

Cooper Review puts the spotlight on SMSFs

On 14 December 2009, the panel charged with conducting a comprehensive review of Australia's superannuation system (the Cooper Review), released its [Phase Three: Structure Issues](#) paper.

The second part of this issues paper is dedicated to *SMSF Issues* and raises a number of broad-ranging issues relevant to the SMSF superannuation sector.

The issues set out in the paper are not intended to be exhaustive, nor is the scope of submissions limited to the issues identified in this paper. The closing date for submissions is 19 February 2010.

The table below provides a summary of some of the key questions raised in the paper specific to SMSFs. These issues have been broadly grouped into topic areas which may be of particular interest to SMSF planners:

Issue	Questions raised
Trustee/Structural Issues	
Trustee Issues	<ul style="list-style-type: none"> – Are the current SIS requirements, broadly requiring all trustees to be members and all members to be trustees, still appropriate for SMSFs? – What purpose does the current limit on fund members serve? Is four the right number? Why not seven or ten? Alternatively, should SMSFs be limited to one member? – If the membership limit were to be increased, should other conditions such as family relationships be imposed on fund membership? – As trustees are responsible for managing their fund's affairs and it is their own retirement savings that are influenced by their management, should trustee responsibilities be less onerous than for trustees of APRA-regulated superannuation funds? – Is there an age where the trustees of an SMSF need to be encouraged to move their retirement income arrangements out of their own hands or at least into simpler products needing less active management?
Trustee education	<ul style="list-style-type: none"> – Given the obligations of being a trustee and the minimal barriers to entry, should there be some minimum level of financial and compliance knowledge/ongoing training required? – Is there another way of addressing the issue of low trustee financial literacy, such as a mandated limitation on the products in which SMSFs are permitted to invest?
SMSF structure	<ul style="list-style-type: none"> – SMSFs are trust (and tax) structures, governed by their trust deed and the SIS Act, which also specifies obligations of trustees that automatically form part of the SMSF's governing rules. An alternative model would be for SMSFs (and the rules that govern their operation) to be created by legislation, rather than by private instrument. A SMSF could then be created simply by completing an approved form and paying a prescribed fee to the ATO. Alternatively, a standard trust deed could be provided by the ATO at no cost. Trustees could elect to opt-out of the standard trust deed and use their own if they wished. – Would either of these approaches save costs and benefit new SMSF members?
Custody	<ul style="list-style-type: none"> – Could aspects of the Small APRA Funds (SAF) model be incorporated into SMSFs, such as a hybrid structure where trustees are comprised of both members and an independent external trustee? – Would third party custody of fund assets have a role to play in removing the instances of illegal early release (and other breaches of the SIS Act) in the industry? – For new SMSFs should custodial arrangements be mandated for at least an initial period, or universally?

SMA's and wraps	<ul style="list-style-type: none"> – Could these be viable alternative structures to SMSFs? If so, what would need to be done?
SMSF Investment Issues	
Asset allocation	<ul style="list-style-type: none"> – SMSFs in pension phase show very similar asset allocations to SMSFs in accumulation phase. Is this optimal for SMSF members given the different liquidity requirements of the two phases? If not, what could be done about it? – Would it assist SMSF members if there was more information available to help them understand asset allocation, diversification and other investment concepts? – SMSFs have been over-represented among the creditors to several high profile corporate failures such as Westpoint, while the balance of the superannuation industry had very little exposure. Does this reflect a particular vulnerability for SMSFs in the face of commission-driven marketing by financial advisers?
Investment Restrictions	<ul style="list-style-type: none"> – Should SMSFs be required to invest funds in a certain manner within a specified time period or should it be left to the judgment of the trustees? – Should SMSF investments be restricted to what might be regarded as 'financial assets', such as listed equities and managed funds? – Should SMSFs be permitted to continue investing in artwork and collectables or should they be phased out over time?
Borrowing/ Leverage	<ul style="list-style-type: none"> – Should leverage which places at risk an amount greater than the initial capital investment be permitted in SMSFs? – Are the current exceptions to the borrowing prohibition suitable or have the most recent changes, which allow for instalment warrant arrangements for assets other than shares, gone too far?
In-house assets and related parties	<ul style="list-style-type: none"> – Should the in-house asset investment concessions, allowing trustees limited investment in related parties, continue within SMSFs? – Are there benefits to the superannuation system or the broader economy in allowing SMSFs to partially finance trustee's related businesses?
Acquisition of assets from related parties	<ul style="list-style-type: none"> – Are the current exceptions that apply to the prohibition against acquiring assets from related parties, generally where an unambiguous market valuation can be established, still appropriate for SMSFs?
Investment strategies	<ul style="list-style-type: none"> – Is there benefit to be gained in seeking to increase the regulatory burden around investment strategies or should it be presumed that self-interest will prevail to see the appropriate investment strategies undertaken?
Regulatory/Compliance Issues	
Role of the ATO and other regulators	<ul style="list-style-type: none"> – Are the ATO's regulatory powers strong enough, or appropriate, in the SMSF sector? – Is the ATO the appropriate regulator for SMSFs? – Would it be in the interest of SMSF members to legislate that responsibility for some actions rested with parties other than the trustee or is the current structure where trustees are ultimately responsible for their actions the right setting?
Compliance coverage	<ul style="list-style-type: none"> – Given the significant portion of retirement benefits under the control of an ever-increasing number of SMSF trustees, what level of oversight is required? – Given the community interest in the efficient operation of SMSFs, should the supervisory levy, currently set at \$150, be increased to, say \$500, to match the level applying to SAFs to fund higher levels of regulatory oversight?
Penalties	<ul style="list-style-type: none"> – Is the existing penalty regime that applies to SMSFs appropriate? – Would a sliding scale of administrative penalties, that are applied against the trustees (jointly and severally), or enforced third party custody of fund assets, be more appropriate or useful adjuncts to the existing powers?
Advice Issues	

Advisers	<ul style="list-style-type: none"> – Should competency standards be increased (i.e. beyond ASIC Regulatory Guide 146 standards) for financial advisers who provide advice to SMSF members? – The justification for this would be that an SMSF is a special vehicle and not directly prudentially regulated. Under such a proposal, if an adviser wanted to provide advice to an SMSF, they would need to have a higher standard of training and be licensed accordingly. This could increase the cost of SMSF advice, but the average SMSF has substantial assets and therefore could afford to pay for higher quality advice. – The question then arises whether remuneration for advice to SMSFs (that is paid for out of the fund) should be restricted to a fee-for-service model (subject to the sole purpose test). That way, the true cost of the advice could be determined at the time it is given and it would be more likely to be in the best interests of the members. – Is there justification for a different charging model for advice to SMSF members?
SMSF costs	<ul style="list-style-type: none"> – Are SMSF trustees aware of the cost of operating their SMSF and do they understand the cost of alternative structures? – What is the best method of comparing the cost of running an SMSF with the cost of other options? – Is there appropriate disclosure of costs by service providers or through other avenues? – Are SMSFs disadvantaged compared to APRA-regulated funds by their lack of scale because they cannot adequately defray fixed costs and cannot access certain investment products or markets or can only do so at uncompetitive prices?
Barriers to entry	<ul style="list-style-type: none"> – There is no particular licence or other qualification needed to establish and recommend that a person acquire an SMSF, and there is no qualification or other requirement imposed on a person wanting to become a member/trustee of an SMSF. – Should there be barriers to entry in either sense? If so, what barriers?
Minimum monetary balance	<ul style="list-style-type: none"> – Is there any justification to mandate a minimum balance for establishing an SMSF, perhaps by imposing controls on the persons authorised to establish SMSFs? – Alternatively, can this issue be addressed through education and the publication of better data?
Life insurance default	<ul style="list-style-type: none"> – Does there need to be an insurance default in the SMSF sector, for example similar to the minimum insurance cover required for default funds? – Would compulsory death or disability insurance be inconsistent with the self-managed character of an SMSF?
Other Issues	
Complexity	<ul style="list-style-type: none"> – Do the current compliance requirements for SMSFs impede an individual's choice to manage their superannuation given the perceived complexity in operating an SMSF? – Alternatively, given the complexities of managing a person's retirement savings, do the perceived complexities amount to a useful barrier of entry to the sector?
Dispute mechanisms	<ul style="list-style-type: none"> – Should the SCT's jurisdiction be extended to resolve disputes between SMSFs and third parties affected by a decision of the SMSF trustee? – Given that all SMSF members are also trustees, is there any need for an external complaint mechanism other than a court? – Is the exclusion of SMSF members from the financial assistance provisions of SIS still appropriate? – For disputes with the ATO, is there a need for a simpler resolution mechanism than the initial internal ATO review followed by access to the Administrative Appeals Tribunal if still dissatisfied? – Would there be any benefit in extending the legally binding ruling system to the SIS Act, which would be equivalent to the private ruling system for income tax?
Technology	<ul style="list-style-type: none"> – Can more technology be applied to the operation of SMSFs to drive down costs, improve efficiency in administration and improve regulation?
Accounting and Auditing issues	
Accountants	<ul style="list-style-type: none"> – Should all SMSFs be required to use at least one key service provider licensed by ASIC? – Is the existing accountants' exemption appropriate and should it be maintained, or should it be broadened as per the recommendation by the Parliamentary Joint Committee on Corporations and Financial Services (PJC) report?

Audits	<ul style="list-style-type: none"> - The interaction of approved auditors with trustees often occurs months after the end of the financial year being audited. Potentially, a contravention could occur between seven and 22 months before an audit takes place. Should this time period be reduced or should administrators, who could have more active involvement with SMSFs, play a greater role? - Should the requirement for annual audits be retained or should they be less frequent? - Anecdotal evidence suggests there is insufficient emphasis being given to the SIS compliance component of the audit. Is this observation correct? If so, how could this be improved?
Auditor competence	<ul style="list-style-type: none"> - Are current professional requirements and audit competency standards adequate? - Do approved auditors in general have the necessary level of skill and expertise to audit SMSFs? - Given the key role auditors play, how independent should auditors be from those who administer SMSFs, prepare their financial accounts or annual returns, or provide financial advice? - Should approved auditors be registered?
Illegal early access schemes	
Illegal early release	<ul style="list-style-type: none"> - What weaknesses exist in the governance framework and what controls could be implemented to reduce the likelihood of such frauds continuing to occur? - Are there still too few barriers to SMSF establishment which benefit scheme promoters? - Can the SMSF registration process be further improved to mitigate the risks of illegal early release? If so, how? - Can 'Super Fund Lookup' be expanded to provide member details to enable APRA-regulated funds to verify that a requested rollover is to an SMSF of which the transferring member is a trustee? - Would verification of bank account details, such as a bank audit confirmation by the recipient institution, act as a significant deterrent to would-be offenders?
Penalties - scheme promoters	<ul style="list-style-type: none"> - While the ATO is able to apply tax penalties to illegal scheme participants affecting SMSFs, scheme promoters are generally outside its reach and it requires ASIC's intervention to prosecute the promoters. - Would it be more appropriate for the ATO to deal with both the participants and promoters?
Auditing SMSF establishment	<ul style="list-style-type: none"> - Would the SMSF system benefit by having an approved auditor verify that a fund was appropriately established before it could be registered with the ATO? - Would there be value in having an approved auditor attest that the fund's deed satisfied the SIS requirements, that all members were trustees or trustee directors, and that none of the members was a disqualified person? - Would this reduce the number of new illegal early release schemes?

While this update provides a list of key questions, it is not intended to provide a complete list. To access the paper directly, please click on the link provided on page 1.

TapIn will endeavour to keep you updated as further developments come to hand.

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