

InvestorDaily

In search of control: will the financial crisis cause an influx into SMSFs?

IFA Cover Story

Wouter Klijn

Mon, 09 Mar 2009

October is an eerie month for global stock markets. In most years, the month will pass by without much vexation, but every once in a while panic sets in and traders worldwide participate in large scale sell-offs.

During October in 1929, 1987 and 1997 stock markets lost more than 20 per cent. October 1987 was a particularly bad month for Australia, when the local market lost more than 40 per cent.

And the list of horrible Octobers was added to last year.

Not many people will argue October 2008 was a good month. The S&P/ASX 200 Index fell almost 13 per cent that month, continuing its decline in November to a low point of 3350, an overall drop of 27 per cent since the start of October.

October crashes are followed by prolonged economic downturns; sentiment turns sour and investors become cynical about the capabilities of their money managers. For the self-managed superannuation fund (SMSF) industry it means more funds are established.

"The SMSF establishment rate spikes when you have a protracted bear market," Investment Trends principal Mark Johnston says.

"We really saw this on the back of the dotcom crash. Over 2000-03 we saw that the establishment rate spiked by about 50 per cent."

Poor investment returns raise the awareness of fees, Johnston says. "[This] prompts a number of people to say, 'I can do better or at least as well myself and save some money'," he says.

Research by Investment Trends suggests a new spike in SMSF establishment rates is building up. In November last year, when stock market declines were at their worst, Investment Trends surveyed more than 1100 active investors' opinions on the causes of the crisis, capturing the sentiment just after October.

It found almost 70 per cent of active investors believed the current crisis was caused by greedy people within the financial services industry, and many investors said they had lost their trust in fund managers.

"We found that people who held these kinds of beliefs were also more [likely] to switch super provider and it does appear that they switch to SMSFs," Johnston said.

He expects this trend to accelerate as the bear market continues. "This effect is really predicated on a prolonged bear market, because it is a response to consecutive negative returns," he says.

"There are still a lot of retail and industry funds that only report their returns once or twice a year, and it's really when there is a build up of negative return reports when it becomes an issue."

Super funds seem to have realised this and have now joined forces to prepare investors for the return statements they are about to send out. The Association of Superannuation Funds of Australia (ASFA) brought nine financial services organisations together and issued a statement in February reminding investors that superannuation is a long-term game.

"Over the coming month, many Australians will receive their interim superannuation statements. It is important that they review the performance of their superannuation fund in the context of their own long-term objectives," the statement said.

Rate spike

Evidence of a spike in fund establishments as a result of the current financial crisis is still mainly anecdotal. Official SMSF establishment figures are provided by the Australian Taxation Office (ATO), but the latest data only gives the state of the industry up until the September quarter 2008.

This data shows a steady increase in the number of funds that have been set up, moving from 364,857 funds at the end of September 2007 to 394,996 funds a year later. At the same time, total assets under management declined from \$352.8 billion at the end of September 2007 to \$347.6 billion a year later.

But Super Concepts general manager Paul May says he has seen an increase in interest from investors since then.

"When there is a downturn in the market we usually see an increase at our end," May says.

"It always gets back to the fact that people want to take more control when those conditions are in place - self-managed funds are all about control."

Super Concepts has about \$4 billion in money from SMSFs under administration. In 2008, it established more than a thousand of these funds.

May says the company's establishment rate is likely to go up further towards the end of the fiscal year. "Traditionally the June quarter is when the activity starts to increase. People are setting up funds for taxation purposes prior to 30 June," he says.

ATO statistics show the establishment rate in the June quarter 2008 spiked to 11,072 funds, from an average rate of about 6000. In June 2007 the rate was a staggering 22,671 as people were establishing funds before the looming deadline of the after-tax \$1 million contribution to super funds.

But cyclical effects aside, May doesn't expect the establishment rate to drop off any time soon. "I haven't seen any flattening out here. It won't slow down for Super Concepts," he says.

Smartsuper managing director Andrew Bloore has also seen increased interest in the establishment of SMSFs, especially over the past six months. Bloore says negative investment returns are the primary driver for people to set up funds. But investors do not necessarily blame super funds for their dwindling capital, they also blame themselves.

"People are disheartened by not looking at their investments," he says.

"By establishing an SMSF they force themselves to become more involved in attending to their super savings."

Smartsuper currently has an establishment rate of about of 150 to 180 funds a month. "In years past this would have been 30 to 40 funds a month, but that is not just the downturn, we have also grown as an organisation," Bloore says.

He also does not believe fund establishments will peak soon, and says he expects funds to continue to build up in the industry. But he does warn that the higher establishment rates experienced at the moment will translate into more people exiting SMSFs over the next 12 to 18 months. This is because some investors establish funds for the wrong reasons, and he expects especially those investors with limited capital to return to managed funds.

"At \$70,000 people are interested in the returns, at \$100,000 people are interested in the cost of fees and at \$200,000 people want to be involved in the decisions," he says.

"You have to have a purpose otherwise it's a waste of time [to set up an SMSF]."

Who can manage?

For some investors who already had SMSFs, the downturn in the market has provided a moment of truth, as they realised that it is one thing to make money in a bull market, but an entirely different thing to retain money in a bear market.

HLB Mann Judd head of wealth management Michael Hutton has seen some investors exit their funds. "[They] are concerned about the money they have lost by investing themselves," Hutton says.

"Even some people who have had SMSFs for many years have been shocked by how badly they have gone."

Not everybody is suited to run a super fund themselves and financial advisers can play a pivotal role in determining a person's eligibility. Eureka Financial Group's

Andrew Jones specialises in advice on SMSFs. He confirms there have been more people making inquiries, but says not all people walking through the door are well informed about the work involved in managing a fund.

"You've got to find out whether a person is the right sort of person to run a self-managed super fund, and it is not necessarily the size of the investment account that will determine whether you are appropriate to have an SMSF," Jones says.

Besides considering the practical aspects, investors have to set time aside for complying with industry regulations and reporting. This can take up a considerable amount of time, as the regulatory regime is strict.

"You have to understand what it is all about before you decide to start a fund yourself," Jones says.

He has advised several clients not to set up an SMSF. "There is a screening process to see whether the person understands what they get themselves into. We have turned people away because we didn't think it was appropriate," he says.

"It's a wonderful opportunity, but it comes at a price."

It remains to be seen if the current economic downturn will lead to a significant spike in new SMSFs, but a glance over the establishment rates at some of the leading players in the industry seems to suggest this is the case.

If so, planners will be there to advise those investors who have taken control over their super savings. "Planners don't see this [development] as a threat in any way, and in fact have become far more heavily engaged with the SMSF industry over the last couple of years," Mark Johnston says.

"A growing proportion of planners' businesses is already servicing SMSFs clients."

Perhaps we will get an answer in October.

This story appeared on InvestorDaily.com.au ©2006 InvestorDaily