

# Guidance Note for advising on SMSFs

Guidance for CPA Public Practitioners  
October 2006

Spectacular growth in the numbers of Self Managed Superannuation Funds (SMSFs) illustrate their well recognised benefits for retirement saving and estate planning.

From June 2001 to June 2006 their numbers increased from 210,667 to 320,003 with a total of \$209.9 billion in assets. Speculation that changes to rules would reduce their popularity have proved unfounded. In the first six months of 2006, a further 10,219 funds were established. While demonstrating a slowing of the growth rates of 2003 and 2004, Australians have embraced SMSFs as a useful tool.

Accountants are the dominant source of advice on SMSFs and have proved to be strong proponents of their advantages. The purpose of this guidance note is NOT to provide detail on either the operation of SMSFs nor to emphasise the benefits but rather to provide a checklist for those advising clients to ensure that members consider all factors in the choice.

An SMSF is one of several superannuation structures available to individuals to save for their retirement. An 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. What key factors members should take into account when recommending SMSFs;
2. What advice members can provide regarding SMSFs if they are not licensed under Financial Services Reform (FSR); and
3. What the legal requirements are for providing advice for members who are licensed.

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## 1. Key factors you should take into account when recommending SMSFs

ASIC Policy Statement 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 the advice (if followed) will not produce the expected benefits;
- existing investment portfolio; and
- 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.

The differences that apply if you are not operating under a Financial Services License are so important that we devote sections 2 and 3 to them.

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## KEY FEATURES OF SMSFS

<p><b>Control</b></p>	<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 and have prepared for choice of superannuation fund, many have offered investment choice so that there has been an increasing amount of space for control.</p>
<p><b>Broadest flexibility of investments</b></p>	<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> <p>Within an SMSF it is possible to operate different types of pensions in the same fund.</p> <p>Currently, the types of pensions that may be commenced by an SMSF are limited to market-linked income streams (MLISs) and allocated pensions, though commercial defined-benefit pensions can be purchased by the fund.</p> <p>The changes announced in the 2006 Federal Budget will open new options for SMSFs in relation to the types of pensions available.</p>
<p><b>Succession planning</b></p>	<p>A key advantage of an SMSF is the estate planning benefits, allowing family members to combine their assets to grow for retirement.</p> <p>In the context of a defined-benefit pension, this was particularly useful as any unused balance on death of a member remained in the fund rather than, as with a lifetime annuity purchased from a life office, reverting to the life office.</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. **(That does not mean that an SMSF with a low account balance is necessarily inappropriate. It just means that there is an even greater requirement to be able to document the reasons why it is appropriate and demonstrate that the issues have been discussed and agreed with the clients.)**

There are a number of key factors that need to be considered when recommending SMSFs:

FACTOR	ISSUES TO CONSIDER
<p>Is the client prepared to take control and be actively involved in the financial affairs of the SMSF?</p>	<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 also needs to be made aware that establishing an SMSF does not mean that they are able to gain early access to their superannuation savings.</p>
<p>Does the client understand their legal and taxation obligations if they establish an SMSF?</p>	<p>The client will ultimately be 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. For example, they will be required to keep proper records such as accounting records and minutes of meetings and retain these for the required 5-10 years.</p>
<p>Is the client aware that they are responsible for where their funds are invested?</p>	<p>The client will be required to have 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>An 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>

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FACTOR	ISSUES TO CONSIDER
Are they also aware of the restrictions on underlying assets of the fund?	<p>The client must be aware of the sole purpose test, that is the SMSF must be maintained for the sole purpose of providing benefits to members upon their retirement. Therefore 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. Other than that, many wraps for example now offer access to direct investments in superannuation products.</p>
Does the client have sufficient funds to establish an SMSF?	<p>Many of the costs associated with running an SMSF are fixed, so for smaller account balances (less than \$200,000), these costs can be significant and uncompetitive with other available super options. Therefore they often outweigh other benefits of an 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>ASIC have cautioned planners they will be watching cases where a planner has advised a client to establish an SMSF when their current super savings are insufficient and their circumstances do not otherwise support the advice.</p>
Are they aware of both the initial and ongoing costs?	<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 that may include accountancy fees to prepare financial accounts, audit fees, preparation or lodgement of annual taxation and APRA returns, tax advice and transaction costs on brokerage for example.</p> <p>ASIC are monitoring where a planner has failed to advise a client properly about all ongoing costs.</p>
Is the client prepared and able to allocate the time and skill needed to administer an SMSF?	<p>A significant amount of time and skill is required to manage an 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 <b>Superannuation Industry (Supervision) Act 1993 and/or the Superannuation Industry (Supervision) Regulations 1994</b>, 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>ASIC are monitoring where a planner has failed to advise a client properly about the time and skill needed to administer an SMSF.</p>
Will the client still have adequate insurance cover if they establish an SMSF?	<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 an 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 as this is factual information BUT you must refer the client to a licensed adviser to provide the client with advice about the insurance within their own or any other super fund.</p>
Has the client had poor experience / general distrust with managed funds?	<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 an SMSF structure.</p>
In the case of a dispute?	<p>There is no access to the Superannuation Complaints Tribunal in the case of a dispute with an SMSF.</p>
Does the client want to establish an SMSF because it is the 'in' thing to have?	<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>

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## 2. Advice you can provide regarding SMSFs if you are not licensed under FSR

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. This section focuses on what services CPA Australia members can and cannot provide in regards to SMSFs if they are not licensed under FSR.

Regulation 7.1.29 of the Corporations Regulations **permits** accountants to provide limited advice regarding the establishment, operation or valuation of an SMSF without the need to be licensed, provided that no recommendations are made and any advice given does not

relate to the acquisition or disposal by the superannuation fund of specific financial products or classes of financial product. In all cases where an accountant can provide advice under this exemption, the client must be or is likely to become a trustee, a director of a trustee, an employer sponsor or a person who controls the management of the superannuation fund.

The following is a summary of what advice you can and cannot provide as a 'Recognised Accountant' (i.e. CPA or FCPA) under Reg 7.1.29 and Reg 7.1.29A:

YOU CAN	YOU CANNOT
✓ Recommend that your client establish an SMSF	<ul style="list-style-type: none"> <li>✗ Recommend a super fund other than an SMSF</li> <li>✗ Recommend a client switch into another type of superannuation fund</li> </ul>
✓ Provide factual advice about the value of consolidating super assets into a single fund	<ul style="list-style-type: none"> <li>✗ Recommend transferring assets from any financial asset to another</li> <li>✗ Recommend closing a super fund</li> </ul>
✓ 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 where the decision to transfer or rollover the funds has already been made	<ul style="list-style-type: none"> <li>✗ Recommend a client to transfer or rollover funds to the SMSF</li> </ul>
✓ Provide advice about administration and operational issues – including how to establish an SMSF, the addition of new trustees and members and valuation of the fund assets	<ul style="list-style-type: none"> <li>✗ Give any advice that relates to particular assets of the SMSF, including disposal or acquiring of financial products or classes of financial products</li> <li>✗ Prepare or review an investment strategy for an SMSF</li> </ul>
<ul style="list-style-type: none"> <li>✓ 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</li> <li>✓ Provide advice for the sole purpose of ensuring compliance with super legislation such as in-house asset rules and modifying contribution levels due to changes in the super guarantee level</li> </ul>	<ul style="list-style-type: none"> <li>✗ 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</li> <li>✗ Recommend the client's employer cease making super guarantee contributions to another fund and commence making contributions to the SMSF</li> </ul>
✓ Provide a recommendation to a client on whether the client should acquire or dispose of an interest in an SMSF, however the client must be 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	<ul style="list-style-type: none"> <li>✗ Advise the client on specific investments that should be acquired or disposed of</li> <li>✗ Provide financial product advice on any other superannuation</li> </ul>
✓ Advise on insurance risks associated with changing superannuation funds	<ul style="list-style-type: none"> <li>✗ Provide advice about insurance within a client's super fund or any other fund</li> </ul>
✓ Provide factual information about the tax treatment of contributions to superannuation and the level of the compulsory superannuation guarantee	<ul style="list-style-type: none"> <li>✗ Recommend any specific contribution level</li> </ul>
✓ Advise on SIS compliance in a fund audit	

**CPA Australia strongly recommends that members familiarise themselves with Regulation 7.1.29 and Regulation 7.1.29A.**

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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 to the clients and arrange to set up the SMSF, but they should not be drafting the documentation themselves unless also legally qualified.

### 3. The legal requirements for providing advice by members who are licensed

Section 945A(1)(c) of the Financial Services Reform Act (FSRA) states that advisers must only provide advice to a client if 'the advice is appropriate to the client' having regard to the client's personal circumstances.

So, what does this mean? ASIC specifies in Policy Statement 175 (section 89) that in administering the law on the appropriate advice requirement, they will take into account all the circumstances when determining whether s.945A(1)(c) has been satisfied, including (but not limited to) whether the advice, if acted upon by the client, would be reasonably likely to satisfy (or fail to satisfy) critical aspects of the client's relevant personal circumstances (e.g. the client's need for regular income).

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 of the risk of capital loss, especially where this is a significant possibility if the advice is followed;
- e) tolerance to the risk that the advice (if followed) will not produce the expected benefits;
- f) existing investment portfolio;
- g) need to be able to readily cash-in the investment;
- h) capacity to service any loan provided for a financial product; and
- i) tax position, social security entitlements, family commitments, employment security and expected retirement age.

Note: This is not an exhaustive list. The client's relevant personal circumstances (as defined in s761A) include any other matter that would reasonably be considered to be relevant to the advice. This would normally encompass any matter that the client indicates is important.

### Super Switching Advice

There are no new rules when it comes to superannuation switching advice, as an adviser you must still:

- **Know your client:** work out their situation, objectives, needs and their financial literacy level
- **Have reasonable basis for advice:** know your product and the consequences of your advice, ensure the advice is appropriate for the client
- **Comply with statement of advice (SOA) requirements:** the SOA must clearly and in simple terms set out your advice, the basis for your advice, the costs, benefits and any significant consequences for your client should they act upon the advice. Remember your disclosure requirements under s.947D (additional requirements when the advice recommends the replacement of one product with another).

ASIC defines 'switching' as both the transfer of the whole or part of an existing super account balance and also the redirection of future contributions.

You **must always** consider both the 'to' and 'from' funds when providing super switching advice. What you will need to consider will vary, however where you do recommend that your client switches funds you must always make reasonable enquiries about the costs and charges involved, benefits that might be lost and any other significant consequences that may be involved.

Always remember:

- Where a switch is recommended but there is no obvious overall benefit to the client, ASIC will look closely at the disclosure given to the client about conflicts, fees and the basis for the advice
- Unless a feature in the 'to' fund would satisfy the clients needs or objectives, it could be seen as misleading to describe that feature as a benefit, especially where the same feature is already available in the 'from' fund
- Incomplete client information does not negate your obligation to know your client and have a reasonable basis for your advice.

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## References

You may find the following references useful.

### [Australian Taxation Office](#)

*DIY Super. Its your money..... but not yet*

<http://www.ato.gov.au/content/downloads/nat11393.pdf>

*Role and responsibilities of trustees*

<http://www.ato.gov.au/content/downloads/n11032-11-2005.pdf>

### [Australian Securities Investment Commission](#)

*Policy Statement 175 Licensing: Financial Product Advisers - Conduct and Disclosure*

[http://www.asic.gov.au/asic/pdf/lib.nsf/LookupByFileName/ps175.pdf/\\$file/ps175.pdf](http://www.asic.gov.au/asic/pdf/lib.nsf/LookupByFileName/ps175.pdf/$file/ps175.pdf)

*Super switching advice: Questions and answers*

[http://www.asic.gov.au/asic/ASIC\\_PUB.NSF/byid/7095BBEC9C47C9F6CA25702A0016380E?opendocument](http://www.asic.gov.au/asic/ASIC_PUB.NSF/byid/7095BBEC9C47C9F6CA25702A0016380E?opendocument)

*QFS 123 I am an accountant. What advice can I provide about SMSFs and related activity under reg 7.1.29?*

<http://www.asic.gov.au/asic/asic.nsf/ASIC+FSR+FAQ+DisplayW?ReadForm&unid=1567F3AC0FAB85C4CA256F65001B317A>

### [CPA Australia](#)

*FSR: Your Obligations and Options*

[http://www.cpaustralia.com.au/links?14131\\_3937](http://www.cpaustralia.com.au/links?14131_3937)

### [Training from CPA Australia](#)

*Advising in Self-managed Superannuation Funds program:*

SMSFs – Taxation, Legislation & Regulations (1 day workshop)

SMSFs – Investment & Trustee Issues (4 hour workshop)

SMSF Assessment (optional assessment)

(This program is on the ASIC Register of Compliant courses. It has PS146 compliance in superannuation as a pre-requisite for the assessment.)

*A complete Guide to Self-managed Super Funds (e-learning product)*

This CD-ROM includes the content of the two SMSF Advice workshops plus essential tools for auditors of SMSFs.

*Audit of Self Managed Super Funds*

*Advanced Audit of Self Managed Super Funds*

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This guidance note series has been developed by CPA Australia. For further information visit [www.cpaustralia.com.au](http://www.cpaustralia.com.au)