



Things to consider in Turbulent Markets

With investment markets in volatile times, many SMSF Trustees are exercising the control and flexibility of their SMSF by making investment changes in response to market conditions.

However, Trustees must also remember their Trustee obligations and ensure that compliance requirements are being met.

Trustees should consider the following:

- Has there been a change in strategy?
- Has this influenced the asset allocation and risk profile for either the fund members or the overall fund profile?
- Has the SMSF Investment Strategy been updated?
- How do market conditions impact your pension payments?
- Do you have an in-house asset that might be nearing or exceeding the 5% limit?
- Is your estate planning strategy still in order?
- What alternate investments can I invest in?

A Change in Strategy

At the end of the March quarter 2008, \$58.6 billion of SMSF dollars were invested in cash, debt securities and term deposits – up \$1.8 billion on the previous quarter.

Investments in listed shares and equities fell from \$107.4 billion in December 2007 to \$93.7 billion at the March quarter's end.

Where Trustees dispose of assets in favour of retaining cash or other assets during volatile times, this inevitably varies the fund's asset allocation. The volatility may also influence the Member risk profile. A complete review of the investment strategy would be required in this instance.

Trustee Tip: The SMSF Investment Strategy must be kept up to date by the fund Trustees at all times. Any major changes need to be documented and reflected in the document.

No Change in Strategy

ATO roles and responsibilities require SMSF Trustees to 'exercise the same degree of care, skill and diligence as an ordinary prudent person in managing the fund'.

If, in turbulent times, no action is undertaken for a fund – it could be questioned as to whether the Trustees are managing the investments 'prudently'.

Therefore, Trustees should be seen to consider the portfolio performance and if the Trustees agree on no change in strategy - this should be documented to provide evidence that the Trustees are fulfilling their duties.

Pensioners

Account based pension minimum levels are derived on commencement date, and then based on the market value of assets as at 30 June of each year.

The All Ords index in Australia was 5654.70 points, down 17.5% from its high of 6851.5 on 1/11/07.

The reduction in equities markets may have diminished the asset value of your fund as at 30/6/08.

Those with pensions carried forward from previous years or commencing pensions on 1/7/08 may therefore see a lower level of pension minimums for 2008/09 than would normally be the case.

The lower minimum pension levels may benefit some who wish to withdraw the minimum pension level and retain as much capital in their fund as possible.

Conversely, for those running Transition to Retirement Pensions, which have a maximum withdrawal limit of 10% of the member account balance for the financial year, the lower than normal asset values will reduce the maximum withdrawal amount. This may impact those needing the funds for personal living, as well as those commencing a pension and salary sacrifice strategy.

Unfortunately, if pension payments are drawn at the same rate as in previous years, this means that the pension payments will represent a greater proportion of the total superannuation balance (assuming the balance has reduced due to declining share values), therefore reducing the superannuation balance at a more rapid rate.

Furthermore, if Trustees need to sell their shares to provide cash to fund pension payments, it may not be the ideal time to sell the investments of the super fund and would prevent the fund from enjoying any benefit should the investment markets rebound.

For example, if a member draws an annual pension of \$80,000 when the pension balance was \$1,000,000, this represents a pension of 8%. If the pension balance as at 1 July 2008 drops to \$750,000 due to market conditions and the member continues to receive an \$80,000 pension, this now represents 10.66% of the pension balance.

SMSF Members approaching retirement may now need to consider working for longer – to ensure they have an adequate starting pension account balance to support their anticipated required income for the future.

In house assets

An 'in house asset' of a SMSF is generally an investment in or a loan to a related party of the members of the fund. The total value of in house assets cannot exceed 5% of the fund value at any point in time.

Therefore, if a SMSF's share portfolio value declines, whereas the market value of in house asset remains the same, then there is a risk that the value of the in house asset will exceed 5%, putting the fund at risk of non-compliance.

For example, assume a SMSF loans \$45,000 to the family company and the SMSF has total asset values of \$1,000,000. The \$45k is deemed to be an in house asset and represents 4.5% of the market value of the fund.

If the following year the SMSF total asset value drops to \$850,000 but the loan remains at \$45k, then the loan now represents 5.29% of the fund balance - a breach of the 5% in house asset allowance and the ATO may deem the fund to be non-complying.

Death Benefit Nominations and Estate Planning

Another area for review and consideration is the Member Death Benefit Nominations.

Often, superannuation is considered as part of a greater estate planning strategy. The estate plan may be put in place based on the value of the different assets held within an estate. For example: a Member may decide to leave assets outside of super (such as property) to an adult child – and the superannuation balance to another (such as a dependent).

If the SMSF assets are impacted by low market conditions, this could mean that upon the event of death, the distribution of the estate is out of proportion. Such a situation could then result in potential litigation consequences.

Death Benefit Nominations should be considered in turbulent times and reviewed regularly.

SuperGuardian clients can access current copies of their Nomination of Beneficiary Forms via the Online Documents Login on our website.

What Can SMSF Trustees Invest in?

In turbulent times, it is natural to consider alternative investments. Such considerations should be made in consultation with your Financial Adviser and the context of your investment strategy and the strategy revisited should you decide to proceed with alternatives.

SMSF Trustees can invest in any asset provided it has the sole purpose of providing financial benefits on the retirement of the members. We have seen investments in real estate, artwork, yacht berths, vintage vehicles, wine, heavy machinery, water licenses, private equity and other abnormal items.

Before investing in such items, the Trustees should ensure that the asset is not acquired from the member of a related party of the member. Additionally, there should be no benefit to the members or a related party unless the asset value is less than 5% of the value of the fund.

Some alternative on-market products that SMSFs are able to invest in include:

- Options
- Bonds
- Futures
- CFD's
- Instalment Warrants

SMSF can invest in such products provided the fund does not borrow or use the assets to provide security unless they qualify under the new instalment warrant provisions.

Investments that SMSFs are not able to make include naked options – i.e. selling options that the SMSF does not already hold stock over. ASIC has recently stopped this practice.

We urge you to speak to your Financial Adviser for more information about alternative investments.

Summary

For further information about compliance issues relating to your fund, or information in this newsletter, please call **Brendan Daw** on **1300 787 576**.



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