Cuffelinks
Connecting investors with ideas

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This Week's Top Articles

Make your money live forever

Chris Cuffe

"A man's dying is more the survivors' affair than his own." – Thomas Mann

"The beginnings and endings of all human undertakings are untidy." – John Galsworthy

While these quotations from Mann and Galsworthy are usually correct, it doesn't have to be that way. Surely an important part of anyone's life is deciding what happens to their assets when they die. It never ceases to amaze me how little thought people put into estate planning and creating a lasting legacy. It's bad enough that an estimated of Australians do not have a valid will, and most have not made a binding death nomination for their superannuation. But how many people put even a fraction of the time into deciding what should happen with their money as they do in accumulating it in the first place? Neat clichés like 'the dead don't care' do not resonate with me – but perhaps that is just the forward planner in me and I may be an outlier.

Putting aside your religious beliefs, let's assume you have departed this world and you are looking down from the heavens on the distribution of your hard-earned money to your loved ones. As Shakespeare wrote in Hamlet, "*What dreams may come, when we have shuffled off this mortal coil, must give us pause."* The children are squabbling over whether to sell the family home, there's a stepson you hardly knew claiming his rights, and your spouse has met a new partner with five screaming kids from a previous marriage. Your sister says you told her you would always support your siblings, and there are family members in your old house grabbing your stuff while they can.

You think you're in heaven and you've gone to hell!

Address the basics

In thinking about estate planning, I believe it is essential that the following basics are covered while you are alive and have your marbles intact:

- Make sure your wishes are clear, unambiguous and in writing. Written instructions usually mean a will, but in addition to this I like to have a one to two page 'plain English' summary (that your solicitor should tick for consistency with the will) to ensure there is no misunderstanding.
- Ensure you cater for all situations, such as if you die, your partner dies, you both die together, providing for the children's needs if they are under 18 (such as who will look after them and whether the carer should be paid).
- 'Complete the package' and ensure you have an Enduring Power of Attorney (for money/finance decisions) and Enduring Guardian (for health decisions) appointed as well as having a documented Advance Care Plan (dealing with resuscitation, organ donation, and where you wish to be cared for when the time for natural dying comes).
- Ideally, discuss your intentions with your family, so they have a chance to contribute and understand before you are no longer there to influence.
- Develop a strategy that ensures your estate is well-managed by people you trust who know what to do with wealth.

Beyond these basics, I want to focus on the possibility of both creating a multi-generational legacy and enjoying giving while you're alive.

Create a fund for future generations

It's natural to care for your own children and grandchildren who you know and cherish while you are alive. But what about their children? What can you do that might also benefit future generations of your descendants?

If your resources are sufficient, one idea is to establish a trust that has the purpose of meeting particular costs of your direct descendants (being your children, your children's children, their children and so on). The costs that come to mind are what I think of as *'must have safety-net costs'* such as medical insurance, trauma insurance, school education and tertiary education. Plan for only 50% of the tertiary education costs so the recipient has 'skin in the game' and an incentive to complete the chosen study.

Imagine the satisfaction of knowing that whatever happens to the family finances, your great grandchild can be confident of a good education and decent health. Who knows what the future brings, as many a family fortune has been destroyed by poor investing or wasteful spending. With Australia facing decades of increasing budget deficits, both health and education expenditure will be targets. We may head more down the US path of user pays and denial of services. While it is hard to estimate what future school, university and hospital costs may be, it's highly likely to be much higher than today.

The trust should have independent trustees and avail itself of investing expertise, so the money lasts as long as possible into future lifetimes (and who knows, future descendants themselves may end up having the means to contribute to the trust so that it lasts longer). In practical terms, any descendant wishing to have such costs met would apply to the trustees. You could even 'force' another gift on them (one that I am passionate about) and insist that any recipient must first complete a basic course in financial literacy before they are eligible to participate in the trust.

Imagine the day your daughter's grandchild graduates from university to become a doctor and makes a toast to you (long past!) for helping to make the event possible through vision and generosity.

Help your children while you're alive

If you started having children at 30 and you live until you're 90, chances are your children will be retired when they inherit your estate. If they've done well already, they probably don't even need the money, and all you are doing is giving more money to an already financially secure person.

If you live in the crazy property markets of the east coast of Australia, and your children are of a mind that they would like to live in a similar location when they leave home (and perhaps be near you), then it is likely that they will struggle to buy their first home given the prohibitive entry level to now get into the property market. So assuming your own financial needs are met, what better way to help your children than to assist them with their first purchase. Consider gifting the deposit or some type of interest free loan so the capital can one day be recycled again or protected in situations of divorce.

Leave an enduring gift to society

Buffett once said in his letter to the Gates Foundation: *'I want to give my kids just enough so that they would feel that they could do anything, but not so much that they would feel like doing nothing.'* I am a big fan of this quote.

Again, if your resources are sufficient, once you have provided for your family, to me there is no better way to leave an enduring gift to society than to set up a Private Ancillary Fund or establish a sub-fund with a Public Ancillary Fund. Any money put into such vehicles is fully tax deductible. The money is invested within the ancillary fund (which is a tax free environment) and from there a minimum of around 5% per annum of your account balance must be donated to charity. Your investment in the fund can last for many years, spinning off a never-ending stream of donations for charity.

[I'll declare an interest here, as I am the founder and Chairman of Australian Philanthropic Services, a not-for-profit organisation that specialises in setting up and administering such vehicles.]

It was not until I reached the age of around 50 that the thought of mortality really entered into my thinking. Perhaps this was from watching my own parents age (and one of them recently passing away). That realisation comes with greater attention to how I can help people while I am alive and after I cross that great try line in the sky!

Chris Cuffe is co-founder of Cuffelinks; Portfolio Manager of the charitable trust Third Link Growth Fund; Chairman of Unisuper and Chairman of Australian Philanthropic Services. The views expressed are his own and they are not personal financial advice.

ASIC's strategic outlook on risk and law enforcement

Peter Kell

As Cuffelinks marks its 100th edition, it is an opportune time to explain to this important audience the role of ASIC as Australia's integrated corporate, markets, financial services and consumer credit regulator and law enforcer.

Making sure Australians have trust and confidence in the financial system is at the heart of everything we do. We regulate entities at every point from 'cradle to grave' - from their incorporation to their winding up – and also look after the interests of the consumers they serve in an increasingly digital world.

Our regulatory priorities are to:

- promote investor and financial consumer trust and confidence, and
- ensure fair, orderly and transparent markets.

ASIC is a law enforcement agency. We use around 70% of our regulatory resources on surveillance and enforcement. A key aspect of what we do is holding gatekeepers to account – identifying and dealing with those who break the law. Where we see non-compliance, we will act quickly and decisively through our 'detect, understand and respond' approach.

Five risk drivers

It is helpful to understand the circumstances that drive risk to investors and financial consumers. In our efforts to understand these drivers, we have identified five broad areas that are having significant impact:

First is the tension between a free market-based system and investor and financial consumer protection. This is influenced by the increasingly global economy, the compliance culture and systems of those we regulate, and the shifts in consumer sentiment and financial literacy.

Second is digital disruption. In financial services, crowdfunding and peer-to-peer lending platforms are disrupting traditional ways of accessing capital. In our markets we see digital disruption in high-frequency trading and dark liquidity. And there will be more digital disruption as we see advances in, for example, the use of mobile technology for financial transactions, increased use of 'big data' by financial services providers to customise their marketing.

Third is structural change. There has been a global shift towards market-based financing. In Australia this has been driven predominantly by growth in the superannuation sector. We also have an aging population. The government's recent Intergenerational Report covers that in detail.

The structure of the Australian funds management industry also continues to evolve with consolidation among the four major banks expected to continue. Financial markets too are seeing competition intensifying and affecting capital raising, secondary trading and post-trade infrastructure.

Fourth is financial innovation-driven complexity. Complex products are available to investors and financial consumers, but can be misunderstood or mis-sold.

Technology-driven financial innovation continues to change how markets interact, including with investors. The rapid pace of technological change has also brought challenges of cyber-resilience to the fore. At the same time Australians' use of information and communications technologies is high on a global scale.

Fifth, and finally, is globalisation. The global financial system has become more integrated, competitive and complex. Australia's financial markets are more integrated with international markets than ever before, and financial facilities, services and products are increasingly provided across borders.

Responding to key risks

Against this background, we have identified key risks that fall into the areas of conduct, innovation-driven complexity, globalisation and expectations gap.

We are undertaking proactive risk-based surveillance of high risk areas that will have the greatest impact on investors and financial consumers and the sectors and participants we regulate. In particular, we are concentrating on financial advisers and responsible entities operating managed investment schemes.

We also continue to undertake reactive surveillance to detect possible wrongdoing. Where there are issues, we take action without fear or favour.

ASIC's latest six-monthly enforcement report, detailing outcomes achieved between 1 July 2014 and 31 December 2014, recorded 348 enforcement outcomes. This included 204 criminal actions as well as civil and administrative (e.g. banning or disqualification) actions, and negotiated outcomes, including enforceable undertakings.

These outcomes were achieved across the financial services, market integrity, corporate governance and small business areas.

The report highlights ASIC's ongoing focus on tackling serious corporate fraud and loan fraud and ASIC's use of civil penalty proceedings to enforce the law.

At the same time, there are some drivers of risks that we cannot influence, and risks that we cannot address within the current regulatory settings. There may be more on this when recommendations of the recent Financial Systems Inquiry are further considered by government.

More positively, some of the risks we have identified may not crystallise.

A more detailed explanation of our work across these risk areas can be read in our [Strategic Outlook] on the ASIC website.

Expectations gap

Different expectations and uncertainty about outcomes in the regulatory settings can undermine confidence and behaviour.

This is magnified by uncertainty about whether the regulatory settings – established by Parliament – will be effective in more difficult economic conditions. Investors and financial consumers may also underestimate the risk they can handle when things get tougher.

We use our resources and powers to ensure that the financial system is robust and operates in the long-term best interest of Australian consumers. However, we cannot eliminate market risk, prevent all wrongdoing or ensure compensation for investors who lose money.

And finally, it is also important that the sectors and participants we regulate must look to, and act in, the long-term best interests of financial consumers to ensure that trust and confidence in the Australian financial system remains strong.

Peter Kell is Deputy Chairman of the Australian Securities & Investments Commission (ASIC).

The comprehensive income product for retirement

Jeremy Cooper

[Editor's note: The words in Jeremy's heading and their abbreviation, CIPR (pronounced 'sipper'), come from the Financial System Inquiry and they are quickly becoming part of the superannuation industry lexicon. We need another word or abbreviation. Such a clunky set of letters will do nothing to encourage engagement with post-retirement products. Suggestions welcome.]

The retirement income stream market in Australia is unusual by global standards, being dominated by the 'balanced' account-based pension (ABP). It has usually been recommended to investors on the basis of underlying investment choice, flexibility, control and liquidity.

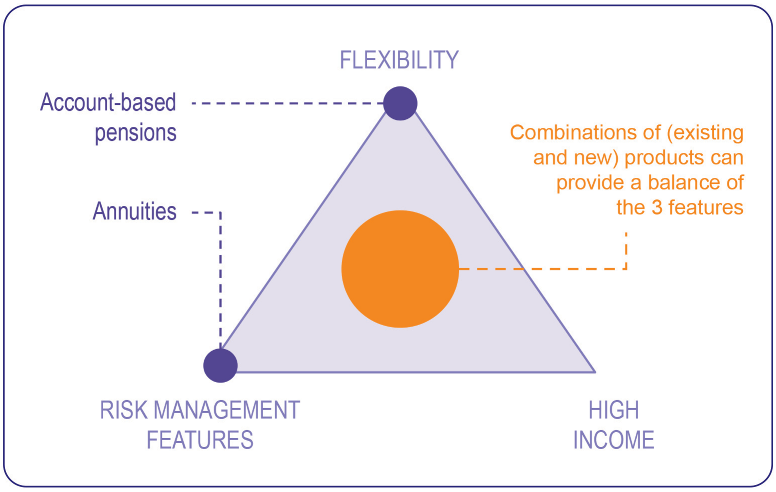
As observed by the Financial System Inquiry (FSI) in its final report, and made clear by their impairment during the GFC and in its aftermath, the average 'balanced' ABP can't adequately manage the unique risks of retirement. It should be viewed as part of any retirement portfolio, rather than the entire solution.

So it makes sense that the FSI recommended that all large APRA-regulated super funds 'pre-select' a comprehensive income product for retirement (CIPR) that addresses the need for retirees to have:

- high income
- risk management features
- flexibility.

The FSI believed that this requirement is likely to be satisfied by using a combination of products, starting with the ABP. This was illustrated in the FSI's final report as follows:

Desired features of retirement income products



The final report suggested the potential for a wide range of CIPRs which, in addition to the existing ABPs and annuity products, included combinations with:

- deferred lifetime annuities (a product commonly used overseas, but not yet here)
- group self-annuitisation schemes (GSAs) (a new concept)
- deferred GSAs and
- other future innovations.

Making the comprehensive income product more understandable

One challenge faced by the broad, non-prescriptive CIPR concept is that any product or portfolio will have to be easily understood and evaluated by fund members. To provide guidance, minimise subjectivity and promote more consistency of retiree outcomes, we might wish to consider the use of a balanced scorecard approach. The scorecard would assign a qualitative rating to each strategy or feature addressing the three CIPR requirements.

The scorecard could be developed by APRA using its standards-making power under broad principles that could be set out in the SIS Act. This process would allow for appropriate consultation with the industry. Designing the scorecard would, however, involve making some qualitative decisions about the differences between certain retirement income strategies. For example, a core principle should be that an investment strategy or asset allocation alone does not satisfactorily deal with longevity risk. Higher expected returns should be a positive, but income volatility should lower the rating. Similarly, CIPRs that did not have an express inflation management strategy or a means for combating sequencing risk would also get lower scores under the balanced scorecard idea.

Using a scorecard would enable easy comparison for retiring fund members and their advisers, and provide some regulatory guidance, without reducing the ability of fund trustees to tailor their offer to the specific needs of their own members (eg taking into account different demographic factors and the like). The balanced scorecard would essentially operate as a 'nudge', using a transparent rating system to influence the behaviour of product providers and retirees alike.

Recognise every retirement is different

To take our retirement income system to the next stage of its evolution, the CIPR concept must be impactful, while at the same time allowing tailoring, innovation and the accommodation of different demographics, account balances and so on. After all, every retirement will be different.

It also needs to be palatable. Given that workers are already forced to save some of their own wages through compulsory superannuation contributions, further compulsion is unwarranted. Murray has highlighted though, that the system is letting retirees down in leaving them exposed to risks that they cannot manage on their own.

Disclosure of the ratings to consumers in a meaningful way could be key to the success of the concept. Getting the disclosure right will involve attention to other global examples and, ultimately, consumer testing. Something similar to the ENERGY STAR® ratings used for new electrical appliances in Australia might be a start. Ideally, the rating system would be something that consumers will understand and trust.

If done properly, it should be possible for the scorecard to highlight trade-offs between risk management, flexibility and returns. If retirees, as consumers, come to understand that they cannot have the highest income with full flexibility and be protected from every risk, then advisers and funds can have a discussion about the mix that they provide.

The scorecard is likely to be both informative and slightly normative in effect. Funds and product makers are likely to respond to the incentive to seek higher, rather than lower, ratings. A low-scoring CIPR would still be compliant and there would be nothing preventing retirees from investing in it. Retirees might be advised to opt for a low-scoring CIPR because they have, for example, substantial assets, an expected inheritance or a longevity product in another structure. Similarly, the scorecard would not supplant advice and is really a 'labelling' idea. It would necessarily be only part of the process of determining the appropriate retirement strategy for a retiree. There is no silver bullet solution in retirement.

More choice for retiring members

There is only upside in introducing CIPRs. A CIPR simply provides more choice for retiring members. Super funds will be free to retain their existing range of retirement options and to introduce new products alongside CIPRs. Retirees would have no obligation to participate in a CIPR. In every way a CIPR would be a 'choice' product, especially when compared with MySuper. Whereas MySuper requires a young, typically less-interested worker to do nothing or opt-out, a 'nudged' CIPR requires a mature, engaged retiree to opt-in. This is a key point.

It is a well-recognised feature of pension systems around the world that a retirement solution put forward by the fund itself carries with it an implicit recommendation that it is appropriate. This, again, positions the CIPR as a useful policy initiative. Fund trustees will be aware of the duty of care involved. The underlying policy purpose of the CIPR concept is to provide better risk management for retirees than is currently being afforded to them.

The retirement phase is the remaining aspect of super that needs to be brought into the 21st century. If the idea of some sort of qualitative filter or signal, such as the balanced scorecard, is embraced by the industry, then the CIPR might just be the springboard for super to become recognised as the world's leading retirement income system.

Jeremy Cooper is Chairman, Retirement Income at Challenger Limited, former Chairman of the Super System Review (the Cooper Review) and Deputy Chairman of ASIC from 2004 to 2009.

Do you plan to be a 'have' or a 'have not'?

Noel Whittaker

The latest Intergenerational Report (IGR) contains some scary statistics. Within 40 years the life expectancy of the average male will be 95.5 years, and for a female 96.6 years. The population will be almost 40 million and include more than 40,000 people aged over 100.

There is nothing really new in this. For more than 35 years, there have been warnings galore about the problems that will come when the baby boomers start to leave the workforce. These people, born between 1946 and 1964, are now aged between 69 and 51 - the oldest of them are either retired or thinking about it.

Their exit from the workforce will cause labour shortages, and put pressure on wages as employers compete for a dwindling number of workers. Furthermore, their increasing need for health services will cause immense challenges for an already stretched health sector.

Adversarial politics creates inaction

Governments of all persuasions have long been aware of this ticking time bomb, but thanks to the adversarial nature of politics, there has been a lot of talk but not much action. In 1997 the Howard Government tried to fix the crisis in the nursing home industry by introducing accommodation bonds. Labor ran such a successful scare campaign the scheme was dropped.

For example, in budget after budget there have been attempts to address the rising cost of the Pharmaceutical Benefits Scheme which in 2007/2008 delivered 170 million prescriptions at a cost of $6.6 billion. In 2006 the Howard Government laid out a four year reform package that was designed to save $3 billion over ten years, and in the 2008/2009 Budget the Rudd Government introduced new therapeutic groups which are aimed at driving down the cost of drugs. Still the costs escalate, and in 2013/2014 exceeded $9 billion.

The first IGR was included in the 2002/2003 budget, and a second report was released in 2007 and a third in 2010. Every time a new IGR is released we hear statements from the government of the day that we face massive problems in the future unless we make big changes to our tax and welfare system in the short to medium term. Unfortunately there is more talk than action.

The time to act is now

The good news from the latest IGR is that average annual income is expected to rise from $66,400 to $117,300, which will boost the property and share markets. The bad news is that there will be just 2.7 people aged between 15 and 64 — potential taxpayers — for every person aged 65 and over.

It is a wake-up call for every Australian. If you are under 40, you have time for compound interest to work its magic, which should enable you to build a decent portfolio if you start now and choose the right mix of growth assets. You will need this portfolio because you may well live to 100, at which time the age pension is certain to be severely restricted.

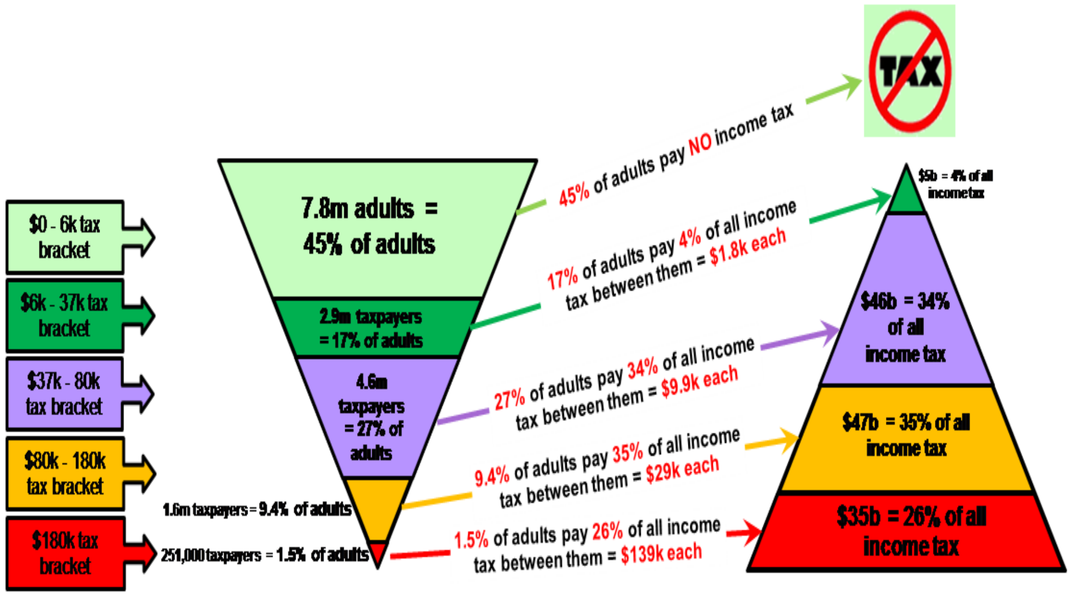
If you are between 40 and 65 you cannot afford to rely solely on employer-paid superannuation. The age at which you can access the age pension is being raised, and there are calls to also raise the superannuation age to 67 to match. The best strategy for you is to salary sacrifice to the maximum, and hone your skills so that you can work as long as possible. This will increase the power of compounding and make your money last longer, as it will delay the time you need to start making withdrawals.

Are you already over 65? Don’t panic. Any changes to the age pension will come in gradually, and are certain to be grandfathered. However, you need to be getting good financial advice to ensure your money works as hard as realistically possible. The alternative is to face the challenge of living longer than your money.

Where will the taxes come from?

The following case study illustrates the difficulty facing any government trying to get the budget back on track. Think about a single income couple with two children aged 8 and 10, where the primary breadwinner earns $75,000 a year. The income tax on this would be around $16,000, but the family's contribution to the national coffers would be just $9000 after family payments of $7,000 a year are taken into account. If we assume the cost of the full age pension for a couple is $36,000 a year when healthcare concessions are factored in, it is obvious that it takes four such single income families to support one pensioner couple.

This imbalance will get worse as the ratio of dependants to workers grows over time. Our taxation system presents grave challenges too. Currently, 61% of personal income tax is received from a mere 11% of taxpayers, leaving the bulk of taxpayers contributing very little. In addition, 87% of those aged 65 and over pay no tax whatsoever.



Source: Philo Capital

A full review of our tax and welfare system is overdue, but the adversarial nature of politics does not make for optimism. Right now, the federal government reminds me of a dysfunctional family. Dad and Mum (the two major parties) spend all their time abusing each other and promising the world to their constituents (us, the children) while well-meaning but inexperienced relations (the minor parties) add to the turmoil by telling the kids that their parents don't know what they are talking about.

Unless you have more faith than I do that politicians of all parties will be able to solve these problems over the next 40 years, you should be making every effort to work as long as possible to accumulate as much as you possibly can for your retirement. Australia is moving inexorably to a society of haves and have nots. Despite a lot of rhetoric from our politicians, it will be the haves who will be first in line for medical care as the queues for health services grow.

Noel Whittaker is the author of Making Money Made Simple and numerous other books on personal finance. His advice is general in nature and readers should seek their own professional advice before making any financial decisions. See www.noelwhittaker.com.au