

**Vanguard**<sup>®</sup>

# Self-managed super funds

**Plain Talk**<sup>®</sup> Library





# Contents

Introducing self-managed superannuation funds	5
What is an SMSF?	6
Things to be aware of with SMSFs	8
Is an SMSF right for you?	10
Starting an SMSF	13
Choosing your investment strategy	14
Tax advantages of super	18
The Vanguard difference	22



# Introducing self-managed superannuation funds

Self-managed superannuation funds (SMSFs) are increasingly popular with Australians who are choosing to manage their own retirement savings.

In June 2017, there were over 595,000 SMSFs<sup>1</sup> in Australia with assets of more than \$696 billion<sup>2</sup>, making them the largest type of superannuation (super) fund in the market.

And SMSFs tend to hold more money than other super funds, with average assets per fund of more than \$1.1 million and an average account balance per member of \$616,000<sup>3</sup>.

So why have SMSFs become so popular? While many people like the idea of managing their financial destiny, it's not for everybody. SMSFs can be costly to establish and administer and you need the skills and time to manage your own fund.

But if you're committed and informed, an SMSF can be a powerful way to save for retirement. This Plain Talk<sup>®</sup> guide explains the pros and cons of SMSFs, how to go about setting up your own fund and the potential traps you need to watch out for.

---

1,2,3 Source: <http://www.superguide.com.au/smsfs/smsfs-lead-the-super-pack-again>

# What is an SMSF?

Like other super funds, SMSFs are used to build wealth for retirement. SMSFs are different from other super funds as members are also trustees. Members are responsible for running the fund, investing the fund's assets, paying benefits and meeting administrative and compliance requirements.

The Australian Taxation Office (ATO) regulates SMSFs to ensure trustees comply with the Superannuation Industry (Superannuation) Act 1993 (SIS Act) and other regulations.

## SMSF tip 1

Develop an investment strategy that fits your risk profile, investment objectives and timeframe.



# Things to be aware of with SMSFs

## Advantages of SMSFs

SMSFs provide control and flexibility for people who have the time and inclination to build their own wealth for retirement.

### Control

Owning an SMSF puts you in control of your retirement nest egg. You are responsible for:

- setting the investment strategy
- determining the asset mix
- monitoring and reviewing your strategy.

### Flexibility

You can tailor your investments to suit your specific needs before and after retirement. You have the flexibility to make changes to the SMSFs investments quickly and easily and allow for income payments on your retirement.

### Investment choice

Subject to certain limitations, you will generally be able to invest in an extensive range of investments available to Australian investors including investments not always available in other types of super funds, such as investment properties, direct Australian and international shares and direct fixed interest. You may choose to seek the assistance of a financial adviser to assist in selecting the most appropriate investment strategy to meet your investment needs.

### Fees

You have greater control over the fees you pay. By choosing your investments carefully and keeping transactions to a minimum, you can reduce the ongoing fees of the fund. But administrative fees can be high so make sure you compare the potential fees against what you are paying now.

## Self-managed super funds

### Insurance

SMSFs provide the ability to package very tailored insurance solutions for members over and above the standard schedule based solutions offered in many larger funds.

## Disadvantages of SMSFs

Managing your own SMSF is not a decision to be taken lightly as it carries responsibilities and risks. After all, you are dealing with your potential standard of living in retirement.

### Responsibility

Trustees are legally responsible for all decisions concerning the fund. Part of your responsibility as trustee is to ensure you understand the rules governing your fund and to keep abreast of any legislative changes. Although an adviser such as an accountant or lawyer can assist, the ultimate responsibility rests with you.

Penalties for mismanaging a fund or a compliance breach are high. If the fund is found to be non-compliant, a tax rate of 45 per cent is potentially payable on all income or other gains, and on the assets of the fund in the first year of non-compliance.

### Administration

Meeting all the statutory obligations, such as filing tax returns, keeping minutes of meetings and lodging annual tax returns, takes time.

### Fees

The costs of operating an SMSF vary, but according to SuperGuide, the average operating expense ratio (calculated as the costs of running an SMSF divided by the fund assets) is 1.10% or \$12,200 for the average fund balance of \$1.1 million, based on figures from the ATO. It's important to note that the operating costs of an SMSF will vary depending on the fund size, with the average expense ratio typically declining in direct proportion to the increase in fund size.<sup>4</sup>

---

<sup>4</sup> Source: <http://www.superguide.com.au/smsfs/how-much-does-a-diy-super-fund-cost>

# Is an SMSF right for you?

Whether an SMSF approach is the right option for you depends on a number of factors.

## Super assets

If you are considering setting up a fund, you will need enough in your super to make it worthwhile. The larger your retirement savings, the more economically viable an SMSF becomes. Annual accounting fees can cost around \$2,000, which is two per cent of a \$100,000 fund.

## Commitment

SMSFs require 'hands-on' management. While other super members hand over responsibility for managing their money to professional trustees and fund managers, SMSFs owners are responsible for the overall running of their fund.

## Skill

The more financially literate you are, the better your chances of investment success. Lack of knowledge can lead to poor or rash investment decisions that can have serious consequences on your returns.

A professional financial adviser can help you set your fund's investment strategy based on your objectives and circumstances. Advisers may charge you a fee for their services.

## Time

Running an SMSF takes time and effort. As a trustee you are responsible for keeping records, meeting reporting requirements and investing assets according to your investment strategy. A super administration service can help for an additional cost. You should weigh up the fees against the time you will save and compare them to what you are paying in your current super fund.





# Starting an SMSF

Here's a few key things to consider when you're planning to start an SMSF.

## Seek advice

You should talk to a professional adviser about whether an SMSF is right for your individual circumstances. Accountants, financial advisers and super specialists have packages and kits to help simplify the process.

## Prepare a trust deed

A trust deed sets out how the fund will operate. An accountant, solicitor or legal service company can help to prepare the deed.

## Appoint trustees

Trustees must be appointed to properly manage the fund and ensure it meets its legal and tax obligations.

## Open a bank account

A separate bank account must be opened for the fund to separate the fund's assets from personal and/or business assets.

## Keep your paperwork in order

You need to keep and retain all the paperwork for your SMSF, including accounts, annual statements, minutes of trustee meetings and trustee agreements.

## Appoint an auditor

Your SMSF must appoint an eligible auditor to conduct an annual audit of the fund's financial accounts and statements.

## SMSF tip 2

Follow the ATO's strict guidelines on SMSF investments—it's your money, so make sure you take care of it.

# Choosing your investment strategy

All SMSF trustees must prepare an investment objective for their fund and implement an investment strategy to achieve it. The investment strategy must reflect the fund's purpose and circumstances and detail how it will:

- maximise member returns within an acceptable level of risk
- diversify across a range of assets (for example, shares, property, fixed interest)
- pay benefits and fees as required.

There are a number of factors you should consider before setting your fund's investment strategy.

## Objectives and time horizon

Before you start building your investment portfolio, you need to determine your investment objectives and timeframe.

Super is a long-term investment, so it's important to take a long-term view when setting your investment strategy.

With current life expectancies and medical advances we can now look forward to a longer retirement. This means you may spend more than one third of your life in retirement.

The Association of Superannuation Funds of Australia's retirement standard for June 2017 estimates that a couple needs around \$60,063 a year to maintain a comfortable lifestyle in retirement.

It's important that you plan for your retirement income to outlive you—not the other way around.

## Risk tolerance

All investments carry some form of risk. Usually, the higher the risk the higher the potential return. It is important to understand your attitude to risk before you invest. Risk is measured in terms of volatility, that is, the amount that returns fluctuate from year to year. Growth assets like shares and property tend to be more volatile over shorter timeframes, but offer greater growth potential over the longer term. Generally, the longer your investment timeframe the more growth assets you can include in your portfolio.

If the thought of your investments going up and down is going to keep you awake at night, you may feel more comfortable choosing a more conservative or balanced investment approach. Although taking no risk can be one of the biggest risks of all, if you invest all your money in cash, inflation and costs can erode your investment returns and purchasing power over time. According to the SuperGuide, SMSFs have around 23 per cent of their assets invested in cash<sup>5</sup>. If in doubt, speak to a professional financial adviser about the best options for your investment time horizon and risk profile.

## Diversification—the key to reducing risk

Spreading your money across a range of investments is one of the best ways to reduce your exposure to market risk. This way you are not relying on the returns of a single investment. Investment markets move up and down at different times. With a diversified portfolio of investments, returns from better performing investments can help offset those that underperform.

### SMSF tip 3

Review your investment strategy regularly and whenever your circumstances or objectives change.

---

5 Source: [http://www.superguide.com.au/smsfs/smsf-investment-diy-super-asset-types#Three\\_most\\_popular\\_investment\\_classes](http://www.superguide.com.au/smsfs/smsf-investment-diy-super-asset-types#Three_most_popular_investment_classes)



## Investment restrictions

SMSFs must only invest in assets that meet the sole purpose test. This means they invest in assets for the purpose of saving for retirement.

Except in limited circumstances SMSFs can't:

- acquire assets from a related party (subject to a limited exception)
- borrow money
- allow in-house assets (such as a loan, investment or lease of a fund asset to a related party) to exceed five per cent of total assets.

Rules are subject to change. Please visit the [www.ato.gov.au](http://www.ato.gov.au) for further information.

The investment restrictions imposed on SMSFs are subject to change so it's important to keep up with legislation.

## It all starts with the right asset allocation

Once you have established your SMSF, one of the most important decisions you will make is how to invest your funds. SMSFs can invest in traditional assets such as shares, property, bonds and cash as well as more complex financial instruments such as options and certain kinds of warrants.

You should seek advice if you are considering investing in more complex or non-traditional investments.

The key to long-term performance is asset allocation—that is, the amount you allocate to shares, property, bonds and cash. Your lifestyle in retirement will depend on you setting an asset allocation that is appropriate for you and other members of the fund.

## SMSF tip 4

Make sure you have the right balance between income and growth assets.

# Tax advantages of super

Successive federal governments have confirmed super as a low-tax environment to encourage Australians to save for their own retirement and reduce the pressure on the pension system.

Super's tax advantages include concessional tax rates, franking credits on Australian share investments and even tax deductions for contributions if you're self-employed.

Super tax is a complex area that's continually changing so it is worth seeking advice from a professional tax adviser to make sure you're taking advantage of tax-smart strategies.

## SMSF tip 5

Make the most of super's tax concessions so you can keep more of your investment returns—it can make a big difference to your retirement nest egg.

## SMSF tip 6

Invest in a diversified range of assets, industries and securities to reduce market risk and improve your investment performance.



## The major asset classes

### Cash

- for short-term investors
- usually includes higher interest paying securities than bank accounts or term deposits and lowest risk of all asset classes.

### Fixed interest

- for short to medium-term investors (around three to five years)
- low to medium risk and can provide a steady and reliable income stream and potential for capital growth
- usually offers a higher interest rate, or yield, than cash
- provides access to Commonwealth Government, state governments, semigovernment authorities and company debt from Australia or overseas.

### Property

- for long-term investors (five years plus)
- lower risk growth asset than shares
- returns include income and capital growth
- diversification benefits with access to properties in retail, office, industrial, tourism and infrastructure sectors both in Australia and overseas.

### Australian shares

- for long-term investors (seven years plus)
- potential for higher returns with higher risk
- potential for income through payment of dividends and tax benefits in the form of dividend imputation and access a diversified range of companies listed on the Australian Stock Exchange.

### International shares

- for long-term investors (seven years plus)
- potential for higher returns with higher risk
- access industries and investment opportunities not available in Australia
- diversification benefits when investing in a range of countries, industries and companies.



# The Vanguard difference

When you invest with Vanguard, you have more than 40 years of investing experience behind you. So no matter which investment products suit your needs, you can feel confident that Vanguard investments are built on a rigorous investment philosophy that stands the test of time.

Since launching the first index mutual fund for individual investors in 1976, Vanguard has strived to be the world's highest-value provider of investment products and services. We have an unwavering focus on our clients with a commitment to champion what's best for investors by offering outstanding service, while keeping costs low.

## Low-cost investing

We know we can't control the markets, but we can control the costs of investing. To that end, providing low-cost investments isn't a pricing strategy for us. It's how we do business.

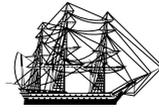
We can keep our costs low because of our unique ownership structure in the United States, which allows us to return profits to investors through lower costs so investors can earn more over time.

## Our range of managed funds and ETFs

Vanguard offers a complete range of funds across all asset classes.

To see our complete product offerings, visit [vanguard.com.au](http://vanguard.com.au).





**Vanguard®**

## **Connect with Vanguard™**

vanguard.com.au

1300 655 101

This material contains general information and is intended to assist you. Vanguard Investments Australia Ltd (ABN 72 072 881 086 / AFS Licence 227263) is the product issuer. We have not taken your circumstances into account when preparing this material so it may not be applicable to your circumstances. You should consider your circumstances and our Product Disclosure Statements ("PDSs") before making any investment decision. You can access our PDSs at [vanguard.com.au](http://vanguard.com.au) or by calling 1300 655 101. Past performance is not an indication of future performance. This material was prepared in good faith and we accept no liability for any errors or omissions.