Outsourcing adds to DIY super costs

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The popularity of self-managed superannuation funds continues to grow, with Australian Prudential Regulation Authority (APRA) data showing they now account for almost one-third of all super assets.

This rise has been predominantly at the expense of retail super funds; however, the majority of self-managed super fund (SMSF) investors are now paying their fees, instead, to financial advisers.

A survey by a specialist market research group, Investment Trends, reveals that 55 per cent of investors have sought advice about their SMSF from a financial planner in the past year.

Investment Trends analyst and the author of the *Investment Trends 2010 SMSF Investor Report*, Recep Peker, says the global market downturn has contributed to these outcomes. "What happens in general when there are long bear markets, they realise their existing super has been doing relatively poorly and they notice how much they've been paying in fees and they think, 'I could do the same for cheaper and get better returns,'" Peker says.

Ironically, it has turned into a boon for financial planners, with the survey showing SMSFs now contribute to 27 per cent of their business, with an expectation there will be further growth, he says. "If those expectations are fulfilled, we could soon see SMSF advice becoming a billion-dollar industry for Australia's financial planners."

The NSW state director of the Association of Financial Advisers, Marc Bineham, says consumer awareness of the benefits of SMSFs has been growing and they are an option all investors should consider once their super lump sum reaches $200,000. "People are more aware and more educated and they want more direct control over their investments," Bineham says.

"They can put property in [the SMSF], they can buy direct shares, they've got more flexibility and a lot more investment options. The popularity of SMSFs is going to increase."

The SMSFs are tightly regulated and carry strict audit requirements that can be time-consuming for investors, Bineham says. "Once people realise the duties of being a trustee, they realise they still need education and help to guide them through the legislation and the trustee role."

Bineham says the GFC has provided a catalyst for changing the way investors view the role of financial planners and this aligns well with the ongoing relationship provided through the management of SMSFs.

"In the past, people saw a financial planner's role was to give a certain investment return, whereas that was never really the case - the sharemarkets get the performance," he says.

"What financial planners do is provide advice, strategy and education for their clients to help them retire comfortably. With the SMSF and financial planners that specialise in that area, it's even more of a help."

Bineham says the high administrative and audit costs associated with SMSFs are the reason it is not appropriate for investors until they reach the $200,000 mark and adds that the flat nature of fees means cost benefits improve as the funds continue to grow.

"A lot of the expenses are set fees or hourly rates so as your fund grows and your expenses stay fairly level, the overall fee does come down. You might have $1 million [of assets] and the fee is 1 per cent but if you have $3 million it's 0.33 per cent - that's assuming a maximum fee structure of $10,000, which is probably at the high end," Bineham says.

But Jeff Bresnahan, from independent rating agency SuperRatings, argues the level at which expenses of SMSFs becomes competitive with mainstream funds is closer to $400,000.

"SMSFs are normally more expensive than mainstream super funds up to about $400,000 - and that's a little-known fact," Bresnahan says.

He says the SMSFs that primarily invest in cash and managed funds will almost always be more expensive.

"A lot of people set up SMSFs and then, through their adviser, go and buy managed funds and I can't work out the logic of it - they're paying retail rates for funds they can access on a wholesales basis through a mainstream super fund," he says. "A lot of SMSFs run at about 1 per cent in terms of administration costs, then you've got investment costs on top of that. Investment costs in SMSFs are often hidden or not directly identifiable, particularly if you've got direct shares.

"And if you went into managed funds through SMSFs, that might cost you 1.2 per cent, so your total cost of running that SMSF is around 2.2 per cent. A mainstream super fund will cost anything from 0.4 per cent to 2 per cent and you'll be able to get access to the same managed funds through mainstream super."

Bresnahan says the hidden costs make it difficult to compare the performance of SMSFs with that of mainstream funds.

"How are you going to measure your own performance over the medium to long term? If an individual or a financial planner thinks they can outperform a mainstream or professional investment manager over the long term, they are deluding themselves."

Bresnahan says SMSFs can also be difficult to wind up, both for regulatory and personal reasons.

"The level of wind-up is very low and you can't convince me that people are 100 per cent confident and that they're benefiting from the establishment of the SMSF," he says. "It's a complex process to wind up. One of the key reasons is, when you set it up it's sold on the premise you can do it better yourself.

"The old DIY thing - you can build a deck out the back cheaper than the carpenter can do it, so we all rush out and make this deck and three-quarters of the way through realise we've stuffed it up. So if the SMSF doesn't work, it's very hard to admit to yourself that you're wrong - you persevere with this thing for a lot longer than you should."

Bresnahan says investors need to think carefully about whether the structure is suitable for their circumstances.

"SMSFs are really good structures for self-employed people, people who want to hold unusual asset classes in super funds and for people who are financially literate and have a lot of time to manage investments," he says. "They are not appropriate for people who are financially illiterate - which is a lot of people - and people who just don't have any time on their hands."