



SMSF Investment Decision Tree 2025-26

To achieve your superannuation goals a disciplined approach to investment is required. This approach must also ensure that your investment decisions satisfy the prudential investment requirements of the SIS Act. The following step-by-step approach and Decision Tree outlines the prudential investment requirements of the SIS Act in a manner which is easy to understand and apply when considering a particular investment decision.

1 Investment Power within Trust Deed

The Governing Rules of each superannuation fund will have a provision specifying the types of investments in which the Trustee can invest. Previously, these investment provisions included a long list of particular types of investments and the issue was whether the proposed investment was on the list.

The modern approach is for investment provisions to authorise the Trustee to invest the Fund in any manner the Trustee considers appropriate.

Before any particular type of investment is contemplated the Trustee must confirm that the investment provision permits the particular type of investment.

If the proposed investment is not permitted by the investment power, the Trustee must either:

- (a) reject the proposed investment; or
- (b) consider amending the investment provision so that the proposed investment is expressly authorised.

2 Consistency with Investment Strategy

Every self managed superannuation fund must have a written investment strategy providing a framework for the investment decision-making of the Trustee. Any proposed investment must be consistent with the current investment strategy of the Fund.

If the proposed investment is not consistent with the current investment strategy, the Trustee must either:

- (a) revise the investment strategy; or
- (b) reject the proposed investment.

3 The Merit of the Proposed Investment

The proposed investment must be able to be justified having regard to general investment criteria. Justification may be straightforward for common investments in large managed investment schemes, pooled superannuation trusts or in blue chip shares.

Justification of specific investments (eg particular shares, real estate etc) or uncommon types of investments (eg collectibles, art works etc) will require the application of the investment criteria to ensure the investment complies with the investment strategy.

Such investment criteria could include:

- (a) likely income flow and capital return of the investment;
- (b) likely acquisition, holding and disposal costs of the investment;

- (c) depth and breadth of any secondary market for the proposed investment; and
- (d) risk assessment.

4 Consistency with Expected Cash Flows

The Trustee will have to consider whether making and retaining the proposed investment is consistent with the Fund's expected liquidity and cash flow requirements; eg to pay benefits or tax liabilities.

In particular, acquiring an illiquid investment at or near a time when benefits are likely to be paid may not be justifiable if those benefits cannot be readily paid by cash on hand or by selling liquid assets.

5 Is the Investment a Derivative?

If the investment is a derivative and, in relation to the derivative, a charge over Fund assets is required to be given by the rules of the relevant approved derivatives exchange, the investment must be made in accordance with the Fund's written derivatives risk statement.

If the proposed investment is not in accordance with the derivatives risk statement then either the statement must be reconsidered or the proposed investment rejected.

6 Does the Proposed Investment Satisfy the Sole Purpose Test?

The sole purpose test is a requirement of the SIS Act and applies to all superannuation funds regulated under the SIS Act.

Essentially, the test requires that the Trustee maintain the superannuation fund solely for one or more specified purposes. The common element of the specified purposes is the provision of individual financial benefits - whether as lump sums or income streams - upon retirement, attaining age 65, death or disablement and certain similar events.

This test prevents superannuation funds from providing non-superannuation benefits to members or using the Fund to provide benefits to third parties.

More...

7 Will the Investment Give Rise to a Charge Over Fund Assets?

The Trustee must not give a charge (eg mortgage) over the assets of the Fund.

However, there are two permitted exceptions to this general *SIS Act* rule.

The first exception relates to charges arising from certain derivatives transactions (refer Section 5 above).

The second exception applies to mortgages of an asset acquired as part of a limited recourse borrowing arrangement under s.67A of the *SIS Act*.

8 Arm's-Length Terms

The Trustee of a superannuation fund must only invest on arm's-length terms.

This *SIS Act* requirement does not preclude a Trustee from investing in or with a related party (though other *SIS Act* requirements may apply, given the particular circumstances) so long as the terms of the proposed investment are arm's length.

9 Lending/Financial Assistance to Members

The Trustee must not loan money to a member (or a relative of a member) or provide any other form of financial assistance to a member (or a relative of a member).

It is irrelevant that the terms of the loan or financial assistance are arm's length (or even advantageous to the superannuation fund) or that security is granted for the loan or financial assistance.

If the proposed investment breaches this *SIS Act* requirement, the Trustee must reject the investment.

10 Does the Investment Involve a Borrowing?

It is a requirement of the *SIS Act* that the Trustee of a *SIS* regulated superannuation fund must not borrow. In relation to superannuation funds, there is one significant exception to this general requirement which is relevant to investments - the limited recourse borrowing exception.

(While there are other exceptions they either do not relate to investments or relate only to temporary borrowings to cover settlement transactions).

The geared investment exception permits a superannuation fund to borrow in order to acquire an asset in the circumstances contemplated by section 67A of the *SIS Act*. There are very special rules in relation to such investments and these must be strictly followed.

--

The Decision Tree and commentary has been prepared only for SMSFs and is not a substitute for professional advice. It has been provided to give SMSF Trustees a broad overview of the prudential regulation of superannuation investment having regard to the investment provisions of the *Superannuation Industry (Supervision) Act, 1993* (the "*SIS Act*") as they apply to SMSFs. The Decision Tree and commentary is not and is not intended to be either legal advice or financial product advice. The Decision Tree and commentary was prepared as at July 2015.

11 Related Party Acquisitions

The Trustee of a superannuation fund must not acquire assets from related parties. Related parties include members of the Fund and their associates.

However, this *SIS Act* requirement is subject to a number of exceptions.

The main exceptions to this rule are:

- > listed securities acquired at market value;
- > business real estate acquired at market value; and
- > certain in-house assets - as long as the in-house asset rules are not breached (see point 12 following).

12 Is the Investment an In-House Asset?

It is a requirement of the *SIS Act* that a Trustee must not acquire an in-house asset if the acquisition of that asset would cause the value of in-house assets of the Fund to exceed 5% of the total value of the Fund.

It is also a requirement that a Trustee must not continue to hold in-house assets if at the end of a financial year the value of in-house assets exceeds the 5% limit, in which case the Trustee must devise and implement a strategy (including a divestment strategy) to ensure that the 5% limit is maintained.

In determining the value of in-house assets and the value of the Fund, market values are used and not historical or book values.

So what is an in-house asset? It is any of the following:

- > a loan to a related party,
- > an investment in a related party,
- > an investment in a related trust, or
- > an asset subject to a lease with a related party.

There are two main exceptions to the in-house asset rules. They relate to 'business real property' leased to a related party either directly by the Fund or, indirectly, through a company or unit trust in which the Fund has an interest. The exceptions can be complex so check with us beforehand if you think you might qualify.

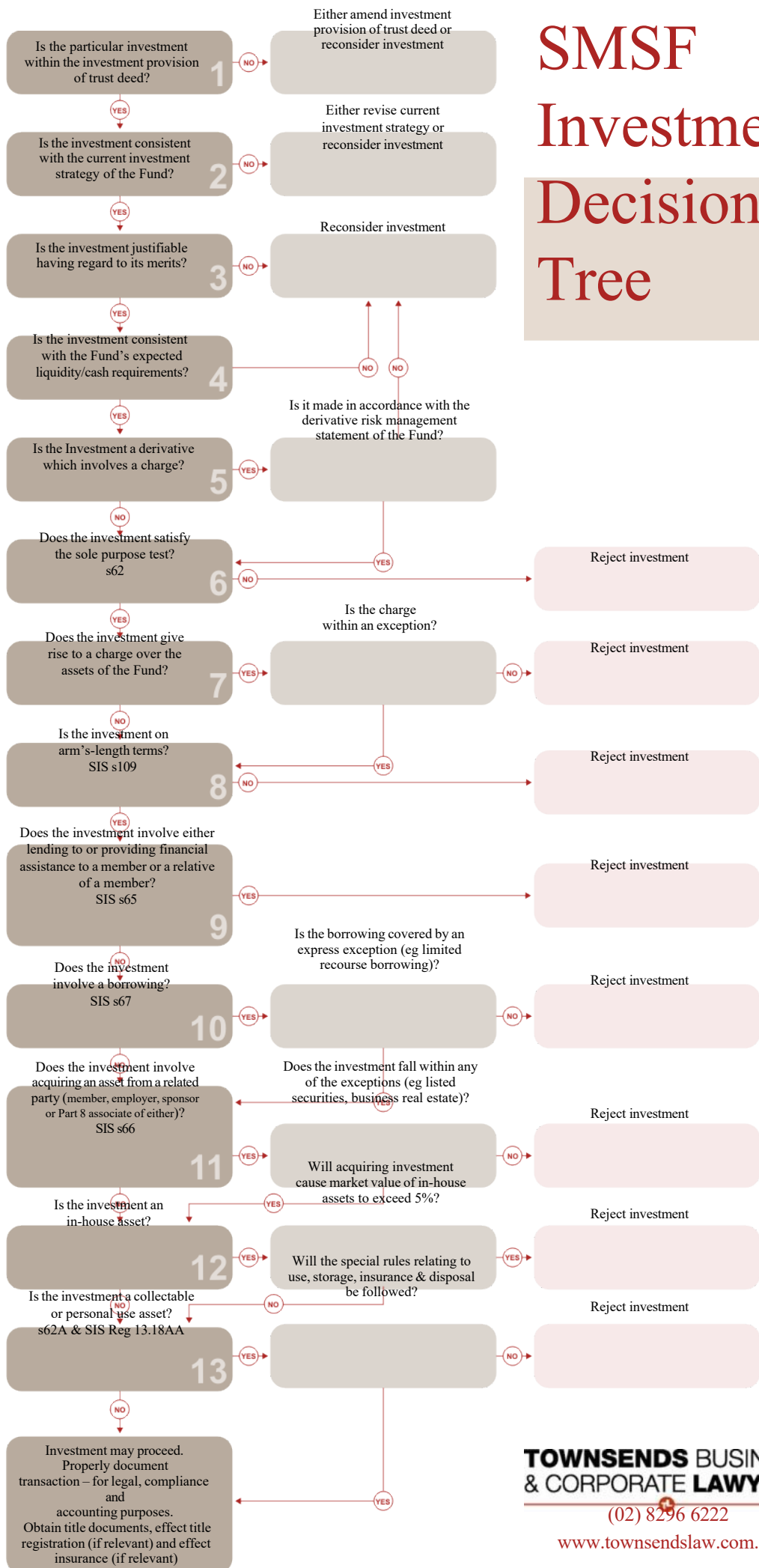
13 Collectables and Personal Use Assets

If the Fund wants to invest in an asset that is a collectable (eg coins, artwork etc) or a personal use asset (eg motor vehicle, jewellery) then special rules must be satisfied as to the storage, use, insurance and disposal of the assets.

The *SIS Regulations* set out what constitutes a "collectable or personal use assets" and the various rules as to storage, use etc.

The Superannuation Division at Townsends Business & Corporate Lawyers have dedicated themselves to understanding the intricate requirements of the SIS Act investment and gearing rules. If you would like more information or assistance, please call Michael Hallinan, Special Counsel Superannuation on (02) 8296 6222.

START



SMSF Investment Decision Tree

TOWNSENDS BUSINESS & CORPORATE LAWYERS

(02) 8296 6222

www.townsendslaw.com.au