26 October 2018

The Hon. Kenneth Hayne AC QC
Commissioner
Royal Commission into Misconduct in the Banking,
Superannuation and Financial Services Industry

Dear Commissioner,

SMSF ASSOCIATION SUBMISSION ON THE ROYAL COMMISSION INTO MISCONDUCT IN THE BANKING, SUPERANNUATION AND FINANCIAL SERVICES INDUSTRY INTERIM REPORT

The SMSF Association (SMSFA) welcomes the opportunity to make a submission on the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry Interim Report.

The Royal Commission has performed an important role in shining a light on misconduct in financial services as well as some of the broader regulatory and cultural issues across the industry. We support the Royal Commission process and recognise the need to improve standards of behaviour and service in the financial services industry given the revelations of the Commission.

We recognise the issues relating to culture and incentives, conflicts of interest and duty, and confusion of roles, and regulator effectiveness. The Interim Report raises important questions about whether the existing law should be amended or enforced differently to prevent misconduct.

We have limited this submission to the issue raised in our specialised area of knowledge relating to encouraging the provision of sound financial advice to SMSFs. Given several of the case studies regarding financial advice highlighted poor advice provided to existing or prospective SMSF trustees, we believe we should provide feedback to the Royal Commission on how standards of SMSF advice could be improved.

CURRENT ISSUES WITH SMSF ADVICE

The SMSFA acknowledges questions regarding the quality of advice provided to members of SMSFs. As highlighted by Royal Commission's case studies, the Australian Securities and Investment Commission's (ASIC) Report 575 SMSFs: *Improving the quality of advice and member experiences* and the Productivity Commission's Draft Report *Superannuation: Assessing Efficiency and Competitiveness* there are areas of concern. We believe the SMSF industry and advisers should treat scrutiny of the sector as an opportunity to raise professional standards and strengthen advice practices to improve member outcomes.

The SMSF sector is important in both its size and role within the Australian superannuation system, containing almost 30% of superannuation assets. It allows individuals the ability to take control and engage with their superannuation and is also an important source of competitive tension in the superannuation industry.

The fact that members of SMSFs are also the trustees and have direct oversight of their funds means that the issues with roles and responsibilities of intermediaries, governance and conflicts of interest that exist in institutional funds are not prevalent in SMSFs.

However, inappropriate advice provided by 'property one-stop shops' and unscrupulous advisers is an area of fundamental concern to the SMSFA. We believe the prevalence of this is low across SMSFs, but the detrimental impact to an SMSF member impacted is high.

The 'property one-stop shop' advice model typically occurs when a firm will source a property, provides financing services and completes a client's SMSF accounting and audit. These businesses have inherent conflicts of interest, lack of specialised advice and SMSF skills, and take advantage of customers with limited knowledge of SMSFs. It is therefore important that where SMSFs are advised to invest in property, it is considered as part of a broader retirement strategy. We have advocated for policy solutions that limit the ability of property spruikers to use SMSF limited recourse borrowing arrangements as an investment vehicle for promoting speculative property investments. In particular, we have advocated to reduce the ability for property spruikers to encourage individuals to establish an SMSF with a small balance simply to purchase a property.

ASIC's Report 575 found that advice given in 10% of reviewed files was likely to result in clients being significantly worse off in retirement. The high proportion of files ASIC classified as "non-compliant" did not indicate a risk of financial detriment but attracted scrutiny for not meeting record keeping and process requirements. The Association believes that advice standards, particularly relating to inappropriate lower balances and unjustified investment advice, need to be improved to rectify these problems.

Nevertheless, the Association believes the large majority of SMSF advisers, especially those who have invested in specialist education, act in the best interests of their clients by providing justified, trusted and valuable advice.

WHY SMSF ADVICE IS IMPORTANT TO MEMBERS

The quality of financial advice provided to SMSF members is crucial to the integrity and performance of the sector. Given that the most significant complex changes to superannuation for a decade took effect on 1 July 2017, the need for high quality specialised advice is paramount.

SMSFs are complex structures that are not for everyone. Consequently, SMSF members and potential SMSF members seek advice to understand the myriad legislative and regulatory conditions applying to SMSFs to determine if an SMSF is appropriate for their circumstances. Notably 63% of SMSFs were established on the suggestion of an adviser and 81% of SMSFs utilise some form of adviser, highlighting that the quality of advice can materially affect the retirement savings of the majority of SMSF members (SMSFA and Commbank 2017).

Recent research commissioned by the SMSFA (Commbank 2017 and Russell 2014) also emphasised the numerous and diverse areas on which SMSFs members seek advice. Compliance is the area members require the most help with, closely followed by tax. If members and trustees do not understand their obligations or allocate the time required to manage an SMSF, this can result in severe penalties and sanctions and a lack of effective engagement and management causing significant financial detriment.

Tailored taxation and retirement planning can also provide substantial beneficial outcomes to members. This includes control over pension strategies, timing of asset sales, retirement and financial goals and exit strategies, the benefits of which are hard to measure by a simple return calculation.

When focusing on the areas which trustees value the most, it is investment advice which is most valued. The SMSFA believes that investment advice, which refers to investment strategy and asset allocation, rather than product or fund selection, is extremely important to the outcomes of members in SMSFs. Advisers have a key role to play in offering strategic holistic investment advice across a member's SMSF and other non-superannuation assets to provide diversified portfolios, the benefits of which are well known. Furthermore, advised client portfolios are much more diversified across asset classes than those of unadvised trustees (Russell 2014).

SMSF advice is necessary, and when provided, is relied upon heavily by members. This means the quality of the advice is extremely important to the SMSF sector. Despite only a small minority of SMSF members stating that the cost of advice was an important factor (Commbank 2017), the SMSFA believes it is still crucial that advisers exhibit transparency in the costs of advice provided. This includes clear disclosure regarding all fees, potential returns, obligations and compliance.

HOW TO IMPROVE SMSF ADVICE

SMSF EDUCATION REQUIREMENT FOR FINANCIAL ADVISERS

The SMSFA believes that advisers who provide advice to individuals about SMSFs should have specific SMSF education and qualifications that underpin their advice. SMSFs are now a major part of the advice framework making up almost one-third of all superannuation fund assets. As stated, they are complex vehicles that need to be accompanied by high quality and specialised advice, especially given they are only appropriate for certain types of individuals. This was also recommended in ASIC's Report 575 where ASIC stated the results of their review of SMSF advice indicate, *"a need to increase the education and training requirements for advice providers who provide personal advice on SMSFs."*

ASIC further stated "a specific SMSF qualification for advice providers wishing to provide SMSF advice" would be under discussion.

The Financial Adviser Standards and Ethics Authority (FASEA) is the new education standards-setting body which is currently determining the education and training requirements which will be required for advisers to give advice under a 'new' financial advice profession. We believe it would be unfortunate for new advisers to be able to reach the required FASEA threshold to give financial advice and be able to give SMSF advice without specific SMSF knowledge being part of the required learning outcomes. This is essential given that SMSFs are a specialised retirement savings vehicle and are distinctly different to large superannuation funds. SMSF advice requirements should not be a minor subset of financial advice education requirements of superannuation or retirement advice. This is especially pertinent when SMSF trustees, due to the self-directed nature and complexity of SMSFs, are susceptible to poor financial advice with potentially significant detrimental outcomes to individuals.

The table below compares the learning outcomes relating to superannuation in a graduate diploma of financial planning to a graduate certificate in SMSFs. It highlights the difference in specialist SMSF education and broader superannuation/retirement education that can be undertaken by financial advisers. A broad high-level education approach does not give an adviser enough insight to reach a threshold where they can comprehensively advise on SMSFs. For example, complex SMSF limited recourse borrowing arrangements, business real properties and related party transaction issues are not discussed in any material detail in the current education standards for advisers but involve significant strategic and compliance issues for SMSF trustees.

The following is a comparison in learning outcomes between a broader financial planning post-graduate qualification in superannuation and an SMSF focused qualification:

Graduate Diploma of Financial Planning (Kaplan Professional: Superannuation and Retirement Advice)
• Analyse superannuation structures and strategies for various client situations. • Explain the taxation implications of superannuation strategies for contribution, withdrawal and insurance at the fund level. • Analyse superannuation retirement income stream strategies according to their benefits, tax implications and social security treatment as they relate to different client situations. • Formulate strategies to maximise superannuation benefits and clients' entitlements to social security benefits and aged care. • Discuss the advantages and disadvantages of equity release schemes as a source of retirement income. • Design superannuation strategies in respect of divorce, bankruptcy and death benefits. • Develop a compliant statement of advice (SOA).

Graduate Certificate in Self-Managed Super Funds (Kaplan Professional)
• Explain how the different SMSF-related occupations can contribute to the optimal operation of an SMSF. • Integrate regulatory and legislative requirements into SMSF advice functions. • Research, assess and apply best practice methodology to the operation of an SMSF. • Critically review relevant contemporary behavioural finance models. • Evaluate the application of behavioural finance models in the adviser – trustees. • Research and explain factors resulting in measurable, systemic biases in investment decisions including difference between collective and individual decision-making processes. • Analyse impact of behaviour biases on SMSF fund investment strategies. • Develop a methodology for mentoring and guiding SMSF Trustees. • Elaborate on the differences and similarities between SMSF strategic financial advice and comprehensive SMSF financial advice, with reference to the literature. • Research and explain the strategic purpose of a range of SMSF strategies. • Model a range of strategies to achieve fund/trustee objectives. • Explain to trustees the identified strategy, the associated benefits, risks and restrictions and how it supports the SMSF strategic objective. • Undertake research on significant SMSF auditing issues. • Apply the Auditing Standards to identify compliance issues in an SMSF. • Complete an SMSF audit that is compliant with both Australian Auditing Standards and SIS Regulations. • Create the required Australian Taxation Office reports and Fund reports. • Research and explain the legal regulations that apply to SMSFs. • Research and critically evaluate the special taxation rules applicable to superannuation contributions, superannuation funds and superannuation benefits. • Develop and critically evaluate an SMSF strategy to deal with regulatory and tax requirements in a complex SMSF scenario. • Justify an SMSF strategy to deal with regulatory and tax requirements in a complex SMSF scenario. • Critically analyse a trust deed for compliance, including all compulsory statutory provisions and those provisions that cannot or should not be included. • Research and explain the common triggers for SMSF Trust Deed review and propose amendments to minimise compliance risk. • Compare and contrast a range of publically available SMSF trust deeds to determine suitability for use. • Review SMSF trust deeds using best practice principles.

Currently, we understand that FASEA's approach will be to settle general financial advice standards before addressing specialist areas such as SMSFs. While this approach fits with FASEA's need to implement standards by 1 January 2019 we believe it forgoes a substantial opportunity to lift the standard of SMSF advice. Given this opportunity to create new professional standards, the Commission could consider recommending that FASEA should mandate an increase in SMSF education and advice standards.

Not only would raising the education standards of SMSF advisers increase their knowledge relating to specific and complex legislation, it would also discourage advisers who wish to give SMSF advice but have not undertaken specialist SMSF training. For example, there will be many situations where financial advisers who are licensed to give SMSF advice may have not have many SMSFs in their portfolio of clients. These individuals may not have the required level of expertise and experience to deal with complex SMSF issues when they arise infrequently in their working life, yet they are not forced to seek expert support. An SMSF education licensing requirement to provide SMSF advice in this situation would either force the adviser to complete specialist education requirements to advise their SMSF clients or encourage SMSF members to seek licensed advisers whom deal with SMSFs and the specialist issues involved on a regular basis.

Introducing an SMSF education requirement, would also limit advisers who are licensed but have poor knowledge of SMSFs and limited recourse borrowing arrangements from advising on the product. In turn it then discourages property spruikers from entering the SMSF advice market as the education requirement could be too high.

Regarding the case studies considered in the second round of Commission hearings, a specialised SMSF education requirement could have limited the detriment to Mr and Mrs McDowall caused by Mr Mahadevan who provided poor and incorrect advice regarding borrowing to purchase a property to live in and operate a bed and breakfast. Also, a specialist SMSF education requirement could have discouraged Mr Palmer from providing SMSF advice and his inappropriate property spruiking.

Understandably, the SMSFA notes education cannot entirely prevent poor and misleading advice, but along with the implementation of other policy measures, it will provide a safeguard for SMSF members from advisers who potentially lack the required knowledge to provide the specialist advice needed for SMSFs. Furthermore, a requirement to seek specialist SMSF advice would restrict the current practice we see in 'one-stop property shops' which the ASIC Report notes as a detrimental path to limited recourse borrowing arrangements.

If you have any questions about our submission, please do not hesitate in contacting us.

Yours sincerely,

[redacted]

John Maroney
CEO
SMSF Association

ABOUT THE SMSF ASSOCIATION

The SMSF Association is the peak professional body representing SMSF sector which is comprised of over 1.1 million SMSF members who have $750 billion of the funds under management and a diverse range of financial professionals servicing SMSFs. The SMSF Association continues to build integrity through professional and education standards for advisors and education standards for trustees. The SMSF Association consists of professional members, principally accountants, auditors, lawyers, financial planners and other professionals such as tax professionals and actuaries. Additionally, the SMSF Association represents SMSF trustee members and provides them access to independent education materials to assist them in the running of their SMSF.