

GUIDANCE NOTE FOR ADVISING ON SMSFS

GUIDANCE FOR CPA AUSTRALIA PUBLIC PRACTITIONERS

FINANCIAL ADVISORY SERVICES

Continuing growth in the number of self-managed superannuation funds (SMSFs) illustrate the important role that they play for retirement saving and estate planning.

The number of SMSFs still continues to steadily increase. According to the ATO there were just over 572,000 SMSFs at the end of March 2016 with approximately \$590 billion in assets. These figures demonstrate that Australians have certainly embraced SMSFs as a useful tool to save for their retirement.

Accountants are the dominant source of structuring advice on SMSFs and have proved to be strong proponents of their advantages. The purpose of this guidance note is to provide a checklist for those advising clients to ensure that members consider all factors in the choice.

A SMSF is one of several superannuation structures available to individuals to save for their retirement. A SMSF is certainly not appropriate for every client and recommending this structure should only be made after careful consideration of all the benefits and disadvantages of this option, as well as the client's individual circumstances.

This guidance note focuses on three areas:

1. Key factors you should take into account when recommending SMSFs;
2. Advice you can provide regarding SMSFs if you are not licensed under the AFS licensing regime; and
3. The legal requirements for providing super advice for licensed members.

1. FACTORS TO CONSIDER IF RECOMMENDING A SMSF

ASIC Regulatory Guide 175 provides generic guidance on what factors should be taken into account when recommending a financial product. Of particular relevance to SMSFs would be:

- Desire to minimise fees and costs
- Tolerance of the risk that advice (if followed) will not produce the expected benefits
- Existing investment portfolio
- Tax position, social security entitlements, family commitments
- Employment security and expected retirement age.

However, SMSFs are not only a financial product in their own right but also a structure which holds other financial products. As such, a range of additional factors such as control, ease of administration and tax need to also come into the equation.

KEY FEATURES OF SMSFS

Control	<p>Many clients prefer to make their own decisions on the investments of their superannuation savings. Managing their own funds through an SMSF allows them to combine the assets of up to four family members into a single fund and decide where the investments should be made.</p> <p>There are limits on the investments that can be made. As superannuation funds have become more competitive, many now offer investment choices and greater control.</p>
Broadest flexibility of investments	<p>Within the constraints of the rules relating to investments, an SMSF has a greater degree of flexibility of investments, allowing the members to hold a wide range of direct assets through their fund, including 'business real property', as well as make 'in specie' contributions and payments.</p>
Succession planning	<p>A key advantage of an SMSF is the estate planning benefits, allowing family members to combine their assets to grow for retirement. Also a specific asset can be allocated within the SMSF via in-specie allocation and specific rules can also be put in place as to how assets are to be distributed.</p>

Two of the biggest issues that ASIC and the ATO have focused on to date are the costs of SMSFs and SMSFs being established with low account balances.

This does not mean that an SMSF with a low account balance is necessarily inappropriate - there is no legislated minimum. However, this focus and the best interests obligations for licensed financial advisers means you must be able to document the reasons why an SMSF is appropriate for a client demonstrating relevant issues have been discussed, understood and agreed to by the client.

Importantly, there are a number of key factors that need to be considered when recommending SMSFs.

FACTOR	ISSUES TO CONSIDER
Is the client prepared to take control and be actively involved in the financial affairs of the SMSF?	<p>The driving factor in selecting an SMSF structure for your client should be whether the client is prepared and understands the level of involvement they are committing to, if they establish an SMSF.</p> <p>The client must be made aware that establishing an SMSF does not mean they are able to gain early access to their superannuation savings.</p>
Does the client understand their legal and taxation obligations if they establish an SMSF?	<p>Is the client eligible to a trustee of the SMSF? In general, individuals over 18 years old can be a trustee provided they are not under a legal disability or are a disqualified person.</p> <p>As a trustee of the fund and ultimately responsible for the SMSF, even if they obtain help from a professional. Therefore they must be prepared to be personally involved in the fund and understand this will include the need to comply with all taxation and superannuation legislation obligations.</p> <p>Furthermore, an individual who becomes a trustee or director of the corporate trustee of an SMSF must sign a declaration stating that they understand their duties as a trustee of an SMSF. This must be signed within 21 days of becoming a trustee or director, retained for at least 10 years and made available to the ATO if required.</p> <p>Administrative penalties may also be applied where funds fail to lodge returns on time, keep and retain records or advise the ATO of a change of trustee or other changes in the fund, for example.</p>
Is the client aware they are responsible for where their funds are invested?	<p>The client will be required to formulate and implement an investment strategy and ensure that all investment decisions are made in accordance with this strategy. Again, if they obtain help from a financial adviser, they are still ultimately responsible, as the Trustee, for the investments of their fund.</p> <p>A SMSF does allow complete control of the investment decisions, flexibility to change investments and the asset mix. However, does the client know that most other superannuation structures are now catching up and offer the client similar choices?</p>
Are they also aware of the restrictions on underlying assets of the fund?	<p>The client must be aware of the sole purpose test. They cannot purchase an investment that provides them with a benefit before they retire such as a holiday home or buying art as an investment and then hanging it on their wall.</p> <p>Satisfying the definition of holding business real property would be a key consideration. Also, many wraps for example now offer access to direct investments in superannuation products.</p>
Does the client have sufficient funds to establish a SMSF?	<p>Many of the costs associated with running a SMSF are fixed, so for smaller account balances (less than \$200,000), these costs can be significant and uncompetitive with other super options and often outweigh other benefits of a SMSF structure.</p> <p>If the fund has a variety of transactions and types of investments, the costs again can be relatively higher than a public super fund due to economies of scale.</p> <p>SMSF advice is subject to the super switching requirements. It is also a focus area of ASIC. Recommendations to a client to establish an SMSF with insufficient super savings or their circumstances do not otherwise support the advice, will be closely reviewed.</p>

<p>Are they aware of both the initial and ongoing costs?</p>	<p>Initial set-up costs will include the preparation of a trust deed by a solicitor and the trustees will need relevant professional advice (e.g. assistance in preparing the SMSF investment strategy).</p> <p>There will also be annual ongoing costs such as the ATO supervisory levy, accountancy fees to prepare financial accounts, audit fees, preparation and lodgement of annual taxation returns, tax advice and transaction costs on brokerage for example. Additional costs may also be incurred for the ongoing review of the SMSF trust deed.</p>
<p>Is the client prepared and able to allocate the time and skill needed to administer a SMSF?</p>	<p>A significant amount of time and skill is required to manage a SMSF. It is important that the client not only realise this, but that they also have a sufficient level of financial literacy to understand what this means and to comply with all legal requirements.</p> <p>For example if the Trustee, that is the client, breaches the Superannuation Industry (Supervision) Act 1993 and/or the Superannuation Industry (Supervision) Regulations 1994, the penalties can include freezing the assets of the fund, making the fund a non-complying fund so the fund's income is taxed at the top marginal tax rate and/or civil and criminal penalties through the courts.</p> <p>As part of its focus on this area ASIC are monitoring where a financial adviser fails to advise a client properly about the time and skill needed to administer a SMSF.</p>
<p>Will the client still have adequate insurance cover if they establish an SMSF?</p>	<p>The only life and TPD insurance cover that many Australian hold is through their superannuation. The client must be made aware that switching to a SMSF may leave them without any life or other insurance cover, unless the SMSF Trustee specifically takes out insurance for fund members. SMSF insurance may be more expensive and harder to get than in larger funds.</p> <p>Remember, if you are not licensed, you can advise the client of the insurance risks associated with changing superannuation funds. However, you must refer the client to a licensed adviser who can provide the client with advice about the insurance, the amount of cover or specific insurance products within their own or any other super fund.</p>
<p>Has the client had poor experience / general distrust with managed funds?</p>	<p>Clients must be comfortable with their investments. They need to be aware that the negative experiences they had with their managed funds, may still occur with a SMSF structure.</p>
<p>In the case of theft, fraud or a dispute?</p>	<p>SMSFs are not subject to the same government protections that would be available in APRA-regulated funds</p> <p>In the event of theft or fraud, they do not have access to statutory compensation (which can only be granted in specific circumstances by the Minister).</p> <p>There is also no access to the Superannuation Complaints Tribunal in the case of a dispute.</p>
<p>Does the client want to establish a SMSF because it is the 'in' thing to have?</p>	<p>It is important the client is aware of the advantages and disadvantages of this type of structure.</p> <p>They must be comfortable with their investment structure, having a fashionable investment is not always the cheapest or the most appropriate for your client.</p>

2. ADVICE YOU CAN PROVIDE IF YOU ARE NOT LICENSED

CPA Australia members must always be mindful that unless they are appropriately licensed, their ability to consider all the issues and provide comprehensive recommendations is limited.

The accountants' exemption, regulation 7.1.29A of the Corporations Regulations was repealed on 1 July 2016. Accountants can no longer recommend the establishment or winding up of a self-managed superannuation fund unless they are appropriately licensed.

The following is a summary of what advice a 'recognised accountant' (CPA or FCPA) under Regulation 7.1.29.

YOU CAN	YOU CANNOT
	Recommend that your client establish or wind-up an SMSF.
	Recommend a super fund or that a client switches to another type of super fund.
Provide factual advice about the value of consolidating super assets into a single fund.	Recommend transferring assets from any financial asset to another super fund or closing a super fund.
Where the client controls, or will control the management of the SMSF you can process the transfer or rollover of funds into, or out of, an SMSF provided the decision to transfer or rollover the funds has already been made.	Recommend a client transfer or rollover funds to the SMSF.
Advise on administration and operational issues, including establishment, the addition of new trustees/members and valuation of the fund assets.	Provide any advice relating to particular assets of the SMSF, including disposal or acquiring of financial products or classes of financial products. Prepare or review an investment strategy for an SMSF.
If the recommendation is reasonably necessary to and an integral part of advice about the establishment, operation, structuring or valuation of the fund, you may be able to recommend your client join an SMSF. Provide advice for the sole purpose of ensuring compliance e.g. in-house asset rules, modifying contribution levels due to changes in SG.	Recommend the client change contribution level or stop making contributions to an existing fund and instead contribute to the SMSF or change the investment options of an existing fund. Recommend the client's employer cease making SG contributions to another fund and commence making contributions to the SMSF.
Advise a client on whether they should acquire or dispose of an interest in an SMSF, provided the client is or is likely to become a trustee, a director of a trustee, an employer sponsor or a person who controls the management of the SMSF.	Advise on specific investments that should be acquired or disposed of. Provide financial product advice on any other superannuation.
Advise on insurance risks associated with changing superannuation funds.	Provide advice about insurance within a client's super fund or any other fund.
Provide factual information on the tax treatment of contributions and compulsory SG.	Recommend any specific contribution level.
Advise on SIS compliance in a fund audit.	

You can provide financial product advice in the course of advising on taxation issues if you are not licensed, such as taxation implications of holding an interest in an SMSF, HOWEVER, if the service you provide is financial product advice you must give your client a written warning that you are not licensed to provide financial product advice and that they should consider taking advice from an AFS Licensee before making a decision.

In setting up an SMSF, it is important to note that accountants should not be setting up an SMSF from scratch as this would constitute legal advice. Accountants can supply a trust deed prepared by lawyers and arrange to set up the SMSF, but they should not be drafting the documentation themselves unless also legally qualified.

3. PROVIDING LICENSED SUPER ADVICE

A financial adviser must act in the best interests of the client and give priority to the interests of the client when providing personal advice to a retail client.

So, what does this mean? ASIC has formulated a number of basic policy principles as stated in Regulatory Guide 175 (RG 175.214) which will guide its administration of the best interests duty and related obligations:

- a) the provisions are intended to enhance trust and confidence in the financial advice industry
- b) increased trust and confidence in the financial advice industry should lead to more consumers accessing financial advice
- c) the provisions should lead to a higher quality of advice being provided compared to the general standard of advice previously being provided under s945A and 945B
- d) a reasonable advice provider should believe that the client is likely to be in a better position if the client follows the advice. For more information, see RG 175.224–RG 175.231
- e) the best interests duty in s961B, the appropriate advice requirement in s961G and the conflicts priority rule in s961J are separate obligations that operate alongside each other and apply every time personal advice is provided.

Furthermore, if the advice provided does relate to a financial product(s) with an investment component, ASIC consider the 'relevant personal circumstances' of the client will normally include the client's:

- a) need for regular income (e.g. retirement income)
- b) need for capital growth
- c) desire to minimise fees and costs
- d) tolerance for the risk of capital loss, especially where this is a significant possibility if the advice is followed
- e) tolerance for the risk that the advice (if followed) will not produce the expected benefits. For example, in the context of retirement advice, this may include considering longevity risk, market risk and inflation risk
- f) existing investment portfolio
- g) existing debts
- h) investment horizon
- i) need to be able to readily 'cash in' the investment
- j) capacity to service any loan used to acquire a financial product, including the client's ability to respond to any margin call or make good any losses sustained while investing in leveraged products
- k) tax position, social security entitlements, family commitments, employment security and expected retirement age.

Note: This is not an exhaustive list.

If it's apparent that you don't have complete information about your client's relevant circumstances, you'll need to make reasonable inquiries to obtain complete and accurate information.

Super switching advice

Super switching advice refers to personal advice given to a retail client about either (or both) the transfer (in whole or part) of an existing super account balance from one super fund to another super fund or the redirection of future contributions away from one super fund to another super fund.

When providing super switching advice you must comply with the obligations of the best interests duty and related obligations, which means you must:

1. complete a 'fact find' for your client to establish their situation, objectives and needs
2. do your 'homework' on the advice you provide, know your product and the consequences of your advice; and
3. provide advice that's in your client's best interests.

While the 'fact find' will depend on the advice you are providing, ASIC has stated it expects this to include things like:

Your client's age	Dependents	Intended retirement age
Future financial needs and goals	Insurance needs	Desire to minimise fees and costs
Risk tolerance and tax position	Financial literacy	Existing investments, including super

ASIC will generally consider the advice inappropriate if you knew (or should have known) that the:

- overall benefits likely to result from the 'to' fund would be lower than under the 'from' fund, unless outweighed by overall cost savings
- cost of the 'to' fund is higher than the 'from' fund, unless the 'to' fund better satisfies your client's needs.

Where a switch is recommended but there is no obvious overall advantage to the client ASIC will look more closely at the disclosure provided to the client about conflicts, fees and the basis for advice.

The statement of advice must explain, in clear and simple terms, the costs, benefits and significant consequences for your client if the advice is acted on. There are also specific disclosure obligations where switching advice recommends moving your client's existing super fund balance(s) from their current super fund(s) to a new fund.

It may be misleading to describe a feature of the 'to' super fund as a benefit of making a switch unless that feature satisfies a client's need or objective and is not already available in the 'from' fund.

ASIC has stated that where the advice includes a recommendation to switch to an SMSF, it is important for you to consider and discuss with the client a number of the key factors, such as those listed in this guidance note.

In particular, in its surveillance ASIC will look for instances where a financial adviser has:

- advised a client to establish an SMSF when their current super savings are insufficient and their circumstances do not otherwise support the advice; or
- failed to advise a client properly about ongoing costs (at least in very broad terms, based on average costs) and the time and skill needed to administer an SMSF.

REFERENCES

Australian Taxation Office

The ATO have a range of SMSF resources including:

- *Thinking about self-managed super*
- *Setting up an SMSF*
- *Managing your fund's investments*
- *Accepting Contributions*
- *Reporting, record keeping and administration*
- *Accessing your super*
- *Understanding tax and SMSFs*
- *Winding up an SMSF.*

<http://www.ato.gov.au>

Australian Securities Investment Commission

ASIC resources include:

- Regulatory Guide 175 *Licensing: Financial Product Advisers – Conduct and disclosure*
- *INFO 182 Super switching advice: Complying with your obligations*
- *INFO 205 Advice on self-managed superannuation funds: Disclosure of risks*
- *INFO 206 Advice on self-managed superannuation funds: Disclosure of costs*

www.asic.gov.au

CPA Australia

CPA Australia offers a range of SMSF resources, training and events including:

- Financial advice and regulations: Guidance for the accounting profession
- RG 146 Compliance Solution, which includes the Advising in SMSFs Assessment
- SMSF Trustee Education Program
- SMSF Conference
- SMSF Financial statement and compliance audit.

www.cpaustralia.com.au

Acknowledgements

This document is an initiative of the Retirement Savings Centre of Excellence.

Issued July 2016

BE HEARD.
BE RECOGNISED.

