Mr Graham Meyer
Chair
SMSF Working Group
c/- Department of the Treasury
Australian Government
Canberra

Via email: StrongerSuperSMSFs@treasury.gov.au

Dear Mr Meyer,

Issue 1 – Recommendation 8.13 – Acquisition and Disposal of Assets.

Amendment

The proposed amendments will require:
a) where an underlying market exists, all acquisitions and disposal of assets between SMSFs and related parties must be conducted through that market; or
b) where an underlying market does not exist, acquisitions or disposals of assets between related parties must be supported by a valuation from a suitably qualified independent valuer.

Rationale

The Issues paper states at page 2 that "the most common asset transfer that will be affected by paragraph (a) will be listed securities. Currently shares can be transferred to and from a related party off-market without having to engage a broker to buy and sell the shares. Under the proposed amendment, listed securities will have to be sold on and purchased through the market or exchange. These amendments are intended to mitigate the potential risk of transaction date and asset value manipulation to illegally benefit the SMSF or the related party."

Comment 1 – increased transaction costs

The Issues paper states at page 2 that "It is acknowledged that these changes will result in an increase in transaction costs for SMSFs; however these additional costs will only be borne by those who chose to enter into related party transactions."

With respect, one of the main purpose of entering into an offmarket transaction is to reduce transaction costs. The overall effect of the amendment is to eliminate the benefits to members of reduced transaction costs. Increased costs results in lower benefits for members and "weaker super".

In the absence of **widespread evidence of systematic abuse** it follows that this proposed amendment is attempting to fix something that isn't broken. Tinkering, if you will, for the sake of addressing theoretical possibilities of abuse rather than practical issues of abuse.

Comment 2 – increased compliance and administration costs

If the reform is enacted, then trustees will be required to open broker accounts, and spend numerous hours complying with significant identification, AML/CTF, and other administrative requirements. The delays involved in opening a broker account can often run to several weeks. Brokers will often seek to undertake a sales pitch under the guise of "know your client". Now that a broking account is open, audit costs can be expected to increase on an ongoing basis because there is yet another set of statements for auditors to investigate for 'unreported' transactions.

The delays associated with giving effect to the transaction can be significant (weeks) and result in significant changes in market price. Even where the delays are relatively small, significant changes in market price can still occur, disadvantaging the fund and its members, and their benefits.

Comment 3 – undermines self management

Since an SMSF can only deal through an underlying market through a broker and/or financial planner, the amendments itself undermines the notion of self management. The SMSF will be requiredto open an account at a broker, and the SMSF will invariably be required to divulge a range of personal and other information to that broker in order to transaction under, supposed, 'know you client' rules. This is a practical reality of sales pitches and information fishing disguised as a quasi regulatory requirement. I have to put up with it all the time, and it's extremely annoying and frustrating.

Brokers will invariably use this information to , the amendment undermines the very nature of a "self managed" scheme, ie. keeping middle men to a minimum.

Comment 4 – Conflict with ASX business rule 2.2.4(3)(b)

<u>**ASX business rules prohibit related party transactions where there is no change in beneficial ownership.**</u> The proposed change of requiring these transactions to take place on an exchange therefore cannot be implemented at all under current business rules, or only with difficulty and substantial additional administrative compliance of proving that there is no intention to mislead the market.

The type of transaction which is envisaged will be transferred to ASX cannot be easily implemented on such a market. Therefore, the practical effect of the proposed change will be to ban inhouse acquisitions from members and force funds to accept the increased costs of dealing on-market instead of enjoying the cost benefits of dealing off-market without brokers and other middle-men.

Although there are some circumstances where the business rules might permit such a transaction to occur, Brokers generally regard related party transactions where there is no change in beneficial ownership as something to be avoided. If you doubt this, I suggest you anonymously ring a few brokers and ask them what their view is. Speak to advisers at the coal face and watch them twitch!

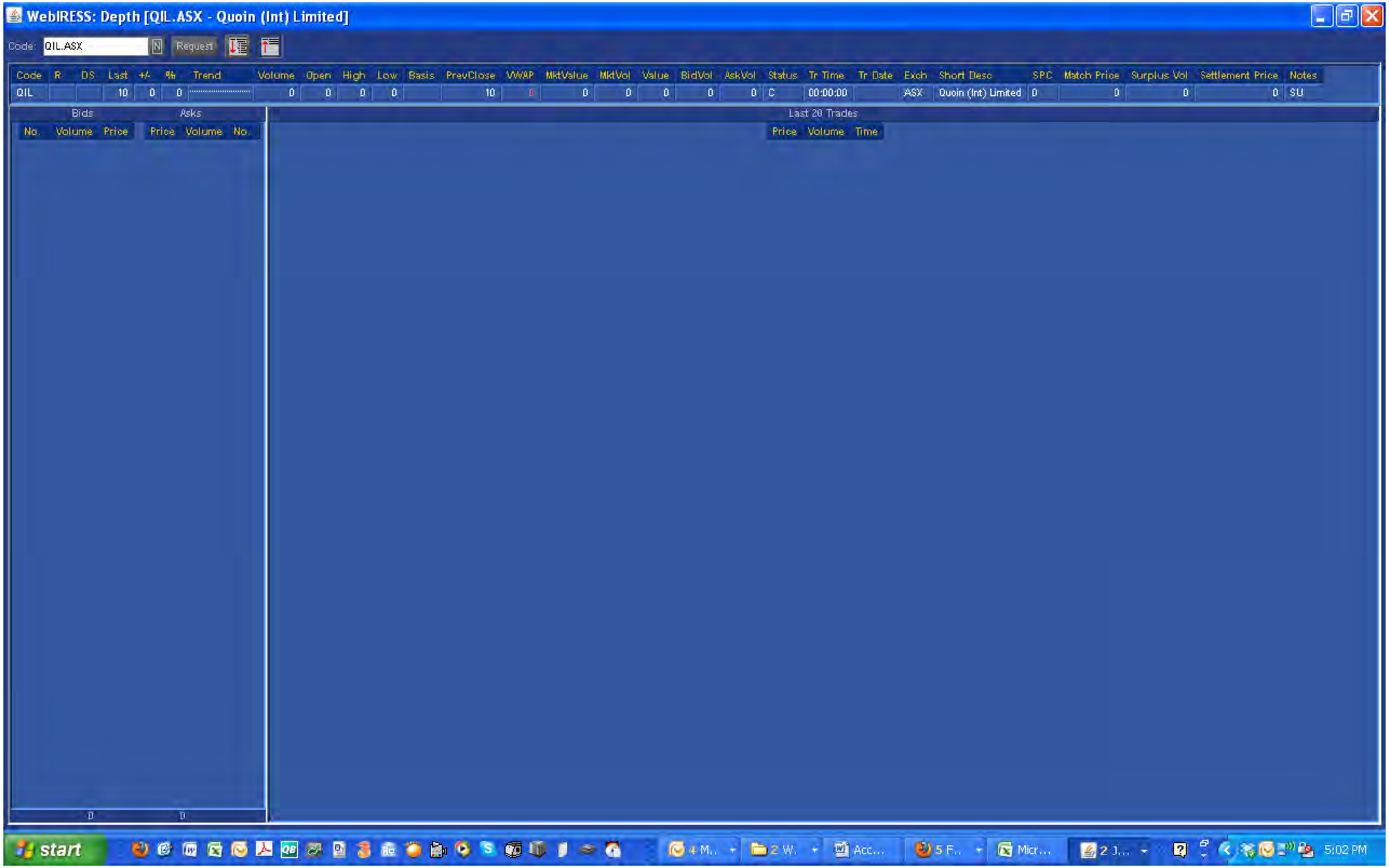
Therefore, the practical effect of the proposed amendment will be to prohibit this type of in-house asset acquisition and directly conflicts with the government's stated policy of allowing them to continue.

Comment 5 – Interaction with Corporations Act 2001 (Cth) sections 1041A, 1041B, or 1041C.

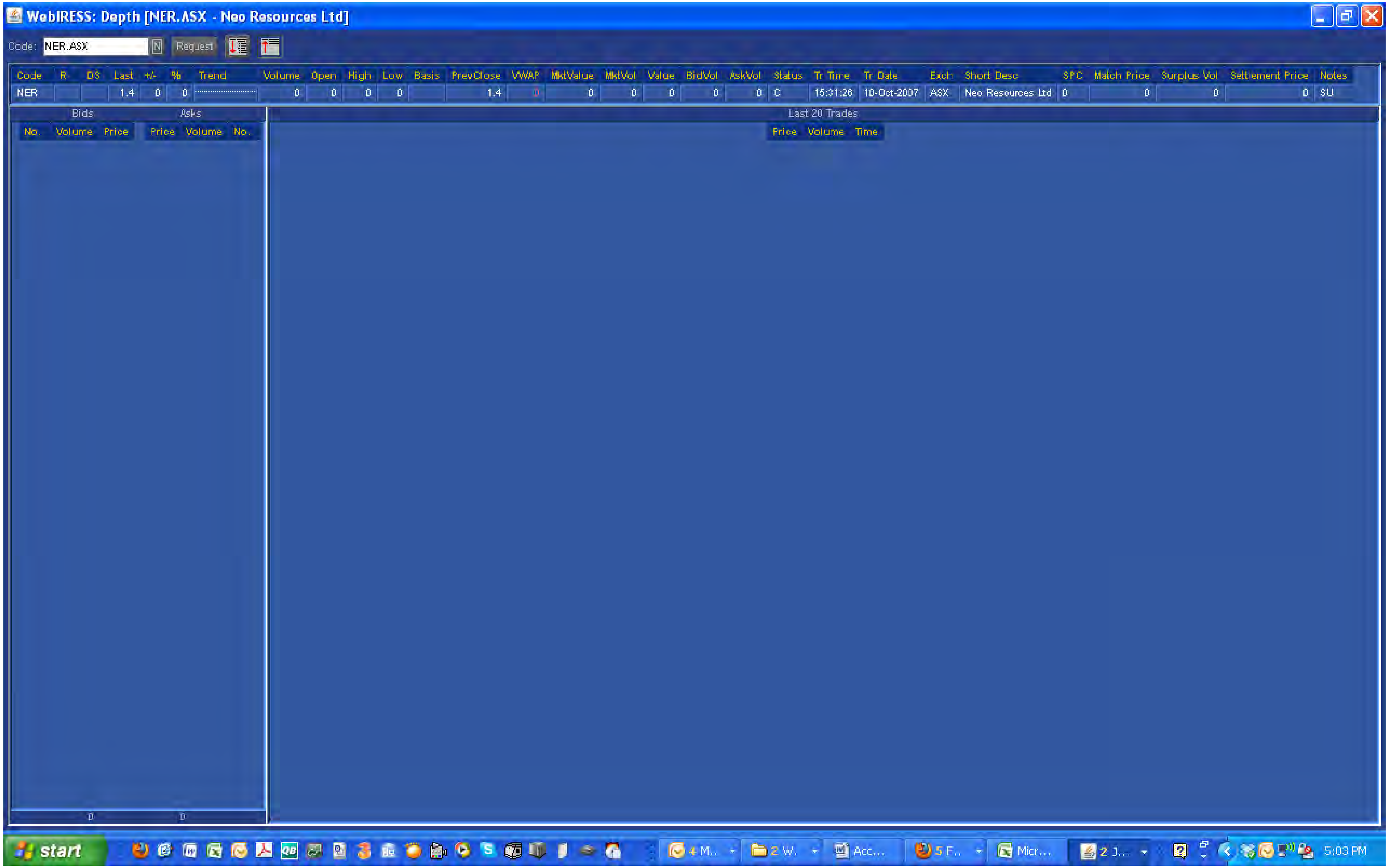
Sections 1041A through 1041C of the Corporations Act 2001 (Cth) ('Corporations Act') prohibit trading on a public market where an 'artificial price' (an undefined expression) is created or maintained. The price between a member and the member's fund is inherently artificial in the relevant sense. Therefore, the proposal appears to promote a breach of the Corporations Act or, at the least, will require additional amendments to the Corporations Act to be workable.

Apart from the issues of legal construction of the sections, there are practical issues with establishing whether a price is artificial or not. The market for many listed shared is 'highly illiquid'. It may be impossible to know with any certainty what the true market price is. Very often it is accepted that the 'last sale price' reflects the last arms' length transaction but this is not necessarily the case. The 'last sale price' may not reflect a true market price where there has been a significant lapse of time between the date of the last market sale and the date of the proposed transaction between the fund and its member, or where there are new events unfolding which could have a material affect on market prices (even though no shares have yet traded).

An example of this is the stock QIL. The last traded price was 10 cents. However, there are no bids and no offers. What, then, is the 'market price'?


WebIRESS: Depth [QIL.ASX - Quoin (Int) Limited]
Code: QIL.ASX
N
Request
Code R DS Last +/- % Trend Volume Open High Low Basis PrevClose VWAP MktValue MktVol Value BidVol AskVol Status Tr Time Tr Date Exch Short Desc SPC Match Price Surplus Vol Settlement Price Notes
QIL 10 0 0 0 0 0 0 10 0 0 0 0 0 0 C 00:00:00 ASX Quoin (Int) Limited 0 0 0 0 SU
Bids
Asks
No. Volume Price
Price Volume No.
Last 20 Trades
Price Volume Time
0
0
start
5:02 PM

How could a member transfer their shares into their super fund without breaching the ASX Business Rules or Corporations Act? See also the stock NER (below) which also has no buyers or sellers in the market.


WebIRESS: Depth [NER.ASX - Neo Resources Ltd]
Code: NER.ASX
Request
Code R DS Last +/- % Trend Volume Open High Low Basis PrevClose VWAP MktValue MktVol Value BidVol AskVol Status Tr Time Tr Date Exch Short Desc SPC Match Price Surplus Vol Settlement Price Notes
NER 1.4 0 0 0 0 0 0 1.4 0 0 0 0 0 0 C 15:31:26 10-Oct-2007 ASX Neo Resources Ltd 0 0 0 0 SU
Bids
Asks
No. Volume Price
Price Volume No.
Last 20 Trades
Price Volume Time
start
5:03 PM

Now consider a 'small cap' stock such as IMF. The last traded price was 163 cents, but the highest bidder is only 155.5 cents. If a seller was trying to 'immediately' sell 100,000 shares (at 'best' or 'market' order), then prices as low as 120 cents would need to be accepted and, even then, there order would be unfulfilled. Similarly, if a buyer was trying to 'immediately' buy (again an order at 'best' or 'market') 100,000 shares then prices as high as 179 would have to be paid. In short, for this hypothetical transaction of buying 100,000 shares by a fund from its member, the "market" price appears to be anywhere between 120 and 179 cents – a range of 60 cents, or 36% of the last traded price.

For example, a member has 300,000 shares in IMF. The last traded price is $1.63. The member wishes to sell at a low price to minimise their capital gains tax. The super fund puts an order in the market for 239,000 shares at $1.46. The member places their shares in the market at an offer price of $1.46. This order would be matched against the existing buy orders at 1.46 or above, and a total of 61,000 shares would be purchased from the 'market', However, the remaining 239,000 shares would be purchased from the member at the 'market price' of $1.46. The member as avoided CGT on approximately $40,000 on this example.

WebIRESS: Depth [IMF.ASX - IMF (Australia) Ltd]

Code: IMF.ASX N Request

Code	R	DS	Last	+/-	%	Trend	Volume	Open	High	Low	Basis	PrevClose	VWAP	MktValue	MktVol	Value	BidVol	AskVol	Status	Tr Time	Tr Date	Exch	Short Desc	SPC	Match Price	Surplus Vol	Settlement Price	Notes
IMF			163	3.5	2.19		2,000	159.5	163	159.5		159.5	159.827	3,197	2,000	3,197	5,700	6,150	C	12:08:15	31-May-2011	ASX	IMF (Australia) Ltd	0	0	0	0	

Bids			Asks		
No.	Volume	Price	Price	Volume	No.
1	5700	155.5	162.5	6150	1
2	19495	155	163	7145	1
1	6000	153	164	22400	1
1	10000	152	165	30150	2
1	10000	151	168	6600	1
1	10000	150	170	500	1
2	10050	145	172	3000	1
2	5000	140	174	3500	1
1	1000	135	175	14000	1
1	15000	130	177	2075	1
1	1300	122	179	34710	4
1	8300	120	180	13743	3
			193	3750	1
			205	4895	1
	101,845			152,618	

Last 20 Trades

Price	Volume	Time
163	187	12:08:15
159.5	1,813	12:08:15

start 4 M... 2 W... Acc... 5 F... Micr... 2 J... 5:05 PM

It is a trivial matter to construct a scenario where the member places their shares on offer at $1.80, and the fund purchases all shares from other market participants up to the price of $1.80 in order to buy from the member at an artificially high price.

I suggest when thinking about how the proposed rule will work in relation to one of the well known top 100 stocks in the ASX200, but one rather think about how this will be implemented in relation to small companies whose shares are thinly traded. While the above examples are 'obvious' and contrived, they highlight the important principle that transaction 'on market' is not the panacea that it is perceived to be for the putative abuse.

Even if one were to adopt the last sale price of 1.63, and attempt to create a market deal which operated at the last sale price, there is a very real risk that the parties could be artificially maintaining that price and thereby breaching Corporations Act s1041A(d).

Put simply, otherwise honest and law abiding funds and members who are trying to obtain the legitimate benefit of avoiding transaction costs and dealing with their fund in a fair and equitable manner may be exposed to a minefield of regulation including the potential for prosecution under sections 1041A through 1041C for potentially creating a 'false market' because they created an artificial price, or maintained a price artificially, on a traded market which they were forced to use by the proposed amendment. This is, simply, an unacceptable consequence of the proposed solution.

Comment 6 – Abuses created by the proposed regime

The foregoing examples were designed to show how prices might be seen to be artificially created or maintained, and they are contrived in their nature and extent. Nevertheless, they demonstrate not only how difficult it will be for members and funds to legitimate transaction with each other under the proposed regime, but the **potential for even greater price manipulation and fraud** that could occur by forcing these transactions on market.

SOLUTION – REQUIREMENT TO LODGE OFF-MARKET TRANSFERS ON A TIMELY BASIS

There did not appear to be any evidence in the issues paper of any actual widespread abuse. Therefore, the goal is simply to improve the integrity of the system from an academic and hypothetical perspective. In light of the serious costs and regulatory and other problems highlighted, it begs the question of whether the solution to the perceived problem is simply a bureaucratic pyrrhic victory.

However, if the committee is determined to propose a solution to this putative problem, then I suggest a simpler one, namely timely registration of off-market transfers.

In order to abuse a related party acquisition in the manner hypothesised by the issues paper, there must be a passing of time between the date on which the transaction is said to have taken place (the date on written on the transfer form) and that date on which the form was completed (the true date of the transfer). Without an elapse of time, the existing requirement to deal with each other at arms length prices creates no window for abuse. By closing or severely restricting the window of time, and requiring the fund to keep records of market price at the time of the transaction, the putative abuse can also be limited WITHOUT the increased costs, administrative burdens, and regulatory compliance problems of forcing these transaction into the open market.

When one realises that the settlement of shares in an off-market transaction takes place by completing an off-market transfer form and submitting that form to the relevant share registry, then the objective of the amendment can be substantially met by requiring the SMSF to lodge a related party transaction transfer form at the registry within a specified period of time, eg. 5-10 business days. This prevents backdating of transactions and the selection of a date which has a beneficial price associated with it.

Furthermore, by requiring evidence of market prices that are contemporaneous with the transaction to be retained, the possibility of abuse through price manipulation is also minimised. This compliance can be as simple as printing out a page from the ASX website on a particular day. By comparison, the compliance burden imposed with the forcing transactions on market is significantly higher.

SUMMARY

The objective of the amendment can be achieved through different means, namely timely lodgement of off-market transfers, without forcing increased costs onto SMSFs. Furthermore, there are a range of complex regulatory issues associated with complying with ASX Business Rules and the Corporations Act 2001 (Cth) which indicate that the proposed 'market' solution is unworkable and has not been properly thought through. The proposed SIS amendment may require additional amendments to other legislation to be negotiated with regulators responsible for that legislation, as well as changes to private rules having regulatory effect.

One is left wondering whether the cure is worse than the problem.

Regards,

Bradley Maguire, BSc BCom LLB GDLP
Barrister and Solicitor of the Supreme Court of Western Australia