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Lessons from results of CalPERS, Buffett and super funds

Graham Hand

The largest Australian and global asset managers are reporting their results for the last financial year, and they are useful benchmarks for all retail and institutional investors. While everyone has different goals and strategies, there is some reassurance for the novice investor that even the most sophisticated managers are struggling in the current market.

This article looks at the results from CalPERS released this week, Warren Buffett's Berkshire Hathaway in 2015, and Australia's superannuation funds in the past financial year.

California Public Employees' Retirement System (CalPERS)

CalPERS is the largest defined-benefit public pension scheme in the United States, managing over US$300 billion on behalf of millions of Californian school and public service members.

This week it reported an annual return of 0.61% net of fees for the year to 30 June 2016. Far from being embarrassed about the result, Chief Investment Officer Ted Eliopoulos said, "Positive performance in a year of turbulent financial markets is an accomplishment we are proud of."

CalPERS split its performance into asset classes as shown in Table 1.

Table 1: Asset class performance by CalPERS in year to 30 June 2016

	Net Rate of Return	Versus Indexes
Public Equity	-3.38%	58 bps
Private Equity	1.70%	253 bps
Fixed Income	9.29%	(2) bps
Real Assets	5.99%	(516) bps
Real Estate	7.06%	(557) bps
Infrastructure	8.98%	402 bps
Forestland	-9.56%	(1,246) bps
Liquidity	0.36%	17 bps
Inflation Assets	-3.64%	147 bps

Returns are heavily dependent on the performance of listed companies, since half their portfolio is in equities, but they point to the merit of diversification. The poor equity result was offset by strong fixed income, real estate and infrastructure results, largely driven by declining interest rates. Unfortunately, these rate gains will be difficult to repeat.

As expected from such a massive fund, its processes are supported by a detailed Asset Liability Management system, described here. It covers asset allocation, demographic change, actuarial assumptions and estimates of the overall soundness of their defined-benefit plans. The assumptions were last reviewed in 2014. This might explain why they continue to assume strong rates of return, as shown by their statement on common misconceptions:

*"**Myth: CalPERS 7.5% assumed annual rate of investment return is too high and cannot be achieved**: CalPERS investments have earned an average 7.6% annual return over the past 20 years and 9.4% over the past 30 years. CalPERS investments earned 13.2% in Fiscal Year 2012-13. CalPERS assumed rate of investment return is a long-term [20 years or more] average. Any given year is likely to be higher or lower than the assumed rate."*

Not only are they quoting returns from another world in 2012/2013, but their more recent commentary talks about the current challenging conditions. Eliopoulos will struggle to explain in his next review of assumptions how he can achieve 7.6% in the coming decade.

Berkshire Hathaway

Warren Buffett's annual letter to shareholders contains the usual gems, and he dispels the negative 'drumbeat' about his country's problems.

"The babies born in America today are the luckiest crop in history ... For 240 years it's been a terrible mistake to bet against America, and now is no time to start. America's golden goose of commerce and innovation will continue to lay more and larger eggs. America's social security promises will be honoured and perhaps made more generous. And, yes, America's kids will live far better than their parents did."

(As an aside, the millions of babies and kids whose parents earn the minimum wage of US$7.25 an hour will struggle to appreciate how lucky they are unless someone funds their college education).

Buffett reports his performance in many ways, including per-share book value (up 6.4% in 2015 versus a long-term average since 1965 of 19.2%) and per-share market value (down 12.5% in 2015 versus up 20.8% since

1965). He discusses intrinsic value at length, including earnings from Berkshire's businesses increasing by 2.1% in 2015 versus 23.7% since 1970. In 2015, the S&P500 rose by only 1.4% including dividends.

So while Buffett continues to demonstrate outstanding investment acumen and long-term optimism, the recent performance is a far cry from historical levels, any way the results are measured. There are many reasons for this, not least the fact that his company is now valued at about US$330 billion. Small investments do not move the needle.

Obviously his short-term performance is affected by market forces, but he considers the major risks for his companies are:

1. The railroad business is certain to lose significant coal volume over the next decade.
2. At some point, his insurance and auto dealership companies may shrink because of driverless cars.
3. Circulation of his print newspapers will continue to fall.
4. Renewables have previously helped his utility operations but this could change, particularly if storage capabilities for electricity materially improve.
5. Online retailing threatens the business model of his retailers and certain consumer brands.

But he is not concerned about year-to-year vagaries of the stock exchange:

"These potentialities are just a few of the negative possibilities facing us – but even the most casual follower of business news has long been aware of them. None of these problems, however, is crucial to Berkshire's long-term well-being."

If only all company executives and investors could think with such a long-term horizon.

Australian superannuation industry funds

The major industry superannuation funds returned 3% in the year to 30 June 2016, the lowest annual level in four years, according to superannuation researcher Chant West. The median fund returned 6.2% over the past 15 years. These numbers apply for the Growth category (see Table 2 below) used by the majority of Australians, where 61% to 80% of investments are allocated to growth assets.

Table 2: Diversified Fund Performance (results to 30 June 2016)

Fund Category	Growth Assets (%)	1 Mth (%)	Qtr (%)	1 Yr (%)	3 Yrs (% pa)	5 Yrs (% pa)	7 Yrs (% pa)	10 Yrs (% pa)	15 Yrs (% pa)
All Growth	100	-2.2	2.9	0.2	9.6	9.2	9.6	4.8	5.1
High Growth	81 – 100	-1.5	2.9	2.8	9.3	9.0	9.4	5.2	6.3
Growth	61 – 80	-1.0	2.8	3.0	8.6	8.2	8.8	5.3	6.2
Balanced	41 – 60	-0.4	2.4	3.1	7.0	7.1	7.7	5.1	5.7
Conservative	21 – 40	0.2	2.0	3.6	5.8	5.9	6.6	5.1	5.5

Source: Chant West

Note: Performance is shown net of investment fees and tax. It is before administration fees and adviser commissions.

Warren Chant described the benefits of diversification enjoyed by the best performers, as Australian equities returned less than 1%. Strong returns came from listed property (up 24.6%), unlisted infrastructure (up 17.9%), global fixed interest (up 9.3%) and domestic fixed interest (up 7%). The top-performing fund was up 7.6%.

"While this year's return is significantly lower than the previous three years (15.6% in 2012/13, 12.8% in 2013/14 and 9.8% in 2014/15), members shouldn't be too disappointed with the result given that super funds are faced with a very uncertain global political and economic environment. They've had a particularly good run since the end of the GFC."

The major lessons from experienced investors

Three messages from professional investors are: think long term, accept lower returns in the current market, and diversify exposure.

The biggest challenge facing all investors, and especially the less experienced, is how to focus on a long-term strategy and not blink every time the market has a correction. Buffett has such faith in the long-term robustness of his businesses that he sees market falls as buying opportunities (during the GFC, he bought options expiring in 2021 with the right to acquire 700 million Bank of America shares for US$5 billion which are now worth US$12 billion). CalPERS may be optimistic in expecting a 7.6% return in coming years but they remain unfased by a poor year.

Where Australian industry super funds have gained an edge is holding a decent allocation, around 20%, in unlisted assets such as private equity, infrastructure and property. These 'alternative' assets are available to most retail investors, either through unlisted syndicates, listed investment companies, exchange traded funds or managed funds.

Notwithstanding the benefits of diversification supported by recent experience, it is difficult to see the strong performance of fixed interest being repeated in coming years, and it could be negative as rates rise. Equities are fully valued and property has had a stellar run. While 'lower for longer' has become the common cliché, the last year has shown that even when equities struggle, there are other opportunities for those who are canny at asset allocation.

Graham Hand is Editor of Cuffelinks. This article is general information and does not consider the needs of any individual.

Innovation offers big opportunities for investors

Dawn Kanelleas

Australia's National Innovation and Science Agenda appears to have sharpened the focus on companies perceived as 'innovative' in nature. From an investment perspective, innovation represents opportunity. It also present risks, however, primarily for incumbents whose margins or market shares are threatened by new entrants or more innovative competitors.

By understanding the breadth of opportunities for new entrants in an industry, as well as the threats to incumbents, professional long-short investors are able to profit from opportunities on both sides of the ledger. In this article, we consider what innovation means in the Small Companies sector and how innovation and disruption can drive investment decisions in this often under-researched space.

What does disruption mean for small company investors?

The information technology age in which we live means many people associate innovation with something digital or online. Consider how innovative products like Uber and iTunes have revolutionised the taxi and music businesses. In fact innovation, and therefore disruption, is occurring in all kinds of businesses in Australia, across a wide range of sectors.

From an investment perspective, you need to consider much more than the innovation itself. Many other factors will determine whether an innovative company is a good investment such as the size of the market for the product or service. Then there are questions like:

- are there barriers to entry or lack thereof?
- how many years a product has been in development?
- is it meaningfully different from competitors?
- is it patented?
- how much money has been invested in research and marketing?
- how broad is the distribution footprint?

All of these considerations determine whether a company has competitive advantages and, importantly, the sustainability of those advantages over time.

There are also investment considerations for incumbent operators. Some of these established, listed companies may have been operating successfully in an industry for many years, with earnings streams that were previously deemed defensive and sustainable. For long-short investors, the potential negative effects of disruption can be as appealing as the potential benefits of innovation.

Innovation in established industries

In any industry, there is almost always some level of product development or innovation occurring. The car industry is one of the most established and competitive in the world and there is an astonishing level of innovation underway, including the development of electric motors and the release of prototype driverless vehicles.

For Australian small cap investors, there are exciting earnings opportunities from companies with innovative products and services in rather less futuristic areas.

In the 1970s, owners of 4x4 vehicles relied on homemade or ill-fitting equipment for use in rural or outback regions. At that time, ARB Corporation was established and the company started designing and producing a range of 4x4-related accessories. Following more than 40 years of product development and innovation, the company is a global market leader in the manufacture and supply of bull bars and other accessories. The 4x4 market is growing at a double-digit pace due to the ever-increasing popularity of SUVs and utility vehicles.

ARB currently exports to more than 100 countries, has a vast distribution footprint and owns its own outlets to service the aftermarket for additional, non-standard accessories. The global reach of this business model is not easily replicated. The company is on a strong financial footing, too. ARB is in a net cash position and earnings margins in the 20% range are the envy of companies in many other industry sectors.

Whilst many of ARB's products are perceived to be innovative, the key appeal for us as investors is the sustainability of the competitive advantages developed over more than four decades.

Innovators completing Initial Public Offerings (IPOs)

Many of the most innovative companies are relatively immature, unlisted companies. Some of these go on to complete IPOs, crystallising gains for founders and seed investors and raising capital to fund future growth. An example in the Australian small cap sector is Reliance Worldwide Corporation, a recent IPO of a company operating in plumbing, an established and 'old fashioned' industry.

Among the company's main products is a 'push-to-connect' pipe fitting. The product offers plumbers and DIY users an efficient, less labour-intensive solution to repairs following pipe leaks. While Reliance Worldwide has about 80% share in the push-to-connect market in the US, Canada and Australia, the real attraction is that push-to-connect currently only accounts for about 10% of the plumbing supply market in the US. The growth opportunity is significant and the company is experiencing sales growth of more than 10% per annum.

Reliance Worldwide has been distributing plumbing products into the US for more than 16 years and has market-leading positions in primary locations. Trademark protection of the product provides another important competitive advantage. Market share is protected from imitation products and, importantly, means Reliance Worldwide can maintain decent pricing power with stockists.

Will we continue to see innovative companies in Australia?

Given the National Innovation and Science Agenda of the Federal Government, we expect to see a steady stream of start-up companies threatening incumbent operators in many industries. Some of these companies will have aspirations to list and will go on to complete IPOs.

As pioneers such as REA Group (in real estate digital advertising) and TPG Telecom (in both internet and

telephony services) have proved, disruptive companies with innovative products and services – combined with the right focus from a capable management team – can generate handsome returns for investors.

On the other hand, there have been countless examples of companies, whose products and services have not lasted the test of time, resulting in a permanent loss of capital for investors. The challenge is to identify the key differences between the two and position your investment portfolio accordingly.

Dawn Kanelleas is Senior Portfolio Manager at Colonial First State Global Asset Management. This article is general information and does not consider the investment needs of any individual.

Wealth managers need to focus on what clients really want

Antoinette Elias

The wealth management industry is undergoing unprecedented change and, depending where you stand, this can feel like a big opportunity or a big threat. Shifting client demographics and preferences have changed the landscape, with fintech entrants starting to commoditise the traditional asset allocation advice model. This has eroded pricing power while simultaneously raising the bar for better and faster service.

Wealth managers face both significant opportunities to acquire new clients and assets, as well as daunting challenges in retaining clients in the face of competitive threats and digital disruption. What can Australian wealth managers do now to weather the storm and grow their businesses?

Invest in the client experience

For starters, they need to adopt more client-centric strategies and make better use of technology to capture a bigger share of the sector's US$200 billion global revenue opportunity. Ernst & Young's latest global wealth management report, *The experience factor: the new growth engine in wealth management*, found firms that don't make strategic investments in client experiences risk losing a substantial portion of their business. In fact, 28% of all Australian clients said they were open to switching wealth managers under the right circumstances.

The majority (73%) of both Australian and global clients have relationships with multiple wealth managers, and while those Australians are less likely than the global average to consolidate their assets (38% compared to 57%), there are still over a third who would. This figure should make the local industry sit up and take notice.

The report found that Australian clients want greater fee transparency and more focus on goals-based planning. One in four was open to investing via automated advice services, such as robo-advisors. In this environment, wealth managers need to offer a superior customer experience to maintain and increase market share.

Regulatory compliance a huge burden for APAC managers

With client assets in play, 50% of global wealth managers said revenue growth is their major strategic business priority over the next few years, with specific initiatives focusing on enhancing client experiences. Within the Asia-Pacific (APAC) region, however, only 31% of wealth managers saw revenue growth as their top focus.

APAC wealth managers are instead bogged down by regulatory compliance. Regional managers expect to spend 42% on average of their strategic budgets on compliance, highlighting the sheer size of the regulatory burden in the region.

While passporting schemes can facilitate cross-border marketing of managed funds, their immediate impact is to ramp up compliance costs. This, when combined with increasing competition, is having a big impact on margins regionally. Some 62% of APAC firms reported declining margins, citing competitive fee pressure and regulatory compliance costs as the key causes, compared with just 18% in North America.

Improving the client experience

The client experience in the wealth management sector is unique and complex, as it spans an individual's life journey, often into the investment unknown. As a result, wealth managers have lacked a common definition or standard by which firms can measure themselves. Yet, the report identifies a common view of client experience – respondents value performance, engagement and trust the most in their wealth managers.

While clients and firms are aligned on most of these values, there were three key areas where firms appear to be out of step with their client's expectations. They were:

- **Transparency** — clients want far greater transparency that includes rating their advisors and connecting with similar clients in public forums
- **Advice channels** — clients are significantly more open than firms are to adopting digital channels for wealth advice, not only service
- **Role of the advisor** — the financial advisor may become more like a financial therapist in the future, helping clients with spending habits or reaching life goals instead of strictly providing standard asset allocation advice or other activities that could be automated.

How should wealth managers prioritise their client strategies? A firm's reputation is no longer a barrier to entry. Newcomers can build trust with transparency and steal current and potential clients from existing players. Digital services are already here, and digital advice is inevitable for certain client segments. The wealth advisor's value goes well beyond assigning clients to asset allocation models, but clients need to become believers too. Firms need to evaluate their strategies and align them with the key elements of what clients want – performance, engagement and trust.

The rules of the game have changed. To continue to grow, managers must learn to compete with man, machine, and hybrid-based firms to retain and attract assets.

In an industry where advances in technology, new types of competition and client expectations will be changing rapidly, firms that challenge traditional norms while remaining true to their core value proposition are in the best position to succeed. Delivering a comprehensive client experience is more essential than ever in this new wealth management landscape.

Antoinette Elias is Wealth and Asset Management Leader for Oceania at Ernst & Young

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10 reasons for poor hedge fund performance

Adam Parker

At two recent Morgan Stanley investor conferences, the question of poor hedge fund performance surfaced repeatedly. We surveyed a group of long/short fundamental equity hedge fund managers at one of the conferences as to what they thought was the primary reason for poor performance in their industry. Of all the answers received, 54% said 'crowding', 23% said 'factor exposures', 8% blamed 'macro headwinds' and 8% said 'poor liquidity'. The remaining group (also 8%) said 'poor stock selection'.

In other words, when performance is bad, it is beta (the market), when performance is good, it is alpha (returns above the market). The truth is that 100%, at some level, should have said 'poor stock selection', and what this data reveals is that 92% of respondents are blaming something other than their stock selection methodology for the current underperformance. Our portfolio has outperformed for five straight years, and is lagging this year. It is 100% stock selection.

The alpha from the Hedge Fund Research Inc (HFRI) long-short index was close to 14% per annum in the early 1990s, and has been slightly below zero for the past few years. Why is this? We don't claim to have some systematic rank ordering of explanations for the decay in performance, but there are many possible reasons.

Ten possible explanations

First, there has been a sharp rise in the number of funds, with HFR estimating that there are 3,400 equity-focused hedge funds today (about as many as stocks under global coverage by the Morgan Stanley research department).

Second, low interest rates have removed the rebate hedge funds received, a non-trivial driver of historical returns when rates were materially higher.

Third, hedge fund CIOs are increasingly cautious. Since 2003, US regulation FAS123R has made it illegal for hedge funds (and everyone) to know anything material and non-public in the US, at least, and frequent, high-profile hedge fund investigations have curtailed information-seeking at some level.

Fourth, the more rapid availability of information has materially shortened the time arbitrage that previously existed. The days when you ran to a pay phone to call a large portfolio manager in Boston when you learned something you thought mattered have been over for years. You have to publish something first that passes the smell test from nine different editors, compliance officers, control groups and stock selection committees.

Fifth, there increasingly appears to be a 'group think', as going to Omaha to hear what Warren Buffett says has transitioned to systematically tracking billionaire holdings and riding out the last bit of momentum from their ideas. Everyone attends or hears about the pitches made by successful hedge fund owners at industry conferences, dinners, charity events and presentations, raising questions about 'crowding'.

Sixth, the quants have stolen some of the alpha. Everyone knows the quants are onto something, so they are hiring junior quants to analyse their 'factor exposures', even though they don't know what to do with the information once they get it. The HFRI equity market neutral index has beaten the HFRI long-short by about 3% per year for the past 10 years, so the 'quant thing' isn't new. In addition, liquidity quant trading, baskets and ETFs have potentially been 'sucking' alpha out of the traditional long-short industry.

Seventh, limited partnerships don't invest in hedge funds for as long as they used to, as their manager selection gets analysed and evaluated, creating more fear of redemption today versus yesteryear, and exacerbating short-termism among the hedge funds. We don't remember anyone saying in 1995 that they were bullish on the market because hedge fund performance has been so bad that there may be redemptions and a 'you might as well go for it' melt-up. We hear that regularly now.

Eighth, macro factors account for a higher percentage of total returns today than in the past, and most hedge funds are set up for bottom-up security selection. This may have been prudent in a 1995 world where 80% of the average stock's performance was idiosyncratic, but with macro now explaining well over half of the average stock's returns, many classic hedge funds may be sub-optimally staffed for the current opportunity set. This has, in turn, affected dispersion (which became low) and correlation (which became high), and the dollar, rates and oil exposures, among others, are material on many books.

Ninth, while all active management has suffered, long-only firms began to realise they could replicate some of the more successful hedge fund approaches, shifting some of the alpha away from the hedge fund industry over time.

Tenth, the capital markets have been less supportive, meaning, the 'free money' associated with IPOs in the 1990s has clearly slowed. Very few high-profile deals have been monster stocks this cycle.

When can we expect excess performance to return?

While this surely isn't a comprehensive or rank-ordered list of reasons for weak alpha generation, it hopefully touches on some of the issues. When will excess performance be likely again? Our suspicion is that much wider dispersion is required, and this isn't likely until long-dated rates back up meaningfully or economic volatility grows materially. That said, dispersion is clearly wider than it was a year ago, and active management has yet to enjoy an improvement in performance. Here's hoping that later this year we won't need any excuses due to good stock selection.

Adam Parker is a Chief US Equity Strategist at Morgan Stanley.

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Why Australian investors use offshore funds

Craig Stanford

The recent release of the 'Panama Papers' shone a spotlight on offshore financial centres, but unfortunately, most of the reporting painted an incomplete picture of the industry. Many articles confused the concept of an offshore financial centre with that of a tax haven, but these are two separate concepts. The important differentiating feature of a tax haven is not that is has low or no taxes, but rather that it tends not to share data with the tax or regulatory authorities of other countries. In other words, not all offshore financial centres are the same.

This article explains the differences and why setting up a fund offshore can be attractive.

The Cayman Islands for instance is a popular domicile for hedge funds and has no corporate taxes, although it does have a well-developed reporting framework that automatically shares important tax data on locally-domiciled entities with the relevant tax authorities in the US and UK. For this reason, it is not regarded as a tax haven despite having zero tax rates.

A few articles took matters a step further, suggesting that all offshore hedge funds were secretive and opaque investment vehicles used by wealthy individuals to avoid paying taxes. This fiction was enhanced when the hedge fund is incorporated in a jurisdiction which was incorrectly portrayed as a tax haven.

Although this makes a great story, the press frequently confuses a tax neutral jurisdiction with a tax haven. The reality is that the largest investors in hedge funds are institutions including pension funds, sovereign wealth funds and insurance companies in developed countries and regions like the US, UK and Europe. These investors require the benefits that come from investing in a tax neutral, offshore jurisdiction.

No imposition of an additional layer of taxes

Tax neutrality essentially means that the country where the fund is domiciled (or registered) does not impose its own additional layer of taxes on the investors in the fund. But this does not mean that investors in tax neutral funds do not pay taxes. Tax neutral status is not unique to offshore funds and there are tax-neutral investment fund categories in the UK and the USA, for example. What sets offshore funds apart is the combination of tax neutrality and investment flexibility allowed by the fund structure.

Investment through a fund adds a potential layer of tax as opposed to the investors owning the underlying investments directly. Funds are given tax-neutral status to prevent the layer 2 tax being applied in addition to the taxes incurred at layers 1 and 3, so that an investor would be indifferent to holding the assets directly or through a fund, as illustrated Table 1 below.

Table 1: Different layers of potential tax in any fund

Layer of tax	Description	Comment
Layer 1 - Investors	Tax in investors' own jurisdictions on investment income and realised capital gains, either as these arise to the fund or when the investors realise their interests in the fund.	The investors do not cease to be liable to this tax, even if they invest in an offshore fund.
Layer 2 - Fund	Tax in the jurisdiction where the fund is registered on the fund's investment income and realised capital gains.	This would be an additional tax charge to be borne by the investors as it arises in respect of the same amounts as in Layer 1 and Layer 3.
Layer 3 - Investments	Tax in the jurisdiction where the fund invests on income and realised capital gains from the fund's investments, e.g. on an equity stake that the fund has taken in a shares or bonds that the fund holds.	Some jurisdictions charge tax on non-resident investors, unless they benefit from a double tax treaty or other relief.

Investment flexibility

Another key benefit of investing in an offshore fund is that it can have more investment flexibility than a domestically domiciled fund. Although we have a flexible investment regime for domestically-incorporated

hedge funds in Australia, other countries are not so fortunate. For those managers the ability to leverage investments with borrowed money, or to undertake short selling, is an important part of being able to manage their client's capital effectively.

Regulation is continually evolving, and as it has the scope of 'know your client' rules have been expanded. As such, investors in certain offshore fund jurisdictions are fully and automatically reported to international tax authorities such as the US IRS and the UK HMRC. With the implementation of FATCA, the hedge fund must register and provide this data and if it does not, it will face penalties and will be unlikely to be able to trade with market counterparties (who are required to confirm the FATCA compliance of firms or funds they deal with). Funds will likely expel investors who refuse to disclose sufficient information about their identity rather than risk running foul of the tax authorities.

This is what makes offshore funds so attractive to investors. Investors seeking to invest in stocks or bonds have a choice. They can either buy these instruments directly themselves or via collective investment vehicles such as funds, which pool monies from a number of investors and then manage the pool on their behalf. The use of collective investment schemes gives investors, including pension funds and other sophisticated investors, the ability to diversify their portfolios across a broad range of investment strategies such as those pursued by hedge funds.

The investment fund management industry is global in terms of the location of investors, the fund management team and the portfolio investments. Consequently, the challenge for fund managers is how and where to create investment fund structures which are able to accommodate in a cost- efficient way investors from all over the world. They must operate within the complexities of existing tax and securities laws that apply to those investors, the management team and the business or investment activities, in their multiple home jurisdictions.

Craig Stanford is Chair of the Alternative Investment Management Association (AIMA)'s Investor Education Committee in Australia and Head of Alternative Investments at Morningstar Investment Management Australia. This article is adapted from the AIMA paper, 'Transparent, Sophisticated, Tax Neutral: The Truth About Offshore Funds.' For further information, contact AIMA. The information provided is for general use only and does not constitute personal financial advice. Views expressed are those of the Alternative Investment Management Association and do not necessarily represent those of Morningstar Investment Management Australia or Morningstar, Inc.

SMSF accountants and the unexploded grenade

Gordon Mackenzie

There is something more interesting in the SMSF market than speculation about what super changes in the Budget will see the light of day, especially for many accountants. Perhaps a hand grenade ready to explode is the best analogy for the change in the rules regarding how accountants can give SMSF advice from 1 July 2017.

Accountants who want to advise on SMSFs are currently subject to regulation that is significantly different from normal accounting practice. Specifically, they have to follow the rules that financial planners use when advising, though they supposedly have reduced obligations if the advice is limited to SMSFs.

Broadly, following the miss-selling in the financial planning community, the rules for giving financial planning advice are pretty onerous. They now obligate someone to, in effect, do a financial risk and needs due diligence on their client, make recommendations that are consistent with what they found in that investigation and formally document that they have done both those things (the ubiquitous Statement of Advice).

What happened to 'financial planning lite'?

So did accountants get the 'financial planning lite' regulation they were promised? Probably not. I've scoured the ASIC rulings to see if those client due diligence obligations are less onerous if they are just talking to them about an SMSF as opposed to full financial service advice. I'm blowed if I can see it.

ASIC makes some observations about 'scaled' (read limited) advice, but even when you are operating in a scaled environment you still have to tell the client that their other financial risks and needs, death and disability insurance for example, are not being advised on.

Now, I'm not the smartest person it the room but it seems to me that if you have to tell them that you are not advising on their other financial risks and needs you have to know what those other financial risks and needs are.

In that case, you, in effect, have to do a full financial risk and needs due diligence to be able to tell them you won't be advising on all those financial risks and needs, just on SMSFs.

So, these financial planning lite rules limit your workload, right? No. They limit your regulatory risk, right? Well, no again. Tick tick tick. Is that an unexploded hand grenade I hear ticking away in the background?

Oh, and finally, there is the hostility of the accounting profession having to now practice in this way. I will admit I'm pretty close to the accounting profession, having worked with them on SMSFs for the last four years, but I do have some sympathy for their predicament.

The fact is that there is virtually no significant evidence of malpractice by accountants in the SMSF space. OK, there were some recommendations about setting up a SMSF when the indicators were that it wasn't in the clients' interest but benefitted the accountant. However, Jeremy Cooper's Panel's view of the SMSF sector was that it was well managed.

Regulatory overreach on accounting profession

It seems to me that the accounting profession has been sold a pup with these rules. Indeed, it can even be said that what we have here is regulatory overreach. All very interesting, but these rules, if breached, have serious consequences; the grenade exploding perhaps.

Gordon Mackenzie is a Senior Lecturer in taxation and business law at the Australian School of Business, University of New South Wales.

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