

Self managed superannuation funds—investment strategy and investment restrictions

Investment management is a key area of responsibility for trustees of self managed superannuation funds (SMSFs). The *Superannuation Industry (Supervision) Act 1993* (SISA) places certain duties, responsibilities and restrictions on trustees when making investment decisions. They aim to protect and increase member benefits for retirement purposes.

Investment strategy

The trustees of every SMSF are required to prepare and implement an investment strategy for the superannuation fund. The strategy must reflect the purpose and circumstances of the superannuation fund and have particular regard to [SISA s52(2)(f)]:

- investing in such a way as to maximise member returns taking into account the risk associated in holding the investment;
- appropriate diversification and the benefits of investing across a number of asset classes (for example, shares, property, fixed deposit) in a long term investment strategy; and
- the ability of the superannuation fund to pay benefits as well as other costs of the superannuation fund as they become due and payable.

An appropriate investment strategy will set out the investment objectives of the superannuation fund and detail the investment methods the superannuation fund will adopt to achieve these objectives. Trustees must ensure that all investment decisions are made in accordance with the investment strategy and should seek investment advice or appoint an investment manager in writing if in any doubt.

Trustee should be able to demonstrate through trustee minutes or other documentation that they have taken into account all the circumstances of the fund in formulating the investment strategy. Trustees may seek professional advice in formulating the investment strategy, however this does not reduce their responsibilities or obligations. Any professional advice received should be documented.

SISA provides a defence to trustees against an action for loss or damage suffered as a result of the trustee making an investment. This defence is available where the trustee can show that the investment was made in accordance with an investment strategy formulated under the investment strategy covenant [SISA s55(5)].

It is therefore recommended that the investment strategy be documented, such as in minutes, so that trustees can show that investment decisions are made in line with the investment strategy.

For further information please refer to the Australian Prudential Regulation Authority (APRA), Superannuation Circular No.II.D.1, *Managing Investments and Investment Choice* available from the APRA website.

Investment restrictions

SISA restricts some investment practices of superannuation funds. The investment restrictions aim to protect superannuation fund members from being overly exposed to undue risk (for example, an associated business failing). Secondly, they aim to ensure that superannuation funds make investment decisions with the sole purpose of generating retirement benefits for members rather than providing current day support.

Investment rules are one of the most important requirements of SISA and failure to comply with the rules could result in trustees being fined and/or the superannuation fund losing its complying status.

Loans or financial assistance to members or a member's relative

Trustees are prohibited from lending money or providing financial assistance from the superannuation fund to a member or a member's relative. The use of a superannuation fund asset by a member or a member's relative for no cost or as a guarantee to secure a personal loan for example, would be in breach of this investment restriction [SISA s65(1)].

Borrowings

SMSFs are prohibited from borrowing money except in certain limited circumstances. Trustees are able to borrow for a maximum of 90 days to enable the trustee to make benefit payments or pay a surcharge liability if the borrowing does not exceed 10% of the fund's total assets. In specified circumstances trustees can also borrow for a maximum of 7 days to cover the settlement of security transactions if the borrowing does not exceed 10% of the superannuation fund's total assets (SISA s67).

Acquisition of assets from 'related parties'

Trustees are prohibited from acquiring assets from a 'related party' of the superannuation fund. The limited exceptions to this rule include assets acquired at market value, if:

- the acquisition is an 'in-house asset' which, after being acquired by the trustees would not result in the level of 'in-house assets' of the superannuation fund exceeding more than 5% of the superannuation fund's assets;
- the asset is a listed security (for example, shares, units or bonds listed on an approved Stock Exchange);
- the asset is 'business real property'.
(SISA 66)

'Business real property' of an entity generally relates to land and buildings used wholly and exclusively in a business. Trustees of SMSFs are permitted to acquire up to 100% of the fund's total assets as 'business real property'.

Related party of a fund

A 'related party' of a superannuation fund covers all members of the superannuation fund and their Part 8 associates and all standard employer sponsors of the superannuation fund and their Part 8 associates (SISA s10).

Part 8 associates of members includes their relatives, partners and any companies or trusts that they control (either alone or with their other Part 8 associates).

Part 8 associates of standard employer sponsors includes partners and any companies or trusts that the employer controls (either alone or with their other Part 8 associates) or companies and trusts which control the employer.

In-house assets

'In-house assets' are loans to, investments in, and assets subject to a lease or lease arrangement with a related party of the superannuation fund. In general, SMSFs are restricted from lending or leasing more than 5% of the superannuation fund's total assets to a related party of the superannuation fund and are generally restricted from investing more than 5% of the superannuation fund's assets in a related party of the superannuation fund [SISA s66 (2A)].

Some exceptions do exist, including allowing an exemption for 'business real property', which is subject to a lease between the superannuation fund and a related party of the superannuation fund.

In addition SMSFs may invest in a unit trust or a company, without that investment being considered an 'in-house asset', if certain conditions are met [Superannuation Industry (Supervision) Regulations 1994 (SISR) 13.22C]. The main conditions being that the trust or company:

- does not borrow;
- has no assets with a charge over them;
- does not loan money to individuals or other entities (other than deposits with authorised deposit-taking institutions);
- does not acquire an asset from a related party of the superannuation fund other than business real property acquired at market value;
- does not directly or indirectly lease assets to related parties, other than business real property;
- does not conduct a business; and
- conducts all transactions on an arm's length basis.

Investments to be made and maintained on an 'arms length' basis

Investments by SMSFs must be made and maintained on a strict commercial basis. The purchase and sale price of assets and the income from assets held by the superannuation fund should always reflect a true market rate of return (SISA s109).

Changes in the investment rules

The investment rules outlined above incorporate amendments which received Royal Assent on 23 December 1999. These changes apply from **11 August 1999** and a number of transitional measures apply to the introduction of the new rules. These include:

Existing Investments at 11 August 1999

Superannuation fund investments, leases and loans in place at 11 August 1999, are not subject to the new rules (SISA s71A and s71B). That is, they are not counted as in house assets (unless they were already in house assets under the old rules).

A superannuation fund cannot however, make additional investments in such an arrangement (for example, purchase additional units in an existing related trust investment) unless specifically allowed under the transitional rules discussed below.

Certain specified investments after 11 August 1999

Certain specified investments made after 11 August 1999 will also not be subject to the changes, until 30 June 2009 (SISA s71A – s71E). The exceptions include, reinvesting earnings from an entity back to the entity, if a superannuation fund had an investment in the related entity (for example, a trust) at 11 August 1999. Also, if a superannuation fund had partly paid shares or units at 11 August 1999 it may make additional payments on those shares or units after that date (provided they are made no later than 30 June 2009).

Some common issues about investments

Investment in art

SISA attaches certain requirements that trustees must consider when developing and implementing an investment strategy but does not prescribe the types of investments. Fund investments should be made with the fundamental objective of providing for the members' retirement. Trustees should seek expert advice on the potential income, capital growth and liquidity of the asset before acquiring any non-traditional asset including art. Trustees should consider the costs associated with the storage and insurance of the art. Also, where a fund acquires an asset which is utilised by the member at no cost, a breach of the sole purpose test may have occurred. An example would be if the art is housed in the business premises or residence of a member at no cost to the member. These arrangements may breach other requirements of the SISA including the in-house asset provisions and the requirement to deal at arms length.

Discount card shares

Trustees of SMSFs may acquire publicly listed discount card shares, provided the investment is in accordance with the fund's investment strategy, and the SMSF does not participate in a discount plan where the trustees agree to a regular debit of their dividend payments.

Certain shareholder discount plans require the purchase of a nominal number of publicly listed Discount Card shares which entitles a shareholder to participate in the Shareholder Discount Plan provided they agree to a regular debit of their dividend payments. The shareholder may then obtain discounts on purchases from particular stores.

In such arrangements, the discount shareholder card can not be viewed as an incidental benefit to a member because the dividend payments resulting from the shareholding are reduced in order to pay for participation in the discount shareholder plan. This is a direct use of the fund's income to pay for a current benefit enjoyed by a member and is not consistent with paragraph 62(1)(a) of the SISA which requires that the trustee ensure that the fund is maintained solely for at least one or more of the specified core purposes.

Loan to an employer-sponsor

Under s109 of the SISA the investments of a superannuation entity are to be maintained on an arm's length basis. The terms

and conditions of the transaction should be no more favourable than if the parties were at arm's length in the same circumstances. For example, an unsecured loan between the trustee of the fund and the employer-sponsor, where there is no interest being paid, no reduction on the outstanding loan amount, and no written contract regarding the unsecured loan is a contravention of s109 of the SISA. It is reasonable to expect that parties dealing at arm's length would have a written contract including the term of the loan, the rate of interest, and the loan repayment requirements. Accordingly the parties are not dealing at arm's length because the terms of the loan are more favourable to the employer-sponsor than they would be if the parties were at arms length.

Loan to a member after 16 December 1985

Section 65 of the SISA prohibits the trustee from lending money of the fund to a member or a relative of a member. A contravention of s65 of the SISA has therefore occurred.

Loan to a Property Trust

A loan from a SMSF to a Property Trust will not be treated as an in-house asset if the property trust is neither a related trust (a trust controlled by a member or a standard employer sponsor of the SMSF) nor a related party of the SMSF.

Reinvestment in a related unit trust

Until 30 June 2009 a SMSF fund can invest up to the level of debt held by the related unit trust as at 11 August 1999 under s71D of the SISA.

If in any doubt about the validity of an investment decision, trustees should seek professional advice or contact the Australian Taxation Office for assistance.

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Need more information?

For further information on this topic:

- visit our website at www.ato.gov.au/super
- phone our information line on **13 10 20**
- write to:

**Australian Taxation Office
Superannuation Business Line
PO Box 277
WTC VIC 8005**

If you do not speak English well and want to talk to a Tax Officer, phone the Translating and Interpreting Service on **13 14 50** for help with your call.

People with a hearing or speech impairment with access to appropriate teletypewriter (TTY) or modem equipment, phone **13 36 77**. If you do not have access to TTY or modem equipment, phone the Speech to Speech Relay Service on **1300 555 727**.

Last Modified: Thursday, 15 April 2004

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