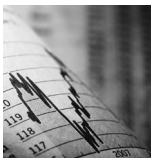
TAMIM

SMSF Investment Strategy
Explanatory Document



S52(2)(f) of the Superannuation Industry (Supervision) Act 1993 Regulations (SISR) requires the Trustee of a Self Managed Super Fund (SMSF) to maintain a current Investment Strategy. Tamim Asset Management is not authorised to produce investment strategies for its clients. An Investment Strategy must be prepared by the Trustees, who may seek professional advice in the preparation of the strategy. This explanatory document is intended as a guide only to assist Trustees in the development of the Investment Strategy. This pro-forma Investment Strategy is written in such a way that it can be used by the Trustee of a SMSF to develop their own strategy for their fund. However, it is only a guide and we would encourage you to add to it to take into account the particular aspects of your fund.

What is an Investment Strategy?

An Investment Strategy is a detailed financial plan made by the Trustees of a SMSF based on consideration of the sole purpose of the fund. It takes into account the current and/or future financial needs of each of the fund members and is framed in the context of their risk preferences.

Why should we have an Investment Strategy?

A SMSF is a form of Trust. It operates under a variety of Governing Rules including a Trust Deed and SIS legislation.

The cornerstone to the SIS legislation is that a SMSF must exist for the sole purpose of providing retirement or death benefits. Much of the legislation is built around this purpose including the covenant contained in s52(2)(f) which requires the Trustee:

to formulate and give effect to an investment strategy that has regard to the whole of the circumstances of the entity.

The logic behind this covenant is that the Trustees of the SMSF have the responsibility for running the fund on behalf of the fund members. In order for the ATO to be satisfied that the Trustees are operating in accordance with this sole purpose, there needs to be something to show that the Trustees have considered the member specific circumstances and have formed a plan on how they will manage the investments in order to meet the sole purpose.

The ATO treats the Investment Strategy with significant importance and it is likely to be one of the first documents requested should an audit be undertaken. Other benefits of an Investment Strategy are:

- Member specific risk and return expectations are established providing a clear framework for the Trustee to make investments and monitor results;
- It may reduce the potential for making rash and risky investments;
- Trustees can engage professional assistance from investment advisers and use the document to establish a framework for the investment adviser to use when making investment recommendations;
- The Trustees have greater surety that investment advisers truly understand and operate in their best interests.

Contravention and non-compliance

Contravention of the Covenant in s52(2)(f) is not an offence and does not result in the invalidity of a transaction.

However, the ATO indicates in several of their publications that the existence of a valid and current Investment Strategy is an important factor when testing the Trustees compliance with the sole purpose test. If the ATO determines the fund is non-complying, you risk:

- Losing the tax concessions;
- Disqualification as a trustee;
- Prosecution and/or penalties;
- All of the assets held within the fund being taxed at the top marginal personal tax rate.

When should we formulate and review our Investment Strategy?

The Trustee should formulate the Investment Strategy upon establishment of the SMSF. The Investment Strategy precedes the investment decisions. By its very nature, decisions should be made that fit within the strategy; the strategy should not be set to fit with current investments.

Every time the Trustees contemplate an investment decision, they should refer to the Investment Strategy to ensure it will align. The strategy should not necessarily be restrictive on the Trustee, moreover it is something that can and should be revised at any time and on a regular basis to reflect changing circumstances.

Examples of times where it is wise to review and if necessary, update the Investment Strategy include:

Identification and intent to invest in a specific investment opportunity that does not fit with the current strategy;

- Change in risk tolerance of the member(s);
- Change in financial needs or expectations of the member(s) over time;
- Adding a new member to the fund;
- Commencement of a pension for a member (likely to require higher cash liquidity);
- Death or change in health of a member;
- Marriage breakdown;
- Change in SIS legislation regarding permitted investments.

Key Aspects of the Investment Strategy

The investment strategy must have regard to the whole of the circumstances of the fund including:

- Risk tolerance in making, holding and realising investments;
- Minimum and desired rate of return;
- Asset allocation and diversity;
- Liquidity having regard to anticipated cash flow requirements;
- The ability of the fund to discharge existing and future liabilities.

Trustee Responsibilities

Trustees need to consider the risk involved in transacting within a SMSF and review and monitor the returns on their investments. They should look at historical and projected returns to determine if they will meet their overall fund objectives.

One of the key roles is determining the underlying assets you wish to invest in. When considering these assets, Trustees need to ensure they are allowable under SIS legislation, and that they demonstrate appropriate diversity in their asset selection.

SIS Act Requirements Bind Trustees to:

- Act honestly in all matters concerning the fund;
- Exercise the same degree of care, skill and diligence as an ordinary prudent person in managing the fund;
- Act in the best interest of all fund beneficiaries;
- Keep the money and assets of the fund separate from other money and assets (for example, your personal assets);
- Retain control over the fund;
- Not enter into contracts or behave in a way that hinders Trustees from performing or exercising their functions or powers;
- Allow members to access certain information; and
- Develop and implement an investment strategy.

Trustees should implement a due diligence process, promoting well thought-out and responsible decision making. This also protects the Trustee from action by members if the investments turn out to be disastrous.

Prohibited Investments

Trustees must ensure the investment strategy complies with SIS legislation, and the SMSF trust deed.

When formulating the Investment Strategy, Trustees need to ensure:

- They do not make loans to members or their relatives;
- The investments are on an arm's length basis;
- They do not breach the in-house asset rules;
- They observe the restrictions on acquiring assets from related parties;
- They do not grant security, mortgage or other charge over any assets of the fund;
- They do not borrow money; (unless following the rules found in s67A & s67B of SISA);
- They comply with the sole purpose test.

The Audit Process

Every SMSF is required to appoint an independent Auditor to audit the fund's activity each financial year. The Auditor will review the investments by the Trustees to ensure they are consistent with the Investment Strategy.

If the Investments do not align to the Investment Strategy, the Auditor will report this as a breach of the Covenant contained in s52(2)(f). Whilst the contravention is not in itself an offence, it can potentially draw attention to your SMSF with the possibility of a detailed ATO audit being conducted at considerable expense.

Insurance

One of the recommendations to come out of the federal governments Cooper Review is the requirement that trustees of an SMSF consider insurance of its members as part of its Investment Strategy. Whilst at this stage this requirement is purely a recommendation and not law, Tamim Asset Management strongly suggests you consider insurance and seek advice if appropriate.

Preparing the Investment Strategy

Attached with this document is a pro-forma Investment Strategy that you can use to prepare your own strategy. Alternatively, you can utilise one prepared by an Investment Adviser.

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