Retirement Planning 101, or: How I Learned to Stop Worrying and Love the SMSF

Nowadays, it's easier than ever to setup and run a Self Managed Super Fund or SMSF. Sick of those fund managers who to date have squandered your hard earned retirement, and then had the gall to charge you a hideous fee while doing it. Your accountant, your (now independent) financial advisor, not to mention your friends and colleagues are touting the benefits of setting up an SMSF. Changes to the regulatory environment have made it easier than ever. You know you could invest yourself. Just a matter of learning the ropes. How difficult could that be. There's no better time than the present, so you give your accountant the nod, sign a few documents, write a few cheques, and before you've said "1.5 percent Management Fee, plus costs every year", it's all setup. All done quickly and painlessly (and supposedly without much expense – but that's a topic for another time). You now have a brand new SMSF with it's very own bank account, trust deeds and investment mandate. You even get to choose a funky name for it.

The fund itself will be run by a Trustee. The Trustee will most likely be a (Pty. Ltd.) Company, and you'll be a director of that Company. This means that you are now effectively in control. If, in the unlikely event, it all goes pear shaped, there is a Proprietary Limited Company between you and the creditors (disclaimer – seek your own advice on the validity of this statement!)

Once your new SMSF is ready to go, it's a simple process to roll existing super assets (think 1.5 percent fee …) into it. If your employer is making regular super payments for you, they can also be directed into your SMSF. If you are self employed, just make all future payments into the new fund.

Next Steps

What to do with your new SMSF. You've rolled in assets (in the form of cash). Future payments will go into it. What next.

If you consult the fund documentation (or your accountant), you should now start the investment process. To do this, you must set an investment plan or strategy. If, however, you've used one of the many readily available third party documentation services, this is probably all already taken care of. The investment rules will be very generic, and wide ranging. There's not going to be too much to constrain you. Of course, you must abide by these rules, but don't be intimidated by the bundle of documentation you've received (and signed). Some of it dictates the legal framework and structure around the fund, the trustee setup, and ongoing obligations. All the rules and regulations applicable to the fund will be there. Hopefully a simplified "plain English" explanation of all this exists. Take some time to read it in detail. The documentation ticks all the boxes required by the regulator – namely around investment mandate, permissible investments, guidelines for dealing, compliance etc. Provided you adhere to these, investing is actually very simple. It may seem intimidating, but remember, these documents were created to make your role as straightforward as possible. They are set up to protect you from making mistakes as much as possible (interesting to note, that nowhere in the process have you explicitly had to prove that you are a suitable candidate to make decisions for the Trustee. Your experience and knowledge with respect to investing or managing investments was probably never part of the setup process.)

Your first SMSF Investment

As discussed above, you've set up an SMSF because of unsatisfactory outcomes with managed investments. Other than regular contributions, asset growth has not been spectacular. Maybe it has even been negative (especially after fees and costs). So, once you understand what investments are possible, it's time to begin.

Given your prior experience, you're determined not to get caught out again. The funds that were rolled in from your existing super are ready at call in the Fund's bank account. The interest being paid (if you're lucky) at this time is almost zero. While you learn about the investment process, and until you decide how to invest, you'd be remiss just leaving the cash at call in your account. There are a huge variety of term deposits being advertised. You've also heard about hybrid securities. Pay a decent yield – well above bank rates – and maybe even fully franked (you know franking is a good thing, especially in an SMSF). You've heard that hybrids are liquid – easy to buy and sell on the stock exchange (note to self – set up online brokerage account for SMSF). Because they can be sold anytime on the exchange, you won't get stuck like you could with a term deposit, when you identify other investments (another disclaimer – caveat emptor and caveat hybrids – are investors aware of all the risks of hybrid securities..).

While waiting for your brokerage account to be operational, why not check what investments are possible.Permissible investments (per SUPERCentral Governing Rules Version 11/13, and not exhaustive):

- Shares, debentures, corporate bonds etc., listed or unlisted
- Units in any listed or unlisted unit trust (including pooled superannuation trusts)
- Interests in any managed investment scheme (MIS), registered or not
- Financial instruments
- Derivatives
- Real estate
- Personal property "whether tangible or intangible and whether movable or immovable and including Collectables and Personal Use Assets"
- Loans (secured or unsecured)
- Business ventures "including underwriting or sub-underwriting and securities lending transactions"

This is far ranging. Not much which won't fit into one of the above categories. Shares, bonds, fund units etc., are probably familiar. They were very likely a major component of your legacy super investments, and will probably be part of your SMSF too. Still, worth considering some of the other available options.

Personal property might be interesting. Your wine collection (even if it is only a few cases) can't be incorporated into your SMSF. There's a rule around related party transactions. Nevertheless, you can go online and find a pretty good collection (Jacks Wine www.jackswine.com.au currently has a special on mixed dozens of fine reds at $71.99). As director of the Trustee Company, it would be your duty to ensure they are cellared properly (you've always wanted a wine cellar!), but what happens if you drop the cases when loading them into your newly constructed wine cellar. Does your investment literally go down the drain. Not much explicitly spelled out in the documentation about storage, handling, insurance. It probably falls under appropriate risk management...

Looking further: Derivatives – some warrants – out of the money, and about to expire. They're going cheap. Load up, and tomorrow you could be rich, or.........

And what exactly is a "Financial Instrument". Probably not Bitcoin. At least not yet, but cash or any "real" currency certainly is. How about some Albanian Lek, Congolese Franc and Paraguayan Guarani. You never know what exotic destinations you'll want to visit during your long and prosperous retirement. To ensure diversity, add few other financial instruments –some interest rate swaps, a few FRAs, and an impaired loan or two. Is this a good place to start.

Business Ventures – do you go the Kickstarter (www.kickstarter.com) route - or maybe get involved in a syndicate looking to establish a new casino; a legal brothel; the next killer app. Just pick the next Apple or Google, and eventually Paraguayan tourism will become mainstream, so you can go and spend that Guarani. In the mean time, the process can also be a lot of fun. Who needs plain old stocks, bonds and managed funds.

Back to reality. You probably don't have enough money to buy a company or to invest in non performing loans Do you really understand how FRA's, swaps and fx work. Stocks and bonds seem to be the nuts and bolts of most SMSFs (at least that seems to be a popular viewpoint). And you probably know a little about listed equities, funds and bonds. You just have to do it better than those fund managers did (and of course you won't be paying horrendous fees anymore).

So go ahead and form an equity investment strategy. Listening to many planners, advisors and other so called experts, and you'll hear a lot about asset allocation, diversification, active vs. passive, stock selection vs. quant., growth, momentum, value, fundamental investing, tactical, strategic, IPO's, low volatility, alpha, beta, risk on, risk off, dispersion, correlation…. Very confusing - but since many of the professionals - who are supposed to understand all this, seem to have underwhelmed in the performance stakes, you can probably afford to be different. There must be simpler and more creative ways to invest.

With this in mind, here are some investment themes which are fully compliant with your SMSF mandate, and are certainly a lot more interesting. A few suggestions (disclaimed again):

- Stocks which have gone down by more than X% in the last 6 months must be a good buy. They're bound to go up again
- Stocks which have gone up by more than X% in the last 6 months must be a good buy. They're bound to keep going up
- Pick stocks based on their alphabetic ranking (ie those beginning with letter A, F, K and Y this month, or how about a portfolio where every stock begins with a vowel)
- Or, a strategy which invests in stocks worth $1.00 or less, or $50 or more, or prices which are prime numbers, or match the day of the month
- Or any other fun and interesting ways to choose stocks

Your online brokerage account should by now be operational, so you're ready to start buying listed investments. If you're really bullish, take advantage of the many margin lending for SMSF's offerings, as borrowing is now possible in SMSFs. You can effectively double your investment size. If it goes wrong, the loans are totally non recourse. And the rate seems reasonable at 7.5%!

Outside equities, there is a lot more available. You've probably seen advertising for off the plan properties in Darwin. They come ready with financing, and a guaranteed 7%+ yield for 3 years (sounds great, but what happens after 3 years. Are the tenants actually paying 7% plus, or is the developer or some other friendly party helping…). If you're prepared to look further afield, you may even get a free trip and accommodation to view a potential investment (see for example http://www.homeinturkey.com/inspection.htm or http://www.emergis.co.uk/page-inspection-trips-

32.html). There are some unorthodox operators and operations in this arena (read http://www.spainmadesimple.com/property/inspection-trips/). Probably worth running this one by your accountant before you pack your bags (another disclaimer – this is not investment or travel advice).

Seriously, and In Conclusion

Although the above is flippant, it hopefully conveys that there are many ways for an SMSF to go horribly wrong. Whilst this author is not against (and actually is very much in favour of) SMSFs, there is (in his opinion) a lot wrong with the current regime under which they can be established and operated.

Personal and professional experience has shown how easy it is to set up an SMSF. How little experience, knowledge and accountability there is on the person making investments for an SMSF. Most of the rigour is focused on getting the framework right, documentation compliant and making the investment process as broad as possible. By removing constraints around the investment process, the risk of non compliance is decreased. The consequence is creation of a broad mandate in the hands of an inexperienced investor. This must be a recipe for increased investment risk. Ironically, ensuring compliance is also the priority of many of the suppliers who operate around the SMSF space (for example producers of documentation, audit, accounting). Their aim is to make the process easy, rather than making the outcome a priority.

Cost seems to be a major driver of the move to setting up SMSFs. What has happened to the benefits of scale that seem to apply everywhere else. These questions should be answered before setting up an SMSF:

- Are new SMSF beneficiaries given enough information about the cost of setting up and running and SMSF
- How much misinformation is there (especially in some of the offers to set up SMSFs for low fees with low AUM)
- What is the tradeoff between costs of running an SMSF compared to a managed scheme

Trustee/Stakeholder responsibility – is this adequate (here Trustee also refers to the person acting or making decisions for the Trustee where it is a Company).

- Do Trustees actually have the right skills to run an SMSF
- Compliance is easy – just follow the off the shelf docs
- Accountability – who monitors and enforces.
- How little does a Trustee need to know to run a fund (rather then how much does a Trustee need to know)
- How should an appropriate investment mandate be formulated and implemented
- After the fact – compliance, performance measurement and attribution, and assessment of these against the investment mandate. Is there any scope for adjustment if the fund is not running to plan, or if the beneficiaries’ circumstances change. How to do this without introducing a new cost layer into the process

How can the SMSF process and practice improve. Is more education for the decision makers adequate. Ultimately, there must be freedom to invest, but there needs to be responsibility, accountability and a robust framework across compliance, risk and investment – not just the former. Add to this rigorous “a posteriori” attribution and benchmarking, and the outcome will improve.

Several recommendations and areas for consideration:

- Detailed disclosure of the cost framework around setting up an SMSF. There is substantial advertising and marketing which promotes setting up of SMSFs. Even stakeholders with small pools of assets are being encouraged to set up SMSFs. At low asset levels, the fixed costs will be substantial (compared to the fund size). This means that fees may be comparable to (or greater than) those for legacy managed funds
- More information on all options available to investors. For example, many established industry fund schemes are providing a “Member Direct” offering. This may provide a balance, which allows for varying degrees of self management whilst leveraging an established (and scaled) platform, at a reasonable cost
- Education – mandate that anyone with an investment responsibility be suitably qualified. A basic understanding of available instruments (even a certification regime), the value of diversification, a stakeholder generated (as opposed to service provider generated) investment strategy
- Review and adjust the investment approach as necessary. This will require performance attribution and benchmarking. Risk is that yet another industry forms around this function, and costs increase, The regulator should become actively engaged here, to ensure positive outcomes
- Maybe it is necessary to mandate a diversification framework. As an example, funds under a certain size should be required to adhere to concentration limits, and be exposed to more than one market factor (without being too specific). Perhaps an explicit opt out of such a framework can be allowed. This means conscious non compliance, rather than the current laissez faire situation.
- Accreditation – service providers should be accredited (outside the existing system), and adhere to s strict code of practice. Although most of the providers around SMSFs are operating with integrity, the growth of the sector has seen unscrupulous practices. Providers should operate from a standpoint which states that most individuals should not be setting up an SMSF unless they have the knowledge to operate them properly, sufficient assets, and a clear reason (see the points about compliance vs. investment above). Penalties for non compliance or bad practice should be public and harsh
- Comprehensive guidance is needed, about thresholds which make running an SMSF viable
- Ongoing education

There is much more to be said, and even more to achieve. While the option for individuals to manage their retirement savings via an SMSF is positive, it can also be risky. A shortfall in retirement savings will impact the individual, the government and ultimately the whole society. Only by providing a robust framework around the SMSF, can they properly be a viable and valuable option for retirement saving.

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