NTAA ADVICE

The NTAA's Financial Advice Newsletter Edition No. 4

Trustees' and Advisers' obligation in relation to SMSFs

In its ongoing surveillance of advice regarding SMSFs, ASIC is promoting that potential trustees be given more information when being advised to commence their own fund.

While these measures are targeted at financial planners providing SMSF advice, it will also encompass accountants operating under a licence (when the accountant's exemption has been removed).

Duties, obligations and risks

ASIC believes that the minimum advice to be given to clients should include information about the responsibilities of trustees, such as:

- the need to formulate an appropriate investment strategy;
- what the annual administration requirements are; and
- that while tasks may be outsourced to administer the fund, the trustee is ultimately responsible.

ASIC believes that the due diligence to support the recommendation of an SMSF would then include ensuring the client has the ability to meet those obligations.

This action may be the result of an explosion of SMSF numbers in recent times (many due to conflicted advice to do with property investment).

For accountants to demonstrate that they are acting in the clients' best interests, adopting a process to consider these issues might be a prudent form of business risk management.

For example, a checklist for this might include points such as:

- Does the client have past investment experience?
- Has the client demonstrated an ability to manage their business/financial affairs?
- Does the client readily accept suggestions or advice regarding their situation?
- Have I outlined to the client that they are ultimately responsible for running the fund?
- Has the client offered direct input into their role in the operation of the fund?

Such points held on file will provide support should advice provided in this area ever come into question.

How much is not enough?

Further to the above, ASIC commissioned Rice Warner to examine what would be the minimum cost effective SMSF balance.

Their findings were:

- A balance of less than $100,000 would not be competitive with other funds (regulated by APRA*) in the short term;
- A balance between $100,000 and $200,000 could be competitive with other APRA regulated funds if the trustees take on the broader investment and administration functions; and
- Balances between $200,000 and $500,000 could provide equivalent value with APRA regulated funds.

Such analysis cautions the need for good record keeping to support the advice in relation to setting up an SMSF should it ever be questioned by clients or regulatory bodies.

Further analysis should be made to show the SMSF places the client in a better position, as per the "Clients Best Interest Duty".

Consideration must not only be given to costs (in both dollar and percentages terms) but also to any benefits lost such as insurance cover that may be in place when changing over from the APRA fund.

Similar to the above checklist of trustee qualities, a checklist for cost/benefit comparison could be best practice as we move forward to the world where you will need to be licensed to give SMSF advice.

**Australian Prudential Regulation Authority*

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Investment Strategy – what can I do?

Under The Accountants' Exemption, Not very much!

Operating under the accountant's exemption only allows advice on the set-up of an SMSF; not on the investments within it.

So while an investment strategy is an essential part of the SMSF, directing clients as to what to invest in for the SMSF can lead to a breach of the Corporations Act.

Definition

To be clear, to provide financial product advice requires a person to be authorised under an Australian Financial Services Licence (AFSL).

So what is "financial product advice"? It is:

"A recommendation or statement of opinion ... intended to influence a person or persons in making a decision of a particular financial product or class of financial products ..."

This is taken from ASIC's Regulatory Guide (RG) 36 and tells us that if what you say influences a person to invest in a product or even a type (class) of product then you have given financial advice.

For this you need to be authorised.

What can I do if I'm not authorised under an AFSL?

If you are not authorised, then your advice must necessarily be very general.

Basically you can help them set goals for what their investments are to achieve (liquidity, tax benefits, returns).

You can also help them understand basic concepts such as:

- Diversification – the "putting all your eggs in one basket" image is a simple but still effective means by which to explain this.
- Volatility – property and share markets have done well over the last couple of years, but we all remember the Global Financial Crisis.
- Risk vs. Reward – remind them that if they want great returns then they need to be able to cope with the occasional loss.

The 'Trade-Off' Concept

This can be crucial to a trustee planning their way forward because it helps them understand that not all investments will do everything.

Most investors are seeking the high returning, capital guaranteed, tax reducing investment. Unfortunately no such thing really exists.

This is where an accountant can guide a general discussion of areas a client should consider. For instance:

- Guaranteed funds and high returns – as already discussed, taking on risk for higher returns normally involves accepting there may be a loss – only bank deposits are guaranteed (ask Banksia Group investors);
- High returns and liquidity – the price to pay for quick access is a lesser return; and
- Guaranteed funds and tax benefits – tax benefits are normally associated with share and property investments that don't provide a guarantee of the amount invested.

By guiding the clients through these points you will help them meet and understand their trustee responsibilities.

While the accountant's exemption provides some ability to advise clients on their SMSF needs, it does not offer the flexibility that comes with being licensed.

What if I want to do more?

If you want to really help your client by giving them real direction with product advice you'll need to be authorised under an AFSL.

To help you make the transition to the new way of SMSF Advice, the NTAA provides the support with:

- **The NTAA's SMSF Advisers Network Australian Financial Services Licence** – a licence by which you can continue to advise clients on their SMSF needs, with the flexibility to allow those who wish to place investments and personal insurance.

For more information please go to the NTAA website and visit the section on **NTAA ADVICE.**

What you need to know about SMSFs and "collectables"

The government has implemented legislation (with effect from 1 July 2011) specifying how and when SMSF trustees can invest in collectables and personal use assets. These provisions cover such assets as artwork, jewellery, antiques and wine.

Briefly, the provisions are that:

- SMSF trustees must not lease collectables and personal use assets to a related party of the SMSF;
- SMSF trustees must not allow collectables and personal use assets to be used by a related party of the SMSF;
- SMSF trustees must not store collectables and personal use assets in the private residence of related parties (and must keep written records for at least 10 years of any decisions regarding storage);
- the transfer of a collectable to related party requires independent valuation; and
- within seven days of acquisition, SMSF trustees must insure collectables and personal use assets in the name of the SMSF.

The provisions are relatively strict and severe penalties apply to each and every trustee involved in the case of a contravention, i.e., if both spouses are trustees, they will each be subject to a penalty on each offence.

Collectables acquired prior to 1 July 2011 must comply with the new regulations by 30 June 2016. Collectables acquired after 30 June 2011 must comply with the new regulations immediately.

Members/trustees of SMSFs think twice before going overseas!

There are serious taxation consequences for a superannuation fund (including an SMSF) that ceases to be a resident fund and therefore loses its complying status.

To be a complying superannuation fund, an SMSF must be an **Australian superannuation fund** at all times during the year of income when it was in existence. This requires the following:

(a) The SMSF was established in Australia or any asset of the SMSF is situated in Australia at that time; **and**

(b) At that time, the central management and control of the SMSF (i.e., trustees decision making) is ordinarily in Australia; **and**

(c) At that time, if the SMSF has active member(s) (i.e., member(s) making contributions or on whose behalf contributions are made), at least 50% of the SMSF's assets are attributable to superannuation interests held by active members **who are Australian residents.**

Once an SMSF ceases to be a resident superannuation fund, it automatically ceases to be a complying fund. Accordingly, care must be taken by trustees of SMSFs who are considering going overseas, or who already live overseas, to ensure that their fund does not lose its complying status as a non-resident fund.

The following strategies should be considered by trustees of SMSFs who are considering going overseas, in order to ensure that their fund continues to be a resident fund.

- A member's legal personal representative (including someone who holds **an enduring power of attorney**) may possibly be appointed as a trustee (or director of the corporate trustee) in place of the member;
- The individual trustees/corporate directors of an SMSF may **delegate all or any of their duties and powers** where permitted by the trust deed of the fund and the relevant trustee and superannuation legislation;
- the benefits of the members in the SMSF planning to move overseas can be **rolled over to another superannuation fund**, such as a master fund, after which the SMSF may be wound up.

Detailed legal and tax advice should be sought in relation to the proper implementation of the above strategies.

Retirement not according to plan

A recent survey performed by HSBC has painted a relatively bleak picture of retirement for Australians.

The 16,000 person global study included responses from 1,000 Australians (just over 6% of the total sample) in which it was found:

- 40% find their income at retirement drops by half;

- only 60% regard their retirement income as adequate; and
- one in six working Australians believes he or she will never be in a position to fully retire.

The "Sole Purpose Test" for an SMSF is to provide benefits to members on retirement.

Establishing the fund should have trustees consider their retirement funding position and whether their investment and contribution strategy will meet their needs.

Look to the future

You can help your clients begin the planning process very simply.

Ask them "What income would you need if you retired today to do the things that you want?"

Help them imagine the retirement years:

- What do they plan to do with their time?
- Will they be replacing any items (e.g., car) or taking on additional expenditure (e.g., travel)?
- Do they plan to take up a new activity?
- What will these things cost?

What can we take from this?

It goes without saying that the better the planning, the better the outcome.

What should also be said is that the earlier the planning, the less impact on your current situation. There is no better time to plan in this way than when setting up an SMSF.