REVIEW INTO THE GOVERNANCE, EFFICIENCY, STRUCTURE AND OPERATION OF

AUSTRALIA'S SUPERANNUATION SYSTEM

SELF-MANAGED

SUPER SOLUTIONS

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PHASE THREE — PRELIMINARY REPORT

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1 INTRODUCTION

On 29 May 2009, the Government announced a comprehensive review of Australia's superannuation system: the Super System Review (**Review**).

The Review has broad terms of reference.[1] It has been charged with examining and analysing the governance, efficiency, structure and operation of Australia's superannuation system. The Review is focused on achieving an outcome that is in the best interests of members and which maximises retirement incomes for Australians.

On 14 December 2009, the Review Panel released an Issues Paper titled 'Phase Three: Structure' calling for submissions by 19 February 2010 on a range of issues relating to self-managed superannuation funds (**SMSFs**) and small APRA funds (**SAFs**).

This Preliminary Report contains the Panel's views on the issues raised in Phase Three insofar as they relate to SMSFs only. The Panel has done this to assist in the process of articulating and refining the recommendations that will ultimately be made to the Government. The Panel believes that there is a reasonably high degree of consensus on many of the issues if the numerous, high quality submissions received in response to the Phase Three issues paper are indicative.

The Panel also notes the *Future of Financial Advice* package of financial advice reforms announced by The Hon Chris Bowen MP, the Minister for Financial Services, Superannuation and Corporate Law, on 26 April 2010.[2] The Panel believes that this SMSF Preliminary Report is consistent with the Government's *Future of Financial Advice* reform package; in particular, in areas such as adviser competency and remuneration and the removal of the accountants' licence exemption.

It is intended that this document give stakeholders a clear picture of the likely shape of the final recommendations on SMSFs to be made by 30 June 2010.

2 TEN GUIDING PRINCIPLES FOR SMSFS

As a starting point, the Panel has articulated ten guiding principles that it believes should underpin the regulation of SMSFs. The principles have informed the Panel's preliminary recommendations and could have a longer term role in guiding policy-making in the SMSF sector.

Principle 1 — Ultimate responsibility

SMSFs are unique in Australia's superannuation system in that SMSF members have effectively assumed sole responsibility for the adequacy of their retirement savings. This affects a wide range of regulatory settings that are appropriate for SMSFs.

1 http://www.supersystemreview.gov.au/content/terms_of_reference.aspx.

2 http://ministers.treasury.gov.au/DisplayDocs.aspx?doc=pressreleases/2010/036.htm&pageID=003&min=ceba&Year=&DocType=.

Principle 2 — Freedom from intervention

Given that SMSF members are entirely responsible for their own decisions (principle 1), the Panel sees the ability to be genuinely self-directed and self-sufficient as an important feature of SMSFs.

The Panel believes that trustees should not lightly be exposed to administrative and other burdens that are not directly relevant to building their retirement savings through sound investment practices.

Principle 3 — ... but not complete absence of intervention

All superannuation funds, including SMSFs, benefit from valuable tax concessions that are designed to encourage and help members to save for retirement. In addition, the government underwrites the risk of SMSF failure via the social security system. The Panel believes that this justifies *some* intervention in the way SMSFs are managed and that the community also has a right to a certain level of information about them. That intervention is currently reflected in a range of rules and restrictions in the SIS Act and associated regulations.

Principle 4 — Service providers

Consistent with the first three principles, trustees are not required to use a service provider when running an SMSF, other than the annual audit, which must be carried out by an approved auditor.

SMSFs might also choose to use a range of other service providers (for example, administrators, platform providers and accountants) and these service providers also play an important ‘gatekeeper’ role in the SMSF sector. As a result, the Panel believes that government policies should be directed at ensuring service providers maintain a high standard of competency and compliance as part of the overall regulatory framework. Where appropriate, licensing should be used to achieve this, but only in a way that demonstrably adds value to the sector.

Principle 5 – Gatekeeper on establishment

The Panel believes that the viability of the SMSF sector is strongly dependent on the composition of its population. An influx of trustees who were less well-equipped to cope with the responsibilities and disciplines inherent in running an SMSF could lead to serious public policy concerns for the sector. Such a development could see a call for more severe regulatory restrictions on all SMSFs which would be to the detriment of all existing members and the sector as a whole. The Panel recognises that this Review could create an interest in SMSFs from people who would, in fact, be better off remaining in an APRA-regulated fund.

The Panel therefore favours a mechanism that allows new entrants to the SMSF sector to assess whether they would be suited to its unique features and responsibilities and understand the need for a certain size of fund to make an SMSF cost competitive with an account in an APRA-regulated fund. The Panel has not made any preliminary recommendation, but decided to leave open for further discussion the way this could be achieved by proposing a number of options. The various options it has looked at are canvassed in section 7.2.1 ‘SMSF Establishment – gatekeeper mechanism’.

Principle 6 — Consistent treatment with APRA-regulated funds where appropriate

The Panel believes that the norm should be that all superannuation funds are treated in the same way. For example, notwithstanding that outcomes might differ because of fund size, scale and other individual fund circumstances, the same tax legislation, sole purpose and preservation rules should apply across all sectors. This suggests that many rules for SMSFs will be the same as those applicable to APRA-regulated funds and that is in fact the case.

However, there is no escaping the fact that SMSFs are different and that they call for different rules in a number of areas. It is not always appropriate or desirable that all superannuation funds should operate under precisely the same legislative framework. The Panel recognises that this runs counter to many submissions that argued their particular position on the basis of a 'level playing field'. However, the Panel has specifically taken the view that consistency with APRA-regulated funds will not always be appropriate for SMSFs. This position also reflects the distinct supervisory approach necessarily applied by the ATO and APRA to their respective superannuation populations.

Principle 7 — Recognition of special risks in an SMSF environment

Extending principle 6, the Panel recognises that the SMSF environment creates some particular tensions in appropriately managing the personal preferences and lifestyle choices of the members (and their related entities). While trustee decisions for all funds are made within the framework of the sole purpose test, the Panel believes that it is appropriate to impose *some* additional restrictions on SMSF trustees (over and above the restrictions imposed on funds with an external trustee) given those tensions.

Principle 8 — Leverage

Leverage should not be a core focus for SMSFs. While views will differ on this issue, the Panel believes that there is room for leverage in SMSFs, but it should be ancillary to the main strategies employed to build retirement savings over the longer term.

Principle 9 — Compliance, rather than prudential, regulatory focus

An important element in the supervision of APRA-regulated funds is ensuring that trustees are acting in members' best interests at all times.

In the Panel's view, a different regulatory focus is appropriate for SMSFs. The role of the regulator and key industry participants (such as auditors) for this sector should be legislative compliance, rather than a prudential objective.

Principle 10 — Pursuit of excellence

Given that SMSFs are widely dispersed and non-institutionalised, and that many SMSF service providers are also fragmented and lack scale, there is a challenge for the sector in investing in improvements such as technology, governance and investor education. The Panel believes that a sector that has such a large proportion of Australia's retirement savings needs an aggressive agenda aimed at pursuing excellence across all its activities.

The Panel believes that it might be worthwhile for government to consider measures to support, promote and champion the development of best practice among SMSF trustees.

3 THE PANEL'S VISION FOR SMSFS

The Panel's vision for SMSFs is one where:

- Trustees act diligently to build their retirement savings and are supported by highly competent and skilled service providers; and approved auditors and financial advisers have a greater 'gate keeping' role to ensure that those in the SMSF sector are more likely to be able to cope with its challenges;
- the sector is able to innovate quickly, is efficient and well-managed and largely free of asset-based or percentage fees;
- SMSFs are simpler for trustees to operate and manage; operating costs continue to decline through improved efficiency, greater use of technology and less reliance on paper-based accounting approaches; and SMSFs are subject to more effective regulation and better governance;
- trustees are supported with access to information that is relevant, reliable and comparable, enabling the costs of running SMSFs to be known, comparisons with other forms of superannuation to be performed and facilitating better decision-making;
- trustees are focused on investing for their retirement and not on related party or present day benefits; and
- SMSFs are safer, as the risk of illegal schemes and fraud have been mitigated.

4 STRUCTURE

The vast majority of submissions supported the view that the SMSF sector, with a few exceptions, generally works well. This view is shared by the Panel. Submissions overwhelmingly supported the retention of the trust structure for SMSFs.

The Panel has previously indicated support for the trust structure in the APRA-regulated sector and it sees no reason why the SMSF sector should operate under a different structure (such as a statutorily formed trust or a purely contractual structure) given its substantial size and history and the costs and challenges in replacing it.[3]

While some submissions canvassed ideas such as the appointment of asset custodians, external trustees, mandated service providers (such as administrators or licensed advisers), mandated asset allocation and investment restrictions, most strongly rejected them.[4] The ability to retain 'control' over all aspects of an SMSF is a very powerful and attractive feature for trustees. Submissions overwhelmingly supported the retention of 'control', as does the Panel.

3 Super System Review 2009, Clear Super Choices: Matching Governance Solutions, 14 December 2009.

4 R.E. Reid and S.M. Reid, Phase Three Submission, page 5; G. Hurford, Phase Three Submission, page 4; J and V. Mahon, Phase Three Submission, page 10-11; A. Cummings, Phase Three Submission, page 20; Taxation Institute of Australia, Phase Three Submission, page 7; SPAA, Phase Three Submission, pages 23-25; ING Australia Limited, Phase Three Submission, page 20.

Inherent in the 'control' concept is the recognition and acceptance that ultimate responsibility rests with trustees.[5]

The Panel believes these 'control' features and acceptance of ultimate responsibility, which characterises the SMSF sector, have contributed to its sustained growth.

4.1 Membership size

The majority of submissions supported increasing the four member limit on the basis that it restricted the ability to involve all family members and that the limit was arbitrary. While there was no general consensus as to what the increased limit should be and some submissions even suggested there should be no limit, there was a general consensus that any increase should be restricted to 'family members'. Submissions varied on who constitutes a 'family member' — suggestions included: Part 8 associates,[6] relatives and the immediate family, to name a few.[7]

Increased membership size, though, would introduce new complexity to SMSFs and might start to blur the line between SMSFs and APRA-regulated funds.[8] If all members were still to be trustees, increased numbers would raise management, agency and control issues, which would place a strain on the SMSF model, given that it does not employ prudential supervision.[9] Potentially, larger numbers could lead to member disenfranchisement and the possible need for external arbitrators (to resolve deadlocks between trustees) was also raised.[10] While these issues could potentially be mitigated by the appointment of representative trustees,[11] this would lead to a fundamental change to one of the SMSF's guiding principles: that every member is a trustee and has ultimate responsibility for their retirement (principle 1).

While the Panel accepts the arbitrary nature of the limit and sees some of the attractions for wider family participation, the Panel does not propose to recommend changing the existing membership limit. It believes that the complications inherent in expanding the limit outweigh the possible advantages. The Panel also notes that more than 90 per cent of SMSFs currently have only one or two members and more than 95 per cent have three or fewer members.[12]

4.2 Minimum fund asset size

There has been a long-running debate about whether there should be a minimum SMSF asset size, with many industry participants questioning whether an SMSF with $200,000 in assets could be cost competitive with APRA-regulated funds.

The Review's previous publication '*A statistical summary of self-managed superannuation funds*' identified a less than optimal picture of smaller-sized SMSFs ($200,000 or less). It

5 D. Evans, Phase Three Submission, page 7; B. Alexander, Phase Three Submission, page 2; Pitcher Partners page 12; A. Cummings, Phase Three Submission, page 18; Law Council of Australia, Phase Three Submission, page 16.
6 As defined in the SIS Act.
7 Lambourne Partners, Phase Three Submission, page 5; Heffron Consulting Pty Ltd and Cavendish Superannuation Pty Ltd, Phase Three Submission, page 17; Taxation Institute of Australia, Phase Three Submission, page 9.
8 Williams Partners, Phase Three Submission, page 2.
9 A. B. Jacobs, Phase Three Submission, page 8.
10 Multiport Pty Ltd, Phase Three Submission, page 18.
11 Taxation Institute of Australia, Phase Three Submission, page 9.
12 Super System Review, 'Statistical Summary of Self-managed superannuation funds,' 10 December 2009.

showed that, on average, they lacked investment diversification, suffered higher relative costs and underperformed larger-sized SMSFs. Given this, the Review undertook further analysis on smaller-sized SMSFs, the results of which are set out in the Appendix.

A number of submissions highlighted that cost should not be the primary focus when establishing and maintaining an SMSF. According to CPA Australia, trustees need to consider the fund's break-even point, which would depend on how much work the trustees did themselves as against services that were paid for.[13] Submissions also supported the view that SMSF trustees know the costs of running their SMSFs because they pay them directly;[14] it was also argued that this cannot be said for members in APRA-regulated funds.[15] The Panel accepts that this is one of the many significant differences between the two models.

While the Panel remains concerned about the number of small-sized SMSFs, it acknowledges that their existence is generally due to the conscious choice of members. The Panel also believes that the debate over the cost-competitiveness of small-sized SMSFs, over the last few years, might already have reduced the number of small-sized SMSFs.[16]

The Panel does not believe there is a need to mandate a minimum SMSF asset size; within the choice architecture model members have the right to choose. With appropriate disclosure (further discussed in section 7.2.1 'SMSF Establishment - gatekeeper mechanism') and an increase in comparable data, people will be able to make more informed choices that are in their interests. The Panel believes this will ensure that SMSFs are established for a suitable purpose, resulting in a reduced instance of small-sized SMSFs.

4.3 Trustee structure (corporate v natural person trustees)

The number of SMSFs with natural person (member) trustees is much greater than those with corporate trustees and this trend appears to have been increasing in recent years. As at 30 June 2009, around 29 per cent of all SMSFs had a corporate trustee. However, for the 2008 and 2009 financial years, nearly 90 per cent of new SMSFs were established without a corporate trustee.[17]

The Panel and various stakeholders have expressed their surprise at this trend in various consultations and submissions. It is widely accepted by professionals and the ATO that a corporate trustee is superior. Some of these benefits, outlined in submissions, include:

- perpetual succession — the corporate entity cannot die, so it enables better control in the event of member death or incapacity;
- greater administrative efficiency;
- greater flexibility to pay benefits as lump sums or pensions;

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13 CPA Australia, Phase Three Submission, page 11.

14 A. Cummings, Phase Three Submission, page 17; A. Bloore, Phase Three Submission, page 22; Dixon Advisory, Phase Three Submission, page 20; D Proctor, Phase Three Submission, page 14; Rice Warner Actuaries, Phase Three Submission, page 31.

15 Multiport Pty Ltd, Phase Three Submission, page 9.

16 Super System Review, 'Statistical Summary of Self-managed superannuation funds,' 10 December 2009.

17 Super System Review, 'Statistical Summary of Self-Managed Superannuation Funds,' 10 December 2009.

- greater estate planning flexibility;[18] and
- reduced risk of deliberate or accidental intermingling of fund and personal assets, in breach of the covenant in section 52(2)(d) of the SIS Act.[19]

The trend towards individual member trustees could be due to limited advice or understanding of the benefits and the higher establishment costs of the corporate trustee option over the member trustee option.

Some submissions, recognising the benefits of corporate trustees, supported the use of a sole purpose corporate trustee (**SPCT**).[20] One submission recommended that the ASIC company registration fee be reduced to $100 and the $40 ASIC annual review fee be removed.[21] A number of submissions also suggested that all SMSFs should be required to have a corporate trustee.[22]

The Panel is attracted to the potential benefits provided by the corporate trustee structure and is concerned about the large proportion of new SMSFs choosing not to use a corporate trustee. However, consistent with principle 2 regarding freedom from intervention, the Panel believes that the solution here is a better standard of advice, an aim which is addressed by other recommendations. The Panel therefore does not intend recommending any change on this issue.

4.4 Custody

Submissions did not support the concept of compulsory use of third party custodians. Submissions pointed out that this option would add to cost with arguably little benefit to compliance levels. The Panel agrees with these views and does not propose to pursue this option.

5 SMSF TRUSTEES — EDUCATION AND COMPETENCY

Risks associated with a trustee's lack of financial literacy or understanding of longevity risk is potentially magnified in an SMSF. While SMSF members face complexity in relation to their funds, complexity affects every superannuation member in one way or another.

The Panel does not believe that SMSF trustees should be expected to become superannuation experts; that is simply not realistic. Increasing trustee knowledge and competency is desirable and was mentioned in many submissions. This is, of course, a view shared by the Panel.

The Panel, however, believes that increased knowledge and competency can be achieved through other methods rather than by requiring trustees to undertake compulsory education.

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18 DBA Lawyers, Phase Three Submission, appendix 1; Outlook Tax and Accounting Solutions Pty Ltd, Phase Three Submission, page 6.
19 Section 52(2)(d) SIS Act.
20 SPAA, Phase Three Submission, page 22; DBA Lawyers, Phase Three Submission, page 4.
21 DBA Lawyers, Phase Three Submission, page 4.
22 J. and V. Mahon, Phase Three Submission, page 6; DBA Lawyers, Phase Three Submission, page 4; K. Bailey, Phase Three Submission, page 1.

The Panel believes that improvements in SMSF trustee knowledge can be realised through:

- Increasing the minimum competency and knowledge levels of participants that service the SMSF sector, given that the majority of trustees engage some form of service provider. The overwhelming majority of submissions were of a similar view.[23] This is further discussed in section 7 'Service providers'.

- Increasing the provision of SMSF-orientated information and education to enable voluntary education. This is further discussed in section 9.4 'Online SMSF resource centre'.

The private sector is already starting to produce this type of education. Accounting professional bodies are in the process of developing an 'on-line self paced training package for SMSF trustees' which will be available free of charge for trustees in the second quarter of 2010.[24]

- While, in principle, the Panel does not favour compulsory trustee education, it is attracted to the idea of compulsory education for those who breach their SIS Act obligations. This is further discussed in section 6.1 'ATO Penalties'.

The Panel does not believe that any particular academic, professional or other qualifications requirement should be imposed on SMSF members. The Panel does not believe SMSF trustees should be mandated to undergo any form of initial or ongoing formal education, training or accreditation. Such decisions should be voluntary.

6 REGULATION

There are over 410,000 SMSFs with an average asset value of $858,000.[25] By contrast, there are only 429 APRA-regulated funds which have more than four members, and for these the average fund size is $1.86 billion.[26] Further, the trustees of SMSFs are the members; there is no 'agency' issue at the trustee level. By contrast, APRA-regulated funds either have a trustee, representative of employer-sponsors and members, or there is more of a commercial relationship between the fund and its members where the trustee and its directors are all part of a corporate group. It is clearly impractical to regulate the two sectors in an identical way.

Prudential supervision is designed to ensure, so far as is reasonably possible, that the trustee operates the fund in such a way as to meet its financial promise to members while also observing the government's retirement income policy objectives reflected in the SIS legislation. The logic is that SMSFs do not require prudential oversight because the trustees and members are one and the same people who have the incentive and responsibility to protect their own interests. This view was generally supported in submissions.[27]

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23 SPAA, Phase Three Submission, page 14; Dixon Advisory, Phase Three Submission, page 14.

24 CPA Australia, Phase Three Submission, page 9.

25 Super System Review, 'Statistical Summary of Self-Managed Superannuation Funds,' 10 December 2009.

26 Does not include 81 Pooled superannuation trusts, APRA 2010 *Quarterly Superannuation Performance December 2009*, 11 March 2010.

27 Law Council of Australia page 17; D. Evans, Phase Three Submission, page 7.

While some submissions suggested a change of regulator to APRA (and greater prudential supervision)[28] most agreed that the ATO, with its compliance-based approach, was best placed to continue regulating the SMSF sector.[29] The Panel agrees that regulation of the self-managed sector should stay principally compliance-focused to ensure minimum standards are met. Given this, and the large number of SMSFs, the Panel believes that the ATO remains the appropriate regulator.

6.1 ATO penalties

The Panel accepts that most SMSF trustees seek to operate their funds properly to secure their own retirement, and comply with the various obligations and standards set out in legislation. However, in any industry with over 410,000 participants, there will be a proportion that disregards the rules. The ATO is not resourced to engage with each SMSF each year, and to do so would be costly and inefficient. It follows that intensive supervision must be based on a risk-based sample of the SMSF population, and that the regulator needs to have and apply effective, flexible and proportionate powers to address wrongdoing or non-compliance.

Those tools must be cost-effective for the regulator to use, and the consequences should be sufficient to deter SMSF members from repeating any misconduct, and to act as a deterrent to others.

The 'nuclear option' in the ATO's regulatory armoury is the power to make a fund non-complying for taxation purposes. This can be invoked if the ATO determines that the trustee has contravened the SIS Act or Regulations and, having regard to the seriousness of the contraventions, the taxation implications of the decision and all other relevant circumstances, it decides to issue a notice of non-compliance. The consequences can be severe, as the accumulated assets of the fund are taxed at the top marginal income tax rate and the fund can no longer accept Superannuation Guarantee contributions.

A number of submissions supported the removal or reduction of the power to declare a fund to be non-complying for taxation purposes.[30]

In relation to both SMSFs and APRA-regulated funds, the relevant regulator can apply to a court for civil penalties to be imposed for certain breaches of the SIS legislation. The Director of Public Prosecutions can also prosecute criminally for more serious breaches. However, both can be costly and time-consuming and the potential consequences can again be disproportionately high unless reserved for very serious breaches.

The ATO also has the power to accept a court-enforceable undertaking from trustees of contravening funds and certain other persons. As a preventative measure, the ATO can disqualify a person from being the trustee of an SMSF if they have been engaged in severe breaches of the rules.

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28 Mercer (Australia) Pty Ltd, Phase Three Submission, page 125; K. Bailey, Phase Three Submission, page 2; Rice Warner Actuaries, Phase Three Submission, page 26.

29 ICAA, Phase Three Submission, page 17; SPAA, Phase Three Submission, page 17; A. L. Truslove, Phase Three Submission, page 1.

30 Multiport Pty Ltd, Phase Three Submission, page 7; T. Horsham, Phase Three Submission, page 1; Taxation Institute of Australia, Phase Three Submission, page 5.

The ATO uses this range of powers sparingly and in only the most severe cases of non-compliance.

Given the ATO's restrained approach in using its enforcement powers in relation to SMSFs, the Panel believes there is clear benefit in retaining this array of potential penalties, and the deterrence effect they can offer.

While the fear of being made non-compliant for taxation purposes acts as deterrent to significant non-compliance, its deterrence factor diminishes as the level of non-compliance reduces; in these circumstances the ATO becomes less and less willing to impose severe penalties and it has few other sanctions to fall back on.[31]

The Panel agrees with the views expressed in a number of submissions that the framing and application of the current penalty regime reflects an 'all or nothing approach' that is not optimal.[32] The absence of an option for the ATO to apply graduated penalties results in the vast majority of contravening trustees avoiding any sanction by simply rectifying their contravention if and when it is detected. Rectification is, of course, appropriate, but it is not appropriate that trustees can continue to contravene and for their actions to have no consequences. This works counter to the principles of compliance and deterrence-based regulation and the Panel believes that credible and proportional penalties are required to support the ongoing integrity of the system.

The Panel considers that the existing penalty regime limits the ATO's ability to achieve optimal regulation. It believes that additional tools (both punitive and educational), in conjunction with its existing powers, are required to give it more flexibility.

6.1.1 A sliding scale of penalties

An overwhelming number of submissions supported the view that the ATO should be provided with a more flexible penalty regime that would enable it to tailor penalties that were commensurate with the contravention.[33] The Panel believes that the development of a new administrative penalties framework should utilise the existing penalty provisions in the SIS Act as a base.

It could be modelled on the attributes of the *Taxation Administration Act 1953* penalty framework such as the application of penalty units, approach to remission, assessment, objection, amendment and review processes. This approach would enable the ATO to apply its existing tax practices, with which SMSF sector participants are generally familiar, to SIS legislation contraventions.

Alternatively, an administrative penalty approach could be directly modelled on the 'speeding ticket' concept applied under the *Financial Sector (Collection of Data) Act 2001* whereby a trustee that breaches an offence provision may be issued with an administrative penalty, the maximum amount of which is set in the legislation. The trustee may seek internal review by the regulator of the decision to impose the penalty, and if dissatisfied

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31 Williams Partners, Phase Three Submission, page 1.

32 Dixon Advisory, Phase Three Submission, page 17; SISFA, Phase Three Submission, page 6; ICAA, Phase Three Submission, page 18; Pitcher Partners, Phase Three Submission, page 9.

33 Pitcher Partners, Phase Three Submission, page 9; D. Evans, Phase Three Submission, page 8; CBA, Phase Three Submission, page 29; Law Council of Australia, Phase Three Submission, page 20; SPAA, Phase Three Submission, page 18; ICAA, Phase Three Submission, page 18.

with the result may contest the matter in a court as though the regulator had initiated criminal charges.

While the availability of an administrative penalty regime has most practical impact for the ATO as regulator of the SMSF sector, the Panel sees no sound reason why that flexibility should not be similarly extended to APRA in respect of funds within its purview. If that were accepted, an approach based on the 'speeding ticket' model might be more suitable than one based on taxation practice. This will be addressed further in the Panel's final report.

Fines imposed under an administrative penalty regime should be payable personally by the trustees who have committed the breach and not drawn from the corpus of the SMSF.

Preliminary recommendation

The Panel recommends that relevant legislation be amended to provide the ATO with the power to issue administrative penalties against SMSF trustees on a sliding scale reflective of the seriousness of the breach. The penalty should not be payable from the corpus of the fund, and may be applied jointly or severally against the trustees or trustee directors.

6.1.2 Transfer of control to a SAF trustee

The Panel contemplated recommending that the ATO be given the power, in certain circumstances, to replace an SMSF trustee with the holder of an extended public offer Regulated Superannuation Entity (**RSE**) licence, thus changing the SMSF into a SAF. This concept was also supported in some submissions.[34] The Panel envisaged this power could be used where trustees showed, through their actions, that they could no longer be entrusted with their retirement benefits; such as where they contravene related party provisions by lending money to themselves, or their related businesses.

The Panel recognises, however, that there are practical obstacles in transferring SMSF control to SAF trustees. For the process to work:

- it would have to be administratively simple yet not impinge on trustees' rights to natural justice. As trustees' rights need to be protected, the Panel does not believe a simple mechanism can be put in place that does not then effectively duplicate existing regulatory powers (ie the powers to disqualify, suspend, or remove a trustee and appoint an acting trustee); and

- there would have to be SAF trustees who were always willing to take on a transferred SMSF. The Panel recognises SAF trustees should have the right to decide what clients they accept and that problem SMSFs might not always be appealing.

The Panel therefore does not intend to make a recommendation on this issue.

6.1.3 Power to give directions

Existing enforceable undertaking arrangements rely on SMSF trustees initiating the undertaking with the ATO. The ATO then has the option to accept or decline the enforceable

34 Outlook Tax and Accounting Solutions Pty Ltd, Phase Three Submission, page 8; National Information Centre on Retirement Investments Inc, Phase Three Submission, page 15.

undertaking that has been offered. This process can often be inefficient and time-consuming.

The Panel instead favours a more direct approach where the ATO is able to issue directions to an SMSF to rectify specified contraventions within a specified time period. Trustee rights can be protected through the implementation of appropriate objection and review procedures. Such a power would be more limited than the power to accept an enforceable undertaking, in that it would be restricted to directing rectification; while an enforceable undertaking could offer things like undertaking education, withdrawing from trusteeship for a period of time or compensating fund members or others whose interests had been harmed by the contravention.

Preliminary recommendation

The Panel recommends that the SIS legislation be amended to provide the ATO with the power to issue relevant persons with a direction to rectify specified contraventions within a specified reasonable time. A breach of a direction should be a strict liability offence.

6.1.4 Compulsory education

The Panel does not favour mandating trustee education across the whole sector. However, it does believe compulsory education can be an appropriate outcome where non compliance with SIS, especially of a lower-level nature, is detected. Compulsory education in these instances will assist to drive up trustee competence and engagement with their regulatory obligations. The Panel would also support further sanctions being imposed on trustees for non-attendance at compulsory education.

Education could be provided either through ATO-developed or externally-provided education courses. Some submissions pointed out that SMSF trustee education courses were already being developed.[35]

Preliminary recommendation

The Panel recommends that the ATO be given the power to enforce mandatory education for trustees who have contravened SIS legislation. Such education should be provided by a body (which could include commercial providers) approved by the regulator and would be at the cost of the trustees and not the corpus of the fund.

6.2 Dispute mechanisms

Generally, the Panel does not favour extending external dispute resolution mechanisms to SMSFs. Trustees should not be protected from the results of their own conduct and matters such as family law disputes have well-established mechanisms to address property entitlements and so on. Submissions were generally supportive of this approach.[36]

6.2.1 Superannuation Complaints Tribunal

Opinions differed, however, in relation to grievances involving a beneficiary in respect of an SMSF who is not a member or a person in their capacity as the legal personal representative

35 CPA Australia, Phase Three Submission, page 9; SPAA, Phase Three Submission, page 14.

36 CPA Australia, Phase Three Submission, page 9; A, Cummings, Phase Three Submission, page 11; B. Alexander, Phase Three Submission, page 2; SPAA, Phase Three Submission, page 18; Dixon Advisory, Phase Three Submission, page 16.

of a deceased member. These can arise particularly in relation to the distribution of a death benefit. Disputed insurance claims were also raised. A number of submissions supported the use of the Superannuation Complaints Tribunal (**SCT**) to resolve such disputes.[37]

The Panel shares these views and believes the SCT is an appropriate venue where these types of disputes arise. The Panel understands that in the case of death benefits (particularly in relation to a former marital partner and children of a former relationship who are not members of the fund) there can be conflicts of interest for the surviving trustees or corporate trustee directors so that the fairness and independence of their decisions can be questioned. The Panel does not believe that other third parties should have the right to dispute trustee decisions. The Panel also notes the SCT's experience in relation to the insurance issues that arise in total and permanent disability claims.

The SCT is currently funded by a levy imposed on APRA-regulated funds, which SMSFs do not pay. Therefore, the supervisory levy imposed on SMSFs might need to be adjusted to fund the SCT's handling of death benefit and insurance complaints.

Preliminary recommendation

The Panel recommends the jurisdiction of the SCT be extended to resolve death benefit disputes between an SMSF and a beneficiary who is not a member or a person in their capacity as the legal personal representative of a deceased member, and to resolve disputes involving external insurance. It does not recommend extending the jurisdiction to disputes between trustees. The Panel further recommends that the additional resourcing required for the SCT be addressed by way of the SMSF supervisory levy.

6.3 The complexity of superannuation law

Superannuation law can be complex both for SMSF and APRA-regulated fund trustees. Within the SIS Act, there are provisions that apply solely to one sector. There are also other provisions, which while applying to all sectors, are more likely to impact one sector more than the other.

The Panel believes the current legislation is complex, confusing for SMSF trustees and service providers and contains elements that should not be applicable to SMSFs. A view supported in many submissions.[38]

These complexities can lead to inefficiencies between industry participants such as trustees, service providers and regulators, where regulatory administration is shared between the ATO and APRA. The combination of complexity and the inherent differences between the regulated sectors can result in the regulators providing different risk assessments and perspectives, leading in turn to inconsistent interpretation and regulatory approaches and slower regulatory responses.

While these complexities exist and add to costs, it does not seem to have impeded the growth of the SMSF sector. In recent years, the SMSF sector has grown rapidly, resulting in it becoming Australia's largest superannuation sector by asset size. In the five years to

37 Law Council of Australia, Phase Three Submission, page 19; A. Stanway, Phase Three Submission, page 6; LBW Chartered Accountants, Phase Three Submission, page 4; KPMG, Phase Three Submission, page 2; ICAA, Phase Three Submission, page 17; R. Smith, Phase Three Submission, page 1; M. Wall, Phase One Submission, page 7.

38 Tax Institute of Australia, Phase Three Submission, page 5; Law Council of Australia, Phase Three Submission, page 17.

30 June 2009, the SMSF sector has increased from $132 billion to $332 billion; an annualised growth rate of 20 per cent.[39]

6.3.1 A separate Act or division of the SIS ACT for SMSFs

Submissions expressed a desire for the removal of unnecessary and complex requirements (aimed at APRA-regulated funds) that were adding to SMSF costs.[40] The Taxation Institute of Australia observed that many parts of the SIS legislation were not applicable to SMSFs;[41] other submissions pointed to a number of confusing and complex technical issues that needed to be addressed.[42] The Panel does not intend to address these technical issues specifically and notes that a number of the technical issues raised apply to all funds and not just SMSFs.

The majority of submissions did not support separate legislation for SMSFs and APRA-regulated funds, with CPA Australia advocating the retention of a 'level playing field'.[43] There were, however, submissions that recommended separate Acts,[44] or separate divisions (within the SIS Act) for each of the sectors.[45] The Panel recognises that some tension exists in this area, where there is the desire to remove unnecessary regulation and provide clarity of law, versus the concern that change might lead to one superannuation sector being unfairly favoured over another. However, the 'level playing field' argument only goes so far.

While the Panel believes that one sector should not be able to point to material advantages over another, the fact remains that there is a distinct difference between opting to have one's superannuation looked after in an APRA-regulated fund and taking the responsibility for one's own retirement savings in the SMSF sector.

Dedicated SMSF legislation could ease the compliance burden and costs for SMSF trustees. This could allow for provisions to be presented in plain English and be structured with more clearly defined compliance requirements, which would help both SMSF trustees and service providers to understand the requirements. It could also better define APRA's and the ATO's roles. The ATO would then be better placed to develop effective guidance material based on that framework. A re-write of the law could also provide an opportunity to address technical issues that stakeholders thought important at the time.

The Panel believes the nearly 800,000 SMSF members would benefit from simplified legislation. The separation of SMSF legislation into a separate Act, or division within the SIS Act, would provide an opportunity to simplify and clarify the SMSF rules by removing inapplicable provisions. This could be done in a manner that still leaves a 'level playing field' in the areas necessary and insofar as the distinct models allow.

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39 Super System Review, 'Statistical Summary of Self-Managed Superannuation Funds,' 10 December 2009.

40 J. Boucher, Phase Three Submission, page 1.

41 Taxation Institute of Australia, Phase Three Submission, page 5.

42 SPAA, Phase Three Submission, page 15; Smartsuper Pty Ltd, Phase Three Submission, page 9; Heffron Consulting Pty Ltd & Cavendish Superannuation Pty Ltd, Phase Three Submission, page 8.

43 CPA Australia, Phase Three Submission, page 9; Dixon Advisory, Phase Three Submission, page 16; SunSuper, Phase Three Submission, page 9; IFSA, Phase Three Submission, page 33; SPAA, Phase Three Submission, page 16; ICAA, Phase Three Submission, page 16.

44 Law Council of Australia, Phase Three Submission, page 17; LBW Chartered Accountants, Phase Three Submission, page 3; A. Cummings, Phase Three Submission, page 9; Taxation Institute of Australia, Phase Three Submission, page 5.

45 Rice Warner Actuaries, Phase Three Submission, page 26; B. Alexander, Phase Three Submission, page 2.

Preliminary recommendation

The Panel recommends that the SIS Act be restructured to separate and set out clearly those areas that are common for all funds and those areas that are only relevant to the individual superannuation sectors under the choice architecture model.

6.3.2 Binding rulings

There was broad support in the majority of submissions for the ATO to be able to issue binding SIS Act rulings to help trustees and service providers cope with the perceived complexities and uncertainty of the current legislation.[46] The Panel is attracted to this view, especially in an environment where SMSF-specific legislation has been incorporated into a separate Act or separate division within the SIS Act, believing a binding ruling system would provide for greater certainty and would also likely lead to technical issues being resolved more expeditiously.

However, the Panel notes risks with this approach, relating to:

- the need to ensure that binding rulings unambiguously apply only to the SMSF sector, with no potential for the position set out in the ruling to be imported by a court or tribunal to apply within the APRA-regulated sector. To this end, the Panel considers that such rulings could be issued only in respect of elements of the Act that apply only to SMSFs;
- the enduring nature of binding rulings in the light of potentially changing circumstances; and
- given the number of people who have expressed a demand for binding rulings, there is a potential risk that the ATO might not have the available resources to cope with the additional workload or that work on rulings might be at the expense of other activities.

Preliminary recommendation

The Panel recommends that the government amend legislation to give the ATO the power to issue binding rulings in relation to SMSFs, subject to the implementation of the Panel's previous recommendation to restructure the SIS Act.

7 SERVICE PROVIDERS

The vast majority of trustees engage service providers to help manage their SMSFs; the main service providers include accountants, financial advisers and administrators.

Given the substantial size of the SMSF sector and the fact that SMSFs are not prudentially regulated, the Panel recognises that service providers also fulfil an important 'gatekeeper'

46 C. Simpson, Phase Three Submission, page 5; J. and V. Mahon, Phase Three Submission, 9; Dixon Advisory, Phase Three Submission, page 17; SISFA, Phase Three Submission, page 6; ASFA, Phase Three Submission, page 12; Smartsuper Pty Limited, Phase Three Submission, page 10; Taxpayers Australia, Phase Three Submission, page 15; SPAA, Phase Three Submission, page 19.

role. Ultimately, the competency and professionalism of these service providers is critical to enhancing SMSF compliance and the efficient operation of the sector.

Submissions consistently supported the view that it was not the level of trustee knowledge, or compliance activity that needed to be increased; rather it was the qualifications, competency and professional standards of SMSF service providers. The theme of raising standards reverberated across all stakeholders groups (members, auditors, accountants, administrators and industry associations).[47]

The Panel believes that the SMSF sector should be serviced by providers who are required to attain and maintain a minimum level of SMSF competency. Minimum standards would be aimed at greater consistency among service providers. More importantly, it would provide members with greater protection and reduce the risk of inappropriate advice.

7.1 Prescribed use of service providers

Many trustees are capable of looking after all (or at least a substantial part of) the affairs of their SMSF and in doing so can considerably reduce their costs and still comply with the law. The Panel acknowledges the strong sentiment in many SMSF trustee submissions, that they should not be forced into using service providers where there was no need for them.[48]

The Panel recognises that in the 'self-managed' sector, people are generally entitled to do just that, unless there is a countervailing public policy reason. Public policy already requires the SMSF to obtain an independent audit. The Panel also sees a countervailing public policy interest in ensuring that SMSFs are established in appropriate circumstances (principle 5).

The Panel has raised the possible option of requiring one-off advice from a licensed financial adviser in order to establish an SMSF as one of a range of options canvassed in section 7.2.1 'SMSF Establishment – gatekeeper mechanism'. The Panel has not made any decision about which gatekeeper mechanism to recommend at this stage and currently prefers one of the other possible solutions (see section 7.2.1).

7.2 Financial advisers

The competency and knowledge levels of licensed advisers are particularly important given their role as one of the 'gatekeepers' in a substantially 'DIY' sector. Many submissions argued that adviser competency standards and qualifications are too low and that all advisers require specialist knowledge, in particular knowledge of the SIS Act, SIS Regulations and the Tax Act, and their application to SMSFs.[49] The Panel supports this view.

The ASIC Regulatory Guide 146 (**RG 146**) expresses ASIC's policy about the level of training necessary for advisers. This imposes minimum requirements, requiring advisers to demonstrate that they have met both generic and specialist knowledge requirements

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47 A. Cummings, Phase Three Submission, page 10; P. Hey, Phase Three Submission, page 2; Outlook Tax & Accounting Solutions PTY Ltd, Phase Three Submission, page 13; Multiport Pty Ltd, Phase Three Submission, page 4; Heffron Consulting Pty Ltd and Cavendish Superannuation Pty Ltd, Phase Three Submission, page 6; Small Independent Superannuation Funds Association, Phase Three Submission, page 5; ASFA, Phase Three Submission, page 14.

48 A. and M. Wells, Phase Three Submission, page 1; N. Pazolli, Phase Three Submission, page 2; R. Jacobs, Phase Three Submission, page 5.

49 Multiport Pty Ltd, Phase Three Submission, page 15; SPAA, Phase Three Submission, page 34; Hewison & Associates, Phase Three Submission, page 12.

relevant to their activities.[50] Among the 'specialist' knowledge requirements is 'superannuation'. Any person advising on SMSFs must complete, as a minimum, the training requirements for superannuation. Regulatory Guide 146 also recommends that advisers should undertake additional specific product training in relation to SMSFs before advising on these products; this, however, is not mandatory.

Some submissions argued that it was not necessary for competency standards to be increased beyond those specified in RG 146.[51] However, the majority of submissions supported increasing adviser competency standards.[52]

One submission pointed out that professional indemnity insurers are currently playing an instrumental role in raising professional standards for advisers giving financial advice to SMSFs. Policy terms have led to many advisers being required to undertake specialist SMSF training.[53]

The Panel also acknowledges the work that has been done by a number of industry participants, the Financial Planning Association (**FPA**) and the Self Managed Super Funds Professional Association of Australia (**SPAA**), to increase SMSF competency by requiring advisers to complete specialised training before they can provide financial advice on SMSFs.

The Panel also notes the proposal within the *Future of Financial Advice* reform package announced by The Hon Chris Bowen MP, the Minister for Financial Services, Superannuation and Corporate Law, on 26 April 2010[54] to establish an expert advisory panel, which will review professional standards in the financial advice industry, including conduct and competency standards.

The Panel considers that competency standards for SMSF advisers need to be raised. The Panel believes ASIC should amend RG 146 to include a specialist 'SMSF' knowledge requirement that must be obtained before advisers can provide advice in relation to SMSFs. This could be developed by ASIC, in consultation with industry and the 'expert advisory panel' announced as part of the *Future of Financial Advice* reform package.

The Panel notes the press release by Senator the Hon Nick Sherry, Assistant Treasurer, on 23 April 2010 headed 'Coverage of tax agent services regime.'[55] The press release indicated that the Assistant Treasurer, the Tax Practitioners' Board (**TPB**) and ASIC are of the view that financial planners offer what amounts to tax advice. Consequently, industry consultation will take place to determine whether financial planners providing tax advice and services within the scope of their AFSL should be registered with the TPB or whether the AFSL regime offers the appropriate regulatory mechanism.

The Assistant Treasurer announced that he has '*determined to provide a one-year deferral to financial planners from the application of the tax agents' regime.*'

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50 ASIC, Regulatory Guide 146, Licensing: Training of financial product advisers, December 2009.

51 Dixon advisory, Phase Three Submission, page 27; CPA Australia, Phase Three Submission, page 19; Taxpayers Australia, Phase Three Submission, page 29.

52 Multiport Pty Ltd, Phase Three Submission, page 16; SPAA, Phase Three Submission, page 34; ICAA, Phase Three Submission, page 25; FPA, Phase Three Submission, page 36; IFSA, Phase Three Submission, page 45.

53 Outlook Tax & Accounting Solutions Pty Ltd, Phase Three Submission, page 13.

54 http://ministers.treasury.gov.au/Ministers/ceba/Content/pressreleases/2010/attachments/036/Future_of_Financial_A vice_Information_Pack.pdf

55 http://ministers.treasury.gov.au/DisplayDocs.aspx?doc=pressreleases/2010/072.htm&pageID=003&min=njsa&Year=&DocType=0.

This deferral period will enable consultation to take place to assess which of the following options should be applied to AFSL holders. The options available are:

- to investigate and implement what changes, if any, might be made to the AFSL regime or its enforcement to ensure that it provide a comparable level of regulatory supervision in relation to tax services provided by financial planners in comparison to the level of supervision imposed on the providers of tax services regulated by the TPB; or
- to bring financial planners permanently within the tax agent services regime and therefore be regulated by the TPB, but to do so in a way that minimised any additional compliance burden.

The Panel believes that the adoption of either of those options would ensure that regulation and oversight of financial planners providing tax advice is likely to be enhanced, which the Panel believes is an important consideration given the relevance of tax to SMSFs. As a result, the Panel does not intend to make any preliminary recommendation on this issue insofar as it goes to tax, leaving the process announced by the Assistant Treasurer to run its course.

Preliminary recommendation

The Panel recommends that ASIC, in consultation with industry and the 'expert advisory panel', develop the SMSF specialist knowledge component of RG 146, which would focus on increased knowledge and competency with respect to the SIS Act.

7.2.1 SMSF Establishment - gatekeeper mechanism

The Panel believes that the establishment of an SMSF is one of the most significant steps a person can take in relation to their retirement savings. As previously discussed, the Panel remains concerned about the number of small-sized SMSFs (see the Appendix for more detail). The Panel also believes that establishing an SMSF cannot be viewed in isolation. Establishing an SMSF is, in the vast majority of cases, linked to decisions about the transfer of balances from APRA-regulated superannuation funds and the direction of an employer's Superannuation Guarantee and other contributions. SMSFs are not just one type of superannuation product in a range of products; they are the product that has the most fundamentally different roles and responsibilities for trustee/members.

As has already been mentioned, the Panel is exploring some form of mechanism aimed at allowing new entrants to the SMSF sector to assess whether they would be suited to its unique features and responsibilities and understand the need for a certain size of fund to make an SMSF cost competitive with other types of fund. The ideas that have been considered by the Panel include:

1. minimum fund size of $200,000;
2. all new entrants be required to get advice from a licensed adviser about the consequences of forming an SMSF. The existence of the advice could then be incorporated into the SMSF registration process and verified by the approved auditor;
3. requirement to get licensed advice if there would be less than a minimum $500,000 fund size;

4. those in the business of providing establishment services in relation to SMSFs be required to hold an 'SMSF establishment AFSL' (ie a licence that would only authorise that activity). This would enable regulators to identify who is establishing SMSFs, but not everyone would be required to use them or to get financial advice;

5. a requirement for prospective SMSF members to complete an online module on a government website which would take them through their possible suitability to participate as a member and trustee of an SMSF.

Discussion of each option

(a) Minimum fund size of $200,000

The Panel does not favour this option. It is an arbitrary limit and, to work properly, might need a large number of exceptions. It offends principle 1 and although the Panel readily acknowledges that small-sized SMSFs do appear to be a problem (see the Appendix), it would be a heavy-handed restriction to apply across the board.

(b) Licensed advice

This option would require a prospective SMSF member of a new SMSF to get advice from a licensed adviser to ensure they are made aware of the consequences of establishing an SMSF and leaving, or not participating as fully, in the MySuper or choice sectors. This option recognises that many prospective SMSF member/trustees already get advice before establishment (either from a financial adviser or an accountant – who in the near future may need to become AFS licensed to continue to provide advice on SMSF establishment).[56] This could be achieved by a specific legislative obligation in the Corporations Act addressing this issue. There could be an obligation to explain specific aspects of the establishment of an SMSF, including the fact that insufficient asset size would generally mean that the SMSF is not cost-effective compared to an account in an APRA-regulated fund. This could also include advice in relation to investment restrictions and other trustee obligations to ensure the prospective trustees understand their obligations and responsibilities as a superannuation trustee and be complimentary to the current trustee declaration.[57] This option could ensure that prospective SMSF member/trustees would get a minimum level of consistent and standardised advice, and it would also ensure that all members (not just the dominant party – if there was one) received that advice, thereby promoting wider engagement.

(c) Licensed advice or $500,000 minimum fund size

An alternative to requiring every prospective member to get financial advice (option b), could be to exempt those members whose SMSF asset size at establishment would be manifestly large enough ($500,000) to be cost-competitive with APRA-regulated funds. The figure of $500,000 is also one of the measures of a 'wholesale client' in the Corporations Act.[58]

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56 http://ministers.treasury.gov.au/DisplayDocs.aspx?doc=pressreleases/2010/036.htm&pageID=003&min=ceba&Year=&DocType=.

57 Currently, the approved forms for the registration of a new SMSF require the members to sign a declaration to the effect that they understand their obligations and responsibilities in areas such as trustee duties, investment restrictions, the sole purpose test, record-keeping and reporting obligations.

58 Regulation 7.1.19 Corporations Regulations 2001.

(d) New SMSF establishment licence

This option would involve requiring any service provider who carried on a business of establishing SMSFs to have an AFSL, but with a specifically limited authorisation that only extended to that activity (and thereby being less onerous to obtain). Providers would also be able to obtain a more comprehensive AFSL with a higher threshold permitting them to both establish SMSFs and undertake other financial sector functions. This would not stop a person from forming their own SMSF without using a service provider, but would see a greater proportion of new SMSFs being established by licence holders so that regulators could better monitor the 'pipeline' of new SMSFs.

(e) Online module

Under this option, a prospective SMSF member would be required to complete an online module on a government website which would take them through their possible suitability to participate as a member and trustee of an SMSF on a self-assessment basis. Issues dealt with could include asset size to be cost competitive, compliance obligations, experience necessary, recognition of possible costs, time commitment and so on. The existing ATO declaration could also be rolled into this process so that the new SMSF member would go through an educative, and then a declarative, process.

The Panel has not yet reached a firm enough view on this issue to make any form of recommendation, but currently favours the online module option.

7.2.2 Adviser remuneration

Remuneration and fee structures employed by advisers (that is whether based on a percentage of assets or fee-for-service) can have a significant effect on the performance of an SMSF. Many submissions have advocated a fee-for-service model for all recipients of financial advice.[59]

The Panel believes the approach on adviser fees needs to be consistent across all sectors. Given the approach it has recommended for MySuper and the Government's *Future of Financial Advice* reform package, it is proposing to recommend the same settings in the SMSF sector; that is the same as is proposed by the Government, with the possible exception of trailing commissions on insurance products. The Panel notes that under the Government's *Future of Financial Advice* reform package, it is intended that there will be further consultation about whether to extend the ban on commission-based fees to risk insurance (including group insurance). The Panel is currently minded to recommend such fees be prohibited in all superannuation sectors, including SMSFs.[60]

7.3 Accountants' financial services licence exemption

Currently, accountants are able to establish and give background advice about an SMSF without any additional regulation, but not about financial products (that is, the investments

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59 Dixon advisory, Phase Three Submission, page 27; AIST, Phase Three Submission, page 44; SPAA, Phase Three Submission, page 34; CPA Australia, Phase Three Submission, page 19; Taxpayers Australia, Phase Three Submission, page 29.

60 Super System Review, 'MySuper — Optimising Australian superannuation' 20 April 2010.

to be made by the SMSF) unless they hold an Australian financial services licence (**AFSL**) from ASIC.[61]

Submissions expressed the view that this exemption was not working well, that it was confusing, might be leading to SMSFs being created unnecessarily and resulted in an unlevel playing field between accountants and financial advisers.[62] It is clearly a quite artificial exemption. For example, if someone went to an accountant asking whether they should switch from a large fund into an SMSF, an accountant without an AFSL would not be able to give any advice about that person's existing fund or make any comparisons or recommend a switch. The accountant would be effectively restricted by the AFSL exemption to only saying 'yes' to the SMSF option without regard for any consequences involving the client's existing arrangements or how those arrangements compare with an SMSF. This is an unsatisfactory situation.

Some submissions argued for the continuation of the AFSL exemption by arguing that '*an SMSF is not an investment product but rather the legal and tax structure in which investment or investment products are to be housed, similar to an investment company or trust that the individual may consider to setup*.'[63]

Other submissions also supported the exemption and argued that it be broadened to enable accountants to provide structuring advice on all superannuation sectors and not just SMSFs.[64]

Conversely, there were other submissions that supported the abolition of the exemption.[65] The Institute of Chartered Accountants Australia (**ICAA**) believes that the accountants' exemption should be abolished because accountants (and their clients) find the exemption of limited value when it comes to advice on superannuation issues.[66] The ICAA suggests that, '*it is necessary to review the current education options and licensing framework to encourage more Chartered Accountants to operate in a licensed regime …* '[67] The Panel agrees with the ICAA.

The *Future of Financial Advice* reform package announced by the Government included a proposal for the removal of the accountants' licence exemption following the implementation of a suitable transitional period.[68] The Government has also announced that it will consult on an appropriate alternative to the current licensing exemption and so the Panel will no longer examine the accountants' licence exemption as part of the Review process.

7.4 Competency of SMSF accountants and administrators

Accountants and administrators supply services to SMSFs such as the preparation of accounts, administration, lodgment of returns and other compliance functions. Accountants

61 Corporations Regulations 7.1.29A.
62 SISFA, Phase Three Submission, page 7; SPAA, Phase Three Submission, page 29; Lambourne Partners, Phase Three Submission, page 3.
63 CPA Australia, Phase Three Submission, page 16.
64 NIA, Phase Three Submission, page 13; CPA Australia, Phase Three Submission, page 16.
65 ASFA, Phase Three Submission, page 1; IFSA, Phase Three Submission, page 40.
66 ICAA, Phase Three Submission, page 25.
67 ICAA, Phase Three Submission, page 25.
68 http://ministers.treasury.gov.au/DisplayDocs.aspx?doc=pressreleases/2010/036.htm&pageID=003 &min=ceba&Year=&DocType=.

and SMSF administrators are often separate entities, potentially competing for the same clients. On other occasions, the accountant or SMSF administrator is the same entity and some accountants engage SMSF administrators to provide many of those services to their clients.

Neither accountants nor SMSF administrators are required by law to have any SMSF expertise. One submission asked whether a regulatory gap existed in relation to SMSF administrators given that '*other participants in the industry (auditors, accountants, financial advisers)* [are] *subjected to various forms of regulation*.'[69] For those accountants with few SMSF clients, it will always be an open question as to how it could be economically viable to maintain the appropriate level of SMSF expertise. Issues of competency though are not necessarily limited to the small end of town.

The Panel does not propose to recommend imposing further requirements on accountants or SMSF administrators, but there was wide support in submissions for increased competency standards. The Panel believes that the accounting professional bodies are currently best placed to achieve this (without further regulation) through the provision of further guidance to their membership. They could adopt an approach similar to that taken for approved auditors, where minimum competency requirements were introduced.

7.5 Approved SMSF auditors

Approved auditors are the cornerstone of the existing regulatory framework and are heavily relied on by the ATO to manage SMSF compliance.

The ATO estimates there were approximately 11,500 approved auditors who conducted an SMSF audit for the 2007 financial year. Auditors, on average, undertook about 35 SMSF audits each in 2008; significantly though, 51 per cent of auditors performed less than five audits in a year, covering around three per cent of the SMSF population. On the other hand, just over two per cent of auditors conducted more than 250 audits.[70]

The SIS Act requires every SMSF to appoint an approved auditor to conduct an annual financial and compliance audit. As at 30 June 2008, approved auditors qualified almost 4 per cent of their SMSF audits, due to either or both a financial and a regulatory compliance issue. Auditors are also required (based on ATO reporting guidelines or on their own professional judgment) to report compliance contraventions to the ATO through an Auditor Contravention Report (**ACR**). In the year to 30 June 2009, auditors lodged ACRs for nearly 6,500 SMSFs. These ACRs contained 15,000 reported contraventions.[71]

Under the SIS Act an approved auditor is required to be an individual who is currently either:[72]

(a) a registered company auditor;

(b) a member of CPA, ICAA, or NIA;

(c) a member or fellow of the Association of Taxation and Management Accountants;

69 ICAA, Phase Three Submission, page 17.
70 Super System Review, 'Statistical summary of self-managed superannuation funds,' 10 December 2009.
71 Super System Review, 'Statistical summary of self-managed superannuation funds,' 10 December 2009.
72 Auditing and Assurance Standards Board, 'Guidance Statement GS 009 – Auditing Self Managed Superannuation Funds,' October 2008.

(d) a fellow of the National Tax and Accountants Association;

(e) the Auditor-General of the Commonwealth, a State or a Territory; or

(f) a SPAA SMSF Specialist Auditor.[73]

7.5.1 Timing of audits

The Panel believes that the annual audit provides a high level of assurance to members, regulators, government and the community more generally. Without this assurance, it would be unlikely the current 'control' features enjoyed by trustees could be retained.

Some SMSF trustee submissions recommended the removal of the audit requirement or for its frequency to be reduced. These submissions often cited cost and the belief that the audit was unnecessary. The Panel strongly rejects these views, noting that the extent of tax concessions for SMSFs justifies the public interest in independent assurance about the existence and value of fund assets, and funds' compliance with legislated requirements.

On the other hand, other submissions indicated that having less frequent audits would result in increased compliance costs and potentially a greater number of contraventions throughout the sector.[74] The Panel agrees with these views and it also believes the annual audit acts to engage trustees with their superannuation.

Given the growing size of the SMSF sector and the importance of the audit role, the Panel believes that the current frequency of annual audits is appropriate and should not be reduced.

7.5.2 Role of SMSF auditors at SMSF establishment

The Panel does not propose to change the scope of the auditing function to include auditing SMSFs at their establishment. Submissions indicated this would have little or no impact on reducing instances of fraud and illegal early release and the Panel agrees with this.[75]

7.5.3 Registration and competence of SMSF auditors

Given the important role that SMSF auditors have, and the reliance placed on auditors by regulators and other industry participants, it is critical for approved auditors to possess the necessary knowledge and skills required to undertake their duties, especially in relation to specific SIS regulatory requirements.[76]

The assurance that an annual audit provides is significantly impacted when the competency or independence of the approved auditor is in question. The quality of the audit role in the SMSF sector has been questioned by industry, and by the regulator, as was noted in the CBA submission:

> *Commissioner of Taxation, Michael D'Ascenzo, indicated that some auditors were 'focusing solely on financial issues and paying insufficient attention to regulatory requirements.'[77] The Commissioner identified the following specific issues with*

73 Superannuation Industry (Supervision) Amendment Regulations 2009 (No 6) (SLI No 389 of 2009).
74 Ulton Chartered Accounts, Phase Three Submission, page 4; J. Trioli, Phase Three Submission, page 2.
75 SPAA, Phase Three Submission, page 32; LBW Chartered Accountants, Phase Three Submission, page 8.
76 CBA, Phase Three Submission, page 28.
77 Speech to SPAA National Conference, Michael D'Ascenzo, ATO Commissioner of Taxation, 12 March 2008.

> *approved auditors: failure to follow basic auditing standards (including record keeping), failure to report contraventions and a lack of independence.*[78]

The accounting professions and the Australian Auditing and Assurance Standard Board (**AUASB**) have done a lot of work in the area of auditor competency. The AUASB issued a guidance standard for auditing SMSFs (GS 009) in October 2008 and the three professional accounting bodies (ICAA, CPA, NIA) jointly released competency standards that have applied since 1 July 2008. The standards articulate and clarify the skills required of SMSF auditors and stipulate the professional standards to be met by SMSF auditors.[79]

As indicated by CPA Australia in its submission, failing to meet these requirements would result in disciplinary action by an auditor's professional body, with severe contraventions subject to potential monetary fines and loss of professional designation.[80]

However, not all approved auditors are subject to the same minimum competency standards, nor are they subject to the same potential enforcement actions. Each of the three professional bodies has its own disciplinary guidelines. Auditors who are not members of any of those bodies are not subject to the minimum requirements, but might be subject to some other standards or possibly none at all. As shown in the following table, auditors who are not members of any of the three professional accounting bodies did the audits on 4.3 per cent of the SMSF population. CPA Australia proposed in its submission that auditors who are not members of any of the professional accounting bodies should be subject to the same minimum requirements as apply to members.[81]

Table 1: Proportion of SMSF audits by auditor membership

	Company auditor	CPA	ICAA	NIA	Other	Total
Percentage of SMSFs audited	8.0%	28.8%	50.4%	8.5%	4.3%	100%

Based on the 2008 SMSF Annual Return.
Source: ATO unpublished data.

The Panel favours an approved auditor framework where all auditors operate on a level playing field and enforcement is consistently applied. It believes compulsory registration, which is attached to ongoing competency requirements, would have a favourable impact on the professional standards across the whole industry. Registration of auditors was strongly supported by the majority of submissions.[82]

The Panel believes that the selection of an appropriate 'registration body' for SMSF auditors should be the outcome of industry consultation. One option could be to extend the ATO's current role; it already has the ability to audit the auditors and to disqualify approved auditors. Other options include ASIC, which already has an auditor registration process in place for company auditors, or the Tax Practitioners Board, given its new registration role for tax agents, many of whom may already be approved auditors of SMSFs. Alternatively, ASIC or the Tax Practitioners Board could act as the registrar and the ATO could continue to play

78 CBA, Phase Three Submission, page 28.
79 CPA, Phase Three Submission, page 17.
80 CPA, Phase Three Submission, page 18.
81 CPA, Phase Three Submission, page 18.
82 CBA, Phase Three Submission, page 29; ICAA, Phase Three Submission, page 27; William Partners, Phase Three Submission, page 1; R Smith, Phase Three Submission, page 3; SPAA, Phase Three Submission, page 32; ASFA, Phase Three Submission, page 14.

its existing policing role. Whatever the alternatives, the Panel believes that the cost of registration should be borne by the auditor.

The Panel believes that the registration body should have the powers to set competency standards, develop and apply a robust penalty regime and have powers to disqualify and deregister auditors. These powers and standards will ensure that minimum standards and enforcement are applied consistently. The Panel believes that the powers and standards of the 'registration body' need to be developed in conjunction with industry; though the Panel favours the ASIC company auditor registration model being adopted, regardless of who is ultimately selected as the registrar.

The Panel believes registration will enable targeted communication and education leading to raised competency, especially on the compliance aspect of audits. This will also enable better targeting of non-compliance by the ATO as SMSF auditors will become identifiable through their unique registration number. A central, publicly accessible register of all SMSF auditors will also help SMSF trustees identify appropriately qualified auditors.

Preliminary recommendation

The Panel recommends that:

a) approved auditors be registered, with registration requirements linked to minimum ongoing competency and knowledge standards;

b) the 'registration body' be given the power to determine the qualifications (including professional body memberships as appropriate) required for eligibility to be registered, set competency standards, develop and apply a penalty regime and have the ability to deregister approved auditors (or have one of the regulators perform those functions if the body is not a regulator); and

c) the 'registration body' (in consultation with industry) should develop the powers and standards listed above.

7.5.4 Independence of SMSF auditors

Given the fundamental role auditors play in the SMSF regulatory framework, true independence of auditors is crucial for the efficient and effective operation of the SMSF sector.

Independence requirements relevant to auditors are those prescribed in Accounting Professional and Ethical Standard 110 — *Code of Ethics for Professional Accountants* (**APES 110**), which requires that auditors must not only be independent in action, but must also be perceived to be independent. It is difficult to see how an auditor could appear to be independent when their firm provides advice, prepares the financial statements or provides other services to SMSFs or their members.[83] Auditors who are members of the professional accounting bodies are professionally obliged to comply with the requirements of the Code.

83 Williams Partners, Phase Three Submission, page 1.

However, approved auditors who are not members of the professional accounting bodies are not.[84]

Based on 2008 SMSF annual return data, auditors of 18 per cent of SMSFs provided some other services, such as acting as a tax agent, accountant, financial adviser or administrator.[85] The ATO's 2009 compliance activities targeting high risk approved auditors identified 29 per cent of auditors who were an SMSF's accountant and who had prepared a material part of its financial statements. Additionally, 28 per cent of auditors exhibited evidence of a relationship or conflict of interest that might impact the auditor's ability to be independent and had no safeguards to mitigate that risk.

A number of submissions expressed the view that auditing firms should not be providing SMSFs with any other services and should be completely independent.[86] The Panel accepts this view, given the particular features of the SMSF sector. It also believes the auditor independence model needs to be wider than just requiring auditors to have no connection with services or advice provided to the audited SMSF. The Panel prefers an independence model where the auditor or auditing firm also has no connection to services or advice provided to the individual member/trustees or their family businesses (ie wider than just in relation to the SMSF itself).

Some industry participants have questioned why there is a need to mandate audit independence, arguing that it would be singling out SMSF auditors for treatment inconsistent with international auditing standards and practice. The Panel acknowledges this, but believes that different treatment is justified, given the unique features of SMSFs and their regulation (that is there is no direct equivalent in any overseas jurisdiction that the Panel is aware of). The closely held nature of SMSFs requires both a traditional financial audit as well as a compliance audit. The compliance audit is the central component of the SMSF regulatory framework.

Requiring true independence should not result in increased audit fees (unless cross-subsidisation within the accounting industry is actually occurring). It would, however, likely result in more specialisation and this could assist to reduce audit costs. The following table illustrates that greater scale already reduces the average and median audit costs for auditors who perform a higher number of audits compared to auditors who only conduct a small number of audits.

84 CPA Australia, Phase Three Submission, page 18.

85 This figure is potentially understated. Anecdotal information from accounting professionals suggests that accounting practices are providing other services in addition to the audit service. It is thought that this is not disclosed in the SMSF annual return because those services are carried out by others in the practice. Super System Review, '*Statistical summary of self-managed superannuation funds,'* 10 December 2009.

86 William Partners, Phase Three Submission, page 1; ING Australia Limited, Phase Three Submission, page 22; D Evans, Phase Three Submission, page 21; Smartsuper Pty Ltd, Phase Three Submission, page 14.

Table 2: Average and median audit fees relative to the number of audits performed

No. of audits performed by an auditor (2008)	Average fee	Median fee
1 fund	$865	$550
2 - 4 funds	$951	$570
5 - 10 funds	$911	$600
11 - 25 funds	$810	$550
26 - 50 funds	$686	$517
51 - 100 funds	$602	$495
101 - 250 funds	$540	$440
>250 funds	$413	$380
Total	**$664**	**$495**

Based on the 2008 SMSF Annual Return.
Source: ATO unpublished data.

Additionally, the following table also supports the view that the use of truly independent auditors is already a cheaper proposition for SMSF trustees.

Table 3: Auditor fees based on whether the auditor did or didn't provide other services

	Auditors providing other services		Auditors providing no other services		All auditors	
SMSF Size	Avg	Median	Avg	Median	Avg	Median
$0 to $50k	$841	$550	$571	$440	$627	$440
>$50k to $100k	$732	$539	$519	$440	$556	$440
>$100k to $200k	$772	$550	$541	$440	$580	$462
>$200k to $500k	$823	$550	$567	$462	$608	$495
>$500k to $1m	$922	$600	$599	$489	$649	$495
>$1m to $2m	$1,105	$660	$645	$495	$717	$500
>$2m to $5m	$1,379	$800	$746	$528	$839	$550
>$5m to $10m	$2,050	$1,100	$913	$532	$1,079	$550
>$10m	$2,740	$1,400	$1,433	$695	$1,634	$750
Total	**$954**	**$594**	**$608**	**$480**	**$664**	**$495**

Based on the 2008 SMSF Annual Return.
Source: ATO unpublished data.

Given the importance of the audit role in lifting system integrity, many submissions called for legislated independence, whereby firms who audit an SMSF cannot also provide non-audit services to that SMSF.[87] The Panel agrees with these submissions and supports legislating full audit independence. It believes that unless independence is legislated, independence standards cannot be reliably enforced and auditor behaviour will not change.

Preliminary recommendation

The Panel recommends legislating full audit independence whereby an individual or firm providing any service in connection with an SMSF or its individual trustees or trustee directors in any capacity is to be expressly prohibited from auditing that SMSF.

8 INVESTMENTS

The majority of submissions opposed any notion of restricting SMSF asset allocation or investments. The Panel generally supports this position. It believes that the government should not constrain superannuation trustees' options on how to invest fund assets unless there are clear prudential or retirement income policy reasons to do so.

87 A. Cummings, Phase Three Submission, page 2; Heffron Consulting Pty Ltd and Cavendish Superannuation Pty Ltd, Phase Three Submission, page 7; CBA, Phase Three Submission, page 29.

Conceptually, the Panel agrees that those within the 'self-managed' sector should have as much choice as members in the 'choice' sector. Curtailing investment options in the 'self-managed' sector that are still available in the 'choice' sector would be illogical, counterproductive and lead to inefficiencies.

8.1 Leverage

In principle, the Panel has concerns with the concept of direct borrowing within any superannuation funds, whether SMSFs or APRA-regulated funds. In principle 8, the Panel expressed the view that leverage should not be a core focus for SMSFs.

The original default position adopted in the SIS legislation was that superannuation funds should not engage in borrowing, other than in the very short term to address cash flow issues. The rationale for this stance was simply that leverage for asset acquisition amplifies both gains and losses and this was seen as placing fund members' retirement savings at too much risk. The Panel agrees with the original default position adopted in the SIS legislation.

On 24 September 2007, the SIS Act was amended to allow all regulated superannuation funds, including SMSFs, to invest in instalment warrants. Initial interest in instalment warrants was modest, with only 0.9 per cent of the SMSF population having a derivative or instalment warrant at 30 June 2008.[88] There are, however, indications that this trend might have changed in recent times. Data from Investment Trends' surveys suggest that more than five per cent of SMSFs already invest in such instruments.[89]

While the number of SMSFs has increased greatly, so also has their average asset size and, by implication, their capacity to invest in more complex assets. SMSFs are nevertheless at greater risk than APRA-regulated funds, which are required to have licensed trustees and comprehensive risk management strategies. SMSFs do not have the mandated controls and risk mitigation strategies imposed on APRA-regulated funds.

The Panel is concerned that if direct borrowing had been more widespread before the recent GFC then a substantial amount of retirement savings could have been lost. The Panel therefore believes that the 2007 amendments to the SIS Act, which relaxed the borrowing provisions, are inconsistent with Australia's retirement policy.

The majority of submissions supported the retention of leverage in SMSFs. However, there was a general theme that the existing provisions are complex, create unnecessary confusion and require clarification.[90] Some submissions suggested that recourse be restricted to the initial capital investment with no risk to a fund's assets as a whole or from personal guarantees from any SMSF trustees.[91] Other submissions suggested introducing a maximum loan-to-valuation ratio.[92]

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88 Super System Review, 'Statistical Summary of self-managed superannuation funds,' 10 December 2009, table 18.

89 Investment Trends, May 2009 Self Managed Super Fund Investor Report, August 2009.

90 IFSA, Phase Three Submission, page 39; DBA Lawyers, Phase Three Submission, page 5; Taxpayers Australia page, Phase Three Submission, 22; Heffron Consulting Pty Ltd and Cavendish Superannuation Pty Ltd, Phase Three Submission, page 14; Multiport Pty Ltd, Phase Three Submission, page 12.

91 CPA Australia, Phase Three Submission, page 14; ICAA, Phase Three Submission, page 23; Outlook Tax & Accounting Solutions, Phase Three Submission, page 11.

92 ICAA, Phase Three Submission, page 23; Heffron Consulting Pty Ltd and Cavendish Superannuation Pty Ltd, Phase Three Submission, page 13; Multiport Pty Ltd, Phase Three Submission, page 12; Dixon Advisory, Phase Three Submission, page 24.

Many submissions also called for greater regulation of borrowing in SMSFs. On 10 March 2010, the Minister for Financial Services, Superannuation and Corporate Law, Chris Bowen MP, released a press statement headed 'Financial services consumer protection framework extended to superannuation borrowing arrangements.'

The press release outlined the Government's proposal to amend the Corporations Regulations to provide that certain borrowing arrangements by superannuation fund trustees permitted by the SIS Act are 'financial products' under the *Corporations Act 2001*. This proposal will extend the Government's consumer protection framework to instalment warrants and thereby assist to protect the savings of fund members. This means that only financial service providers with an AFSL will be able to offer these products to superannuation funds.[93] The Government also indicated that it is aware of some areas of uncertainty with borrowing arrangements and will be considering these issues in future.

The Panel recognises that the 2007 changes are still recent and that the extra safeguard recently announced by Government has not yet been implemented. The Panel therefore does not intend to make recommendations to restrict the current borrowing framework; it believes the announced initiatives will need time to be implemented. The Panel believes, however, that the relaxation of the borrowing provisions and the impact of the new consumer protection measure need to be monitored to ensure that borrowing does not become a significant focus of SMSFs. The Panel proposes that the scale and extent of borrowing within superannuation be formally reviewed in the near future. Additionally, the Panel strongly believes that there should be no further relaxation of the current borrowing framework that would permit more direct borrowing within superannuation funds.

Preliminary recommendation

The Panel recommends that the 2007 relaxation of the borrowing provisions and the consumer protection measure that the Government has recently announced be reviewed in two years' time to ensure that borrowing has not become, and does not look like becoming, a significant focus of superannuation funds.

To assist in monitoring the levels of instalment warrant borrowings by superannuation funds, the Panel believes that credit providers should be required to collect and provide relevant data to APRA that would enable the RBA to publish statistics; in the same way that credit providers must currently report on the level of finance provided for residential purchases, margin loans etc. These statistics should be at a level that can distinguish the level of finance being provided to SMSFs and APRA-regulated funds.

Preliminary recommendation

The Panel recommends that credit providers should be required to collect and provide relevant data to APRA that would enable the RBA to publish statistics on the level of finance being provided to superannuation funds.

93 http://mfsscl.treasurer.gov.au/DisplayDocs.aspx?doc=pressreleases/2010/020.htm&pageID=003&min=ceba&Year=&DocType=.

8.2 Related party investments

Retirement policy is that superannuation savings should be invested for the sole purpose of providing retirement savings (together with certain approved ancillary benefits) and not for providing current-day benefits.

SMSFs are closely held entities and there is substantial opportunity for SMSF members to engage in behaviour that is inconsistent with government policy and the purpose of their fund.

In 1997, an Insurance and Superannuation Commission survey identified that around 20 per cent of 'excluded funds' (as SMSFs were previously known) invested in related trusts and around 13 per cent of funds leased assets to related parties, raising concerns that superannuation savings were not being appropriately safeguarded.[94] Subsequent amendments to the SIS Act in 1999, generally tightening the in-house asset (**IHA**) test and related party rules, have (with other changes) resulted in the current reduction of these investments to less than 3 per cent of the SMSF population.[95] Nonetheless, these types of contraventions still account for 16 per cent of all the contraventions that auditors report to the ATO.[96]

The Panel accepts the argument that some related party investments are made in line with government policy and acknowledges that in some instances these investments have performed well. It also acknowledges that the majority of submissions have recommended no change to the current rules. Nonetheless, the Panel believes that the current exemptions still provide an avenue for potential abuse, which is inconsistent with government policy, and whose regulatory compliance costs across the superannuation system outweigh the benefits they bring to individual funds.

The Panel believes that non-prudentially regulated, closely held retirement vehicles, such as SMSFs, should not be able to make related party investments and they should not be in a position to inappropriately benefit from acquiring or disposing of assets with related parties.

8.2.1 5 per cent in-house asset limit

The purpose of the IHA test is twofold. It serves to protect fund members from the risk that, in the event of the employer failing, they lose both their source of income and their retirement savings. It also limits the extent to which business funding arrangements can be distorted, particularly in the small business sector, through access to relatively cheap, tax-advantaged working capital derived from a related SMSF.

The Panel believes that the 5 per cent IHA limit is appropriate within the APRA-regulated sector. Unlike SMSF members, there is generally no opportunity for APRA-regulated fund members to get direct benefits from these investments. Additionally, the 5 per cent limit enables APRA-regulated funds to have limited exposure to an employer sponsor where its exclusion could limit the capacity of the trustee to invest in, for example, index linked funds where the employer forms a significant part of the ASX 200.

94 http://law.ato.gov.au/atolaw/view.htm?DocID=NEM%2FEM99051%2FNAT%2FATO%2F00004.
95 Super System Review, 'Statistical summary of self-managed superannuation funds,' 10 December 2009.
96 Super System Review, 'Statistical summary of self-managed superannuation funds,' 10 December 2009.

However, given the closely-held nature of SMSFs, the Panel believes that SMSFs should be prohibited from holding any IHA investments.

For those SMSFs with existing IHA investments, grandfathering or transitional arrangements would be required. Potential options to facilitate this could include:

- Existing IHA investments under 5 per cent could be grandfathered, in a similar manner to the 1999 grandfathering rules, whereby these investments could be retained and defined so as not to constitute an IHA investment. However, no new or further IHA investments would be permissible.

- Alternatively, SMSFs with IHA investments could be provided with a transition period, say up to 30 June 2020, to dispose of their existing IHA investments. No new or further IHA investments would be permissible during or after this period.

The Panel favours the latter option. This would result in the removal of all IHA investments from SMSFs and provides sufficient time for funds to dispose of existing IHA investments. The Panel believes prohibiting these IHA investments would have minimal impact on SMSFs, as the vast majority of SMSFs do not have IHA investments and should lead to reduced compliance costs for the system overall. However, the Panel is not proposing to unwind the previous 1999 grandfathering arrangements or alter the existing IHA definition exemptions.

The Panel wants it to be understood that the current extent of IHA investments is not material in the overall context of the SMSF sector, but that the continued existence of the exemption has the potential to undermine confidence in the sector as a whole and should be eliminated.

Preliminary recommendation

The Panel recommends that in relation to the self-managed sector:

a) the 5 per cent IHA investment limit be removed so that no IHA investments would be allowed;

b) SMSFs with existing IHA investments be provided a transitional period, up to 30 June 2020, in which to dispose of their IHA investments (no new or further IHA investments are to be permissible during this transition period); and

c) APRA-regulated funds be exempted from these changes.

8.2.2 Acquisition and disposal of assets from related parties

The Panel believes that the off market acquisition and disposal of assets between related parties (where the guiding mind of both buyer and seller can effectively be the same person), does not provide transparency, is inherently risky and is open to greater abuse than non-related party transactions. The Panel believes the current provisions relating to related party acquisitions and disposals are insufficient to mitigate the potential risk of transaction date and asset value manipulation to illegally benefit the SMSF or the related party (depending on the transaction).

While the Panel debated recommending prohibiting all related party transactions (to ensure that trustee retirement decisions were in no way affected by the personal tensions that related party transactions can present) it concluded that retaining the ability to conduct limited related party transactions was still a desirable feature. As previously mentioned, the Panel is not proposing to change existing exemptions to the IHA definition, such as the lease of business real property to related parties. The Panel recognises that, unlike the removal of the 5 per cent IHA investment limit, removing the business real property exemption would have a very significant impact on the SMSF sector and on a large number of individual SMSFs.

Given the longstanding nature of the business real property exemption, the benefits it provides to business and farmers (especially as it engages them with providing for their retirement) and the lack of reports of any significant abuse in this area, the Panel believes, that with additional related party safeguards, it should remain in place.

The Panel believes that any acquisition or disposal of an asset (including in specie acquisitions and disposals) to a related party where there is an underlying formal market or exchange (for example, securities quoted for trading on ASX) must be conducted through that market. Where a market does not exist, then that acquisition or disposal must be supported by a current independent valuation from a registered valuer (for example, a business real property transaction will need to be supported by a valuation).

These changes will provide greater transparency to related party acquisitions and disposals, enabling approved auditors and the ATO to monitor this area more effectively. This will enhance the integrity of the SMSF system. While the Panel recognises these changes are likely to add to individual transaction costs, such costs will only be borne by those SMSFs that choose to engage in related party transactions.

Preliminary recommendation

The Panel recommends that the SIS legislation relating to acquisitions and disposals between related parties should be amended so that either:

a) Where an underlying market exists, all acquisitions and disposal of assets between SMSFs and related parties must be conducted through that market; or

b) Where an underlying market does not exist, acquisitions or disposals of assets between related parties must be supported by a current independent valuation from a registered valuer; and

c) APRA-regulated funds are exempt from these changes.

8.3 Collectables and personal use assets

While the Panel recognises and supports the freedom of investment choice that SMSFs afford their members, it believes that there are certain types of assets that should not be regarded as investments that build retirement savings and which consequently should not

be available to SMSFs. Such assets are broadly equivalent to 'collectables' and 'personal use assets' for tax purposes.[97] Examples include (but are not limited to):

- paintings, jewellery, antiques and stamp collections ; and
- wine, exotic cars, golf club memberships, race horses and boats.

The Panel accepts that some of these types of assets may appreciate in value over time and that investors with the appropriate specialist knowledge can profit out of them. However, the Panel points out that people who want to own such assets are free to do so outside the SMSF environment in a way that does not involve special concessions from the tax system.

Again, the Panel accepts that the proportion of SMSF sector assets invested in collectables and personal use assets is modest. While there will be some SMSFs where the concentration of such assets is quite pronounced, this is not the core issue. The principal concern is that the cumulative regulatory and compliance complexities outweigh the potential benefits of allowing such a liberal investment menu to a sector that is not directly prudentially regulated.

Preliminary recommendation

The Panel recommends that:

a) the acquisition of collectables and personal use assets by SMSF trustees be prohibited;

b) SMSFs that own collectables or personal use assets be provided a transitional period, up to 30 June 2020, in which to dispose of those assets; and

c) APRA-regulated funds be exempted from these changes.

8.4 Investment resources

The Panel believes appropriate information and guidance on SMSF investments, such as the concepts of investment risk, diversification, liquidity and the different considerations of the accumulation and payment phase, should be made more widely available. This is discussed further at section 9.4 'Online SMSF resource centre'.

9 SMSF INFORMATION

The level and quality of information available on SMSFs and the SMSF sector does not reflect the sector's position as Australia's largest superannuation sector by value. Given the scale of the sector, the government and the community as a whole have an interest in quality data on SMSFs.

The information needs for industry participants will vary significantly depending on their involvement. Information helps to:

- improve decision-making and choice;

97 http://www.ato.gov.au/individuals/content.asp?doc=/content/36555.htm&page=1#P10_750.

- improve understanding; and
- enhance competition, analysis and monitoring of Australia's superannuation system.

Ensuring that there is reliable and relevant SMSF data is an integral part of the efficient operation of Australia's superannuation system. Achieving comparability of data between SMSFs and APRA-regulated funds is viewed as a positive outcome.[98] The Panel is conscious of submissions warning that changing the information requirements for SMSFs should not overly burden SMSF trustees with additional data collection obligations,[99] but the Panel is also optimistic that this can be managed once an enhanced data collection and publication regime is achieved in the APRA-regulated sector.[100]

Comparability with the APRA-regulated fund sector is but one reason for improving SMSF data. Good comparable SMSF data gives trustees practical information to help them manage their fund. For example, it might be of assistance to see what the average audit fee is for the industry as a whole or for a similar sized fund. Likewise, it could help a trustee to be able to see what the average long term returns or what the administration, investment, and advice costs have been for similar-sized funds with similar investments.

9.1 SMSF data provider

There is currently no organisation charged with producing information for the benefit of the SMSF sector.

While several organisations have released statistical reports on SMSFs in the past six months,[101] these summaries draw on information from different sources, are based on different populations and calculate key metrics differently. Also, the SMSF information in these reports is largely incomparable with APRA-regulated fund data.

A number of submissions suggested that the ATO[102] was the most appropriate entity to collect and provide data in the marketplace, while others suggested that APRA[103] or the Australian Bureau of Statistics[104] might be better placed to collect and provide data on SMSFs.

To improve the level of available information, additional data would need to be collected from SMSFs. While the Panel recognises this would have cost implications, it believes the long-term benefits to public policy-making and to the industry would outweigh these costs and so satisfy principle 3 in relation to government intervention. To achieve the objective of comparable data, standards need to be developed that clearly identify the data required. The development of these standards would enable better comparisons between the APRA-regulated and SMSF sectors. The Panel recognises this process would not occur quickly, but nonetheless believes it to be an important objective.

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98 ICAA, Phase Three Submission, page 20; Heffron Consulting Pty Ltd & Cavendish Superannuation Pty Ltd page 5.
99 KPMG, Phase Three Submission, page 3.
100 SPAA, Phase Three Submission, page 22.
101 Super System Review, '*Statistical summary of self-managed superannuation funds*,' 10 December 2009; CPA Australia, 'Self-managed super fund insights,' November 2009.
102 ASFA, Phase Three Submission, page 12; CPA, Phase Three Submission, page 11; Taxpayers Australia, Phase Three Submission, page 18; SPAA, Phase Three Submission, page 20.
103 AIST, Phase Three Submission, page 38.
104 Rice Warner Actuaries, Phase Three Submission, page 30.

The Panel believes that an organisation (government or private) should be responsible for the production of SMSF statistics on an ongoing basis. Preferably, this organisation's mandate would cover the whole superannuation industry and not just this sector, but the Panel also recognises the logic for the industry regulator to collect all the data needed for both regulatory and broader public purposes.

Alternatively, the ATO could be specifically given responsibility for the ongoing production of SMSF statistical reporting that benefits greater market and member understanding of the SMSF sector and its performance.

This will be addressed further in the Panel's final report.

9.2 SMSF accounting

The Panel recognises that SMSF trustees report to themselves as members. Accounting standards, however, are not tailored for SMSFs. This can produce shortfalls in the information provided to members and the community (which has a valid interest in some of this information).

9.2.1 Asset valuations

Australian Accounting Standard 25 — *Financial Reporting by Superannuation Plans* (**AAS 25**) applies to 'reporting entity' superannuation funds, requiring them to value their assets at their net market value as at the reporting date. However, SMSFs are not reporting entities and are therefore not required to comply with AAS 25.[105] The ATO's preferred valuation method, as outlined in its Superannuation Circular 2003/01, is for all SMSFs to use market values for all valuation purposes, but this is not mandatory.[106]

Asset valuation is a key component in preparing meaningful SMSF financial reports. It has an impact on the returns for members and, ultimately, SMSF sector performance as a whole. Currently, SMSFs are generally able to choose either the historical cost or market valuation accounting method to value their assets; although SMSFs in the pension phase[107] or those with IHA investments, must value assets at market value each year.

The differing use of these valuation methods in the SMSF sector has a significant impact on a member's ability to ascertain current superannuation benefits, affects the reliability and usefulness of superannuation data, and compounds the difficulty in comparisons with APRA-regulated funds (which use the market valuation methodology). Ultimately, market value accounting is essential for the reliability, transparency and accountability of Australia's superannuation system.[108] It would also ensure that SMSF members are given a truer picture of their SMSF and their likely personal entitlements. As one submission pointed out:

> *'a requirement that SMSF financials be prepared at net market value would be useful and fair in regards to calculation of minimum and maximum pension amounts,*

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105 KPMG, Phase Three Submission, page 3.

106 http://law.ato.gov.au/atolaw/view.htm?dbwidetocone=03%3ASuperannuation%20Circulars%3AATO%20Superannuation%20Circulars%3A%23SC20031%23Australian%20Taxation%20Office%20Superannuation%20Circular%202003%2F1%20%20Self%20Managed%20Superannuation%20Funds%3B.

107 SMSFs in pension phase (either fully or partially) represented 27 per cent of all SMSFs as of 30 June 2008.

108 A. Jocobs, Phase Three Submission, page 5.

> *members' roll ins and roll outs and consistent measurement of compliance breach amounts.'*[109]

The majority of submissions supported the reporting of assets at market value.[110] Submissions also supported the view that most SMSFs already use market valuations because trustees want an accurate picture of their fund's investment performance.[111] The ICAA has suggested that the requirement for all SMSFs to value assets at market value be incorporated in the SIS legislation.[112] The Panel believes that the consistent use of net market valuation would benefit members.

The Panel considers that all SMSFs should value assets annually at net market value, though it does not believe that SMSFs should be required to prepare general purpose financial reports. This would make valuation principles consistent across all superannuation sectors. The Panel believes that implementation of market value accounting would not impose significant cost or burdens on SMSFs. The majority of SMSFs are already valuing assets at market and most SMSF assets (72 per cent) are 'market assets' and readily conducive to annual valuation (listed equities, cash, listed trusts and managed funds).[113]

Some difficulties may be faced when valuing certain assets, such as units in unlisted unit trusts. In these cases, guidelines on different asset classes could be provided by the ATO to ensure consistency of valuation and enable clear auditing of the requirements. It should also be recognised that formal (external) valuation would not be required every year, but rather at a suitable intervals developed in consultation with accounting industry (say every three years as per the current standard). Trustee's valuations, with appropriate supporting documentation, would then be acceptable in the interim.

Preliminary recommendation

The Panel recommends:

a) legislation be passed to require SMSFs to value their assets at net market value; and

b) the ATO, in consultation with industry, publish valuation guidelines to ensure consistent and standardised valuation practices.

9.2.2 Disclosure to members

The Panel is keen to encourage further engagement by all trustees in the affairs of their SMSF, not just the dominant party (if one exists). The Panel believes there is some key information that SMSF trustees should provide annually to all SMSF members, beyond what the Corporations Act currently requires. This includes:

- whether or not a binding death benefit nomination is in place and if so, the name of the beneficiary(ies) and the date on which the notice will lapse (if applicable);

109 Williams Partners, Phase Three Submission, page 1.

110 ICAA, Phase Three Submission, page 21; SPAA, Phase Three Submission, page 21; CPA Australia, Phase Three Submission, page 12; Ulton Chartered Accountants, Phase Three Submission, page 3; Outlook Tax and Accounting Solutions Pty Ltd, Phase Three Submission, page 6.

111 SPAA, Phase Three Submission, page 21; CPA Australia, Phase Three Submission, page 12; ICAA, Phase Three Submission, page 21; Partners Superannuation, Phase Three Submission, page 5.

112 ICAA, Phase Three Submission, page 3.

113 Super System Review, 'Statistical Summary of Self-managed Superannuation Funds,' 10 December 2009, table 18.

- notification as to whether a pension is in place and whether that pension automatically reverts to the pensioner's spouse on death;
- whether the member's death benefit includes any insurance and if so, the amount of that insurance;
- showing the member's balance divided between each 'superannuation interest' held for that member in the fund;
- the investment return (after fees and tax) achieved on each member's balance over the previous financial year; and
- where investment choice is exercised, how the member balances have been invested.

The Panel expects that some trustees are already acutely aware of this information and have no need for further prescription. The Panel believes, however, that requiring trustees to report on these items (in addition to the SMSFs annual financial statements and tax return) will prompt those with less involvement in the day-to-day running of the fund to be more aware of what is happening. This will also have the benefit of standardising the minimum type of information that services providers must consistently prepare and provide to SMSF trustees.

It might be appropriate to add to the above list of disclosure items following consultation with industry.

Preliminary recommendation

The Panel recommends (after appropriate industry consultation) the Corporations Act be amended to ensure SMSF members are provided with certain key information on an annual basis.

9.3 Administrative requirements

While the Panel supports specific disclosure items that add to member level understanding and engagement with their superannuation, it does not support unnecessary administrative burdens that are not directly relevant to helping members build their retirement savings.

As outlined in section 6.3.1 'A separate Act or division of the SIS ACT for SMSFs', a restructuring of the SIS Act could provide an opportunity to remove provisions that are inapplicable to SMSFs. Irrespective of whether the Panel's recommendation at section 6.3.1 is accepted, the Panel supports the removal of unnecessary administrative burdens on SMSF trustees, such as trustee minutes which require paper shuffling from the 'trustee' to the 'member'.

All superannuation entities, including SMSFs, with two or more individual trustees and all directors of a corporate trustee, are currently required to prepare minutes of all meetings of trustees or directors at which matters affecting the fund are considered. This can be contrasted with the requirement for a single individual trustee simply to retain records of all **decisions** made.[114] The Panel considers that while there might be some specific areas in

114 Section 103 SIS Act

which a minute-keeping requirement of some form would be appropriate for SMSFs, it might be that minute-keeping in relation to most aspects could removed to reflect the existence and effect of records commonly maintained by SMSFs (eg bank statements, CHESS statements, contract notes and the like).

The Panel would like to see the administration of an SMSF align more with the rules applying to small and single member proprietary companies under the Corporations Act, where meetings, minutes and other formalities have been reduced to an absolute minimum.

The Panel believes that as part of the industry consultation (outlined in the above recommendation to increase member disclosure) that industry should also consider what unnecessary administrative requirements relating to SMSFs should be removed from the SIS Act.

Preliminary recommendation

The Panel recommends (after appropriate industry consultation) that legislation be amended to remove SMSF trustee administrative burdens that are identified as unnecessary.

9.4 Online SMSF resource centre

As indicated in section 5 'SMSF trustees', the Panel believes that increased knowledge and competency can be achieved through methods other than requiring trustees to undertake compulsory education. Other methods include voluntary education, provision of SMSF operational guides and through a dedicated online SMSF resource centre,[115] which would probably form part of a wider superannuation website that the Panel is likely to recommend in its final report.

The Panel believes SMSF trustees should have access to resources (such as general advice, statistics and educational material) that would help them build their knowledge and competency voluntarily. This would require all SMSF information to be brought together, catalogued and indexed, and incorporate an enhanced 'search tool' enabling information to be accessed and found easily.[116]

The resource centre could provide further information on matters such as:

a) **investments**: covering aspects such as asset allocation, diversification, liquidity and risk; it could provide investment strategy templates tailored to SMSFs, rather than the current 0-100 per cent investment range templates so commonly adopted that are of little or no value. Professional investment advisers could be engaged by government to provide recommended asset allocation templates, perhaps on a quarterly basis, based on member ages, risk tolerances and asset sizes;

b) **compliance**: covering regulatory obligations in relation to both administration and investments;

115 Outlook Tax and Accounting Solutions Pty Ltd, Phase Three Submission, page 8.
116 G. Hutchison, Phase Three Submission, page 3.

c) **regulatory changes**: listing of all key changes to applicable laws, regulations and standards; and

d) **industry participants**: link to the ATO and a link to a 'SMSF service provider register' that enables SMSFs trustees to look-up and identify registered SMSF auditors and licensed advisers. ASIC's website already enables searches of registered company auditors and licensed advisers.

This centre would be developed as a central repository and access point for SMSF knowledge and information, similar to the Employee Benefit Research Institute for 401(k) plans in the United States.[117] This could be provided as part of a central government website on superannuation, which could be a 'one-stop-shop' for SMSF trustees and include all information and tools needed by trustees when carrying out their SMSF duties.[118] The development of such a site and the inclusion of SMSF information listed above would facilitate increased trustee knowledge and competence.

The formation of a dedicated government website on superannuation was canvassed in the *Phase Two: Operation and Efficiency — Issues Paper,*[119] and has been supported by the majority of submissions to Phase Two. Submissions have suggested that the website should be easy to use and have content that is both comprehensive and practical to SMSF members.[120]

The Panel believes that an information centre, to house SMSF knowledge, information, statistics and other educational tools, should be developed for the benefit of SMSF trustees and the wider market. This should be an online platform and administered by a single entity. The Panel believes this concept should also apply to the wider superannuation industry. This concept will be expanded on in the Review's final report.

10 IMPROVING INTEGRITY

Fraud and illegal early release schemes using SMSFs reduce participants' confidence in the integrity of the superannuation system and is currently causing difficulties in processing rollovers from APRA-regulated funds to legitimate SMSFs.

The Panel believes that a single 'point of truth' needs to be established so that APRA-regulated funds can quickly and efficiently establish whether or not an SMSF that is the subject of a rollover request is legitimate.

Schemes exist to facilitate illegal early release and fraud. Fraud can occur where unrelated parties dishonestly use a member's identity to move their benefits out of their superannuation fund without their knowledge or consent. With illegal early release, members participate with a promoter to access their benefits ahead of time. In either scenario, the funds are usually transferred from an APRA-regulated fund to an SMSF that has been established so as to facilitate the scheme.

117 http://www.ebri.org/.
118 Dixon Advisory, Phase Three Submission, page 22.
119 http://www.supersystemreview.gov.au/content/downloads/operation_effiencency_issues_paper /Phase_Two_Operation_and_Efficiency_Issues_Paper.pdf.
120 Dixon Advisory, Phase Three Submission, page 22.

The Panel notes that there are well-established mechanisms permitting legal early release of preserved superannuation in clearly defined circumstances, such as proven financial hardship, or to meet legitimate expenses to address life circumstances such as medical expenses for life-threatening or chronically painful medical conditions where treatment is not reasonably available through the public health system.[121]

Key to making fraud and early release schemes more difficult, and so improving the efficiency and integrity of the industry overall, is improving the integrity of the processes and information around the establishment and operation of SMSFs.

10.1 SMSF registration

SMSFs currently can be registered online or through a paper-based process. SMSF registration applications are processed by the Australian Business Register. Identity checks of the member/trustees are not part of the registration process; nor are there any records of whether the SMSFs are established through an adviser.[122]

10.1.1 Member identification

The superannuation system as a whole needs to have confidence that members are who they claim to be. For the 'self-managed' sector this issue is magnified. Once superannuation savings leave the APRA-regulated fund sector, there are few safeguards around the subsequent movement of assets. Reliable and effective SMSF member identification at registration is therefore essential.

The Panel considers member identification could be achieved with little to no additional burden placed on SMSF members as follows:

- The member/trustees establish the SMSF (signs trust deed etcetera).
- The member/trustees then open the SMSF bank account and provide the 100 points of ID for all member/trustees. It is likely that the account would be internally frozen until the bank was able to confirm that the SMSF actually exists — that is verified to Super Fund Lookup or directly with the ATO. This would enable contributions or rollovers to be deposited, but would stop any withdrawals or transfers from the account.
- The SMSF trustees would provide the bank account details to the ATO as part of the registration process.
- The ATO verifies with the appropriate financial institution that the details provided on the SMSF registration form (both for the SMSF itself and the member/trustees) match the bank account records and confirms that 100 point ID for all member/trustees has been obtained.

The SMSF registration form would need to be designed so that the ATO is given authority to conduct this check so as not to infringe privacy laws.

121 See SIS Regulations r6.19A and Schedule 1

122 ASIC is not required or entitled to perform identity checks on a person seeking to become a director or shareholder in a corporation either. However, it does have a data matching protocol with the Insolvency and Trustee Service Australia concerning bankruptcies and other circumstances that disqualify a person from being a director or other officer.

Long term, an electronic portal could be created to allow all deposit taking institutions and the ATO to communicate and confirm details. In the interim, this could be potentially done manually.

- If the details do not match – either:

  a) the registration application could be suspended until the problem can be resolved (for example, the trustees provide ID details to the bank for the missing member or amend the registration details etcetera); or

  b) The SMSF could be registered, but a suitable status is reflected on Super Fund Lookup that would not enable a rollover to occur. It would then fall on the members/trustee to correct the problem and have the ATO re-check with the bank.

The Panel prefers option (a) as providing greater security for the super system and being more efficient.

- If the details match — the SMSF is registered and appears on Super Fund Lookup as an SMSF that can receive rollovers.

This would enable the collected information (that all members have been identified and the confirmed SMSFs bank account) to be shared with, and verified by, APRA-regulated funds to enable both secure and fast rollovers. Members would not be required to do anything they do not already do.

This would require systems to be built, given the need to interact with all financial institutions. The system costs could be re-couped as part of an initially higher supervisory levy for first year SMSFs.

For efficiency reasons, identification requirements should not apply retrospectively to existing SMSFs. The exception to this is where an existing SMSF is organising a rollover from an APRA-regulated fund. In these instances, SMSFs could notify the ATO of its nominated SMSF bank account and the ATO could then verify the relevant details and update Super Fund Lookup, following the same process as previously articulated.

Preliminary recommendation

The Panel recommends:

a) proof of identity checks be required for all people joining an SMSF, whether they are establishing a new fund or joining an existing fund; and

b) identification measures should not apply retrospectively except for existing SMSFs wishing to organise rollovers from an APRA-regulated fund.

10.1.2 Adviser identification

The Panel is concerned to ensure that there is a simple process to monitor and regulate any potentially inappropriate advice in relation to establishing SMSFs, and to bolster the integrity of the SMSF registration system.

Section 7.3 'Accountants' financial services licence exemption' noted the Government's announced intention to abolish the accountants' AFSL exemption for SMSF advice. Complementary to this, section 7.2.1 'SMSF Establishment – gatekeeper mechanism' explores different options for some form of mechanism in relation to the establishment of an SMSF aimed allowing new entrants to assess whether they would be suitable to become trustees and members of an SMSF and understand what asset size is required to make an SMSF cost competitive with an account in an APRA-regulated fund.

Some of these options involve prescribing that the establishment of a new SMSF would require advice from a licensed adviser. One advantage would be that the AFS licensing process provides for unique IDs that could be captured as part of the registration process for an SMSF created by a licensed adviser.[123]

Preliminary recommendation

The Panel recommends that the SMSF registration process capture the details of the person who has provided advice in relation to the establishment of the SMSF (where applicable). This information should also be available to ASIC to assist in regulating AFSL holders and form part of the risk assessment process for both ASIC and the ATO.

10.1.3 SMSF naming conventions

Currently, an SMSF can be registered with any name.[124] In a few instances, an SMSF has been established with a name that mirrors an existing APRA-regulated fund. This then allows cheque rollovers, intended for the APRA-regulated fund, to be banked into the SMSFs bank account. Similarly, a person could form an SMSF with a name suggesting a connection with a bank, an insurance company or the government.

A name registration system, along the lines of ASIC's national names index for company and business names, would stop this.

Preliminary recommendation

The Panel recommends that controls be put in place to ensure SMSFs can be neither established with, nor subsequently change their name to, the name of, or a name similar to, an existing APRA-regulated entity and that other naming rules applicable to bodies corporate under the Corporations Act be applied to SMSFs.

10.2 Super Fund Lookup

The ATO recently announced measures to fight illegal schemes through tightening the SMSF registration process.[125] As part of this, APRA also provided advice to the funds it regulates on what checks the trustees should perform before processing rollover requests.[126] The Panel believes there is opportunity to harness technology to improve the current process, which would not only strengthen the security of the registration system, but also enable

123 SPAA, Phase Three Submission, page 76.
124 ASFA, Phase Three Submission, page 16.
125 ATO 2009, *SMSF newsletter -Edition 11*, December 2009.
126 http://www.apra.gov.au/Superannuation/upload/IER-FINAL-LETTERTO-TRUSTEES-5-Feb-2010-Vn-2.pdf.

rollovers to SMSFs to be processed from APRA-regulated funds in a much more efficient and timely manner.

In section 10.1.1, the Panel outlined its proposal for the validation of the SMSF, member and trustee identities as well as the validation of the SMSF's bank account number. With this information, Super Fund Lookup (or a similar system) could be upgraded to provide APRA-regulated funds with the following information:

- the SMSF member/trustee level details (such as the member/trustee names and date of birth);
- a status confirming that the identity of the member/trustees have been verified;
- the SMSF's validated bank account number; and
- member TFN validation. APRA-regulated funds could enter their record of the member's TFN into the Super Fund Lookup field that contains the member's records and the ATO system could then validate whether it matches its internal records.

APRA-regulated funds could check Super Fund Lookup on receipt of a request to rollover to an SMSF. Where the member and destination SMSF details provided on the rollover request match the Super Fund Lookup details, the rollover could be immediately processed and electronically transferred to the SMSF bank account. Where details do not match, the obligation would be on the SMSF trustees to update the SMSF details with either or both the ATO and their financial institution, as applicable.

Given the additional member level and SMSF bank account information now available, access to Super Fund Lookup (or a similar system) would need to be restricted to APRA-regulated funds via secure systems.

Preliminary recommendation

The Panel recommends:

a) Super Fund Lookup (or an alternative system) provide appropriate SMSF information to APRA-regulated funds (which would include member level details, confirmation that identification of member/trustees has occurred and the SMSFs bank account number) to enable the APRA-regulated fund to verify the details of SMSF membership before processing rollover requests to SMSFs; and

b) upon appropriate confirmation the APRA-regulated fund would immediately process the request and electronically transfer the rollover to the validated SMSF bank account.

10.3 Penalties for illegal early release

10.3.1 Promoter penalties

Stronger sanctions must exist to deter promoters of illegal early release schemes from undermining the Government's retirement policy and harming members in the process.

Existing laws enabling the ATO to target and address illegal tax scheme promoters do not apply to the SIS Act. Currently, illegal scheme promoters are principally dealt with by ASIC which relies on its powers to take action against them, often on the grounds that they are providing unlicensed financial advice.

Submissions supported the ATO having extended powers to address those promoting and facilitating illegal early release.[127] Rice Warner Actuaries suggested implementing a similar model to the existing tax promoter laws.[128] The Panel shares these views; it believes that the ATO is best placed to manage all players (promoters and participants) in illegal early release schemes.

Preliminary recommendation

The Panel recommends legislation be enacted to provide for criminal and civil sanctions to enable the ATO to penalise and discourage illegal early release scheme promoters.

10.3.2 Participant and member penalties

Depending on their overall assessable income, individuals who illegally release their superannuation early (through a scheme or otherwise) possibly face paying tax on the amounts released. Penalties might also be applicable if they do not declare these amounts as income. This, however, is the same for those who follow the law and get early release legally. The current position is therefore inequitable.

The Panel believes that those without an entitlement to early release should not benefit from their access. Presently, people who have their illegal withdrawals assessed will still have the benefit of what they are left with. For example, if someone releases $10,000 illegally and the tax on this is $1,500, they will keep the $8,500 balance. If their income is low enough, they will not pay tax at all. For some people, forfeiting a portion of their superannuation to tax (and promoter fees where applicable) to access the remaining balance, years before they are legally entitled to, might be quite appealing.

Tax rates and penalties need to be amended to ensure there is both a greater deterrence factor and to ensure that those committing illegal early release do not enjoy the same treatment as those who legally get early release of their superannuation.

The Panel considers a standard flat tax rate, equal to the superannuation non-complying tax rate, should apply to all money illegally released. In addition, a sliding scale of penalties (with the potential to be remitted to zero under appropriate circumstances), should be applicable and take into account individual circumstances.

127 SPAA, Phase Three Submission, Page 42.
128 Rice Warner Actuaries, Phase Three Submission, page 44.

Preliminary recommendation

The Panel recommends existing tax laws be amended so that:

a) amounts illegally early released be taxed at the superannuation non-complying tax rate; and

b) an additional penalty, based on a sliding scale of penalties that takes into account the individual circumstances, should apply.

10.4 Use of superannuation for criminal purposes

Some functions of prudentially supervised funds are subject to the *Anti-Money Laundering and Counter-Terrorism Financing Act 2006* (AML/CTF Act) as designated services, but trustees of SMSFs are excluded. The rollover of a superannuation benefit to another fund, including SMSFs, is not captured as a designated service under the AML/CTF Act because preservation requirements mean that the assets are retained within a regulated financial sector and therefore the transaction represents a very low risk of being used for money laundering or terrorism financing. However, because the trustees and members of an SMSF are the same, there is greater scope for assets, once received in the SMSF, to be diverted for illicit purposes. Introducing a new designated service, to apply to regulated superannuation funds when they roll over assets to an SMSF, will ensure consideration is given to the ML/TF risk associated with the rollover of assets, and that appropriate customer identification and reporting obligations exist when assets exit the formal financial sector.

Preliminary recommendation

The Panel recommends that rollovers to an SMSF be captured as a designated service under the AML/CTF Act.

11 OTHER

11.1 Standard trust deeds

The vast majority of submissions supported the idea of an optional standard trust deed.[129] The Panel was attracted to this proposition in that a standardised trust deed (either maintained by the ATO or applying on an opt in basis like the Corporations Act replaceable rules) could provide SMSFs with upfront savings in their establishment and reduce ongoing administration costs. Standardised documentation could also provide for more uniformity across the sector, making it easier for trustees and their service providers (administrators, auditors etc) to follow, which could lead to further efficiency.[130]

During industry consultation, most participants expressed in principle support for the idea and the benefits it could provide, however they believed SMSFs would still opt for tailored deeds in a large number of cases. This suggests that the time, effort and cost involved in

129 ICAA, Phase Three Submission, page 29; Australian Investors Association, Phase Three Submission, page 2; Dixon Advisory, Phase Three Submission, page 27.

130 Rice Warner Actuaries, Phase Three Submission, page 23.

creating, hosting and maintaining a standard deed could not be justified. The Panel therefore believes, that some of the pressure to update trust deeds regularly (especially where there is a change in the law) could be reduced by introducing, into the SIS Act, provisions which would automatically deem anything permitted by the SIS Act to be permitted by SMSF trust deeds, such as stipulating that the following provisions are deemed to be included in the trust deed of each SMSF:

(a) notwithstanding anything in this document, if the SIS Act or a Tax Act prohibits an act being done, that act must not be done;

(b) nothing in this document prevents an act being done that the SIS Act or a Tax Act law requires to be done;

(c) if the SIS Act or a Tax Act requires an act to be done or not to be done, authority is given for that act to be done or not to be done (as the case may be);

(d) if the SIS Act or a Tax Act requires this document to contain a provision and it does not contain such a provision, this document is deemed to contain that provision;

(e) if the SIS Act or a Tax Act requires this document not to contain a provision and it contains such a provision, this document is deemed not to contain that provision;

(f) if any provision of this document is or becomes inconsistent with the SIS Act or a Tax Act, this document is deemed not to contain that provision to the extent of the inconsistency; and

(g) if a thing is permitted to be done under the SIS Act or a Tax Act, this document is deemed to permit it unless it is expressly prohibited by another provision of this document.

Preliminary recommendation

The Panel recommends that the SIS Act be amended as outlined in section 11.1 to reduce the need for amendments to SMSF trust deeds when the SIS legislation or tax laws change.

11.2 Separation of assets — section 52(2)(d) of SIS

There is no effective power to enforce a separation of fund assets from those held personally by the trustee, an employer sponsor or an associate, because the obligation is established by way of a covenant deemed to be incorporated into the governing rules of the fund.

Breaches of the covenant occur with some frequency, such as where an SMSF is run through a member's bank account, rather than the SMSF's or where assets are recorded in one or more members' names, rather than that of the SMSF.

The ATO is unable to enforce compliance with covenants. It is limited to providing education on what would constitute appropriate separation of assets and then relies on the trustees to comply voluntarily – which for the most part they do.

The Panel believes that the ATO should be able to enforce such a fundamental concept, recognising that contraventions of the separation of assets covenant are one of the most commonly reported, both by number and value, in auditor contravention reports.[131]

The Panel notes that the requirement for a trustee to devise and implement an investment strategy for the fund appears as both a covenant under section 52(2) of SIS and also as an operating standard for the purposes of section 34 of that Act. It considers that appropriate separation of assets is of sufficient significance for the operation of SMSFs that an operating standard should be adopted, so giving the ATO a direct power to enforce the provision.

Preliminary recommendation

The Panel recommends the covenant requiring separation of fund assets from personal or employer assets, as set out in section 52(2)(d) of SIS, be replicated in a SIS operating standard.

11.3 Life Insurance default

The Panel does not believe there should be an insurance default within SMSFs. SMSF trustees are expected to be self-reliant in determining the levels of insurance cover they might require, whether within or outside their SMSF.

As shown in the following table, ATO data shows that less than 13 per cent of SMSFs have insurance. However, the majority of submissions suggested that SMSF members were more likely to hold appropriate levels of insurance or be able to hold insurance outside their superannuation, than members of other superannuation sectors.

Table 4: Proportion of SMSFs with insurance[132]

Proportion of all SMSFs with insurance	**12.7%**

SMSF Size	**Proportion of SMSFs**
$1-$50,000	4.7%
>$50,000-$100,000	7.3%
>$100,000-$200,000	16.0%
>$200,000-$500,000	30.1%
>$500,000-$1m	21.7%
>$1m-$2m	13.3%
>$2m-$5m	6.2%
>$5m-$10m	0.7%
>$10m	0.1%
Total	**100%**

Source: ATO unpublished data.

To ensure that trustees appropriately consider this issue, one submission suggested that the investment strategy operating standard (SISR 4.09) be modified so as to include the consideration of death and disability insurance.[133] The Panel agrees with this suggestion.

131 Super System Review, 'Statistical Summary of Self-Managed Superannuation Funds,' 10 December 2009, table 31.
132 As determined by deduction claims in the 2008 SMSF Annual Return.
133 B. Alexander, Phase Three Submission, page 5.

Preliminary recommendation

The Panel recommends that the consideration of death and disability insurance for members should be incorporated as part of the investment strategy operating standard.

12 SMSF ISSUES RAISED, BUT NOT TO BE PURSUED

This is a non-exclusive list of SMSF issues raised by the Panel in the Phase Three: Structure Issues Paper that it now does not propose to pursue:

12.1 SMSFs later in life

Submissions were not supportive of restricting choice or control of SMSFs after members had reached a certain age. Understandably, because this challenges the ethos of SMSFs. Given the principle that SMSF trustees are ultimately responsible for their retirement outcomes, the Panel does not intend recommending any changes in this area.

12.2 Compliance coverage

Compliance coverage should ultimately reflect the level of risk. The Panel believes that this is best left to the ATO to determine.

The current levy collection arrangements are to be reviewed by the ATO no later than 30 June 2011. Ultimately, a number of recommendations made in this preliminary report might have some impact on this consideration which could prompt pressure for an increase. This will have to be judged according to the circumstances applying at the time.

12.3 Technology

Technology within SMSFs can be applied in a number of areas, such as administration, investing, reporting and compliance. The Panel believes that costs within the SMSF sector can be reduced by increased use of IT solutions, enabling fewer moving parts and greater automation. IT solutions could improve efficiency in operation and reduced reliance on paper-based accounting approaches.

The Panel's views on SMSF technology is shared by a submission from the National Institute of Accountants (NIA), '*Technology is a great tool for driving down costs and while SMSF do not have the scale in an individual sense, the large size of the sector as a whole provides a degree of scale that should be attractive to technological development … It would appear that there is genuine market interest in developing technologies that will drive down administrative and other costs of SMSF.*'[134]

While submissions acknowledged the benefits of technology within the industry, many indicated that any government interference could potentially stifle future technology development which should therefore continue to be developed by the market.[135]

134 Submission from National Institute of Accountants, February 2010, page 9.

135 NIA, Phase Three Submission, page 9; Smartsuper, Phase Three Submission, page 10; CPA, Phase Three Submission, page 11; Mercer, Phase Three Submission, page 132.

Some submissions have recommended particular information technology developments within SMSFs. One submission recommended that industry and regulators support the Australian Payment Clearing Association's project to modernise the payments system to include superannuation in an industry-wide solution encompassing SMSFs.[136] Another submission suggested that the development of online facilitation and standard templates for data transfer protocols between service providers would assist financial planners.[137] The ICAA suggested that efficiencies could be increased and costs reduced if there were the '*ability to link and digitally transfer vast amounts of information from various sources*' within the SMSF sector.[138]

A submission from Rice Warner Actuaries recommended that '*the CHESS system of the ASX could be modified to provide an SMSF administration and reporting facility … A standard form of investment administration though CHESS would simplify the system and aid accountants and auditors. The ATO (and APRA if appropriate) should be allowed viewing access to CHESS for the purposes of reviewing compliance of any SMSF*.'[139]

The Panel supports the development of standardised data and transmission throughout the SMSF industry. Enabling transaction protocols and data standardisation ensures that SMSF data is comparable and consistent. Data standardisation would specifically help SMSFs and their service providers in the preparation of financial reports, including information on the fund's investment transactions, investment income, bank transaction statements, etcetera.

While standardised data and transmission would be broadly consistent with the recommendations proposed in the Panel's SuperStream[140] report, the Panel does not believe the same underlying technological problem exists in the SMSF sector. While the Panel would encourage industry to consider further data standardisation, that would enable the more efficient use of information, it is not proposing to make any recommendations in this area.

12.4 Investment strategies

Submissions reflected contrasting views about the importance of requiring that an SMSF's investment strategy be recorded in writing. While the Panel recognises the importance of a strategy, it also recognises that for over 410,000 SMSFs, there will be great variations in SMSF investments and trustee investment knowledge, which a 'template' approach will not address. Some trustees would gain little or no benefit from having their strategy reduced to writing, while others might gain something from the experience. While the Panel believes that it is desirable for investment strategies to be in writing, it is not proposing to recommend that it be mandated.

The Panel does, however, believe there is value in providing guidance and tools to assist trustees in this area and has discussed this in section 9.4 'Online SMSF resource centre'.

136 IFSA, Phase Three Submission, page 36.
137 FPA, Phase Three Submission, page 28.
138 ICAA, Phase Three Submission, page 19.
139 Rice Warner Actuaries, Phase Three Submission, page 29.
140 Super System Review, 'SuperStream: a proposal to bring the back office of super into the 21st century', 22 March 2010.

12.5 Rollovers

Many submissions expressed frustration over the current rollover process from APRA-regulated funds to SMSFs. The Panel believes that its proposals on improving the integrity of SMSF identity data in section 10 'Improving Integrity' should substantially address these concerns.

12.6 Other issues

There might be other issues raised in the Phase Three: Structure Issues Paper that will not develop into final recommendations. The above list only represents those issues that the Panel has already decided not to pursue.

APPENDIX

SMSFs with $200,000 or less in assets make up 26 per cent of the SMSF population; approximately 108,000 SMSFs.[141] SMSFs with $50,000 or less in assets represent 36 per cent of that sub-$200,000 population, (refer Table A).

Table A: (2008) Distribution of existing funds with $200,000 or less in assets

	$1 - $50k	>$50k - $100k	>$100k - $200k	All $200K and under SMSFs
Number	38,980	23,388	45,545	107,914
Percentage	36.1%	21.7%	42.2%	100.0%

Source: ATO unpublished data.

Of existing SMSFs with $200,000 or less in assets, almost all of them (97 per cent) were established within this range; few SMSFs that started with a greater asset size have fallen below this range in subsequent years (refer Table B).

Table B: (2008) Percentage of existing funds with assets of $200,000 or less that had $200,000 or less in assets in their first year of establishment[142]

	SMSF Size			
	$1 - $50K	**$50K - $100K**	**$100K - $200K**	**All $200K and under SMSFs**
Percentage of SMSFs	97.5%	98.6%	95.3%	96.7%

Source: ATO unpublished data.

As at 30 June 2008, SMSFs with $200,000 or less, had on average been in existence for over six years (refer Table C).

Table C: (2008) Age of SMSFs with $200,000 or less in assets

SMSF age	Percentage of SMSFs with $200,000 or less in asset size
In 1st year of establishment	15.5%
Between 1 and 2 years	12.7%
Between 2 and 3 years	7.7%
Between 3 and 4 years	7.4%
Between 4 and 5 years	9.6%
Between 5 and 6 years	8.8%
Between 6 and 7 years	4.9%
Between 7 and 8 years	4.0%
Between 8 and 9 years	5.2%
Between 9 and 10 years	4.2%
Between 10 and 11 years	4.5%
Between 11 and 12 years	3.5%
Between 12 and 13 years	3.3%
Between 13 and 14 years	2.1%
Between 14 and 15 years	1.1%
Older than 15 years	5.4%
Average age*	**6.2 yrs**
Median age	**5 yrs**

* SMSFs older than 15 years are assumed to be 16 years old to simplify these calculations.
Source: ATO unpublished data.

141 Super System Review, '*Statistical summary of self-managed superannuation funds*,' 10 December 2009.

142 Population is drawn from all SMSFs established since the 2000 financial year, where the ATO is able to identify SMSF balances at the end of their first financial year.

On average, since 2000, it took approximately five years for an SMSF established with $200,000 or less to grow above $200,000. Over the same period, there have been, on average, almost 13,000 new SMSFs established every year whose asset size at the end of their first financial year was $200,000 or less. By the end of their second financial year, 77 per cent of these SMSFs still had $200,000 or less in assets. This percentage progressively reduces in subsequent years; almost half of these SMSFs were still within this range after the fifth year and over one third after the seventh year (refer Table H).

Significantly, when one also considers their average expense ratios (refer to Table D); a large number of members of these SMSFs will be potentially experiencing fixed costs well above what they might have experienced in APRA-regulated funds. Though again, there are also a number of small-sized funds (that is $200,000 or less) that appear to be very cost effective, with over 28 per cent of those SMSFs still having an average annual expense ratio of 1 per cent or less.

Table D: 2008 SMSF Average Expense ratios

Operating expense ratio	$1 - $50k	>$50k - $100k	>$100k - $200k	All $200K and under SMSFs	>$200k - $500k	>$500k - $1m	>$1m - $2m	>$2m	All SMSFs
0.25% or less	0.0%	6.3%	12.6%	8.1%	19.2%	34.3%	48.9%	62.1%	30.1%
>0.25% to 0.5%	4.9%	10.2%	6.3%	7.0%	12.6%	18.0%	16.4%	13.9%	13.4%
>0.5% to 0.75%	5.5%	4.5%	7.8%	6.4%	12.7%	11.2%	9.6%	8.7%	9.9%
>0.75% to 1%	4.4%	4.9%	8.8%	6.8%	10.4%	8.0%	7.1%	5.6%	7.9%
>1% to 1.5%	6.4%	11.2%	16.9%	13.0%	14.5%	12.3%	9.7%	5.8%	11.8%
>1.5% to 2%	5.5%	11.7%	11.9%	10.4%	10.3%	7.6%	4.2%	2.0%	7.7%
>2% to 3%	10.9%	17.8%	15.1%	14.9%	11.1%	5.4%	2.5%	1.1%	8.0%
>3% to 5%	16.1%	16.7%	12.1%	14.2%	6.3%	2.2%	1.0%	0.5%	5.6%
> 5%.	46.3%	16.7%	8.6%	19.3%	2.9%	1.1%	0.5%	0.4%	5.5%
Total	**100%**	**100%**	**100%**	**100%**	**100%**	**100%**	**100%**	**100%**	**100%**

Source: ATO unpublished data.

The data in Table H tend to support the view that more recently established SMSFs are growing at a faster rate than older established SMSFs. For example, after the fifth year, 58 per cent of SMSFs established in 2000 were still within the $200,000 or less range, whereas this only applied to 42 per cent of SMSFs established in 2004. Likewise, SMSFs established in the 2007 financial year with $200,000 or less were twice as likely to have exceeded this threshold by the end of their second financial year compared to those SMSFs that were established in the 2000 financial year. However, the 2007 temporarily high one-off annual contribution limit of $1 million has arguably driven this recent acceleration.

When comparing these smaller sized funds to the overall SMSF population, they are:

- More likely to be a two member SMSF. Nearly 78 per cent of small-sized SMSFs are made up of two member funds, which is 11 per cent above the overall SMSF average membership size distribution.

Table E: Proportion of SMSFs by member size

Number of members	$1 - $50K	$50K - $100K	$100K - $200K	All $200K and under SMSFs	All SMSFs
1	16.4%	15.0%	15.7%	15.5%	23.0%
2	77.7%	79.4%	79.0%	78.9%	67.9%
3	3.3%	3.2%	3.1%	3.2%	4.5%
4	2.7%	2.4%	2.3%	2.4%	4.6%
Total	**100%**	**100%**	**100%**	**100%**	**100%**

Source: ATO unpublished data.

- Less likely to be in pension mode. Only five per cent are in full or partial pension mode. This is significantly below the SMSF average of 27.5 per cent. This tells us that the small-sized SMSF phenomenon is not explained by funds being at an advanced stage of decumulation.

Table F: 2008 Proportion of SMSFs in accumulation or pension phase

Pension/accumulation, funds $200k and under	$1 - $50K	$50K - $100K	$100K - $200K	All $200K and under SMSFs	All SMSFs
SMSFs in pension phase	2.9%	3.2%	7.4%	5.3%	27.5%
SMSFs in accumulation phase	97.1%	96.8%	92.6%	94.7%	72.5%
Total	**100%**	**100%**	**100%**	**100%**	**100%**

Source: ATO unpublished data.

- More likely to have younger members. 51 per cent of the $200,000 and under SMSF member population is under 50 year of age, compared to 33 per cent of the overall SMSF population. This, coupled with the fact that the majority of funds are in accumulation mode, would indicate the majority of members are still attempting to grow their fund.

- More likely to have members with lower income levels. When compared to the overall SMSF members in their respective age ranges (apart from the <35 yr old range) incomes are lower than the average and median amounts in the SMSF sector overall. The lower income levels may present a real practical impediment to many of these SMSFs growing sufficiently, in the short term, to negate their fixed costs which leads to their considerably higher average operating expenses.

Table G: SMSF member level demographics (ages, gender, superannuation balances and income)

	Members of SMSFs with $200,000 or less in assets						
				Super balance		Assessable income	
Age range	**Male**	**Female**	**Total**	**Average**	**Median**	**Average**	**Median**
< 35	7.1%	8.4%	7.7%	$22,371	$14,336	$58,565	$44,608
35 - 49	40.9%	46.2%	43.3%	$51,329	$42,500	$84,453	$58,761
50 - 59	30.2%	28.9%	29.6%	$60,475	$51,286	$68,792	$49,908
60 - 65	13.0%	11.0%	12.1%	$61,583	$51,683	$54,903	$37,018
> 65	8.7%	5.5%	7.3%	$67,743	$55,104	$46,299	$26,824
Unknown	..	..	..	-	-	-	-
Total	100%	100%	100%	$54,262	$43,087	$71,439	$49,338
All ages	55.2%	44.8%	100%				

	All SMSF members							Non-SMSFs members	
				Super balance		Assessable income		Assessable income	
Age range	**Male**	**Female**	**Total**	**Average**	**Median**	**Average**	**Median**	**Average**	**Median**
< 35	5.3%	5.5%	5.4%	$185,593	$106,153	$59,338	$44,905	$36,539	$31,989
35 - 49	26.7%	28.1%	27.3%	$175,462	$118,132	$115,523	$67,386	$58,330	$47,271
50 - 59	30.8%	32.4%	31.5%	$360,635	$252,364	$116,338	$64,996	$58,225	$46,879
60 - 65	20.4%	20.1%	20.2%	$556,654	$388,997	$92,474	$44,908	$49,946	$39,553
> 65	16.8%	14.0%	15.5%	$660,956	$450,781	$76,207	$31,928	$45,612	$32,418
Unknown	..	..	..	-	-	-	-	-	-
Total	100%	100%	100%	$467,453	$255,030	$101,426	$54,553	$49,280	$40,037
All ages	53.9%	46.1%	100%						

Source: ATO unpublished data.

Table H: 2008 Time view of SMSFs established with $200,000 or less[143]

SMSFs established with $200,000 or less		Percentage after 1 yr*		Percentage after 2nd yr		Percentage after 3rd yr		Percentage after 4th yr		Percentage after 5th yr		Percentage after 6th yr		Percentage after 7th yr		Percentage after 8th yr		Percentage after 9th yr	
Year	Number	$200k or less	wound up	$200k or less	wound up	$200k or less	wound up	$200k or less	wound up	$200k or less	wound up	$200k or less	wound up	$200k or less	wound up	$200k or less	wound up	$200k or less	wound up
2000	12,521	99.4%	0.6%	85.5%	1.8%	78.0%	3.8%	69.5%	5.7%	58.1%	7.6%	48.7%	9.7%	39.0%	11.5%	28.7%	12.6%	25.5%	13.9%
2001	9,732	99.0%	1.0%	85.4%	2.6%	76.0%	4.2%	64.7%	6.4%	53.8%	8.4%	43.9%	10.4%	32.6%	11.6%	28.4%	13.1%		
2002	11,353	99.3%	0.7%	82.3%	1.6%	68.5%	3.1%	56.6%	4.7%	45.9%	6.5%	33.8%	7.7%	29.2%	9.1%				
2003	17,310	99.4%	0.6%	80.1%	1.5%	68.1%	2.8%	55.5%	4.6%	42.0%	6.0%	35.0%	7.4%						
2004	16,230	99.0%	1.0%	81.7%	2.4%	67.3%	4.4%	50.2%	6.2%	41.9%	7.9%								
2005	11,572	98.4%	1.6%	75.9%	3.2%	56.8%	4.8%	46.6%	6.5%										
2006	11,211	99.0%	1.0%	59.9%	2.2%	47.9%	3.5%												
2007	13,168	98.5%	1.5%	65.5%	2.8%														
Average	**12,887**	**99.0%**	**1.0%**	**77.0%**	**2.3%**	**66.1%**	**3.8%**	**57.2%**	**5.7%**	**48.3%**	**7.3%**	**40.4%**	**8.8%**	**33.6%**	**10.7%**	**28.6%**	**12.9%**	**25.5%**	**13.9%**

* That is, the SMSFs' first annual return.

Note: the percentages displayed under the '$200k or less' and 'wound up' columns represent distinct SMSFs, eg of the 12,521 SMSFs established in 2000 with a balance of $200,000 or less at the end of their first year, after the ninth year, 25.5 per cent of those SMSFs (3,193) were still actively operating (with a balance of $200,000 or less), while 13.9 per cent of the SMSFs (1,704) had wound up over the nine years.

Source: ATO unpublished data.

143 Population is drawn from all SMSF established since the 2000 financial year, where the ATO is able to identify SMSF balances at the end of their first financial year.