



SMSFs
**A sector
in bloom**

The self-managed superannuation fund (SMSF) sector has been growing rapidly over the last decade, as more investors seek to go it alone with their super. And while the Cooper review has made a range of recommendations on the sector, it still presents opportunities for planners.

According to APRA figures to June 2009, the number of self-managed super funds (SMSFs) has grown steadily from just over 262,175 in 2003 to 414,707 in 2009, with the sector now worth around \$332 billion. This contrasts with continuing consolidation in corporate, industry, public sector and retail superannuation funds, and is illustrative of a desire by investors to have more control of their superannuation fund and investments.

Tim Mackay CFP®, director of Quantum Financial Advisors, which specialises in SMSF advice, is finding that they continue to be the vehicle of choice for wealthy Australians.

“Typically clients who seek to set up their own SMSF are approaching retirement and seeking to optimise their retirement savings, with three clear goals: control and flexibility, tax-effective wealth accumulation, and retirement income strategies. We find many clients interested in SMSFs are currently unhappy with their existing platform-based investment structure where fees and lack of control are an ongoing issue.”

Cindy McDonald, managing director of specialist SMSF advisory firm, Opez, is also seeing more demand for SMSFs as a vehicle to invest in property via instalment warrants, rather than the stockmarket.

The Cooper review

The management and regulation of SMSFs came under close scrutiny this year, with the third phase of the Super System Review (the Cooper review) devoted to this sector. In releasing the report, review chair, Jeremy Cooper, said, “Whichever way we look at it, SMSFs are here to stay, but we want them to focus more on investing for retirement savings, rather than related party transactions, collectables and leverage. Most SMSFs already do this so the vast majority of SMSFs will not be affected by these particular proposals. We think this will be treated as good news in the SMSF sector.

“Our preliminary recommendations are designed to improve the safety and integrity of SMSFs, while continuing to allow a high degree of self-determination and flexibility

for trustees taking responsibility for their own retirement outcomes,” Cooper said.

Some of the key recommendations include:

- prohibiting investment in collectables and personal-use assets (such as artworks, wine collections, exotic cars and yachts);
- strengthening the competence and independence of approved auditors;
- an online SMSF resource centre to help trustees build skills and make better decisions;
- making the Australian Taxation Office’s penalty regime more flexible to enable more effective and equitable regulation;
- tightening the SMSF registration process, including the introduction of member identity requirements, to reduce instances of fraud and illegal early release schemes; and
- reducing the potential to benefit illegally from related party transactions by prohibiting the acquisition of in-house assets and imposing restrictions on the way in which an SMSF can transact with related parties.



Tim Mackay

While these recommendations have not yet been passed into law, particularly in light of the Gillard Government’s re-election, it is worth examining the recommendations and their implications for financial planners.

Overall, the review’s SMSF recommendations have been largely well-received by the financial planning industry, but as always, the devil is in the detail.

Mackay said, “We support the Cooper proposals as they appear to be motivated by strengthening the industry and assisting consumers, which we support, and do not see any

Page 26 ►

major adverse impacts on how we do business. However, we note the proposals lack detail and look forward to industry consultation. It is a concern that some proposals poorly implemented may not address the issues raised in Cooper and therefore industry consultation is vital.”



Andrea Slattery

Education and registration for trustees, auditors and advisers

Under the recommendations, approved SMSF auditors would be required to be registered with the Australian Securities and Investments Commission (ASIC), with registration requirements linked to minimum ongoing competency and knowledge standards. Legislation would also require full audit independence – meaning that if an individual or firm provided any services to an SMSF, it would not be allowed to audit that SMSF.

The review has also recommended that financial planners should obtain specialist knowledge before providing advice on SMSFs. If this recommendation was adopted, RG146 would be amended to include a specialist SMSF component, and planners who had not undertaken specialist education in this area may be required to do so in order to continue providing advice. This recommendation has drawn

support from the Self-Managed Superannuation Fund Professionals Association of Australia (SPAA).

Education of trustees also came under the spotlight in the review.

The FPA’s view, expressed in its submission, was that education and improved competency standards of trustees should be encouraged but not mandated, and that the ATO should establish a dedicated SMSF website with freely available information for trustees.

In its findings, the review did not support compulsory education, but it did favour voluntary education and online resources. However, in situations where trustees breach the legislation, compulsory education may be enforced as part of the ATO’s penalty regime.

Opez’s McDonald is in favour of this recommendation, but believes trustee education would also be beneficial.

“I think that would really reshape the industry, because you would have trustees with a better understanding of the roles they play, which would make them more accountable,” McDonald said.

The industry may be ahead of the curve on accreditation, with SPAA reporting a 30 per cent jump in the number of advisers completing its SMSF accreditation program over the six months to 30 June 2010. Similarly, there has also been a huge 330 per cent increase in the number of auditors completing the SPAA’s specialist accreditation in the same period.

Slattery said SPAA will soon be releasing updated education standards as part of its specialist education program,

WHAT ADVISERS THINK

In the 2010 SPAA Technical Conference Adviser Survey, SMSF advisers have expressed strong support for raising adviser competency standards through the proposed Future of Financial Advice reforms (93 per cent), and 60 per cent agreed SMSF auditors should be registered with ASIC. On the proposal to remove the current accountants’ exemption for advice on establishment of an SMSF, less than

half (43 per cent) those surveyed agreed with the measure, but more than half (56 per cent) supported a restricted licence which would provide greater clarity around who can give advice on the set-up of an SMSF. Only 33 per cent of respondents agreed with the need for financial planners to become registered tax agents in order to provide incidental tax advice. “More than half the survey responses were from financial

planners, so opposition to the tax agent measure clearly signals that planners see the proposal as a backward and unnecessary step for their businesses,” SPAA CEO Andrea Slattery said. “Most respondents favoured restricted tax agent registration for financial planners, which shows a preference for a licensing option that covers their ability to provide incidental tax advice.”

covering a broader range of competencies. Previously focusing on advice, understanding and application of the superannuation, income tax and corporations law, the new standards will now test a range of SMSF knowledge and skills including investment strategies, managing risk and superannuation choice.

Licensing

The exemption held by accountants from being required to hold an AFSL to advise on SMSFs has long been a point of contention. The FPA called for the removal of this exemption in favour of accountants being required to hold a full AFSL, as is the case for financial planners. SPAA also advocated for the removal of the exemption but instead felt a restricted licence regime should be instituted for accountants, recognising the incidental nature of this advice.

The final report of the Cooper review in fact supported the FPA's view – that all SMSF advisers be required to hold a full AFSL licence, in order to create a true level playing field and the same level of accountability and responsibility, regardless of role.

Dr David Knox, senior partner, retirement risk and finance, Mercer, believes this recommendation, if it becomes law, will serve to slow the pace of growth in the sector.

"I think that [recommendation] makes sense. Some of the people who are encouraging these funds at the moment are unlikely to hold the licence. We want to make sure that people who are advised to set up an SMSF receive the best advice possible and have sufficient scale so they can do it efficiently," Knox said.

Another area worth keeping an eye on, according to McDonald, is the government's decision on how the tax agent services regime will apply to financial planners, particularly as former Assistant Treasurer Nick Sherry, the Tax Practitioners' Board (TPB) and ASIC are of the view that financial planners offer what amounts to tax advice in relation to SMSFs. Consultation is underway on whether planners providing tax advice and services within the scope of their AFSL should be subject to additional regulation by the TPB, so this is one aspect planners need to be mindful of.

Investment restrictions

The Cooper review also recommended some changes to the way SMSFs invest, including a prohibition on SMSFs investing

in related parties, and tighter regulations on the acquisition and sale of assets from related parties. Under the recommendations, these assets must be conducted through the market, where an underlying market for that asset exists, and if no market exists, independent valuation must be sought.

According to Chris Morcom CFP, private client adviser and director of Hewison Private Wealth, the implication of this recommendation is that the popular strategy of individuals making in-specie contributions of personally owned shares to their SMSF will no longer be available.

Instead, under Cooper's recommendations, individuals would have to sell those assets, transfer the cash to their

Page 28 ►

NEW ATO INITIATIVES ON REGISTRATIONS AND ROLLOVERS

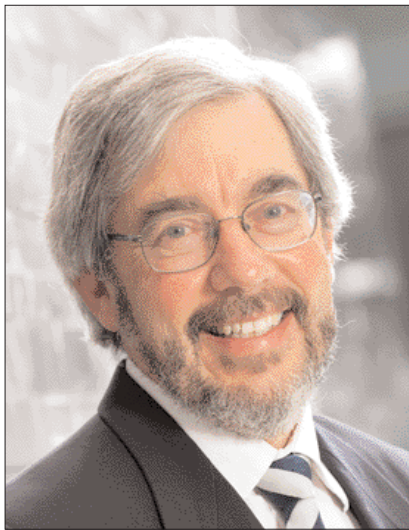
The ATO has rolled out a series of initiatives designed to improve the integrity of the SMSF registration and super rollover process, including measures to prevent illegal early access to super.

Changes to the SMSF registration process include the ATO completing a risk assessment on all new SMSF trustees and the use of a new 'Registered – status not determined' status in the ATO's Super Fund Lookup (SFLU). As a result of these changes, it currently takes up to seven days before an SMSF's details are shown on SFLU. This provides time for SMSF trustee risk assessments to be completed by the ATO and means the ATO can identify and prevent illegitimate SMSFs from operating.

The ATO also stated that later this year it would implement the SMSF member verification service that will provide greater transparency around rollovers from APRA regulated funds into SMSFs. This change will mean APRA regulated funds making a rollover to an SMSF can check the member requesting the rollover is a member of an SMSF. The service will enable APRA regulated funds to have more confidence that a rollover is genuine when interacting with members of an SMSF and reduce the risk of fraud and other illegal activity. APRA regulated funds must then rollover funds in a timely manner to registered SMSFs when the rollover request and legislative requirements have been met.

superannuation fund and then re-buy those assets in the fund.

“We believe this change is ludicrous and will only increase red tape with no benefit to the superannuation system or its SMSF participants. The current system works, has strict obligations on trustees, and is cost-effective. The recommendation would increase costs and investment risk should markets move during transactions,” Morcom said, adding that he does believe independent valuation for some assets makes good sense.



Dr David Knox

McDonald supports these provisions as a means of improving the integrity of the SMSF system – particularly given that during the GFC, there was some “creative licence” about market values used when moving assets between SMSFs and other related parties, and some serious compliance issues arising.

Also recommended was that the 5 per cent limit on in-house assets be abolished, and that the instalment warrant arrangement remain in place, effectively continuing to allow gearing within SMSFs. The report did, however, recommend that a review be undertaken in two years to ensure gearing had not become a focus of SMSFs.

While the report included a recommendation to ban collectables and personal-use assets, the Federal Government later made a statement that it would not be implementing this proposal, although these assets will be subject to new legislative standards around their storage, documentation and valuation.

Penalty regime

The Cooper report also contained considerable detail about the penalty regime applying to SMSFs and the powers wielded by the ATO, including proposing a sliding scale for breach penalties, according to the seriousness of the breach, giving the ATO the power to issue directions for a breach to be rectified within a specified period, and to issue binding rulings in relation to SMSFs, providing greater clarity to trustees and service providers. As previously mentioned, mandatory trustee education would also be

recommended in the instance of a breach.

“I think a couple of things will come out of that. If, on the back of advice from a financial planner, a trustee is in breach and has to attend mandatory education, planners are going to have to be more conscious of their role in that occurring,” McDonald said.

She also believes that the Cooper review has not gone far enough in requiring reporting of the adviser who originally recommended that the client enter an SMSF, alongside other professionals such as the tax agent.

“When the regulator is aware of who that adviser is, they are more accountable. I think that would force them to be more mindful and conscious of the compliance requirements of the trustees,” McDonald said.

Changes to insurance within SMSFs

Under Cooper’s recommendations, trustees may also need to consider the life and total disability insurance needs of members in an SMSF, similar to the way in which trustees are currently required to consider the objectives and risk appetite of members when constructing a SMSF investment strategy.

Morcom said while it will not be required in writing, best practice would suggest documenting the insurance strategy of the SMSF in a similar fashion to the investment strategy of the fund.

SuperStream

While not directly related to SMSFs, Knox believes the SuperStream proposal – that is, the evolution of the superannuation back-office into a much more electronic environment – also has important implications for the sector.

“For many SMSFs that might not be such a big deal – if they deal with an accountant, lawyer or other small administrator, they might be doing that anyway,” Knox said, adding that for those still working with paper-based correspondence, it is more likely to be significant.

“It will cost money in terms of infrastructure initially, but longer-term, it will save a lot of money,” Knox said.

All eyes are now on new Assistant Treasurer and Minister for Financial Services and Superannuation, Bill Shorten, for an indication of if, how and when these recommendations will be adopted – but with strong investor engagement and a more robust regulatory framework, the SMSF sector may gather even more momentum. ♦