SMSF considerations
Risks & Costs

Current as at 31st August 2015

This factsheet is designed to provide an overview of the risks and costs of establishing and operating an SMSF.

The factsheet should not be considered a substitute for specific financial advice. Potential or existing trustees should seek professional advice if they are unclear as to how any of the factors in this factsheet relate to their circumstances.

Target Clients

- People thinking of establishing an SMSF
- Trustees of existing SMSFs

An SMSF is no better or worse than any other type of superannuation, such as an 'industry' or 'retail' fund, they are different types of superannuation fund. When making an assessment, there are two key areas that should be considered for an SMSF:

- Risk
- Cost

These will be covered in general terms. However trustees should consider a more detailed look at each of the areas covered, as it is not within the scope of this factsheet to perform an exhaustive explanation.

Further sources of information are listed at the end of the factsheet. Super Plus has also produced more detailed factsheets on several of the areas noted in this factsheet.

Risk

People often associate the term "Risk" within the context of investments and the potential to make or lose money. However there are many different types of risk in the SMSF context and we have listed a number to be considered:

- Obligations and the time and skills necessary to operate an SMSF
- Lack of statutory compensation
- Impact on insurance
- Access to complaints mechanisms
- The appropriateness of different SMSF structures
- Trustee obligations to develop an investment strategy
- The need to consider an exit strategy

Even though risk can be reduced by using the services of a suitable professional, the trustee of the SMSF is still ultimately responsible and thus they should understand the risks and consider these in the context of their own circumstances.

Obligations and skills to operate an SMSF

An SMSF is not for everyone, even if an investor does have a significant amount to invest. Factors such as their financial literacy, understanding of the legal, taxation and other requirements, available time and general interest are all things to be considered.

Obligations with which SMSF trustees must comply under superannuation and taxation laws include:

- Maintaining the fund for the sole purpose of providing retirement benefits to SMSF members, or to their dependants if a member dies before retirement
- Accepting contributions and paying benefits (pension or lump sums) to members and their beneficiaries in accordance with superannuation and taxation laws and the SMSF trust deed
- Valuing the fund's assets at market value for the preparation of financial accounts and statements
- Having the financial accounts and statements for the SMSF audited each year by an approved SMSF auditor
- Meeting the reporting and administration obligations imposed by the Australian Taxation Office (ATO)

When establishing an SMSF, trustees (individually or as directors) will be required to sign a Trustee Declaration. This is an ATO form that lists the major responsibilities, and therefore by signing you confirm you understand your responsibilities as trustees.

Failure to comply with obligations under superannuation and taxation laws can have significant consequences (e.g. the loss of tax concessions or significant fines). Even if one trustee is less actively involved, all trustees are equally required to comply with these trustee responsibilities and obligations and are liable for the actions of other trustees.

A number of functions may be performed by a professional administrator such as Super Plus, however the trustee is still ultimately responsible. You can outsource some of the work, but you can't outsource the responsibility.

There may be other options available for those who may not be prepared to take on the responsibilities and obligations of an SMSF trustee. These other options may still provide some of the benefits of an SMSF, such as a 'member direct investment facility' within an APRA-regulated fund.

Lack of a statutory compensation scheme

A superannuation fund regulated by the Australian Prudential Regulation Authority (APRA) has government protections, such as statutory compensation. This provides compensation in the event of theft or fraud.

An SMSF is **not** subject to the same compensation arrangements and therefore taking legal action, which may be expensive, may be the only option an SMSF trustee has.

Therefore an individual's existing superannuation (not in an SMSF) may be protected from theft and fraud and so moving to an SMSF will result in reduced protection or no statutory compensation arrangements.

Impact of insurance

Unless the SMSF trustee specifically takes out insurance for fund members, there may be no insurance cover for members in the event of death or disability.

The lack of insurance cover may have significant consequences for an individual and their dependants. It is also a requirement of the SMSF investment strategy that trustees consider insurance cover for members. This includes no insurance in the SMSF, where the member is satisfied with the level of insurance cover elsewhere (personally or in another super scheme).

Due to personal medical underwriting, life and TPD insurance may be more expensive and harder to obtain for an SMSF than for larger APRA-regulated superannuation funds where often there is no medical underwriting assessment required.

The possible longevity of the SMSF should also be considered. As the SMSF is the owner of the policy, should the SMSF become unviable and need to be closed, this could create a significant issue if the insured member is no longer insurable due to health reasons. This creates a difficult choice between continuing with an SMSF (that is not cost effective) verses closing the SMSF and having no insurance cover.

Cost vs Benefit considerations could include:

- Not fully closing down an existing APRA regulated superannuation fund, to maintain an existing life and TPD insurance cover
- Not holding any life and TPD insurance in the SMSF, but instead holding in personal names
- Replacing existing cover with a new insurance policy taken out by the SMSF on behalf of some or all of the members of the SMSF
- Cost of insurance cover in the SMSF verses Individually verses existing APRA fund
- Longevity of the SMSF (impact on insurance of SMSF wind up)
- Level of cover and its cost eroding the value of members accumulated super balance, thus reducing their retirement benefits. Consider striking a balance between the two.
- In some circumstances, an insurance payout inside super maybe subject to 30% tax, therefore a consideration of the premium deduction needs to be made against the large tax cost. So a comparison needs to be made with holding insurance in a personal name.

Access to a complaints mechanism

Members should be aware and understand that certain dispute resolution mechanisms, such as the Superannuation Complaints Tribunal (SCT), may not be available to SMSFs.

However, the types of disputes and complaints that may arise for SMSF investors can be different from those in an APRA-regulated superannuation fund.

Where a licensed financial adviser has been used other complaints mechanisms may be available to SMSF investors (e.g. the Financial Ombudsman Service Limited or the Credit and Investments Ombudsman).

Different SMSF structures

When establishing a new SMSF or running an existing SMSF, the structure (i.e. a corporate or individual trustee) can have important operational and succession planning implications.

The structure can be changed, ie from individual to corporate or vice versa, however there will be costs involved in changing and the process can be time consuming, as the ownership details on all investments will need to be amended.

Therefore consideration should be given to the type of trustee structure required both at establishment stage and during later operation of the SMSF.

- ➢ Super Plus has a more detailed factsheet for clients: "*Factsheet – Individual vs Corporate Trustee*"

Properly developed investment strategy

Under superannuation laws, SMSF trustees must develop an investment strategy to ensure the SMSF is likely to meet members' retirement needs. Such a strategy may also consider whether the members of the fund have other retirement or investment savings they can draw on outside the SMSF and whether the SMSF's investments are appropriately diversified.

There are three main aspects to an investment strategy:

- The investment aspects, including type and asset allocations
- Consideration of the insurance requirements of members
- Cash flow to meet expenses and pension payments (when applicable)

SMSF trustees should conduct a regular review of the fund's investment strategy to ensure it remains current.

It is important that trustees understand:

- The benefits associated with asset diversification and investing across a number of asset classes (e.g. shares, real property and fixed interest products) in a long-term investment strategy, such as improving the risk and return profile of an SMSF
- The types of restriction on SMSF investments
- Certain transactions are prohibited, such as lending the fund's money, or providing financial assistance, to a member of the fund or their relatives.

Where a limited recourse borrowing arrangement is being considered, trustees should understand the associated risks and how this arrangement is appropriate for the SMSF. This might include the cash flow requirements for meeting loan repayments or the insurance requirements of a property.

- ➢ Super Plus has a more detailed factsheet for clients: "*Factsheet - Investment Strategy – Basics*"

SMSF exit (wind up strategy)

Trustees may, at a future date want to wind up their SMSF for a wide range of reasons:

- Compliance requirements become too onerous
- The SMSF value falls and therefore it's not cost effective to keep the SMSF operating
- A trustee dies or becomes incapacitated

To make any exit as straightforward as possible, it is important that trustees consider and develop an exit strategy for their SMSF.

- Super Plus has a more detailed factsheet for clients: "*Factsheet – SMSF Wind-up factsheet*"

Cost

There are many factors which need to be considered when weighing up the pro's and con's of an SMSF.

These might include:

- Control over one's superannuation
- Investment choice
- Estate planning requirements
- Cost

When making any financial decision, cost should always be considered and this is no different when considering a SMSF.

There are a number of costs that are associated with the operation of an SMSF and the potential ongoing costs should form part of the decision process in deciding to establish or continue to operate an SMSF.

When considering costs, any assessment can be broadly broken into these 3 categories.

- Cost-effectiveness of an SMSF
- Costs of setting up, operating and winding up an SMSF
- Continued suitability of an SMSF

Cost effectiveness

An important consideration in an SMSF is whether the likely balance will make it cost-effective.

The ASIC (Australian Securities and Investments Commission) has provided a general figure of $200,000, below which an SMSF might not be cost effective.

However cost is only one consideration, as there may a number of other reasons why an SMSF may be appropriate.

While this $200,000 is a useful starting point, the figure is rather arbitrary and it is not quite that straight forward. So depending on the individual circumstances, investments and estate planning choices that are to be made, the actual cost effectiveness figure may be above or below $200,000.

While the SMSF setup costs are an important aspect to consider, when assessing cost effectiveness, more focus should be applied to the on ongoing operating costs (these will occur year after year).

Other options may include a superannuation scheme you are already in, such as a superannuation fund regulated by the APRA. APRA regulated funds include retail super schemes (offered by financial institutions), Industry funds and government run schemes.

Comparing various scheme costs

When comparing costs a far more useful assessment method is to compare the setup and running costs of the various options being considered.

Therefore draw up a list of all the likely costs and compare the overall costs. It is important to note that many of the costs in an SMSF are of a fixed size and therefore as the balance rises, the relative cost becomes smaller. Other schemes may charge on a percentage basis and so smaller balances are cheaper and larger balances more expensive (although some APRA schemes now have fee caps of higher balance accounts).

When comparing fees it is vital that a balance be selected in order to give a relative cost. Thus it is important to consider a range of balances that are likely to be relevant to your size, eg, $150,000 and $300,000 and $500,000.

It is also important to use a balance figure, as you'll need to calculate a dollar figure for schemes charging fees based on a percentage of balance.

To assist in this comparison, included at the end of this document is a template you may use to help in the comparison.

Starting balances below $200,000

If the SMSF costs are high, then the costs of establishing and operating an SMSF with a balance of $200,000 or below could be un-competitive, compared to a fund regulated by the APRA.

However, there are circumstances where an SMSF with a starting balance of below $200,000 may be appropriate – for example:

- Where a large asset (e.g. business property or an inheritance) or funds in another superannuation account will be transferred into the fund within a short timeframe (e.g. within a few months) after the SMSF is set up
- Where estate planning matters are a consideration, e.g. non-lapsing binding death nominations
- Running costs are reasonable
- Direct share investments are desired and the current APRA fund does not provide such a facility
- Trustee choice as to which institution/company to invest with for term deposits or individual bonds (fixed interest)
- Overseas direct share investments

SMSF Costs

There are different costs with any investment structure and in an SMSF there are costs associated with setting up, operating and winding up.

Some of the cost considerations should include:

- The costs that are expected to be incurred in establishing, operating and winding up an SMSF – in particular, which costs are unavoidable, as well as costs that may vary depending on how much of the SMSF's administration the trustees are intending to undertake
- How the average annual operating costs of an SMSF compare with the annual administration costs of the client's current superannuation fund or other APRA regulated superannuation fund

It is also important to understand any costs that are not immediately apparent. **At Super Plus we operate a fully transparent charging structure, so you always know what to expect.**

However there are other SMSF providers and other schemes that have costs tied to particular investments or structures.

This may result from a requirement that you use a particular brokerage service (which charges higher brokerage) using only certain term deposit providers (where you receive a lower rate of interest and a fee or commission is being paid). These arrangements may be disclosed in the fine print, but may not be immediately apparent.

So with some providers and super schemes what initially appears cheap, may not be.

Unavoidable vs optional costs

Some costs applicable to setting up, operating and winding up an SMSF are unavoidable, while other costs depend on decisions the trustee makes.

Examples of unavoidable costs include:

- The annual SMSF supervisory levy (collected by the ATO)
- The costs to produce an annual financial statement and tax return
- Annual independent audit fees
- Costs relating to the establishment of the SMSF, including costs for a trust deed
- The fee for annual actuarial certification (when required)

Examples of possible avoidable costs:

- Establishment of a corporate trustee, including ASIC fees to establish a corporate entity and the annual corporate trustee fee
- Ongoing SMSF administration costs, including the cost of amending the trust deed of the SMSF
- Professional investment advice fees
- Investment management fees (these fees may be unavoidable depending on the type of investments made)
- Costs relating to the winding up of an SMSF, including compliance costs and transaction costs related to realising assets.

Continued suitability

At periodic intervals, maybe after each year's financials have been completed, an assessment should be conducted by the trustee(s) to see if the SMSF is still relevant to the members circumstances. This includes considering the:

- Continued capacity and capability of the members/trustees
- Continued time commitments of the members/trustee
- Total SMSF value failed to meet or has fallen below a cost effective balance
- Continued cost effectiveness for the style of investments being made
- Pensions being paid from SMSF (including grandfathered pensions)

For SMSFs established with a starting balance below $200,000 a review should be conducted to see if the balance will reach a cost effective level in a reasonable time period (due to new members, further contributions etc).

Summary

This factsheet has presented a number of matters that a trustee or potential trustee should consider prior to establishing an SMSF and that they periodically review thereafter.

Considerations should include:

- Risk
- Cost
- Investments to be made in SMSF
- Insurance arrangements for members
- Continued ability and time of members/trustees to operate the SMSF

Advice from a financial professional, such as a qualified financial adviser, should also be considered as part of any establishment or review process.

Additional information

There are many available sources of information that can expand on the subject matter in this factsheet. For some free additional reading, you can consider:

Super Guide: **www.superguide.com.au**
The SMSF Review: **www.thesmsfreview.com.au**
ASIC's Money Smart website: **www.moneysmart.gov.au**
SMSF trustee education courses: **www.ato.gov.au/smsfcourses**
SMSF trustee short videos: **www.ato.gov.au/smsfvideos**
SMSF trustee news: **www.ato.gov.au/smsfnews**

Cost comparison template

This template is designed to assist in a cost comparison between an SMSF and an alternative. A range of cost types have been listed to help assist, however this list is not exhaustive. It is also important to note that some of the types listed may not be relevant in all circumstances and various schemes may name their fees differently.

Cost type	SMSF	Existing Super	Alternative
Establishment / Setup			
Trust deed			
Company structure (if applicable)			
Entry fees			
Pension establishment			
Adviser/plan fees			
Limited recourse borrowing structure			
Ongoing Costs (total per annum cost)			
Financials & tax return			
Annual audit			
Actuarial certificate (if applicable)			
ASIC company fee (If applicable)			
Annual ATO levy			
Wrap account/platform fees			
Expense recovery fees			
Adviser Fees			
Trust deed update (periodically – maybe every 3 to 4 years)			
Related unit trust fees			
Share trading costs			
Insurance cost and flexibility			
Wind up			
Wind-up specific costs			
Rollover fees			
Company closure fees (if applicable)			
Total Costs			
Fund balance: $			
Cost as a percentage (balance / cost)%:			

Notes:

1. Where a scheme charges fees on a percentage basis, these will need to be converted to a dollar figure. E g: Management fee 0.6% pa on a balance of $200,000. Fee will be $200,000 x .006 = $1,200
2. Decide whether to include GST in the figures. For comparison purposes it is not important to include/exclude GST, however be consistent for all fees in the comparison. Compare like with like, either exclude the GST or include it, but do it the one way for all the fees entered in the comparison.