NEW RULES TO WATCH

Writing on the wall for super art

Monica Rule

A client recently asked whether she should get rid of some artwork that her self managed superannuation fund had bought a few years ago and displayed in her home.

A major concern was that the possessions could be affected by the new superannuation rules covering collectables that come into effect on July 1, 2011.

A series of conditions now govern an SMSF's purchase of assets that are ordinarily used or kept for family enjoyment. These assets include art works, jewellery, antiques, artefact, coins or medallions, postage stamps or first day covers, rare folios, manuscripts or books, memorabilia, wine, cars and recreational boat.

Funds must comply with the following conditions: the asset must not be used by a related party; the asset must not be leased to a related party; the asset must not be stored in a private residence of a related party; trustees of the SMSF must have a documented decision on storage of the asset and this document must be kept for ten years.

Also the asset must be insured in the SMSF's name within seven days of being purchased and, if the asset is sold to a related party, then the trustees must have an independent valuation of the asset and the sale price must reflect its true commercial value.

A "related party" includes members of the SMSF, relatives of the members of the SMSF and any business associates/entities that the members of the SMSF control.

The good news for my client is that because her SMSF purchased the artwork before July 1, 2011, she has two options as to what she can do with the artwork in order to comply with the superannuation law.

Her first option is to lease the artwork from her SMSF. This is because, under the old superannuation law, she is able to lease the artwork from her SMSF provided the value of the artwork is no more than 5 per cent of the total value of the assets held by her SMSF. For example, if the total accumulated superannuation savings in her SMSF is $250,000, then provided her artwork is no more than $12,500, she can lease the artwork from her SMSF. This transaction is referred to as an "in-house asset" transaction. She would need to pay her SMSF a commercial rate of rent for the usage of the artwork.

Her second option is to purchase the artwork from her SMSF. If she decides to do this she needs to prove that the price she paid to her SMSF to purchase the artwork is at the market rate. She could perhaps ask the art gallery where her SMSF purchased the artwork to give a written quote on the artwork's value.

If the artwork remains in her SMSF, she needs to insure the artwork in the SMSF's name and store it in a secure place and not display if on the walls of her home for her enjoyment or personal use.

However, my client does need to be aware that although the law is for new investments acquired by SMSFs from July 1, 2011, the conditions under the new law will also apply to her SMSF from July 1, 2016. When the law was introduced, it provided a five-year transitional period for any investments acquired prior to July 2011. This means, come July 2016, my client will no longer be able to lease the artwork from her SMSF; store the artwork in her private residence or use the artwork for any other purposes.

She must also have a documented decision on storage of the asset and this document must be kept for 10 years.

I hear all the time from lovers of artwork who are not too happy about the new law. I guess I can only say that you need to keep in mind that the sole purpose of a superannuation fund is to provide for your retirement. Therefore, investments must be made solely for retirement income purposes.

Arguably, up until now, assets such as collectables and personal use assets have been acquired by SMSFs to provide immediate personal enjoyment for their member which is not in keeping with the sole purpose of a superannuation fund. I guess the good news is that our Government does recognise that these assets can be legitimate investments for some SMSFs and has not stopped SMSFs from acquiring them.

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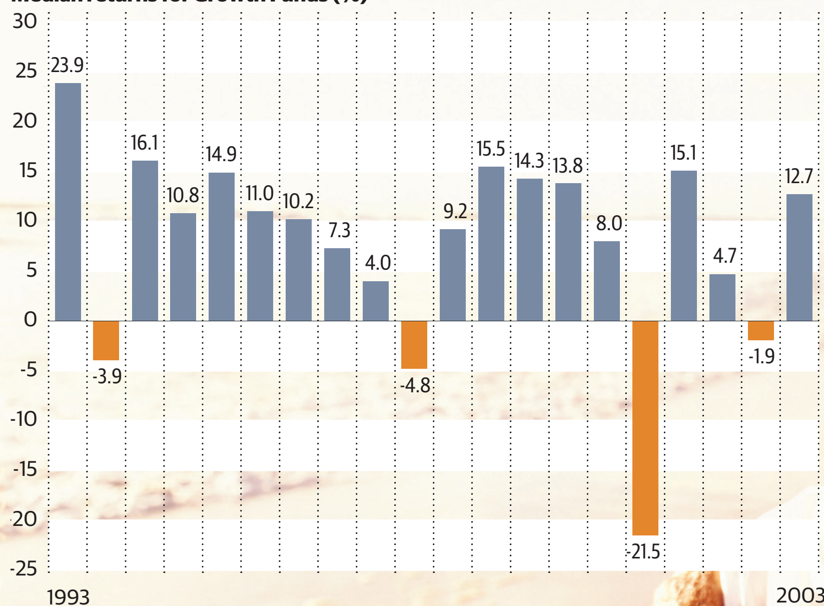
Bad year can ruin lifetime savings

Lesley Parker

FOR BETTER AND WORSE



For nearly 20 years, the two super fund members neatly track each other, contributing similar amounts and earning similar returns within the balanced option of their super fund. Yet, despite picking up their final pay packet within about a year of each other, they retire with markedly different balances of $444,609 and $308,716.

In this illustration, based on the real-life returns for two average members of industry fund QSuper, one person retires just before the financial crisis hits, while the other retires just after global sharemarkets capitulate.

Most of us would describe the second member's experience as bad luck. But the experts have another name for it: sequencing risk.

Sequencing risk is one of the "big ideas" being discussed in the super industry as funds try to work out how to better protect members the next time there's a market shock.

As the first round of baby boomers heads into retirement, new approaches and products are starting to emerge as a result.

Stephen Huppert, a partner in Deloitte's actuaries and consultants team, said funds were starting to look at outcomes from a member perspective, rather than just beating a benchmark or in the top quartile of league tables.

"The conversation is becoming louder and louder, and it's a very important shift in the conversation," he said. "It's about retirement income."

A professor of finance at Griffith University, Michael Drew, works in this area and laments that until now the focus has been: "How do we achieve the pot of gold?"

What results is the feeling of being "rich on Friday, poor on Monday", as retirees put away the farewell card and sit down to do the maths on what sort of income their payout will fund.

The first baby boomers to reach official retirement age know all about bad luck and bad timing.

"In their last decade of work, they experienced the bursting of the dotcom bubble, the subprime (mortgage) crisis, the GFC and they're now living through a sovereign-debt crisis," Professor Drew said. "That to me is sequencing risk."

He is referring to the way the order of investment returns — not just the scale of them — affects your final balance. "It's not just the average of returns over a period that matters, it's the ordering of those returns," says Drew, who is leading Australian research in the area.

Two people making similar contributions can earn the same average return over 20, 30 or 40 years, and yet retire with vastly different sums. That's because while the average comes out the same, the returns may have fallen in a different order for those two people.

Drew's work shows that a negative return near the end of your working life has a much larger impact than if it had occurred near the start. That's because the negative return applies to a much greater account balance.

Only a minority of Australians — about 20 per cent — can afford, or are willing to access, individual advice from a financial planner, so the pressure is on super funds to provide sound strategies for members. For some funds, this is pointing to what's being called "mass customisation", where they attempt to tailor strategies to individual members, rather than having default strategies where one size is supposed to fit all.

The director of superannuation for asset consultancy Russell Investments, Tim Furlan, said mass customisation should be the "minimum standard" for super funds. "The fact is that different individuals with different numbers need different solutions," he said.

He said the best approach depended on who you spoke to.

Bond managers say Australians are overly exposed to equities and need to take a more defensive approach to protect their retirement savings. Equity managers say only growth assets such as shares can combat longevity risk. Annuities are promoted by some but dismissed by others as too expensive.

"There are lots of thoughts out there, but a lot of the ideas are conflicting," Mr Furlan said. "That's confusing for people.

"But the idea that there will be one killer solution is probably a little fanciful."

The century-old industry super fund, QSuper, is taking the radical step of running separate investment strategies for members aged in their late 50s, even when they remain in the "default" option.

Those who haven't exercised their investment choice will be streamed according to factors such as age, contribution rates and accrued balance, and assigned one of a number of strategies according to their circumstances.

QSuper will eventually roll out this form of mass customisation to all members in the default option, but started with those in their late 50s because they faced the greatest risks — including sequencing risk.

Managed funds listings

Technical difficulties have prevented the publication of the managed funds page this week. We apologise for the inconvenience. The page will return next week.

EQUITY WORLD LARGE GROWTH

FUND NAME	SIZE $m	MER % pa	RETURNS TO DEC 31 1 yr %	3 yr %	5 yr %
Walter Scott Global Equity	1612.96	1.28	14.73	2.87	-0.22
Zurich Investments Gl Thematic Shr Pool	1385.16	0.98	12.90	1.53	-2.51
Aberdeen Actively Hedged Intl Equities	756.27	0.98	14.49	4.37	-2.37
Capital International Global Equity	322.09	0.96	15.49	1.15	-
Peters MacGregor Global	68.82	1.58	18.30	9.58	1.46
BT-Aberdeen Act Hgd Intl Eq	14.91	2.15	11.76	2.84	-3.66
CFS FC Inv-MFS Global Equity	8.43	2.06	19.76	3.58	-7.94
CFS FC Inv-Generation Global Share	6.46	1.86	15.72	0.78	-1.51
OnePath OA IP-MFS Global Equity EF	5.95	2.85	20.09	3.55	-1.70
Franklin Global Growth W	3.86	1.10	21.36	3.33	-

MER: Management expense ratio is the ongoing annual fee as a percentage of the amount invested

SOURCE: MORNINGSTAR