ASIC

Australian Securities & Investments Commission

Self-managed superannuation funds regulatory update

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Introduction

Good morning and thank you very much for inviting me to speak today. I'm delighted to be at the Tax Institute's National Superannuation Conference. Today I will be focusing on the recent work ASIC has undertaken in relation to self-managed superannuation funds (SMSFs), which includes the new limited Australian financial services (AFS) licence.

In September last year, Deputy Chairman Peter Kell and I became jointly responsible for heading up ASIC's SMSF taskforce, so it's fair to say that I have a strong interest in all things SMSF.

There's a lot that we could cover this morning. The SMSF sector is growing rapidly and more Australians than ever before are either considering or operating an SMSF. Today, however, I'd like to focus on three key things:

- the critically important role of gatekeepers in the SMSF sector. I'll speak here about the new, limited licence for accountants and the registration of SMSF auditors
- ASIC's focus on SMSFs and our review of the quality of advice provided to SMSF investors
- working together to ensure that the SMSF sector remains healthy, vibrant and safe for investors.

SMSFs and the critically important role of gatekeepers

SMSFs are the fastest growing sector of the superannuation industry. Since their official introduction in 1999, the number of SMSFs has grown rapidly. According to the latest Australian Prudential Regulation Authority (APRA) figures, SMSFs now account for about a third of total superannuation assets in Australia, with $439 billion funds under management.[1] As at 30 June 2012, there were over 470,000 SMSFs with around 913,550 members.[2]

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

The primary drivers for setting up an SMSF include a desire for control 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 investment decisions. This is important, as SMSF members have the ultimate

[1] APRA, *Annual superannuation bulletin: June 2012*, issued 9 January 2013, p. 5 and Table 9, p. 40.
[2] Australian Taxation Office, *Self-managed super fund statistical report: A statistical overview 2010–11*, Table 1: Yearly SMSF population and asset size.

responsibility for their own investments and are not covered by the compensation scheme that applies to APRA-regulated funds.

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

We think that accountants and other gatekeepers have a critically important role to ensure that:

- at an individual level, only those investors for whom an SMSF is suitable go into the SMSF sector and, in doing so, they are fully informed
- at an aggregate level, that the overall health of the SMSF sector is sound.

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

The important role of accountants as gatekeepers has been recognised by the Government. Two key law reforms – the introduction of a new, limited financial service licence and the registration of SMSF auditors – highlight the trusted role accountants play in the SMSF sector.

We want to ensure that accountants and financial planners who are advising retail clients about SMSFs are providing good-quality advice. If we can encourage these gatekeepers to lift the standard of their advice, SMSF investors will really see the benefits.

New, limited licence

The Government has passed new law that will replace the 'accountants' licensing exemption' with a new form of limited AFS licence. Currently, reg 7.1.29A of the Corporations Regulations 2001 (Corporations Regulations) permits accountants to provide advice on the establishment of SMSFs without the need for an AFS licence. This exemption will cease on 1 July 2016, and from that date all accountants who wish to give advice on SMSFs will need to be licensed.

The reform highlights the important role that professional accountants play in providing advice to the community. In the words of the Hon Bill Shorten, the Minister for Financial Services and Superannuation:

> [t]his … is a major step forward and will help to facilitate a significant expansion in the provision of financial advice to Australians. As accountants begin operating within the AFSL regime, there will be more options for consumers to access low-cost financial advice on important issues including insurance and superannuation needs.[3]

The new reforms will enable accountants to have broader discussions with investors on financial issues, if they choose to apply for and are granted a limited AFS licence. Further, the reforms provide accountants with the opportunity to expand and diversify their business.

From 1 July 2013, accountants have been able to apply for and, if the application is approved, be granted the limited AFS licence.[4] Recognised accountants[5] who apply between 1 July 2013 and 30 June 2016 will be able to take advantage of transitional arrangements for entry into the AFS licensing regime. Under the transitional arrangements, different organisational competence requirements will apply where the responsible managers of the applicant are recognised accountants. Once the transitional period is over, all applicants will need to meet the full competence requirements under s912A(1)(e) of the *Corporations Act 2001* (Corporations Act).

When applying for a limited AFS licence, applicants can choose which authorisations they wish to apply for. In addition to being able to advise on SMSFs and a client's existing superannuation if certain conditions are met, limited AFS licence holders may also be authorised to give 'class of product advice' on basic deposit products, general and life insurance, securities, superannuation more generally, and simple managed investment schemes. Class of product advice is financial advice that does not make a recommendation about a specific financial product.

To help reduce the costs of operating within the AFS licensing regime, holders of a limited AFS licence can lodge a compliance certificate rather than undertake an annual external audit of their financial statements and internal controls. This exemption from the annual external audit requirement will be available to limited AFS licence holders who do not handle any client money in connection with the provision of financial advice.

It is important to note that, apart from the annual compliance certificate, holders of the limited AFS licence will need to meet the same ongoing requirements as other AFS licensees. This includes all other licensing conduct and advice requirements to which financial advisers are subject, as

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[3] The Hon Bill Shorton MP, Minister for Financial Services and Superannuation, Media Release No 036, *New form of licence expands access to financial advice*, 23 June 2012.
[4] As at 27 August 2013, ASIC has received 11 applications and have issued two limited AFS licences.
[5] '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.

well as membership of an external dispute resolution scheme and compliance with the Future of Financial Advice (FOFA) measures, such as the best interests duty.

ASIC has provided guidance on the regulations that replace the existing accountants' exemption with the new limited AFS licence in Information Sheet 179 *Applying for a limited AFS licence* (INFO 179). Our guidance provides an overview of the relevant steps in applying for a limited AFS licence, as well as explaining how existing ASIC guidance will apply.

It is worth briefly discussing other options that are available for accountants who do not wish to obtain a limited AFS licence. For accountants who wish to continue providing advice on SMSFs, but do not wish to obtain their own AFS licence, an option would be to become an authorised representative of an existing licensee. As an authorised representative, an AFS licensee with the relevant authorisations can authorise you to provide SMSF advice and class of product advice, as would be allowed under the limited AFS licence. If you do not want to become an authorised representative, another option would be to refer work advising on SMSFs to an entity that either holds an AFS licence or is themselves an authorised representative.

It is also worth noting that accountants may be able to continue providing some services in relation to SMSFs under the existing licensing exemption in reg 7.1.29. For example, under this regulation, a person can provide services relating to the administration and operation of an SMSF without holding an AFS licence.

Registration of SMSF auditors

As part of the Stronger Super reform initiatives, ASIC became the registration body for approved SMSF auditors from 31 January 2013. This reform recognises the key gatekeeper role that approved SMSF auditors play. The objective of SMSF auditor registration is to raise the standard of SMSF audit competency and ensure there are minimum standards across the sector. Registration identifies, formally recognises and enables the provision of tailored support to those approved SMSF auditors that are currently producing high-quality audits. It forces those that lack the competence to conduct an SMSF audit to raise their standards or cease conducting SMSF audits.

Under the new regime, ASIC has responsibility for registering 'approved SMSF auditors', setting competency standards and imposing administrative sanctions on errant auditors. The Australian Taxation Office (ATO) will continue to monitor the conduct of SMSF auditors and may refer an auditor to ASIC so that ASIC can consider taking disciplinary action.

From 31 January 2013, auditors have been able to apply for registration with ASIC. When registration is granted, ASIC registers the approved applicant on the ASIC register with a corresponding SMSF auditor number. This number is required to be included when making annual lodgements with the ATO.

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

Approved SMSF auditors have ongoing obligations under s128F of the SIS Act to comply with the competency standards set by ASIC, and 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 regarding the registration requirements.

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.[6]

A competency exam for SMSF auditors has also been 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 taskforce on SMSF auditor independence, which is made up of professional association representatives.

ASIC has been grateful for the cooperation and assistance of the professional associations in developing a registration regime and a competency framework. We think the new regime is workable, practical and meets the Government's objectives of improving minimum competency standards across the sector.

Since the introduction of the SMSF auditor registration regime on 31 January 2013, as at 27 August 2013 ASIC has received 7,232 applications and we have registered and approved 7,009 SMSF auditors.

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

[6] The Representatives of the Australian Accounting Profession are CPA Australia, the Institute of Chartered Accountants and the National Institute of Accountants.

We also hope that, among those using the register, there are accountants who either verify that the auditors they are referring to SMSFs are registered with ASIC to conduct SMSF audits, or are looking to prove to others that they are in fact registered to conduct audits. Our records show that as at 27 August 2013, 64,886 SMSF auditor searches have been conducted on ASIC Connect.

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

Financial advisers who provide tax advice

I would also like to touch on the recent announcement by Minister David Bradbury on 20 June 2013, introducing legislation that amends the *Tax Agent Services Act 2009* (Tax Agent's Act) and enables the Tax Practitioners Board (TPB) to regulate the provision of tax advice by financial advisers. These amendments aim to ensure all forms of tax advice are consistently regulated and provide consumers with appropriate protections when receiving tax advice from a financial adviser.

Financial advisers will continue to be licensed (or authorised under an AFS licensee), and the obligations under the Corporations Act are not affected by the new regulatory framework. ASIC will continue to regulate the AFS licensing regime, independently of the TPB. Financial advisers who provide tax advice will need to comply with the new requirements under the Tax Agent's Act, which will supplement their existing skills and competencies, to cover tax advice.

We will work with the TPB on the proposed approach to these new requirements as appropriate, to ensure effective administration of the new regime whilst minimising duplication for industry.

ASIC's focus on SMSFs and our review of advice

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

ASIC established this taskforce in September 2012. We were concerned by several developments, including an increase in geared investment strategies and increasingly aggressive advertising for SMSFs. We have also seen an increase in the targeting of SMSFs by less scrupulous operators, and we are keen to address this risk. The collapse of Trio and the Parliamentary Joint Committee on Corporations and Financial Services' (PJC) inquiry into this collapse highlighted what can go wrong.

As well as focusing on specific issues that concerned us, we wanted to work more broadly on encouraging advisers to SMSFs to lift the quality of advice because, as I said earlier, better advice ultimately means better outcomes for SMSF investors.

As I previously explained, the taskforce is headed by me and Deputy Chairman Peter Kell.

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

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

The purpose of our review was threefold. First, we wanted to 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. Second, we wanted to test whether gatekeepers were doing their job in ensuring that only those investors for whom an SMSF was suitable were advised to set up an SMSF. Third, we wanted 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.

We reviewed over 100 investor files relating to the establishment of 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:

- older members (i.e. members at, or close to, retirement age)
- members with a low income
- borrowing
- investment in a single asset class (e.g. real property).

It is important to be very clear upfront that we did not select a random sample of files for review. Instead, we targeted files that looked more likely to be higher risk for SMSF members.

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

We graded one piece of advice as good. While it is disappointing that we did not find more examples of good advice, I think it is worth looking at the elements that meant this advice achieved a 'good' rating.

The advice considered all of the investor's relevant information. The adviser paid specific attention to the client's financial situation, needs and objectives, including their cash flow.

The advice covered insurance issues and the recommendations about insurance were well considered and balanced.

Finally, the adviser communicated the scope of their advice clearly and gave the client a Statement of Advice that was logical, well structured and easy to follow.

I think it is really important to draw attention to examples of good-quality advice like this one. If we can encourage more advisers to give good-quality advice, SMSF investors and the SMSF sector as a whole will really see the benefits.

Having said that, 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. Where this advice was inappropriate for the individual investors, ASIC has been following up and taking regulatory action.

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

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

Notably, we also found that investors were not warned about the very real risk of not having access to a statutory compensation scheme in the event of theft or fraud. Going forward, this will be an area of focus for us. We expect to see advisers warning investors about this risk.

We provided feedback to all entities involved in the review and we have seen a number changes to templates, compliance arrangements and overall business practices.

In April, we published Report 337 *SMSFs: Improving the quality of advice given to investors* (REP 337). The report summarises our findings from our SMSF file reviews and identifies a number of practical tips advisers can use to improve the quality of SMSF advice they provide to investors.

Consultation paper on additional disclosure and costs

We think there are a number of things advisers and investors need to consider and discuss before setting up an SMSF. These include:

- the roles and responsibilities associated with being a trustee of an SMSF
- the time, cost and resources required to run an SMSF
- the risks associated with an SMSF structure (i.e. not having access to a Government compensation scheme)
- whether the investor has the necessary skills and expertise to make the investment decisions for the SMSF
- the importance of asset diversification
- whether the investor's investment strategy will deliver the returns required to adequately fund the investor's retirement
- the advantages and disadvantages associated with a switch from an APRA-regulated fund.

As part of the next stage of taskforce work, we are about to release a consultation paper that:

- proposes implementing specific disclosure requirements to improve the quality of advice given to investors who are considering setting up or switching to an SMSF
- attaches a research report we commissioned Rice Warner Actuaries to prepare around the costs of operating SMSFs and asks for feedback on it
- proposes to give guidance to improve the quality of advice to establish an SMSF including the consideration of cost issues.

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

Working together to ensure the SMSF sector remains healthy

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 choice.

In the right hands, SMSFs can be very effective retirement savings vehicles. Part of our job is to help the gatekeepers who advise SMSFs to give good quality advice.

In the wrong hands, however, SMSFs can be high risk.

As gatekeepers you are on the front-line. Where you see examples of sharp practices and poor advice, please let us know. The reality is that the success of SMSFs will attract those operators hoping to make an easy buck, whether that comes from inappropriate advice or, at worst, involves outright fraud. While it is impossible to prevent inappropriate advice or fraud, it's in our interests *and* your interests to work together to make sure this sort of activity is kept to an absolute minimum. We are willing and able to take appropriate regulatory action to stamp out misconduct and safeguard the reputation of the SMSF sector.

If there are widespread losses in the SMSF sector, it is likely that investor confidence will be seriously eroded, there will be increased scrutiny on gatekeepers and there may be calls for a move to restrict choice, perhaps through greater regulation of SMSFs and the advisers that work in this sector.

We want to continue to work with gatekeepers in the coming year to ensure that the SMSF sector remains healthy and safe for investors.

Particular focus areas for us this year include unlicensed SMSF advice and misleading SMSF advertising. Of course, we also have a number of ongoing enforcement matters that I will also briefly mention.

Unlicensed financial advice

In the past you may have seen ASIC comment that we do not regulate direct property investment. This is the case except where the investment is made through an SMSF.

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

Let me be very clear – a person requires an AFS licence if they recommend that a member of an SMSF purchase a 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.

In the past year, we have seen an increase in the number of advertisements pushing property purchases through SMSFs. We do not want to see SMSFs become the vehicle of choice for unlicensed property spruikers. Where we see examples of unlicensed SMSF advice we will be taking regulatory action.

Where you see examples of unlicensed SMSF advice, please let us know.

Misleading SMSF advertisements

In the last year we have seen a rise in SMSF advertising. Unfortunately, we've also seen some blatant examples of misleading or deceptive advertisements. Particular problem areas we have seen include misleading or deceptive statements about SMSF fees, returns and risks.

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 advice services (including credit) good practice guidance* (RG 234).

The law provides ASIC and investors with a range of different remedies in cases where misleading or deceptive statements are made. Section 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:

- seeking injunctions to stop the disclosure being made
- seeking civil penalties of up to $340,000 for an individual or $1.7 million for a body corporate
- seeking compensation for investors
- seeking undertakings or orders requiring corrective disclosure
- issuing an infringement notice.

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.

Several matters that include consideration of SMSF advertising related conduct are currently the subject of ongoing investigation within our Enforcement teams.

Ongoing enforcement work

Currently, we have a number of other matters under investigation where the core misconduct being considered revolves significantly around SMSFs. Some observations regarding the nature of these matters are as follows:

- the misconduct generally involves recommendations to retail investors to either establish an SMSF and/or invest their SMSF funds
- the recommendations typically include or lead to the investor switching from their current, APRA-regulated superannuation fund to an SMSF

- the products recommended for investment are varied and include company shares, managed investment schemes, debentures and real property
- some cases involve recommendations to the trustees of SMSFs to loan funds to companies associated with the adviser, investing funds into property developments associated with the adviser
- some matters involve schemes designed to achieve illegal early access to superannuation benefits
- 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
- where misconduct occurs, it is common for high returns to be promised, be that 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
- the people making such recommendations vary and include AFS licensees and people who are unlicensed
- in some cases, the recommended investments have involved large overall losses for the SMSFs.

ASIC has released information to the public concerning a number of the larger enforcement matters that involve significant SMSF-related misconduct. These include Super Save Superannuation Fund, Royale Capital and Trio/Astarra.

In relation to Super Save Superannuation Fund, in February this year the matter resulted in the Supreme Court delivering a record pecuniary penalty of $500,000 and permanent banning for David Hobbs. Mr Hobbs was the 'mastermind' of a number of illegal schemes sourcing investments from Australians, which included SMSF investments in the order of US$6.5 million in two of the schemes.[7]

The Royale Capital matter involves 18 defendants and has had a number of court outcomes to date. The defendants are currently the subject of a civil trial in the Federal Court, which relates to multiple alleged contraventions of the financial services laws.[8]

[redacted]

[7] See Media Release (13-031MR) *Ponzi scheme 'mastermind' handed record penalty* (21 February 2013).
[8] See Media Release (12-161MR) *ASIC obtains court orders against Queensland-based self-managed super advice companies* (12 July 2012) and Media Release (13-054MR) *Provisional liquidators appointed in SMSF investigation* (19 March 2013).

[redacted]

In addition to investigations that involve significant SMSF-related misconduct, ASIC will at any time have a number of other investigations that in some manner involve SMSFs. For example, ASIC is aware that – in relation to the Westpoint, Australian Property Custodial Holdings (APCH) and Banksia matters – funds were raised from the public for investment from a variety of sources, including SMSFs.

Concluding comments

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

Thank you very much for your time this morning. If we have time I'm happy to take a few questions.

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