ASIC

Australian Securities & Investments Commission

The regulator's perspective on the regulation of SMSFs

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CHECK AGAINST DELIVERY

Introduction

Good morning and thank you very much for inviting me to speak today. I'm delighted to be at the annual CPA Australia Self-Managed Super Fund (SMSF) Conference. Today I will be focusing on the recent work ASIC has undertaken in relation to SMSFs and give an update on the proposed work over the coming months.

ASIC's Deputy Chairman, Peter Kell, and I became jointly responsible for heading up ASIC's SMSF taskforce in 2012, which was set up as a response to an increase in geared investment strategies, increasingly aggressive advertising, the collapse of Trio, and the subsequent Parliamentary Joint Committee on Corporations and Financial Services inquiry into the collapse of Trio. The taskforce's main purpose is to examine high-risk SMSF issues.

The SMSF sector continues to grow rapidly and more Australians than ever before are either considering or operating an SMSF. Today, therefore, I'd like to focus on four key things:

- SMSFs and the critically important role of gatekeepers (including an update on the limited AFS licence for accountants and SMSF auditor registration)
- misleading and deceptive conduct, including misleading advertising of SMSFs
- ASIC's focus on SMSF 'one stop shop' operators, and
- unlicensed financial services conduct.

Trust in the financial system

Australia's financial system – indeed, any financial system – is built on trust: trust in financial institutions and their staff, trust in financial intermediaries, and trust in the regulatory arrangements that underpin them.

A casual observer of the Australian financial system today would probably feel that the trust of Australian consumers and investors has been eroded. All of us have an important role to play in restoring that trust. Financial institutions and intermediaries need to foster a culture not just of compliance with the law, but of focus on the long-term best interests of their customers. For the men and women who work at ASIC, we regulate by using the tools at our disposal to further the long-term interests of consumers of financial services, including investors. We are committed to improving our regulatory activities in the interests of promoting a better financial system, because that produces better outcomes for consumers of financial services. Without better outcomes, trust will not be restored.

SMSFs and the critically important role of gatekeepers

It's quite well known now that SMSFs are the fastest growing sector of the superannuation industry.

ASIC's primary role in relation to SMSFs is to regulate the gatekeepers – the accountants, financial planners, SMSF auditors and providers of products and services to SMSFs. ASIC also regulates many (but not all) of the financial products that SMSFs commonly invest in. From that perspective, we are very keen to ensure that SMSF trustees are adequately equipped to make good investment decisions by being fully informed about the risks and returns.

We think that accountants and other gatekeepers have a critically important role to ensure that:

- at an individual level, only those investors for whom an SMSF is suitable go into the SMSF sector and, in doing so, they are fully informed, and
- at an aggregate level, the overall health of the SMSF sector is sound.

The important role of accountants as gatekeepers has been recognised by the Government. You may be aware of the two key law reforms – the introduction of a new, limited AFS licence and the registration of SMSF auditors – which highlight the trusted role accountants play in the SMSF sector.

We want to ensure that accountants and financial planners who are advising retail clients about SMSFs are providing good quality advice. If we can encourage gatekeepers to lift the standard of their advice, SMSF investors will really see the benefits.

Limited AFS licence

Since 1 July 2013, accountants have been able to apply for (and, if the application is approved, be granted) a limited AFS licence.[1] Recognised accountants[2] (the definition of which includes members of CPA Australia) who apply between 1 July 2013 and 30 June 2016 will be able to take

[1] Application fees for a limited AFS licence are: for a body corporate, $1,522; for an individual, $846.
[2] 'Recognised accountants' refers to members of the Institute of Chartered Accountants in Australia, CPA Australia or the Institute of Public Accountants who comply with their membership professional education requirements: see reg 7.1.29A(2) of the Corporations Regulations.

advantage of transitional arrangements for entry into the AFS licensing regime. Under the transitional arrangements, different organisational competence requirements will apply where the responsible managers of the applicant are recognised accountants. Once the transition period is over, all applicants will need to meet the full competence requirements under s912A(1)(e) of the *Corporations Act 2001* (Corporations Act).

Update on applications

As of 27 May 2014:

- the ASIC Licensing team has received 62 applications for a limited AFS licence
- 27 applications have been approved – 25 of these were from new applicants and two were variations (conversions) from existing AFS licences
- 15 of the approved applications were lodged by Public Practice Certificate members of CPA Australia Ltd
- one application is likely to be refused on the grounds that the applicant failed to submit the prescribed documents and information required to support the application
- 25 applications have either been withdrawn by the applicant or returned to the applicant on the grounds that they are materially deficient in respect of the documentation and information which had been submitted in support of the application, and
- two applicants have been offered draft limited AFS licences subject to the provision of some final outstanding documentation and information.

Major trends that have emerged in relation to limited AFS licence applications

While it is obviously early days in the implementation of the limited AFS licence regime, we have identified some concerning trends from the process so far:

- inadequate or no evidence of RG 146 training course completion for all or some of the financial products sought under the application
- inadequate coverage of professional indemnity insurance
- limited or no knowledge of the restricted scope of the 'class of product' advice authorisation, and
- financial statements lodged in the name of a trust and not the entity or individual applicant.

We have amended and strengthened key messages in response to some of these trends in Information Sheet 179 *Applying for a limited AFS licence*

(INFO 179), which is available on our website. Our guidance provides an overview of the relevant steps in applying for a limited AFS licence, as well as explaining how existing ASIC guidance will apply.

In recent discussions we have had with accountants, we have heard your questions and feedback on wanting additional guidance on what activities the limited AFS licence will cover as well as what activities do not need a licence, and we are looking at putting together another information sheet in an attempt to answer those questions.

To help reduce the costs of operating within the AFS licensing regime, holders of a limited AFS licence can lodge a compliance certificate rather than undertake an annual external audit of their financial statements and internal controls.[3] This exemption from the annual external audit requirement will be available to limited AFS licence holders who do not handle any client money in connection with the provision of financial advice.

It is important to note that, apart from the annual compliance certificate, holders of the limited AFS licence will need to meet the same ongoing requirements as other AFS licensees. This includes all other licensing conduct and advice requirements to which financial advisers are subject, such as providing clients with a Statement of Advice (SOA) where required, as well as membership of an external dispute resolution scheme and compliance with the Future of Financial Advice (FOFA) measures, such as the duty to act in the best interests of clients.

Registration of SMSF auditors

As part of the Stronger Super reform initiatives, ASIC became the registration body for approved SMSF auditors from 31 January 2013. This reform recognises the key gatekeeper role that approved SMSF auditors play. The objective of SMSF auditor registration is to raise the standard of SMSF auditor competence and ensure there are minimum standards across the sector.

To audit an SMSF you must be registered with ASIC as an approved SMSF auditor. It is an offence under the *Superannuation Industry (Supervisory) Act 1993* (SIS Act) for a person to hold themselves out as an approved SMSF auditor if they are, in fact, not an approved SMSF auditor.

ASIC released Regulatory Guide 243 *Registration of self-managed superannuation fund auditors* (RG 243) in January 2013 to provide further guidance to the industry regarding the registration requirements.

[3] The annual fee for lodging the Form FS70 *Australian financial services licensee profit and loss statement and balance sheet* along with the annual compliance certificate is $563 for a body corporate and $231 for an individual.

Since the introduction of the SMSF auditor registration regime on 31 January 2013, ASIC has registered approximately 7,500 approved SMSF auditors. Prior to the commencement of registrations, it was estimated that SMSF audits were being conducted by 11,500 individuals.

Public register

ASIC maintains a public register of the approved SMSF auditors, available through our ASIC Connect website. Being able to identify approved SMSF auditors is one of the key objectives of the regime. Having a publicly available register should promote a level of confidence that the sector meets minimum standards.

With the establishment of the register, for the first time SMSF trustees are able to check whether an SMSF auditor is registered and not under suspension.

We hope accountants also find the register search capability helpful. We also hope that, among those using the register, there are accountants who are either verifying that the auditors they are referring to SMSFs are registered, or are looking to establish to others that they are in fact registered.

Our records show that over 109,000 SMSF auditor searches have been conducted on ASIC Connect.

The register information enables ASIC to get updates to auditors quickly and easily if the need arises. It also allows the Australian Taxation Office (ATO) to more efficiently and effectively police approved SMSF auditors, through the ATO's continuing compliance program.

Approved SMSF auditor competency exam

To be eligible for registration, you must have passed a competency exam within the 12-month period before you apply. The exam is two hours in duration and consists of 60 multiple choice format questions. The questions address learning objectives available on ASIC's website and the competency standards issued by ASIC in Class Order [CO 12/1687] *Competency standards for approved SMSF auditors*.

The exam has been developed with the assistance of relevant professional associations and the ATO.

Certain exemptions from the exam requirement were available during the six-month transitional registration period, which ended on 30 June 2013. Under the transitional arrangements, around 1,500 auditors were registered with a condition that they pass the exam by 1 July 2014.

Through our exam provider, Assessment Services Pty Ltd, ASIC has received approximately 1,300 exam bookings and delivered around 830 exams, across the 44 exam venue locations.

So far, about 78% of those sitting the exam have passed on their first attempt. Candidates are generally permitted two attempts at the exam. Of those that have attempted the exam a second time, 70% have passed.

Based on our experience so far, we are confident that the exam is achieving its objective of ensuring a higher standard of competence in the sector. This is both directly, through the exclusion of those that demonstrate clearly through their exam results that they are not at the minimum level of competence required, but also indirectly.

An example of the indirect effect that the exam has had is that we have noticed a significant amount of SMSF audit training and exam preparation activity being provided by the relevant professional associations. This has been in response to demand created by the registration requirements and the exam requirement in particular. Also, the mere existence of the exam requirement, in conjunction with the other registration requirements, appears to have been a notable factor in many existing SMSF auditors, who had only ever audited a handful of funds, choosing not to apply for registration. These auditors had been identified previously by the ATO as having a higher risk of non-compliance.

Annual statements

Approved SMSF auditors registered with ASIC must provide an annual statement to ASIC. The statements include information relevant to ensuring compliance with ongoing obligations, and the fitness and propriety of the auditor. This information, which was not previously available under the former regime, will go towards improved regulation of the sector.

ASIC has commenced receiving annual statements and has seen a high degree of compliance with this requirement.

Administrative actions

Under the SIS Act, ASIC may decide to take certain administrative actions in relation to poor auditor conduct. These actions may include: suspension, disqualification or cancellation of registrations; entering into enforceable undertakings; or imposing conditions on registrations. The ATO has commenced referral of matters to ASIC as a result of its compliance program, and ASIC will consider these matters with regard to administrative action.

ASIC separately maintains a public register of disqualified SMSF auditors. Since the commencement of the regime ASIC has issued one disqualification order preventing a person from being an approved SMSF auditor.

Misleading and deceptive conduct including misleading advertising of SMSF advice

Let me now turn to ASIC's work on misleading and deceptive conduct in relation to SMSFs.

In January, we issued our latest enforcement report, which outlined our enforcement outcomes in the second half of 2013.The report includes the regulatory outcomes of our SMSF work and a warning to consumers and industry. It is important to note that we are constantly reviewing and monitoring advertising in the SMSF space, and any misleading or deceptive statements are likely to result in regulatory action, as seen in the outcomes below:

- Media Super were issued with an infringement notice after we raised concerns about a factsheet it distributed which inaccurately represented the costs and benefits of Media Super funds compared to SMSFs.
- SMSF Property Capital Pty Ltd paid a $10,200 penalty in response to an infringement notice we issued after making potentially misleading statements about 'ASIC approved' financial products.
- SuperHelp Australia Pty Ltd paid a $10,200 infringement notice in relation to making free SMSF fund setup claims.
- In October 2013, we released a warning to consumers about advertisements recommending the purchase of properties through government schemes like the National Rental Affordability Scheme (NRAS). Specifically, we are concerned about advertisements claiming that consumers can use their superannuation to purchase a property using the NRAS and receive '$100,000 tax free'. These advertisements do not provide a balanced message about the features, benefits and risks of investing in NRAS property through an SMSF.

Early this year the SMSF taskforce announced that it would expand its work on misleading advertising of SMSFs. ASIC regularly reviews advertising of SMSFs on websites, print media and radio, to assess whether they are misleading and deceptive. We are expanding this advertising work to cover online advertising channels, such as Twitter, Facebook and YouTube.

We will also be looking at SMSF seminars for evidence of misleading and deceptive conduct, as well any unlicensed financial services conduct. Where we identify any breaches, regulatory action will be sought and we will look to issue an alert to industry and the public to be wary of shonky selling tactics at SMSF seminars.

As I said here last year, where you see examples of possible misleading and deceptive conduct or unlicensed SMSF advice, please let us know.

ASIC’s focus on SMSF ‘one-stop shop’ operators

The purpose of ASIC’s SMSF taskforce is to examine high-risk SMSF issues.

In February of this year the Charterhill group collapsed. It operated as a ‘one-stop shop’, providing advice to clients on the establishment of SMSFs, rollover of existing superannuation funds into an SMSF, sourcing and purchase of investment properties, property management, insurance and taxation services. This raised a number of questions about operators using this business model.

The taskforce appointed a small project team to explore the trend of ‘one-stop shop’ operators offering a range of services to SMSFs. The purpose of the project team is to investigate the (often complex) business model structures of these operators and the risks to investors that this trend poses.

So far the project team have identified that a feature of these business models is a ‘one size fits all’ approach where all investors who use their multiple services receive the same suite of products and services – that is, they end up with an SMSF, a property investment and a limited-recourse borrowing arrangement.

The project team is also exploring whether commissions are being paid within these business models and whether these commissions are consistent with the restrictions on payment of commissions for advice under the FOFA reforms. Under the Corporations Amendment (Streamlining of Future of Financial Advice) Bill 2014 introduced on 19 March 2014, some forms of commission that were originally banned under FOFA will be reintroduced. It is worth noting that where commissions are permitted, they must still be clearly disclosed to retail clients.

Unlicensed financial services conduct

ASIC is aware that there has been a sharp rise in promoters recommending that investors either set up or use an existing SMSF to invest in property. These promoters may not be complying with the law.

Section 911A of the Corporations Act requires any person carrying on a financial services business in Australia to hold an AFS licence or be a representative of an AFS licensee.

A person provides a financial service if they provide financial product advice. Financial product advice is defined as a recommendation, a statement of opinion or a report of either of those things that is, or could reasonably be regarded as being, intended to influence a person's decision in relation to a financial product.

Providing financial product advice includes making a recommendation or a statement of opinion to a person to set up an SMSF or use an existing SMSF to purchase property through that SMSF. This is because the vehicle through which the underlying investment is made is an SMSF, and an interest in an SMSF is a financial product. That is, a person who makes such a recommendation or statement of opinion provides financial product advice even where the underlying investment – property, in this case – is not a financial product.

ASIC is concerned that, with the increased popularity of SMSFs and property investment, real estate agents and property advisers may not realise that they may be carrying on a business of providing financial product advice and may need an AFS licence, or authorisation under an AFS licence, when making recommendations or statements of opinion to a person to use an SMSF to invest in property. Where an AFS licence is required, unlicensed entities must immediately cease offering and providing financial services or advertising the provision of financial services until such time as an AFS licence is obtained or they become a representative of an AFS licence holder.

A person convicted of carrying on an unlicensed financial services business may be subject to a fine of up to $34,000 or imprisonment for two years or both. If a company is convicted it may also be liable to penalties, including a fine of up to $170,000.

We understand that some industry sectors do not fully understand that they need a licence to recommend that a client establish an SMSF or use an existing one to invest in property. We have worked with the state and territory real estate bodies and the Real Estate Institute of Australia to help educate the real estate industry about this. We are now working with individual businesses whom we suspect of engaging in unlicensed conduct to help them understand their obligations.

We also issued a warning that any real estate agents recommending investors use SMSFs to invest in property must ensure they are appropriately licensed to provide the advice.

If a person does not hold an AFS licence or is not authorised by an AFS licensee, they can only provide factual information to consumers in relation to SMSFs. We have published Regulatory Guide 244 *Giving information, general advice and scaled advice* (RG 244), which explains the difference between factual information and financial product advice.

As I said about misleading and deceptive conduct, where you see examples of unlicensed SMSF advice, please let us know.

Concluding comments

ASIC is focused on encouraging gatekeepers to lift the standard of their advice and we expect SMSF investors to really see the benefits.

I suggest that if accountants haven't already, you start thinking about preparing to enter the licensing regime and understanding the conduct and advice requirements that will apply to limited AFS licensees.

I hope that today I've given you a sense of some of the work ASIC is doing in the SMSF sector and the important gatekeeper role your industry plays in helping us ensure that the SMSF sector remains vibrant, healthy and safe for investors.

And, finally, I will just take the opportunity to mention that ASIC meets with the ATO on a regular basis and they have some great resources available on SMSFs that may be useful to you as accountants. Just go to the ATO website.

Thank you.