate multiple super funds' and 'borrowing/gearing within my super'.[13]

[13] Investment Trends 2012 report, volume 2 of 3, p. 14 (base sample: 1,479); pp. 18–21 (base sample: 1,575).

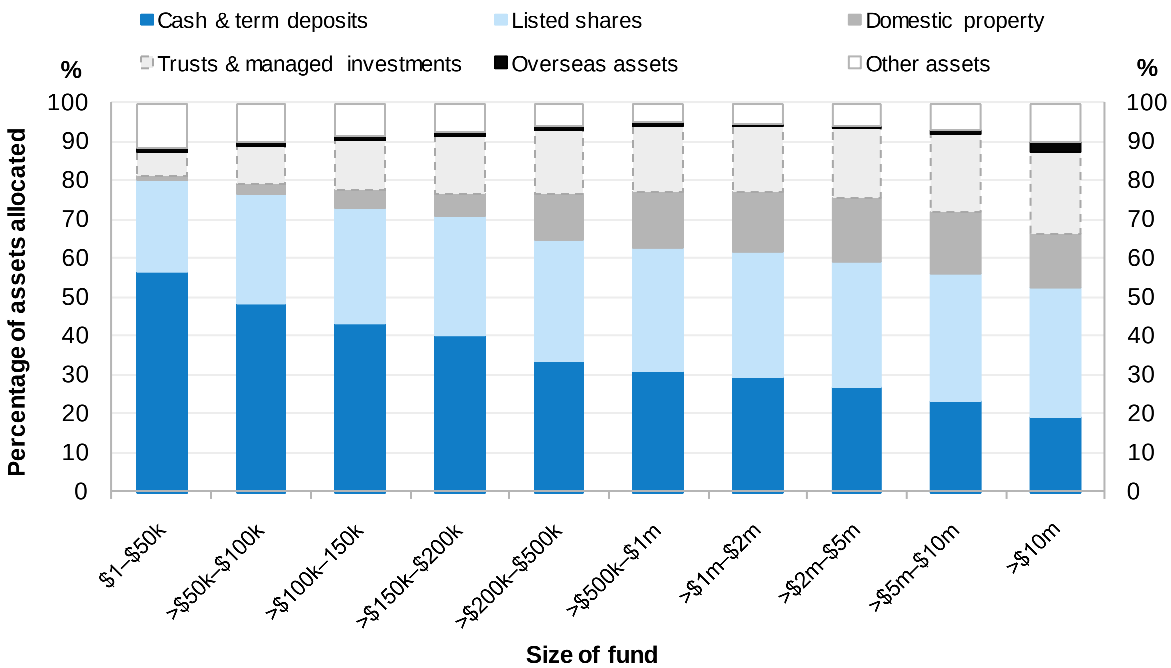
Asset allocation and gearing

38 There has been a general shift among SMSFs to more conservative investment choices, with a trend towards cash, debt securities and term deposits: from 23% in June 2004 to 31% in June 2012.[14] However, this trend is partly determined by the size of the fund: see Figure 7. Generally:

(a) the smaller the fund, the larger the allocation to cash; and

(b) the larger the fund, the more diversified the investments, with a substantially smaller allocation to cash.

Figure 7: SMSF asset allocation by fund size—2010–11



Notes:

(1) Domestic property includes non-residential and residential real property in Australia.

(2) Trusts and managed investments include listed trusts, unlisted trusts and other managed investments.

(3) Overseas assets include shares, non-residential and residential real property, managed investments and other overseas assets.

(4) Other assets include insurance policies, debt securities, loans, unlisted shares, derivatives and instalment warrants, artwork, collectibles, metal or jewels and other assets.

Source: ATO, *Self-managed super fund statistical report*, September 2012 (annual SMSF population analysis tables and asset allocation by asset value of the fund table); ASIC aggregation.

Accumulation versus pension phase

39 The asset allocation of SMSFs in the pension phase is broadly similar to the asset allocation of SMSFs in the accumulation phase. According to the Investment Trends 2012 report, the main differences between asset allocation of SMSFs in the pension and accumulation phases were that SMSFs in the pension phase:

[14] ATO, *Self-managed super fund statistical report,* June 2012, Asset allocation tables.

(a) had a larger proportion of assets in listed direct shares (43% versus 38%, as at April 2012);

(b) had a larger proportion of assets in cash and cash products (31% versus 25%); and

(c) had a lower proportion of assets in real property (9% versus 21%).[15]

40 Despite the similar asset distribution, SMSF members in the pension phase were more likely to hold a diversified investment portfolio.[16] This suggests that members seek diversity in the pension phase to ensure an income stream, which may be due to the minimum annual payment rules. Another possible reason is that SMSF members in the pension phase are older and more likely to have a larger fund that can afford greater diversification.

41 The Investment Trends 2012 report identified that there was an inverse relationship between gearing and age, with younger SMSF members likely to borrow more than older members. Among those borrowing within their SMSF, a significant portion (83%) did so to invest in real property.[17]

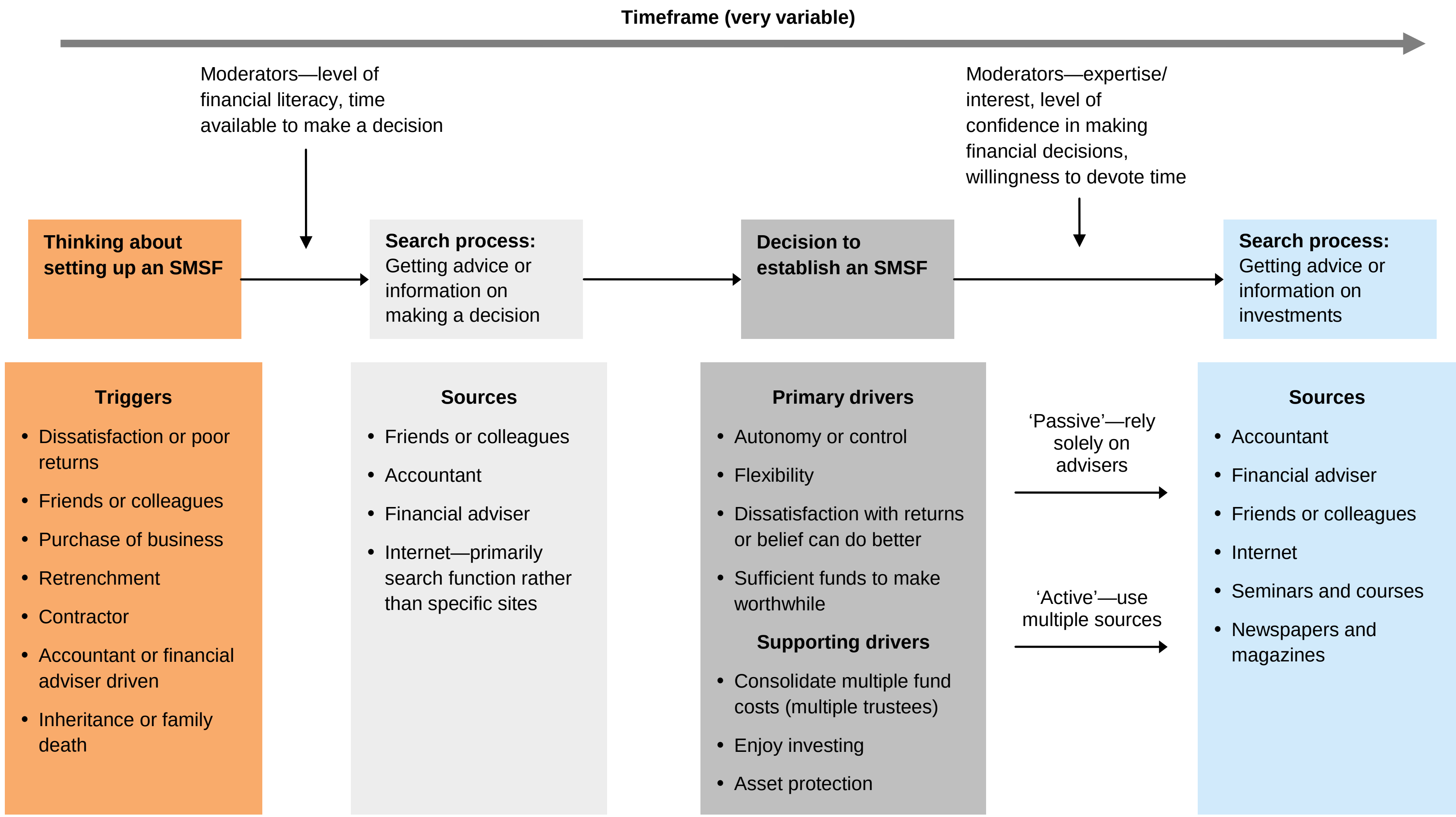
Use of advice and service providers

Making decisions

42 When making decisions about their SMSF, members are influenced by many factors, as outlined in Figure 8.

[15] Investment Trends 2012 report, volume 1 of 3, p. 94. Base sample: 1,572 (accumulation phase), 928 (pension phase).
[16] ATO 2010–11 overview, 'SMSF asset concentration', http://www.ato.gov.au/superfunds/content.aspx?menuid=49150&doc=/content/00341497.htm&page=24&H24.
[17] Investment Trends 2012 report, volume 1 of 3, p. 358. Base sample: 1,479.

Figure 8: Overview of decision process



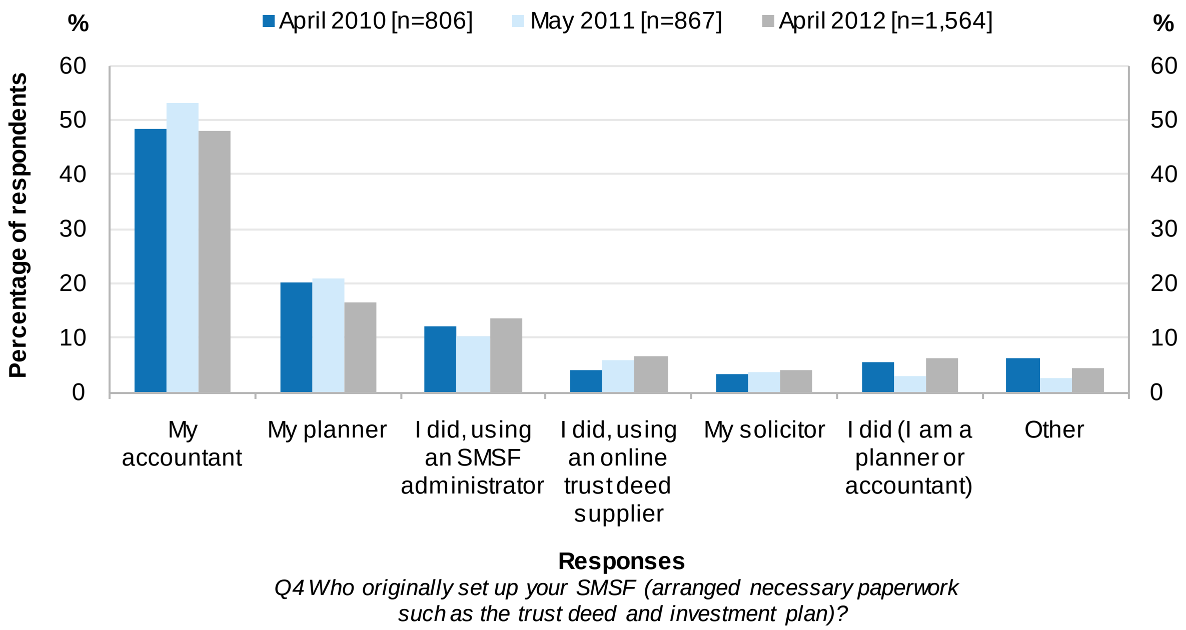
Note: Sample: 20 in-depth interviews with SMSF members in Melbourne; prepared by ASIC’s Consumer Advisory Panel.

Source: Chant Link, *A report for ASIC on self-managed superannuation funds,* 2005, p. 17.

Establishment

43 Despite the desire for control, the complexity and regulatory obligations associated with establishing an SMSF mean that the majority of SMSF members outsource the establishment of their fund to a professional, with accountants establishing almost half of all respondents' SMSFs: see Figure 9. According to the Investment Trends 2012 report, around one in four members set up their own SMSF using an SMSF administrator or an online trust deed supplier, or because they were a planner or accountant themselves.[18]

Figure 9: Intermediaries who set up SMSFs



Note: Base sample: 1,564 SMSF members sourced via an online survey. Samples were sourced from a broad-based survey of the Australian population and further SMSF members were recruited via Investment Trends' institutional clients.

Source: Investment Trends 2012 report, volume 2 of 3, p. 13.

Main sources of advice

44 When members were asked to specify the main source of advice for their SMSF, Figure 10 shows that:

(a) 32% of members cited accountants;

(b) 19% of members cited a financial planner or adviser; and

(c) 23% of members stated not having a main source of advice.[19]

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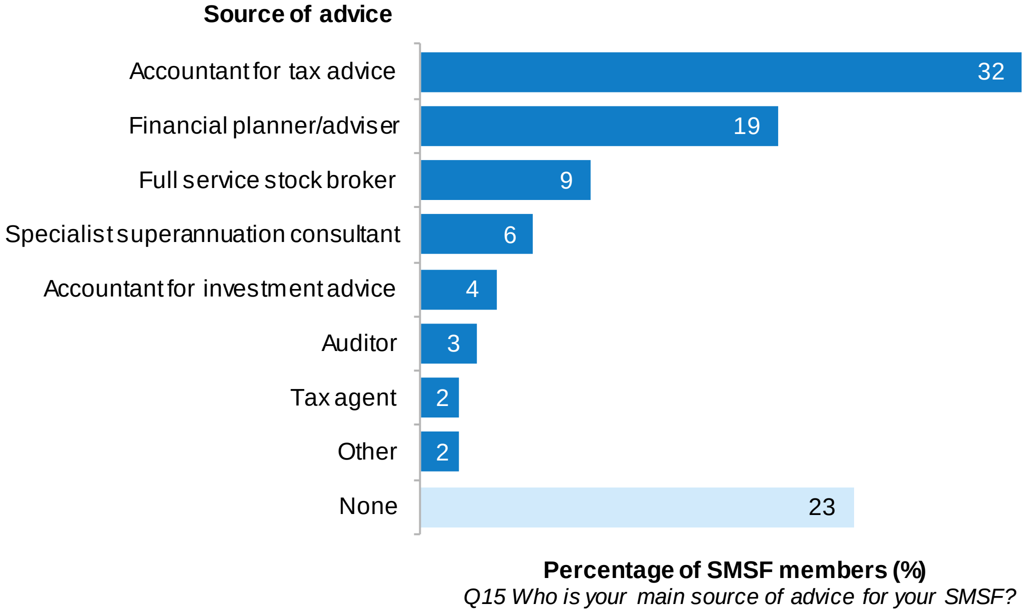
[18] Investment Trends 2012 report, volume 2 of 3, p. 13. Base sample: 1,564.
[19] Investment Trends 2012 report, volume 2 of 3, p. 34. Base sample: 1,533.

Figure 10: Main sources of advice for SMSF members—April 2012



Note: Base sample: 1,533 SMSF members sourced via an online survey. Samples were sourced from a broad-based survey of the Australian population and further SMSF members were recruited via Investment Trends' institutional clients.

Source: Investment Trends 2012 report, volume 1 of 3, June 2012, p. 33.

45 There are a range of reasons why SMSF members choose not to seek professional advice. The Investment Trends 2012 report found the primary reasons for SMSF members not seeking advice from an advice provider were:

(a) the ability to manage their own financial affairs (36%);

(b) the perception of high costs and the lack of value added (33%); and

(c) the lack of confidence in advisers' expertise (33%).[20]

Satisfaction and trust

46 The levels of SMSF members' satisfaction with their main advice provider have remained broadly stable since May 2009. The Investment Trends 2012 report found that SMSF members reported highest satisfaction with accountants (for both investment and tax advice)[21] and lower (but still high) satisfaction with financial planners/advisers.[22] However, SMSF members who had received professional advice in 2012 were more likely to seek advice on their asset allocation and investment strategy than in 2009.[23]

47 The survey also revealed that technical knowledge, knowledge of the superannuation system and the frequency of contact were important contributors to SMSF members' satisfaction with their main advice provider.[24]

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[20] Investment Trends 2012 report, volume 1 of 3, p. 14 and p. 69. Base sample: 1,479.
[21] Investment Trends 2012 report, volume 1 of 3, p. 39. Base sample: 60 (investment advice), 477 (tax advice).
[22] Investment Trends 2012 report, volume 1 of 3, p. 39. Base sample: 281.
[23] Investment Trends 2012 report, volume 1 of 3, p. 56. Base sample: 770 (2009) and 929 (2011).
[24] Investment Trends 2012 report, volume 1 of 3, p. 46. Base sample: 1,137.

B ASIC's review of the quality of SMSF advice provided to investors

Key points

In late 2012, ASIC conducted a review of over 100 investor files relating to the establishment of an SMSF. The investor files reviewed were provided by both financial planning and accounting entities (entities).

The purpose of our review was to test and rate the quality of SMSF advice provided to investors and to explore whether there were weaknesses in the advice-giving process in order to develop some practical tips for improving the quality of SMSF advice in the future.

We used a combination of indicators of potentially inappropriate advice to select the SMSF advice files for review. The majority of files we selected had:

- a fund balance of $150,000 or less; and
- one or more of the following features: funds with older members, members with a low income, borrowings, or investments in a single asset class (e.g. real property).

We graded the personal advice we reviewed as good, adequate or poor.

Our overall findings were that the majority of investors in the categories outlined above were provided with adequate quality advice. However, we identified a number of areas for improvement in the advice-giving process.

All of our file reviews were conducted in-house by staff members with the appropriate skills, training and experience.

We will be providing individual feedback to the entities involved in our review in the coming months.

Our surveillance methodology

48 In late 2012, we conducted a surveillance of 18 entities that provided a financial service involving the establishment of an SMSF. The entities represented a combination of Australian financial services (AFS) licensees and accountants. The entities were selected based on a combination of factors, including their size and prominence in the SMSF market, their level of advertising and, in some limited cases, their complaints history.

49 The purpose of our surveillance activity was to:

(a) develop a high-level picture of the types of investors seeking SMSF advice over a six-month period in 2011; and

(b) test the quality of SMSF advice provided to investors.

50 Our surveillance activity involved a two-step process. First, we gathered high-level information about the types of investors seeking SMSF advice. Second, we used the high-level information gathered to select a number of files for review. The files chosen for review were selected on the basis of a number of indicators of potentially inappropriate advice. These indicators of potentially inappropriate advice are discussed in more detail at paragraph 64 of this report.

Snapshot of SMSF advice: Step 1

51 To develop a snapshot of the types of investors seeking SMSF advice, we used our compulsory powers to gather the following information:

(a) the investor's name;

(b) the type of financial service provided to the investor (personal advice, general advice, exempt service[25] or execution only);

(c) the number of SMSF members in the fund;

(d) the age of the SMSF members in the fund;

(e) the recommended starting balance of the fund;

(f) the dollar amount of the SMSF invested in cash, fixed interest, Australian shares, international shares, real property and any other asset class;

(g) whether the fund had borrowed to invest;

(h) if the fund had borrowed to invest, the initial borrowing amount;

(i) if the fund had borrowed to invest, the type of investment the borrowed funds were invested in (e.g. commercial property, residential property, structured products, shares or other); and

(j) the name of the representative who provided the financial service.

52 Our snapshot findings are summarised below:

(a) the majority of SMSFs reviewed had two members (84%), followed by single-member funds (15%) and funds with more than two members (1%);

(b) the average age of SMSF members was 52, with the oldest member aged 80 and the youngest member aged 22;

(c) the median recommended fund balance was $300,000, the highest recommended fund balance was $3,953,961, and the lowest recommended fund balance was $10,000;

[25] Regulations 7.1.29 and 7.1.29A of the Corporations Regulations 2001 (Corporations Regulations) provide that certain services are taken not to be financial services under the Corporations Act for licensing purposes.

(d) 18% of SMSFs borrowed money to invest—of these SMSFs, the median amount borrowed was $350,000, the highest amount borrowed was $870,000, and the lowest amount borrowed was $22,803; and

(e) in 98% of cases where funds were borrowed, the loaned funds were for investing in real property.[26]

Selecting files for review: Step 2

53 We used our snapshot findings to select a number of investor files for review.

54 The purpose of our file reviews was to:

(a) test whether gatekeepers were doing a good job in ensuring that only those investors for whom an SMSF was suitable were advised to set up an SMSF; and

(b) explore whether there were weaknesses in the advice-giving process in order to develop some practical tips for improving the quality of SMSF advice in the future.

55 Given the dual purpose of our file reviews, we did not select a random sample of files for review. Instead, we targeted files that looked more likely to contain problems.

56 The majority of files we selected to review had a fund balance of $150,000 or less and included at least one of the following features:

(a) older members (i.e. members at, or close to, retirement age at the time of establishing the SMSF);

(b) members with a low income;

(c) borrowing; and

(d) investment in a single asset class (e.g. real property).

57 We reviewed files from both AFS licensees and accounting firms. As such, not all of the files we reviewed contained personal advice recommendations. In a number of cases, general advice, execution-only services or an exempt service was provided to the investor.

58 Table 2 summarises our file reviews by service type.

[26] From the SMSF advice reviewed, we were unable to ascertain whether the property was residential or commercial.

Table 2: Number of investor files reviewed

Type of service	Number of investor files reviewed	Percentage (%) of investor files reviewed
Personal advice	74	56
General advice	1	1
Exempt service	20	15
No advice—execution only	37	28
Total	**132**	**100**

Source: ASIC file reviews.

Our key findings

59 The key findings of our file reviews were as follows:

(a) The majority of investors who received personal advice received adequate quality advice. We identified, however, a number of areas for improvement in the advice-giving process, as discussed in paragraph 63.

(b) There were concerning pockets of poor advice. Much of this advice involved recommendations that investors set up an SMSF to gear into real property.

(c) There was only one example of general advice provided to an investor and this example complied with the law.[27]

(d) In some cases, there was not strict compliance with the requirements for providing an exempt service: see paragraphs 67–71.

(e) The execution-only services provided to investors were genuine execution-only services where no personal or general advice was provided to investors.

Personal advice file reviews

60 The key findings of our personal advice file reviews are summarised in Table 3.

[27] Advice providers may wish to refer to our guidance on providing general advice in Regulatory Guide 175 *Licensing: Financial product advisers—Conduct and disclosure* (RG 175) and Regulatory Guide 36 *Licensing: Financial product advice and dealing* (RG 36).

Table 3: Overall quality of personal advice files

Quality of advice	Number of personal advice files reviewed	Percentage (%) of personal advice files reviewed
Poor	21	28.4
Adequate	52	70.3
Good	1	1.3
Total	**74**	**100.0**

Source: ASIC file reviews.

61 When conducting our file reviews, we decided that a range of grades was needed to reflect the range in the quality of advice available to investors. This approach is consistent with the approach we took in our 2011 shadow shopping exercise.[28]

62 The quality of advice that we graded as good complied with the law and contained the following elements:

(a) the advice considered all of the investor's relevant information;

(b) the advice provider paid specific attention to the investor's financial situation, needs and objectives, including in relation to their cash flow (income and expenses);

(c) the personal insurance recommendations were well considered and balanced;

(d) the scope of the advice was clearly explained;

(e) the Statement of Advice (SOA) was logical, well structured and easy to follow; and

(f) the investor's file contained a number of useful file notes which demonstrated the advice provider's knowledge of the investor's circumstances.

63 Where we found problems with the advice, it tended to be in the following areas:

(a) the advice was not sufficiently tailored to the investor's circumstances in that it did not show evidence of prioritising the goals and objectives of the investor;

(b) disclosure about product replacement was absent or inadequate;

(c) suitable alternatives to an SMSF were not considered; and

(d) there was inadequate consideration of the investor's long-term retirement planning objectives.

[28] ASIC Report 279 *Shadow shopping study of retirement advice* (REP 279), March 2012.

64 The quality of advice we graded as poor did not comply with s945A of the Corporations Act. The advice resulted in the investor being worse off after having received the advice. Particular problem areas we saw included that:

(a) the SMSF did not meet the financial situation, needs and objectives of the investor and was not suitable for the investor;

(b) the investment strategy recommended was inappropriate and, in some cases, was not affordable;

(c) the use of gearing was inappropriate and exposed the investor to a high level of financial risk;

(d) the investor possessed low levels of financial literacy and was incapable of running an SMSF;

(e) the investor's starting balance was so low that it made an SMSF unviable; and

(f) the insurance advice was inappropriate.

65 Where advice was graded as poor, we will be taking follow-up regulatory action. This may include taking action against an individual advice provider (i.e. a banning) or taking action against an AFS licensee (i.e. licensing action). In some cases, we may take action against both the individual advice provider and the AFS licensee.

66 Based on our reviews, there is room for improvement in the quality of SMSF advice provided to investors. Section C of this report provides some practical tips on how to provide good quality advice to SMSF investors.

Exempt services

67 As part of our SMSF file reviews, we reviewed files from 'recognised accountants'.[29] Recognised accountants who provide financial product advice are exempt from holding an AFS licence if they meet certain requirements while providing an exempt service.[30]

68 An 'exempt service' is provided if:

(a) the person provides advice in relation to the establishment, operation, structuring or valuation of a superannuation fund, other than advice for inclusion in an exempt document or statement; and

(b) the person advised is, or is likely to become:

 (i) a trustee; or

 (ii) a director of a trustee; or

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[29] 'Recognised accountants' refers to members of the Institute of Chartered Accountants in Australia, CPA Australia or the Institute of Public Accountants who comply with their membership professional education requirements: see reg 7.1.29A(2) of the Corporations Regulations.

[30] Regulations 7.1.29(5) and 7.1.29A of the Corporations Regulations.

(iii) an employer sponsor; or

(iv) a person who controls the management;

of the superannuation fund; and

(c) except for advice that is given for the sole purpose, and only to the extent reasonably necessary for the purpose, of ensuring compliance by the person advised with the SIS Act (other than para 52(2)(f)), the SIS Regulations (other than reg 4.09) or the *Superannuation Guarantee (Administration) Act 1992*—the advice:

(i) does not relate to the acquisition or disposal by the superannuation fund of specific financial products or classes of financial products; and

(ii) does not include a recommendation that a person acquire or dispose of a superannuation product;[31] and

(iii) does not include a recommendation in relation to the person's existing holding in a superannuation product to modify an investment strategy or a contribution level; and

(d) if the advice would otherwise constitute financial product advice provided to a retail client—the advice includes, or is accompanied by, a written statement that:

(i) the person providing the advice is not licensed to provide financial product advice under the Corporations Act; and

(ii) the investor should consider taking advice from an AFS licensee before making a decision on a financial product.

69 In some cases, we did not see strict compliance with the exemption. For example, we did not see many examples on file of the written statement described in reg 7.1.29(5)(d) of the Corporations Regulations. This may be because the written statement was provided to investors, but a copy was not retained on file. Accountants relying on the exemption should keep a copy of the written statement on file.

70 Accountants should also remember that the accountants' exemption is limited in scope. For example, if an accountant makes a recommendation that an investor switch their superannuation from an APRA-regulated fund to an SMSF, the exemption will no longer apply and the accountant will require an AFS licence.

71 The accountants' exemption will be removed from 1 July 2016. Recognised accountants operating under the current exemption will need to apply for an AFS licence if they want to continue to give advice on SMSFs after 1 July 2016: see paragraphs 190–195 for more information about the removal of the accountants' licensing exemption.

[31] Regulation 7.1.29(5)(c)(ii) of the Corporations Regulations does not apply to a recommendation by a recognised accountant in relation to an SMSF: see reg 7.1.29A.

C Practical tips for advice providers

Key points

Our review of SMSF advice revealed a number of areas for improvement in the advice-giving process. Given the risks associated with a DIY option, we think there are certain things advice providers and investors should discuss and consider before setting up an SMSF.

In this section, we outline some practical tips that advice providers can use to improve the quality of SMSF advice they provide to investors. These tips are based on the problems we saw in our file reviews.

The examples in this section represent a mix of good and poor advice practices. Many of the examples we use are based on real examples from our file reviews.

We hope advice providers find our tips useful: see Table 6 in the appendix for a complete list. It is important to remember that these tips may be more or less relevant depending on the investor's circumstances, and that all advice is subject to a number of legal requirements, such as the requirement in s945A of the Corporations Act to give appropriate advice.

Note: From 1 July 2013, under Div 2 of Pt 7.7A of the Corporations Act, advice providers providing personal advice to retail clients must comply with the 'best interests duty' and related obligations. These obligations have been introduced as part of the Government's Future of Financial Advice (FOFA) reform package to improve the quality of financial advice received by retail clients.

The obligations in Div 2 of Pt 7.7A replace the 'suitability of advice' requirements in s945A and 945B. Until 1 July 2013, AFS licensees can either elect to comply with the new requirements in Pt 7.7A or continue to comply with the 'suitability of advice' requirements in s945A and 945B.

Because the advice files reviewed were subject to the 'suitability of advice' requirements, our report focuses on these requirements instead of the new best interests duty and related obligations.

For more information on the new obligations, see Regulatory Guide 175 *Licensing: Financial product advisers—Conduct and disclosure* (RG 175), Regulatory Guide Regulatory Guide 244 *Giving information, general advice and scaled advice* (RG 244), and Regulatory Guide 246 *Conflicted remuneration* (RG 246).

Role and obligations of SMSF trustees

72 Deciding to become a trustee of an SMSF is not a decision to be taken lightly. Being a trustee of an SMSF carries duties and responsibilities which are serious and wide ranging. While many potential SMSF investors are aware that setting up an SMSF will require them to take control of the fund's

investment decisions, trustees need to understand that there are a number of other responsibilities and obligations that they must meet on an ongoing basis.

73 From our review of SMSF advice files, it is clear that trustee duties and obligations are discussed to varying degrees by advice providers. Given the significant responsibilities associated with establishing an SMSF, we think there is room for improvement in this disclosure to investors.

74 Of particular note, we found that, in nearly half of the files reviewed, investors were not told that:

(a) the trustee is required to put in place, document and regularly review the fund's investment strategy;

(b) trustees are responsible for the fund even when they outsource functions;

(c) managing an SMSF takes more time and skill than participating in an APRA-regulated superannuation fund; and

(d) restrictions apply to SMSF investments.

75 We expect that advice providers who recommend the establishment of an SMSF to investors will explain the duties and obligations attaching to SMSF trustees. Advice providers should also remind investors that it is illegal to use an SMSF to allow SMSF members to gain early access to their superannuation savings. Advice providers should refer investors to the ATO's guidance on accessing superannuation.[32]

76 Advice providers should also explain that each trustee is liable for managing the SMSF and that there are serious consequences if trustees do not properly fulfil their duties as trustees.

Example 1: Trustee duties—The consequences of getting it wrong

In 2011, the Administrative Appeals Tribunal (AAT) delivered a decision in *Shail Superannuation Fund v Commissioner of Taxation* [2011] AATA 940. The AAT found that Mrs Shail, a trustee of the SMSF, was liable for the actions of her estranged husband in illegally transferring nearly all of their SMSF money offshore without her knowledge or consent. This act left Mrs Shail liable for nearly $3 million in additional tax and penalties.

While the AAT was sympathetic to Mrs Shail's situation as an individual, it affirmed the ATO's decision, making the point that 'any appearance of unfairness to the trustee as an individual should not, however, obscure the nature of the fund, the role of trustees or the regulatory regime within which they function'.

[32] ATO, *Guide to self-managed superannuation funds*, 'Accessing your super', viewed 27 March 2013, http://www.ato.gov.au/superfunds/content.aspx?menuid=0&doc=/content/00251857.htm&page=37&H37.

Tips for advice providers—Role and obligations of SMSF trustees

C1 The ATO regulates SMSFs and provides a number of useful publications on its website about the obligations and duties of trustees in managing an SMSF.[33] As good practice, you should:

(a) direct investors to the relevant pages on the ATO website; or

(b) provide investors with a copy of key ATO publications with their SOA to ensure investors understand their obligations.

C2 You should explain to investors the duties and obligations that each trustee has to meet by law: see Table 6 in the appendix (under C2) for further details about these obligations.

C3 You should explain to investors that, within 21 days of becoming an SMSF trustee, they will need to complete the ATO's trustee declaration.

C4 You should walk investors through the ATO's trustee declaration, explain each obligation and duty, and allow investors to ask any questions about their obligations.

C5 If you do not adequately understand the role and obligations of SMSF trustees, it is inappropriate for you to advise investors about SMSFs.

Suitability of an SMSF structure

77 It is important to remember that SMSFs are not a suitable retirement savings structure for every investor.

78 Before setting up an SMSF, advice providers and investors should discuss:

(a) whether the investor's fund balance is enough to justify setting up an SMSF;

(b) the annual costs associated with setting up and running an SMSF;

(c) the time associated with running an SMSF;

(d) the financial literacy skills required to run an SMSF; and

(e) whether the investor possesses any special characteristics that may make an SMSF structure inappropriate.

Fund balance size

79 One of the key issues that advice providers need to discuss with investors interested in an SMSF is the appropriate level of resources required before establishing an SMSF. In particular, investors need to understand the disadvantages associated with setting up a low balance fund.

[33] ATO: *Self-managed super funds—Key messages for trustees* (NAT 71128), December 2012; *Thinking about self-managed super* (NAT 72579-11.2011), November 2011; *Running a self-managed super fund—Your role and responsibilities as a trustee* (NAT 11032-10.2011), October 2011.

80 Where a fund balance is so low that it makes the SMSF unviable, we expect the advice provider to refuse to set up the SMSF.

81 In late 2012, ASIC commissioned Rice Warner Actuaries to examine the fund balance at which an SMSF will be cost-effective compared with an APRA-regulated fund. Rice Warner found that the cost-effectiveness of an SMSF is very much affected by the amount of work the trustee is prepared to do themselves in administering the fund. As such, there will be a range of fund balances at which an SMSF will be cost-effective compared with an APRA-regulated fund.

82 We intend to release Rice Warner's report along with a consultation paper on the issue of costs in the next few months. The purpose of the consultation paper is to better explore the issues in relation to costs rather than to seek to mandate a minimum fund balance for SMSFs.

83 It is worth nothing that, in our file reviews, we found that there was often a reasonable explanation for the establishment of a lower balance SMSF, including:

(a) the investor's financial situation, needs and objectives in setting up the fund;

(b) the investor's ability to transfer additional money into the fund;

(c) the investor's ability to contribute more to the fund;

(d) the investor's willingness to take on some of the administration of the fund;

(e) a low-cost investment strategy being implemented by the investor (i.e. cash and term deposit investments). We saw very few instances of platforms being recommended and used by lower balance SMSFs; and

(f) the relatively high costs of some investors' APRA-regulated funds.

84 For older investors, it will often be appropriate for the advice provider to revisit the issue of fund balance size. SMSFs will generally have a reduced asset balance size as investors progress through retirement. This is because, as investors age, they are required to make minimum pension drawdowns.[34] It may be beneficial for these investors to move out of the SMSF sector.

85 Cost is just one of the many factors that need to be considered when deciding whether an SMSF is an appropriate retirement savings vehicle for an investor. Other factors that are equally relevant include whether the investor is comfortable with taking on the responsibility, time commitment and risks associated with managing their own superannuation. For many investors, including those with high superannuation balances, an APRA-regulated superannuation fund may be a more attractive superannuation vehicle than an SMSF.

[34] ATO, *Pension standards for self-managed super funds*, 8 February 2012, viewed 6 March 2013, http://www.ato.gov.au/content/00120916.htm.

Example 2: Appropriate establishment of a low balance SMSF

Scenario

An AFS licensee conducted its regular review of advice files with a focus on SMSF advice. The licensee reviewed a file for a couple in their 40s who sought financial product advice on all aspects of their financial situation. The SOA recommended the investors set up an SMSF by rolling over their existing superannuation balance of $87,000.

At first glance, and based on the investors' existing superannuation balance alone, the licensee thought the advice appeared to be inappropriate. However, a thorough review of the advice file and SOA revealed that the investors:

- were both professionals, with a combined income of $700,000;
- had multiple trust and company structures established;
- in addition to their family home, had multiple investment properties, including a rural property. They also had debt relating to these investments—however, the value of investments far exceeded their level of debt;
- had lower superannuation balances than expected, given their age and income, because they were self-employed. Accordingly, the investors had not been required to make compulsory superannuation contributions and had only made irregular voluntary contributions in the past;
- had minimal levels of insurance; and
- had a cash flow surplus and were seeking advice to ensure they were making the most of all their financial opportunities.

The SOA had also recommended that the investors fully utilise their concessional contributions cap and transfer their rural property (valued at $600,000 and held in their personal names) into their SMSF.

A complete review of the advice file revealed that, although the starting balance of the SMSF was low, the advice was appropriate because:

- the recommendations in the SOA ensured that the fund would quickly build to a cost-effective level;
- the investors already had corporate structures and were familiar with arranging their finances in this manner; and
- the SOA covered issues such as information about product replacement, insurance, estate planning, cash flow and efficient debt management.

The licensee was able to efficiently complete its review because the advice file was easy to follow, contained a full fact find and detailed file notes, and the SOA was clear, concise and easy to read.

Commentary

The advice was appropriate because the investors' personal circumstances demonstrated they had experience with different assets and investment structures. They also had the ability to build the SMSF balance quickly and ensure that the SMSF would be cost-effective for them over their lifetime.

The cost of running an SMSF

86 There are a number of unavoidable costs associated with setting up and running an SMSF. Advice providers and investors should discuss these costs before setting up an SMSF.

87 Some examples of common legal and related establishment costs include:

(a) preparing the trust deed;

(b) preparing and lodging ATO application forms;

(c) applying for bank accounts;

(d) developing an investment strategy;

(e) preparing and lodging a notice of election to become a regulated fund; and

(f) obtaining insurance coverage (if required).

88 There are also additional costs associated with a corporate trustee of an SMSF, including:

(a) searches and reservations of company names;

(b) preparing company constitutions and memoranda of articles of association;

(c) incorporation and registration of company fees; and

(d) obtaining legal advice on the corporations law and compliance obligations.

89 There are a number of annual compliance and administration costs that may be incurred in operating an SMSF. These may include:

(a) statutory charges;

(b) financial statements and tax returns; and

(c) audits.

90 Advice providers should discuss these categories of costs with investors and provide investors with an estimate of these costs before an SMSF is established.

Financial literacy

91 The risks associated with a trustee's lack of financial literacy are potentially magnified in an SMSF.

92 SMSF trustees have a duty to exercise skill, care and diligence in managing an SMSF, and therefore need to possess a sufficient level of financial literacy to manage the fund and make investment decisions in line with the fund's investment strategy. While SMSF trustees can use external research

and advice to develop their financial knowledge over time, they remain responsible for ensuring that investment decisions are made and implemented in line with the fund's investment strategy.

93 In our file reviews, we saw some examples of advice providers recommending the establishment of an SMSF even though the investor had asked for a simple and low-maintenance superannuation solution. On the face of it, we consider this to be inappropriate advice.

94 We also saw several examples of advice providers recommending an SMSF despite the fact that it was clear that the investor was not adequately managing their personal financial affairs.

95 If an investor is struggling with their personal financial affairs, it will be inappropriate, on the face of it, to recommend that the investor set up an SMSF.

Example 3: Investor with a low level of financial literacy

Scenario

An investor met with an advice provider to discuss their retirement goals and setting up an SMSF. The advice provider analysed the investor's financial situation and identified that the investor was not on track to satisfy their retirement goals.

The advice provider's first recommendation to the investor was to repay a persistent and large credit card debt that the investor had been unable to get under control for a number of years. The advice provider noted that, on numerous occasions, the investor had neglected to make the required monthly payment on the credit card.

Commentary

An advice provider should be alert to signals from investors that they may not have the time or the financial literacy skills needed to manage an SMSF. In the above example, given that the investor was struggling to manage their personal financial affairs, it was extremely unlikely that the additional responsibilities of an SMSF would have been appropriate for the investor.

SMSF succession planning

96 An important consideration for investors when considering whether to establish an SMSF is the issue of succession planning. In our file reviews, we saw evidence of two 80-year-old investors establishing an SMSF. In this case, there was no discussion of succession planning issues.

97 An SMSF is a long-term retirement savings vehicle—however, unexpected events such as illness, unemployment or death can occur. Trustees should think about the succession planning steps they need to put in place to deal with these situations.

98 Where there is one trustee more heavily involved in the day-to-day running of an SMSF (e.g. a husband managing the SMSF on behalf of a married couple), we expect the less active trustee (e.g. the wife) to have considered and planned for what they will do if the controlling trustee becomes unable to manage the SMSF.

Tips for advice providers—Suitability of an SMSF structure

C6 You should discuss the investor's fund balance size and whether it is likely to be cost-effective for the investor to set up an SMSF. Cost is just one factor to consider and does not mean by itself that an SMSF will be appropriate or inappropriate for the investor.

C7 You should discuss the likely costs associated with running an SMSF, including the costs of establishment, ongoing investment management, compliance and advice, and explain these costs to the investor before making a recommendation to establish an SMSF.

C8 Before recommending an SMSF, you should consider the investor's ability and willingness to manage the fund and meet their trustee obligations on an ongoing basis.

C9 Be aware of 'red flag' indicators that may suggest an SMSF will not be suitable for an investor, including, but not limited to:

- (a) a low fund balance where the members have a limited ability to make future contributions;
- (b) the investor wants a simple, low-touch superannuation solution;
- (c) the investor wants to delegate decision making to someone else;
- (d) the investor does not have a lot of time to devote to managing their financial affairs;
- (e) the investor has little investment decision-making experience;
- (f) the investor, or suggested trustee, is an undischarged bankrupt or has been convicted of an offence involving dishonesty (as such, persons are prohibited from acting as a trustee); and
- (g) the investor has a low level of financial literacy.

C10 You should explain to investors approaching the pension phase that there may be a point at which the SMSF may cease to be cost-effective because fixed costs will remain constant or increase while the balance of the fund diminishes.

C11 Where appropriate, you should discuss SMSF succession planning issues with investors (this will be more relevant for older investors). Some key questions to discuss include:

- (a) For investors who are individual trustees, what will happen if one of the trustees dies?
- (b) If one trustee (the controlling trustee) is more actively involved in the day-to-day management of the SMSF, what will the less active trustee do if the controlling trustee is unable to manage the SMSF?

Risks of an SMSF structure

99 There are a number of risks associated with setting up an SMSF. Advice providers and investors need to discuss and consider these risks before establishing an SMSF.

100 The key risks we think advice providers need to draw to the investor's attention are the risks associated with:

(a) not having access to a statutory compensation scheme in the event of theft or fraud (see paragraphs 102–107);

(b) reduced access to dispute resolution bodies to resolve complaints (see paragraphs 108–111);

(c) using individual trustees as opposed to a corporate trustee (see paragraphs 112–116);

(d) a breakdown in the relationship of fund members (discussion of this point is more important where the membership structure of an SMSF is unusual) (see paragraphs 117–120); and

(e) inappropriate insurance coverage (see paragraphs 121–140).

101 There may be additional risks that need to be discussed with the investor, depending on their individual circumstances.

Lack of statutory compensation in the event of theft or fraud

102 Unlike members of APRA-regulated superannuation funds, SMSF investors are not entitled to receive compensation under the SIS Act in the event of theft or fraud. Part 23 of the SIS Act makes provision for financial assistance to superannuation funds regulated by APRA that suffer loss as a result of theft or fraud—however, this does not extend to SMSFs.

103 Following its inquiry into the collapse of Trio Capital, the PJC noted in its report that most SMSF investors in Trio were unaware that protections available to superannuation fund members under the SIS Act were not extended to SMSF members.

104 Following Trio's collapse, the PJC recommended that ASIC examine gatekeepers' advice to SMSF investors to see whether the investors were informed that they were not entitled to compensation in the event of theft or fraud.

105 ASIC found limited evidence of the appropriate warning having been provided to Trio investors.

106 We also examined this issue in our review of SMSF advice and found that, when advising investors to set up an SMSF, very few advice providers warned investors about the lack of compensation available. It is of concern

that investors were not warned about the very real risk of not having access to a statutory compensation scheme in the event of theft or fraud. This will be a future area of focus for us. We expect to see advice providers warning investors about this risk.

107 Investors need to consider this risk when determining whether or not an SMSF is the right superannuation vehicle for them. SMSF trustees should also be alert to the risk of theft or fraud when making investment decisions for the fund.

Reduced access to dispute resolution bodies

108 Unlike members of APRA-regulated superannuation funds, SMSF members do not have access to the Superannuation Complaints Tribunal (SCT) to resolve complaints.

109 The SCT was established under the *Superannuation (Resolution of Complaints) Act 1993* to deal with complaints about the decisions and conduct of trustees and other decision makers in relation to superannuation. However, this Act does not apply to SMSFs, and the SCT has no jurisdiction to deal with complaints about SMSFs.

110 Licensed advice providers must be members of an ASIC-approved external dispute resolution (EDR) scheme. If an investor suffers financial loss due to fraudulent conduct, theft or inappropriate advice by their advice provider, the investor may have access to the advice provider's EDR scheme (provided that the advice provider has maintained their membership, as required by law[35]).

111 If issues or disagreements arise about how the SMSF is being managed, it is up to SMSF members to sort these issues out between themselves or seek legal advice (which can be costly).

Individual trustees versus a corporate trustee

112 Before setting up an SMSF, advice providers and investors should discuss the advantages and disadvantages associated with having a corporate trustee versus an individual trustee.

113 There are a number of benefits associated with having a corporate trustee, including:

(a) limited liability for directors;

(b) simpler segregation of SMSF assets;

(c) administration efficiencies for changes in members;

[35] Section 912A(2)(b) of the Corporations Act.

(d) simpler trustee succession (i.e. a corporate trustee will continue in the event of a member's death); and

(e) access to limited recourse borrowing because lenders often insist an SMSF has a corporate trustee.

114 Despite these benefits, almost 75% of all SMSFs had individual trustees as at 30 June 2012.[36]

115 The ATO has published information on this issue and we suggest that advice providers draw the information to the attention of investors.[37]

116 In our SMSF advice file reviews, we saw little evidence that the issue of corporate versus individual trustees was discussed with investors.

Relationship breakdown

117 Most SMSFs are established as two-member funds. Typically, they are husband and wife funds.

118 In our review of SMSF advice, we saw some atypical examples of SMSF member relationships, including:

(a) four friends;

(b) two unrelated couples;

(c) business partners; and

(d) adult siblings.

119 While no relationship is risk free, we think that certain relationships, such as those listed above, are at higher risk of failing.

120 Where the membership structure of an SMSF is unusual, the advice provider may need to spend more time discussing the risks of relationship breakdown with investors, and whether those risks are best mitigated, managed or avoided.

[36] ATO 2010–11 overview,'Trustee structure', http://www.ato.gov.au/superfunds/content.aspx?menuid=49150&doc=/content/00341497.htm&page=11&H11.
[37] ATO, *Guide to self-managed super funds,* 'Step 2: Work out the structure of your fund', 12 March 2013, http://www.ato.gov.au/superfunds/content.aspx?menuid=0&doc=/content/00251857.htm&page=12&H12.

Example 4: Four friends set up an SMSF

Scenario

Four friends, all aged in their early 30s, decided to consolidate their combined superannuation to set up an SMSF. They knew this was a big financial decision so they decided to seek financial advice.

They met with an advice provider who explained to them the risks and benefits that generally apply when establishing an SMSF. In addition, the advice provider explained that they would all be trustees of the fund and would be responsible for:

- the SMSF's investment strategy;
- administering the SMSF; and
- funding their eventual retirements out of fund money.

The advice provider explained that, because the proposed membership structure was unusual, the four friends should consider whether they still wanted to proceed with an SMSF and, if so, what steps they would put in place to mitigate against the risk of a relationship breakdown (i.e. have a clearly documented investment strategy and an SMSF trust deed with dispute resolution clauses).

Following the initial consultation with the advice provider, the four friends decided not to proceed with the SMSF.

Commentary

SMSFs should be viewed as a long-term investment for retirement. Unbundling SMSF investments following a relationship breakdown may be difficult and may have legal and taxation consequences.

All trustees are responsible and accountable for running the fund and making decisions. Investors need to be aware that they are jointly liable for the fund: see paragraphs 72–76 for further information about a trustee's obligations.

Inappropriate insurance coverage

Getting insurance wrong

121 According to a recent report released by the ATO, only 0.25% of SMSFs hold insurance coverage.[38] The reason for this may be that many members hold insurance outside their SMSF. However, in some cases, SMSF members may not realise that they have lost insurance benefits by switching from an APRA-regulated fund to an SMSF.

122 The potential loss of insurance benefits is an important issue that advice providers and investors should discuss before setting up an SMSF. Investors who switch all of their superannuation money out of an APRA-regulated

[38] ATO 2010–11 overview, Table 15: 2011 SMSF asset allocations, http://www.ato.gov.au/superfunds/content.aspx?menuid=49150&doc=/content/00341497.htm&page=43&H43.

fund and into an SMSF need to understand that they will be uninsured unless they purchase a new insurance policy.

123 Advice providers should also note that from 7 August 2012 it has been a requirement that trustees of an SMSF consider insurance for fund members as part of the fund's investment strategy.[39]

124 In our file reviews, we identified a number of areas where insurance advice could be improved. Problem areas included:

(a) discussing insurance after, and not before, an SMSF had been established;

(b) inappropriately excluding insurance from the scope of the advice;

(c) keeping some money in an APRA-regulated fund for insurance purposes without discussing the advantages and disadvantages of this approach; and

(d) some small pockets of over-insurance.

Discussing insurance before establishing an SMSF

125 Advice providers and investors should discuss insurance issues before setting up an SMSF. This is because insurance considerations may affect an investor's decision to set up an SMSF.

126 Before setting up an SMSF, advice providers and investors should discuss:

(a) the investor's current level of insurance;

(b) their required level of insurance in the future; and

(c) how best to implement the right insurance strategy. Where this involves a change to the investor's existing insurance arrangements, this will involve comparing the costs and benefits or disadvantages of changing the investor's insurance: see paragraphs 161–164 for information about product replacement.

127 It is important to note that, in an APRA-regulated superannuation environment, funds may have access to competitive insurance premium rates, such as group insurance policies and discounts. These will often be unavailable to members of an SMSF and may mean that each SMSF member needs to be individually assessed for insurance purposes. This may lead to potentially higher premiums, loadings, exclusions or refusals of insurance for investors. It is important that advice providers explain the risk of investors not being accepted on similar insurance terms to their APRA-regulated superannuation fund if they choose to move to an SMSF.

[39] Regulation 4.09(2)(e) of the Superannuation Industry (Supervision) Regulations 1994, as amended by the Superannuation Industry (Supervision) Amendment Regulation 2012 (No. 2).

128 If the advice provider does not have the necessary expertise to advise the investor on insurance issues, they should communicate this to the investor, refer the investor to an insurance specialist with the expertise to provide the advice, and wait until the investor has received the insurance advice before setting up an SMSF.

Inappropriately excluding insurance from the scope of advice

129 In our advice reviews, we saw examples of advice providers identifying an insurance need, but inappropriately excluding insurance from the scope of the advice.

130 Where an advice provider identifies insurance as an advice need, they must deal adequately with the investor's insurance needs before setting up an SMSF.

Example 5: Inappropriately excluding insurance from the scope of advice

Scenario

An investor in their mid-40s with financial dependants sought advice on their superannuation arrangements. The advice provider recommended an SMSF.

The advice in the SOA provided general information on the importance of having adequate personal life insurance, but did not provide any personal recommendations to the investor.

Commentary

Providing general or educational information in an SOA is not a substitute for providing appropriate personal advice recommendations.

Appropriately excluding insurance from the scope of advice

131 In some situations, it may not be necessary for an advice provider to discuss insurance issues with an investor. For example, an investor may inform the advice provider that they have insurance outside their superannuation and do not require any additional insurance.

132 Where insurance is excluded from the scope of SMSF advice, the advice provider needs to make it clear to the investor that no insurance advice is being provided and explain the potential downside, if any, to the investor by choosing not to receive advice on this aspect of their personal circumstances.

Example 6: Investor declines to receive insurance advice

Scenario

A couple in their late 50s seeking advice to set up an SMSF contacted an advice provider. They had life insurance outside their superannuation and told the advice provider they did not wish to receive advice on this topic.

The advice provider gave the investors advice on the relevant issues and confirmed the investors' instruction not to provide life insurance recommendations. The advice provider also explained the risks to the investors of not receiving advice on life insurance.

Commentary

The advice provider used their judgement to assess the impact for the investors of excluding advice on this topic, and provided a clear explanation to the investors about the risks of this decision.

Keeping some insurance in an APRA-regulated fund

133 To qualify as an eligible choice fund that can accept superannuation guarantee contributions, a fund must offer a minimum level of life insurance cover.

134 This means that the vast majority of Australians currently have some insurance cover through their APRA-regulated superannuation.

135 Because of their size, most APRA-regulated superannuation funds are able to access competitive insurance premium rates. As such, retaining insurance through an APRA-regulated fund may be appropriate in some circumstances. Before considering this approach, however, the advice provider should:

(a) consider the investor's insurance needs and circumstances;

(b) discuss with the investor the costs and disadvantages associated with having membership of more than one superannuation fund (i.e. an SMSF and an APRA-regulated fund);

(c) explain the risk that the balance in the APRA-regulated superannuation fund may reduce to a point where there is no member benefit left to pay the insurance premium, requiring the investor to make arrangements to cover the shortfall; and

(d) explain that the insurance in the APRA-regulated fund may have eligibility requirements that may be compromised by moving money to an SMSF.

Over-insurance

136 There may be situations where the investor needs additional insurance, but the insurance recommended by the advice provider is more than the investor can afford.

137 In our advice reviews, we found that only a small number of investors received an insurance recommendation before setting up an SMSF, and some investors were advised to take out too much insurance.

138 When recommending insurance, the advice provider needs to consider the investor's overall financial situation and discuss realistic insurance options with the investor.

139 Where there are shortcomings in the insurance recommended because of the investor's inability to pay, the advice provider should discuss the advantages and disadvantages of the recommended strategy.

140 The advice provider should decline to give advice if the recommended strategy would be inappropriate for the investor.

Example 7: Over-insurance

Scenario

A couple in their early 50s approached an advice provider for SMSF advice. After reviewing their financial position, the advice provider recommended establishing an SMSF and advised the investors that they were underinsured.

The advice provider entered the details of the investors' income, asset and liabilities into an insurance needs calculator to determine the level of life, total permanent disability (TPD), income protection and trauma insurance required.

The advice provider recommended that the couple purchase life, TPD, income protection and trauma insurance for both SMSF members (with the life and TPD to be owned by the SMSF). The combined cost of the recommended insurance was $24,000 per year and the investors could not afford this level of cover.

Commentary

In this example, the risk insurance advice was inappropriate. The advice was provided without taking into account the investors' ability to pay for the risk insurance and contribute to their retirement goals.

Tips for advice providers—Risks of an SMSF structure

C12 You should warn investors looking to set up an SMSF about the lack of Government compensation available to SMSFs. This information will help investors properly weigh up whether an SMSF structure is right for them.

C13 You should warn investors that SMSF trustees and members do not have access to the Superannuation Complaints Tribunal (SCT) to resolve complaints.

C14 You should explain the advantages and disadvantages of establishing an SMSF with a corporate trustee versus individual trustees, and provide investors with relevant ATO publications via hard copy or web-links.

C15 If the investor's proposed membership structure of an SMSF is unusual, you may need to spend more time discussing the duties and obligations of trustees, the risks associated with the membership structure, and the importance of having a well-documented, specific investment strategy and a trust deed that contains dispute resolution clauses.

C16 You should reiterate the role and responsibilities of trustees, and explain that, even if one trustee is less actively involved, they are equally liable for the SMSF's compliance with the superannuation and tax laws.

C17 When you recommend an SMSF to an investor, you will need to discuss their insurance needs. This will often involve discussing:

(a) their existing insurance coverage;

(b) the level of insurance coverage they will need in future;

(c) the cost and options for maintaining, increasing or decreasing (as appropriate) their existing insurance coverage through an SMSF;

(d) whether the investor has any health issues that may affect their ability to get insurance coverage;

(e) the advantages and disadvantages of retaining a portion of their APRA-regulated superannuation for insurance purposes (if considered appropriate); and

(f) the impact of the insurance recommendation on the investor's SMSF balance.

C18 If you identify an investor needs advice on insurance, you must consider and advise the investor on their insurance needs before recommending an SMSF be established. If you do not have the necessary expertise to provide insurance advice, you should notify the investor and refer the investor to an advice provider who has the expertise to provide the advice.

Investment strategy

141 The most common reason cited by existing SMSF investors for setting up an SMSF is to have more control over their investments.[40] The benefits of control can include the ability to:

(a) develop a tailored investment strategy;

(b) be directly involved in making investment decisions; and

(c) invest in some investments that may not be available in an APRA-regulated superannuation fund.

142 While these advantages of SMSFs appeal to many potential SMSF investors, formulating and implementing an appropriate investment strategy is a serious responsibility.

[40] Investment Trends 2012 report, volume 2 of 3, p. 16.

143 SMSF trustees have an obligation to ensure the SMSF's money is invested appropriately and for the sole purpose of saving for retirement. To achieve this, the law requires that trustees prepare, implement and regularly review the SMSF's investment strategy. The investment strategy should be designed to deliver the level of returns required to adequately fund investors' retirement, taking into account:

(a) the members' financial situation, needs and circumstances (e.g. their age and retirement needs);

(b) diversification by investing in a range of assets and asset classes;

(c) the risk and likely return from investments, to maximise member returns;

(d) the liquidity of the fund's assets (how easily they can be converted to cash to meet fund expenses); and

(e) the fund's ability to pay benefits when members retire and any other costs the fund incurs.[41]

144 Some SMSF trustees will seek investment advice from an advice provider. When a trustee receives advice on an SMSF investment strategy, it is important to remember that the trustee remains ultimately responsible for the investment strategy. SMSF trustees will therefore need to possess a reasonable level of financial literacy (i.e. skills and expertise) to understand the investment decisions they are making on behalf of the members the fund.

Developing an investment strategy

145 When developing an investment strategy for an SMSF, advice providers and trustees should give consideration to:

(a) the needs of all SMSF members;

(b) the need for regular income to cover the expected costs and benefit payments for the SMSF;

(c) the preservation of trust assets required by the fund members;

(d) the capital growth required by fund members;

(e) the need for liquidity above the provision of regular investment income;

(f) the need for diversification of fund assets;

(g) the individual investment and behavioural biases of fund members; and

(h) excluding certain investments considered outside of the risk tolerance of fund members.

[41] ATO, *Guide to self–managed superannuation funds—Your investment strategy*, http://www.ato.gov.au/superfunds/content.aspx?menuid=0&doc=/content/00251857.htm&page=22&H22.

Investment diversification

146 Diversification is an important consideration for an SMSF investment strategy because it can improve the risk and return profile of the SMSF. A diversified investment strategy can help reduce risk, while an undiversified investment strategy magnifies risk. We expect advice providers to explain the importance of a diversified SMSF investment strategy to investors.

147 If an investor specifically requests advice on a single asset class, advice providers should provide a clear and unambiguous warning to the investor about the risks associated with an undiversified portfolio. Where advice on a single asset class would be inappropriate for the investor, the advice provider should refrain from providing advice: see paragraphs 152–157.

148 Investors need to be aware that, if setting up an SMSF with a lower balance, it can be more difficult to achieve investment diversification because there is less money to invest.

149 In our review of SMSF advice, we saw several instances of investors receiving advice to set up an SMSF to invest in a single asset class, or even in a single asset (e.g. real property). Having an undiversified investment strategy poses a significant risk for investors if there is a reduction in their investment's performance.

150 We consider that an SMSF should generally be diversified across a number of asset classes—the most common being cash, fixed income and shares. We expect that the spread of these investments will change over time as the circumstances of the fund members change: see paragraphs 158–160 on preparing for retirement.

151 Advice providers should explain to investors that there are restrictions on SMSF investments, which prohibit:

(a) lending fund money or providing financial assistance to a member of the fund or a member's relative;

(b) acquiring assets[42] for the fund from members or other related parties of the fund;

(c) borrowing money (or maintaining an existing borrowing) on behalf of the fund except in certain limited circumstances (e.g. limited recourse borrowing arrangements);

(d) 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 (e.g. loans to, or investments in, related parties of the fund); and

(e) entering into investments on behalf of the fund that are not made or maintained on an arm's length (commercial) basis.[43]

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[42] Other than business real property, listed securities, certain in-house assets and acquisitions made under mergers allowed by special determinations or acquisition as a result of the breakdown of a relationship: see ATO, *Trustee declaration,* December 2012 (NAT 71089-12.2012).

Investing in real property

152 In our review of personal SMSF advice files, we found that 35% of SMSFs made a geared real property investment.

153 Given the high upfront investment costs associated with many real property investments, limited recourse borrowing is often used to fund the real property purchase.

154 We consider limited recourse borrowing arrangements are often long-term investments and will generally not be appropriate for older investors, particularly where those investors have no other retirement savings and have a low superannuation balance.

Example 8: Inappropriate SMSF advice to invest in a single asset

Scenario

A married couple aged 55 and 53 approached an advice provider for financial advice. They had a home loan of $220,000, personal debts of $28,000 and a combined superannuation balance of $135,000.

The couple sought advice about:

- repaying their debts as quickly as possible; and
- budgeting so they could afford a holiday in 12 months time.

During their discussions with the advice provider, it became clear that:

- the wife had some health issues (non life threatening) and may need to reduce her work hours;
- the couple had a cash flow deficit of $5,000 per year;
- the couple were financially unsophisticated; and
- the couple wanted to retire at age 60, but expected to work until age 65.

The advice provider recommended that the investors:

- roll over their existing superannuation into an SMSF;
- use a limited recourse loan to borrow $195,000 to purchase a $300,000 (plus costs) investment property; and
- increase their current annual salary sacrifice contributions from $3,215 to $6,340 to assist with funding the recommended SMSF strategy.

The estimated costs of the SMSF recommendation were $22,000, which included set-up costs, an advice implementation fee and stamp duty. The annual ongoing costs of running the SMSF were $7,000, which included SMSF administration, regulatory fees and real property expenses. These costs were considerably more expensive than the combined costs of the investors' current employer superannuation funds.

[43] ATO, *Trustee declaration*, December 2012, (NAT 71089-12.2012) and ATO, *Guide to self-managed superannuation funds*, 'Restrictions on investments', viewed 27 March 2013, http://www.ato.gov.au/superfunds/content.aspx?menuid=0&doc=/content/00251857.htm&page=23&H23.

Commentary

The advice was inappropriate. The investors did not receive the advice they sought and instead received advice on a strategy where the fees would erode the potential benefits based on their timeframe of 10 years until retirement. If they retired at age 65, they would still have a debt on the SMSF property and would need to consider selling a potentially illiquid asset to meet pension payments. The investors would be unable to contribute more to their superannuation, given their current cash flow problems and the wife's reduction in hours due to health problems. The investors would have been better off staying in their existing APRA-regulated fund.

155 In our review of SMSF advice, we identified at least one advice provider with a bias towards recommending the set-up of an SMSF for direct real property investment. This had the effect of predetermining the advice that was provided to investors, without adequate consideration of each investor's individual relevant circumstances and objectives.

156 When advising investors to set up an SMSF that invests directly in real property, the advice provider must set out in the SOA the basis for the advice, including the personal circumstances relevant to the investor that make the recommended strategy appropriate.

157 We expect that an SOA will set out the advantages, disadvantages and special characteristics associated with the SMSF investing in real property, including:

(a) the impact (benefits and risks) of leveraging an investor's superannuation savings to purchase an asset that an investor's fund could not ordinarily afford;

(b) the concessional tax rate available to income received from an SMSF holding a beneficial interest in an asset acquired under a limited recourse borrowing arrangement;

(c) the high upfront costs of purchasing the real property (e.g. stamp duty, loan fees, estate agent location fees);

(d) the ongoing costs of managing and maintaining the real property (e.g. repairs, improvements, agent costs, rates, insurance);

(e) that the real property may be illiquid and difficult to sell quickly if the investor requires it to be converted to cash or requires liquid funds to pay a retirement pension or death benefit;

(f) the risk that the real property may become untenanted or suffer damage; and

(g) the risk that the value of the real property may decrease.

Example 9: Advice on establishing an SMSF to invest in real property

Scenario

A couple in their early 50s received advice on establishing an SMSF. The advice provider discussed the various investment options and asset classes available to the SMSF. The investors informed the advice provider that they were experienced real property investors, having acquired three investment properties in their personal name, and that they now wished to use their superannuation savings to purchase a further investment property with the assistance of gearing.

The advice provider undertook further inquiries and determined that the investors:

- owned their home outright and had no dependants;
- had an investment property portfolio totalling $1 million, with investment loans of $800,000 and 20 years remaining on the term of the loans;
- had combined superannuation totalling $200,000 to which they only contributed superannuation guarantee contributions;
- earned a combined annual income of $120,000 which only just covered their annual living expenses, tax and the commitments for their investments; and
- intended to retire in 10 years time with a retirement income of $60,000 per year in today’s dollars.

The advice provider immediately identified the following issues for the investors:

- they had no budget, which was limiting their ability to contribute to superannuation and accumulate retirement savings;
- they had no plan in place to repay their investment loans before retirement;
- the establishment of a real property investment in the SMSF would further increase their outstanding debt and concentrated investment exposure to direct real property; and
- to retire in 10 years with an annual retirement income of $60,000 in today’s dollars, they would require retirement savings of around $1.5 million in 10 years time.

Following a discussion with the investors, it was decided that the SMSF real property investment was not appropriate for the investors.

Preparing for retirement

158 As members of an SMSF grow older, their financial situation, needs and objectives will change. At establishment and through the accumulation phase, a high-growth investment strategy may be in the best interests of some members. However, as those members get older and move towards retirement, their investment strategy will vary and generally become more conservative.

159 At retirement, the SMSF investments will need to be realisable to allow members to make their minimum pension drawdown.

160 Members with undiversified SMSF investments, or single asset investments (e.g. an investment property), face a risk that their investments will not be realisable for their retirement. For example, an SMSF with 100% of funds invested in real property, and providing a rental income of approximately 4%, will only cover the minimum pension drawdown up until age 74.[44]

Tips for advice providers—Investment strategy

C19 You should explain to investors the sole purpose test and the requirement for investments to be made and maintained on an arm's length basis.

C20 When you are advising investors on their SMSF investment strategy, you should explain the benefits of asset diversification and investing across a number of asset classes (e.g. shares, real property and fixed interest products) in a long-term investment strategy.

C21 You should explain to investors that some investments are restricted and that it is the trustee's obligation to ensure that the SMSF does not make restricted investments: see tip C2(i) in Table 6.

C22 You should explain to trustees that they are required to regularly review the fund's documented investment strategy to ensure that it suits the needs of fund members.

C23 If you are recommending that an SMSF be established to invest in a single asset, you should ensure that the SOA adequately documents the basis for the advice in light of the investor's financial situation, needs and objectives. In particular, you should set out why the investment is appropriate, rather than a diversified investment portfolio, and whether the investment will generate a sufficient return to fund the investor's retirement needs and, if not, what the exit strategy is and any costs or risks associated with this exit strategy.

C24 You should explain to investors that the SMSF investment strategy is likely to change as members approach the retirement phase and their needs and circumstances change.

C25 If an investor has a preference towards a real property investment, you should consider whether the real property investment is appropriate.

C26 If you are recommending a real property investment, you should discuss with the investor:

(a) the needs and circumstances of the fund members (e.g. their age and retirement needs);

[44] ATO, *Pension standards for self-managed super funds*, 8 February 2012, viewed 6 March 2013, http://www.ato.gov.au/content/00120916.htm.

(b) if the recommendation involves an investment loan, how long it will take for the investor to repay the loan;

(c) the investor's ability to repay the loan if an unexpected event occurs (e.g. the investor becomes unemployed for a period);

(d) how the investor's retirement will be funded by the real property investment (i.e. through the sale of property or through rental income);

(e) how likely the property can be sold quickly (i.e. whether it is in a high-demand area); and

(f) what the investor will do if the property is not rented for a period.

Note: If the investment property is not the SMSF's sole asset, you may need to spend less time discussing the above issues.

Switching from an APRA-regulated superannuation fund

Inadequate or no disclosure

161 Our surveillance work found a significant lack of compliance with the replacement product obligations set out in s947D of the Corporations Act. In just under half of cases where advice was provided to replace a superannuation product, the file contained inadequate or no information on product replacement.

162 When an advice provider recommends that an investor replace one financial product with another financial product—in full or in part—the advice provider must compare the 'from' fund (i.e. the APRA-regulated fund) with the 'to' fund (i.e. the SMSF): see s947D of the Corporations Act.

163 When an SMSF is being recommended, the advice provider must explain in the SOA, in clear and simple terms, the following information (where it is known or could reasonably be found out):

(a) information about the exit fees or any other charges applying to the withdrawal from the APRA-regulated fund;

(b) the loss of access to rights or benefits (e.g. insurance cover and compensation);

(c) the loss of other opportunities, including incidental opportunities associated with the existing product (e.g. rights or opportunities not presently available to the investor, but which may become available in the future);

(d) the set-up costs and ongoing fees for the SMSF; and

(e) any other significant consequences for the investor in changing their superannuation to an SMSF.[45]

[45] Regulatory Guide 175 *Licensing: Financial product advisers—Conduct and disclosure* (RG 175) at RG 175.160, p. 46.

164 The lack of adequate disclosure about product replacement was a significant factor that contributed to advice being downgraded.

Example 10: Getting disclosure about product replacement right

Scenario

An investor aged 53 sought a retirement health check. He owned his own home, had cash savings of $50,000 and a share portfolio of $40,000. The investor had $350,000 in his superannuation fund, invested in the moderate investment option. He 'salary sacrificed' a portion of his salary into superannuation and wanted to retire at age 63 with an annual income of $40,000.

The investor was happy with his existing superannuation arrangements, but had heard about SMSFs from a colleague and wanted to know more about whether an SMSF was a good option for him.

The advice provider considered the investor's circumstances and confirmed that, if the investor continued on his current path, he would meet his retirement goals. The advice provider gave the investor a detailed comparison of his existing APRA-regulated fund compared with an SMSF, and included the following information:

- details of the costs to exit the investor's existing fund and set up an SMSF;
- a comparison of the annual administration and investment costs;
- a comparison of the investor's current insurance arrangements compared to insurance within the SMSF, including a comparison of premiums. All comparison costs were disclosed in dollars and presented in an easy-to-read and understandable format;
- a balanced comparison of the advantages and disadvantages of both superannuation arrangements; and
- a comparison of other relevant features. For example, the investor's current superannuation fund provided access to discounted banking and health insurance, which the investor used. The fund also had group insurance premium rates, including automatic additional underwriting for life events (these were not important to this investor) and automatic payment of anti-detriment benefits.

The advice provider and investor discussed the advantages and disadvantages of each superannuation arrangement. The SMSF really appealed to the investor because he had an avid interest in finance and markets and saw the time required to administer the SMSF as more of a hobby than a chore. When considering all of the relevant information and investor's personal circumstances and preferences, the advice provider recommended the establishment of an SMSF.

Commentary

This advice was appropriate because the advice provider clearly explained to the investor the relevant information on the existing product and the recommended product, enabling the investor to make an informed decision.

The use of disclaimers

165 In our surveillance, we saw examples of a product replacement waiver form provided to investors, stating that the advice provider had not considered the ‘from’ fund. Such a disclaimer cannot limit an advice provider’s consideration of the ‘from’ fund (i.e. the APRA-regulated fund) if the substance of the advice provider’s advice is, or includes, a recommendation to switch or replace funds.

166 We consider there are legitimate areas for using clear, concise and effective disclaimers in setting the boundaries of advice (e.g. an acknowledgment that an investor is not receiving advice about the disposal of real property in order to invest in superannuation). However, advice providers cannot disclaim their obligation to comply with their legal obligations to know the investor, investigate the subject matter of the advice and to ensure the advice is appropriate for the investor.

Tips for advice providers—Switching from an APRA-regulated superannuation fund

C27 When recommending an SMSF, you will need to explain the charges and significant consequences the investor will, or may, incur as a result of changing (fully or partially) from an APRA-regulated fund to an SMSF.

C28 When discussing the consequences of a switch, you will need to use language and concepts that the investor will understand.

C29 If you assess an investor has a low level of financial literacy, an SMSF will not be an appropriate retirement savings vehicle for the investor.

Alternatives to an SMSF structure

167 If the main reason for establishing an SMSF is to obtain greater investment control, a number of APRA-regulated superannuation vehicles may facilitate this without the need for the investor to take on all the responsibilities and obligations of running an SMSF.

168 For example, a number of APRA-regulated superannuation funds are now offering members a DIY option, where members are able to self-direct part of their retirement savings towards assets such as shares, exchange-traded funds and term deposits.

169 In our SMSF advice reviews, we saw very little discussion of alternative DIY options. This may, however, be because the advice we reviewed was provided in 2011 and there were fewer alternative DIY options available at this time.

Example 11: Purchasing shares with superannuation

Scenario

An investor approached an advice provider about purchasing listed shares with their superannuation. The investor's existing superannuation fund did not provide this option so the investor sought advice about an appropriate alternative that would allow them to purchase listed shares.

The investor undertook their own research and selected a portfolio of blue chip shares that they intended to buy and hold as a long-term investment.

The advice provider determined that the investor was not nearing retirement and was correctly prioritising the repayment of their mortgage. The advice provider appropriately scaled the advice to the recommendation of a superannuation account that suited the specific needs of the investor.

Commentary

The advice provider determined that the needs of the investor were not complex and identified an APRA-regulated superannuation fund that offered all of the features that the investor required at a competitive price.

The advice provider also considered an SMSF for the investor, but decided that it would not be suitable, given that the investor was looking for a simple option and had no desire to be actively involved in the administration of the fund.

The advice provider appropriately recommended the APRA-regulated fund to the investor.

Tips for advice providers—Alternatives to an SMSF structure

C30 Before recommending an SMSF to an investor, you should consider whether an APRA-regulated fund will meet the financial situation, needs and objectives of the investor. Many APRA-regulated funds now offer a DIY investment option.

C31 APRA-regulated funds may be more cost-effective for investors than an SMSF, depending on the size of the investor's superannuation balance, and the extent to which the SMSF trustee(s) would engage external professionals to undertake administrative and other functions.

C32 Setting up an SMSF, which then invests through an investment platform, may not be as cost-effective for investors as becoming a member of a public offer investment platform directly.

D Other SMSF work

Key points

This section summarises some of ASIC's other SMSF-related work.

In addition to looking at the quality of SMSF advice, ASIC's particular focus areas over the next 12 months include:

- *enforcement*—looking at unlicensed financial advice, misleading or deceptive advertising in relation to SMSFs, and continuing to actively pursue enforcement matters in the SMSF sector;
- *policy implementation*—working with accountants following the Government's announcement to remove the accountants' exemption, consulting on SMSF issues (e.g. SMSF disclosure requirements and the costs of establishing an SMSF) and registering SMSF auditors; and
- *education and disclosure*—continuing our financial literacy work, updating our MoneySmart website to provide Australian consumers with useful and reliable information about all types of superannuation, including SMSFs, and examining investor attitudes to SMSFs.

Enforcement

170 Over the next 12 months, we will be continuing to take enforcement action in the SMSF sector, with a particular focus on unlicensed SMSF advice and misleading or deceptive advertising.

SMSFs and the licensing regime

171 In the past year, we have seen an increase in the number of investors purchasing, or looking to purchase, real property through an SMSF.

172 Anecdotally, we believe there is some market confusion about how the AFS licensing regime applies to operators who recommend that investors purchase real property through an SMSF, with some operators mistakenly thinking they do not require an AFS licence.

173 A person provides a financial service (i.e. financial product advice) if they recommend that an existing or proposed trustee/member of an SMSF purchase real property through their SMSF. This is because the vehicle through which the underlying investment is made is an SMSF and an interest in an SMSF is a financial product. It does not matter for licensing purposes that the underlying investment (real property in this case) is not a financial product. A person who carries on a business of providing financial services in Australia is generally required to hold an AFS licence. For the avoidance of doubt, we note that this does not mean that a real estate agent will ordinarily require an AFS licence. A real estate agent who does not specifically

market to SMSFs, or carry on a business of recommending that SMSFs be used to purchase real property, is not required to obtain an AFS licence.

174 A limited exemption to the requirement to hold an AFS licence currently applies to 'recognised accountants'.[46] The exemption enables a recognised accountant to recommend acquiring, or disposing of, an interest in an SMSF: see paragraphs 67–71. It does not extend to making recommendations about the product or real property that an SMSF invests in—nor does it extend to advice on switching or product replacement. This means that an accountant who recommends that an investor roll their existing APRA-regulated superannuation into an SMSF requires an AFS licence.

175 The Government has announced that the accountants' exemption will be replaced by a new form of limited AFS licence. Accountants and other professionals will be able to apply for and, if the application is approved, be granted a limited AFS licence from 1 July 2013.

176 Unlicensed financial advice in the SMSF sector will be a focus for ASIC in 2013 and we will be taking regulatory action against unlicensed operators. In particular, we will be targeting property spruikers. We do not want to see SMSFs become the vehicle of choice for unscrupulous operators.

SMSF advertising

177 As part of the taskforce's work, we have been reviewing SMSF advertisements and will continue this work in 2013.

178 We have seen some blatant examples of misleading or deceptive advertising and have taken regulatory action to stop these advertisements. Particular problem areas we have seen include misleading or deceptive statements about:

(a) SMSF fees;

(b) SMSF returns; and

(c) SMSF risks.

179 We strongly encourage all SMSF advertisers to carefully review the content of their advertisements against our good practice guidance for advertising set out in Regulatory Guide 234 *Advertising financial products and services (including credit): Good practice guidance* (RG 234). Table 4 provides an overview of the guidance we give in RG 234.

[46] Regulations 7.1.29(5) and 7.1.29A of the Corporations Regulations.

Table 4: Overview of good practice guidance

Issue	Summary of guidance
Returns, features, benefits and risks	Advertisements for financial products and credit products should give a balanced message about the returns, features, benefits and risks associated with the product. Benefits should not be given undue prominence compared with risks.
Warnings, disclaimers, qualifications and fine print	Warnings, disclaimers and qualifications should not be inconsistent with other content in an advertisement, including any headline claims. Warnings, disclaimers and qualifications should have sufficient prominence to effectively convey key information to a reasonable member of the audience on first viewing the advertisement. Consumers should not need to go to another website (or other page of the website) or document to correct a misleading impression.
Fees and costs	Where a fee or cost is referred to in an advertisement, it should give a realistic impression of the overall level of fees and costs a consumer is likely to pay, including any indirect fees or costs.
Comparisons	Comparisons should only be made between products that have sufficiently similar features or, where an advertisement compares different products, the differences should be made clear in the advertisement. Comparisons should only be made about returns if the information used is current, complete and accurate. If an advertisement discloses a rating, the rating used should be properly explained either in the advertisement itself or by including details of where an investor can obtain further information about the meaning of the rating and the rating scale.
Past performance and forecasts	Past performance information should be accompanied by a warning that past performance is not indicative of future performance. Forecasts about the future performance of a financial product should be based on reasonable assumptions and should also state that the forecasts are not guaranteed to occur.
Use of certain terms and phrases	Terms and phrases should not be used in a particular way by industry where these are not consistent with the ordinary meaning commonly recognised by consumers (e.g. ‘free’, ‘secure’ and ‘guaranteed’). Industry concepts or jargon should be avoided unless the promoter is confident that these terms will be understood by the audience.
Target audience	Advertisements should be capable of being clearly understood by the audience that might reasonably be expected to see the advertisements. Advertisements should not state or imply that a product is suitable for particular types of consumers unless the promoter has assessed that the product is suitable for that class. Advertisements for complex products that are only appropriate for a limited group of people should not be targeted at a wider audience.
Consistency with disclosure documents	Where an advertisement draws attention to specific product features, the advertisement should be consistent with information contained in any disclosure document (such as a PDS or prospectus) or contract.

Issue	Summary of guidance
Photographs, diagrams, images and examples	Photographs and images should not contradict, detract from or reduce the prominence of any warnings, disclaimers or qualifications. Graphical presentations should not be ambiguous or overly complicated.
Nature and scope of financial advice and credit assistance	Advertisements for a financial advice service should not create unrealistic expectations about what the service can achieve. Advertisements about credit assistance should be clear about the scope of the service that will be provided to the customer.

Source: RG 234, Table 1, p. 7.

180 The law provides ASIC and investors with a range of different remedies in cases where misleading or deceptive statements are made. Part D of RG 234 outlines how we will deal with contraventions, and the regulatory options for dealing with breaches of the misleading or deceptive conduct provisions in the Corporations Act and the *Australian Securities and Investments Commission Act 2001* (ASIC Act). These options include, but are not limited to:

(a) seeking injunctions to stop the disclosure being made (see s1324 of the Corporations Act and s12GD of the ASIC Act);

(b) seeking civil penalties of up to $340,000 for an individual or $1.7 million for a body corporate (see s12GBA of the ASIC Act);

(c) seeking compensation for investors (see s12GM of the ASIC Act);

(d) seeking undertakings or orders requiring corrective disclosure (see s12GLA and 93AA of the ASIC Act); and

(e) issuing an infringement notice (see s12GXA of the ASIC Act).

181 Other action that may be taken includes seeking criminal charges, taking licensing action or making banning orders. The type of regulatory response will depend on the circumstances of each case, including the seriousness of the contravention and its consequences.

Enforcement matters

182 ASIC takes enforcement action in relation to a wide range of misconduct involving corporations, and the financial services and credit industries. ASIC's approach to its enforcement role is set out in Information Sheet 151 *ASIC's approach to enforcement* (INFO 151), issued in February 2012.

183 We are currently working on a number of matters where the core misconduct involves SMSFs. Because these matters are subject to ongoing investigation, we cannot comment on the matters specifically, other than to say that:

(a) the misconduct generally involves recommendations to retail investors to either establish an SMSF and/or invest their SMSF funds;

(b) the recommendations typically include or lead the investor to switch from their current APRA-regulated superannuation fund to an SMSF;

(c) the products recommended for investment are varied and include company shares, managed investment schemes, debentures and real property;

(d) some cases involve recommendations to the trustees of SMSFs to loan funds to companies associated with the advice provider or to invest funds into property developments associated with the advice provider;

(e) some matters involve schemes designed to achieve illegal early access to superannuation benefits;

(f) some misconduct involves random direct marketing to the public, such as cold calls and advertising—the aim of which is to have people establish an SMSF and/or invest their SMSF money;

(g) where misconduct occurs, it is common for high returns to be promised to investors, whether in relation to the ability of the SMSF to generate an overall portfolio return or in relation to a specific investment recommended to the SMSF;

(h) the people making misleading recommendations vary and include advice providers who are AFS licensees, company directors and property spruikers; and

(i) in some cases, the recommended investments have involved large overall losses for the SMSFs.

184 ASIC routinely considers whether provisions of the Corporations Act or ASIC Act have been contravened in matters involving SMSFs relating to:

(a) unlicensed financial advice;

(b) the requirement to have a reasonable basis for financial advice;

(c) hawking of financial products;

(d) directors' duties;

(e) dishonest conduct in relation to a financial services business; and

(f) misleading or deceptive conduct in relation to financial products or services.

185 We also consider whether any other contraventions have occurred, such as against other Commonwealth and state laws, including offences involving fraud and deception.

186 Investigation of these matters can result in a number of enforcement outcomes that include:

(a) administrative action, such as the banning of individuals from the financial services industry, or the cancellation/suspension of AFS licences;

(b) injunctive court action to protect assets and prevent parties from leaving the jurisdiction;

(c) civil proceedings to obtain declarations of contraventions and impose penalties, such as directors' bannings and financial penalties; and

(d) criminal charges.

187 Some SMSF enforcement matters that we can comment on publicly include Royale Capital, Trio/Astarra and Super Save Superannuation Fund. We have summarised the outcomes achieved to date in Table 5. Additional information about these matters is available on our website.

188 In addition to our investigations that involve significant SMSF-related misconduct, we will often have a number of other investigations that in some way involve SMSFs. For example, we are aware that, in relation to the Westpoint, APCH and Banksia matters, funds were raised from the public for investment from a variety of sources, including SMSFs.

Table 5: Examples of outcomes in ASIC's enforcement matters involving SMSFs

Enforcement matter	Outcomes
Royale Capital Pty Ltd and ActiveSuper Pty Ltd—These were Queensland-based companies that solicited members of the public to establish SMSFs and then recommended various share-related investments to the SMSFs.	Civil proceedings commenced in the Federal Court of Australia involving 17 defendants, including several international entities. To date, asset protection and travel restriction orders have been obtained against various defendants. A provisional liquidator has also been appointed to various entities, including a Queensland property development company MOGS Pty Ltd.
Trio/Astarra—Trio Capital Ltd was a trustee company that invested funds, including those directly invested by SMSFs, into a managed investment scheme named Astarra Strategic Fund.	A variety of administrative and criminal outcomes have been obtained to date, involving action against 10 individuals, including lifetime bannings from the financial services industry and the imprisonment of the director of Astarra Strategic Fund.
Super Save Superannuation Fund—This fund was only open to SMSFs. Many investors rolled their superannuation out of APRA-regulated funds to invest in this fund, which attracted more than 100 SMSFs and over $7 million from mid-2006, before being shut down by ASIC in late 2007.	A variety of criminal and civil penalty outcomes were awarded by the courts against the operators of this and related funds, including custodial sentences for three Australian operators and a record penalty of $500,000 for the New Zealand operator. ASIC secured the return of substantial funds from the United States for investors, which have been returned through a liquidation.

Policy implementation

189 Over the next 12 months, we will be implementing a number of policy initiatives, including working with accountants on the removal of the accountants' exemption, consulting on additional disclosure for SMSF advice and on SMSF costs, and registering SMSF auditors.

Removal of the accountants' exemption

190 The Government has announced that the accountants' licensing exemption will be replaced with a new form of limited AFS licence. We will be working closely with accountants to ensure that the new licensing regime operates smoothly.

191 The Government has issued for public comment draft regulations to allow accountants and other advice providers to apply to ASIC for the limited AFS licence. From 1 July 2013, accountants will be able to apply for and, if the application is approved, be granted a limited AFS licence. Although any person will be able to apply for the limited AFS licence, recognised accountants who apply between 1 July 2013 and 30 June 2016 (transition period) will be able to take advantage of being 'streamlined' into the AFS licensing regime. This means that recognised accountants will only need to satisfy the knowledge requirements in Regulatory Guide 105 *Licensing: Organisational competence* (RG 105) and will not need to demonstrate experience.

192 Other applicants (i.e. those who are not recognised accountants) cannot be streamlined and must meet ASIC's full licensing requirements in RG 105. This means that they will need to demonstrate that their responsible managers have the knowledge and skills (i.e. experience) to meet the organisational competence requirements. After the transition period is over, all applicants will need to meet the full competence requirements under s912A(1)(e) of the Corporations Act.

193 Applicants can choose which authorisations they wish to apply for. In addition to being able to advise on SMSFs and superannuation generally, limited AFS licence holders may be authorised to give 'class of product advice' on basic deposit products, general and life insurance, securities and simple managed investment schemes. Class of product advice is financial advice that does not make a recommendation about a specific financial product.

194 To help reduce the costs of operating within the AFS licensing regime, holders of a limited AFS licence will be able to lodge an annual compliance certificate rather than undertake an annual external audit of their financial statements and internal controls. However, this compliance certificate requirement will only be available to limited AFS licence holders who do

not handle any investor money in connection with the provision of financial advice.

195 It is important to note that, apart from the annual compliance certificate, we expect that holders of a limited AFS licence will need to meet the same ongoing requirements as other AFS licensees. This includes all other licensing conduct and financial advice requirements to which advice providers are subject, as well as membership of an EDR scheme and compliance with the FOFA measures, such as the best interests duty.

Consultation on SMSF issues

196 In the next few months, we will be releasing two consultation papers on SMSF issues. The first consultation paper deals with additional disclosure obligations for providing SMSF advice and the second consultation paper deals with the costs associated with SMSFs.

Additional disclosure obligations for SMSF advice

197 In the next few months, we will be releasing a consultation paper which will outline our proposal to impose additional disclosure obligations on AFS licensees who give advice to retail clients on establishing or switching to an SMSF. These obligations include the need to:

(a) warn investors that Government compensation arrangements do not apply to SMSFs in the event of theft or fraud; and

(b) explain other matters that may affect an investor's decision to set up an SMSF.

198 The consultation paper will build on the results of our surveillance activity and the tips for advice providers that we have set out in this report.

SMSF costs

199 In late 2012, ASIC commissioned Rice Warner Actuaries to examine the fund balance at which an SMSF will be cost-effective compared with an APRA-regulated fund. Rice Warner found that the cost-effectiveness of an SMSF is very much affected by the amount of work the trustee is prepared to do themselves in administering the fund. As such, there will be a range of fund balances at which an SMSF will be cost-effective compared with an APRA-regulated fund.

200 We intend to release Rice Warner's report along with a consultation paper on the issue of costs in the next few months. The purpose of the consultation paper is to better explore the issues in relation to costs rather than to seek to mandate a minimum fund balance for SMSFs.

Auditor registration

201 As part of the Stronger Super reform initiatives, from 31 January 2013, ASIC became the registration body for approved SMSF auditors.

202 Under the new regime, ASIC has responsibility for registering ‘approved SMSF auditors’, setting competency standards and imposing any necessary administrative outcomes. The ATO will continue to monitor the conduct of SMSF auditors and, in some cases, may refer an auditor to ASIC to consider taking further action.

203 From 31 January 2013, auditors have been able to apply for registration with ASIC. All auditors will need to be registered with ASIC by 1 July 2013 to conduct SMSF audits. Conducting SMSF audits after 1 July 2013 without being registered may incur penalties.

204 To make the registration process as smooth as possible, some approved SMSF auditors will have access to transitional arrangements until 30 June 2013. These auditors include those who have signed off on 20 or more audits in the 12-month period before registration, as well as registered company auditors.

205 Approved SMSF auditors will have ongoing obligations under s128F of the SIS Act to comply with the competency standards set by ASIC. They are also required by the legislation to comply with the auditing standards issued by the Auditing and Assurance Standards Board (AASB). ASIC released Regulatory Guide 243 *Registration of self-managed superannuation fund auditors* (RG 243) in January 2013 to provide further guidance to the industry on the registration requirements.

206 The competency standards for SMSF auditors, set by ASIC, were based closely on the *Competency requirements for auditors of self-managed superannuation funds*, issued by the Representatives of the Australian Accounting Profession, which consist of the Institute of Chartered Accountants in Australia, CPA Australia and the Institute of Public Accountants.

207 A competency examination for SMSF auditors is also being developed with the assistance of an examination committee, which consists of representatives of professional associations, the ATO and ASIC. ASIC and the ATO have also been observers on the Accounting Professional & Ethical Standards Board (APESB) taskforce on SMSF auditor independence, which is made up of professional association representatives.

208 ASIC has been grateful for the cooperation and assistance of the professional associations to date in developing a registration regime and a competency framework that we think is workable and practical, while still meeting the Government objectives of improving minimum standards across the sector.

209 Since the introduction of the SMSF auditor registration regime, ASIC has received 3,799 applications, and we have registered and approved 2,056 SMSF auditors. Approximately 18,652 SMSF auditor searches have been conducted on ASIC Connect.[47]

210 We value our relationship with the professional associations and will continue to collaborate with them to communicate with the SMSF auditor industry, and to advance key registration issues as they arise.

Education and disclosure

211 ASIC wants all consumers to be able to access reliable, accurate and trustworthy information about SMSFs.

212 To this end, we are continually updating and improving the content of our MoneySmart website. We have also commissioned a piece of qualitative research that will explore the extent to which the aims and goals of SMSF investors are realised. The results of this qualitative research are due to be completed later in 2013.

Financial literacy work

213 ASIC has a long-term strategy for the development and delivery of initiatives to improve the financial literacy of all Australians and enhance their financial wellbeing. As part of our strategy, we are continually updating and improving the content of our MoneySmart website.

214 Over the next few months, we will be updating our MoneySmart website to include some additional practical tips for investors considering setting up an SMSF.

Consumer Advisory Panel work

215 ASIC receives advice on our education, policy and compliance work from a variety of stakeholders, including our Consumer Advisory Panel (CAP), whose membership consists of a diverse range of consumer and investor organisations.

> Note: For more information about CAP and its membership, see www.asic.gov.au under 'About ASIC', and then 'ASIC and consumers'.

216 A number of CAP members have expressed concerns about whether investors understand what they are taking on when they establish an SMSF. Given these concerns, CAP has suggested that ASIC commission a research project to explore investor attitudes to SMSFs.

[47] According to ASIC's current records as at 14 April 2013.

217 The qualitative research will explore the extent to which the aims and goals of SMSF investors are realised. We are aiming to complete this research within the next six months.

218 CAP hopes that the findings of the research will help inform ASIC and industry and consumer representatives about whether SMSFs deliver the benefits investors sought when setting up an SMSF.

Appendix: Tips for advice providers

Table 6: Some tips for advice providers giving advice to retail clients on SMSFs

Issue	What you should do or consider
Role and obligations of SMSF trustees	**C1** The ATO regulates SMSFs and provides a number of useful publications on its website about the obligations and duties of trustees in managing an SMSF.[48] As good practice, you should: (a) direct investors to the relevant pages on the ATO website; or (b) provide investors with a copy of key ATO publications with their SOA to ensure investors understand their obligations.
	C2 You should explain to investors that, by law, each trustee has duties and obligations to: (a) act honestly in all matters concerning the SMSF; (b) exercise skill, care and diligence in managing the SMSF; (c) act in the best interests of all SMSF members; (d) take appropriate action to protect SMSF assets and manage them separately from the trustee's own affairs; (e) comply with the SMSF trust deed and review and update it as required; (f) be responsible for and control the SMSF, even where the trustees outsource the required expertise or one trustee is more actively involved in the day-to-day running of the SMSF; (g) have a documented investment strategy that considers all the circumstances of the fund, and review and update the investment strategy as the members' financial situation, needs and objectives require; (h) consider insurance for fund members as part of the fund's investment strategy; (i) understand which investments are restricted and that SMSF investments must be made solely to pay retirement benefits to members or the members' dependants if a member dies; (j) accept and document contributions in accordance with the superannuation laws; (k) ensure the SMSF's money is invested appropriately (even if the trustee outsources the investment to an advice provider); (l) keep proper and accurate tax and superannuation records (e.g. minutes of all investment decisions) and allow members to have access to such information and records; (m) comply with the superannuation and tax laws (and the Corporations Act for corporate trustees); (n) value the fund's assets at market value for the purposes of preparing financial accounts and statements; (o) have the SMSF audited annually by an independently approved auditor; (p) comply with the reporting obligations to the ATO (e.g. report contributions from members, lodge annual returns, report on any changes to trustees, directors or members of the SMSF; lodge a business activity statement if the SMSF is registered for Goods and Services Tax (GST));

[48] ATO: *Self-managed super funds—Key messages for trustees* (NAT 71128), December 2012; *Thinking about self-managed super* (NAT 72579-11.2011), November 2011; *Running a self-managed super fund—Your role and responsibilities as a trustee* (NAT 11032-10.2011), October 2011.

Issue		What you should do or consider
		(q) pay the supervisory levy and the SMSF's income tax liability when due; (r) refrain from entering into contracts or behaving in a way that hinders trustees from performing or exercising functions or powers; (s) refrain from entering into transactions that circumvent restrictions on the payment of benefits; and (t) ensure that the money in the SMSF is only accessed by members when the trust deed and law allow it.[49]
	C3	You should explain to investors that, within 21 days of becoming an SMSF trustee, they will need to complete the ATO's trustee declaration.
	C4	You should walk investors through the ATO's trustee declaration, explain each obligation and duty, and allow investors to ask any questions about their obligations.
	C5	If you do not adequately understand the role and obligations of SMSF trustees, it is inappropriate for you to advise investors about SMSFs.
Suitability of an SMSF structure	**C6**	You should discuss the investor's fund balance size and whether it is likely to be cost-effective for the investor to set up an SMSF. Cost is just one factor to consider and does not mean by itself that an SMSF will be appropriate or inappropriate for the investor.
	C7	You should discuss the likely costs associated with running an SMSF, including the costs of establishment, ongoing investment management, compliance and advice, and explain these costs to the investor before making a recommendation to establish an SMSF.
	C8	Before recommending an SMSF, you should consider the investor's ability and willingness to manage the fund and meet their trustee obligations on an ongoing basis.
	C9	Be aware of 'red flag' indicators that may suggest an SMSF will not be suitable for an investor, including, but not limited to: (a) a low fund balance where the members have a limited ability to make future contributions; (b) the investor wants a simple, low-touch superannuation solution; (c) the investor wants to delegate decision making to someone else; (d) the investor does not have a lot of time to devote to managing their financial affairs; (e) the investor has little investment decision-making experience; (f) the investor, or suggested trustee, is an undischarged bankrupt or has been convicted of an offence involving dishonesty (as such, persons are prohibited from acting as a trustee); and (g) the investor has a low level of financial literacy.

[49] These duties and obligations were compiled from a number of ATO publications: *Self-managed super funds—Key messages for trustees* (NAT 71128), December 2012; *Thinking about self-managed super* (NAT 72579-11.2011), November 2011; *Running a self-managed super fund—Your role and responsibilities as a trustee* (NAT 11032-10.2011), October 2011; *Trustee declaration* (NAT 71089-12.2012), December 2012; *Obligations and responsibilities for self-managed super fund trustees*, viewed 14 March 2013, www.ato.gov.au/content/00328799.htm.

Issue	What you should do or consider
	C10 You should explain to investors approaching the pension phase that there may be a point at which the SMSF may cease to be cost-effective because fixed costs will remain constant or increase while the balance of the fund diminishes.
	C11 Where appropriate, you should discuss SMSF succession planning issues with investors (this will be more relevant for older investors). Some key questions to discuss include: (a) For investors who are individual trustees, what will happen if one of the trustees dies? (b) If one trustee (the controlling trustee) is more actively involved in the day-to-day management of the SMSF, what will the less active trustee do if the controlling trustee is unable to manage the SMSF?
Risks of an SMSF structure	**C12** You should warn investors looking to set up an SMSF about the lack of Government compensation available to SMSFs. This information will help investors properly weigh up whether an SMSF structure is right for them.
	C13 You should warn investors that SMSF trustees and members do not have access to the Superannuation Complaints Tribunal (SCT) to resolve complaints.
	C14 You should explain the advantages and disadvantages of establishing an SMSF with a corporate trustee versus individual trustees, and provide investors with relevant ATO publications via hard copy or web-links.
	C15 If the investor's proposed membership structure of an SMSF is unusual, you may need to spend more time discussing the duties and obligations of trustees, the risks associated with the membership structure, and the importance of having a well-documented, specific investment strategy and a trust deed that contains dispute resolution clauses.
	C16 You should reiterate the role and responsibilities of trustees, and explain that, even if one trustee is less actively involved, they are equally liable for the SMSF's compliance with the superannuation and tax laws.
	C17 When you recommend an SMSF to an investor, you will need to discuss their insurance needs. This will often involve discussing: (a) their existing insurance coverage; (b) the level of insurance coverage they will need in future; (c) the cost and options for maintaining, increasing or decreasing (as appropriate) their existing insurance coverage through an SMSF; (d) whether the investor has any health issues that may affect their ability to get insurance coverage; (e) the advantages and disadvantages of retaining a portion of their APRA-regulated superannuation for insurance purposes (if considered appropriate); and (f) the impact of the insurance recommendation on the investor's SMSF balance.
	C18 If you identify an investor needs advice on insurance, you must consider and advise the investor on their insurance needs before recommending an SMSF be established. If you do not have the necessary expertise to provide insurance advice, you should notify the investor and refer the investor to an advice provider who has the expertise to provide the advice.

Issue	What you should do or consider	
Investment strategy	**C19**	You should explain to investors the sole purpose test and the requirement for investments to be made and maintained on an arm's length basis.
	C20	When you are advising investors on their SMSF investment strategy, you should explain the benefits of asset diversification and investing across a number of asset classes (e.g. shares, real property and fixed interest products) in a long-term investment strategy.
	C21	You should explain to investors that some investments are restricted and that it is the trustee's obligation to ensure that the SMSF does not make restricted investments: see tip C2(i).
	C22	You should explain to trustees that they are required to regularly review the fund's documented investment strategy to ensure that it suits the needs of fund members.
	C23	If you are recommending that an SMSF be established to invest in a single asset, you should ensure that the SOA adequately documents the basis for the advice in light of the investor's financial situation, needs and objectives. In particular, you should set out why the investment is appropriate, rather than a diversified investment portfolio, and whether the investment will generate a sufficient return to fund the investor's retirement needs and, if not, what the exit strategy is and any costs or risks associated with this exit strategy.
	C24	You should explain to investors that the SMSF investment strategy is likely to change as members approach the retirement phase and their needs and circumstances change.
	C25	If an investor has a preference towards a real property investment, you should consider whether the real property investment is appropriate.
	C26	If you are recommending a real property investment, you should discuss with the investor: (a) the needs and circumstances of the fund members (e.g. their age and retirement needs); (b) if the recommendation involves an investment loan, how long it will take for the investor to repay the loan; (c) the investor's ability to repay the loan if an unexpected event occurs (e.g. the investor becomes unemployed for a period); (d) how the investor's retirement will be funded by the real property investment (i.e. through the sale of property or through rental income); (e) how likely the property can be sold quickly (i.e. whether it is in a high-demand area); and (f) what the investor will do if the property is not rented for a period. Note: If the investment property is not the SMSF's sole asset, you may need to spend less time discussing the above issues.

Issue	What you should do or consider	
Switching from an APRA-regulated superannuation fund	**C27**	When recommending an SMSF, you will need to explain the charges and significant consequences the investor will, or may, incur as a result of changing (fully or partially) from an APRA-regulated fund to an SMSF.
	C28	When discussing the consequences of a switch, you will need to use language and concepts that the investor will understand.
	C29	If you assess an investor has a low level of financial literacy, an SMSF will not be an appropriate retirement savings vehicle for the investor.
Alternatives to an SMSF structure	**C30**	Before recommending an SMSF to an investor, you should consider whether an APRA-regulated fund will meet the financial situation, needs and objectives of the investor. Many APRA-regulated funds now offer a DIY investment option.
	C31	APRA-regulated funds may be more cost-effective for investors than an SMSF, depending on the size of the investor’s superannuation balance, and the extent to which the SMSF trustee(s) would engage external professionals to undertake administrative and other functions.
	C32	Setting up an SMSF, which then invests through an investment platform, may not be as cost-effective for investors as becoming a member of a public offer investment platform directly.

Key terms

Term	Meaning in this document
advice providers	These include financial planners and accountants
AFS licence	An Australian financial services licence under s913B of the Corporations Act that authorises a person who carries out a financial services business to provide financial services Note: This is a definition contained in s761A.
AFS licensee	A person who holds an AFS licence under s913B of the Corporations Act Note: This is a definition contained in s761A.
APRA	Australian Prudential Regulation Authority
APRA 2012 bulletin	APRA, *Annual superannuation bulletin*, June 2012 (issued 9 January 2013)
ASIC	Australian Securities and Investments Commission
ASIC Act	*Australian Securities and Investments Commission Act 2001*
ATO	Australian Taxation Office
ATO 2010–11 overview	ATO, *Self-managed super funds: A statistical overview 2010–11*
Corporations Act	*Corporations Act 2001*
Corporations Regulations	*Corporations Regulations 2001*
DIY	Do-it-yourself
EDR	External dispute resolution
entities	Financial planning and accounting entities
exempt service	See paragraph 68 for the definition of 'exempt service'
FOFA	Future of Financial Advice
gatekeepers	Advice providers, SMSF auditors, and providers of products and services to SMSFs
GFC	Global financial crisis
Government	Australian Government
Investment Trends 2012 report	Investment Trends, *April 2012 self-managed super fund: Investor report*, issued in June 2012
PDS	Product Disclosure Statement

Term	Meaning in this document
PJC	Parliamentary Joint Committee on Corporations and Financial Services
recognised accountants	Members of the Institute of Chartered Accountants in Australia, CPA Australia or the Institute of Public Accountants who comply with their membership professional education requirements Note: See reg 7.1.29A(2) of the Corporations Regulations for the exact definition.
RG 175 (for example)	An ASIC regulatory guide (in this example numbered 175)
s761A (for example)	A section of the Corporations Act (in this example numbered 761A)
SCT	Superannuation Complaints Tribunal
SIS Act	*Superannuation Industry (Supervision) Act 1993*
SMSF	Self-managed superannuation fund
SOA	Statement of Advice

Related information

Headnotes

advice provider, AFS licence, approved SMSF auditor, APRA-regulated superannuation fund, auditor registration, disclosure obligations, financial product advice, general advice, misleading or deceptive advertising, personal advice, retail client, self-managed superannuation fund, SMSF, Statement of Advice, trustee

Regulatory guides

RG 36 *Licensing: Financial product advice and dealing*

RG 105 *Licensing: Organisational competence*

RG 175 *Licensing: Financial product advisers—Conduct and disclosure*

RG 234 *Advertising financial products and services (including credit): Good practice guidance*

RG 243 *Registration of self-managed superannuation fund auditors*

RG 244 *Giving information, general advice and scaled advice*

RG 246 *Conflicted remuneration*

Legislation

ASIC Act, s12GBA, s12GD, 12GLA, 12GLC, 12GM, 12GXA and 93AA

Corporations Act, Div 2 of Pt 7.7A, s912A, 945A, 945B, 947D and 1324

Corporations Regulations, regs 7.1.29 and 7.1.29A

SIS Act, Pt 23, s52 and 128F

SIS Regulations, reg 4.09

Superannuation Guarantee (Administration) Act 1992

Superannuation (Resolution of Complaints) Act 1993

Cases

Shail Superannuation Fund v Commissioner of Taxation [2011] AATA 940

Reports

REP 279 *Shadow shopping study of retirement advice*

Information sheets

INFO 151 *ASIC's approach to enforcement*