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THE SUPER GAME

Timing creates a new challenge for self-starters

Do-it-yourself super can add beneficial cash to the equation, writes **Sara Rich**

FACED with the prospect of another year of negative returns in the public superannuation system, an increasing number of Australians have decided to try their hand at do-it-yourself super.

More than 40,000 people set up a self-managed superannuation fund last year and the number keeps rising, making DIY funds the largest sector by assets in Australia's superannuation system.

While comparative figures for SMSFs are difficult to track down, research into their performance by Peter Townsend of Townsends Business & Corporate Lawyers has found that they are outperforming their public offer counterparts.

Based on anecdotal evidence, he estimates that SMSFs have lost an average of 8 per cent this financial year compared with a drop of 16.54 per cent in super funds' balanced portfolios as of the end of March.

"This is mainly because of the SMSFs' higher percentage of cash and the relatively stronger performance of real estate to that of equities," Townsend says. But the Government, financial advisers and industry bodies are all concerned that many people are going in blindly and don't realise the disastrous consequences, financial as well as legal, that can arise from getting it wrong.

Superannuation Minister Nick Sherry recently revealed that he was concerned about several features of the SMSF sector, "many of which have actually grown more acute as the global financial crisis has hit our shores". Then there is also the issue that anyone who cashed in their superannuation investments in the past six months would have crystallised any losses and will never be able to get that money back from those assets, according to Association of Superannuation Funds of Australia chief executive Pauline Vamos.

She says that even when measured after a serious market crash, the average annual return to members of superannuation funds during the past five years is 6.1 per cent. "These figures will improve as the market recovers. When you take this view, the super industry is still holding up. But super is not immune to the turmoil on world markets," Vamos says.

According to SuperRatings, a sharp rally in Australian and international share markets saw many balanced options recording a 2.24 per cent increase for March.

"In what is a clear lesson to consumers on the risk of trying to time markets, this March mini-rally has surprised many by both its timing and degree," the researcher says. "So, for those who switched at the end of February to cash, their minds must be spinning over just what to do next."

But SMSF Strategies principal Grant Abbott says this isn't the first time people have moved in droves to set up SMSFs.

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A new challenge for self-starters

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"The last time this happened was in 2002-03, when the share market dived 18 per cent and there was a 22 per cent increase in the number of SMSFs," he says.

At the end of last year, there was a 20 per cent increase in the number of SMSFs, coinciding with the release of the year's mostly bleak super returns.

"I would expect this year there will be another sharp increase from September to December because obviously this year's returns are going to be significantly worse than last year's returns," Abbott says.

However, not everyone is cut out to be a SMSF trustee, according to Investment Trends principal Mark Johnston.

"About half of the time when someone goes to their adviser and says, 'I want to set up an SMSF', the adviser talks them out of it," he says.

"The main reasons planners and accountants would tend to talk people out of having an SMSF is either the person doesn't have sufficient funds for it to be viable on a cost basis [or] if they don't think they are organised enough to be a trustee."

"There is a lot of paperwork and you need to make sure everything is up to date and there are minutes for investment decisions."

For this reason, SMSF administrators (specialists who, among other things, assist with a lot of the paperwork) are becoming very popular, but that doesn't mean trustees can put up their feet.

One expert likens the regulatory requirements of a trustee to being a company director.

"So if people aren't seen to be likely to do all that, then sometimes the advisers say: 'Maybe it is not the best structure for you,' " Johnston says.

Although there are no legal requirements about minimum balances, Abbott thinks a minimum of $200,000 would be a good starting point, but adds that on average SMSFs have about $800,000 in assets.

"Bear in mind that even the most basic SMSF is going to cost at least $2000 in terms of fees, audit and administration, so if you take it from there, a good figure to draw a line in the sand is probably about $200,000, which means you are paying around about 1 per cent in fees," Abbott says.

"But there will be instances where a $200,000 fund for a 65-year-old doesn't make sense because they won't be putting further amounts of money into that fund, so as they keep drawing down on it, the percentage of their fees will increase." He warns, however, that being a SMSF trustee isn't just a matter of having the right amount to play with and then choosing a few investments.

Abbott says new trustees are required to sign a declaration that they understand all the superannuation laws and that the trust deed — a document setting out the rules of the fund, which must be drafted before the fund is established — meets their exact requirements.

"I would encourage everyone to have a look at the Australian Taxation Office website before they move in, have a look at what they getting themselves into," he says.

"Even those people who are in an existing SMSF, it is incumbent upon them to really get out and about, and go to the seminars to keep themselves educated."

The latest ATO survey of new SMSF trustees says more than 30 per cent could not provide an explanation of the sole purpose test and 15 per cent did not have an investment strategy.

Townsend says other surveys reveal some trustees don't even know they are trustees, while others who do know are not sure what it entails.

WLM Financial Services managing director Laura Menschik says the Government is coming down hard — and fast — on non-complying SMSFs.

Whereas in the past the ATO took an educational approach to regulating the sector, letting trustees know where they had tripped up and allowing them to rectify it, it now seems to be much stricter.

Under a new audit process, auditors must tell the ATO if a new fund fails to comply with any of the rules, no matter how small the slip-up.

"If a fund is found to be non-compliant, the Government can come back and tax the fund at the highest marginal tax rate, so you could have 45 per cent wiped off your fund, and there are penalties for the trustees that can include jail," Menschik says.

Partners Superannuation Services found that 11.25 per cent of SMSFs are in breach of regulatory requirements, the main violations involving the in-house asset rule, personal loans to members, personal use of assets and the ownership of assets.

There are also serious adequacy implications relating to how much money the investment strategy employed by the SMSF will deliver in retirement.

Multiport technical services director Philip La Greca says one of the clients to whom his company provides SMSF administration services lost 77 per cent last year because of what that client had invested in.

"In that particular occasion that client was very heavily invested in resources," he says.

La Greca asks whether people who set up an SMSF are prepared to wear that responsibility. He believes many people's expectations in terms of returns are unrealistic.

"You talk to an asset consultant or an actuary and they'll talk about long-term performance, but they don't talk about long-term performance as in 12 months, they talk about 20 years," he says.

"They will say what you are looking for is 2 to 3 per cent outperformance over inflation. That's really got to be the aim, 12 per cent is not the norm, and that's where all this has come about," La Greca says.

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