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Technically Speaking: The Perfect SMSF Storm: Options & Crypto

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Introduction

One of the main reasons SMSF trustees invest in risky assets such as derivatives and cryptocurrency is they think they can outperform the market and get a quick return.

With official interest rates hovering at an all-time low of 0.25% (as at October 2020), the ability to generate a return in an SMSF through more defensive assets such as cash, term deposits, bonds and fixed interest becomes more challenging.

While this not only impacts SMSF trustees who have reached, or who are approaching, their retirement age, it also means trustees require a higher return to cover fund expenses and liabilities. And there is no doubt that the lure of getting enough money into an SMSF for retirement purposes plays on the mind of all trustees, regardless of age.

Traditionally, very few trustees make a reasonable return from these types of investments. Unless they are professionals, most of them post losses (sometimes significant ones), and they make only short-term gains.

SMSF trustees will keep investing in high-risk assets no matter what. The purpose of this paper is to assist SMSF practitioners in identifying and understanding derivatives and cryptocurrency to ensure fund compliance.

What is a Derivative?

A derivative investment is a contract that enables the investor to purchase or sell a set number of shares or commodities for a specific price at a predetermined date. While this means that investors are exchanging contracts rather than buying and selling physical assets, there is always an underlying asset attached to the contract.

An SMSF trustee can invest in derivative investments such as options and futures contracts (options) as long as they meet the requirements of the Superannuation Industry (Supervision) Act 1993 and the Superannuation Industry (Supervision) Regulations 1994 ('SIS') under regulation 13.14.

In real terms, the investor does not have to own the assets at any point to make a profit regardless of whether the stock, commodity or forex prices are rising or falling.

At all times, the taker (the buyer) has the right, but not the obligation, to buy or sell the security. To acquire this right, the taker pays a premium to the writer (the seller) of the contract.

There are two (2) types of options traded on the Australian Stock Exchange (ASX):

1. Call option – gives the taker the right, but not the obligation, to buy the underlying shares
2. Put option – gives the taker the right, but not the obligation, to sell the underlying shares

While the taker is not obligated to exercise the option, they may decide to sell the option before the contract expires, or they can let the contract lapse and forego the option premium.

In both cases, however, the writer receives and keeps the premium, but has an obligation to either deliver or buy the underlying shares if the taker exercises the contract.

SIS Compliance in Derivative Trading

Firstly, the fund's trust deed must permit investment in derivative investments and, secondly, the investment strategy must explicitly state that the trustees intend to invest in derivatives.

Under r13.14 SIS, SMSF trustees may not give a charge over the fund assets which includes a mortgage, lien or other encumbrance. The regulation prohibits trustees from activities such as participating in margin lending products.

One of the exceptions is where the fund creates a charge over fund assets as a result of investment in derivatives, such as options and futures.

Under r13.15A SIS, an approved charge on fund assets can be given over investments with Australian and specified foreign stock exchanges and futures exchanges ("approved body") as long as:

- the derivatives contract complies with the rules of the approved body (13.15A SIS), and
- the fund has a Derivatives Risk Statement (DRS) in place.

Trustees can give a charge over the assets of the fund under certain circumstances which allows them to trade in derivatives from the list of approved bodies in SISR Sch 4, which includes domestic and foreign exchanges and clearinghouses. These types of derivatives are traded through a centralised, regulated source and referred to as exchange-traded derivatives.

Most importantly, under r13.15A SIS, a DRS must be in place, separate to the investment strategy, which outlines:

- Policies for using derivatives, including an analysis of the risks associated with using derivatives within the fund's investment strategy
- The restrictions and controls on using derivatives, taking the expertise of the staff involved into consideration
- The compliance processes to ensure the controls are effective

Remember, too, that while the term "derivative" applies to a variety of financial arrangements, not all are eligible obligations that will meet the requirements under the SIS legislation.

The ATO has stated that in general, an SMSF should not use derivatives as a speculative tool in situations where:

1. The net exposure of the fund to an asset class is outside the limits set out in the fund's investment strategy
2. The fund's total portfolio is geared up through derivatives to circumvent the borrowing limitations imposed by SIS s67

Documentation matters

The Australian Prudential Regulation Authority (APRA) has released Superannuation Circular No. II.D.1 Managing Investments and Investment Choice, which provides general guidance on the requirements for APRA funds to formulate, review regularly and give effect to a risk management strategy. This guide may provide insight and assistance for SMSF trustees in developing their DRS.

In some cases, trustees have been unaware that they have given a charge over the assets of the fund to trade derivatives. A simple review of the original documentation signed by the trustees (e.g. the Product Disclosure Statement) may not always show whether a charge or guarantee has been provided or not.

Regardless, the fact remains that SMSF trustees are required to provide a security over fund assets to deal with a broker and to trade in options and futures.

Rights Issues and Options

A company can elect to raise capital by offering shareholders a rights issue. In most cases, the shares issued through the capital raised are usually priced at a discount to the prevailing share price or the volume-weighted price leading up to the offer.

During the event of a rights issue, a company may also issue other entitlements to shareholders, such as the granting of options which allows them to raise more capital in the future. Options are made available to investors under many varied conditions but have an exercise date and price attached.

Under these circumstances, the trustees did not have to provide a charge over the assets of the fund. The options were free, and the trustees will have the choice to exercise them or not.

Where the fund purchases more options in the same company through the ASX; then a charge has been given over fund assets, and a DRS is required.

Employee and Performance Options

Directors, executives and employees can receive share/option schemes and performance shares, rights and share options as incentives in relation to their employment.

Generally, shares or options transferred to an SMSF under an ESS are considered to be an acquisition from the employee or director (who is usually a related party of the fund).

An SMSF trustee can acquire shares or options in companies from related parties as long as they are at market value and either:

- the shares or options are listed on the Australian Securities Exchange (ASX)
- the company is a related party of the SMSF, and the acquisition will not result in the level of in-house assets of the fund exceeding 5%.

There is an issue where listed shares or options are transferred to an SMSF for no consideration or less than market value. However, the acquisition is considered to be at market value, where the difference between the market value and actual consideration paid is treated as a contribution.

Some companies also provide these arrangements based on a greater return on equity depending on the employee or directors performance. This could give rise to non-arm's length considerations (NALI) that apply to any dividends or capital gains derived in respect of ESS shares by an SMSF. SMSFs are also at risk under these circumstances where the remuneration provided to the employee or director is below market value.

Shares or options in companies that are not related parties of an SMSF, and are not listed on the ASX, cannot be acquired from related parties of the SMSF.

Over the Counter Derivatives

Over the counter derivatives (OTCs) trade through decentralised dealer networks monitored and regulated by ASIC. These service providers are issued with an Australian Financial Services License (AFSL) and provide access for SMSF trustees to trade in derivatives and financial products such as contracts for difference (CFD), binary options and margin foreign exchange.

One advantage of OTCs is that they are more flexible than derivatives traded on an exchange because they can be customised to meet the individual needs of each counterparty.

All OTC derivatives are allowable under SIS because the SMSF trustee does not grant a charge over the assets of the fund.

However, entering into a margin lending account by providing security over fund assets is a breach of r13.14 SIS, as is lodging monies with the service provider to enter into a margin loan agreement.

Contracts for Difference

A CFD provides the investor with an opportunity to profit from price movement without owning the underlying asset. CFDs are synthetic financial products (or derivatives) which are tradable through OTC providers on stock indices, stock options, currencies and futures contracts.

The CFD price is calculated by the asset's movement between the entry and exit price, with the investor not required to own the underlying assets. Essentially, a contract exists between two parties, typically described as the buyer and seller.

The appeal of CFDs is that SMSF trustees can leverage by only having to put up a small margin deposit to hold a trading position. There are no restrictions regarding the timing of the entry or exit and no time limits regarding the duration of the contract.

Once a CFD position is opened by buying a CFD (going long) or selling a CFD (going short), it remains in place until closed out, as traditional CFDs do not expire.

While CFDs can seem attractive, the investor is trading with leverage which magnifies the gains and losses. And as CFD's are not standardised, every CFD provider has their own terms and conditions, which can quickly lead to compliance issues for SMSF trustees if they are not clearly understood.

Risk of CFDs

Unfortunately, many investors get lured into trading CFDs by trying to tap into a potentially lucrative market without fully understanding all the risks involved. The reason is not that investors are "slow" but because CFDs are very complex.

ASIC has said a CFD can make potentially unlimited losses and has since published a [CFD Trading Guide] to help trustees assess the risks of CFDs.

The type of risks associated with trading CFD's include:

1. Investment risk - the risk of markets moving against the CFD trade
2. Counterparty risk – the risk of the CFD providers or another party failing to fulfil their obligations
3. Client money risk – the risk of losing some or all of your money held by the CFD provider
4. Liquidity, gapping and execution risks – market conditions and trading mechanics may result in unfulfilled trades at the expected time or price

Depending on market movements, the deposit made by the SMSF trustee may not be enough, and the variation margin called for maybe much more than the initial margin paid. To this end, CFDs should not be viewed as a set and forget investment, as SMSF trustees must actively monitor and manage their positions.

SIS Compliance with CFDs

An SMSF trustee may invest in a CFD as long as it is allowed under the fund's investment strategy and not explicitly prohibited in the trust deed.

While a CFD is a derivative, it is not an options or futures contract, and the SMSF trustees provide no charge over the assets of the fund. As a result, regulation 13.15A SIS does not apply.

Depending on the requirements of the CFD provider, a CFD will be allowable under SIS, or it may result in a breach of r13.14 SIS.

When opening a CFD, the trustee pays a deposit into a CFD bank account. They may also need to make additional margin payments to cover running losses on open positions. All monies deposited into the CFD bank account by the fund is the property of the CFD provider, as the fund has no beneficial interest in that account.

According to the Australian Taxation Office (ATO), this does not constitute a loan between the CFD provider and the fund because needing to pay a deposit and meet margin calls does not represent a borrowing. They are contractual liabilities to make payments if and when required — not repayments.

As there is no loan between the CFD provider and the fund, the borrowing prohibition in s67 also does not apply.

However, it is a breach if the trustee, under a separate written related agreement with the CFD provider, deposits fund assets with the provider as security relating to the trustee's obligations to pay margins.

The terms of the agreement state the circumstances in which the fund's assets would be realised and show intent to create a charge over the assets.

By entering into this type of agreement with the CFD provider, the trustee has contravened regulation r13.14 SIS.

Margin Lending

Not all derivatives are compliant, such as where the fund trades derivatives, CFDs and over the counter (OTC) derivatives through a margin account (refer ATOID 2007/57 and ATOID 2007/58).

Generally, the SMSF trustee maintains a margin account with a cash and loan component used in combination for the acquisition of shares, CFDs and instalment warrants.

As part of the margin lending arrangement for shares, the SMSF can drawdown additional amounts to finance the acquisition of shares. Each drawdown represents an obligation to repay the amount with interest and represents a borrowing in contravention of s67 SIS and also r13.14, as it creates a charge over fund assets.

Identifying whether the SMSF trustee has entered into a margin account will mean reviewing the option trading statements to determine whether an interest amount and drawdown limit exists.

ASIC CFD Warning to SMSF Trustees

ASIC has provided a warning for SMSF trustees at risk due to increased trading activity in derivative investments and CFDs in the current volatile markets created by COVID-19.

ASIC's market analysis during COVID-19 has revealed a substantial increase in retail activity as well as greater exposure to risk. They have found that some investors are engaging in short term trading strategies unsuccessfully attempting to time price trends.

The trading frequency has increased rapidly, as has the number of different securities traded per day, and the duration for holding the securities has significantly decreased indicating a concerning increase in short-term and 'day-trading' activity.

Even market professionals find it hard to 'time' the market in a turbulent environment, and the risk of significant losses is a common challenge.

Short Term Trading

For SMSF trustees to attempt the same is incredibly dangerous, and likely to lead to massive losses – losses that could not happen at a worse time for many funds during COVID-19.

SMSF trustees who chase quick profits by playing the market over the short term have traditionally performed poorly – in good times and bad – even in relatively stable, less volatile market conditions.

The analysis suggested that only a few investors pursuing quick windfalls were successful. During the focus period, on more than two-thirds of the days on which retail investors were net buyers, their share prices declined the following day. On days where retail investors were net sellers, their share prices more likely increased the next day.

In addition to the increased trading, the number of new retail investors increased sharply to the market – up by a factor of 3.4 times – and the number of reactivated dormant accounts also increased.

The higher probability and impact of unpredictable news and events in offshore markets overnight only magnifies the danger.

What is Cryptocurrency?

Cryptocurrency is a digital currency using encryption to regulate the generation of units of currency and verify the transfer of funds. It is 'a virtual currency that essentially operates as online cash' and as a 'crypto-currency, designed to reinvent the way that money works'.

Crypto operates through a decentralised peer-to-peer payments network whose implementation relies on the use of public-key cryptography to validate transactions. They live in electronic ledgers that are continuously updated, open to everyone who uses it and those willing to download it.

As the payments system operates independently of a central bank and is not under the control of a central authority, the value of crypto is 'not derived from gold or government fiat, but from the value that people assign it'.

While cryptos do not earn income, investors only receive a return after they are sold at a higher than original price. Other factors that influence the price includes:

- Its popularity at a given time (demand vs supply)
- How easy it is to trade or use it
- The perceived value of the currency
- Its underlying blockchain technology

Types of Cryptocurrency

While the presence of BTC continues to be the most popular crypto, there are many more alternatives available to investors. Here is a selection of the most popular cryptocurrencies.

Bitcoin

BTC is a digital currency worth $295 billion. Users in the BTC network (bitcoin miners) use computer-intensive software to validate transactions that pass through the network. They earn new BTC in the process. BTC is a decentralised global payment system, but it is bought and sold in large volumes as a speculative investment.

Ethereum

Ethereum operates on an open-source platform using blockchain technology. It can process transactions and contracts, allowing developers to create and run any program, in any programming language, on a single decentralised platform. In the Ethereum blockchain, miners work to earn 'ether', which is a crypto token and can pay for fees and services within the network.

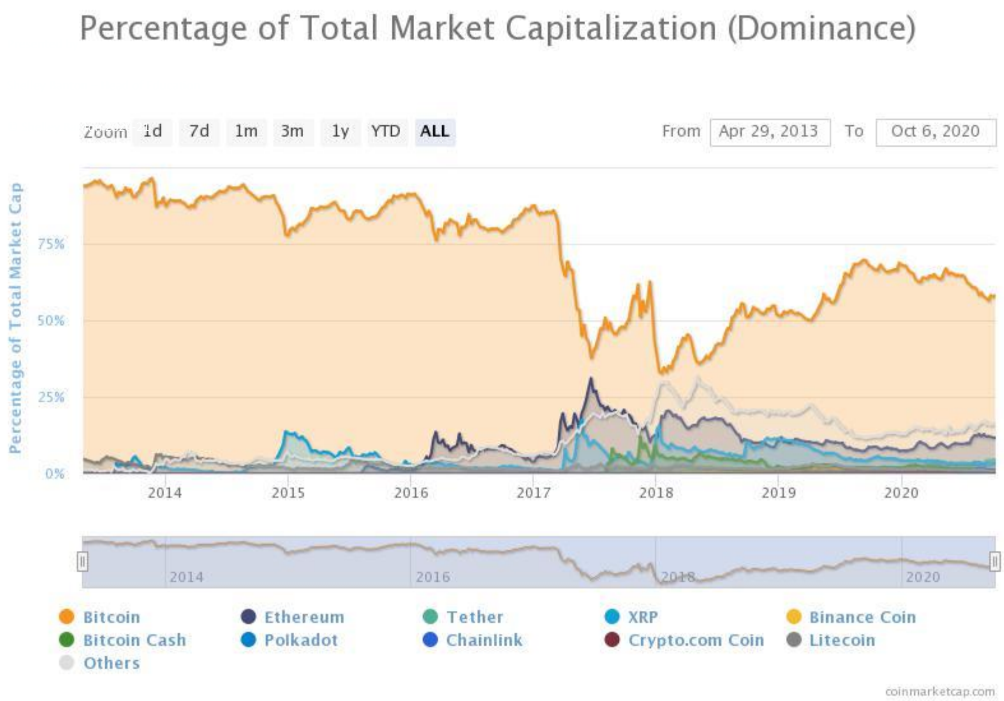
Litecoin

Litecoin is an electronic payment system which processes transactions faster than Bitcoin. There are also more Litecoins in circulation than there are BTCs. Some users see Litecoin as a 'lighter' version of, or back for, BTC.

Ripple

Ripple is a transaction protocol designed to complement BTC. It allows real-time transfers between users in any currency, including other cryptos. Ripple is a database in which users can store and transfer value in any currency on a protected network. Ripple uses tokens created by developers, rather than mined or earned like other digital currencies. Some users don't see Ripple as a real cryptocurrency, but the technology has been popular with financial institutions.

The following graph shows the dominance of BTC over a seven (7) year period in terms of market capitalisation, with Ethereum a very distant second.



ATO Viewpoint

The ATO has shown concern where SMSF trustees have invested in crypto. They issued two (2) taxation determinations in 2014, TD 2014/25 and TD 2014/26 which clarified that bitcoin and cryptocurrencies like bitcoin are not money, but capital gains tax (CGT) assets.

Where a fund transacts in crypto, SMSF trustees and members need to be aware of the tax consequences as well as price volatility, which can impact returns.

In each case, the outcome will depend on the nature of the SMSF's circumstances. SMSFs involved in acquiring or disposing of cryptocurrency must keep records concerning their transactions as it could give rise to a CGT event.

In general, crypto is classified as a personal use asset if it is kept or used mainly to purchase items for personal use or consumption. An example of a personal use asset is where a person acquires crypto and uses it to pay for tickets to a concert or to purchase computer games or other goods and services.

Only capital gains made from personal use asset for less than $10,000 are disregarded for CGT purposes. However, all capital losses made on personal use assets are disregarded.

As SMSFs traditionally acquire crypto for investment purposes, they are required to keep their records to ensure that the tax on disposal is calculated correctly.

Investment Risks

While the risks of trading crypto are mainly related to price volatility, it is considered a high-risk and speculative investment that is subject to changes in market sentiment.

As an unregulated market, there are questions about the susceptibility of error and hacking with little possibility of preventing technical glitches or human error.

Crypto can also be affected by forks or discontinuation, which sees investors switching to a new chain and no longer using the old one, or where both new and old chains are maintained and compete for dominance and branding. Examples of these include Ethereum vs Ethereum Classix, Bitcoin vs Bitcoin Cash and Bitcoin Cash vs Bitcoin SV.

Storage Practicalities

Investors buy or sell crypto on an exchange platform such as Swyftz, CoinSpot, Binance and Independent Reserve using traditional money. The crypto then needs to be stored in a wallet, which is a software program that enables investors to store, send and receive digital currencies.

As each crypto has a different address type, holding multiple cryptos may mean the investor needs to set up numerous wallets if the wallet they choose cannot support several digital currencies.

The wallet contains both a public and a private key. The public key is a long sequence of letters and numbers that forms the wallet address and is similar to a bank account number.

The private key allows the investor to access the funds stored in the wallet and is similar to a PIN which should be kept secret and secure.

An exchange can provide a wallet for storage, but it means that the exchange stores the private key on behalf of the user. The vital thing to note here is that an exchange wallet is a custodial account provided by the exchange.

While convenient, this also compromises security because where the exchange stores millions of private keys, they become targets for motivated and well-resourced hackers.

One of the most well known hacking incidents occurred in January 2018 where Coincheck, a Japan-based crypto exchange had their servers compromised and hackers stole $500 million worth of investor's digital tokens.

Hot Wallet vs Cold Wallet

Online wallets are also known as "hot" wallets, which run on internet-connected devices like computers, phones or tablets. The security surrounding a hot wallet can be vulnerable because these wallets generate the private keys on these devices.

Investors used hot wallets to store small amounts of crypto to help facilitate basic transactions.

A cold wallet, on the other hand, is not connected to the internet and therefore stands a lesser risk of being compromised. They are also referred to as offline or hardware wallets.

These types of wallets require USB drive devices specifically designed to store physical crypto and the user's private keys securely. One of the drawbacks is that cold wallets have a minimal number of cryptos they can store and that transferring crypto can be more difficult and less practical using these devices.

Paper Wallet

A paper wallet is becoming an obsolete and unsafe method of cold storing crypto, which was popular between 2011 and 2016. It works by having a single private key and bitcoin address, usually generated by a website, being printed out onto paper, which is then stored and saved in a secure place.

The Difference Between an ICO and IPO

There are new cryptos promoted and sold through initial coin offerings (ICOs) every day. An ICO is merely raising capital by offering a new cryptocurrency to the market.

Under a capital raising banner, promoters sell "tokens" to investors who pay with legal tender or other cryptos such as BTC or Ethereum. They are not the same as an initial public offering (IPO), because they are not regulated; do not provide investors with an ownership stake in the company and are prone to scams and securities law violations.

The most common scam is known as the "pump and dump", where scammer talks up the value of an ICO to generate interest, then "dumps" the coins for a profit.

During 2019, ICOs raised almost $11.4 billion through a total of 3,782 ICOs. On any given day, there were an average of 482 ICOs opened, and each one raised $11.5 million, with only 33% of all ICOs completed over the year.

SMSF Compliance

Sole Purpose Test

Given that the original purpose of crypto assets is not for trading, is this an appropriate investment for an SMSF and does it pass the sole purpose test?

Of course, an SMSF trustee can invest in any asset allowed under SIS as long as it is a permitted acquirable asset. The investment must:

- Be allowed for under the fund's trust deed
- Be in accordance with the fund's investment strategy
- Comply with SISA and SISR regulatory requirements concerning investment restrictions.

Trust Deed

Trust Deeds often have prudent trustee investment considerations under the various state and territory Trustee Acts. SMSF trustees who consider crypto investment must review the Trust Deed to see if these provisions exist.

In some states, it may be difficult to comply with these provisions and invest in crypto due to the high-risk nature of the asset.

Trustees are also bound by the governing rules of the fund relating to investments. An SMSF trustee should ensure the governing laws allows them to invest in crypto. Where not explicitly stated and the fund’s investment in crypto is material, the governing rules may require a variation. Under these circumstances, the trustees may wish to seek professional advice to ensure that the trust deed continues to meet the needs of the members given the volatile nature of the asset.

Investment Strategy

Under S52B of SISA and reg 4.09 of the SISR, the trustee of an SMSF is required to formulate, review regularly and give effect to an investment strategy.

The investment strategy must allow for investment in digital assets. Crypto is a high-risk investment due to the volatility of prices. As mentioned previously, there is no income generated from Cryptocurrency, with the only return coming from speculative capital growth.

The investment strategy should also mention other risks concerning the secure storage of the hot or cold wallet and private keys.

Risk Management

Under SIS, if a person suffers loss or damage from investing in an asset not covered by the trust deed or investment strategy, they may take action against a person involved in the contravention to recover the amount of the loss or damage.

By way of example, an SMSF advisor assisting a client in investing in cryptocurrency where the governing rules do not authorise such as investment may face legal liability where the member suffers loss or damage.

As can be seen in the Ryan Wealth Holdings Pty Ltd v Baumgartner NSWC [1502] case and Cam & Bear Pty Ltd v McGoldrick [110] case, SMSF auditors can also incur significant risk when members suffer a loss by not bringing these matters to the attention of the trustees.

Compliance Breaches

Where an SMSF trustee decides to invest in BTC to trade and not just to hold the asset, the main risk is when the identification of the other party in the transaction results in compliance breaches.

As crypto assets are complicated, they should be reviewed in light of the SIS legislation, especially when SMSF trustees are chasing easy returns without an understanding of how they work.

Keep Assets Separate

In according with r4.09A SISR, all assets must be kept separate from any money and assets that are held by the trustee personally.

The fund will comply with r4.09A SISR were the exchange account, and wallet are held in the name of the SMSF trustee as trustee for the fund. Difficulties arise where the wallet is held with the exchange, because an exchange wallet may be held custodially.

The problem starts where reports and statements from the exchange show that the wallet is held in the name of the trustees personally, even though it may be held custodially. SMSF auditors may have no discretion but to qualify their audit reports on r4.09A SISR where the SMSF trustees cannot provide further documentation on this issue.

Additionally, the trustee must use the fund's bank account to buy and sell cryptocurrency at all times to ensure regulatory compliance.

Acquisition From a Related Party

Section 66 of SIS prohibits an SMSF trustee from acquiring an asset from a related party of the fund. An exemption in S66(2)(a) exists for listed securities acquired at market value but does not include cryptocurrency.

While 'acquiring an asset" does not include accepting money, the ATO does not consider crypto to be money or fiat currency.

As a result, the fund cannot accept crypto via a contribution or from a related party transfer, as this breaches the acquisition of asset rules from a member or related party.

Charge over the Assets of the Fund

A cryptocurrency exchange may allow a user to hedge their crypto against standard currencies or other cryptos.

When an SMSF traditionally invests in derivatives, a separate DRS is required under r13.15(1A) to 13.15(1G) SIS because a charge has been given over fund assets.

The exemptions available only apply to approved bodies in respect of certain derivatives listed in Sch 4 of SISR, which does not include cryptocurrency exchanges.

If a fund trades in derivative products using BTC, the fund will be in breach of r13.14 SIS. The reason is that a charge is provided over fund assets (the wallet) to undertake hedging activities or make margin deposits to the exchange in BTC to eliminate counterparty risk.

SMSF auditors and advisors need to be aware that crypto exchanges are quickly developing sophisticated unregulated financial instruments which will result in compliance breaches for the unwary.

Pensions or Benefit Payments

Where a trustee or member satisfies a condition of release, the SMSF can make an in specie lump sum payment by way of transfer of cryptocurrency. However, actual pension payments must be made in cash.

Death of the BTC Wallet

One of the biggest headaches will be when an SMSF trustee dies. Typically, the private key and password to access the wallet are known and stored by the user who set it up.

Documenting and sharing this information is critical; otherwise, in the event of death, the crypto is lost forever because access to a wallet has stopped.

It is difficult to think of another asset (unless it is in a tax haven) that is not recoverable when an SMSF trustee dies. To this extent, ensuring that the BTC wallet details are documented and stored securely should be considered BTC insurance.

Where the BTC is a material asset, the fund should document the fact that precautions have been put in place to securely pass on the BTC wallet details to other trustees or beneficiaries in the event of death.

Where no such documentation exists, the SMSF auditor may consider qualifying part A of the audit report as fund assets are at risk.

Classification of Cryptocurrency

As a digital asset, SMSF auditors will be very wary about the classification of crypto on a fund's financial statements. Given the volatility of crypto, an incorrect classification may result in issues not only for SMSF trustees but also for SMSF practitioners.

Cryptocurrency has been incorrectly classified as foreign currency, foreign assets, unlisted units, unlisted unit trusts and listed shares. As a result, SMSF trustees can have their investment decision making impaired as they think they have less volatile assets in the fund.

The problem of asset misclassification is one of the cornerstones of the Cam & Bear Pty Ltd vs McGoldrick [110] case where the NSW Court of Appeal found that the SMSF auditor engaged in negligent, misleading and deceptive conduct.

The issue at stake was the auditor signing off on the fund's financials and failing to qualify the audit report because high-risk unsecured loans were reported as cash.

The court determined that the auditor, Mr McGoldrick, should have made proper enquiries of the financial condition of the company holding the monies, alerting him to the risks associated with the investment which he should have then communicated to the trustee.

Conclusion

High-risk investments are possible within an SMSF, but trustees need to understand the risks and make sure the correct documentation is in place.

Unless they are a professional, however, it will be difficult to make reasonable returns.

In the case of derivative investments, SMSF trustees will mainly be betting against professionals and every contract they enter into has a winner and a loser.

And the high-risk and volatile nature of crypto will not stop SMSF trustees from investing in them.

SMSF trustees, therefore, should carefully consider whether having either options or crypto in an SMSF creates the perfect SMSF storm.

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