Your ASIC "Red Flags" Summary – Improving the quality of advice and member experiences

ASIC's Report 575 on improving the quality of advice and member experiences focused on whether advice providers are complying with the law when providing personal advice to retail clients to set up an SMSF. The findings from the review of SMSF advice found that the advice process, particularly around establishment of an SMSF could be improved.

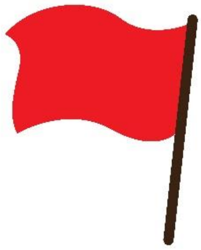
Is an SMSF the right fit?

An SMSF is not the right choice for everyone. It is important that your clients understand their obligations as SMSF trustees and the pros and cons of setting up an SMSF. ASIC released a list of 'red flags' indicators that may suggest an SMSF is not suitable for your client and these issues should be carefully considered.

Red Flags

The red flags include, but are not limited to, clients who:

- Have a low superannuation balance, and would have a limited ability to make future contributions.
- Would like a simple super solution.
- Delegate all of the running of the SMSF to a paid advice provider.
- Delegate all of the investment decision making to someone else.
- Do not have a lot of time to devote to managing their financial affairs.
- Have little experience in making investment decisions.
- Are an undischarged bankrupt or has been convicted of an offence involving dishonesty (as such, persons are prohibited from acting as a trustee).
- Have a low level of financial literacy.



Low Balances

While a low balance can be a red flag, it is the SMSF Association's view that this is not always a barrier to entry.

As outlined in our submission to the Productivity Commission on their Draft Report on Superannuation: Assessing Efficiency and Competitiveness, SMSFs with smaller balances can be cost competitive with APRA-regulated superannuation funds depending on the level of fees and the amount of administration trustees are willing to undertake.

However, in many cases, a recommendation for a retail client to set up an SMSF with a starting balance of $200,000 or below is unlikely to be in the client's best interests.

This conclusion is based on our analysis of industry data and the report, "Cost of Operating SMSFs" for ASIC prepared in 2013, by actuarial consulting firm Rice Warner. This report has been an important source of information regarding SMSF costs and establishments since it was published and was the basis of ASIC guidance in 2015 that SMSFs should have a minimum balance of $200,000.

Noting this, there will be cases where specialist SMSF advice may indicate that the establishment of an SMSF with a balance lower than $200,000 is appropriate. For example, if the trajectory of anticipated contributions is such that the fund will grow to this point within a short period.

Time

The ASIC report found that 38% of respondents found running their SMSF to be more time consuming than expected.

Trustees underestimated the amount of time involved in setting up and managing an SMSF, including where tasks are outsourced to third parties. It is therefore important that trustees understand they are accountable for the decisions and actions of the fund and even outsourcing of administration activities will still require a time commitment from trustees.

Costs

The ASIC report found that 32% of respondents found the costs of setting up their SMSF was more than expected.

Ensure clients have a clear understanding of the fees they are being charged over the life of the fund and are aware of unavoidable costs including:

- The annual SMSF supervisory levy collected by the ATO.
- The cost of producing an annual financial statement, tax return and TBAR reporting.
- Annual independent audit fees.
- Costs associated to setting up the SMSF and advice, including
    - Trust deed.
    - Preparing ATO application forms.
    - Cash management application
    - Provision of binding death nomination forms.
    - Investment strategy.
    - General trust and legal advice.

Optional costs to discuss also include:

- The costs of establishing a corporate trustee, including
    - ASIC's fees to establish a corporate entity.
    - Annual corporate trustee fee.
    - Searches and reservation of company names.
- Ongoing SMSF administration costs.
- Professional investment advice fees.
- Accounting and bookkeeping fees.
- The cost of an actuarial certification (when required).
- Investment management fees.
- The cost of obtaining insurance cover; and
- Costs relating to winding up an SMSF, including compliance costs and transactions costs related to realising assets.

The Productivity Commission Report quantified SMSF establishment costs at ranging between $916 and $2,035. Costs can be more substantial where complex legal or financial advice is required to implement bespoke strategies for the SMSF members.

A significant difference in costs of SMSF compared to an APRA-regulated fund relate to the administration fees. SMSF members have the option to effectively manage the administration services of their SMSF such as managing compliance responsibilities, ATO correspondence and paperwork, or they can outsource these services to a professional SMSF administrator.

For example, some individuals choose to use a full or part administration service which may add $1,000 to $2,000 in fees (when compared to an APRA-regulated fund) but allows trustees to focus on other aspects of their SMSF or finances such as investment strategies and investments.

The below table highlights the most common costs that are not adequately disclosed to SMSF trustees on SMSF establishment.

Table 5: Client files demonstrating inadequate disclosure of costs

Cost category	Proportion of files with inadequate disclosure
Types of costs associated with winding up an SMSF	54%
'Opportunity cost' associated with managing an SMSF	48%
Investment costs	16%
Insurance costs	14%
Ongoing costs associated with operating an SMSF	12%
Costs associated with setting up an SMSF	8%

Financial literacy skills

It is also important to recognise if a client is struggling with their personal financial affairs, it will not be appropriate to recommend establishment of an SMSF.

SMSF trustees have a duty to exercise skill, care and diligence in managing an SMSF, and therefore need to possess a sufficient level of financial literacy to manage the fund and make investment decisions in line with the fund's investment strategy.

ASIC highlighted a case where potential clients who were struggling to manage their personal financial affairs with a large amount of debt and numerous unsecured loans were provided advice to establish an SMSF with a combined superannuation balance of $150,000. We agree this is inappropriate.

Switching from an APRA-regulated fund to an SMSF

When an advice provider recommends switching from an APRA-regulated fund to an SMSF, they must explain in the Statement of Advice (SOA), in clear and simple terms, the following information (where it is known or could reasonably be found out):

- Information about the exit fees or any other charges applying to the withdrawal from the APRA-regulated fund.
- The loss of access to rights or benefits (e.g. insurance cover and compensation).
- The loss of other opportunities, including incidental opportunities associated with the existing product (e.g. rights or opportunities not presently available to the client, but which may become available in the future).
- The set-up costs and ongoing fees for the SMSF.
- Any other significant consequences for the client in changing their superannuation fund to an SMSF.

Record Keeping and SOAs

The ASIC report observed there were problems in record keeping, when setting up an SMSF. Record keeping is important part of the decision making process and while the relevant issues may have been discussed it is important they are also recorded.

When discussing setting up an SMSF with a client ASIC provides the following should be recorded:

- Why the client is dissatisfied with current superannuation arrangements.
- What the client hopes to achieve by setting up an SMSF.
- What outcomes the client would like to achieve.

- Why any recommendations are suitable and consistent with the client’s objectives and financial situation.

This should be clear and recorded in the client’s own words in the client file and in the SOA.

You must also not reduce the scope of advice to exclude critical issues that are relevant to the subject matter of the advice sought. Where the subject matter of the advice is limited in scope at the request of the client, you should record this carefully in the client file, including the client’s reasons for the request. This should also be detailed in the SOA.

Complex financial products and strategies necessitate more extensive inquiries. The decision to move from an APRA-regulated fund to an SMSF is a significant decision for clients. Therefore, you should demonstrate in the client file that you have undertaken reasonable inquiries into the financial products and strategies that could meet the client’s needs and objectives.