# What the future holds

**The financial services industry, including SMSFs, has been subject to several reviews and developments set to shape sector in the years to come. Rob Lavery takes into account all of the influencing elements and predicts what it all means for SMSFs over the next 11 years.**

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Earlier this year, wealthdigital released a white paper that projected what the financial services industry will look like in 2030. The white paper found the 2030 environment for SMSFs and SMSF advice looms as one profoundly different from the current day. The importance of SMSF advice is set to increase as retail super advice loses prominence, while the challenge of justifying a recommendation to establish an SMSF is likely to become greater.

## The basis of the projections

The projections outlined in this article consider six main drivers of change:

1. The Life Insurance Framework reforms.
2. Retirement income reform.
3. The Financial Adviser Standards and Ethics Authority reforms.
4. The Productivity Commission's final report on efficiency and competition in the superannuation industry.
5. The Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry's final report.
6. The Royal Commission into Aged Care Quality and Safety.

To clearly formulate the projections, it has been presumed the recommendations of the Productivity Commission and royal commissions will be executed in totality. Furthermore, already implemented reforms are presumed to be maintained, with planned future reform programs executed as currently outlined.

## Advice on super in 2030

According to the Productivity Commission's report, financial advice revenue currently relies heavily on superannuation and retirement advice (a little under 35 per cent), loan and investment advice (26 per cent) and SMSF advice (over 20 per cent). This balance is set to change with the commission calling for an individual's default super fund to follow them from employer to employer. What's more, it also recommended the act of choosing a default fund be taken away from employers and given to an independent body.

These changes will remove a significant component of financial planning for wealth accumulating clients – super fund consolidation and selection. Outside of recommending an SMSF for strategic reasons, it would take a brave planner to claim they could select a better retail fund for a client than the independent body solely charged with that job.

Exacerbating this shift is the policy outlined in Treasury's position paper on retirement incomes that would put the onus on a client's super fund to help guide the client in planning for their retirement income needs. Take away the need for advice on fund selection and retirement planning in retail funds, and the proportion of advice that relates to retail superannuation and retirement planning looks likely to significantly decrease.

## Superannuation products and their purpose

The default super recommendations aren't the only ones in the Productivity Commission's final report that stand to dramatically change advice on superannuation.

The Productivity Commission called for reforms that ensure consistent performance of all available retail superannuation products. The report recommends that each default and choice retail super fund stay within a narrow band of investment returns centred on a set of market indices. This compulsory benchmarking against indices will effectively see the end of active investment in retail super. The risk a fund would absorb in trying to outperform an index would be far too great as the downside risk would be banishment from the marketplace. This would mean the only way to actively invest in superannuation would be through an SMSF.

The Productivity Commission also issued a set of recommendations that would see retail super funds only able to charge fees on a cost-recovery basis.

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The cumulative effect of these recommendations will make retail superannuation a very standardised and unvaried consumer offering. What's more, running a retail superannuation product will likely be unattractive to any for-profit organisation. If there is no positive revenue to be generated from fees, and the investment options are supposed to be low cost and effectively track indices, what incentive does the private sector have to run retail superannuation products?

By contrast, SMSFs will provide consumers, their advisers and product providers with far greater flexibility and opportunity. SMSFs would be the only way to access active investment options through super and would be essential for advisers looking to create diversified and bespoke investment strategies for the retirement savings of high net wealth clients. This need will likely be well serviced as providing investment services for SMSFs will become a vital way for active investment managers to distribute active offerings, particularly as no retail super funds will be able to use their services.

It is likely SMSFs' popularity, and the range and availability of investment products designed to service SMSFs, will increase significantly by 2030.

## The challenges for SMSF advisers in 2030

As noted earlier, SMSF advice currently makes up more than 20 per cent of advice revenue. With limited scope to recommend clients switch to a retail fund, SMSF recommendations will become more appealing to advisers. That said, such recommendations will also face significant barriers. The financial services royal commission discussed abolishing the safe harbour steps that accompany the current best interests duty.

"Another option would be to remove the safe harbour provision entirely. In my view, such a change would not be without merit. As I have said, the safe harbour provision currently has the effect that, in practice, an adviser is required to make little or no independent inquiry into, or assessment of, products. By prescribing particular steps that must be taken, and allowing advisers to adopt a 'tick a box' approach to compliance, the safe harbour provision has the potential to undermine the broader obligation for advisers to act in the best interests of their clients," the royal commission's final report said.

It should be noted the royal commission did not overtly recommend abolishing the safe harbour steps, however, it does build on a theme established by the Productivity Commission in its final report. The Productivity Commission expressed concerns around the adequacy of approved product lists when researching which products can be recommended in a client's best interests. The natural extension of these concerns is to remove the current 'reasonable investigation' step in the safe harbour provision and require advisers to conduct broader product research.

Such broader product investigations will be an additional challenge for an adviser recommending an SMSF. Iron-clad proof an SMSF is in the client's best interests will need to be provided when all reasonably available alternatives are considered. Given

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a 2018 Australian Securities and Investments Commission review found 86 per cent of SMSF advice did not prioritise the client's interests, the challenge of meeting a tougher best interests duty is significant.

## Other SMSF advice hurdles

The Productivity Commission also recommended extending the design and distribution obligations for product providers to SMSF advice. These obligations include:

1. Requiring offerors to make a target market determination. No determination would mean the product cannot be distributed.
2. Requiring offerors to review target market determinations and adhere to those determinations.
3. Requiring offerors to maintain distribution information (including around complaints).

These obligations will require any adviser who recommends a client commence an SMSF to establish further documentation. This documentation will need to identify the characteristics of a client for whom an SMSF would be appropriate. If the adviser then recommends an SMSF to a client not captured in their documentation, they may face penalties.

The Productivity Commission separately recommended advisers be able to justify why an SMSF is recommended for a client with a balance below $500,000.

## SMSFs' role in Australian financial services (AFS) licensing by 2030

According to the royal commission's background paper, in October 2017, 44 per cent of advisers operated under licences controlled by one of the 10 largest institutions. That said, the vast majority of licensees were small operations, with 78 per cent of licensees having less than 10 advisers each.

Vertical integration, or product providers owning financial planning businesses or operating aligned AFS licences, has been the predominant model of licensee/adviser relationships. That said, some of the largest organisations have already shown their concerns about the vertically integrated model of financial advice, with five major institutions selling, or attempting to spin off, their wealth arms. While this strategy is not universal, and bank sentiments around wealth businesses tend to fluctuate, it does signal a significant redistribution of aligned advisers.

It seems likely these divested and sold former-bank businesses will retain some salaried and aligned planners as a direct connection to their customers. As retail superannuation product advice becomes less prevalent, such arrangements will focus more on direct investment, SMSF investment and, in the short term, some insurance product advice.

Smaller, or more boutique, wealth management businesses that employ a vertically integrated structure, commonly involving an in-house or white-labelled investment platform or a managed account product, loom as another likely licensing solution for planners leaving institutional licensees. The platform or managed account product in such arrangements would likely be a preferred vehicle for investment recommendations in a client's SMSF. Such structures are already common in firms that target high net wealth clients and seem set to grow in number.

## Models of advice

The projected outcome of all the reforms, reviews and regulation currently encompassing the financial services industry is that financial advice will likely become dominated by three models:

1. Medium-to-high net worth investment advisers with ongoing client relationships. This includes the potential to have some high-value transactional services, such as property buyer agency or stockbroking. SMSF expertise will be central to this approach.
2. Transactional, broad-based advisers. May include some short to medium-term recurring services, such as financial counselling, as well as non-traditional transactional services, such as mortgage broking.
3. Aged-care adviser specialisation. May include some additional specialised services, such as estate planning, and some ongoing investment management for high net wealth clients.

Within the model that focuses on the ongoing servicing of clients, the key cross-specialisations, such as stockbroking or property buying agency, will themselves serve to assist in SMSF investment advice and management. Bespoke investment solutions in a flexible environment will be crucial to the clients of this model of advice.

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## The big picture

SMSFs are already a significant part of the financial landscape in Australia. The importance of SMSFs, SMSF advice and SMSF-focused products will only increase over the next decade. With retail superannuation offerings becoming increasingly homogenous, SMSFs will be the only vehicle through which bespoke investment of superannuation savings will be possible.

This increased importance will in turn lead to growth in the provision of services that target SMSFs and their members. Demand will drive greater product innovation and the members of SMSFs will benefit accordingly.

The growth of the SMSF sector in Australia looks set to continue, potentially at an increased pace, as more Australians seek a personalised solution to their retirement income needs.