Cuffelinks
Connecting investors with ideas

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Trust alternatives after 1 July super changes

Reuben Zelwer

Given the impending superannuation changes, it's worth taking a fresh look at estate and superannuation succession planning arrangements.

Background

From 1 July 2017, individuals will be able to have a maximum of $1.6 million in the tax-free pension stage of superannuation. Amounts surplus to the $1.6 million need to either be rolled back to the accumulation stage of superannuation (tax rate of 15% applies to income and 10% to capital gains) or withdrawn from superannuation where earnings may be taxed at personal marginal tax rates.

To illustrate the changes and new opportunities, consider the following example:

- High net worth retired couple, Simon and Danielle, both age 65 with an SMSF total balance of $3.5 million ($1.6 million for Simon and $1.9 million for Danielle). The SMSF is entirely in pension phase so no tax applies.
- Simon also has an investment portfolio valued at $2 million outside super.
- Simon passes away in June 2017.
- They have two minors as grandchildren who do not have any other income.
- SMSF succession arrangements are such that Danielle can take Simon's balance as a reversionary pension, lump-sum payment directed to the estate or Danielle, or a combination of the above (the precise mechanics of this will be discussed in another article).
- For simplicity, assume an earnings rate of 5% (all income, no franking credits) on investments regardless of entity holding assets.

Pre-1 July 2017 consequences

a) Before Simon's death

In a pre-1 July 2017 world, there is no tax on earnings within the SMSF as it is all in pension stage. Simon pays tax at his marginal rate on his $2 million personal investment portfolio.

	Mode	Balance	Earnings	Tax
Simon	Personal name	$ 2,000,000	$ 100,000	$ 26,632
Simon	SMSF Pension	$ 1,600,000	$ 80,000	$ -
Danielle	SMSF Pension	$ 1,900,000	$ 95,000	$ -
	Total	$ 5,500,000	$ 275,000	$ 26,632

b) After Simon's death

Danielle continues Simon's pension as reversionary and inherits the $2 million personal portfolio directly. The tax position is the same as when Simon was alive.

Post-1 July 2017 consequences after Simon's death

Option 1 - Super roll back

Danielle can hold a maximum of $1.6 million in the pension phase. In this example, we assume that the balance above this amount is rolled back to the accumulation stage. Danielle inherits the $2 million share portfolio and pays tax at her marginal rate.

	Mode	Balance	Earnings	Tax
Danielle	Personal name	$ 2,000,000	$ 100,000	$ 26,632
Danielle	SMSF Pension	$ 1,600,000	$ 80,000	$ -
Danielle	SMSF Accumulation	$ 1,900,000	$ 95,000	$ 14,250
	Total	$ 5,500,000	$ 275,000	$ 40,882

Option 2 - Withdraw excess from superannuation

As a superannuation tax dependant, Danielle is paid a tax-free lump sum death benefit of $1.6 million of Simon's benefit, withdraws $300,000 of her benefit, and retains a total of $1.6 million in pension stage. The funds withdrawn from the SMSF are invested in Danielle's name alongside the inherited $2 million portfolio and taxed at her marginal rate.

	Mode	Balance	Earnings	Tax
Danielle	Personal name	$ 3,900,000	$ 195,000	$ 65,182
Danielle	SMSF Pension	$ 1,600,000	$ 80,000	$ -
	Total	$ 5,500,000	$ 275,000	$ 65,182

Option 3 - Super roll-back and share portfolio directed to a testamentary trust

[Note: A testamentary trust is a trust which arises upon the death of the testator, and which is specified in his or her will].

This strategy is a combination of the above two with a twist!

- $1.6 million stays in pension stage
- The excess over $1.6 million in the SMSF is rolled back to accumulation stage
- The $2 million investment portfolio is directed to a testamentary trust with flexibility to distribute income to Danielle and potentially two minor grandchildren who have no other income.

	Mode	Balance	Earnings	Tax
Testamentary Trust*	Personal name	$ 2,000,000	$ 100,000	$ 9,288
Danielle	SMSF Pension	$ 1,600,000	$ 80,000	$ -
Danielle	SMSF Accumulation	$ 1,900,000	$ 95,000	$ 14,250
	Total	$ 5,500,000	$ 275,000	$ 23,538

*Assuming 3 beneficiaries earning $33,333 each with no other income

Conclusion

In a pre-1 July 2017 world, it was often best to continue a reversionary pension to the surviving spouse given that all earnings would continue to be 100% tax-free. In these circumstances, testamentary trusts may have had limited appeal.

However, from 1 July 2017, given that high superannuation balances will be excluded from the zero-tax pension environment, an individual's overall tax position may be optimised by using testamentary trusts for estate assets. This, when combined with careful superannuation succession planning, can lead to significantly better outcomes.

Reuben Zelwer is the Principal of Adapt Wealth Management Pty Ltd. Reuben is a CERTIFIED FINANCIAL PLANNER® practitioner and an SMSF Specialist Advisor™. This article is for education purposes and does not consider the circumstances of any person, and is based on an understanding of the legislation at the time of writing.

Preparing for the ups-and-downs of 2017

Robin Bowerman

After the rollercoaster of investment emotions that was 2016, investors have been cautiously embracing a more upbeat feeling across markets so far this year.

Perhaps it is wishful thinking, but it seems many pundits and punters alike are growing comfortable with the fact that, although the world looks a lot different to what it did a year ago, it's not all doom and gloom where investing is concerned.

Although a market rally can certainly buoy hopes for a more stable year, we should remember that last year was certainly no slouch for returns, despite medium-to-long-term forecasting pointing to market returns lower than historical averages, underpinned by slowing global economic growth.

In fact, the broad Australian sharemarket returned more than 11% last year, despite early concerns that China's slowing economic growth and softer commodities prices would hurt the local economy.

Resilience is conditional

With that example in mind, it can be comforting to think that our investments might be more resilient than expected. Diversification and discipline are essential to 'future proofing' a portfolio, allowing it to weather oscillating markets by being more resilient in the face of volatility.

Diversification allows investors to spread risk and avoid a catastrophic hit to their portfolio if they are over-exposed to a single company, sector or market that tumbles. Having exposure to multiple countries, industry sectors, varying market caps and asset classes (e.g. equities and fixed income) gives portfolios a better chance at carrying on should only a portion of its holdings go through a cycle of underperformance, or loss.

While diversification acts as a shock absorber for a portfolio, discipline is the key to letting diversification do its job of managing risk. By avoiding the temptation to follow market trends, either by selling an asset when its value falls, or buying an asset that's on an upward march, investors can remove perhaps the riskiest factor that can hammer potential returns: human behaviour.

Human behaviour, particularly fear and temptation, are what can drive investors to make ill-considered decisions in times of market fluctuation. We saw this last year when many investors sought to flee UK equities ahead of the Brexit vote, only to miss out on a fairly quick recovery in that market. An investor with a broad exposure to the British sharemarket would have likely been better off gritting their teeth through the tumult and seeing it through to the other side.

Vanguard's global CEO, Bill McNabb, discussed this recently with *The Evidence-Based Investor*, outlining how Vanguard approaches market flashpoints like Brexit in terms of understanding risk, rather than trying to work out trading strategies to minimise damage or maximise opportunity.

In a recent letter to investors, the full version of which is featured below, McNabb also outlined the need for investors to be prepared for future volatility, saying that surprises should be expected in 2017. Although Vanguard isn't in the habit of offering 'hot tips' for investors, McNabb outlined in his letter these four pieces of advice to help investors navigate uncertainty and set themselves up for investment success.

Valley Forge, Pennsylvania
9 January 2017

As we begin 2017, I'm struck by the questions we've been receiving from our investors. Never before — not even during the Global Financial Crisis — have investors come to us with such specific concerns about the movements of the markets and governments around the world.

We're living in unprecedented times, so we certainly can't predict what this year will bring. And if you know Vanguard, you should know not to expect 'hot tips' or 'sure bets' from us either. But I do have four suggestions that I believe can help investors reach their goals.

1. Prepare for uncertainty. *Several political and economic events caught observers by surprise in 2016, including the results of the Brexit vote in the United Kingdom, the presidential election in the United States and the federal election in Australia. Markets respond to surprises with volatility, and we expect more surprises in 2017. With a new US administration comes the potential for changes to policies that affect investors. Some may be beneficial; some may trigger market volatility. The best approach in any environment is to maintain a long-term perspective and a balanced and diversified portfolio.*

2. Save more. *In addition to potential near-term volatility, we expect the equity and bond markets to produce lower returns in the next ten years than they have over the past several decades. This will place the burden on investors to save more. Saving more is an asymmetrical proposition: If you don't save enough and the markets don't assist you, there's nothing you can do. If you over-save and do well, great – you can retire a few years earlier.*

3. Safeguard your assets. *As the threat of cybercrime continues to grow, we work hard to protect our clients' assets and data. But investors must be aware of the risks and take precautions too.*

4. Stay well-informed. *Great investors understand how all the pieces fit together. Become familiar with all the components of your portfolio and know the role that each one plays in your investment plan. Stay abreast of the markets and economy but don't be driven by their movements. I realise it sounds paradoxical to say, "Stay current but resist the urge to act." But that's exactly what you should do.*

Here's to a prosperous 2017.

F. William McNabb III, Chairman and Chief Executive Officer, The Vanguard Group, Inc.

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A study on NAB's Subordinated Notes 2

Sulieman Ravell

NAB has just announced the launch of a new income offer, NAB Subordinated Notes 2, with the primary purpose of repaying NAB Subordinated Notes (NABHB), which are due to mature this year.

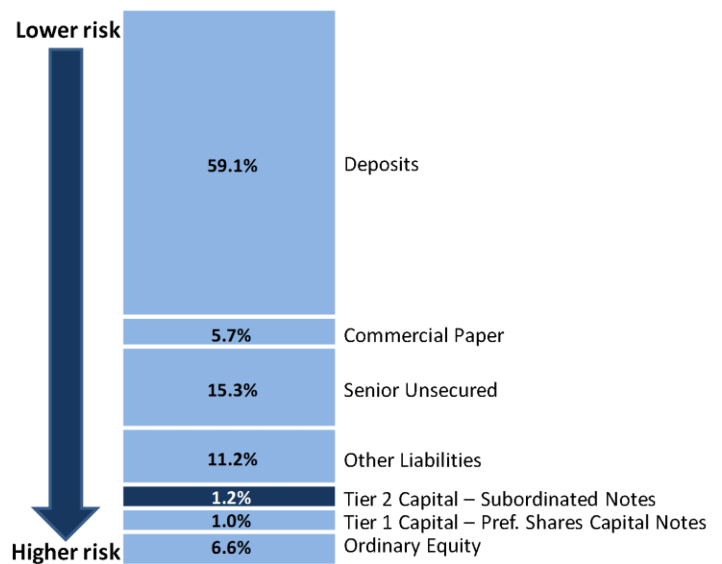
The Notes will pay a quarterly coupon of 2.2%-2.3% (margin determined by the book build) over the 90-day bank bill swap rate (BBSW), which was 1.77% at 10 February 2017. The initial indicative rate will be 3.97%-4.07% pa with the rate set on the date of issue. The Notes are expected to redeem on 20 September 2023 (subject to mandatory conditions not being breached) and will be tradable on the ASX under code NABPE.

NAB Subordinated Notes 2 Offer Details	
Issuer	National Australia Bank
Security Name	NAB Subordinated Notes (NABPE)
First Call Date	20 September 2023
Mandatory Conversion Date	20 September 2028 (unless redeemed earlier)
Margin	90 day BBSW + 2.2%-2.3% (rate to be determined by the book build)
Size	$750 Million +
Minimum Parcel	$5,000

Source: NAB Subordinated Notes 2 prospectus

Subordinated Notes

A key consideration in this issue versus last year's hybrid or preference share issues from CBA, NAB and Westpac that offered margins of 4.9%-5.2% over BBSW is that NABPE is a subordinated note and will be treated as Tier 2 Capital. The reduced margin reflects the lower risk of these securities and offers investors another risk choice. This is more akin to a debt instrument, and unlike the listed bank capital notes and preference shares, distributions are non-discretionary.



Comparative Securities

While there are a handful of listed subordinated notes (ANZHA, WBCHA, WBCHB and NABHB), Westpac Capital Notes 2 remains the only listed issue containing a non-viability clause (explained later) and offers the closest comparison.

Due to the short term to maturity of the existing Tier 2 subordinated notes, investors should also consider the unlisted institutional market when looking at relative pricing.

Issue	Listed/Unlisted	Issue Margin over BBSW	Trading Margin over BBSW	Term to call (years)	Trading Margin over BBSW	Price 10/02/17	Accrued income
ANZ Sub. Notes (ANZHA)	Listed	2.75%	1.57%	0.4	1.57%	$ 102.50	$ 0.78
NAB Sub. Notes (NABHB)	Listed	2.75%	1.73%	0.4	1.73%	$102.00	$ 0.80
Westpac Sub. Notes (WBCHA)	Listed	2.75%	1.26%	0.5	1.26%	$ 102.69	$ 1.09
Westpac Sub. Notes ii (WBCHB)	Listed	2.30%	1.70%	1.5	1.70%	$ 102.69	$ 1.01
Westpac +205 FRN	Unlisted	2.05%	1.62%	2.1	1.62%	$ 101.52	$ 0.64
ANZ +193 LT2 FRN	Unlisted	1.93%	1.66%	2.4	1.66%	$ 101.17	$ 0.48
CBA +195 LT2 FRN	Unlisted	1.95%	1.67%	2.7	1.67%	$ 100.85	$ 0.07
NAB +185 LT2 FRN	Unlisted	1.85%	1.83%	3.1	1.83%	$ 100.56	$ 0.47
Westpac +310 LT2 FRN	Unlisted	3.10%	1.97%	4.1	1.97%	$ 105.03	$ 0.84
ANZ +270 LT2 FRN	Unlisted	2.70%	1.96%	4.3	1.96%	$ 102.81	$ -
CBA +265 LT2 FRN	Unlisted	2.65%	1.99%	4.3	1.99%	$ 103.41	$ 0.85
NAB +240 LT2 FRN	Unlisted	2.40%	1.99%	4.6	1.99%	$ 102.35	$ 0.62
NAB Sub. Notes ii (NABPE)*	Listed	2.20%	2.20%	6.6	2.20%	$ 100.00	-

** Anticipated Margin - Not yet listed on ASX*

Arguably, the closest comparable in the unlisted market is NAB’s Tier 2 Floating Rate Notes expected to be repaid in 2021 (NAB +240 LT2 FRN above).

Our view on NAB Subordinated Notes 2

We find that retail investors are often looking to hybrids as an alternative to cash accounts rather than equities. The fall in cash rates to historical lows means investors are forced to look elsewhere than term deposits or cash accounts for income and hybrids have been a natural beneficiary.

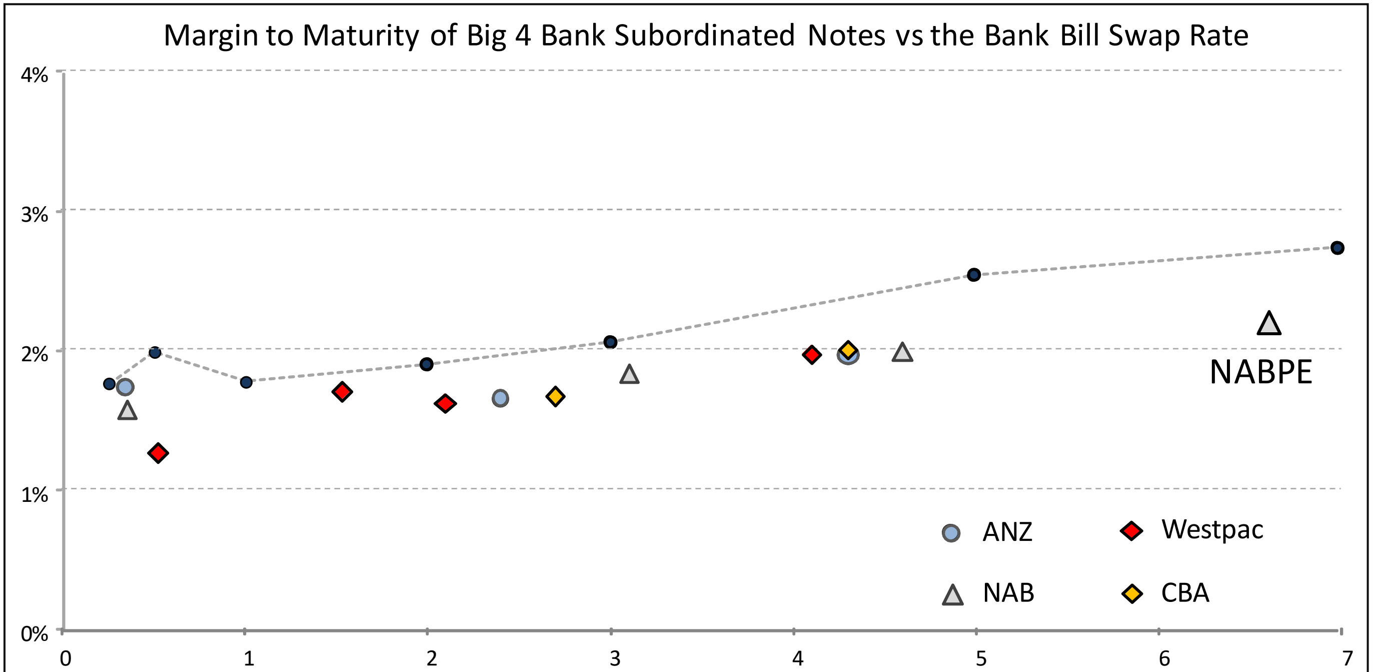
However, subordinated notes are often overlooked as their perceived risk among direct investors is equal to preference shares and capital notes. This likely explains the wider margins we often see in the listed subordinated notes vs the unlisted market.

Our view is that they can offer value as an alternative to investor portfolios. The greater security, lower volatility and increased certainty of income distributions means they are attractive to those willing to take more risk than government bonds yielding below 2% pa and term deposits yielding anywhere between 2%-2.5% pa, but less volatility than the listed hybrids. In a world where rates look like they may be on the rise, floating rate notes can offer value to investors seeking income.

Equity pundits will often point to equities providing both income and capital growth, but for investors who can’t stomach the equity roller coaster, subordinated notes offer a lower risk alternative to equities, preference shares and capital notes.

Pricing NAB Subordinated Notes 2

At first glance, the Margin to Maturity of both listed and unlisted subordinated notes indicates that NAB’s anticipated margin of 2.2% over BBSW is priced in line with the secondary market. However, the listed market typically trades at wider premiums than the institutional market and we would prefer a wider margin. In addition, the new NAB issue includes some updated APRA-required write-off clauses which make it rank junior to other Tier 2 issues by NAB.



Note: Investors in subordinated notes earn the sum of the margin and BBSW.

The pricing reality is that NAB does not need to pay over the odds and the bank is not looking to raise large swathes of new money. The majority of this issue is expected to be acquired by existing investors rolling from NABHB and the lack of longer term ASX-listed subordinated notes means the demand will be strong.

Overall, it's an opportunity for investors to diversify into lower risk listed securities that offer greater capital stability than hybrids. Do not feel neglected if you do not secure an allocation, and investors should note the anticipated repayment of ANZHA and WBCHA in mid-2017 is likely to result in further issuance in the near future.

Note there is automatic conversion under the Non-Viability Trigger Event (explained below) and income is unfranked. Investors often overlook that returns quoted on some hybrids include franking credits. Unfranked payments should be considered more attractive, avoiding the need to wait until the end of the tax year to claim back the franking.

Non-Viability and Inability Event clauses

Investors who are familiar with the new style hybrids seen over the last couple of years will be aware of the new clauses. They are a result of APRA requiring further reassurance that in another GFC event, if required, some securities such as hybrids would convert to ordinary equity, thereby reducing the bank's debt costs and protecting deposit holders.

Now that banks have to hold a higher level of subordinated debt and a better-quality loan book, it seems unlikely that these conditions will be breached, however, investors would do well to consider the increased disclosure and warnings within each prospectus over the last couple of years.

Newer style subordinated notes contain a Non-Viability Trigger Event that is subject to rulings by APRA that have yet to be tested. In theory, should APRA view the bank as non-viable without a capital injection, the subordinated notes and Tier 1 hybrids would automatically convert to ordinary shares. Tier 1 hybrids would convert prior to Tier 2 subordinated notes, and there may be junior categories within the subordinated notes issues.

We have also seen a gradual introduction of an Inability Event Clause added which states that in the event that the issuer is unable to issue further ordinary shares, ie the company has ceased trading, note holders lose their investment. Investors would do well to remember this is an additional risk.

NAB Subordinated Notes 2 will be listed on the ASX and the price will be subject to market movements. Investors selling on market may receive a price lower or higher than the issue price.

Sulieman Ravell is Managing Director at Wealth Focus, and published the FundsFocus newsletter This article is general in nature and it does not take into account your needs, objectives or financial situation. You should always take these matters into consideration before making an investment decision.

Is super segregation still possible for an SMSF?

Bruce Brammall

When the Government's recent changes to superannuation laws were under discussion, the prevailing 'logic' in the financial advice industry was that a $1.6 million pension cap required segregation of assets in a SMSF between accumulation and pension. However, this logic was overturned in the final legislation.

It initially seemed likely that trustees would need to choose, based on their personal risk and return requirements, what assets to leave in the $1.6 million maximum 'transfer benefit cap' pension and what assets would be transferred back to accumulation.

However, the legislation that was eventually passed outlawed segregation for tax purposes inside a super fund.

The Government does not want you to be able to use segregation to manage your tax in your pension fund. It is banning segregation for tax purposes.

Instead, a proportionate method will be used for tax purposes. Simply, all the assets of the fund will be taxed based on the proportion that is in pension and the proportion that is in accumulation (which will be worked out by an actuary). If you have $2 million in super, with $1.6 million in pension and $400,000 in accumulation, then 20% of gains will be taxed at accumulation rates and 80% will be taxed at pension rates.

Segregation historically

Segregation has always been available to SMSFs from a tax perspective, but has not been widely used, mainly because pension funds were allowed to contain an unlimited amount. Most people would generally have their entire super balance in pension, making segregation somewhat irrelevant.

Or they would use the proportionate method anyway, as it is administratively easier (and generally preferred by accountants).

But segregation certainly had its uses and potential benefits. For example, in two-member funds, where only one person was in pension, it might have made sense to have purposefully chosen assets backing the pension for tax reasons, and other assets backing the other member's accumulation account.

(Note: you will still be able to segregate assets for investment strategies for individual members, but not for the tax paid on earnings by the fund in super/pension.)

Banning segregation from a tax perspective will take away a lot of guesswork, or a lot of crystal ball gazing, from what was likely to be the lot of SMSF trustees post 1 July 2017.

But using segregation did pose opportunities. And, despite what the Government appears intent on trying to achieve, segregation is unlikely to be dead. It might have to take a different form.

Beating the segregation ban

One possible approach is to have two SMSFs.

Under the current legislation, the Government/ATO is aiming to stop SMSF trustees from using segregation within a fund to avoid paying taxes.

But it is difficult to see how the ATO could stop segregation being used effectively across multiple funds under current reporting requirements.

Aaron Dunn of the SMSF Academy took me through the following example.

Let's take a member with $2.6 million currently in pension in SMSF1, which includes a property worth $1 million. In time for 1 July 2017, the trustee takes the $1 million property and transfers it to a second SMSF (SMSF2).

There has been a CGT event, as it would be considered a disposal by SMSF1, but the transfer occurs while SMSF1 is in pension phase, so there would be no tax to pay.

SMSF1 now has $1.6 million in pension. It then rolls back $1 million from pension to accumulation. The member then has only used $600,000 in pension of the $1.6 million cap.

It then turns on a pension for the $1 million property in SMSF2. This property is now the only asset in the SMSF and is, therefore, effectively segregated. If this is likely to be a high income, or high growth asset, and you've chosen it for that reason, then the segregation – according to what the experts currently believe – would have been achieved.

This would appear to be allowable under the new rules, but it's early days and something that will require extra consideration by the experts.

There will be some extra costs in setting up and running the second SMSF, but if the trustees believe that it will deliver dividends in excess of those costs, then it could be worth it.

Dunn said that it is too early to tell how this will work in regards to reporting (to the ATO) the movements in and out of pension phase for SMSF1 and SMSF2.

So the strategy comes with a 'kids, don't try this at home' warning. At least not yet. There's no great rush to, as the new rules don't hit for five months. But, the best brains in the business are still trying to work their ways through the new laws.

What are the potential downsides?

If the asset being transferred is property, then a potential downside is stamp duty in some states. This is something to check, state by state (potentially with your SMSF accountant). Dunn said that some states will not charge stamp duty when the beneficiaries remain the same, but other states will charge it.

So, even though there might not be any capital gains tax, having to pay up to around 5.5% in stamp duty, if applicable, could turn a good idea into a marginal one.

Bruce Brammall is Managing Director of [Bruce Brammall Financial Pty Ltd] and Bruce Brammall Lending Pty Ltd. The information contained in this article is general information and does not consider anyone's specific circumstances. If you are considering a strategy such as mentioned here, consult your adviser.

Size matters for SMSF performance

Lee Anthony

An SMSF needs a balance of at least $200,000 to be cost-effective and sustainable, new research by SuperConcepts and The University of Adelaide's International Centre for Financial Services has found.

A major study, *When Size Matters: A closer look at SMSF performance*, based on more than 88,000 fund-year observations, examined the performance of four fund sizes. The study found that SMSFs with balances over $200,000 significantly outperformed smaller funds in both cost-effectiveness and investment diversification. All SMSFs in the study had outsourced their administration.

Just over 20,000 individual funds, with an average asset value of $845,000 and average annual expenses of $8,919, were examined using figures from the 2008-9 to 2014-15 financial years.

The fund sizes were:

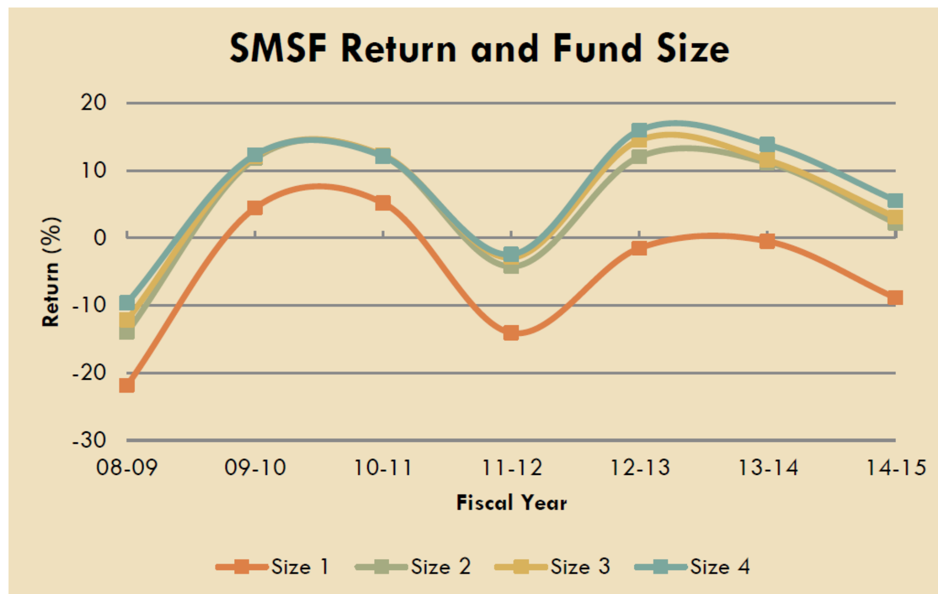
Size 1 funds: Asset values less than $200,000

Size 2 funds: Asset values between $201,000 and $500,000

Size 3 funds: Asset value between $501,000 and $1,000,000

Size 4 Funds: Asset values greater than $1,000,000.

As shown below, performance was found to be relatively similar for size 2 to 4 funds, although fund size 4 outperformed the others slightly during the last three fiscal years of the study period. The smallest size 1 funds consistently underperformed against all other sizes, and posted negative returns in five of the seven sampled financial years, including the last four.



Diversification into asset types

The study measured diversification by the number of asset classes in which a fund had invested with a weighting of 10% or more.

The largest size 4 funds held significantly more asset classes than size 1 SMSFs and, in fact, a balance of less than $200,000 showed deterioration in asset diversification.

"Fund diversification has, on the whole, marginally improved over time," the report says. *"At the beginning of our sample period, the average fund held investments in 2.06 asset classes, and this has increased to 2.15 at the end of our sample period. We observe an inverse relationship between the level of diversification and the volatility of fund returns."*

Expenses come in many guises

SMSFs incur many establishment and administration costs. The ATO's list of common costs include:

- actuarial costs
- accountancy fees
- audit fees
- costs of complying with Government regulations
- investment adviser fees
- SMSF's annual lodgement fee
- life insurance or total and permanent disability insurance premiums
- investment research subscriptions, and
- costs for amending a trust deed.

As funds grow larger, the expense ratio drops due to greater operational efficiency.

"Expense ratios for the largest funds (size 4) are significantly lower than the expense ratios for the smallest funds (size 1). When a fund passes a threshold of having $550,000 under management, its expense ratio dips below 2%, whilst diversification and performance of the fund is comparable to any of the larger funds. Below this threshold, performance, diversification and expenses begin to deteriorate".

The study concludes that while performance, diversification and expense ratios continue to improve as funds grow, these traits deteriorate in funds with asset balances below $200,000, making smaller funds inefficient. Some commentators suggest that small SMSFs are not sustainable and that the government should legislate a mandatory minimum size to start an SMSF.

Lee Anthony is Assistant Editor at Cuffelinks. The full report can be downloaded here: '[When size matters: A closer look at SMSF performance](#)'.

Five ways to filter the fintech hype

Ian Dunbar

#Fintech, #WealthTech, #InsureTech, #DigitalMortgages, #P2PLending, #Crowdfunding, #Cryptocurrencies and so on. The list of buzzwords that dominate the landscape of tech innovation in financial services grows by the day (and yes, they all have to come with a hashtag). But so what?

It is easy to get swept up in the hype of the industry and forget what the point of all this innovation is. What defines innovation that changes the shape of an industry and more importantly makes a difference to real people's lives? I have been to many fintech innovator conferences and have organised two of them, and I must have seen 500+ 'innovators' presenting their carefully crafted wares to the eager (or cynical) audience.

But again, so what?

Here is an example of how big a difference technology innovation can make in the convenience of life. The 'old banking' in the story is a big lumbering Australian bank and Visa. The 'new banking' is Apple and American Express. I really wish I had been able to say it was a super exciting fintech start-up operating from a garage somewhere that was the star of this story. But yes, it is Apple and AmEx (and how often do you read about Amex in a fintech blog?)

I was travelling in the UK earlier this year and I managed to lose my wallet. That is a horrible experience at the best of time, but absolutely the worst experience when sitting at a train station outside of London, heading to Heathrow to catch a flight to Zurich.

Hmm, little money (about 5 quid in change), no cards, no drivers licence. What does one do?

The 'old bank' financial services provider:

Emergency phone call to Visa and the Bank in Australia. Absolutely no way I can get an emergency card quickly in London, but I can arrange an emergency funds transfer to Western Union in 48 hours. No worries, I will walk from Zurich Airport to the Airbnb and eat nothing for 2 days!

I borrow 200 pounds from a friend in London (phew) and get on my way.

The problem, no confirmation ever arrives of the emergency funds. I phone Visa and the bank a grand total of seven times. Each time I get one step closer to my emergency funds. The final hurdle, the bank won't release the funds because Visa has spelled my address with 'St', rather than 'Street'. Seriously!

Later, when I get back from Zurich to London, I receive my emergency card via courier. But my unbranded Visa card comes with no PIN (number) so I cannot use a cash machine. No bank in London has any idea what to do with the card. Four more calls to the bank in Australia and I give up.

The 'new bank' financial services innovator:

Wondering how I survived? Straight after the first call with Visa and the bank in Australia, I called American Express to cancel my Amex Card and order the new one. Within two hours, I received an alert on my Apple Pay Wallet on my iPhone that my new Amex Card had been loaded and activated. Wow. No more calls, no need for a PIN, no courier.

I survived for the next seven days on the cash I had borrowed and using Apple Pay on my phone absolutely everywhere. The Tube in London, supermarkets, cafes, shops and Uber. I became the walking example of the cashless society. Before trying to buy anything, I would check for the Apple Pay sign.

The point of this story is not to promote Apple or Amex. They are well and truly big enough to do that without me.

The point of recounting my story is that technology needs to make a difference, not just a little difference but a big difference. Combine that with good marketing and excellent management and you have a winner.

Five ways to cut through the hype of fintech?

The 'difference' can come in a number of ways:

1. Deliver convenience

Make people’s lives easier. Much, much easier. Cut out the friction in the way we interact with financial services. By reducing wait times, cutting out painful steps in a process, eliminate repeated identity verifications, eliminate paper, printing and postage, offer services when the client is free, not when you are.

The story above, whilst being an infrequent occurrence, is all about convenience. Automated advice tools (whether adviser or consumer led), online FX, virtual meeting rooms, video banking, digital signing, digital mortgages, mobile payments, digital identification, biometrics, all fall into the domain of enhancing convenience.

2. Save people money (lots of money)

Not just a little bit, as consumers we don't generally change our behaviour for a small saving, but offer exceptional value (and that generally means savings) and you will be onto a winner. Innovators in the foreign exchange space are great examples. The large banks are making huge returns on small business and consumer FX, which is now being eroded by new entrants. Peer to Peer lending is another example, providing lower cost lending to many individuals that might otherwise be denied credit or use pay-day lenders.

3. Enhanced security of services

Consumers might not pay for this, but businesses will. Cyber-security, identity theft, payments fraud are all huge businesses. In Australia in 2015 some 8.5% of the population experienced some form of online theft, costing over $2.1 billion (ABS release, 20 April 2016). Biometrics (voice, eye, thumb print, facial) are growing rapidly and will make a substantial difference to the security of our online and mobile transactions of the future (forget cards, what will a card be?). Back the leaders in enhancing the security of our financial transactions.

4. Create an exceptional customer experience

Innovative client facing experiences are not an area that the financial services industry is well known for. Delivering a mobile app is not enough. A staggering 23% of apps are abandoned after first use and 90% after a month (Localytics, April 2016). Fintech innovators are changing this rapidly, with the use of innovative user experience design, gamification, behavioural psychology and more.

5. Collate, use and share (API) data to create powerful insights and connected eco-systems

Fintech leaders know how to source and use data. Credit scoring for example might use information not just from a credit agency (the majority of the world is not scored in credit bureaus) but also source data from social media. Wealth platforms may source website search histories and social media to predict consumer behaviours before they occur. AI engines can assess personality profiles based on written content and social media posts.

But data itself is not enough, but when combined with smart algorithms, powerful and valuable consumer insights are created. These insights are valuable.

Fintech is big, a buzz and it has the attention of the incumbent financial players globally. Spot the difference that a fintech innovator is making, validate it against objective criteria, strap in and enjoy the ride.

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