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SMSF investment strategies –– are they a financial product?

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Many advisers do not foresee the potential flow-on legal consequences from merely providing an investment strategy template to an SMSF client. Indeed, many believe they are merely assisting their client particularly to ensure the SMSF will have the necessary paperwork to survive an audit and not receive an auditor contravention report.

This article therefore focuses on whether an unlicensed adviser who merely provides an investment strategy to an SMSF trustee is providing a financial product or financial service that is covered by the *Corporations Act 2001* (Cth). It also briefly examines potential related legal risks.

Australian Financial Services licence ('AFSL') regime

Accountants and other SMSF advisers who are not covered by an AFSL are not permitted to provide financial product ('FP') advice or related financial services under the *Corporations Act 2001* (Cth).

While some commentators argue that the preparation of an investment strategy is not an FP requiring a licensed adviser, an adviser who is not covered by a licence would be placing themselves at substantial legal risk of contravening the *Corporations Act 2001* (Cth) and potential exposure to damages and other claims by simply providing an investment strategy, especially if this proved unsatisfactory.

For example, a non-licensed adviser supplying an investment strategy covering investments that lost substantial value may be at risk in relation to an SMSF trustee that suffers any loss and damages from the fund's poor investment performance. While the adviser may argue that the investment strategy template was merely provided to satisfy the *Superannuation Industry (Supervision) Act 1993* (Cth) and *Superannuation Industry (Supervision) Regulations 1994* (Cth) criteria and was not intended to be relied upon as a '*real*' investment strategy, that adviser will be tested to the level of care and skill that a reasonably competent licensed professional providing investment strategies would prepare (especially after appropriate fact finding and disclosures of the service offering, etc).

A licensed (AFSL) adviser should typically run through the following steps in relation to preparing an investment strategy for a client:

- agree their relevant terms of engagement and scope and provide their Financial Services Guide;
- undertake an extensive fact finding exercise;
- undertake risk profiling of the client based on their goals and level of risks, etc;
- provide a statement of advice;
- provide an investment strategy based on the above; and
- ensure each step above is appropriately documented/recorded.

A non-licensed adviser who merely provides an investment strategy template without going through the above process, in addition to contravening the *Corporations Act 2001* (Cth) and not being covered by their professional indemnity insurance, would be measured to the standard of a reasonably competent professional adviser with an appropriate licence under the *Corporations Act 2001* (Cth).

Also, the recent SMSF auditor negligence case, namely *Ryan Wealth Holdings Pty Ltd v Baumgartner* [2018] NSWSC 1502, highlights how advisers can readily be liable for any shortcomings in an SMSF's investment strategy.

Broadly, in this case, the SMSF auditor had an '*indirect'* responsibility for checking the SMSF investment strategy for SISA/SISR and financial statement purposes, and the auditor was held primarily liable for the investment losses suffered.

Similarly, as noted in the above example, a non-licensed adviser simply providing an investment strategy template where the SMSF trustee suffers a material loss could potentially be liable for any consequential loss or damages suffered. Moreover, as lawyers often point out, there is always the risk of a vexatious litigant!

An issue with insurance

Moreover, assume that the template investment strategy also covered the requirement regarding the consideration of insurance in reg 4.09(2)(e) and that the non-licensed adviser wanted the client to also be covered from a SISA/SISR viewpoint. Thus, the template investment strategy may include wording such as:

the trustees have considered insurance cover on each member and have resolved not to implement any cover.

Now assume that one of the members, who happens to be the main 'breadwinner' of the family, dies without any insurance. The non-licensed adviser could be liable for substantial damages on the basis that such an investment strategy was a recommendation not to implement insurance when that recommendation has subsequently proved to be inappropriate due to the death of the SMSF member.

This is where the investment strategy involves FP advice under the *Corporations Act 2001* (Cth). Such an adviser may be potentially liable in, among other things, negligence to the SMSF member or anyone else who may suffer due to no or inappropriate insurance in place.

An adviser must generally be licensed to provide a recommendation in relation to insurance. A non-licensed adviser can provide limited factual advice on the general types of insurance available to manage risk without making any recommendation, where a recommendation can include seeking to influence a decision in relation to a financial product.

What is FP advice?

A person provides a financial service under s 766A(1) of the *Corporations Act 2001* (Cth) if they:

(a) provide FP advice (s 766B); or

(b) deal in an FP (s 766C).

An FP under s 763A(1) is broadly a facility through which a person does one or more of the following:

(c) makes a financial investment (s 763B); or

(d) manages financial risk (s 763C).

FP advice, under s 766B (1) of the *Corporations Act 2001* (Cth), means a recommendation or a statement of opinion that:

(e) is intended to influence a person in making a decision in relation to a particular FP or class of FPs; or

(a) could reasonably be regarded as intended to have such an influence.

Thus, while strictly speaking, an investment strategy template is not an FP, by itself (as some commentators have suggested), the provision of an investment strategy template can readily constitute a financial service.

For example, providing an investment strategy template will typically refer to certain investments, eg, Australian shares say 0 to 50% and a range of other FPs and suggested allocations of the fund's investment portfolio into the different classes of FPs. It is also likely to include some wording along the lines that the trustees have considered insurance and decided not to have any or that say death and permanent incapacity insurance has been taken out on the members. This type of wording may influence an SMSF's selection of investments. Invariably, in practice, SMSF trustees come back and ask the adviser how do they complete the strategy and what do they do next. This easily entraps an adviser and unless they have adequate evidence to defend themselves against an ASIC review that they did not provide FP advice, they are at risk of having contravened the *Corporations Act 2001* (Cth). Moreover, the mere provision of the investment strategy template exposes them to the legal risks as outlined above.

As you may appreciate from the above, without the right context, the claim that an investment strategy template is not an FP is, by itself, misleading.

What should advisers do?

As many advisers would be aware in practice, if an investment strategy template is provided to a client with the recommendation that they complete it themselves or engage an expert licensed adviser to do so, many clients will want to come back and ask the adviser supplying that template what to do next. While it may be tempting to say, 'just complete it this or that way with these words or ranges,' etc, a non-licensed adviser should simply state that they are precluded under the *Corporations Act 2001* (Cth) in assisting any further in this regard and should insist on the client seeking assistance from an adviser with an appropriate licence.

Thus, non-licensed advisers should not prepare SMSF investment strategies for their clients. Non-licensed advisers can, however, refer their clients to appropriate resources or to an adviser who is covered by an AFSL in relation to assisting an SMSF with its investment strategy obligations. Another alternative is for a non-licensed adviser to refer their SMSF client to a supplier that provides documentation that can assist SMSF trustees to prepare their own investment strategy (eg, the DBA Lawyers' Investment Strategy Kit).

Where a non-licensed adviser provides an investment strategy template or refers their client on to a licensed adviser, they should also issue an appropriate letter of execution that clearly covers them in the event their client ever alleges that they provided any FP advice or related financial service. Such a template letter of execution is included in DBA Lawyers' investment strategy kit.

Conclusions

If a non-licensed adviser wishes to supply an investment strategy template to a client (which is not recommended), they should at least provide a comprehensive disclaimer letter stating, among other things, that they cannot provide FP advice as they are not covered by an AFSL and that the client should seek FP advice from a licensed adviser with an appropriate AFSL to complete the template.

For the reasons outlined above, we generally suggest that non-licensed advisers recommend their SMSF clients seek advice from a licensed adviser or, if the SMSF trustee does not wish to obtain such advice, to refer their client to resources where the SMSF trustee can prepare their own investment strategy. Naturally, an appropriate comprehensive disclaimer letter should also be issued under this option.

Advisers must be aware of what advice and services they can offer in relation to assisting SMSF trustees and members on their investment strategies, especially if they do not have an AFSL. Otherwise, advisers may be exposed to potential legal risks.

Related articles

For a related article on this topic refer to Investment strategies- what SMSF trustees must do.

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Note: DBA Lawyers hold SMSF CPD training at venues all around. For more details or to register, visit www.dbanetwork.com.au or call 03 9092 9400.

For more information regarding how DBA Lawyers can assist in your SMSF practice, visit

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