DIY super advisers need to lift their game

SMSFs

Tim Mackay

Two self-managed superannuation fund (SMSF) reports from the Australian Securities and Investments Commission (ASIC) should be compulsory and sobering reading for everyone in the SMSF industry.

The reports covered the quality of SMSF advice and the experiences of members. ASIC analysed 250 client files where advice was given to establish an SMSF in the month of September 2016. ASIC's analysis covered a random selection (10 per cent) of the 2370 SMSFs established that month based on the advice from 102 different licensees.

It is a good, representative sample of SMSF advice and so ASIC's findings can't easily be dismissed.

ASIC says it has "seen an unacceptable level of poor-quality [SMSF] advice" where 91 per cent of advice given to set up an SMSF was not compliant with the law.

As an SMSF adviser, this number shocks me and it should shock you. Delving more into the reports, however, brings up other worrying issues in SMSF advice.

So if 91 per cent of the advice wasn't compliant with the law, what was wrong with it?

ASIC found 10 per cent of clients would be significantly worse off in retirement if they followed the advice. Nineteen per cent would be at increased risk of suffering financial detriment if they followed the advice. Combined, a third of clients may have been better off if they'd never met their adviser.

For 62 per cent of clients, their adviser did not provide advice that met the best interest duty and other related legal obligations. The client may not have been financially worse off following the advice, but typically the advisers didn't even show they understood their clients' existing position, goal and needs before giving advice.

Clearly if my industry wants to improve professionalism and rebuild consumer trust, we have a lot of work to do. We need to acknowledge and learn from ASIC's research. A statistic that shocks me is that 41 per cent of advice explicitly recommended the establishment of a higher-risk limited recourse borrowing arrangement (LRBA). It rises to 51 per cent when you include advice implying a LRBA be established.

So it seems that if you seek SMSF advice today, there is more than an even chance you would be advised to borrow in your SMSF, whether it was in your best interests or not. In my opinion, this area needs reform before it becomes an even bigger problem.

When you drill down into the specifics of this LRBA advice, it becomes worryingly apparent that the smaller the initial balance of an SMSF, the higher the average leverage that was recommended. These new smaller balance SMSFs have higher risk and higher concentration of assets (typically in property).

Another problem highlighted by ASIC were SMSF one-stop shops. ASIC found that in 86 per cent of advice, the provider appeared to have prioritised their own interests (or that of a related party) over their client's. So be wary if they also arrange financing, source a property, do your SMSF accounting and audit your SMSF.

In coming years you should expect a regulatory focus on SMSF one-stop shops.

Other important findings include: Roughly 32 per cent of new SMSF members found their SMSF more costly than expected, and 38 per cent found it more time-consuming than anticipated. Fifty-one per cent of SMSFs were established with less than \$250,000 (80 per cent of funds with less than \$500,000). By comparison, existing SMSFs have an average balance of \$1.2 million. ASIC views SMSFs established with less than \$200,000 as a red flag (with some limited exceptions). So in coming years you should expect a regulatory focus on SMSF one-stop shops to stamp out the more questionable sales-based practices. You should also expect a renewed examination of the ongoing suitability of LRBAs in SMSFs.

Also, I strongly believe that higher education standards should be set specifically for SMSF advisers. Some of my fellow advisers may not appreciate me saying so, but we clearly need them.

General advice only. Tim Mackay is an independent financial adviser at Quantum Financial.