

## This Week's Top Articles

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## James Abela on companies, from toddlers to nightclubs

Graham Hand

*James Abela is Portfolio Manager for the Fidelity Future Leaders Fund, which has won the Morningstar Fund Manager of the Year Award for Domestic Equities Small Caps for 2018 and 2019.*

**GH:** James, your fund invests in small cap stocks. How do you define your investment universe?

**JA:** It's basically from a market cap on the ASX of about \$200 million at the bottom end to \$10 billion at the top end. I look at the All Ords, which is 500 stocks, minus the top 50. So that's 450 names and the fund owns around 50 of them.

**GH:** Many of those companies are not as well researched as the larger caps. How do you develop an understanding of the business and competitive advantage of a smaller company?

**JA:** I have three specific pillars: viability, sustainability and credibility. I call these the 'three pillars of success'. If there is a high return on capital, stable or growing, and a market penetration curve the company can monetise and deliver a return on capital, that's the **viability**.

The **sustainability** or durability looks at debt, cash flows, good pricing power, closeness to customers, prominence in the marketplace ... all that tells me about a strong position that can last a long time. And then the **credibility** comes down to management, good accounts and strong governance. They are the keys. If you have these pillars, the chance of success is high, and the company has the potential to be a future leader.

In my experience, disasters have all come from that last pillar, which is credibility. The companies that blow up usually have accounting or management questions, reputational issues or governance problems. They're the red flags not to own those companies.

**GH:** A lot of CEOs are in the role because they have a big personality, and they're good at promotion and marketing, especially at smaller companies. How do you see through that?

**JA:** It comes down to the discipline of the viability, sustainability, credibility. Do they understand the accounting and finance disciplines, the markets they are in and the market power they have? Recognising the storytellers is where that last pillar is important. It's one thing for a CEO to build a billion-dollar business, but to build a billion-dollar business that's sustainable is a whole new ball game. You see companies go bankrupt within three years of listing and get up to a billion dollars at the peak, and they end up disappearing.

**GH:** Do you look for different skills, and perhaps even a change of personnel, in the sustainability stage versus the original building phase?

**JA:** Not really, no. It's more about the value system of the leadership. Personal integrity is important. Integrity in their business, governance, accounting and their markets. You look for the ways they speak and behave, the KPIs they focus on. Avoid those who are very short duration, flashy and with a heavy focus on company size. It's not a sustainable value system in terms of credibility of the business.

**GH:** We've seen a lot of examples of companies creating immense value within just a few years. Does the relative inexperience of the management throw up any problems for you?

**JA:** There's two aspects to it. One is the personal maturity of the leadership, and the other is the maturity of the business. And when I think of small caps, the journey from IPO or small cap to large cap is a 12-year journey.

**GH:** 12 years as a listed company?

**JA:** Yes. I think of a schoolteacher watching school children. They start off as preschool and junior school kids, which is small cap, and then they go into high school kids, which is mid-caps. And if they are successful in high school, they can become leaders in their industry. It's a 12-year journey. So when you see companies that have not been around more than six years, you're dealing with that junior school mentality. It's a young company in the world to be less than six years old. It can be very exciting and they can become multi-billion dollar companies in a short period of time. But the business maturity and perhaps the management maturity is not yet proven enough for them survive through to high school and get promoted into the ASX50.

I like founder businesses. Wisetech is quite different. This is a founder business that's been going for 20 years. So that's like someone who's already been to university with a master's degree. It's a different maturity profile that provides me with a lot of comfort, even if the company was unlisted for a long time. But a business that's just an idea and more of a concept that doesn't generate cash flows and earnings are the ones where I am more cautious.

**GH:** That's a good segue to the Toddler Index, which is something I hadn't heard about until I read some of your material.

**JA:** Yes, it's something I put together using data from Macquarie Research. Toddlers are companies in the index that are under three years old. When you have a large percentage of the index in companies which are very young, say toddlers are half the index, that's when the market is at its peak. In the year 2000, in 2007, and late 2016, either the micro-cap index or the small cap index had the number of toddler companies as a percentage of the index greater than 50%.

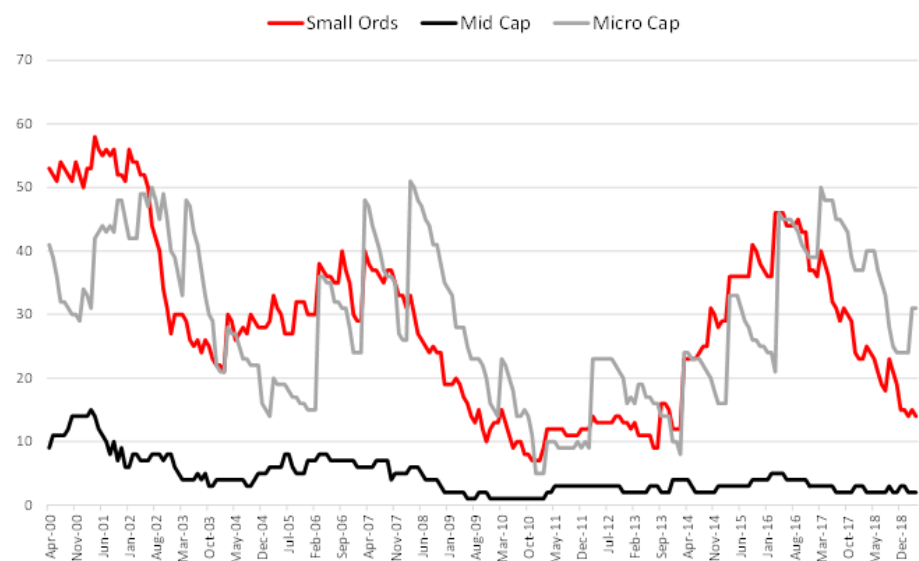
And we all know what happened in 2001 and 2008 and then 2017. Reality bites on these companies, and the reality of competition and the return degradation strikes. Then IPO activity falls off a cliff, and the toddlers go to school and realise there are systems and behaviours that they need to abide by.

**GH:** So where are the percentages at the moment?

**JA:** They've gone down to 30 and less than 20. Since the end of 2016 to now, we've gone down from 50% due to a softer IPO market, but also a maturity, and a seasoning of earlier IPOs. On average, 70% of them are more than three years old, which is actually much more normal.

*(Ed. At this point, James showed me this chart on company age since listing).*

**How many companies are in an index that are under 3 years old?**



Source: Macquarie Research

**GH:** It's an interesting idea. Can you explain what it signifies?

**JA:** It signals times of high liquidity, an arbitrage between private markets and public markets, a high risk tolerance and optimism among investors, and generally a good economic cycle. Now that it's come down, it means that the risks of IPOs and the risks for young companies are probably closer to floor than a peak.

**GH:** Many non-professional investors struggle with market timing. When the market is up with a good momentum, people want to get on board and they create a cycle of buy high sell low. And a lot of companies who may not be great quality are carried along on the tide. How do you separate that momentum of the market from the specifics of the company?

**JA:** Momentum is a specific thing for me. I think about it like a nightclub, and it's about liquidity, sentiment and confidence.

**GH:** Like when Chuck Prince of Citigroup said in 2007, "As long as the music is playing, you've got to get up and dance."

**JA:** Yes, the music's on and the momentum now is still strong. But for me, you need to be careful as you mature in life, you realise you need to leave the market, the party, when you're happy and you've had enough, you don't stay there until you're feeling ill or there are no taxis or there's excessive alcohol consumption. You need to leave at a sensible time.

**GH:** It's a good analogy.

**JA:** And for me, a sensible party time is the same as a sensible investment time. If you take away the liquidity, remove the exuberance, and see what you have left. If you have cash flows, you have profits, you have sustainability. Momentum is very generous. You need to take away that spirit, that sentiment and courage and look at the hard reality of the business. Then when the market does fall, you're faced with lower liquidity. And all those companies that have been feeding on the liquidity and momentum and strong sentiment but not much else will be facing bankruptcy, as we saw in 2008.

**GH:** So we're in the nightclub and we're having a good time, and it feels late ... what time is it now?

**JA:** It feels like about one o'clock right now. And by two o'clock, you definitely need to go. The bull market has been running too long, it's been too generous with cheap money driving all these bubbles around the world. There's a tech bubble, US markets are outperforming, junk bonds have 2% yields. It's the chase for yield which happened in 2008 which means a degradation of the price of risk.

**GH:** Are there particular sectors that you like or dislike now, something that you've identified that the market is not correctly pricing.

**JA:** A lot of things are fully priced right now and there's not a lot that's undiscovered. I'm more focused on what I think is sustainable. Selectively, I like parts of health care and technology, but some of the fintech sector is excessive in terms of valuations. There's a lot of exuberance and a lot of excitement, but valuations are in the danger zone.

*Graham Hand is Managing Editor of Cuffelinks. This article is general information and does not consider the circumstances of any investor. Fidelity International is a sponsor of Cuffelinks. For more articles and papers from Fidelity, please [click here](#).*

## **My nine all-time essential investing lessons**

Shane Oliver

I have been working in and around investment markets for 35 years now. A lot has happened over that time. The 1987 crash, the recession Australia had to have, the Asian crisis, the tech boom/tech wreck, the mining boom, the Global Financial Crisis, the Eurozone crisis. Financial deregulation, financial reregulation. The end of the cold war, US domination, the rise of Asia and then China. And so on.

But the more things change, the more they stay the same, and this is particularly true for investing. Here are the nine most important things I have learned over the past 35 years.

## # 1 There is always a cycle

Droll as it sounds, the one big thing I have seen over and over is that investment markets constantly go through cyclical phases of good times and bad. Some are short term, such as those that relate to the 3 to 5-year business cycle. Some are longer, such as the secular swings seen over 10 to 20-year periods in shares. Some get stuck in certain phases for long periods. Debate is endless about what drives cycles, but all eventually contain the seeds of their own reversal. Ultimately there is no such thing as new eras, new paradigms and new normal as all things must pass. Share markets often lead economic cycles, so economic data is often of no use in timing turning points in shares.

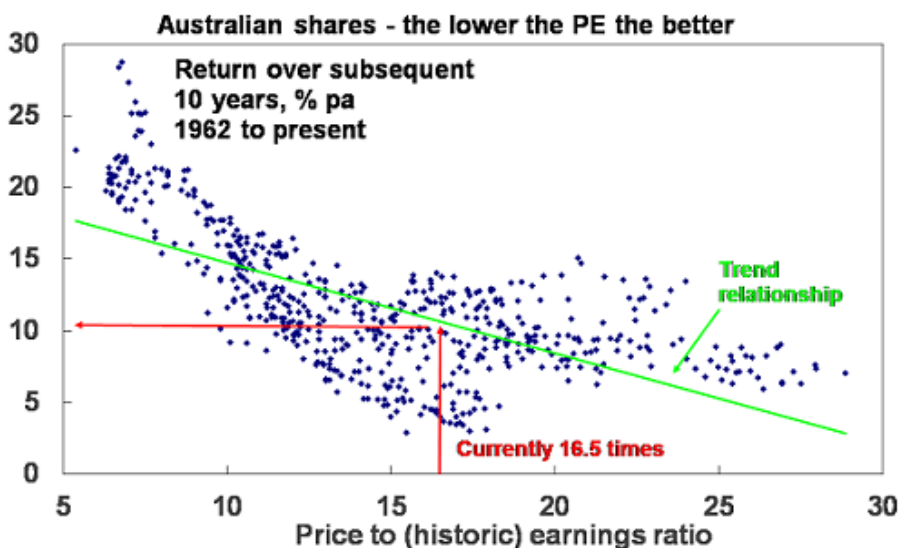
## # 2 The crowd gets it wrong at extremes

These cycles in markets get magnified by bouts of investor irrationality that take them well away from fundamentally-justified levels. This is rooted in investor psychology and flows from a range of behavioural biases. These include the tendency to project the current state of the world into the future, the tendency to look for evidence that confirms your views, overconfidence and a lower tolerance for losses than gains.

It follows that what the investor crowd is doing is often not good for you to do too. We often feel safest when investing in an asset when neighbours and friends are doing the same and media commentary is reinforcing the message that it's the right thing to do. This 'safety in numbers' approach is often doomed to failure. Whether its investors piling into Japanese shares at the end of the 1980s, Asian shares into the mid-1990s, IT stocks in the late 1990s, US housing and dodgy credit in the mid-2000s or Bitcoin in 2017. There is no one left to buy but lots of people who can sell on bad news. So, the point of maximum opportunity is when the crowd is pessimistic, and the point of maximum risk is when the crowd is euphoric.

## # 3 What you pay for an investment matters a lot

The cheaper you buy an asset, the higher its prospective return. Guides to this are price to earnings ratios for share markets (the lower the better – see the next chart) and yields, i.e. the ratio of dividends, rents or interest payments to the value of the asset (the higher the better). Yesterday's winners are often tomorrow's losers because they became overvalued and overloved and vice versa. Many find it easier to buy after shares have had a strong run because confidence is high. Then they sell after a big fall because confidence is low.



Source: Global Financial Data, AMP Capital

## # 4 Getting markets right is not as easy as you think

In hindsight, it all looks easy. Looking forward, no-one has a perfect crystal ball. As JK Galbraith observed, "There are two kinds of forecasters: those who don't know, and those who don't know they don't know."

Usually the grander the forecast – calls for 'great booms' or 'great crashes ahead' – the greater the need for scepticism as such calls invariably get the timing wrong (in which case you lose before it comes right) or are dead wrong. Market prognosticators suffer from the same psychological biases as everyone else. Many are wrong due to blind faith opinions, such as "there is too much debt", "house prices are too high and are

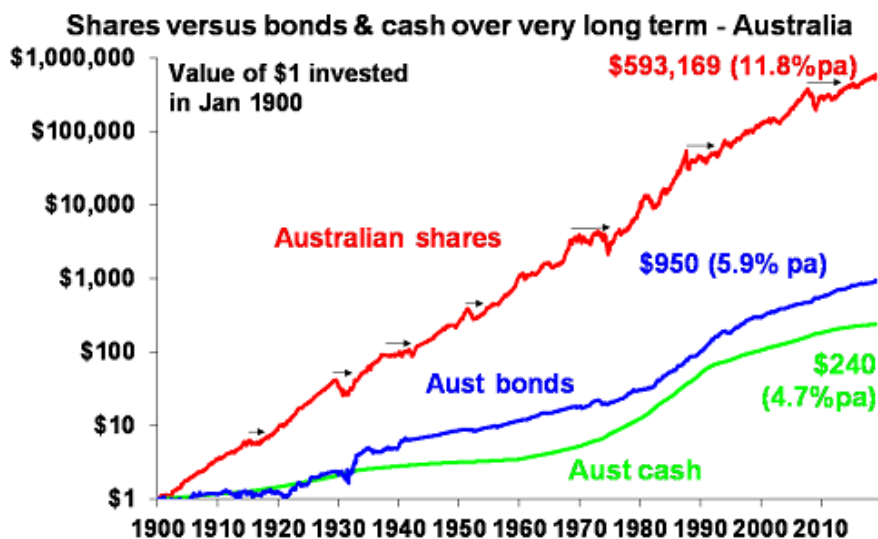
guaranteed to crash”, “the Eurozone will break up”. They may be right one day, but an investor can lose a lot of money in the interim. The world is getting noisier as the flow of information and opinion has turned from a trickle to a flood and the prognosticators become shriller to get heard.

### # 5 Investment markets don't learn

Investment markets repeat the same mistakes as markets lurch from one extreme to another. After each bust, many say it will never happen again and the regulators move in to try and make sure it doesn't. But it does! The details change but the pattern doesn't. Mark Twain is quoted, “History doesn't repeat, but it rhymes.” Sure, individuals learn and the bigger the blow up, the longer the learning lasts. But there's always a fresh stream of newcomers to markets and in time collective memory dims.

### # 6 Compound interest is like magic

This one goes way back to my good friend Dr Don Stammer. One dollar invested in Australian cash in 1900 would today be worth \$240 and if it had been invested in bonds it would be worth \$950, but if it was allocated to Australian shares it would be worth \$593,169. Although the average annual return on Australian shares (11.8% pa) is just double that on Australian bonds (5.9% pa) over the last 119 years, the magic of compounding higher returns leads to a substantially higher balance over long periods. Yes, there were lots of rough periods along the way for shares as highlighted by arrows on the chart, but the impact of compounding at a higher long-term return is huge over long periods of time. The same applies to other growth-related assets such as property.



Source: Global Financial Data, AMP Capital

### # 7 It pays to be optimistic

The well-known advocate of value investing Benjamin Graham observed that “To be an investor you must be a believer in a better tomorrow.” If you don't believe the bank will look after your deposits, that most borrowers will pay their debts, that most companies will grow their profits, that properties will earn rents, etc then you should not invest. Since 1900 the Australian share market has had a positive return in roughly eight years out of ten and for the US share market it's roughly seven years out of 10. So getting too hung up worrying about the next two or three years in 10 that the market will fall risks missing out on the seven or eight years out of 10 when it rises.

### # 8 Keep it simple stupid

Investing should be simple, but we have a knack for overcomplicating it. And it's getting worse with more options, more information, more apps and platforms, more opportunities for gearing and more rules and regulations around investing. We can't see the wood for the trees. We spend too much time on second-order issues like this share versus that share or this fund manager versus that fund manager, and we end up ignoring the key driver of your portfolio's performance : the high-level asset allocation across shares, bonds, property, etc. It's best to keep it simple, don't fret the small stuff, keep the gearing manageable and don't invest in products you don't understand.

## # 9 You need to know yourself to succeed at investing

We all suffer from the psychological weaknesses referred to earlier. Smart investors are aware of them and seek to manage them. One way to do this is to take a long-term approach to investing. But this is also about knowing what you want to do. If you want to take a day-to-day role in managing your investments then regular trading and/or an SMSF may work, but it requires effort and a rigorous process. If you don't have the time and would rather do other things like sailing, working at your day job, or having fun with the kids, then it may be best to use managed funds.

It's also about knowing how you would react if your investment suddenly dropped 20% in value. If your reaction is to get out, you could be selling low and locking in a loss. You may need an investment strategy offering greater stability over time, which would probably mean accepting lower returns.

All of this underpins what I call the [Nine Keys to Successful Investing](#) which also covers diversification and seeking financial advice.

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## How important are investment costs for retirement?

Aidan Geysen

Retirement is complex, and in spite of the volumes of research on the topic, there are rarely simple answers to many questions for those moving into retirement.

Detailed planning around goals, risks and financial resources is critical to manage a long retirement, and a lack of sufficient planning makes retirees financially vulnerable to the risks of outliving retirement savings, overreacting to market volatility, holding inappropriate portfolios and being unprepared for unexpected costs.

### The one item that can be controlled is often overlooked

There is however one simple concept that is universally true when it comes to choosing an investment product. It is more important than ever when you are in the drawdown phase. That is, all else being equal, a lower cost product will produce more retirement income than a higher cost product.

Think about that for a second. We spend a lot of time as investors looking for ways to increase retirement income, and one of the easiest ways is often overlooked.

To illustrate how important costs can be, we have looked at income from both the age pension and superannuation drawdown, and the amount a retiree can spend in real terms each year for 30 years with 95% certainty, and we compare two cost scenarios. The **first** assumes that the retiree is invested in a high cost product charging 1.5%, and the **second** is a lower cost product charging 0.5%.

The differences are striking.

A single retiree with a \$400,000 superannuation balance at retirement can spend over \$1,600 (a 4.5% increase) more per year, adding up to more than \$48,000 over the course of their 30-year retirement, if they use the lower cost investments (all else equal). For a couple with a combined \$800,000 superannuation balance, they can spend more than \$2,800 (a 5.0% increase) more per year, or over \$85,000 total, when using lower cost solutions.

*Source: Vanguard, June 2018 Vanguard Capital Markets Model Simulation. See Note 1 below for more details.*



## The importance of fees increases with wealth

Driven by the higher dependence on superannuation to meet income needs, those retiring with superannuation balances over \$1,000,000 will find their sustainable annual retirement income increases 6% to 9% when using lower cost products versus higher cost products.

A key question, always top of mind for those saving for retirement, is 'How much is enough'? Or how much do they need to save to be comfortable in retirement.

There are many complex planning elements involved in answering that question, but the universal truth on controlling costs still holds.

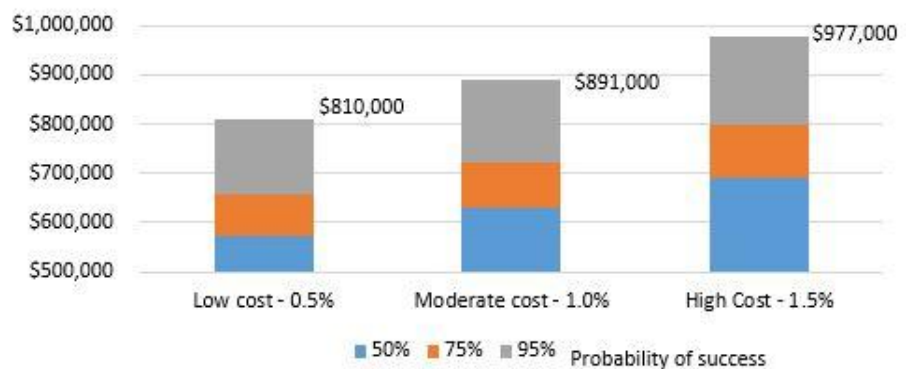
Assume a couple planning for retirement would like to spend the ASFA Comfortable Retirement Standard (\$60,604 in real terms) for 30 years and would like to see the wealth needed to meet that goal with different probabilities of success.

Again, we have incorporated both the age pension and superannuation drawdown, and we look at the superannuation balance needed to meet this income objective with 50%, 75%, and 95% probability while paying low (0.5%), moderate (1.0%), or high (1.5%) costs.

Focusing on the 95% probability, we see that roughly for every 50 bps increase in costs, the couple needs an additional 10% in their superannuation to meet their goal, and comparing the high cost 1.5% scenario to the low cost 0.5%, we can see a difference of **\$167,000 (\$977,000 versus \$891,000)** in wealth needed to meet the same objective.

Source: Vanguard, June 2018  
Vanguard Capital Markets Model  
Simulation. See Note 2 below for more details.

Wealth needed for a couple to meet the ASFA Comfortable Retirement Standard



## All costs cannot be avoided

Investors will almost certainly need to pay some investment costs for a quality product, with some choosing to pay higher fees for the prospect of outperformance, and there is more to investing than costs alone, such as the value of quality financial advice.

But in the end, cost is one of the few things you can control and keeping an eye on costs is a great way to boost your retirement income prospects.

## Notes on charts

Note 1: The income levels shown are based on a constant real spending amount over a 30-year horizon with a 95% probability of success. Retirees are homeowners with a balanced (50% equity/50% bond) portfolio. The model incorporates the age pension as at 20 September 2018 and only considers financial wealth and therefore does not consider assets that would not be deemed to earn an income (i.e. home contents) or additional income (i.e. employment income) which would shift eligibility. The model treats superannuation and non-superannuation assets as one pool of financial assets and therefore we have assumed that any minimum withdrawals from super that exceed the retirement income targeted are reinvested in a non-super account. All values are in real terms. The examples used here are general only and do not consider any personal information. Actual age pension received may differ from that represented by the analysis due to a range of legislative and personal factors. The projections or other information generated by the Vanguard Capital Markets Model (VCMM) regarding the likelihood of various investment outcomes are hypothetical in nature, do not reflect actual investment results, and are not guarantees of future results. Distribution of return outcomes from the VCMM are derived from 10,000 simulations for each modeled asset class in AUD. Results from the model may vary with each use and over time.

Note 2: The ASFA Comfortable Retirement Standard as at June 2018 is \$42,953 per year for a single and \$60,604 per year for a couple. We have assumed 0.5%, 1.0%, and 1.5% annual investment fees, the retirees are homeowners and a balanced (50% equity/50% bond) portfolio. The model incorporates the age pension as at 20 September 2018 and only considers financial wealth and therefore does not consider assets that would not be deemed to earn an income (i.e. home contents) or additional income (i.e. employment income) which would shift eligibility. The model treats superannuation and non-

superannuation assets as one pool of financial assets and therefore we have assumed that any minimum withdrawals from super that exceed what is needed to meet the ASFA retirement standard are reinvested in a non-super account. A non-homeowner would need to consider rental costs in addition to the Retirement Standards. All values are in real terms. The examples used here are general only and do not consider any personal information. Actual age pension received may differ from that represented by the charts due to a range of legislative and personal factors. The projections or other information generated by the VCMM regarding the likelihood of various investment outcomes are hypothetical in nature, do not reflect actual investment results, and are not guarantees of future results. Distribution of return outcomes from the Vanguard Capital Markets Model (VCMM) are derived from 10,000 simulations for each modeled asset class in AUD. Results from the model may vary with each use and over time.

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## Five key ASIC findings on marketplace lending

Daniel Foggo

In April 2019, the Australian Securities and Investments Commission (ASIC) released its third report on marketplace lending, the [Survey of marketplace lending providers: 2017–18](#). The report paints a clear picture of a once-nascent industry enjoying growth with new borrowing increasing by nearly 45% in the 2017-18 financial year. The report notes that this growth is moderating compared to the near doubling in funds borrowed the previous year (from \$156 million to \$300 million). By contrast, the Australian Bureau of Statistics (ABS) reports that overall personal lending has declined by an astonishing 24% in the 12 months to March 2019.

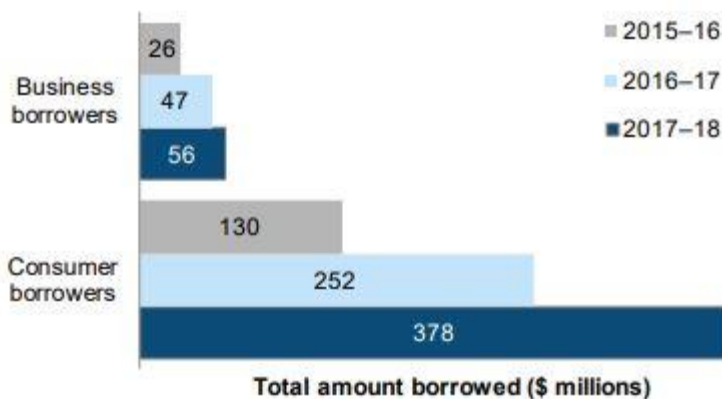
ASIC’s report draws on a survey of 13 marketplace lenders, covering questions such as how investors and borrowers are matched, how credit risk and interest rates are determined and the characteristics of the loans funded, including amounts, term, security and default. Five key findings in the report are:

### 1. More borrowers and investors are choosing marketplace lending

ASIC found that the number of retail investors on 1 July 2018 was 79% higher than in the previous year and had quadrupled since 1 July 2016.

While the *rate* of new investor growth was lower compared with the 2016-17 financial year, the total amount invested had increased by \$108 million. At the same time, demand from borrowers rose from \$300 million in the 2016–17 financial year to \$433 million in the 2017–18 financial year, as shown below:

**Figure 1: Amount borrowed by borrower type (\$ millions)**



There are three main reasons for this growth.

**First**, the consistent returns offered by fixed income investments, such as consumer loans, make them an attractive alternative to more volatile products, such as shares. As investors seek to diversify, consumer loans build financial stability into diversified portfolios.

**Second**, after the revelations of the *Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry*, consumers have become more alert to the issues associated with traditional finance providers and have been more willing to adopt newer business models and brands.

**Third**, consumers are more aware of the dangers of credit card debt and are seeking cost-effective solutions. APRA found that total personal credit card debt owed to banks declined by 4.8% in the year to March 2019, the second largest annual decline since 2002. More Australians are turning to the comparatively affordable interest rates associated with consumer loans.

## 2. Marketplace lenders are exploring new markets

Marketplace lending business models are evolving, with several platforms entering into new territory since the previous ASIC survey. The survey found that one retail platform established a separate platform for wholesale loans to fund specific types of loans, another platform moved investors to funding whole loans rather than fractions of each loan, whilst three platforms had started offering loans originated by third parties.

The report references RateSetter’s renewable energy marketplace which provides loans for the purchase and installation of clean energy products, such as solar panels and home batteries. These markets allowed us to become the official administrator of the South Australian Home Battery Scheme and offers competitive loans supported by the Clean Energy Finance Corporation.

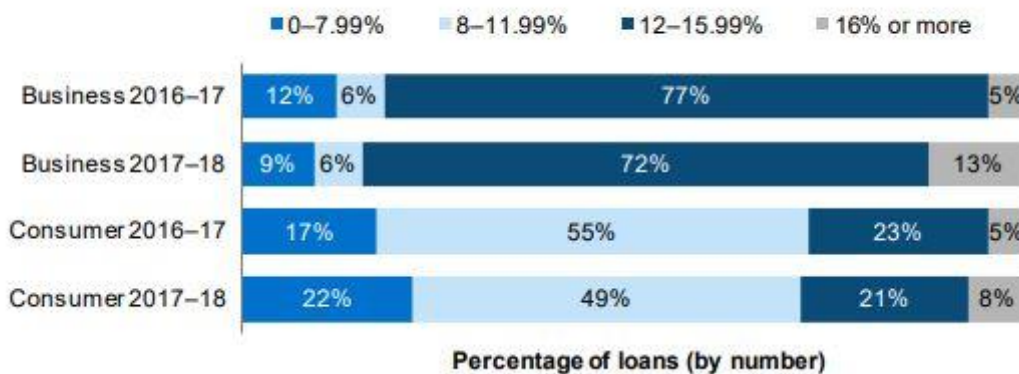
## 3. Interest rates have remained competitive

The ASIC report found that the average interest rate charged for marketplace loans entered into during the 2017–18 financial year was 11.5%, up from 10.5% in the 2016–17 financial year.

The average interest rate has not moved significantly since the first survey at the end of the 2015–16 financial year. With 71% of loans in the 2017–18 financial year attracting interest rates of 12% or less, this indicates that marketplace loans are generally offered at lower rates than those offered by more traditional institutions to this part of the market.

The figure below from the report shows the range of interest rates by borrower type.

**Figure 3: Distribution of loans by interest rate and borrower type (by number of loans)**



## 4. Security remains a priority

Five lending providers identified incidents of fraud, suspected fraud or cyber crime. While Corporations Act breaches were down from 10 to two suspected breaches, application fraud or suspected incidents of fraud increased from 353 to 545. Only one provider identified a cyber security incident.

All financial institutions must commit to robust security protocols including encryption processes (such as SSL Certificates) to secure data against misuse, interference and loss, unauthorised access, disclosure and modification.

## 5. The default rate has increased slightly

According to the report, 'the average default rate for the 2017–18 financial year, weighted by dollar amount, was 2.9%, representing an increase of 0.7 percentage points on the 2016–17 financial year. Meanwhile, default

rates varied across providers from 0 to 7% for consumer loans, compared to 0 to 3.4% in the 2016–17 financial year.”

Although most marketplace lenders had fewer than 1% of loans in default, the risk of losing principal or interest owed in a more uncertain economic environment may drive investors towards platforms that have implemented models that provide additional measures to protect investors, such as RateSetter’s model where investors benefit from its Provision Fund.

### Looking ahead

ASIC’s survey shows that marketplace lending has now established itself as a credible alternative for investing and borrowing in Australia. The industry should continue to ride the wave of consumers looking for transparent, value-oriented products and continue to take market share from traditional financial institutions.

With the three largest marketplace lenders accounting for 86% of outstanding loans, similar to prior years, it also seems the industry make-up is now established.

*Daniel Foggo is CEO of [RateSetter](#), Australia’s largest peer-to-peer lender, and a sponsor of Cuffelinks. This article is for general information purposes only and does not consider the circumstances of any investor. Investors should make their own independent enquiries and consult with a financial adviser.*

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## Why Westpac walked away from advice

Harry Chemay

It was a disarmingly simple question at the Financial Services Royal Commission. Michael Hodge QC, the baby-faced senior counsel assisting Commissioner Kenneth Hayne, leaned forward and asked, *“Do you think that high quality financial advice is ever going to be something that is affordable for ordinary Australians?”*

Brian Hartzler, CEO of Westpac Bank, shifted uncomfortably in his seat. He must have known that his testimony on that 22 November 2018 morning was being viewed in real-time by a legion of lawyers, financial advice licensees and financial planners, all waiting with bated breath on his answer. *“I think potentially, if it’s done through technology,”* Hartzler replied.

He then elaborated:

*“So there are a number of developments around the world in what’s sometimes ... referred to as robo-advice which is where the customer essentially self-serves by putting in their information, taking tests around their risk appetite ...”*

*“I think developments in that regard are going to become more available and – and be more scalable for ordinary people.”*

And there it was. Perhaps not a mea culpa exactly, but an acknowledgement nonetheless that the economics of financial advice had ceased to be viable for the majority of clients, the so-called *mass affluent*, that bank-owned licensees had traditionally served.

Fast forward to 19 March 2019 and Brian Hartzler was once again in the spotlight, this time announcing Westpac’s decision to effectively walk away from the provision of financial advice. BT Financial Group was to be folded into the bank’s Consumer and Business divisions, and its financial advisory business sold to non-aligned advice licensee Viridian Advisory.

In remarks to the media, Hartzler suggested that the impetus for Westpac (and other banks) to offload their advice arms had predated the Hayne RC, although there can be no doubt that it hastened proceedings. Hartzler said:

*“I think the trends in financial advice have been well underway for a number of years, so I don’t think this is the direct result of the Royal Commission. We were already thinking about the sustainability of advice for a number of years.”*

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## An unsustainable business model

In exiting advice, Westpac was merely acknowledging what ANZ, CBA and NAB already had.

It was an environment with remuneration models opaque to the end client, and a legal environment where the best interest duty makes justifying expensive or poorly performing in-house solutions increasingly problematic. Providing advice to clients of more modest means with a reticence to pay its true cost, delivered an inadequate risk-adjusted ROI to the advice provider. That much had already become clear to me.

Some weeks before the Westpac CEO took the stand, my co-founder Sahil Kaura and I bunkered down in a meeting room and stared at the blank whiteboard before us. Our mission – to build out the entire value chain of the financial planning process. Our aim – to find an answer to one question – “Can financial advice be profitable for **non-HNW** (high net worth) clients in a post-FoFA, post-FASEA, post-Hayne RC world?”.

As we mapped all the actors involved, the legal environment, the contingent liability incurred and the fee appetite of the average advice recipient, it became apparent to us that financial planning already was, and would only increasingly become, marginally viable without a significant injection of technology into the process.

I explained some of our thinking shortly thereafter in the Cuffelinks piece [Roboadvice's role in financial advice's future](#). My thesis was simple: financial advice today is **too costly, too complicated and too untrustworthy** for the 48% of adult Australians who say they have unmet advice needs to engage with the advice industry. Eight days later Hartzler took the stand at the Royal Commission.

## Cost management and the journey toward viability

Nothing I've written thus far should come as any surprise to the legion of licensee principals, dealer group boards, executive committees or their consultants, searching for a way forward through the morass. The issues are known knowns.

How does the advice industry find a path forward to sustainable profitability? To my mind, it can be summed up in just two words: cost containment.

Is anyone remotely surprised that the average Australian might balk at paying several thousand dollars for a comprehensive financial plan, and then several more thousand dollars each and every year thereafter in ongoing service fees? Survey after survey generate the same finding; that the fee appetite of Australians can be measured in the hundreds of dollars, not in the thousands.

HNW clients have no such problems justifying the true cost of the advice they receive. But their advice needs are significantly greater, often with business planning, asset protection, tax planning, aged care and inter-generational wealth transfer in the mix.

At the opposite end of the market, the advice models of the big banks were predicated on the assumption that advice could be delivered to the mass market profitably, either on its own or cross-subsidised by the sale of in-house platform, investment and insurance solutions.

If the implementation of FoFA hadn't already dealt this assumption an almighty blow, the furore surrounding the fee-for-no-service scandals and the Commission's final recommendations has sounded the death knell.

In mapping the entire value chain, it became apparent just how many humans are involved in the process. Apart from the adviser responsible for the relationship there are para planners, client services officers, internal compliance staff, practice managers, external (licensee appointed) compliance staff ... and this list goes on.

Receiving quality financial advice now is akin to entering hospital for major surgery. A lot of the people involved won't even register in your consciousness because they aren't there to do anything to you, but rather to sit in the background ensuring that standard operating protocols are followed.

Viewing the financial advice value chain thus, it quickly becomes apparent that advice was never a low-cost proposition and the costs (and consequences of non-compliance) are only ratcheting higher.

I believe this is what Brian Hartzler was alluding to when he conceded that the only probable path forward in providing advice to average Australians is via technology doing the heavy lifting traditionally done by support staff.

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## Digitally-enabled 'hybrid' advice is a way forward

Given the cost of delivering advice today relative to the fee appetite of the average non-HNW client (now bearing the entire cost and painfully aware of its quantum), the road ahead for advice looks rocky in the absence of robo-advice technology.

But that term itself has outlived its usefulness. It was a pejorative expression connoting some dystopian future where 'the machines' have put all advisers out to pasture, and unfortunately it stuck.

In actuality, digitally-enabled advice is a more accurate representation of the true potential of robo-advice. These technologies, of which [Clover.com.au](#) is but one, are tools that can automate and facilitate myriad interactions along the value chain.

From the 'fact find' discovery process to risk tolerance assessments to product selection, advice generation, acceptance and implementation, [AML/CTF](#) checks and order execution, digitally-enabled advice tools will be part of every advisory practice, undertaking mundane, repetitive but crucial tasks in a highly scalable, systematised and compliant manner.

### Potential two-tier value proposition

It's not a future pipe dream either. One of our advisory clients uses our digital technology to power a two-tiered value proposition; a high-touch bespoke service for prospective clients wanting, and able to pay for, holistic advice, and a low-touch, digitally-enabled scaled investment advice solution for those without the capacity to meet the cost of holistic advice.

In a [recent interview with btcn asia](#) in Singapore, I shared a view that, rather than impinging on their territory, robo-advice technologies will allow licensees and their advisers to reach out to, and engage, more individuals with a value proposition that resonates and is sustainably profitable.

The alternative is a back-to-the-future scenario whereby the financial advice landscape contracts to a handful of high-end firms dealing exclusively with multi-millionaire clients who meet the Sophisticated Investor (Wholesale) test.

It should not be the case that only those with six-figure incomes and seven-figure portfolios are able to access quality financial advice.

*Harry Chemay is a Co-Founder of the digital advice provider [Clover.com.au](#). This article is general information and does not consider the circumstances of any investor.*

## Seven property depreciation tips for EOFY

### Bradley Beer

With tax time just around the corner, many property investors are preparing to visit their accountant to complete their annual income tax assessment. Getting your tax in order can be an overwhelming task, but when you have a commercial investment property it can seem even more complex. There are many factors for commercial property investors to consider when lodging a tax return, including property depreciation.

To help you get the most out of your commercial property, here are eight top property depreciation tips for this end of financial year.

#### 1. Both new and old commercial properties can be depreciated

Depreciation deductions can be claimed for the wear and tear of the building structure via a capital works deduction and for the plant and equipment assets within the property.

The Australian Taxation Office (ATO) allows owners of any commercial property in which construction commenced after 20 July 1982 to claim capital works deductions. If your property was built before this date, there may still be deductions available so consult with an expert.

For traveller accommodation, this date is 21 of August 1979. Depending on the year of construction, capital works deductions can be claimed at either 2.5% or 4%.

Depreciation deductions for plant and equipment assets are generally calculated based on the individual effective life for each item as set by the ATO.

## **2. Commercial tenants can claim depreciation too**

It's not just owners who can claim depreciation. Commercial tenants can claim depreciation for any fit-out they add to a property once their lease commences, including blinds, carpets, shelving, smoke alarms and security systems.

If lease conditions mandate a tenant return the property to its original condition, they may also be able to claim a write-off for any remaining depreciable value on the removed assets. In this instance, scrapping can be applied. Assets left behind by a previous tenant may also be available to be claimed by the property owner.

## **3. Know the difference between repairs and improvements**

It's important to understand the difference between a deductible repair and an improvement.

A repair is when an item or property is returned to its original state to retain its value. Repairs attract an immediate 100% deduction in the year of expense.

Improvements, on the other hand, occur when an investor enhances the condition of an item or property beyond that of when it was purchased. As improvements are capital in nature, they must be depreciated over time.

## **4. Don't wait if you've only just purchased a property**

If you haven't owned your investment property for a full year you can still claim depreciation deductions this financial year. Investors can claim partial-year depreciation deductions for the period their property is rented out or is genuinely available for rent. That is, when the property is given broad exposure to potential tenants and considering all the circumstances tenants are reasonably likely to rent the property.

Quantity surveyors use legislative tools such as the immediate write-off rule and low-value pooling method to make partial-year claims more beneficial to investors.

## **5. Make use of techniques that maximise deductions early**

An immediate write-off applies to any item within an investment property with a value of less than \$300. Investors are entitled to write-off the full amount of these assets in the year of purchase.

Low-value pooling, on the other hand, is a method of depreciating plant and equipment assets which have a value of less than \$1,000. Such items can be added to a low-value pool and written off at an accelerated rate to maximise deductions. Item can be depreciated at 18.75% in the first year and 37.5% each year thereafter.

Immediate write-off and pooling rules may also apply if an asset is below a certain value, particularly for small and medium-sized business owners. As plant and equipment items are rarely the same age as the property and are often replaced and updated, there can be significant deductions available.

Specialist quantity surveyors can maximise your tax return by applying the immediate write-off rule and adding eligible assets to a low-value pool.

## **6. Amend previous tax returns**

If you haven't been claiming property depreciation deductions, the ATO allows investors to amend two previous tax returns. A tax depreciation schedule can provide the details of any deductions missed for an accountant to make a claim.

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## 7. Get an expert to assess the property and provide a tax depreciation schedule

To ensure the correct deductions are claimed, investors should speak with a specialist quantity surveyor. Tax Ruling 97/25 states quantity surveyors are one of the few professions qualified to estimate construction costs for depreciation.

A quantity surveyor will inspect the property to make sure every plant and equipment asset is identified and that claims for fit-outs are correctly noted.

Having a tax depreciation schedule for your investment property has many lasting benefits and can help you build your wealth. A schedule will outline the available deductions for your property and help your accountant when lodging your tax return.

*Bradley Beer is the Chief Executive Officer of [BMT Tax Depreciation](#). The website provides additional details. This article is general information and does not consider the circumstances of any investor.*

## Super timing guide for contributions and reversionary pensions

Graeme Colley

This article looks at two common timing issues: the timing of end-of-year contributions, and achieving the most benefit from reversionary pensions.

### Watch the end-of-year contribution timing, especially this year

If you're looking for a tax deduction for superannuation contributions, there are a few things to know. Tightening the timing a little this year is the fact that 30 June 2019 is on a **Sunday**.

If you make a contribution to a superannuation fund well in advance of 30 June, there should be no issue if you wish to claim the deduction.

However, if you delay to the last minute, you could be in for a shock as the contribution needs to be made before 30 June. Give yourself enough leeway, considering that some banks may not include a Sunday in their normal processing times.

Making super contributions to your fund is the easy bit. You can transfer cash electronically or by cheque, but the two have timing timing.

The Australian Taxation Office (ATO) allows a timing exception for cheques. Where a cheque is given to a fund prior to 30 June, but the fund does not bank it until the new financial year, the ATO will still regard it as a pre-30 June contribution.

But the exception will not apply if the transfer has been made electronically and it does not register in the fund's bank account until next financial year. There's already been several tax cases involving the timing of contributions where the taxpayer was the loser.

You can also transfer a limited range of investments to your fund and claim a tax deduction for the value transferred. For listed shares and other securities, the transfer will take place by an off-market transfer (OMT).

You can also transfer commercial or farming property to your fund as a contribution. However, depending on the value of the property, you need to be careful because the value transferred as a contribution may breach the caps with excess contribution penalties applicable.

### How much to contribute

The current cap for tax deductible super contributions is \$25,000 and includes any contributions made by your employer, salary sacrifice and superannuation guarantee contributions, as well as any personal contributions you claim as a tax deduction. Once you have exceeded the cap, any excess plus a penalty interest component can be taxed at your personal tax rate providing you withdraw it from your fund. Or, you can leave it in the fund and the excess will be taxed at 47% and also be counted against your non-concessional contribution cap.

Make sure that before you make the contribution, you make an estimate of other tax-deductible contributions that have been made to the fund for you, such as employer super contributions. This will allow you to maximise the tax deduction without having some of the contribution being excess or treated as a non-concessional contribution.

Claiming a tax deduction for personal super contributions does have some limits. You are not permitted to allow it to create or increase a tax loss. For example, say you run a business as a sole trader or partner which has made a tax loss for the year and you haven't received any other taxable income. You won't be able to claim a tax deduction for personal superannuation contributions as the amount claimed will add to the tax loss you have made from the business.

### **Making the election**

Before you can claim a tax deduction for personal contributions, you must let the fund know that you intend to claim the deduction. The fund must send you an acknowledgement of the amount you intend to claim in your personal tax return. You will need to provide the election to the fund before your income tax return for the relevant tax year is lodged, or by the end of the tax year after the contribution has been made, whichever happens first. If you provide the election to your fund after the required time you will not qualify for the deduction.

### **Reversionary pension timing tips**

A reversionary pension is an income stream superannuation benefit paid to an SMSF member following the death of another member.

When a reversionary pension is reported for the Transfer Balance Cap (TBC), it is not counted against the reversioner's cap until the anniversary of the original pensioner's death. This sounds relatively simple, but an excess TBC determination can issue even where the reversioner has commuted one or more pensions to stay within their \$1.6 million TBC and has reported the commutation to the ATO in time.

No matter how early it is reported the problem still arises even when it is reported on the day of the commutation.

### **Case study when the account passes to a surviving spouse**

Let's look at a case study illustrating the issues that can happen in one situation.

Mark and Lyn were both members of their SMSF on 1 July 2017 and both were receiving account-based pensions which provide reversions to the surviving spouse. Each pension had an account balance of \$1 million at that time which was reported to the ATO for TBC purposes.

On 31 May 2018, Mark passes away and the balance in his account-based pension account at that time was \$800,000. This was payable to Lyn as the surviving spouse.

If Lyn doesn't do anything, the balance of the reversionary pension at the time of Mark's death will be counted against her TBC on 31 May 2019, the anniversary of Mark's death, and will create an excess TBC determination of \$200,000 (\$1.8 million less the \$1.6 million cap).

The excess TBC determination will require Lyn to commute \$200,000 out of pension phase by either:

- Commuting \$200,000 from her existing account-based pension and transferring it to accumulation phase or cashed out as a lump sum, or
- Commuting \$200,000 from the reversionary pension and cash it out as a lump sum.

If Lyn or her adviser understood how the TBC rules operate, the commutation should take place on 31 May 2019 to get the best of all possible options. The strategy would maximise the tax exemption on income from investments supporting Lyn's account-based pension and the reversionary pension. It would also ensure that the value of the pensions calculated for TBC purposes remain within her TBC. Of course, during the year, Lyn would be required to draw at least the minimum account-based pension and reversionary pension.

If Lyn was to commute \$200,000 of one of the pensions on 31 May 2019 there should be no issues as the combined value of the pensions counted for TBC purposes has been reduced to \$1.6 million. For TBC reporting purposes, there is no mandatory requirement to report the commutation of the pension until the time the compliance and tax return for the SMSF has been lodged, possibly in May 2020.

Waiting to report Lyn's commutation in May 2020 is certainly not the best strategy for Lyn's TBC as the ATO will issue an excess TBC determination to her. But, reporting the commutation as soon as it has occurred may provide no better outcome as the ATO will still issue an excess TBC determination.

What happens in practice is that on the anniversary of the commencement of the reversionary pension to Lyn which is 31 May 2019, the ATO will issue the excess TBC determination to her. Even if she was to report the commutation of one of her pensions on the day it took place, the excess TBC would issue as the commencement of the reversionary pension would have been reported previously to the ATO after Lyn became entitled to it.

### **How does this happen?**

The problem with the mismatch with the SMSF Transfer Balance Account Report (TBAR) reporting cycles which result in the 31 May 2019 pension commutation not being reported before the ATO has already made the excess TBC determination on the anniversary date of the death of the deceased.

If the fund was to do nothing about reporting the commutation to the ATO, Lyn could be worse off. The reason is that after the excess TBC determination has issued, she has 60 days to comply with the commutation authority issued as part of the determination. This will result in a double commutation, the first when one of the pensions is commuted on 31 May 2019 and the second made to comply with the commutation authority so that the determination will be satisfied.

Ideally, this should not happen, but it is more unfortunate to occur where a surviving spouse is in receipt of a reversionary pension. Maybe a slight delay in issuing the excess TBC determination or notifying the reversionary that an excess TBC determination is to issue may help the surviving spouse experiencing any undue anxiety.

*Graeme Colley is the Executive Manager, SMSF Technical and Private Wealth at [SuperConcepts](#), a sponsor of Cuffelinks. This article is for general information purposes only and does not consider any individual's investment objectives. For more articles and papers from SuperConcepts, please click [here](#).*

## **What should the government's super and retirement planning priorities be?**

### **SuperGuide**

The superannuation world is ever-changing, which is why it's so important to stay up-to-date with all the rules, caps, rates and thresholds. While many of the changes can be seen as the government fiddling with the rules or shifting the goalposts, many changes can be positive.

Government policy is never flawless and improvements can always be identified. Some policies are designed to be fairer while others may be designed to incentivise Australians to boost their super, or for the industry to cut their fees.

We asked some of Australia's top experts in superannuation and retirement planning what they think the government should be focusing on.

#### **Daniel Brammall**

##### ***President of the Independent Financial Advisers Association of Australia (IFAAA)***

People who are looking to plan their retirement (whether it's 5 years away or 30 years away) ought to have access to the experience, skills and sophisticated financial forecasting tools that independent financial advisers possess. So we want high calibre advice to be more accessible and more affordable. To that end, here are the two keys we want the government to act on immediately:

1. **Quality advice:** the government to keep its promises to implement the Royal Commission's recommendations, particularly 2.2 (warning as to lack of independence of financial adviser)
2. **Affordable advice:** make financial planning advice fees tax deductible if the adviser is a member of a government-recognised financial planning profession (i.e. an association operating a Professional Standards Scheme)

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**Daniel Butler****Director, DBA Lawyers**

- The transfer balance account (TBA) should become a self-assessment exercise for SMSFs rather than the complex reporting now. The reporting is not working and a lot of re-reporting is required and the ATO are experiencing a lot of errors. Many SMSF advisers are having lots of issues with the TBA reporting system and find this the worst part of the mid-2017 reforms.
- Contribution caps should be increased. The concessional cap should increase to \$50,000 per member and the non-concessional contribution cap should increase to \$150,000 per financial year.
- The gainful employment test should be removed as it no longer has relevance to the modern super system. The changes announced in the April 2019 Federal Budget should go further and remove any link to gainful employment altogether rather than just for those under 67 years
- The superannuation guarantee (SG) rules need greater flexibility. Currently the complexity of getting the right calculation for contributions to satisfy the minimum 9.5% of ordinary time earnings is extremely complex given Australia has the most complex workplace set of rules and the most restrictive work practices in the world where multiple awards or industrial agreements may apply to the same employee and similarly different classifications under these multiple awards may apply to the same employee. Employers should not be hit with such a crushing penalty regime for making honest mistakes. The penalty regime needs to encourage voluntary compliance. An SG amnesty should be introduced for a 2 year minimum period so employers can rectify any past issues. Employers should be given an annual reconciliation period rather than getting caught out if each quarter is not precise. There is plenty of work on SG that is needed.
- A genuine effort be made for ATO-Treasury-Industry to work together to cut down on wasteful and inefficient practices to reduce any red tape, eg, the TBAR system which has been and continues to be a real problem for SMSF practitioners. Further effort is required in reducing the red tape and paperwork associated with super which eats up retirement savings and is non-productive.
- The Government should proceed with SMSFs having 6 members as soon as possible.
- That the super system be treated with 'respect' and it is not there for Governments to readily raise tax from, and that successor governments must have regard to the long term goals of members and the super system rather than making changes that cut across members long term retirement goals for Government to extract further tax to balance its budgets from year to year.

**Rafal Chomik and John Piggott****Senior Research Fellow at CEPAR and CEPAR Director and Scientia Professor of Economics at CEPAR (Centre of Excellence in Population Ageing Research)**

Australia's retirement income system is in pretty good shape. It is expected to deliver adequate incomes to Australia's retired population for many decades to come, with sustainability assured in the face of an ageing population.

But there is nevertheless plenty of room for improvement, so a comprehensive review is welcome. It's an opportunity to resolve issues that have weighed on the system for years.

At the ARC Centre of Excellence in Population Ageing Research (CEPAR), we conducted our own review of research into the retirement income system in a [series of Research Briefs](#). These also identify policy gaps that the Government's review should revisit.

Whatever form the Government's review takes, it is vital that it considers the interaction between different components of the system. Too often in the past, one aspect of the system has been examined without giving weight to the way in which it intersects with other parts. A comprehensive review provides an unusual opportunity to look at these together.

In doing so it should assess the current and projected adequacy of the safety net, the need for higher contributions, the framework that allows lump sums to be converted into retirement income, and the appropriateness of taxation settings.

When considering whether the safety net is adequate, it is important to anticipate future trends in the asset holdings of those who are less well off. Retirees without housing security are vulnerable under current policy settings, so we need to make sure that they are adequately supported by public payments such as the Age Pension and Commonwealth Rent Assistance. The role of housing as a retirement asset more generally will also need to be considered.

The review ought to consider the appropriate contribution rate mandated under the Superannuation Guarantee. In addition, more comprehensive mechanisms should be considered to draw non-employees into the superannuation system.

Retirement incomes can not only be increased by higher savings, but also by improving the efficiency of the system and better drawdown strategies. The Productivity Commission, in a recent review, has already suggested several policies that would help keeping costs down, and there are no doubt other possibilities. A comprehensive review must give this issue serious consideration.

The drawdown phase of retirement requires special attention. This should be an important part of the review – how to make drawdowns efficient, especially the management and sharing of risks people face in retirement.

Finally, the retirement income system sits within a broader taxation framework, and that framework must better accommodate settings that support the operation of the system we have adopted.

A comprehensive review provides the opportunity to assess the system against the objectives of adequacy, sustainability, efficiency, fairness, and simplicity and to make Australia's retirement income system even better.

#### **Graeme Colley**

##### ***SuperConcepts Executive Manager SMSF Technical and Private Wealth***

The Federal election and the conservative reaction of voters to proposed significant and inequitable change is a clear signal that stability with superannuation is essential.

What needs to be done is that the superannuation objectives bill should be passed to incorporate the superannuation objectives in legislation to moderate large swings in policy settings over time.

The legislation proposed prior to the election should be examined in light of the objective of superannuation so that it encourages people to save for their retirement. Relevant proposals are those that would clarify some of the Super Reform legislation for pensions, the superannuation guarantee changes and the extension of contributions as announced in this year's Federal Budget.

#### **Jeremy Cooper**

##### ***Chairman, Retirement Income, Challenger***

##### **The Superannuation (Objective) Bill 2016**

Legislating the objectives of the super system was a key recommendation of the 2014 Murray Inquiry and it was a powerful one. Unfortunately, the Superannuation (Objective) Bill 2016, which sought to do this, was not passed during the life of the 45th Parliament. The major parties were unable to agree on the wording. This is a serious bit of unfinished business for the new Morrison government.

Here are a few thoughts on this.

Super is social infrastructure that transforms some of today's wages into capital for spending as 'retirement wages' far into the future. In this way, household consumption can be smoothed out over a lifetime. The first dollar a worker contributes to super at age 25 might remain in the system for 50 or more years, until it is ready to be spent.

This is an epic maturity transformation; deferring a fortnightly wage and turning it into a 50-year compounding asset.

But, at some point, each dollar of super capital needs to be turned back into 'retirement wages.' It is not permanent capital. Super's purpose is to create retirement income, but the sooner we work out what 'retirement income' means, via the Superannuation (Objective) Bill, the better.

The system is currently squibbing on this, at least in part because it suits the agents to hang onto the money. The result is that retirees are underspending and experiencing a lower standard of living than they can afford.

**Sean Corbett**

***Sean has worked in the superannuation industry for more than 20 years and has a specialist knowledge of annuities***

### **1. Amend the indexation of the \$1.6 million pension transfer limit**

I can see some justification for imposing this limit in terms of limiting the benefits accruing to the “rich” but it’s indexation needs to be amended in order to achieve that aim rather than eventually punishing everyone.

What is particularly interesting about this limit is that it is indexed by inflation, unlike all the other limits on contributions to superannuation that were included in the same suite of changes, which are indexed by wages.

The amount that someone saves in superannuation for their retirement is linked to their wages. Wages generally grow faster than inflation, so people’s superannuation balances at retirement will increase faster than inflation over time. Therefore, people’s super balances at retirement will increase faster than the limit will increase. This will lead to more and more of people’s superannuation savings when they reach retirement exceeding the limit.

The tax on earnings that is applied to pension accounts within superannuation is nil, while the tax on earnings that is applied to non-pension accounts is 15%. The limit constrains the amount of superannuation at retirement that can be transferred to a pension account. Because the limit won’t grow as fast as people’s retirement balances, over time more and more people will have more and more tax applied to their superannuation savings in retirement.

At some point in the future the failure of the limit to keep up with people’s superannuation balances when they reach retirement will lead to an increase in tax that will not just apply to the “rich”, it will apply to the average person and, over the very long run, it will apply to everyone.

Higher taxes on retirement savings mean that those savings will either provide a lower level of income or they will provide an income for a shorter period or a combination of the two. More and more people will therefore be forced to rely on the Age Pension in retirement, increasing the burden on the government and working taxpayers.

As a solution, at the very least the limit should be indexed to AWOTE and increased by much smaller increments than the ridiculously high increment of \$100,000, which will be reached less often in a low inflation environment.

### **2. Reverse the changes to the taper rate for the assets test**

This change resulted in the rate at which the Age Pension was reduced as you saved more superannuation being doubled. It therefore introduces a very strong disincentive for people to save more superannuation for retirement.

The change resulted in retirees going from a situation where they received most of any additional super they saved back as total income over retirement (income from super plus Age Pension income) to a situation where they get back much less of any additional savings as total income in retirement.

Furthermore, people with more super who try to draw a regular income from their superannuation that will last for their retirement and index that income to keep up with inflation will find that their total income in the earlier years of retirement will be lower than people with less super.

This is true across a very broad range of balances at retirement from around \$400,000 to over \$1 million which covers what many retirees can expect to have at retirement in their superannuation.

This change manages to both overly punish those who attempt to save more super in order to provide a better life for themselves in retirement without relying on the working taxpayer / government and encourages people to dissipate their super more quickly in retirement.

As a solution, the change should be reversed and the taper rate that prevailed before the change reinstated.

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**John Daley and Brendan Coates*****John Daley is CEO and Brendan Coates a Fellow at the Grattan Institute***

The Morrison Government confronts a big agenda when it comes to retirement incomes. They need to implement the superannuation recommendations of the Hayne Royal Commission and respond to the Productivity Commission inquiry into superannuation costs. And Treasurer Josh Frydenberg hopes to establish an independent review of the retirement incomes system. Here's what their priorities should be:

- Australia needs a new retirement incomes standard
- Scrap the increase in compulsory super to 12 per cent
- Reduce Australia's woefully high super fees

John and Brendan have expanded on these points in the article [Three retirement income priorities for the returned Morrison Government](#).

**Dante de Gori*****CEO of the Financial Planning Association (FPA)***

The super system has undergone significant changes in recent years, with participants adjusting to new rules and requirements. As a first principle, the Government should be cautious with any further reforms to superannuation to ensure the benefits of reform aren't overwhelmed by short-term disruption.

The proliferation of multiple accounts and underperforming super funds continues to be a drain on Australians' retirement savings and should be a focus for the Government's policy work. Initiatives to improve Australians' engagement with their superannuation well before they reach retirement age will help them make better decisions and should form part of any solution. The lack of portability of insurance is a common obstacle to reducing multiple superannuation accounts and needs to be addressed.

Boosting the retirement savings of women is a priority and the Government should report on the retirement income gap between men and women. Extending the superannuation guarantee to paid parental leave and carers leave would be a good step towards closing the gap.

The FPA welcomes the Government's interest in a review of the role of superannuation in retirement income and we encourage the review to consider the role that professional financial planning plays alongside superannuation in supporting Australians achieve their retirement goals.

**Graham Hand*****Managing Editor of Cuffelinks***

Let's bore you with some numbers to start, to show you how the world will change in the next three decades. I've chosen 30 years because the life expectancy of a female born today is 94. Retirees at 65 today need to plan not to run out of money until at least 2050.

- According to actuaries Milliman, health issues now comprise 24% of the spending of 85-year-olds, up from 12% for 65-year-olds.
- ABS data shows there are 7.3 million Millennials in Australia, versus 4.8 million Baby Boomers.
- The Intergenerational Report says that in 1975, there were 7.3 workers (or people aged 18-65) for every retiree, but by 2050, it will fall to only 2.7.
- The same Report says 5% of the population will be over 85 by 2050.

So what? Well, where will government revenue come from in future? Baby Boomers are now aged between 55 and 73. Many have led blessed lives of free education, strong economic growth, generous superannuation rules, cheaper housing and world peace and trade. The younger generations know this, and they will increasingly outvote the old folk. Gradually, age pensions will pay less, entitlement will become stricter, super rules will tighten, health will be more user-pays and aged care will rise in price. The Baby Boomers who are not self-funding their retirement will struggle.

There's a solution right on the doorstep: the equity tied up in the family home (which at some point will no longer be exempt from the assets test). The fact that a person can own a \$5 million house and claim a full pension, plus associated health benefits, is inequitable with increasingly cash-strapped budgets. We are seeing

an early move with the enhanced Pension Loan Scheme. AMP's modelling suggests a single person can borrow on this scheme up to \$36,000 a year, and a couple \$54,000, paid in fortnightly instalments.

This is the start. It will not be long until it is expected that anyone who owns their own house will be expected to draw on home equity rather than receive an age pension, and a chunk of the money will go into health rather than the next trip to Europe.

### **Amara Haqqani**

#### ***Director, Strategy and Solutions, Milliman***

It's time for the Morrison Government to take stock on all things super. 2018 was a busy and high profile year with the 2017 and 2018 budget changes, the Productivity Commission and the Royal Commission. It's important now to not only ensure that the lessons learned are not forgotten, but that also we conversely sift through all the noise to get to the heart of the issues: retirement is a long term game, and it cannot be viewed with a short term policy lens.

As a result, to my mind, all of last year's issues point to three key things: we must not lose sight of truly putting the member first, we must remember that doing so is not purely about fees and returns, and we must not let some bad eggs ruin the overall notion that people will always need financial advice.

This means that the government needs to ensure that the upcoming regulations for the member outcomes regime, clearly outlines what is expected of a fund's knowledge and that they have a true understanding of their member's needs and retirement goals. The government needs to also prioritise overhauling the advice rules and outcomes from the Royal Commission, allowing new forms of adviser technology to complement advice and enable better service for the public – at a time when they need more options than traditionally, advisers have been able to provide.

### **Martin Heffron**

#### ***Executive Director, Heffron SMSF Solutions***

One of the first things Josh Frydenberg did after the Coalition's shock election win last week was to express his support for the Productivity Commission's recommendation of (yet another) review into our retirement incomes system. Unfortunately, however, a review into retirement incomes in isolation is at risk of missing the point. The societal challenge of an ageing population is well known and has been widely discussed. The increase in longevity creates three separate but linked high level needs:

- Health care
- Aged care (including accommodation)
- Retirement income provision

In most developed countries these three needs are partly funded by the state and partly funded by the individual. Often, the proportion of public versus private funding depends on an individual's means. At any rate, all three needs are increasingly expensive and complex areas for state and citizen alike that require strong co-ordinated policy responses. Sadly, this co-ordination is currently lacking in Australia.

At least the Productivity Commission's recommendation was to look at retirement incomes holistically rather than just superannuation but given the nature of the problem, we need to be even broader than that and look at the problems presented by aging overall. If we are going to go through the time, expense and pain of another review, wouldn't it be great if we engaged with the problem at the right altitude and in a coordinated fashion?

### **Paul Howes**

#### ***National Sector Leader, Asset & Wealth Management and National Leader, Customer, Brand & Marketing Advisory, KPMG Australia***

The Federal Government's key focus area for superannuation should be providing certainty around a retirement income framework.

While the accumulation phase within our super system is well developed and globally leading, there are significant opportunities to develop innovative retirement products to meet the diverse range of needs of members transitioning to retirement.

The government has consulted over the past year around a Retirement Income Covenant and Comprehensive Income Products for Retirement (CIPRs) and disclosure to facilitate consumers to self-select a retirement product, however has yet to provide a framework. The sooner certainty is provided by government, the sooner funds can act and further develop our retirement income system.

**Xavier O'Halloran**

***Acting Director – Superannuation Consumers' Centre***

Before the election the Government passed great consumer protections to clean up the glut of erosive duplicate accounts, saving Australians millions of dollars for their retirement.

We support the reintroduction of its legislation to protect people from inappropriate insurance, which entirely wipes out the savings of many young people. It's completely unacceptable that for some young people their first experience of superannuation is to discover their savings have been eaten away by zombie insurance policies.

We are going to need a two pronged attack if we want to see people moved out of poor performing funds and into the best. APRA's new powers directed at weeding out funds that aren't delivering for members is going to take time. APRA needs a bright line test in the regulations if it is really going to turn up the heat on merger activity.

Getting rid of the poor performers alone won't solve the problem of poor competition, we need to be helping people find funds with the best likelihood of success. Therefore we want to see urgent action on fixing the default superannuation system. This is where the biggest potential savings lie for people. The Productivity Commission found that those ending up in a poor performing fund stand to be half a million dollars worse off when they retire, compared to a top fund. The PC's recommendation of 'best in show' is worth trialling and refining in the real world, so that people aren't left to languish in underperforming funds.

**Liam Shorte**

***Family Trust and SMSF Specialist Advisor, Verante***

I believe that we need some stability and restraint when it comes to any further superannuation legislation. What people want is some certainty that if they forego salary and wages to save for retirement that this will benefit them in the long term not disadvantage them. The average mum and dad who have saved (as opposed to the average couple who just have employer contributions) have basically lost out since the changes to the Age Pension tapering rate. Often a couple with \$860,000 of savings has a worse annual income outcome than a couple with \$387,500 who get the full pension. Don't try to tell someone at 65 that they should spend their capital because frankly the prospect of 25+ more years of life and the increased costs of healthcare, aged care and possible GFC events scares the living daylights out of them. Remember these are people who have lived through recessions as adults unlike anyone under 45.

If we want people to be able to plan for retirement and have the confidence to use some of their capital earlier in retirement then better education on budgeting, medical and aged care costs needs to be provided like on the MoneySmart website but promoted much more so people know it is there and it becomes a go to source for unconflicted guidance. The introduction of the ASFA Retirement Standard has provided great information to use in those conversations with people entering retirement who have never really budgeted. The Government needs to take the lead and promote this sort of data and do the same for Aged Care costs and pros and cons of downsizing or the alternative of access the Pension Loans Scheme.

**Noel Whittaker**

***International bestselling author, finance and investment expert, radio broadcaster, newspaper columnist and public speaker***

People are sick of the continual changes to the superannuation regulations. The first thing the government should do is enact legislation, with the support of the opposition, that no fundamental changes will be made to the system within the next five years. This would allow retirees to have more confidence in planning their future.

Most retired people are in pension mode. This requires a minimum drawdown from their pension fund each year which is based on the balance at the previous 30 June. The percentage to be drawn increases with age. For example it is 6% of the balance for those aged between 75 and 79 and 9% of the balance for those aged

between 85 and 89. There has been a massive increase in life expectancies since these numbers were legislated, and there is good reason to reduce them to help retirees make sure that their capital lasts as long as they do.

Under existing rules, a person cannot contribute to superannuation once they turn 65 unless they can pass the work test which involves working 40 hours in 30 consecutive days in the financial year in which they make the contribution. Repeated efforts to simply raise the contribution age 75 have been resisted by Labor and the Greens. The age limit should be raised to 75.

### **Stephen Huppert**

***Stephen is an independent consultant and advisor working with institutions big and small that are committed to improving the retirement outcomes of Australians.***

The primary objective of the superannuation system is not to accumulate retirement savings but to provide retirement income. The areas where the superannuation and retirement income system needs work are:

1. Helping Australians increase their retirement savings; and
2. Helping Australians convert their retirement savings into appropriate retirement incomes.

Most of the focus for the last couple of decades has been on the former – and that work has not yet finished. However, saving for retirement is necessary but not sufficient to improving outcomes in retirement.

We need tweaks to the current SGC system to make it more relevant to broader parts of society. A lot has been written about the gender gap in both salaries and therefore retirement savings. As well as addressing the salary gap, there are a range of initiatives to address the retirement savings gap including SGC payments on parental leave and improving SGC coverage of part-time and casual workers. The latter will address a broader issue than just the gender gap.

Another high priority to increase retirement savings must be to address the epidemic of unpaid superannuation. Recent reports have highlighted the extent of this problem and it needs to be addressed so all workers receive their entitlements.

Whilst Australia has done a good job of increasing the size of retirement savings compared to other countries, there is still a long way to go to help people convert their retirement savings into appropriate retirement income streams. These needs to be done via a range of products and services that assist retirees understand their needs and preferences, and then match them to appropriate products.

The Government should continue where it left off prior to the election with the introduction of the Retirement Income Covenant including the requirement for superannuation funds to offer a broader range of products at retirement, especially those that provide protection against longevity risk.

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