

Is an SMSF the right choice for your super?

By Daniel Hicks

Whenever investment markets experience periods of turmoil, there tends to be a spike of interest in setting up self-managed super funds (SMSFs). Understandable though this may be, there is work and cost involved in setting up and running an SMSF, and the change may also involve considerable disruption to your investment strategy. It's not something you would want to jump into, only to close it down six months or even a couple of years later. You need to be in it for the medium or (preferably) long term, and be doing it for the right reasons. Let's take a look at some features of an SMSF that may help you to decide whether this is your best option.

Ultimate control

An SMSF allows you and up to three other members/trustees to have ultimate control over many aspects of your superannuation. Within the confines of the regulations, you can, for example, choose to pay out a transition to retirement pension, arrange insurance that is individually suited to your needs or choose what the fund invests in. These options are often available through a managed fund or master trust structure, but there may be greater flexibility within an SMSF.

The drawback of having control is that you also have responsibility. There are regulations to be adhered to, and there may be serious penalties for not complying with them. You can usually pay someone to assist you with just about every element of running an SMSF, but ultimate responsibility lies with the members/trustees of the fund. You therefore need to be aware that there will be some extra administrative burden.

Fees

There is usually a higher flat dollar component for SMSF fees than for managed fund fees. An accountant or SMSF service may charge \$1,000 or more to set up the fund, plus an annual fee that usually starts at \$1,000 (and can go much higher depending on the size and complexity of the fund). They may also have an additional percentage-based fee associated with the investment management within the fund. In contrast, a managed fund usually has nominal flat dollar fees, with the bulk of the fees calculated as a percentage of the funds under management. These can also vary significantly, but are normally between 1% and 2.5%.

This is why it is generally recommended that you have a minimum starting balance of between \$150,000 and \$250,000 before going down the SMSF path. At this level an average annual \$2,500 administration fee represents only 1% to 1.7% of the fund value; and on a \$1,000,000 balance it is a very low 0.25%. On a \$50,000 balance, for example, the fee would be 5%, which is too much considering the likely long-term investment returns.

Investment choice

Providing that they also are in line with the regulations (i.e. the sole purpose test, which is to provide retirement or death benefits to its members), SMSFs can choose from a wide range of investment options including direct investments or pooled unit trusts. They could, for example, hold cash in the bank, artwork, a property (now potentially with gearing), some direct Australian shares, and maybe units in a

managed fund invested into international shares. In contrast, managed funds are restricted to listed or structured investments, generally available through a unit trust. Obviously they are unable to invest in direct assets such as art or property.

Managing your own investments

The option of having complete control over your investments is an appealing one for many people, particularly considering the performance of traditional super funds. Whatever the investment strategy, some choose to manage their own investments because of a well-founded belief in their own ability. They may enjoy making their own investment decisions, or they may wish to learn and improve their skills over time in a real-world situation. For most people it is probably a mix of all three.

It's important to be aware that, despite the apparent poor efforts of investment managers over the past 18 months, their job isn't easy. There are simple ways to replicate market returns (e.g. via an index fund) but the decision of which markets to be exposed to still has to be made (shares, fixed interest, cash, property, Australia, overseas etc.). It's easy to say that an investment would have been better in cash over the past 18 months, but the same can't be said about most periods of five years or more. There are a lot of new SMSFs that have been established and moved directly into cash in response to recent market returns, but many of these could be still sitting in cash five years from now, potentially missing out on a rebound in investment markets.

There are ways in which individual investors can help to improve their investment returns. Many individual investors have built up a wealth of knowledge and experience investing in one or more types of assets, such as shares or direct property, and are very capable of managing their own investments. Regardless of what anyone tells you, there were also a lot of savvy investors and market commentators who thought share markets were heading for a big fall about two years ago. Of course that sort of insight doesn't need an SMSF to be beneficial; it can be used to select appropriate investment options in the managed fund space too. But many investors would be shocked to know that the vast majority of balanced funds would not have been able to reduce their exposure to growth assets two years ago even if they had known what was coming.

There are definitely some very good reasons for investing via an SMSF. But they do require extra work, responsibility and potentially additional cost. It's important to understand exactly why you might want to initiate an SMSF. Can you achieve the same result by better utilising the managed fund environment? If not then an SMSF may be the right way for you to go.

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