

Tech Time



Perpetual's monthly technical guide

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Cooper final recommendations

The final recommendations of the Cooper Review have been released, but the outcome depends largely on the outcome of the Federal election.

The report recognised that there are four key sectors that are identifiable by their type of members. These include:

- Members who are disengaged with their super – MySuper is designed to provide for these members.
- Members who want to exercise choice over their superannuation investment strategies, but do not want the responsibility of administering their accounts – choice of super provides for these members.
- Members who choose to be fully responsible for the investment and administration of their superannuation arrangements – the SMSF environment provides for these requirements.
- Members who have lost their superannuation account.

The report made 177 recommendations spread over 10 key areas relating to the governance, efficiency, structure and operation of Australia's superannuation system. Outlined below is a synopsis of the major recommendations.

1. MySuper and choice architecture

- The Superannuation Guarantee (Administration) Act 1992 should be amended so that only a MySuper product is eligible to be a default fund for an employer.
- Industrial relations legislation should be amended so that only MySuper products can be nominated as default funds in awards.
- The Superannuation Industry (Supervision) Act (SIS Act) should be amended to place duties on MySuper trustees to give effect to a single diversified investment strategy and to examine on an annual basis whether the MySuper product has sufficient scale to be continued.
- The superannuation industry should have at least a two year transition period to move to MySuper after passing the legislation.
- Trustees should not be able to charge entry fees and should only be able to charge exit fees on a cost recovery basis.
- Advice to members or employers should not be bundled with products.
- Advice to members should only be provided on request and trustees should only be able to deduct the costs of advice (other than intra-fund advice) with the member's consent.
- Trustees of MySuper and choice products should not pay or fund any product-based up-front or trailing commissions or make any volume-related payment in respect of superannuation advice or other products or services provided to members.

2. Trustee governance

- Creation of a new office of 'trustee director' with duties, powers and standards clearly defined in the SIS Act.
- Establishment of a Code of Trustee Governance, to be developed by industry.

3. Investment governance

- Among other things, the report recommends increased trustee duties when setting investment strategies to take into account costs, tax consequences and valuation issues.

4. Outcomes transparency

- Greater transparency, comparability and accountability in the superannuation system through targeted regulation including standardised disclosure of investment options.
- Reporting returns for one, five and ten year periods showing gross investment returns, costs, and investment returns net of all costs and taxes.

5. Insurance in superannuation

- Commissions should be banned on all insurance products in super, including group risk and personal insurance.
- Trustees would be required to develop a considered insurance strategy and monitor its implementation.
- For MySuper members, insurance (life and TPD) would be offered on an opt-out basis.
- The law to be amended so that a binding death benefit nomination that has not been updated after a 'life event' occurs would become invalidated.

6. Integrity of the system

- A number of measures including a new capital requirement for trustees – these include holding of an operational risk reserve, to be phased in over time.

7. Retirement

- MySuper should be a whole of life product and include a single type of retirement income stream product provided by the fund or in conjunction with another provider.
- Trustees should explicitly consider longevity and inflation risks when developing investment strategies for post-retirement members.
- Trustees should offer pro-actively intra-fund advice to members planning for, or already in, retirement.

8. Self-managed super solutions

Overall the report does not believe that significant changes are required as this sector is well-functioning. However they have recommended the following:

- Raising standards for providers and auditors.
- Imposing a restriction on investment in in-house assets, collectables and personal use assets with a five year transition period to convert to a small APRA fund or dispose of any existing investments.

9. SuperStream

- This is a package of measures designed to improve the efficiency of superannuation back-office through increased use of technology and uniform data standards.

10. Regulatory settings

- APRA would have an increased mandate to oversee and promote the overall efficiency and transparency of the superannuation system.

SMSF instalment warrant changes

Background

In September 2007, the super fund borrowing prohibition was given an exception, which allowed super funds to borrow on a limited recourse basis. This exception is commonly referred to as the 'instalment warrant' exception.

Since then, there has been a significant increase in the use of this arrangement by super funds to acquire assets (especially real estate). As a result, several areas of concern have been identified.

These have been addressed with the passing of the Superannuation Industry (Supervision) Amendment Bill 2010 which is effective from 7 July 2010.

Definition of an asset

The new Act outlines a strict definition of 'an asset', taken to mean, a single asset or group of identical assets treated as a single asset. For this purpose a single asset constitutes shares of the same type in a single company or units in a unit trust that have the same fixed rights attached to them.

This change would exclude using an instalment warrant arrangement to invest in a portfolio of different shares as this would include a number of parcels of shares in different companies and at different prices.

If an SMSF wishes to invest in a number of separate assets, it would be necessary to have a separate instalment warrant arrangement for each of those assets. This could add significant costs to the superannuation fund.



Tech tip: Investing in WealthFocus Investment Advantage can give you the opportunity to invest across a range of different funds without breaching the new more narrowly defined term of 'an asset'.



Refinancing

A big question under the current borrowing rules was whether refinancing was allowable. The Australian Taxation Office stated in a ruling last year that refinancing constitutes a new borrowing and thus it did not believe that refinancing was allowable under an existing arrangement.

Under the new law, a super fund will clearly be allowed to refinance a borrowing arrangement. This change will also apply to borrowing arrangements entered into before 7 July 2010.

'Replacement asset' clarification

The legislation as it stood pre 7 July 2010 made reference to borrowing for the purpose of purchasing an asset and 'replacement assets'. There was concern that some people had interpreted this to mean that an SMSF could have a share facility that could buy and sell shares.

The new law clearly states what assets are allowed to be replaced, and under what circumstances. Broadly, in order to be a 'replacement asset', an asset must be a share in the same company, or units in a unit trust as the original share and must be worth the same amount as the original share. There is also some scope for the replacement asset rules to apply where the replacement occurs as a result of a takeover, merger, demerger or restructure of the original company.

However there is no scope for the replacement asset rules to apply to real estate.



Tech tip: Investing in WealthFocus Investment Advantage will allow you to change the underlying funds held without changing your units and thus allow you maximum flexibility while still operating within the constraints of the new more narrowly defined term of 'replacement asset'.

Personal guarantees

Under the old legislation there was concern over whether a personal guarantee could be provided where a limited recourse arrangement was being made without breaching the legislative requirements under section 67.

The problem existed where the guarantee was required to be exercised. This is because there was the right for the individual to recover the amount from the SMSF's trustee who in turn would be indemnified out of the fund's assets.

As a result all of the fund's assets were potentially being exposed and potentially undermining the 'limited recourse' nature of the borrowings.

The new legislation will ensure the fund's assets are protected and seek to protect fund assets from such outcomes. This means that any guarantees provided will be limited in their recourse to the asset being acquired under the borrowing.

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