A river of gold that's flowing the wrong way

TONY NEGLINE

The last few years clearly shows that super fund death benefits are a new and lucrative river of gold for solicitors.

These death benefits are often sizeable sums of money and are also relatively easy to attack because most people take inadequate steps to protect their super, as several court cases demonstrate. (To read how death benefits actually work under the law see Monica Rule's column on this page.)

About two years ago, the Queensland Supreme Court handed down a decision involving the payment of a $450,000 lump sum death benefit directly to a mother after her adult son had died. He had no dependants and died without a will and under the Queensland intestacy laws his estate had to be shared equally with his surviving parents who had acrimoniously divorced.

The court had appointed the deceased's mother administrator of the estate. A key job of a deceased estate's administrator is to maximise the value of the estate. Her ex-husband's solicitors asked her what she was doing to achieve this, especially as the super fund death benefit was large and had been paid to her personally and not to the estate.

She argued that it didn't form part of the deceased estate and she hadn't done anything wrong. The court disagreed with her and said she had a duty as administrator to maximise the estate. It ordered that the super fund death benefit be paid to the estate and split equally between herself and her previous spouse.

A more recent South Australian case adds extra layers to the puzzle. Professor John Brine died in December 2012 leaving a defacto spouse, Norma Carter, and three adult sons from a prior marriage to argue over his total estate. Most of his super money was held in UniSuper.

At the time of death Brine was semi-retired and was receiving two pensions from UniSuper — one was an indexed lifetime pension and the other a flexi-pension.

As Norma Carter was deemed by the super fund's rules to be John Brine's spouse, she automatically became entitled to continue to receive the income payments from the lifetime pension.

The account balance of the flexi-pension in December 2012 was about $545,000 and UniSuper's trust deed said it would either be paid to Brine's dependants or his estate or a combination of dependants and estate. On his application form for this benefit Professor Brine had said he preferred that any proceeds be paid to his estate.

The executor's of Brine's estate were Carter and his three sons.

Now based on the McIntosh decision, you would imagine that the four of them would have sought to maximise the estate.

The Brine boys contended that Carter had failed to disclose to her co-executors anything about the super benefits and then also failed to say that any part of it could be paid to the estate of which the sons and their children were beneficiaries. They claim that initially she said the flexi-pension account balance could only be paid to dependants such as spouses, adult disabled or minor children.

Ultimately, the Brine sons and Carter all claimed the flexi-pension account balance from UniSuper. Verbally one of the Brine sons told the court that a UniSuper representative had told him that Brine had only given the super fund trustee an indication that he would like this money paid to his estate. The representative further said that "in practise the trustee almost invariably exercised its discretion to pay a dependant rather than the estate if there was a dependant, even if there was a preferred nomination in favour of the estate".

It is therefore unsurprising that UniSuper decided to pay the flexi-pension account balance to Norma Carter even though as executors the Brine sons had objected to this decision and also complained to the Super Complaints Tribunal.

The court did say that until early March 2013, Ms Carter had misled her co-executors and had breached her executorial fiduciary duties until that date.

Both these cases have made everyone in the super industry quite nervous as they clearly show that death benefit procedures, practice and advice need to be drastically improved.

Tony Negline is author of The Essential SMSF Guide 2015-16 published by Thomson Reuters.

Beta out for something better

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Across investment markets investors have always sought to diversify investments: To truly make that happen it's thought investors should have what are known as 'non-correlated' assets. The theory is that non correlated assets will move in the opposite direction to the rest of your portfolio when things get tough.

When market returns are negative, managers of non-correlated assets look for an inverse relationship or a positive return, however technically managers of uncorrelated assets (while not necessarily boosting their returns) would more likely simply avoid losing money.

For example, if there was a stock market crash the non-correlated assets should stay steady while share prices are plunging.

As market volatility has increased we have seen more fund managers presenting more alternative asset opportunities to the wealth management industry. Many hedge funds cite the non-correlated nature of returns to traditional asset classes. The non-correlated activities of the Future Fund, now chaired by former Federal Treasurer, Peter Costello is often cited as a model.

We have now entered a lower return environment where market performance (Beta), a traditional measure of returns has become expensive, and therefore the market is looking to generate "Alpha", or excess return above the market.

Risk adjusted returns are generally measured using the Sharpe Ratio which is the excess return above the risk free rate or the cash rate as it is assumed to have zero risk.

Why is correlation important for investors adjusting their strategy in changing times?

Stephen Romic from DFS Advisory Portfolio Solutions points out that, "equity risk is the main risk that dominates all portfolios and interest rate risk associated with bond markets tends to be the dominant risk factor across the defensive part of portfolios."

As forecasting future returns is problematic and challenging at best, it is sensible to construct diversified portfolios that reduce risk. In this context, reducing risk means allocating a part of the asset allocation to investment strategies that do not follow the direction of equity and bond markets, which generally dominate portfolios".

Which is all very well, but a private investors has to consider a few points when comparisons are made with institutional managers especially the $130 billion Australian Future Fund

*1 Firstly, the Future Fund does not have liabilities or outgoings until 2025 therefore its time horizon is at least nine years. When they look at a certain investment strategy investors must firstly ensure they are comparing apples with apples.

*2 The Future Fund has allocated 10 per cent of its assets towards Private Equity (PE) which can be difficult to access for the private investor. Raphael Arndt Chief Investment Officer at the Future Fund says the approach is to use PE to access "the innovation cycle and disruptive technologies" and stresses it is not "strongly correlated to listed equity markets".

Arndt mentions the "high fees and poor alignment" that can exist in this space and emphasises the importance of a high level of analysis and understanding to provide exposure to managers with "appropriate terms and share an acceptable amount of the 'alpha' they generate with investors".

*3. Non-correlated assets can be illiquid (you can't sell them easily or quickly). Indeed, Private Equity by its very nature is equity as opposed to debt and investors must bear that in mind.

Separately, the Future Fund also has an allocation of 12 per cent to alternative assets. Again due diligence is stressed by Arndt with an emphasis on "true uncorrelated returns and doing so with reasonable fees and liquidity ".

While professional wealth managers emphasise the investment cycle as the time period an investor should approach investment returns, the reality is that many investors approach the time period as three years. Arndt does suggest alternatives need a time frame of the longer term.

Another perspective on alternative assets comes from Stephen Brown of Monash University and the Stern School of Business at New York University, Brown highlights a 60/40 stock/bond portfolio has a ten-year annualised return of 6.6 per cent against 5.6 per cent for hedge funds.

Despite this, Brown does advocate a small allocation towards hedge funds (5 per cent) and says that they do reduce financial risk. Yet many wealth managers under appreciate the due diligence that is necessary to understand the operational risks, and recognise that diversification alone is not sufficient to mitigate such risk. Therefore, unsophisticated investors can fall into the trap of simply chasing past returns..

Romic has a counter to Browns argument and points out that "equity markets offer the greatest upside potential as they come with the highest level of risk. If uncorrelated investment strategies are reducing exposure to equity markets, then it follows that they cannot expect to outperform equity markets over the long term. We see uncorrelated investment strategies playing a defensive role; its' a portfolio diversifier and certainly not a return chaser."

Such portfolios of uncorrelated investment strategies are increasingly becoming attractive in the current environment where cash and bond yields are at historically low levels".

He goes on to point out that "a portfolio of multiple investment strategies (uncorrelated to equity & bond markets and uncorrelated to each another) must have the potential and expectation of outperforming cash over a complete cycle. If they don't then the default quickly becomes cash.

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Super death benefit: how it's passed on to beneficiaries and how to avoid grief

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SMART INCOME

High on the list of the government's superannuation concerns is that self-managed superannuation funds are being used for estate planning purposes.

Although the main purpose of an SMSF is to provide retirement income for members, the superannuation law does allow a member's superannuation savings to be passed on to their beneficiaries upon their death.

There can be serious disputes in this area and it is worth understanding how it all works. (To read more on disputes that have arisen in this sector see Tony Negline's column in this section today.)

If the trust deed of a member's SMSF allows for the payment of a death benefit, then the death benefit can be paid directly to the deceased's dependants or to their legal personal representative.

Under superannuation law, people who are classified as "dependant" are a spouse of the deceased member (including de facto partner or a same-sex partner), any child of the deceased (including a stepchild, adopted child or ex-nuptial child), a person with whom the deceased had an interdependent relationship, and a person financially dependent on the deceased prior to their death.

An interdependent relationship is where two people have a close personal relationship and live together, where one or both of them provide for the financial and domestic support and personal care of the other. Such a relationship can also exist if there is a close personal relationship, but the other requirements can't be satisfied due to a physical, intellectual or psychiatric disability.

The two people can be related (a mother and son or two elderly sisters) or not related to (friends).

A legal personal representative is a person who has been given an enduring power of attorney over the affairs of the deceased member. It is usually someone known to the deceased such as a family member, a trusted friend, or their accountant or solicitor.

So this means, upon the death of an SMSF member, the member's superannuation savings can be passed on to their spouse, their children (including adult children) or to their legal personal representative. If it is passed on to the legal personal representative, this person will distribute the deceased's superannuation savings in accordance with the deceased's wishes stated in the will.

Now, the tax treatment of a death benefit is based on whether the beneficiaries are classified as a "death benefit dependant" under the income tax law. If a person is classified as a "death benefit dependant", they can receive the deceased's superannuation tax free if it is paid as a lump sum death benefit. If it is paid as a pension, no tax is payable provided either the deceased or the beneficiary is over the age of 60. You should be aware that a person who is a dependant under the superannuation law may not be a dependant under the income tax law.

People who are classified as a "death benefit dependent" under the income tax law are: a spouse or a former spouse of the deceased (of the same sex or opposite sex); a child aged less than 18; any other person with whom the deceased person had an interdependent relationship with just before their death; and a person who was financially dependent on the deceased prior to their death.

To satisfy the term "financial dependent", a person would need to have relied on the deceased member for financial support. The financial support must be substantial and the person would need to rely on the financial support to maintain their basic needs. It cannot merely supplement their income or provide them with a higher quality of life. It must be a situation where if the financial support were withdrawn, the person would not be able to survive.

So, in order for an adult child of the deceased SMSF member to receive the parent's superannuation savings tax-free, they would need to either have an interdependent relationship with their parents or they would need to be financially dependant on their parents prior to the death of the parent. While wealthy individuals might be able to support their adult children, this is out of the question for most average SMSF members.

Monica Rule is an author of The Self Managed Super Handbook — Superannuation Law for Self Managed Superannuation Fund in plain English.

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ASX CODE: WTC
SHARES ON OFFER: 24.3m-75m
LISTING PRICE: $2.58-$4.12
MARKET CAPITALISATION: $762.9m-$1,190.7m
LISTING DATE: April 11

SIMON HERMANN

The largest tech IPO and one of the biggest IPOs year-to-date is coming from Sydney-based software company WiseTech Global. Richard White founded WiseTech in his basement in 1994 and could now realise a market capitalisation of more than $1 billion for his company.

WiseTech Global is an Australian software company providing software solutions to the global logistics services industry. WiseTech's flagship product is CargoWise One, a software platform that facilitates the movement and storage of goods and information.

WiseTech has 6000 customers across more than 115 countries with offices in Australia, New Zealand, China, Singapore, South Africa, Britain and the US.

WiseTech is raising capital to repay debt, enabling existing shareholders to monetise on their investment and to achieve financial flexibility to support management's growth strategy.

The price range for one WiseTech security is set at $2.58-$4.12 and the final price will be determined via bookbuild. WiseTech is expected to have a market capitalisation of at least $750 million or more depending on demand and the final price for the IPO.

On paper WiseTech's historical growth trajectory appears to be strong as revenue has increased at an average annual rate of about 25 per cent since the 2013 financial year.

In the same period net profit after tax has tripled and the company is generating free positive cashflow.

Retention rates are high with recurring revenue representing more than 95 per cent of total sales.

Furthermore, management has a strong track record in the industry and aims to direct free cash flow as well as proceeds from the raising towards future growth initiatives.

The competitive industry and reliance on key customers are principal risks.

WiseTech's 10 largest customers represent more than 20 per cent of total revenue and any cancellations would adversely impact financial performance.

Even though the valuation incorporates a degree of ongoing growth, overall the IPO offers an attractive mix of capital growth and income.

Simon Hermann is an analyst at wise-owl.com.