AUSTRALIAN INVESTORS ASSOCIATION

SUBMISSION TO THE SUPER SYSTEM REVIEW – Phase 3

Preamble

The Australian Investors Association Ltd welcomes the opportunity to make this submission on behalf of its members.

The Australian Investors Association (AIA) comprises approximately 2,000 members from throughout Australia, of which about 70% have SMSFs. This submission draws on the views of our members.

SMSFs are an extraordinarily significant element of the superannuation industry as outlined in the Review's own paper about SMSFs. Some statistics that the Review highlighted include:

- SMSFs control 30% of the superannuation market with their $332 billion
- SMSFs returns were larger than those of APRA-regulated funds in recent years
- 90% of SMSFs have 2 members, with 67% aged over 50
- Almost 80% of SMSFs are still in the accumulation stage
- The average member balance in an SMSF is over $450,000
- Almost 30% of SMSFs have corporate trustees.

Most significantly, 86% of trustees indicate that having greater control over their investments was <u>one</u> of their reasons for setting up their fund, and 46% said that this was the <u>main</u> reason.

This latter point leads to the strongest finding in surveying our members: NO reduced control for SMSF trustees, with the corollary: no increased government control, in any form.

Our submission addresses the four main issues in the Consultation paper:

1. the trust model
2. the regulatory framework
3. operation and efficiency
4. investments

Trust Model

The AIA recommends:

1. that the trust structure be maintained but simplified where possible by:
    a. providing a standard or model Trust Deed and appropriate administrative forms, automatically updated as necessary
    b. making it simpler and less expensive to establish a corporate trustee
    c. providing a model constitution for a corporate trustee
    d. requiring trustees to sign-off that they understand and accept their obligations as trustees
2. that the maintaining of SMSF knowledge be the responsibility of the trustee and not be legislated by government i.e. no compulsory trustee education.

Some AIA members perceive the use of the trust structure as being quite complex but, given the long history of trusts and the fiduciary relationship they establish, this helps create the perception of the seriousness the government accords to self-managed super funds. The concessional nature of the taxation applied to an SMSF, along with the purpose of superannuation, compensates in a sense for this complexity.

It is quite common for trustees to note the difficulties associated with having individual trustees compared with a corporate trustee. Succession on the death of one of a couple means searching around for an appropriate replacement. A corporate trustee simplifies this matter, but at the cost of the additional expense and complexity on establishment of the SMSF.

Most members work comfortably most of the time within the trust structure but there are times when the Trust Deed in particular creates difficulties:

- amending the Deed as changes to superannuation legislation and regulation occurs
- having to copy the Deed to meet the requirements of some banks and investment companies for confirmation of the SMSF
- not understanding the full significance of the content of the Deed.

Having a standard or model Trust Deed contained in the Regulations which trustees are able to use and which is automatically updated as necessary, is a common suggestion from AIA members. This could be extended to the provision of templates for the various forms that trustees need to administer their SMSFs.

Legislation affecting, for example, companies, associations and building societies has, at times, provided model rules and forms in their respective regulations. It does not appear that good reasons exist why they could not be provided for self-managed superannuation funds. If these were to be provided for SMSFs, it would reduce costs for fund members as well as provide more certainty that they were complying with legislative requirements.

The same could be extended to providing a model constitution and related forms for a corporate trustee for SMSFs. Again, this would provide cost savings, certainty for members and improved compliance. These efficiency savings would translate into cost savings for the regulator and enable it to focus on significant problem areas.

A fund utilising the model documentation would also be spared having to copy it to send off to third parties as the trustee could provide a certification that the fund was using the model documentation.

Such documents could be readily available on-line to those wishing to establish self-managed funds. Trustees could also be required to sign an acknowledgement they know that model deeds and forms exist and an undertaking that they will keep abreast of changes to them (perhaps they could be reminded through an annual return notification as which occurs with other government registered assets). A trustee's use of model deed and forms, even if they were to make an unwitting error regarding a decision, would be a mitigating factor to be taken into account in assessing any non complying penalty. The AIA believes there are substantial advantages to gain and merits further consideration of a model deed and related SMSF forms.

'Working comfortably' within the trust structure doesn't mean that trustees agree that SMSF administration needs to be as complex as it is. Many regard SMSFs as un-necessarily complicated in the rules that must be addressed. They point out that claims that the present rules are necessary to reduce tax breaches are hard to justify given the exceedingly small number of individuals prosecuted for breaches (50 in the last 3 years, out of three-quarters of a million trustees). SMSFs are said to be more regulated than small businesses. We are conscious of the need for rules, particularly given some of the schemes pushed by unscrupulous advisers or schemes that push the envelope, but an unfortunate side effect is the impact they have on SMSF trustees and members who are in the main and try to do the right thing.

A regular complaint is the continuing change that is occurring to superannuation rules. A view put by the membership stated that members retained considerable assets outside superannuation (that would have been better within the SMSF) because of a lack of confidence in government's changing of the rules such as not to disadvantage them. There is broad discomfort with the extent of changes that have appeared in the last twenty years.

Despite the complexity of the trust structure and of the rules that underpin superannuation, most members do not think that there should be a minimum educational requirement. The provision of an induction program on-line by the ATO has been suggested. The significance of the Trustee Declaration, that trustees sign-off that they understand the requirements of being an SMSF trustee and accept their responsibility to act within the regulations, was confirmed by a number of members.

In fact, the Australian Investors Association offers regular workshops and discussions about superannuation in general and SMSF administration in particular. As an association, we believe that trustees need to acquire significant knowledge and understanding in the course of establishing an SMSF, and we will continue to provide our members with the opportunity to do so. Our outline of the topics that trustees should address in preparing for and managing an SMSF is attached as Appendix 1.

In the matter of the trust structure of SMSFs, the AIA recommends:

1. that the trust structure be maintained but simplified where possible
   a. providing a standard or model Trust Deed and appropriate administrative forms, automatically updated as necessary
   b. making it simpler and less expensive to establish a corporate trustee
   c. providing a model constitution for a corporate trustee
   d. requiring trustees to sign-off that they understand and accept their obligations as trustees
2. that the maintaining of SMSF knowledge be the responsibility of the trustee and not be legislated by government i.e. no compulsory trustee education.

Most important: let's have an end to regulatory change to superannuation and SMSFs.

Regulatory Framework

The AIA recommends:

1. that a sliding scale of penalties be developed for not conforming with regulations, similar to income tax penalties
2. that the independent audit of funds be strengthened to become the main method of supervision
3. that the contribution rules be simplified and amended to take account of the changing circumstances of Australians
4. that contributions to superannuation for all Australians (to pre-set limits) be tax deductible.

Most members are satisfied with the ATO as regulator, with the level of supervision and the penalties for malfeasance. However they often acknowledge that given they don't have any intention of breaching regulations, they have given limited thought to the appropriateness of the current framework.

Those who have accorded these matters some significant thought, offer the following:

1. provide for a sliding scale of penalties that takes into account the extent of the transgression and the record of the transgressor (including penalties for lateness of filing of returns etc.)
2. encourage the ATO to continue administering the SMSF legislation in the spirit of the legislation and educating SMSF trustees and members as to their obligations, with penalties being determined and applied according to the deliberateness or recklessness of any breaches
3. avoid a 'one size fits all' approach to supervision.

The role of auditors in supervision is accepted generally with a view that it could be strengthened. It is the contribution rules that attract most negative comment. They are incredibly complex and subject to large variations according to who is in government.

Some situations that have been reported include:

1. the inability of many SMSF members to contribute a legacy received on the death of a parent to their SMSF, because they no longer meet the work tests
2. the unsatisfactory $25,000 pa maximum (for tax-deductible contributions) that makes it hard for those who start contributing seriously to their funds late in their working lives
3. the fact that some small business owners claim to have limited capacity to contribute to superannuation until the sale of their businesses prior to retirement making larger tax-deductible contribution amounts more effective for them
4. the tax deductibility of contributions is a vexing issue: why not allow <u>any</u> employee to take a deduction on contributions
5. linking the right to contribute to superannuation to work is an archaic notion: after all we all retire eventually and need retirement incomes. Self-funded retirements will lessen the burden of government funded pensions.

In the matter of regulatory frameworks, the AIA recommends:

1. that a sliding scale of penalties be developed for not conforming with regulations
2. that the independent audit of funds be strengthened to become the main method of supervision
3. that the contribution rules be simplified and amended to take account of the changing circumstances of Australians
4. that contributions to superannuation for all Australians (to pre-set limits) be tax deductible.

Operation and efficiency

The AIA recommends:

1. simplification of the administrative (including reporting) requirements of SMSFs
2. use of the fund auditor to ensure compliance in relation to important aspects of an SMSF
3. legislation to allow for SMSFs to accommodate large families
4. that there (continue to) be no requirement that each SMSF should have a professional adviser.

Generally speaking most members are satisfied with these provisions.

Costs of SMSFs vary enormously as some members maintain their own accounts and seek assistance only with filing the necessary forms and conducting audits. On the other hand, some members have accountants/administration systems managing their portfolios and transactions. In the former, costs of $1,500 are quoted while in the latter up to $5,000 is charged. There is a request for much simpler forms (on-line preferably) to reduce the cost burdens in this regard. Our suggestion of prescribing appropriate model forms would meet this concern, as well as save time and money for members and the regulator, and further enhance compliance.

There is almost universal acceptance of the auditor fulfilling a compliance role as happens in many cases at present, and that this be an annual activity.

While members indicate a preference for no minimum amount for the establishment of an SMSF, they do point out that under $250,000 cost effectiveness comes into question. The number of members of a fund is a moot point: while two is common, the practicality of allowing all family members to be part of a fund makes sense – why just only two plus the parents! What if there are three children? Perhaps the legislation could allow for SMSFs for the immediate family of up to 7 members, i.e., both parents and up to 5 children. This would cover the majority of Australian families.

Members agree universally that they would resist strenuously a requirement that there be a professional adviser to each SMSF. Many recount less than favorable experiences with such professionals in the past. SMSFs trustees and members often do not receive value for money from professionals, and advice can be wrong or incomplete. This makes it difficult for those SMSFs trustees and members who endeavour to do the right thing. It would be difficult to argue that many of the schemes promoted, including those which push the envelope, have a net return advantage compared with the more traditional and straight-forward forms of investment. The one thing they do have is high fees! 'Money-grubbers' is a common appellation.

In the matter of operation and efficiency, the AIA recommends:

1. simplification of the administrative (including reporting) requirements of SMSFs
2. use of the fund auditor to ensure compliance in relation to important aspects of an SMSF
3. legislation to allow for SMSFs to accommodate large families
4. that there (continue to) be no requirement that each SMSF should have a professional adviser.

Investments

The AIA recommends:

1. no change to the current practices in relation to investment independence and to the minor limitations placed on trustees in this matter
2. no introduction of a requirement that a proportion of each fund be invested in government-controlled lifetime annuity funds or other government-controlled investments.

There is strong agreement that SMSFs are SELF-managed. Regulatory interference in this matter would be strongly resisted by AIA members. This includes:

1. no government-prescribed educational requirements of trustees
2. no government-prescribed asset allocation impositions
3. no proscription against any specific assets such as derivatives, collectibles, CFDs (but the provision of appropriately-worded warnings about the dangers of some of these)
4. no government regulated lifetime annuities.

Members acknowledge the superficial attractiveness of some of these requirements, but insist that there is evidence that trustees invest wisely and well in the vast majority of cases.

There is a particular antipathy to the notion that a significant proportion of a SMSF should be invested in government bonds or government controlled lifetime annuities. *This is seen as a cynical move by government to help pay off recently acquired debt.*

In the matter of investments, the AIA recommends:

1. no change to the current practices in relation to investment independence and to the minor limitations placed on trustees in this matter
2. no introduction of a requirement that a proportion of each fund be invested in government-controlled lifetime annuity funds or other government-controlled investments.

Concluding comment

The SMSF must be one of the most successful schemes for citizens providing for their own retirement in the world. It certainly is a most significant part of the superannuation industry in Australia.

The AIA feels strongly that this scheme be allowed to continue its vigorous growth and its successful implementation to date. This means lifting un-necessary impediments to further growth and implementation while refraining from imposing further constraints. The very small extent of malfeasance needs to be acknowledged and the imposition of draconian requirements to rein in this malfeasance avoided.

As our life expectancy continues to increase, the need to provide for one's own longer retirement increases quite significantly. This is a time for encouraging even more growth in the SMSF industry.

The AIA is committed to educating and helping investors and look forward to having the opportunity to discuss any of these issues at your convenience.

Jolyon Forsyth
President
Australian Investors Association Ltd
Tel: 07 4942 5764
Email: president@investors.asn.au

Scott McKenzie
Vice President
Australian Investors Association Ltd
Tel: 07 3335 6604
Email: scott.mckenzie@investors.asn.au

Website: www.investors.asn.au

15 February 2010

Appendix 1

SMSF TRUSTEES

TRAINING COURSE

Module 1: Legislation and Regulations

Overview

General Introduction
What is a SMSF
Benefits and Disadvantages of SMSFs

Establishing a SMSF

Trust Deeds
ATO Registration – eg ABN, TFN, GST, complying funds
Trustee Responsibilities
Corporate trustee versus individual trustees
Investment Strategy
Derivative Risk Statements
Residency Requirements

Trustee Obligations

Sole Purpose Test
Related Parties
Related Party Rules
In-house Assets
Loans to Members and Borrowing Rules
Investment Restrictions

Ongoing Administration

Record-keeping
Accumulation & Pension Accounts
Income Tax/GST Payments
Role & Responsibility of Auditors
Financial Reports
Compliance Reports

Module 2: Accumulation Phase

Accepting Contributions

Contributions – concessional, types and limits
Contributions – non-concessional, types and limits
Work test and age limits
Penalties

Assessable Income & Taxation of Same

“Normal” Income – dividends, interest, etc
Contributions
Non-arm’s Length Income (special income)
Deductions (including insurance)
Franking Credits
Capital Gains

Superannuation Components

Restricted, unrestricted and preserved components
Crystallisation of components – taxable and tax-free

Accumulation Strategies

Superannuation guarantee
Government co-contribution
Personal deductible contributions
Salary-sacrificing

Small Business CGT Concessions

15 year exemption
50% CGT concession
50% active asset concession
CGT retirement exemption
Rollover exemption
Lifetime $1.1m non-concessional limit

Other Issues

Segregation of Assets
Reserves
Cash Requirements
Insurance

Module 3: Distribution Phase

Conditions of Release

Age 55
Age 60
65 and over

Lump Sum Payments

Under 55
55-59
60 and over
Taxation of lump sums: under 55, 55-59 and 60 and over

Pensions

Types of pensions
Account-based Pension Rules
Transition to Retirement Rules
Crystallisation of components – taxable and tax-free
Taxation of pensions: under 55, 55-59 and 60 and over
Actuarial Certificates

Pre-Retirement Strategies

Re-contribution Strategies
Transition to Retirement Pensions

Module 4: Estate Planning & Administration

Death Benefits

Superannuation Dependants - definitions
Taxation Dependants – definitions
Benefits Payable – who can receive pension and/or lump sum
Taxation of Benefits (lump sum and pension)
Binding Death Benefit Nominations – pay the dependants or the LPR
Trustee responsibilities
Wills and superannuation

Module 5: Other Issues

Complaints mechanisms: No Superannuation Complaints Tribunal
Binding Death Benefit Nomination Issues
Trustee Succession
Trustee/member rules upon death
Insurance Benefits
Reserves
Anti-detriment Provisions

Module 6: Instalment Warrants

How to set up and structure an arrangement
Borrowing requirements
GST, CGT and stamp duty implications

Module 7: Winding Up

What you need to do.