Is DIY super right for you?

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Challenger's Jeremy Cooper. **Photo: Glenn Hunt**

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The trustees of Australia's 450,0000 do-it-yourself superannuation funds, taking charge of their futures, are hell-bent on creating nest eggs sufficient for long, happy retirements.

But the funds – now the largest sector in the $1.2 trillion super market – are entering a new era and within five years are likely to be operating in an entirely different environment.

Anyone starting a DIY fund, says Graeme Colley of the OnePath financial group, should be aware that extra responsibilities will apply as a result of significant reform.

If you want to join the 860,000 people who have started a DIY fund, it will pay to understand those responsibilities and avoid wasting time and effort setting up a fund only to find it does not meet expectations.

PlanWealth's Darren Kingdon. **Photo: Glenn Hunt**

In the years to come, because of strict annual caps investors will have less opportunity to accumulate super with tax concessions. That will provide a greater impetus to get investments right. There will be a lot more scrutiny of DIY investing. That scrutiny will come from government, regulators and the auditors of funds.

However, the rewards from successful DIY investing will still exist for those with enough assets and energy to make a DIY fund work in their favour. Our special questionnaire should help you decide whether you have the mettle to join the army of investors who have opted out of the traditional super system.

DIY trustees have always had serious responsibilities, including the following:

They are required to concentrate investments on saving for retirement, avoiding any that provide side benefits for members or relatives, such as loans.

Proper record-keeping is a must to ensure all investments are kept separate and fund reporting responsibilities are met.

Trustees must know all the rules for making super contributions or paying a pension.

It is critical to know how to select and deal with service providers.

These fundamentals are essential because DIY super is going to become even more challenging – for a host of reasons, many of which will have a positive impact on the sector.

Advisers involved in DIY super, such as accountants, administrators and financial planners, should, in the future, be more specialised as a result of the impending reforms.

This, in turn, should allow those with DIY funds to confront the greatest regret that many with super face when they reach retirement: that their super nest egg isn't bigger.

A recent survey of retirees and those near retirement, by research company Investment Trends, found that almost half wished they'd saved more during their working life.

When asked what they'd change if they could start their working life again, they picked making extra super contributions, saving earlier and saving more consistently through super as their major choices.

"If I was getting into serious super saving today, I'd prefer to be younger than those [who] have done so in the past," Colley says.

Although the average DIY super fund has investments of just under $1 million, they represent only a quarter of all funds, Another quarter have balances of less than $200,000.

While future generations will benefit from the government's plan to raise compulsory super from 9 per cent to 12 per cent of wages over the next few years, they won't be able to make as many voluntary contributions as previous generations as a result of the strict annual caps on deposits.

So most of us will only retire with decent super if we not only combine compulsory super with extra contributions but also manage these savings carefully, says Jeremy Cooper, chairman of the retirement income division of financial services group Challenger.

Whether your super is accumulated though an industry fund, a do-it-yourself fund, a retail fund or a public sector fund, these basic facts apply, says Cooper, who chaired the Rudd government's review into the super system.

Australia is lucky, Cooper says, in the sense that we have a lot of choices, when it comes to retirement saving, that don't exist in other countries.

This is a plus – but there is also scope for those who exercise choice to muck things up – although Cooper questions whether fears about this risk, when it comes to DIY funds, are as justified as some critics suggest.

There is actually not a lot of hard evidence that people who go into DIY super blow themselves up, he says. The worst thing some do, he suggests, is miss opportunities to enjoy better retirement income.

Still, having a DIY fund is not easy. The most effective super, as a general rule, is very likely enjoyed by those who either work for an employer with a strong superannuation tradition, generally a government organisation, or for a firm that encourages its employees to sacrifice salary into super.

With super, what matters most is starting to make voluntary contributions early; taking advantage of any tax concessions; and allowing investment returns to compound in a low-fee environment.

The chance to be more personally engaged with super is available to everyone, no matter what type of fund they choose. It's just more obvious when setting up a DIY fund.

Being able to control your investments; the tax concessions associated with super; and the fees for other funds are all reasons given for having a DIY fund.

But these reasons are only valid if they are used in an effective way. If the member-trustees of a DIY fund, with or without the help of an adviser, can't achieve this, the money would be better off saved in a standard super fund.

There are a host of reasons given why you should have a DIY fund, quite often by organisations with a vested interest in encouraging clients to hold such a fund. Likewise, big super funds may proffer reasons why DIY super is a bad option, to encourage members to stick with their services.

Whichever is the better option, says Darren Kingdon, of Brisbane financial planning firm PlanWealth, is likely to be an individual decision, one that is influenced by various considerations.

Managing a DIY fund takes time, knowledge, skill and money. So before deciding to set one up, it's important to understand the costs and benefits of this form of super fund over other forms.

You need to know what is involved in managing a DIY fund, with particular emphasis on the legal obligations and

responsibilities, given you can face severe fines if you do the wrong thing – even if it is with your own money.

Cooper says that while control over aspects such as investments and tax are possible reasons why some choose DIY super over traditional super, a major factor in the uptake of the funds is the role of accountants and financial advisers.

Many accountants suggest a DIY fund for a client because of the tax efficiency or the potential for small business people to invest in the real estate from which their enterprise is run.

Cooper is not entirely convinced that this is the correct starting logic for having a DIY fund, but does note that the sector does seem to work and also acknowledges that there are a substantial number of DIY fund members who are heavily engaged in their super.

A potential problem for those with DIY funds, which is not shared by those who belong to other funds, is a clean exit path when the time comes to fold a fund.

Cooper says that people often get into DIY super in their 40s and 50s when their interest in financial matters is possibly at a peak.

They thrive on the financial decision making that is often involved in the operation of a DIY fund, but that interest inevitably wanes over time, particularly in old age as their savings start to dwindle.

So there comes a time when it may be appropriate to exit a DIY fund and switch any capital to an alternative vehicle. Indeed, an alternative vehicle may even be the best one for some people from the outset.

Financial planner Peter Crump, of Portfolio Planning Solutions, says that anyone considering establishing a DIY fund for reasons such as increased investment control should note that there are other options that offer similar attractions.

While investing in direct property is only allowable for DIY funds, a number of big public-offer funds will allow their members to hold direct shares, rather than restrict them to the pooled investments used by the majority of members.

And, after all, there is not much difference between the tax benefits of DIY super versus that of ordinary super.

There are some extra tax attractions, especially when people retire and start drawing a pension from their savings, but these are not necessarily sufficient to make joining a DIY fund a no-brainer.

The choice is yours.

TAKE OUR TEST

I'd like to start a DIY fund to control my investments

On its own, this reason is weak, as investing is not easy. A better answer, which indicates you are a suitable candidate for a DIY fund, might be: I'd like to start a DIY fund to control my investments because I'm an experienced personal investor and can prove it with a track record.

I want to invest in direct property and perhaps borrow money to do it

This could be a good reason for setting up a fund because it is a legitimate strategy under super rules. But it is a weak reason if it is based purely on what you have read in a magazine or newspaper, or on the advice of a real estate agent. A property should also be just one part of a DIY super investment portfolio, rather than its sole asset. A more impressive rationale would be: I'd like a DIY fund because I want to invest in direct property and maybe borrow money to do it. I've bought investment property previously and I understand the vagaries of real estate, as well as the fact that a DIY super fund should have a diversified portfolio.

I'm sick of paying money to an investment manager who hasn't done very well lately and I think I can do better as an investor

These are common reasons for starting a DIY fund. But although many investors can do quite well, it's a bold statement to claim they can outperform a professional investment manager on a consistent basis.

My neighbour/best friend/workmate has set one up and reckons it's easy to run

At best, such a thought may be a trigger to research the viability of a DIY fund. Everyone is different, so the experience of friends may not be relevant. You need better reasons to start a DIY fund.

I'd like a DIY fund to save money because my existing super is costing me too much in fees and expenses

This should not be the sole reason for establishing a DIY super fund. You have to think about other aspects of running your fund, such as maintaining an investment strategy.

It could be a reason to shop around for a cheaper public super fund. Do some research to compare the cost of your existing public super fund, as well as the real cost of a DIY fund.

I'd be a good investor if I had some money to invest

This is a weak reason for establishing a DIY fund. You are suggesting that you want to practise being an investor with your retirement savings. If you are really interested in investment, test any strategy outside super until you're confident it works.

I've managed to accumulate a sizeable nest egg in a public fund

You need to ask yourself if you contributed to this growth by choosing your own investment strategy from the selection offered by your fund. If not, why not leave the money in the public fund.

My fund is only small but DIY super will help it grow

There are no hard and fast rules on fund size, but investors with limited assets should have a clear plan to increase the balance of a DIY fund to $200,000.

Otherwise, it won't be worth it.

I want to manage the tax concessions available in super, such as imputation credits on share dividends

Not a great reason for a DIY super fund unless you can also come up with an investment strategy that will deliver the franked dividends. Your reason is also a bit single-minded.

I'd like a DIY fund when I retire and start drawing a pension from my super

A good reason for starting a DIY fund – as long as you can back it up with confidence as an investor. DIY funds are very flexible when it comes to managing a pension as the tax benefits of super can be maximised when capital is transferred from savings mode to pension mode.

I have a business and I'm very business-minded

Many DIY funds are started by people in small business who do their own books already and manage their tax affairs. If you don't do that, give yourself more time for research before setting up a fund.

I'm retired and have the time to devote to running a fund

Time is certainly an important factor when it comes to running a DIY fund. But investment experience also counts – do not assume all the extra time you have on your hands will cancel out the need for that experience. You also need to be sure your interest in a DIY fund will be maintained once the novelty wears off.

I fully understand the responsibilities involved in running a fund

Really? That must mean you have read – and understood – the statement that all new DIY fund trustees are expected to sign.

I'd like a DIY fund because it can be a fund for all the family

That's nice – but who will run the fund? All the family should be involved.

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Pros and cons of DIY super

John Wasiliev

PROS

A DIY fund gives you control over one of your largest investments after your family home. It provides the flexibility of choosing your own investments, as well as how the benefits are paid in retirement.

Control doesn't necessarily mean doing everything yourself. Many people who have a DIY fund use specialist advisers to help them in key areas such as investments, legislative compliance and tax. Control can therefore also relate to the input you seek from specialist advisers.

A DIY fund will allow you to change service providers you might use without having to unwind the entire

structure. In a public fund, if you want to change to another fund you have to sell your investments, which could have tax consequences or incur fees.

Some investment opportunities are only available via a DIY fund. These include buying a commercial property, particularly business premises, which can then be leased back to your business. You might also want to take part in initial public offerings.

A DIY fund can use a special loan to buy property. It is known as a limited recourse loan and means that, if you default, the lender has recourse only over the property and not the rest of a fund's assets.

You can transfer commercial property or shares listed on a stockmarket in kind to a DIY fund.

If you own shares that support a pension, any dividend franking credits will be paid a tax refund. This also happens in a public fund, but not as obviously.

DIY funds can allow people to take advantage of opportunities not generally offered in a public fund. For example, investments you buy while still saving don't have to be sold until you have started a pension, when capital gains will be tax free.

Public super funds generally charge fees on a percentage of assets basis, whereas the major fees for DIY funds for services such as accounting, compliance and tax work are fixed in dollar terms. For those with larger sums – say, more than $500,000 – a DIY fund is likely to be cheaper than most public super products. The number of members in a fund will have no impact on fees as DIY funds are charged on a per-fund basis whereas public products work on an individual basis.

CONS

DIY super is hands-on super. You need to have the right temperament and not be one to lose sleep over every up and down in financial markets.

Used in the wrong circumstances or without the right advice, DIY funds can be costly and time consuming.

Members who lose interest could find themselves with all sorts of problems.

If you start with too small a balance, fixed costs make it harder to earn a decent rate of return, even on the best investments. Remember, $5000 is 10 per cent of a $50,000 fund, but only 2 per cent of a $250,000 fund.

No more than four members can belong to a DIY fund.

There are strict compliance rules governing DIY funds that seek to ensure the fund deals with members and related parties on an arm's-length basis. While it is your fund and your savings, you are not free to do what you want with this.

Funds need to prepare their own investment strategy, financial statements and tax return and have an audit performed each year. You don't have this responsibility with a public super fund.

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