

ADVISERS GUIDE TO SETTING AN INVESTMENT STRATEGY

Due to questions from Advisers in relation to investment strategies and DIY superannuation funds, especially those with non-standard assets, we have put together this guide to assist you with working with your clients to set an appropriate strategy.

As the responsibility for setting each investment strategy rests with the trustees of each fund and any financial advisers that they work with, no guarantee is given that any examples herein meet any person's particular needs. Any examples are given only to provide some guidance to those setting investment strategies and not as definitive statements.

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The Tax Office's viewpoint

The ATO guide to SMSF Investment Strategies states that:

"The strategy must reflect the purpose and circumstances of the superannuation fund and have particular regard to [SISA s52(2)(f)]:

- investing in such a way as to maximise member returns taking into account the risk associated in holding the investment;
- appropriate diversification and the benefits of investing across a number of asset classes (for example, shares, property, fixed deposit) in a long term investment strategy; and
- the ability of the superannuation fund to pay benefits as well as other costs of the superannuation fund as they become due and payable.

An appropriate investment strategy will set out the investment objectives of the superannuation fund and detail the investment methods the superannuation fund will adopt to achieve these objectives. Trustees must ensure that all investment decisions are made in accordance with the investment strategy and should seek investment advice or appoint an investment manager in writing if in any doubt".

While they have not put it in writing we have been informed in various meetings with them that they consider an appropriate range spread in each investment category to be no more than 30% eg 0-30%, 50-80%.

From a financial planning viewpoint

Think of the strategy as no different to any other financial plan and it will make more sense. We have received investment strategies from advisers with investment ranges of 0-90 for every category. What this is saying to the ATO is "I'm going to invest wherever I feel like". This is not very structured and certainly would not satisfy most financial planners or their compliance officers if such a strategy was implemented in their client's personal financial plan.

The trustees and their financial adviser must treat the financial plan ie investment strategy in the same manner as they would any other financial plan. The risk levels suitable to the members must be ascertained and the investments must match that risk profile and the ages of the members.

Simple Asset Allocation Strategies

The forms supplied for advising us of your investment strategy are only really designed for straight forward asset allocation strategies such as "Cash", "Balanced", "Growth", "Aggressive" etc where the overall strategy is to stay within fairly well defined bounds and they will be monitored fairly closely by the trustees and financial adviser.

If you have needs outside this which are indicated on the form, we will have to get you to create a more comprehensive investment strategy based on your specific needs.

Keep it Simple

Do not put **every** investment class, collectible, in-house assets etc in the strategy just on the off-chance that the fund **MIGHT** invest it one of these classes one day – be specific about where the fund is going to invest over say the next 12 months. It is a strategy, not a wish list or a maybe list. The strategy can be adjusted at any time so do not try to include every possibility at the outset.

Treat a strategy for a super fund like any other financial plan – I do not think any advisory firm would condone a personal financial plan that said "*maybe you should invest here or here or possibly even here*".

Non-standard Asset Allocation Strategies

Non-standard investment strategies include those where investments are made in the following:

- Farms
- A single real estate property
- Antiques, Art, Jewellery, Diamonds
- Frozen embryos
- Shares or units in an unlisted entity
- Boat mooring
- Racehorse sires
- Original Coke bottles

For these types of strategies you will need to be able to **JUSTIFY** your selection by:

- Demonstrating you have adequately investigated the type of investment – likely returns, potential for gain, future market etc.
- Demonstrating that you have the skills or have access to the skills to adequately select and monitor the non-standard investments on an ongoing basis.
- Explaining why the whole fund should be invested in one real estate property for example.

This last area is one of particular concern to the regulators who have indicated that they are unhappy where fund members are older and hence more likely to be wanting to draw on the fund when there is no liquidity to enable them to do so.

There are sample clauses included in our template that you can use to justify single investments.

What if I cannot attain my Investment Strategy in the short term?

Investment Strategies are your medium to long term goals for the fund. Obviously there are situations where funds will remain in cash until a suitable commercial property can be located or using dollar cost averaging to build up a share portfolio for example. The important thing is that you be able to show that you are monitoring the strategy – if there is a reason for the fund still being in cash and you record that then you have “monitored the strategy”. In these cases you could also say in a non-standard strategy document things like:

The medium term goal is to have the assets of the fund invested as follows:

Cash	a%-b%
Australian shares	c%-d%
Property	e%-f%
International Shares	g%-h%
etc	

We intend to use dollar cost averaging to build up the Australian share component of the fund over the next 2 years because Over that time the percentage held in cash is likely to exceed the long term favoured percentage.

In this way any regulator looking at the asset allocation and seeing that it is outside its desired allocation can see that you have a reason for it and are monitoring the progress to the stated objectives.

Similarly:

- If say a real estate property comprising a large component of the fund is sold and you intend to wait to replace it (thereby leaving a large component in cash), a minute should be created to show that you have considered the situation.
- If you intend to purchase a farm over time from ongoing contributions, you should state something like: “The goal is to have 80% of the fund invested in xyz over the next n years by purchasing about \$A’s worth each year from regular contributions to the fund.” Naturally you would need to write up a document as to why you thought the fund should invest in the farm in the first place and as to why the fund should invest so much of its funds in one asset.

Conclusion

When setting an investment strategy you must imagine that you are sitting on the board of a large corporate superannuation fund and as such are keen to protect yourself from attack from the members of the fund due to inappropriate investment decisions, lack of liquidity etc. You need to create a paper trail that will provide this protection.

You may think that this is overkill for a small fund where the members are also the trustees. Unfortunately the legislation and the regulators disagree.



WHY IS AN INVESTMENT STRATEGY SO IMPORTANT?

All superannuation funds, including DIY funds, are required to have an Investment Strategy which is in accordance with the members needs. The need for adherence to these strategies has become a greater administrative burden and necessity due to the new penalties which can be imposed for a fund without a suitable Investment Strategy or one that has not been reviewed regularly. If a fund trades outside its Investment Strategy for more than 90 days it is considered a compliance breach which may render the fund non-complying and expose it to fines.

Upon the establishment of a self managed superannuation fund the members become the trustees of the fund or directors of the trustee company. There are significant obligations and potential liabilities associated with acting as a trustee. The requirement to establish an investment strategy is included in all superannuation fund trust deeds (or is deemed to be included in each deed) and will help protect the trustees from liability in relation to investment decisions that are made.

The trustee of a self managed fund has statutory protection against actions brought against it in relation to losses or damages caused by investments undertaken by the fund but only where the investments are made in accordance with the fund's investment strategy.

APRA's "Super Circular IID1 - Managing Investments & Investment Choice - Investment Strategies" outlines APRA's guidelines on setting appropriate investment standards. Trustees must take into account (but not limited to):

- the risk involved in making, holding and realising investments, as well as the likely return from the investments having regard to fund objectives and expected cash flow requirements;
- the composition of the fund's investments as a whole including the extent to which the investments are or are not diversified and the associated risks;
- the liquidity of the fund's investments having regard to its expected cash flow requirements; and
- the ability of the fund to discharge its existing and prospective liabilities.

Provided the trustee has made investments in accordance with the fund's investment strategy then that strategy can be used as a statutory defence against claims for loss or damage suffered by a person as a result of the making of an investment in accordance with the investment strategy. It is to be noted that the liability for loss or damage can apply to **any** person who is involved in the investment management of the fund, including financial advisers.

It is important that the trustee ensures that the investment strategy is:

- in writing;
- consistent with investment decisions being made by the trustee; and
- is formulated with regard to the whole circumstances of the fund

ONGOING MONITORING

The obligation for the trustee to formulate and implement an investment strategy also requires the trustee to monitor and review the investment strategy on an ongoing basis to help ensure that the investments made by the trustee continue to be consistent with the investment strategy. Where this is not the case the trustee will be required to amend the investment strategy to reflect the change in the investment approach.

ATO REVIEWS

The recent audit reviews carried out by the ATO have shown that the fund's investment strategy is a key point of their audit focus.

SO WHAT IS A GOOD STRATEGY?

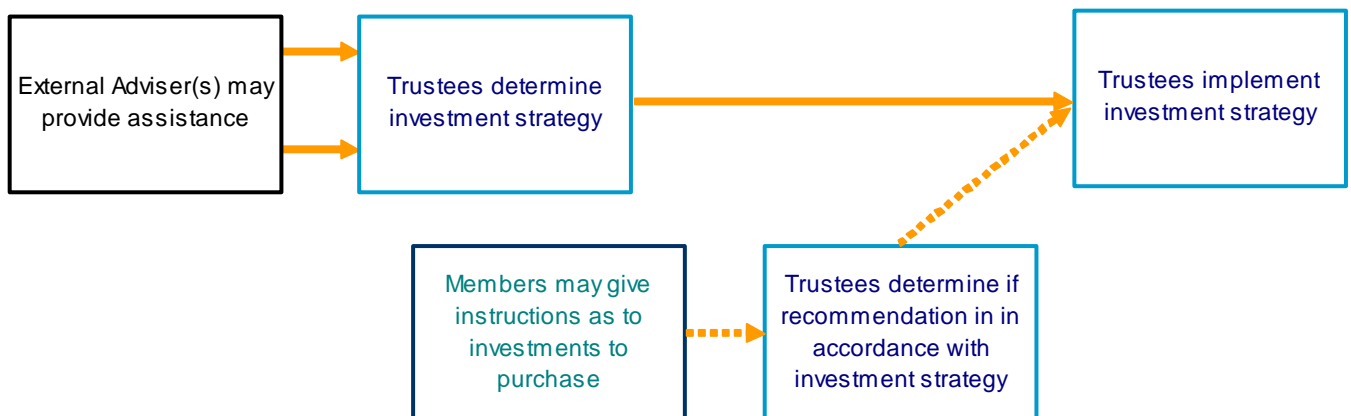
The key is that the strategy meets the need of the members. These needs may be met in a number of different ways, thus no 2 funds need have exactly the same asset mix even if the objectives are identical. A suitable investment strategy will include, but not be limited to the issues noted above i.e. risk, diversity, liquidity and the ability to meet current and future liabilities. In addition, it is suggested that a well drafted investment strategy document should include:

- The fund's indicative asset allocation and strategic ranges to operate within
- Reference to reserves and their management (where the trustees intend to operate reserves)

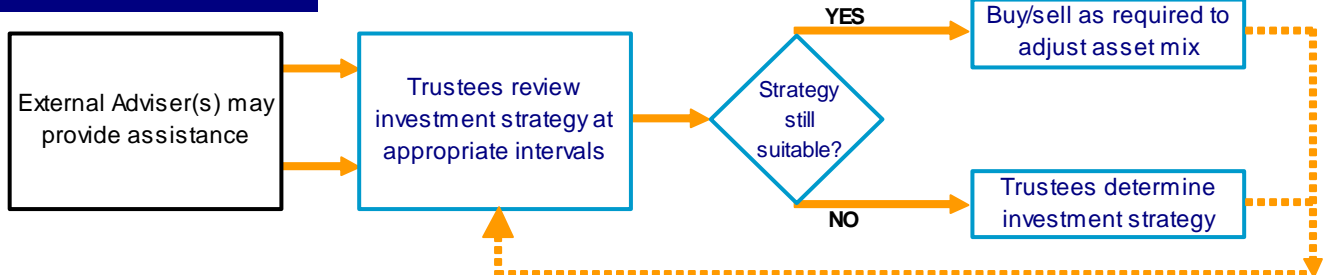
smartsuper can provide your adviser with an investment strategy template document that can be used to set your strategy. This Investment Strategy template document is of a general nature and is not intended to take into account the particular investment needs, objectives or financial circumstances of any particular person. This template is provided on the conditions that:

- it is used only by licensed financial advisers;
- **smartsuper** is not responsible for the provision of any advice; and
- **smartsuper** assumes no responsibility for the formulation and implementation of the Investment Strategy [as that term is understood in the Superannuation Industry (Supervision) Act 1993 (SIS)] for any particular person.

THE INVESTMENT PROCESS



THE MONITORING PROCESS



Any adviser utilising this document is responsible for assessing whether it is appropriate for use in the provision of advice to their clients. In using the investment strategy template to develop an investment strategy, the adviser acknowledges that they must assess the needs of their client, having regard to the whole circumstances of the client in accordance with SIS. This document and the related template are of a general nature only and are not intended as investment advice. The adviser must make his or her own assessment as to the suitability of any products and/or strategies for a particular clients needs. To the maximum extent permitted by law, smartsuper pty limited and any related companies will not be liable to any party in contract, tort or otherwise for any loss or damage arising either directly or indirectly from reliance on, the use of or inability to use this information.

INVESTMENT STRATEGY FOR

[NAME OF FUND] SUPERANNUATION FUND
AS AT [DATE]

Objectives

The Trustees of the fund aim to:

- Invest in such a way as to maximise member returns with regard to the risk associated in holding the investment
- Achieve appropriate diversification and the benefits of investing across a number of asset classes (for example, shares, property, fixed deposit) in a long term investment strategy; and
- Ensure that the superannuation fund can pay benefits as well as other costs of the superannuation fund as they become due and payable.

The Trustees' general investment objective is to achieve real medium to longer term growth, while maintaining a low level of capital volatility.

To achieve this objective, the Trustees have determined the fund will have the ability to invest in the following areas:

- equities and stocks including the participation in dividend reinvestment programs, rights issues and any other investments offered in this area;
- property trusts and associated investments;
- managed investments and associated products thereof;
- direct property investment;
- cash/interest bearing securities; and
- any other investments legally able to be made.

It is noted that the Trustees may from time to time seek professional advice in the formulation of an investment strategy.

In determining this strategy the Trustees have taken into consideration the aspects of the investment in accordance with the fund's objectives and appropriate legislation.

Policies

The policies adopted by the Trustees to adhere to these objectives are:

- Regular monitoring of the performance of the funds investments, rates of return, risk analysis and expected cash flow requirements.
- Balancing the asset portfolio as a result of adjustments to market conditions.

The Trustee will ensure investments continue to comply with the strategy, however, the Trustee reserves the right to alter the strategy at any time.

Asset Mix

After due consideration of the level of risk, diversity, liquidity, the ages of the members and the ability of the fund to discharge the fund's existing and prospective liabilities, the following asset mix was deemed to be appropriate:

	Low %	High %		Low %	High %
Australian Equities	20%	50%	Mortgages	5%	15%
International Equities	10%	25%	Direct Property	20%	40%
Cash	5%	50%	Listed Property	15%	25%
Australian Fixed Interest	10%	20%	Other		
International Fixed Interest	10%	20%			

SAMPLE SUPERANNUATION FUND

INVESTMENT STRATEGY REPORT

Prepared by:
[enter trustee/s here]
(Trustee/s)

On
[enter date here]

To be reviewed on or before
[enter date here]

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SAMPLE SUPERANNUATION FUND

COMPLIANCE

The Fund is a complying superannuation fund under Part IX of the Income Tax Assessment Act 1936 and Section 45 of the Superannuation Industry (Supervision) Act 1993.

OBJECTIVES

Specific Objectives

[Select/delete from the following as appropriate]

- To achieve cash related returns subject to the requirement that the capital value of the Fund is preserved at all times, and to avoid negative return.
- To achieve cash plus related returns subject to the requirement that the capital value of the Fund is preserved in the short term.
- To achieve long term returns slightly above those of the bond market. It is expected that year-on-year returns may vary with there being only a small probability of negative return in any one year.
- To achieve a long term rate of return approximately equal to CPI. It is expected that year-on-year returns will vary considerably with a moderate probability of a negative return in any one year.
- To achieve a long term rate of return in excess of the CPI. It is expected that year-on-year returns will vary widely and that there will be years when returns are negative.
- Other – free form text here

General Objectives

[Select/delete from the following as appropriate]

- To provide retirement benefit for the members. In the event of the members' death before retirement, to provide benefits for the dependants of the members.
- To ensure that sufficient assets will be available to meet benefit payments when those payments are due to be paid (solvency).
- To ensure that sufficient liquid assets will be available to meet benefit payments as and when those payments are due to be paid (liquidity).
- Other – free form text here

SAMPLE SUPERANNUATION FUND

Fund Profile

Fund benefit design:	Accumulation Fund
Fund structure:	Self Managed Superannuation Fund
Current size of the Fund:	[\$Fund size]
Annual contributions this financial year:	[\$Contributions p.a.]
Percentage of unrestricted non-preserved benefits in Fund:	[XX%]

RISK PROFILE

Risk Tolerance:

[Select/delete from the following as appropriate]

- The members are close to retirement and expect the Fund to invest in risk averse investments to achieve capital preservation and avoid volatility in returns.
- The Fund has a relatively long time horizon. The members are prepared to endure a reasonable level of volatility of returns in expectation of long term growth.
- The composition of the members is diverse and the collective risk tolerance indicates that there should be a balance of reasonable risk and volatility to achieve long term capital and income growth.
- The Fund is paying an allocated pension. Investments should be made in risk averse investments, which combine reasonable security of capital with the prospect of long term growth, with the view to prolonging the duration of the pension payments.
- Other – free form text here

Statement on Risk:

[Select/delete from the following as appropriate]

- Investment risk is borne by the members, as fluctuation in investment returns will affect the level of the members' benefits on withdrawal.
- Investment risk is borne by the members, as fluctuation in investment returns will affect the level of the members' benefits on withdrawal. The fluctuation is smoothed by the maintenance of a reserve to which returns are credited or debited according to the credit rate policy.
- Other – free form text here

SAMPLE SUPERANNUATION FUND

LIQUIDITY

Number of existing members	[No. of members]
Time Horizon of Fund	[Time Horizon in Years]

Age distribution of members:

Age	Number of Members
Less than 40 years	[No. of members]
41-49 years	[No. of members]
50-59 years	[No. of members]
60-64 years	[No. of members]
65-69 years	[No. of members]
70 years and over	[No. of members]

Anticipated Membership growth:

Years	Number of Members
One	[No. of members]
Two	[No. of members]
Five	[No. of members]

Statement on Liquidity

■ Anticipated Benefit Payments

1 Year:	[\$ or %]
2 Years	[\$ of %]
3 Years:	[\$ of %]
4 Years:	[\$ or %]
5 Years:	[\$ or %]

[Select/delete from the following as appropriate]

- There is no anticipated benefit payment in the next five years. Cash in excess of anticipated liquidity requirement will be invested in accordance with the Fund's investment strategy.
- Lump sum benefit payment will be made. The Trustee will monitor the liquidity position to ensure that there will be sufficient liquid assets to meet the benefit payments as and when they fall due.
- Pension payments are made annually. The Trustee will monitor the liquidity position to ensure that there will be sufficient liquid assets to meet the benefit payments as and when they fall due.
- Other – free form text here

SAMPLE SUPERANNUATION FUND

DIVERSIFICATION

[Select/delete from the following as appropriate]

- Diversification across currencies, economies and asset classes is achieved through a mix of international and Australian investments. The Trustee recognises that diversification can result in significant reduction to return volatility while maintaining the level of anticipated return.
- Diversification is achieved through a mix of Australian investments across a range of asset classes. The Trustee recognises that diversification can result in significant reduction to return volatility while maintaining the level of anticipated return.
- The funds are primarily invested in equities. The Trustee recognises the higher risk in investing predominantly in only one asset class and the volatility associated with shares. The volatility will be compensated by the prospect of achieving higher return and growth in the longer term. The shares are invested in different industries and sectors, which will spread risk to a satisfactory level.
- The Fund is invested in a Unit Trust and the underlying assets of the Trust are primarily invested in shares. The Trustee recognises that the Fund is subject to higher risk associated with investing predominantly in one asset class and the volatility associated with shares. The Trustee considers that the higher risk will be compensated by the prospect of achieving higher return and growth in the longer term. The shares are invested in different industries and sectors, which will spread risk to a satisfactory level.
- The funds are primarily invested in fixed interest securities and deposits. It is considered that investment in this asset class is suitable for the Fund's policy of maximising capital preservation and avoiding negative return.
- The Fund is invested in a Unit Trust and the underlying asset of the Unit Trust is an investment in a real property. The Trustee recognises that the Fund is subject to a high level of property specific risks. The Trustee considers that real property is a secure investment with the prospect of long term capital appreciation while generating steady income growth.
- The Fund is invested primarily in one real property. The Trustee recognises that the Fund is subject to a high level of property specific risks. The Trustee considers that real property is a secure investment with the prospect of long term capital appreciation while generating steady income growth.
- Other – free form text here

SAMPLE SUPERANNUATION FUND

ABILITY OF FUND TO DISCHARGE EXISTING AND PROSPECTIVE LIABILITIES

[Select/delete from the following as appropriate]

- Sufficient cash flow will be maintained to discharge administration expenses and other outgoings. The Fund is a defined contribution fund and the members are entitled to the accumulation of contributions and earnings in the members' account on withdrawal. The Fund will be able to meet its obligations to the members at all times.
- Other – free form text here

INDICATIVE ASSET MIX AND ASSET CLASS STRATEGIC RANGES FORMULATED

[Enter percentages from 0 – 100% in the table below]

Asset Class	Strategic Ranges	
	From %	To %
Australian Shares		
International Shares		
Cash		
Fixed Interest (Australian)		
Fixed Interest (International)		
Mortgages		
Direct property		
Listed property		
Other (detail below)		

RESERVES MANAGEMENT STRATEGY

[Select/delete from the following as appropriate]

- The fund does not operate reserves
- The fund does operate reserves
- Other – free form text here (some detail on types of reserves and comments on their management)

IMPLEMENTATION OF INVESTMENT STRATEGY

- Insert text describing the implementation of the investment strategy