

SELF-MANAGED SUPERANNUATION FUND (SMSF) MARKET RESEARCH

(QUALITATIVE PROJECT)

KEY HIGHLIGHTS

Final
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Background

The Australian Stock Exchange (ASX) commissioned Creative Catalyst Insights – an independent market research company, to understand the reasons for the growth of Self-Managed Superannuation Funds (SMSFs) and the SMSF landscape in terms of the attitudes, knowledge and behaviour of members/trustees and the roles of advisors working in this market.

This study consisted of 8 focus groups among SMSF members/trustees in Sydney, Brisbane and Gold Coast covering a mix of occupations/professions (including self-employed/business owners), ages and gender, and 8 opinion leaders in-depth interviews among association representatives, financial planners and accountants.

Key Findings

The key findings from this research are divided into:

- ⇒ Motivations and attitudes
- ⇒ Establishing and managing an SMSF
- ⇒ Investments and strategy
- ⇒ Knowledge and education

Motivations and attitudes

Three key aspects are driving the growth of SMSFs:

Mindset/attitudinal characteristics of the individual + Marketplace factors/conditions + Key action triggers/catalysts

- The SMSF **mindset** is characterised by a strong need to have control and responsibility for one's own financial affairs/well-being, and interest in learning about investing, tracking investments and doing the administration. They prefer to make and learn from their own mistakes than pay professionals to do it for them. Opinion leaders also recognized the growing awareness of the need to provide for their own retirement and the desire for choice as factors.
- Several **marketplace** factors contribute to the set up an SMSF:
 - Recent poor performance of managed Superannuation Funds and associated high cost.
 - Consolidation of different super funds from previous employers or redundancy payments. (Not from current employer.)
 - Advice from accountants, especially those establishing or selling a business. This tended to be more tax related instead of investment related. Few sought advice from Financial Planners as they are perceived to have a vested interest in managed funds due to their remuneration commissions.
 - Greater choice and flexibility of choice of investment types and of timing.

- Lower fees than Managed Funds.
 - Tax efficacy as SMSFs are seen as providing personal control over investment decisions and timing. For most tax advantages were seen as a 'bonus' rather than a key motivation.
 - Increasing consciousness of the need to provide for one's own retirement as reliance on a government pension likely to be minimal.
 - In addition to this, opinion leaders also added the bull markets of the late 90s, increasing media coverage, greater general awareness and public education and awareness among pre-retirement market of possible Retirement Benefit Limit issues.
- Also impacted are **life events** that catalyses action like:
 - Change in work circumstances, ie redundancy/retrenchment, changing jobs, starting/selling a business.
 - Age, especially over 40 who are seriously consider their financial future.
 - Losing money in a public/corporate managed superannuation fund, fund closing down and in some cases fraud committed by accountants/fund specialists.
 - Opinion leaders added the collapse of certain master trusts. They believe that future growth would stem from baby boomers moving from accumulation to pension stage, estate planning requirements on retirement, continuing media awareness, growth in value of existing funds and legislation (if passed) allowing choice of employment superannuation fund.

Establishing and managing an SMSF

- For most trustees **establishing** an SMSF is self-initiated rather than following an accountant/adviser's advice. The latter was more common among those running a business.
- Amount of money required to establish an SMSF was not clear. Some thought a large amount (\$100,000) was required, others thought a smaller amount (\$20,000) because it dependent on the attitude and involvement of the trustee. The opinion leaders supported this view.
- Establishment costs were perceived by trustees to range from \$1,000 to \$2,000, while for opinion leaders this varied from \$600 (DIY market) to \$1,500/\$2,000 (most common) to \$3,000 (high net worth niche practices). While ongoing annual costs (accounting and auditing) are a factor, it was accepted as being part of the cost of annual returns and no more than the fee of a fund manager.
- **Investment management** was the most difficult aspect of managing an SMSF, ie what to invest in, when to invest, when to sell etc. Hence many tended to stay with investments they know and understand.

- Relative to investing, the establishment, administration, tax and compliance of SMSFs were seen as not unduly complex, difficult, or time-consuming. For most tax is undertaken by their accountant who also organises the audit, which could be the same person or someone else from the same firm.

In terms of compliance, most know the basics and believe if they unknowingly are not compliant their accountant or auditor would pick it up when annual returns are filed. Opinion leaders said this made it difficult, sometimes impossible, to then 'correct' any non-complying investment strategies. For most trustees the accountant is seen as the key adviser and primary authority on compliance and tax.

- Key barriers to an SMSF are not being able to borrow to purchase investments, and the fear of changing legislation especially due to set-up costs and involvement with an SMSF.

Other barriers identified by opinion leaders are minimum investment level needed to justify costs often being higher than that perceived by the public, increasing costs especially with the need to separate advice, administration and audit, the advent of wrap administration platforms allowing for greater investment flexibility that may negate the need for an SMSF platform and the unknown impact of the March 2004 Financial Services Reform Bill licensing, especially on accountants.

Investment and Strategy

- Trustees were more familiar with 'diversification' than with 'asset allocation'. For most it is a case of 'not having all eggs in one basket' rather than a strict allotment for different asset classes.
- **Investment management** ('what to invest in') is regarded the most challenging aspect of having an SMSF. They recognise they have a lot to learn about investing.
- **SMSF investment strategies** tended to deal with types of investments and allocation rather than with overall goals or defined performance criteria.
- Most SMSFs held direct shares and cash/term deposits, followed by managed funds and property. A small number held listed property trusts/unlisted property trusts and interest rate securities and fewer still warrants/options/Listed Managed Investments.
- For personal investment portfolios, property is as/more popular an investment as shares and cash.
- Overall investment preferences mirror their personality of 'control' and 'self-determination', which tends to favour property, closely followed by shares.
- For many direct property is their preferred investment as they understand it, its tangible, they have control over it and is considered a safe investment.

- While some see the restriction on borrowing under SMSFs, amount of capital needed and lack of liquidity as barriers, other perceive the ability to borrow against property with 'line-of-credit' mortgages as not being an issue.
- There is very limited awareness of other listed securities (Interest Rate Securities, Listed Managed Investments, Exchange Traded Funds, Options and Warrants), except among more sophisticated investors with pre-SMSF share market experience and those closer to retirement who have made an effort to learn and follow investments.
- Whilst being popular, shares were seen somewhat risky, even the "blue chips" with recent corporate scandals, collapses and plummeting share prices. Corporate management of companies is queried, lack of involvement and the time required to follow the share market are factors.

However, they are also perceived as being liquid, requiring less capital outlay, being able to diversify and tailor to own strategies. They are preferred to managed funds because of direct control, are tax effective and being able to offset any capital losses against gains.

- Managed funds are scorned by trustees for not performing well, and for not being able to have control over investment decisions. Nonetheless they are still used in SMSFs for diversification, international exposure, hedging one's bets and to gain time to do other things.
- Whilst awareness and usage of Listed Property Trusts is high, they are not readily recognised as listed investments, nor seen as a managed fund, hence occupy their own space and consequently do not suffer the negative perceptions associated with managed funds or shares.
- Little is known about Interest Rate Securities or what to call them, even if they own them.
- In terms of investment advice, members tended to use their accountants (as first line of advice), their brokers (online and full-service) or other financial advisers (some financial planners, often family/friends in the financial industry).

Knowledge and education

- **Knowledge** level varied considerably among members. Those with accounting/financial backgrounds were most knowledgeable, especially with legislation and compliance however this does not mean investment savvy. Those who came from other backgrounds usually had less detailed 'administrative' knowledge.
- The individual's knowledge of investments tended to reflect where their interest and comfort lay as an investor.
- Most trustees had read their SMSF Trust Deed, at least on the inception of their SMSF. Most believed that they knew the broad terms of their Trust Deed and were happy with this basic knowledge. However gaps in knowledge were evident, eg voting rights, membership of 4 or less, creditor protection etc.

- Those who had set up their own SMSF were more familiar with their Trust Deeds than those who had left it to their accountant. Also if a particular feature were relevant to their circumstances, they would have more detailed knowledge of it, eg a small business operator knowledge of the 5% in-house asset rule.
- Trust Deed issues not seen as currently relevant (eg estate planning, pension strategies) and the changing laws were reasons for not having detailed knowledge. There is also some confusion regarding investment limitations.
- For most compliance was seen to be a matter of following the basic 'rules', ie no borrowing, no more than 4 members, annual audit required, 'sole purpose', 'arms length' investments and investment strategy in place.
- While recognised that having an investment strategy was required as part of SMSF compliance, they were typically worded to be flexible (eg 10-60% investment in shares and 10-60% in property) thereby permitting SMSF trustees to invest pretty much as they liked.
- Trustees were not sure about the penalties for non-compliance, although they knew they would apply. Opinion leaders believe that most trustees have limited knowledge on the penalties for non-compliance and that the ATO would be moving from a more educative corrective stance to more enforcement.
- Opinion leaders' biggest concern for trustees is that "*they don't know what they don't know*". This is often a function of the structure of 'off-the-shelf' Trust Deed that are not tailored to individual trustee needs and highly complex legal areas of Family Law, Corporate Law, Tax Law and Estate Planning. They also believe that most SMSF trustees are not fully conversant with what it means to be non-complying and what that impact is.

Opinion leaders believe the ATO will take a more aggressive stance towards non-complying funds and once this starts to happen, awareness of penalties will grow. They believe the ATO would and should, act against those SMSF funds that were 'wittingly' non-complying.

- While both trustees and opinion leaders recognised the need for **education** on investing especially with listed securities, little is needed for compliance/SMSF establishment or tax as these matters have already been dealt with.
- There was demand for communication regarding changes to SMSF legislation from government/ATO, in plain English, to assist with changing compliance needs.
- Few trustees had undertaken courses predominately as there are a few targeted at 'SMSF/superannuation investment' that are not attached to a financial services vendor. The need for objective and impartial education is highly evident and recognised by respondents for specific SMSF investing.
- In terms of the sources of information and investment advice newspapers are the most popular source followed by accountants and then the internet.
- Accreditation/qualification were a secondary consideration for selecting someone to establish an SMSF as it does not necessarily mean investment savvy however, on the compliance side, accreditation carries more weight.

- Awareness of FSR licensing in March 2004 is limited to professionals (accountants, lawyers, property specialists) which raised awareness of possible increases in cost as different specialists will be used for administration/ compliance and audit.

Final Comments

- Mindset of SMSF trustees, market factors and life events together all are contributing to the growth of SMSFs.
- While establishing an SMSF is not view to be overly complicated and maintaining the fund is viewed more of a chore, it is the investment management component that is the more complex.
- The research clearly points to the need for specific SMSF education focused on different investment types from an organisation that is seen to be impartial, targeted to the needs of SMSFs and available in the suburbs.