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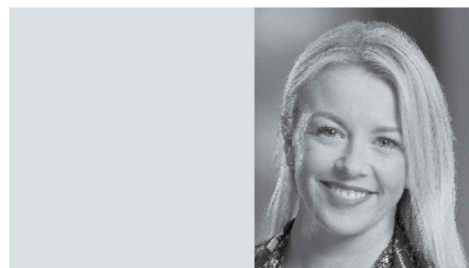
SUPER FORCE

Self-managed superannuation funds are growing in popularity with Millennials. As the desire to take control of their futures grows, they're proving a powerful catalyst for change in the sector. **Cassandra Baldini** reports.



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Jo Hurley
general manager, growth
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02:
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Self-managed superannuation funds (SMSFs) assume 26% of Australia's super sector and, according to Australian Taxation Office data, on average 25,000 new funds are established each year.

The ATO estimates that as of March 2022, there were 605,470 SMSFs holding about $894 billion in assets. The annual average of new accounts opened has also increased 1.7% since 2020.

Historically, a large percentage of SMSF members have been retirees with accumulated wealth who no longer wish to be bound to one superannuation fund or wish to have greater control of their finances. On the other hand, investors wanting to explore unlisted companies or tap into a universe not directly available through their retail or industry fund might have also had their interest peaked.

But as mandatory super blew out its 30th birthday candles, a large cohort of Millennials who have reaped its benefits for the entirety of their working life also extinguished their relationship with the incumbents.

Once viewed as a majestic offering cordoned off for only the wealthy, the SMSF sector has opened its doors to a new generation and the financial services industry has shifted accordingly.

Class' *Annual Benchmark 2022* report found that about 30% of new SMSFs are being established by those aged 33-44 years.

It said SMSFs have been a popular choice among Millennials for three years in a row and the average age of new fund establishments has slid from 51 (2006-2014) to 46 (2020-2022).

"The average age was initially quite high which meant from a retirement savings perspective it's been a short runway from setting up the fund to retiring," Class general manager growth Jo Hurley[01] says.

"Whereas now, it's much more reasonable to see SMSFs being established by 33 to 44-year-olds. That's where the biggest growth has been seen."

Hurley explains the drop in age demonstrates a sensible and balanced approach to engaging with personal finance.

"Paying off your mortgage, raising children, but also having an eye on long-term retirement savings at the same time, opposed to getting one thing out of the way before moving to the next," she suggests.

"That average age reduction is a very good sign of a maturing SMSF market and that's very healthy for our sector."

Super savvy

"If you set up an SMSF at 30 and live until you're 90, you will probably still have that account for the entirety of those 60 years," Heffron managing director SMSF solutions Meg Heffron[02] says.

"That's almost as long as Queen Elizabeth reigned."

Heffron explains that younger people taking up SMSFs is an observable trend across the industry and there are probably a couple of foundational factors at play, including the fact that Millennials are the first age group to have received superannuation contributions for the entirety of their working lives.

"I suspect Millennials are vastly more engaged with their super than older generations because they've got more. They're also in this weird situation where the contribution rate is now 10.5%, which is quite high," she says.

"It's quite a significant amount for a cohort who are probably still trying to pay down a mortgage and, as their super builds, it's most likely their second biggest asset aside from property. A logical response in that situation is the desire for more control."

However, the pandemic is likely also a contributing factor.

"Covid has probably accelerated it, quite like the Global Financial Crisis (GFC) did. You see this foundational shift that prompts the establishment of more SMSFs both for the long and short term," Heffron says.

"It can give people a false understanding of their capability. They think, 'I could do better if I handled it myself.'

"But when markets go down, they go down for everyone and with that, you will quite possibly see a lot of a buyer's remorse as people start to realise they couldn't do it any better."

This new-found but perhaps unearned confidence is also leading to a shift in the portfolio construction side of things, with the traditional SMSF filled with Aussie bluechip stocks, cash and property slowly losing its sheen.

Verante Financial Planning director Liam Shorte[03] is well aware of how the new generation of SMSF investors are shaking up their portfolios.

"The major use of ETFs is the big one," he points out.

"So, people who once mostly ran Australian portfolios are now adding Vanguard ETFs as an example. Retirees are looking into ETFs for the purpose of income, younger people are interested in ESG focused ETFs or themes like antivirus and crypto."

Crowd favourites like Australian direct shares, term deposits and Australian managed funds are not being favoured as much by the new crop of investors.

"The Australian market is still very much banking, insurance and resources. The younger generation has a different product diet than their parents," Shorte says.

He adds that being raised with Facebook (now Meta), Google, and Microsoft has ultimately changed investor behaviour.

"They live in an international world and most of them probably don't bank with the big four in Australia, so they don't really have any loyalty or interest in them. They're looking for the growth stocks of the future," he says.

I suspect Millennials are vastly more engaged with their super than older generations because they've got more.
Meg Heffron

Shorte uses the example of Atlassian, an Australian tech giant listed overseas, moving investors towards foreign shores.

"They want to be investing overseas and the easiest way to do that is through ETFs, the only other option is using a broking account that allows access to overseas exchanges. Once you do that, you're bringing in currency and market's trading hour risks, among other things," he warns.

This change in appetite isn't yet reflected in the ATO data though, which shows allocations to equities and property have remained steady since 2013 while cash has declined slightly. Fixed interest allocations have also grown fivefold in recent years in both percentage share and nominal terms.

Stake SMSF product specialist Ciara Conway[04] backs this, saying many customers are still prioritising exposure to Aussie equities and locally listed ETFs.

"But foreign equities are becoming increasingly popular as customers look to diversify," she says, agreeing with Shorte.

"There's a minority that choose to invest a small part of their portfolio into cryptocurrency ETFs, but traditional investments are far more common. SMSFs overwhelmingly attract those with strong experience in the market and most are focused on long term returns."

SMSF Association policy manager Tracey Scotchbrook[05] agrees that for all the hype surrounding it in recent years and its increasing legitimacy, crypto hasn't seen much recent growth.

According to the ATO, as at end March 2022, SMSFs had only a combined $226 million in crypto assets. This equates to just 0.03% of total assets, and it's a ratio that hasn't changed in several years.

"Crypto across the sector is still a small percentage," she says.

"Each individual trustee member will have their own risk profile but what the statistics do show us is investments in those unlisted shares or unlisted unit trusts tend to be more prominent in the larger SMSFs."

Shorte adds a few reasons why it remains quiet in the DeFi desert.

"Recently I haven't seen much in the form of NFTs and only a little in crypto. An explanation might be a lot of people have just come through the first year of audit on crypto and now see how much work they need to do to prove their holdings in the transactions. Secondly, the market dive has taken a lot of enthusiasm out of the crypto scene."

Looking back, he explains Perpetual or Magellan managed funds were the done thing but now there is a big shift towards exchange listed funds.

"There is a lot more emphasis on index investing nowadays and smart index investing.

04:
Ciara Conway
SMSF specialist
Stake

05:
Tracey Scotchbrook
policy manager
SMSF Association

Investors are trying to cut out the fees that can occur with a lot of these funds. They're moving more money to index," he says.

He adds that some clients simply aren't happy with what their retail or industry fund is investing in, with APRA-regulated funds under increasing pressure to invest in line with evolving social expectations, in addition to an expectation that their greater scale should equal lower costs. There are also lingering gripes around transparency.

Conway believes there was no single event that triggered the increase in SMSF adoption, but says there have been stories around hidden superannuation fees and inflated private valuations associated with traditional funds.

"And this has coincided with increased access to financial information and SMSF tools. Some of those with experience of financial markets feel better in managing their own wealth, and this motivation remains true across gender and age groups," she notes.

As more people become super savvy, a trend advisers are seeing at large is the pursuit of ethical investing. While the pressure is on the incumbent super funds to ensure their investments are ESG compatible, many feel not enough is being done and are taking matters into their own hands.

One financial services professional who knows a thing or two about ESG investing is Kearney Group chief executive Paul Kearney[06].

"We're very vocal in this area, for example our core SMA offering is an ESG first portfolio," he says.

"We see people's eyes lighting up when we lead discussions around ethical investing options.

"And there is no doubt SMSFs give you more range to do something with those factors. We're having more conversations now than we've had in the past about whether it's appropriate for clients to open up their own account. Even if it's not the right time just yet, there is a lot of interest."

He adds the surge in younger people moving to SMSFs is likely driven, at least in part, by the fact their morals no longer align with that of retail and industry funds.

"I think that investors, particularly the younger cohort, feel suspicious about major institutions and question whether they should place all of their trust in a public offer fund because really you're buying into the institution in a large way," he says.

"If you feel discomfort with major institutions and where your money is being invested then an SMSF becomes a way of organising your affairs without having to engage with what makes you feel a bit icky."

Super experts

When you think about it, it's no surprise that this trend in SMSF member demographics and increased confidence in taking a DIY approach to superannuation has emerged in recent years. Over the same period, and preceding it to an extent, has been a monumental surge in interest in personal finance.

Whether it be TikTok or Instagram, Spotify or YouTube, the sheer amount of personal finance content now freely available to the everyday Aussie is astounding. At the same time, the likes of Reddit and other online forums have documented the highs and lows of investing, giving hope that riches can be made in minutes and placing too little impetus on the risk all investors run.

One of the reasons this trend has proved so popular in Australia is the fact that much of the content is being delivered by professional financial advisers or former financial advisers, giving their audience reason to trust them.

However, it can't be denied that the more likely reason is because it gives everyday Aussies access to information they would otherwise have to pay for but cannot afford. Increased compliance and regulatory burden has pushed professional financial advice now much too far out of reach for the majority. There is also fewer advisers to meet the demand that is there, with more than 3000 advisers leaving the industry in each of the last three years, according to analysis of the ASIC Financial Adviser Register.

"Right now, we've got a shrinking pool of financial advisers and many more are needing to focus on high-net-worth individuals because of the cost of providing advice has been driven up by regulatory burden," Scotchbrook says.

"The Quality of Advice Review (QAR) will certainly need to look at that; its proposal paper has interesting thoughts and if legislated it could go a long way to help alleviate some of the friction around providing advice."

She adds particular attention is needed around single or scaled advice that should be available through different life stages.

"There is a push for advice to be provided in bite-sized pieces but in the current environment it's really hard to do because it's just not cost-effective," she says.

However, Scotchbrook says changes like the removal of the Statement of Advice document (SOA) can also open the door to technological benefits and lower costs.

"Instead of complex and chunky documents that are full of disclosures and comparisons to products that you're not even looking at, [we now have] advances like a recording of an adviser and client meeting that can be watched at a later date," she says.

"At the moment, a young adult starting their first job wondering what super fund they should use would not be able to get that information from a financial adviser, it would just be too challenging."

Heffron agrees, saying that financial literacy could do with improvement across the country no matter where your super sits.

We're having more conversations now than we've had in the past about whether it's appropriate for clients to open up their own account.
Paul Kearney

"It doesn't matter where your super is, it's just as important and you've got to care about it because that will make a huge difference to how well you retire," she says.

"The very fact that it's happening in your SMSF means there are bunch more requirements you need to engage with. You need to manage costs like insurance premiums, you're responsible for compliance with legislation and things like an extra tax return.

"I wonder if that just forces some engagement that's good for us all."

She also feels that regulation and trustee obligations around SMSFs can sometimes be overblown.

"Most people do pretty low-key things with their SMSF," she says.

"They really just need to know how to invest in mainstream things. Don't take your money out, lodge your tax returns and know the limits on how much you put in and when you can take money out. That's kind of it."

The idea that you need to become some kind of superannuation expert in order to manage your own retirement savings is a myth, she says. So too is the idea that SMSFs are overly complex, with Heffron saying any perceived complexity can be explained.

"Often what's being commented on is some technical article about pensions or contribution limits, or whatever," she says.

"Now what's in those articles apply to us all, no matter where our super sits. The fact is people who have an SMSF often also take the time to review that kind of information, engage with their super and assets and optimise it.

"But those same people, if they didn't have an SMSF, would still be engaging in strategies to positively contribute to their retirement. In fact, we all should."

Heffron points out that you don't typically suddenly stop worrying about tax deductions just because you have a tax agent doing your return.

"We all have to engage with our finances, no matter where our super is," she reinforces.

And while SMSFs generally do attract more experienced investors, Conway says it's important that participants understand the level of risk when choosing to manage their super and are committed to regularly recalibrating their investment strategy.

"Auditors have found that with SMSFs that hold higher risk investments, such as unlisted companies and crypto, there have been issues around asset recoverability and accurate valuations," she notes.

Due diligence is key, as is having a trustworthy provider, she says.

The future of SMSFs

Ahead of the government's upcoming federal budget, Partners Wealth Group director of wealth Patrick Barry[07] says there will likely be one big change to SMSFs.

06:
Paul Kearney
chief executive
Kearney Group

07:
Patrick Barry
director of wealth
Partners Wealth
Group

"One area that I do believe will come under focus, especially with the Labor government is the end of the limited recourse borrowing arrangement (LRBA)," he says.

"The Labor government did go into the 2019 election saying they would take it away; I don't think they will change their mind.

"We're talking to clients and saying, 'If you wanted to enter that strategy you have four weeks', because they will grandfather existing customers. I don't believe they will let anyone new enter it after that."

He says that LRBA, which has been in place for about 15 years, holds value because it allows for diversification within a fund.

"The good thing about the LRBA arrangement is that you could buy a property and still have diversification," Barry says.

He uses the example of a client with a $1 million balance, who wishes to buy a residential property. In more cases than not, that full amount would be used for the purchase.

"So, all of your retirement is hinging on that property in that suburb doing really well because you've used all your money in the fund to buy it," he says.

"With an LRBA a client could effectively use $300,000 of the money in the fund and then could borrow $700,000. You have that asset there but with the borrowed amount you can still have a diversified portfolio of shares, bonds and so on."

Hurley adds these kinds of borrowing strategies have often been tarnished with that brush of risk.

"Or people are not sure whether it's appropriate or not. Whereas I have long held the view that borrowing in super does support diversification," she explains.

Hurley adds the way the legislation has been written is to protect trustees in setting up a specific kind of borrowing that would best suit the SMSF structure.

"I've always believed that it reduces the risk; it would be a shame if they play with that strategy," she says.

An adviser's role

The reputation of the humble SMSF took quite a beating around the Royal Commission and ASIC's view has long been that a certain threshold balance is required in order for them to be efficient.

"While ever ASIC was very anti-SMSF, it was difficult for licensees and advisers to proactively recommend that they got set up," explains Heffron.

She says only "confident advisers" who worked with high-net-worth clients felt assured they could recommend an SMSF setup.

"That's a real missed opportunity for both clients and advisers," she says.

While negative press slowly dies away, especially from ASIC, and more advisers become self-licensed as opposed to being part of a big bureaucracy, Heffron believes more advisers will naturally shift towards SMSFs.

"For a lot of people, they'll say, 'This client has engaged with advice they are clearly looking long term, willing to spend money to get the best possible outcome'," she says.

"At some point, an SMSF is going to become right for most of them. There's still a bit of this hangover of negativity that makes you feel like recommending an SMSF should be the exception rather than the rule.

"If you think about it, we control our finances in every other way. We decide where we will take out our mortgage, we decide where we get our credit cards, we decide who we bank with - why would we not decide what our super looks like?"

Breaking into SMSF advice could be seen as a steep learning curve but Heffron says upskilling is only needed in part.

"I don't think the main area to upskill in is compliance, if the fund is mainstream," she says.

"There are definitely a lot of rules about things an SMSF can and can't invest in. But if all you're going to do is buy managed funds, property trusts, listed shares, term deposits - which is part of most funds - there is no special knowledge required.

"It's people whose SMSF moves into more complex investments – collectables, investments in private companies, property that's leased to a family business – that need greater understanding of the rules specific to SMSFs."

She explains that an adviser needs that higher level of knowledge of tax planning and pension structure opportunities.

It's a huge opportunity in this space for any adviser who wants to get into it.
Liam Shorte

"That's not so much forced by the fact that their client has an SMSF; it's made available by the fact that they've got an SMSF," she says.

Where a client in an APRA-regulated fund might not incur the same workload or knowledge base, an SMSF requires more strategic planning, particularly around the transition to retirement, including looking at money coming in and money going out, multiple pensions and tax planning for the next generation.

"Advisers who advise a lot in SMSFs, upskill themselves in all that opportunity. It's not really that they suddenly have to become experts in the compliance, it's that they need to do a better job in advising," Heffron asserts.

She concludes that good advisers will gravitate towards SMSFs, "where the benefits of their skills can be more clearly felt by their clients rather than in a retail fund where they're constantly having to compromise and do what's easy."

"Even if none of those advisers ever gave SMSF advice, that upskilling would be so good for their clients. But what would probably happen is that they would bump into the constraints of public offer funds and wish their client was in an SMSF," she says.

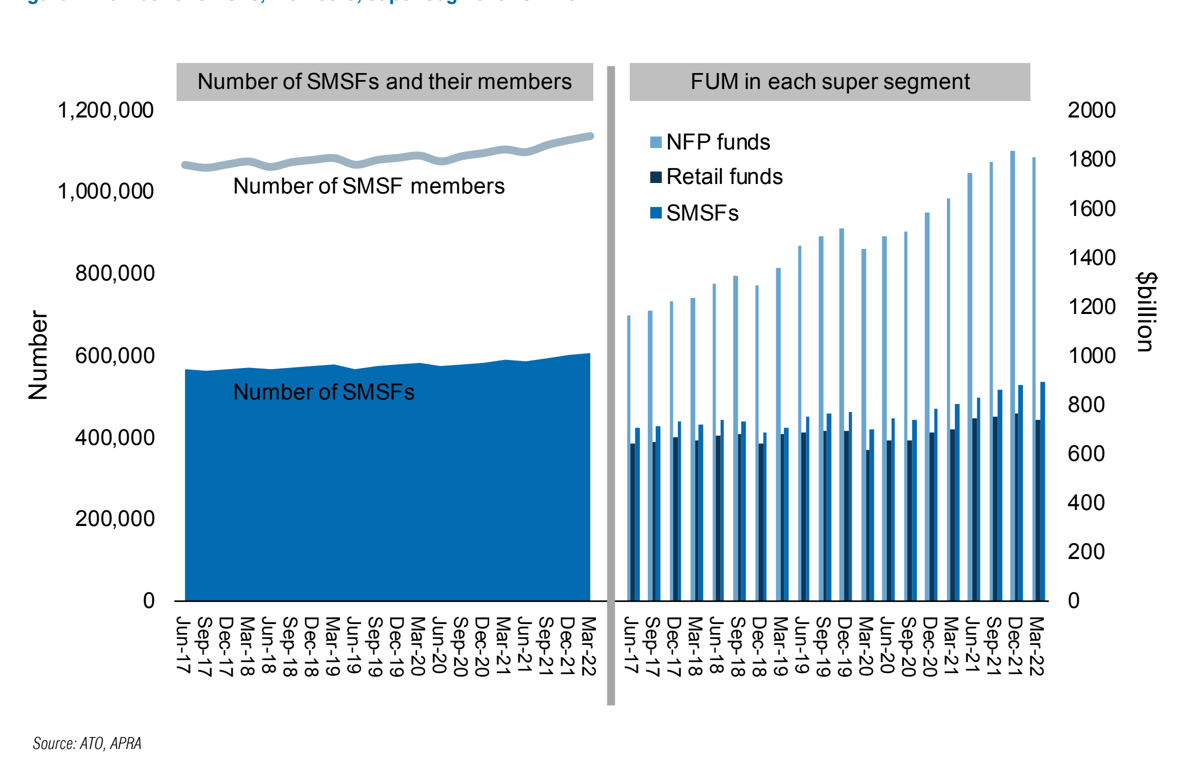
Shorte agrees the opportunity for an adviser is huge.

"You have to remember the number of limited licensed accountants has dropped from 2500 to, I think, about 540," he says.

"I'm closed off to business until July 2023 because there are just so many inquiries on the SMSF side and I've got that arrow in my bow.

"It's a huge opportunity in this space for any adviser who wants to get into it." FS

Figure 1. Number of SMSFs, Members, super segment FUM 2017-22



Source: ATO, APRA