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An insider's view from the top of CBA

Garry Mackrell

Editor's introduction

At the Financial Services Royal Commission, both the CEO of CBA, Matt Comyn, and the Chair, Catherine Livingstone, strongly criticised their predecessors. Ms Livingstone said there was a misplaced confidence by the board, where directors held brief meetings and failed to ask for additional reports. She cleaned out management, including CEO Ian Narev, and built a fresh board. When Matt Comyn was asked whether CBA's previous leaders had been the right people for the job, he replied, "No".

On 21 and 22 November 2018, the Australian Financial Review reported:

"In July 2011, it was announced that the 44-year-old Narev would become the bank's next CEO. In turn, Narev proceeded to hire highly intelligent, well-educated and extremely ambitious young people from outside the CBA to fill the bank's top executive positions, although he did appoint one of the CBA's young rising stars – Matt Comyn – as head of the bank's vitally important retail banking operations.

"Unlike previous CBA chiefs, they noted, he encouraged his team to work together, rather than adopting the divide and rule approach. But this emphasis on harmony meant that Narev was uncomfortable arbitrating on the inevitable conflicts that arose between the bank's different business units, and found it even more difficult to punish members of his executive team when they failed to deliver."

Then quoting from a source who asked not to be identified, the AFR reported:

"The insider said Narev's lack of operational experience and his lack of inquisitiveness meant that he delegated responsibility for operational issues to others. Also, he was unwilling to sack people who had not performed."

"Ian was a great delegator of authority. His go-in stance was: if I ask you to do something I expect you to do it. He was not afraid to challenge you and he was always open for you to come to him with problems."

"Overconfidence, bred from financial success, meant that serious gaps in CBA's controls for non-financial risks were overlooked."

Insights from Garry Mackrell

I was a member of Commonwealth Bank's Executive Committee (Exco) for 13 years until 2010. My roles included Head of Strategy and Head of International. I retired a year before Ralph Norris finished as CEO and before David Turner became Chairman, so I did not see Ian Narev in the top job first-hand. However, I was an ASB Board member alongside Ian Narev and Ross McEwan (the other candidate for the CEO role) and I saw many Board and Exco interactions, including observing the up-and-coming Matt Comyn.

I can say with absolute certainty that all are people of honesty, integrity and good character. But given the revelations of the Royal Commission, what went wrong?

Expectations change over time

I am sure that in hindsight, different decisions could have been made, but CEOs and boards make decisions at the time that others are not empowered to make. The lens they look through changes over time. What was right and proper years ago may look wrong today.

I am constantly amused by the so-called experts denigrating CBA's 'toxic' culture. Few of these experts with loud opinions have worked at the top of a large public company. I think the stuff about culture is mostly rubbish.

I worked for six CEOs and as many chairs, and served on innumerable boards in eight countries. The people I worked with all had different personalities, styles, strengths and weaknesses. And for half my career at CBA, it was government-owned before it became a public company in 2001 with David Murray as the first CEO.

I believe the law of unintended consequences came into play.

Adjustments in responsibilities and accountabilities

Regulators were concerned about the potential for bank CEOs to have too much power, so they wanted heads of departments of Risk, Audit and Finance to be more directly accountable to boards. This led to a weakening of the power of business units as risk and compliance responsibilities were increasingly centralised in head office. The centre became all-powerful and lines of businesses increasingly fragmented. Decision-making was more and more bureaucratic. Inadvertently, operational risk in front office and business lines became much larger than management realised. Problems in the trenches and running up and across business lines got lost in the maze. The understanding of the business drivers of Wholesale Markets, SME, Retail, Wealth and Insurance were weakened by the overly-centralised function.

In my view, the fundamental issues in recent years were that the Chief Financial Officer (David Craig) and the Chief Risk Officer (Alden Toevs) assumed too much power in the APRA-sanctioned model. Craig and Toevs were both technically strong but in their middle-level management, there was a narrower field of knowledge lacking experience in operational matters across all activities. In particular, when the Basle 3 rules came in, capital attribution became incredibly complex. The application to credit and market risk was mostly appropriate, but operational risk models had little precedent and were underestimated. This has since proven to be a far more significant risk than expected, as shown by the Royal Commission and earlier events.

Finally, business divisions and head office functions became silos. The general trend to specialisation and centralisation meant that the career bankers of old, many of whom started in branches and became cadets and therefore moved around the organisation as they moved up, no longer existed in senior positions. Many of these long-term career bankers had come from interstate and regional areas with real world experience (does this sound familiar re current political shortcomings?).

Most new senior executives (other than Matt Comyn) came from outside the bank, often straight into senior roles, with little practical understanding of either front-line operations or adjacent business lines. They couldn't and didn't know what was going on further down the line, or more critically across the chain, and didn't know what questions to ask and what to look for.

With increasing numbers of senior external appointments, company loyalty becomes largely irrelevant. We used to share stories of past legendary leaders and what they instilled in the troops. This was replaced by financial reward and a focus on the next career move. It doesn't engender teamwork and a focus on customer service and efficiency.

The experts who call for outside appointments to change the toxic culture have it the wrong way around. Apart from Matt Comyn, I don't think any senior leader really has had a career in the current CBA in the fullest sense, unlike most of the risk managers of previous decades.

Different CEOs, different styles

David Murray's style was 'presidential' in that division heads ran fiefdoms and fought for their own corner. Decisions were made on the basis that they argued for their department and he would decide. At AMP, he will certainly be analytical and strategic, forget soft and fluffy.

Ralph Norris did not like the fiefdoms and ran a more collegiate processes. We discussed the issues and argued our case and then he would decide. Once he decided, that was it, there was no trying to renegotiate.

The common claim under Ian Narev that there was not enough challenge and CBA became too collegiate, was in my view, because the executives did not know what to ask.

It was a complete contrast to the senior committee brawls that happened in the Murray and Norris eras. We knew a lot about the other businesses and we were not afraid of confrontation. We spoke with knowledge and experience.

Remuneration and market disclosure

When disclosure of senior executive salaries became mandatory, the then Chairman John Ralph said this would not end well. It would lead to endless upgrades in packages as egos and entities fought for their key talent in the public domain, much like international soccer players of today.

The Royal Commission seems to believe that bank staff should not get bonuses and only earn a fixed salary. When I first joined CBA, there were no bonuses and we received a promotion if we did well. Pay levels were below competitors and we were called the Commonwealth Training Bank. If a salary-only rule is introduced for banks, the plodding bureaucrats will stay and the smart, ambitious people will go elsewhere including overseas. If society wants innovation and competition in banking, the salaried model is not going to fly. I also note that if lawyers do well and work hard, they eventually become partners and share in the overall profits of the firm.

Related to this was the move to quarterly financial upgrades. Markets became fixated with short termism and this has fed into a constant focus on meeting or exceeding budget as opposed to longer-term value creation. It is especially so in Australian banks where dividends are more important than capital growth, particularly when relevant capital gains taxes and dividend imputation are factored in.

Colonial First State and vertical integration

There has been a lot of uninformed tosh written about the CBA's supposed suboptimal misadventures in vertically-integrated businesses. Clearly, a lot of time and water has passed under the bridge since the Colonial acquisition and many lessons have been learned, both positive and negative.

The strategic considerations behind acquiring the Colonial Group were several.

One tactical element was that, while the Four Pillars policy remained set in stone, bank growth was constrained. CBA had suboptimal market positions in life insurance and superannuation, and mandatory super was threatening to move domestic savings from bank deposits to wealth products.

Moreover, as a scale intermediary with nearly half the retail customer base of Australia, it was critical that CBA stay at the epicentre of emerging product flows (including on and off bank balance sheet items and derivatives) in both wholesale and retail markets.

This extended to origination but more particularly distribution of equities arising from the privatisation and demutualisation of businesses. A broad retail customer base for the first time was investing in equities, which led to the launch of CommSec.

The Colonial acquisition came in three parts. First, the cost extraction synergies of Colonial State Bank paid for the entire deal within three years. Second, asset manager Colonial First State was destined to grow at a multiple of general asset formation. But third, insurance was a mess, and if CBA had its time again, it should have offloaded the insurance group immediately, rather than spending an enormous effort trying to clean up myriad legacy systems, etc.

I am convinced that Colonial First State remains a valuable growth business. The demerger will be fascinating to watch. The cultural differences and contrasting legal obligations of banking versus wealth will always be a challenge but the fiduciary and other conflicts of interest are in my view soluble. There is too much value along the value chain to meekly fold the tents to political correctness that vertically-integrated businesses are bad.

Open markets should foster, not inhibit, strategic choices, while operating in regulatory frameworks which seek to balance system safety and transparency. If the lawyers' picnic results in legislated fire walls and caveat seller not buyer, the limited market that is Australia will revert to small, undercapitalised risk-averse players. Most will lack the capital to withstand major exogenous shocks or the wit or will to compete in offshore markets.

On financial advice, the end result of the Royal Commission's headline seeking will ultimately be a critical shortage of people willing and able to provide advice backed by capital. The losers will be the Australian public, the opposite result to what the politicians claim is their objective. Moreover, those independent adviser groups left in the game in order to make a living, will be under pressure. If the Commission insists on removing trailing commissions, few advisers will be interested in serving customers over the term of their investments. They also will not have the capital to compensate customers when things go wrong, as they often do.

With Labor also targeting SMSFs via the franking policy and proposing to increase capital gains tax, ordinary individuals will be even more uncertain what they should be doing, other than becoming dependent on handouts.

Mistakes are inevitable but some are unacceptable

I can excuse lots of stuff-ups like charging dead customers and the outdated actuarial tables, and I personally think the CBA-related BBSW arguments are a try-on. Every day, the rate set results in wins and losses even if the dealers try to boost their book profit, but no retail customer was ever remotely affected.

The aspect that I find inexcusable, because it tells me the people didn't know what they were doing or monitoring, was the \$20,000 cash transactions and money laundering mess. It says the approval process, the systems monitoring, the reporting and the follow ups were done by incompetents who didn't understand what they were doing. Again, as to delineation and spans of responsibilities, under David Murray, more authority was held by the business units. Under Ralph and Ian, it became more centralised in Finance and Risk under stipulation by APRA. The business process chains were increasingly sliced and diced.

The danger of mandated social objectives in business

There are moves in banking regulations to incorporate social objectives into formal governance and company legislation. The drafts I have seen dealing with company objectives do not mention shareholder value. I can say with absolute certainty that requiring companies to commit to a long list of essentially conflicting or non-quantifiable social objectives will end in tears for everybody.

When a business has multiple objectives, some are inevitably conflicting, and the likelihood is much greater that they will fail at least some and probably ALL those objectives. The problem with the so-called social licence is it becomes a vehicle for some minority in society to impose their views on others through legalistic artifices, drifting further and further into a rules-based framework. Business and economic progress gets highjacked by politicised leaders who impose their ideology by rules.

A listed entity must balance customer service, efficiency and sustained long-term shareholder value. How they achieve it should blend in social and community aspects, but essentially it is about giving customers better products and services supported by good people, technology and capital. Governments can take *post facto* (i.e. from the owners of the company), a share of the economic surplus generated to support those in need, public safety, border security etc.

I started out in life believing in socialist-type ideals. I am ending life after observing closely many countries' political systems. The best outcomes require the rule of law, freedom of expression and freedom of markets in which the forces of creative and destructive capitalism are allowed to play out. This must occur within level playing fields laid out by government, a strong central tax system to protect the weakest in society and strong institutions to defend against economic and political power becoming too concentrated. These are great achievements for a society and must be fought for.

Garry Mackrell worked at CBA from 1973 to 2010, including 13 years on the Executive Committee and head of various departments. He was Graham Hand's boss for two years in Investment & Economic Research Department. This is his personal recollection after a long career at the top of Australian banking.

6 checks on whether acquisitions create value

Ben Rundle

In the current economic environment many companies are finding it difficult to grow earnings organically so they are turning to acquisitions more frequently. Adding further incentive for management teams to acquire businesses is the disparity between the valuation of an ASX-listed public company and a private company. This can create an opportunity for valuation arbitrage as a listed company is generally valued at a greater multiple. When earnings of a private company are added, they benefit from applying the public company multiple.

However, acquisitions are often unsuccessful, and worryingly we don't see many management teams providing a track record of these in their annual reports. Here are some factors we look for when assessing the potential value of an acquisition:

1. Why is the company making the acquisition? Too often we see only the strategic merits touted, but we need to discover the underlying motivation. If management is diluting earnings ratios in their existing business with a new one, then we need to know what benefits this new business will provide to the existing business. This is particularly important with larger acquisitions relative to the company's existing size.

2. Is there organic growth in the existing business? Always identify the organic earnings growth within the existing business. This is particularly pertinent where companies are making such frequent acquisitions that they are considered a 'roll-up'. If the company is not growing organically, then inevitably all good things will come to an end when the acquisition pipeline dries up.

3. Are acquisition prices increasing? Acquisition prices can tell you a lot about the opportunity available. If a company has made several acquisitions in the same industry and the prices for those acquisitions increase each time, this can be a sign of management becoming desperate to acquire when faced with a lack of opportunities.

4. Are accounting levers being pulled? One benefit of an acquisition is the flexibility it provides management in relation to the accounts. There is opportunity to shift certain costs into what is called a 'non-recurring' item, but often these items are recurring. Acquisition accounting also gives companies a full 12 months to adjust the value of acquired assets and liabilities, meaning they can create certain provisions without dragging on the profitability of the business.

5. Is a contingent consideration in the price? We often see a contingent consideration as part of an acquisition price, but this won't be included in the headline price paid. Contingent considerations can be a great way to incentivise an existing management team, however, the details are not often disclosed. The accounting treatment for contingent consideration is also highly subjective as they are recognised at the present value of a likely future payment. Any adjustments to these figures are taken through the profit and loss which can result in a positive impact on profit and loss even if an acquisition is underperforming.

6. Where is the genuine value creation? Finally, we need to look at how much value is being created by these acquisitions. Instead of simply looking at headline growth each year, we try to focus on the incremental profit growth in relation to the extra capital being employed by the business. This gives us a clearer view on whether the acquisition is actually working or if it is diminishing shareholder returns.

This is not an exhaustive list of items to consider, but rather some key considerations. There are numerous ways for a company to grow and in the current environment, acquisitions are proving popular. Not all acquisitions are bad, but more seem to go wrong than right. A management team which can allocate its capital effectively and continue to grow shareholder returns should see their share prices well rewarded over the longer term.

Ben Rundle is a Portfolio Manager at [NAOS Asset Management](#). This material is provided for general information purposes only and must not be construed as investment advice. It does not take into account the investment objectives, financial situation or needs of any particular investor. Before making an investment decision, investors should consider obtaining professional investment advice that is tailored to their specific circumstances.

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Are retrospective tax policies fair or foul?

Ramani Venkatramani

The introduction to Cuffelinks Newsletter [Edition 280](#) (15 November 2018) says: '*Both sides of politics are guilty of misrepresenting the retrospective nature of policy changes.*'

This is true. However, these days, behavioural psychology holds sway over rational economic assertions (example: 'expected losses occasion greater pain than the pleasure from identical expected profits'); how other stakeholders respond to policy changes is instructive in shaping policy.

These include consumers, product and service providers, associated advisers, employers, employees, academic and media commentators and their many lobby groups. Have they upheld the principles they flaunt in opposing retrospective changes?

All policies have some retrospective element

To clarify: this is not a discussion on the legality of such proposals. Retrospective rule-making has been a feature of Australian policy, and for reasons fair and foul, this will continue.

Take the latest furore on banning imputation refunds larger than the tax due. We have been here before: Contribution limits, the dreaded Super Surcharge (not at all a 'tax' if you recall the government spin), Reasonable Benefit Limits and their latest offshoot balance caps and event-based reporting.

Even those who reluctantly accept the truism that there is no equity, symmetry or justice in taxation – governments tax you because they can and hope in democracies they would get away with it – balk at the apparent abuse of applying rules to the outcome of their **past conduct**.

Reality check: all proposals will have an element of deliberate or inadvertent retro effect as they apply to people who were there before the changes. While the 'flow' of tax laws changes, the 'stock' balance of people to whom they apply carries on from before.

Until Howard and Costello made them refundable in the dying days of their government using the largesse from the mining boom, while also tax-exempting pensions to those aged 60 and above from taxed funds, excess franking credits were lost. Foreign tax credits have had a similar chequered history. Pensioners then got a whopping bonanza in relation to their accumulated balances as they grow in pension phase. The payouts were also exempt for 60+ olds.

Many benefitted from 'suffering' retrospective changes

By any measure, they were retrospective changes as those who had arranged their affairs based on current rules got a windfall they could not have dreamt of. Those who now complain of retrospectivity in the Labor proposal 'suffered' all the elements they decry. Equity, logic, symmetry and integrity will all mean they should have complained as loudly and clearly as they do now, when, in the light of the pressure on unfunded age pensions as we live longer, adverse changes were mooted.

There was no protest. Thus the bipartisan political hypocrisy Cuffelinks has correctly identified seems to derive from the wider community, perhaps proving politicians (most, anyway) are human too.

A less tongue-in-cheek observation: political parties in opposition opposing the government for its own sake invariably get a Damascus-like conversion on the way to government. Suddenly they realise that the burden of holding the purse-strings entails unpopular retrospective steps that they had railed against. On cue, roles are reversed. The erstwhile government assumes their strident mantle.

The objective reality is that every tax measure – beneficial or adverse to particular groups – has an equal and opposite short-term effect on the faceless taxpayer, discounting exaggerated claims about fuzzy long-term benefits. While stakeholders and their lobbyists clamour to protect their interests, the lobbyist for the taxpayer in the fiscal short term, by default, is the incumbent treasurer. It gets very lonely at the top of national finance.

That they try to spin their way out of seeming contradictions and distract, with a grandfathering here and an exemption there, is just another shared bi-partisan attribute.

Tinkering versus noble reforms

This is similar to those who complain against constant tinkering of rules, especially in super. Like retrospectivity and beauty, tinkering is in the eye of the beholder or wallet-holder. Using a semantic makeover, changes against us are 'tinkering', while others are overdue reform, of course. Lobby associations are good at this.

We can reasonably blame the structural mismatch between having to make long-term policy that affects generations on the one hand, and our short-term electoral cycles which oblige many would-be parliamentarians to pander to prevailing populism. One would have to be a true visionary, Machiavellian or plain foolhardy, to attempt otherwise. Death duties, for instance, would tick most boxes in terms of desirable taxation criteria, but the visceral resistance to taxing the inheritors (which is conveniently conflated with 'taxing their dead' benefactors) makes it a 'no go' area.

The above is not meant to be critical of valid criticisms against the proposed cut. Those who complain of retrospectivity would be more credible had they consistently opposed retrospective measures – good or bad.

What might work, apart from reiterating the Keynesian rationale that we must change our mind whenever circumstances change?

Policymakers can transparently announce the alternatives they had canvassed *before* settling on the proposed measure, instead of allowing arbitrary and whimsical discrimination to be alleged. Take the wind out of their sails, as it were.

On the other side, for each submission that critiques proposed revenue measures, we should require the antagonists to recommend alternatives that affect **their** group to the extent of the tax revenue targeted. Otherwise, each will point fingers at others, as generosity begins and ends elsewhere.

There is truth in the aphorism, 'Uneasy lies the head that wears the crown', though the crown itself is often tarnished by self-interest. Like the rest of us.

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RCR Tomlinson collapse gives lessons for retail investors

Marcus Padley

Last year, RCR Tomlinson was a billion-dollar company. Last week, it went into administration.

RCR went bust with a market capitalisation of \$231 million. Two hundred and thirty-one million dollars one day, zero the next. Staggering. A lot of listed stocks have gone bust over the years, 20 Australian stocks in the past year. Well-known ones include Orotan and Quintis. Other memorable disappearances include Sons of Gwalia, OneTel, Mirabela Nickel, Babcock & Brown. All went bust with significant market capitalisations and that money evaporated in a day.

Market darling disappears in a year

A year ago, RCR's share price was 457¢, at which point it was a sharemarket darling, up 300% from the price of 114¢ 18 months earlier. Bust a year later.

RCR employed 3,400 people and had been in business since 1898. It was involved in infrastructure projects including power stations, water-treatment systems and rail infrastructure as well as maintenance of those projects. Safe, long-duration projects. It was perceived as a growth stock, a contractor to one of the most resilient drivers in the Australian sharemarket, government spending on infrastructure. It was an 'infrastructure play'.

But it has all gone wrong. It has been forced to pay liquidated damages to clients after delays on nine solar farms left it unable to pay staff and continue operating. The criticism is it had been undercutting its competitors in the tenders on these projects to the point of irresponsibility.

Even more confounding than this, from a sharemarket point of view, is the company had a capital raising at 100¢ in late August 2018 and raised \$100 million. The stock at the time was trading at 280¢. All that money, \$100 million, has seemingly disappeared three months later. At the time of the capital raising it did admit to a profit guidance downgrade but explained it by saying that broker forecasts “do not reflect the adoption of the new accounting standard for revenue recognition (AASB 15) which came into effect for RCR on 1 July 2018”.

What chance a retail investor?

But this is not a blame piece, this is to make the point that if some of the most prestigious fund managers in Australia can dump tens of millions of dollars into a company three months before it goes bust, what chance has the lowly private investor doing amateur analysis from the comfort of their lounge chair or kitchen bench? Some of these fund managers are extremely well resourced. They employ analysts and pay them \$200,000-plus to assess the risks of companies. Even they, clearly, had no idea of the impending collapse.

Allan Gray, for instance, a highly reputable fund manager with a good performance record, put \$20 million into the stock in October, according to Thomson Reuters. RCR has burnt that money in less than a month. Perpetual, the biggest shareholder, put \$22 million into the stock in September. Pandal, the second-largest shareholder, put \$11 million into the stock in September. That money has gone. And they were not the only ones. RCR had 2831 shareholders.

One of two things must have happened. Either the analysts were incompetent, which is highly unlikely, or the information provided by the company was incomplete. Either way, it is a wake-up call for all of us playing the equity markets, a reminder that analysis is hard and that despite strict continuous disclosure requirements, there are big gaps in the information on which the analysis is based.

The broker analysts were no help either. We all know stockbrokers are conflicted when writing about their corporate clients, but they have been actively wrong in their research about RCR. I have always felt that much broker research follows the share price rather than leads, and this is a prime example. Prior to the capital raising and profit warning, Ord Minnett had a buy recommendation and a 519¢ target price. Citi had a target price of 350¢. Macquarie had an outperform recommendation and a 445¢ target price. Macquarie, by the way, underwrote the \$100 million capital raising in August.

Let it be known that brokers are rarely writing research to help individual investors make money. They are writing research to help themselves make money. The core purpose of the equity market is to raise capital, not to help investors. Research reader beware.

Oh, and the New Zealand government isn't much better either. They awarded RCR the Auckland City Rail Project on October 11. At the time, RCR said: “RCR is very pleased to be recognised for our exceptional rail systems capability and to be selected for this portion of such a landmark project for Auckland.” The City Rail Link, Auckland said, “shows the calibre of talent wanting to be part of delivering this important project that will transform the way people move and live in Auckland”. It is a NZ\$3.4 billion project. It didn't know, either.

Make sure you diversify

The conclusion is you have to accept there is a large element of the unknown in the equity market, research is based on assumptions which can be wrong, information is unavoidably incomplete, brokers are there to make money out of share issues, not to write research for individual investors – and, boringly, you need to invest in more than one stock!

Oh, and that class action against the company? Noble stuff, but there is unlikely to be anything left for investors after the customers, banks and employees are paid out.

Marcus Padley is the author of the daily stock market newsletter Marcus Today. See marcustoday.com.au. This article is republished with permission.

Conexus sees conflict in fund manager awards

Colin Tate

Editor's introduction

Colin Tate is CEO of Conexus Financial, publisher of several trade titles. We admire that he has taken a stance against fund manager awards where conflicts arise. As he says, the awards encourage short termism and the outcome may be influenced by contributions to the revenues of various agencies.

Cuffelinks recently discussed with a major research house the possibility of a new award for the best Listed Investment Company (LIC) and/or Exchange Traded Fund (ETF). We soon realised the dilemma this would create. Any event needs sponsorship, and obviously, LIC and ETF providers would be prime candidates to support the event. But they are unlikely to sponsor an award to one of their competitors, placing the organisers in a compromised position. Some of these award nights have so many prizes, it feels like there's something for everyone.

We reproduce Colin's letter to his subscribers below.

Professional standards in the advice and wealth management industry are shifting quickly. As a publisher and a thought leader, it's important to be ahead of the curve at all times, which is why we've made the decision to discontinue our successful *Professional Planner/Zenith Fund Awards*.

This decision is in no way intended to take away from the efforts and successes of the winners and finalists.

In recent years, I've been struggling to see how sell-side awards ceremonies add any value to the client, not to mention what this backslapping looks like to people outside the industry. By people outside the industry, I mean those paying a percentage of their savings for returns to afford a better lifestyle and a dignified retirement.

The Hayne Royal Commission hearings and interim findings have already called out many conflicts of interests, but many more will be called out in coming months and the industry needs to make some of these calls itself to move forward. I think the fund ratings process is one of the areas that needs to change, which is why – despite the revenue opportunity for our company – we are walking away from the awards.

Conexus Financial, the privately-owned publisher of *Professional Planner*, holds 20 events across its three titles, which also include *Investment Magazine* and Top1000funds.com

The fund awards are the only sell-side event in our stable. The event is inconsistent with our mission to push the industry to lift professional standards and, ultimately, further the interests of the member and the end investor.

By promoting the awards, we are inadvertently promoting short-term behaviour, which is not what investment or super should be about. Firstly, from a portfolio construction point of view, there's plenty of evidence to suggest that it's asset allocation, not fund manager selection, that makes the difference to investor returns over the long term.

Further, the role of fund ratings and research houses in the ecosystem is heavily conflicted and, indeed, is hampering the progress of the industry towards professionalism. Requiring fund managers to pay for ratings makes the system favour larger managers with multiple funds because they contribute more to the revenues of the ratings agencies. It's these types of arrangements that end up creating worse – not better – outcomes for clients.

There are too many agents in this industry already. We need to do much better for the end customer in this regard.

Following the Royal Commission's final report in February, serious reform will be on the way and there will be no appetite for the financial industry to be congratulating itself, so we are moving now to set the right tone.

Conexus Financial, through *Professional Planner* and its other mastheads, has core values of making a quantifiable difference, promoting inclusion for women and minorities, and championing diversity in general. Our goal is to encourage growth within the industry, while also promoting more participation in clear and

sustainable investment outcomes for individuals and society. In every venture, and in every area, our efforts must reflect these values to remain current, contemporary and relevant.

We thank S&P and subsequently Zenith, along with all our partners, for their past support.

Colin Tate
Chief Executive
Conexus Financial

Fintechs could challenge savings banks

Michael Collins

Adyen is a Netherlands-based company founded in 2006 that offers an ecommerce platform that seeks to smooth payments and provide shopper-data insights for businesses. In 2017, Adyen, which employs fewer than 700 people in 15 offices around the world, processed more than €100 billion for the first time.

Commerzbank is a German bank founded 148 years ago that has about 1,000 branches that serve more than 18 million private and business clients. In 2017, Commerzbank's 50,000 employees generated €9.1 billion in revenue, making it one of Germany's biggest banks.

On 24 June 2018, the day after Adyen listed, the two companies had about the same market value. By 1 November, Adyen was worth 60% more than Commerzbank.

This example shows how investors assess the threat to traditional banking from 'fintech', loosely defined as any technological innovation tied to the internet that competes against the services offered by old-style banks. Fintechs are shaking up all areas of banking by offering internet banking, 'crowdfunding', running price-comparison websites, hosting peer-to-peer lending and extending 'point-of-sale' loans. Their app banking aims at the heart of savings banks, the transaction accounts. In time they could challenge the viability of the branch networks that provide savings banks with their core advantage, a large source of cheap funding and clients for life.

Big winners and big losers

Most fintechs are startups and few will be as successful as PayPal. Their lack of distribution networks leaves them more nibbling away at niche banking areas, often ones regarded as too risky by banks. The most likely fintechs to challenge savings banks are the tech giants, as shown below for Amazon. They come to the industry with distribution networks, much capital, hordes of big data on their customers and are IT savvy.

All the ways Amazon is unbundling the bank



Source: CBI Insights. 2018

Whichever sort, fintechs hold advantages over savings banks, which are losing some of their edge in the age of the world wide web. The internet works against banks because it reduces the convenience advantage offered by

their branch and ATM networks. It allows for easy interest-rate comparison, which promotes newcomers undercutting banks. The internet makes it simple to switch banks. Fintechs coming out to fight against banks are generally free of, or less burdened by, the systemic-based capital requirements and compliance controls that smother savings banks. They are risk-takers free of the hodgepodge systems hampering risk-averse banks. Mobile payments present them with an easy entry into finance. Their reputations are cleaner. Regulators are encouraging their rise to boost competition.

Fintechs, especially if big tech gets serious about finance, are likely to peck away over time at the oligopolistic industry structures protecting savings banks (without encroaching on the systemic role banks play in the financial system) because they have two key advantages. The first, stemming from their lower costs and the qualities of the internet, is that they can offer higher returns and lower lending rates than can savings banks. The other advantage is fintechs can easily target the fee (or off-balance-sheet) side of banking, which offers returns on equity of about 20% and where about 65% of banking profits are sourced.

The risk is that the traditional global banking industry might struggle to earn a return on equity that exceeds its cost of capital, usually taken as somewhere between 8% and 10%. The best ones will stay profitable, the average ones are likely to just earn their cost of capital. Regulators need to be on guard that some could fail.

Incumbents need to adapt, including regulators

To be sure, fintech market share is still small, much fintech growth is incremental rather than breathtaking, and many complement rather than disrupt banks. Some fintechs are floundering and most are yet to be tested by recessions. Governments everywhere will protect traditional banks in some form because they are vital to the financial system. Traditional banks are cutting costs and have the resources to reinvent themselves as tech-savvy – and possibly much better – banks or financial services. Banks have enough capital to buy, and co-opt, threatening fintechs. While people might resent traditional banks, they are 'brands that have held their trust over time. Banks have a proven ability to assess credit risk, the core survival skill banks require. Banking virtues – prudent lending, sound risk management, integrity, etc. – will likely hold sway over technology in the long run.

And yet Big Fintechs, and startups to a lesser degree, are capable over time of snapping the traditional and profitable lifelong bank-customer relationship. They intend to go after the juiciest fee-income parts of traditional banking. They will lower margins on the balance-sheet-based lending that is the lifeblood of the economy. Traditional banks will have to adjust to this new competition. Being more like fintechs (perhaps, by partnering with them) is probably the best way for savings banks to do that.

Michael Collins is an Investment Specialist at [Magellan Asset Management](https://www.magellangroup.com.au), a sponsor of Cuffelinks. This article is for general information purposes only, not investment advice. For the full version of this article go to: <https://www.magellangroup.com.au/insights/fintechs-could-challenge-the-business-model-of-savings-banks/>

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Senior Australians' changing relationship with advisers

Olga Galacho

This article is the fourth in a series written by leading retirement website YourLifeChoices. It draws on surveys that show the level of satisfaction with the financial services sector.

YourLifeChoices' members say that they are less likely to seek advice from financial advisers in the aftermath of the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry. Tellingly, for those who have sought financial advice, satisfaction with the quality of the guidance has fallen sharply from 75% to 50% in the past two years. Our members are aged from 55 to 75 years and have a focus on maximising their retirement income.

Reasons for not visiting a financial adviser

Two years ago, the *YourLifeChoices 2016 Insights Survey* showed that of 4,155 respondents, 57% had visited a professional to discuss finances in the previous year.

The main reasons given for not visiting a planner were:

- Perceived high costs
- Insufficient assets or funds
- Ability to satisfactorily manage their own financial affairs
- Lack of trust in the profession

Many responses complained of financial planners pushing their own products. Another sizeable group said they had not sought advice because they did not understand how to assess the quality or independence of the guidance. Still others claimed they had received bad advice that had hampered their returns, which had put them off seeking financial advice again.

Royal Commission will affect use of advisers

Early this year, the *2018 Insights Survey* found the proportion of members that had sought financial advice had grown from 57% in 2016 to 63%. However, by July 2018, after the Royal Commission had been in hearings for a few months, members started to lose faith in the financial services sector. The percentage of those who had or would consider consulting a financial adviser about their retirement had fallen to 53%.

The vast majority of members, 86%, say they manage their own finances, although some may also see a financial adviser. In the *YourLifeChoices Boomer Consumer Survey* undertaken in October 2018, 37% said they would be willing to take an average risk in order to receive average returns. Almost 9% said they would take substantial risk with investments and less than a third said they were not willing to take financial risks.

Asked where they had sought advice, of 1,719 respondents, about 500 had reached out to their superannuation fund and approximately 500 to their own financial planner. The next highest category was banks (about 200 respondents), an accountant (158) and Centrelink (140).

The recent Interim Report on the Royal Commission's findings continued to highlight failures in the financial planning sector, leaving many Australians wondering if they should pay for advice. Commissioner Kenneth Hayne said about those providing advice.

"Whether the conduct is said to have been moved by 'greed', 'avarice' or 'the pursuit of profit', it is conduct that ignored the most basic standards of honesty."

Winning back client confidence

On World Financial Planning Day in October 2018, the Financial Planning Association of Australia outlined six steps to help people locate a reputable adviser. We outlined those steps in an article, [Who can you trust with your money?](#)

Judging from the responses to that article, it will take more than a how-to guide to restore confidence in this profession. Here is a sample of what retirees said:

- "Why is it taking so long to bring in education/regulations for new and existing advisers? This should be immediate. Why should it take five years for current advisers to meet the required standard? Either they meet it now through 'recognition of prior learning', which allows for experience to be accepted, or they should be suspended from working until they can."
- "Massive internal changes and changes in ethos are required *now* to restore any faith or trust in financial institutions."
- "Financial advisers want *profit*, and they will always put their own income ahead of client interests. (Now) they will make noises. They will change the technicalities in a few rules, but nothing will change for the client."

Other survey respondents blamed the regulators – the Australian Securities and Investments Commission (ASIC) and the Australian Prudential Regulatory Authority (APRA). They are, after all, entrusted to ensure misconduct in the financial services sector is minimised.

Olga Galacho is a writer at [YourLifeChoices](#), Australia's leading retirement website for over-55s. It delivers independent information and resources to 230,000 members across Australia.

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