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Undiversified SMSFs face being sued

Duty to diversify overlooked

By Krystine Lumanta
Wed 09 May 2012

Beneficiaries can sue trustees for the difference in return when an SMSF is not properly diversified, a DBA Lawyers associate says.

Self-managed superannuation fund (SMSF) trustees run the risk of being sued when a fund is invested in only one asset or class of assets, as beneficiaries can claim it prevented a higher return.

"Though trustees did not properly diversify the SMSF but still made money, beneficiaries are popping up years down the track and claiming that had the trustee invested in an index fund or [used] modern portfolio theory, they would've had more money," DBA Lawyers senior associate Bryce Figot told *InvestorDaily*.

"Therefore, they are suing for the difference. It doesn't really get much airplay so a lot of trustees don't know that there is essentially a duty to diversify, unless your trust deed says you don't have to diversify."

It was common for SMSFs to be invested in one asset class, Figot said.

"You see this a lot with super funds that buy a business or a property as $1 million doesn't get you much in the real estate business these days and, of course, the majority of SMSFs only have about $800,000," he said.

"Small business people also start a SMSF specifically for the purpose of buying premises where their business is run so when they pay rent, they get a tax deduction."

The Australian Prudential Regulation Authority (APRA) superannuation circular stated "a well-formulated investment strategy would not ordinarily provide that all, or a large proportion, of the fund's assets be invested in one asset (such as a single property) or a single asset class".

It does not preclude specialised pooled superannuation trusts concentrating on particular market segments.

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However, if investments did not display adequate diversification given the nature of the fund, the onus was on the trustee to provide justification for the investments and how they were consistent with the investment strategy, Figot said.

"The duty only says you're supposed to think about diversification, not actually do it," he said.

"That same APRA document also says in formulating diversification you should look at each super fund on an isolated basis."

If a potential breach was investigated, SMSFs were examined separately, thus splitting assets over multiple SMSFs did not help the diversification of any SMSF, he said.

"If you do spread things across multiple super funds, it just becomes harder to diversify," he said.

Previous case law examples suggest SMSF trustees should invest in fully diversified index fund-style assets constructed around the basis of modern portfolio theory.

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