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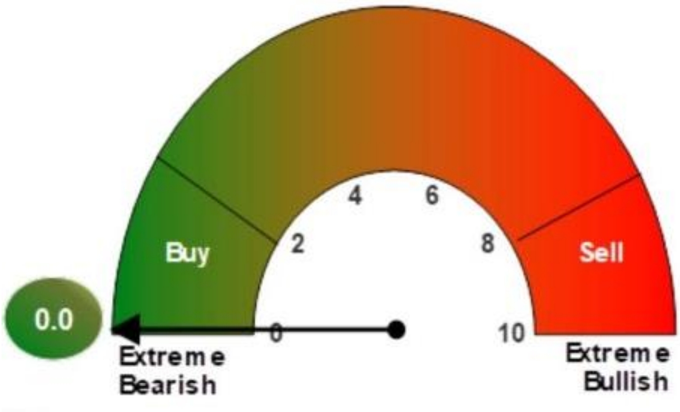
Editorial

There is a common frustration among investors and financial advisers that obtaining a single piece of advice - such as should I salary sacrifice? or should I invest or repay my mortgage? - involves a lengthy consultation process and a 70-page Statement of Advice. It increases the cost and complexity of financial advice and is a reason the Quality of Advice Review was commissioned. But it is easy to understand why it is necessary. How can anyone answer these questions without knowing a bigger personal picture, especially about long-term goals?

We're all different. I might think borrowing to invest in equities is too risky (yes, I do believe that at the moment) but another person might say we are near the best time for equity exposure, when markets are gloomy. They might be correct, as **Ashley Owen's** article explains this week, that recessions are usually good for stock returns. It's all in the timing and the cycle of investing, and maybe pessimism is a buy signal.



Our lifestyles are also different, especially the need to forgo something in the present in return for something in the future. Retirement security usually requires saving rather than spending, and buying a home rather than consuming, but plenty of people want the designer clothes, the flash cars, the fancy vacations and the latest tech. It's their life, their goals, their decisions, their consequences, making financial advice rarely a one-size-fits-all.

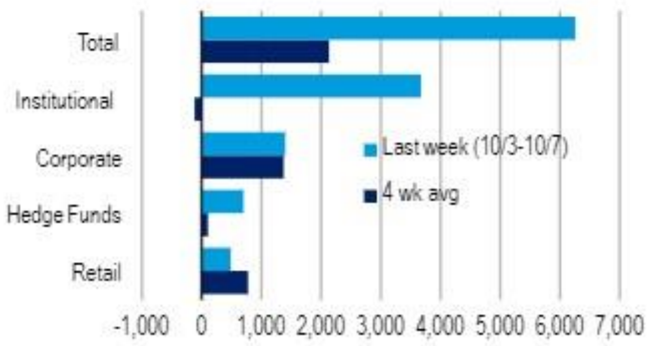
In car racing, a solid green flag is waved to start a race. In sharemarkets, nobody waves a green flag to start taking on more risk. As famous asset manager, Howard Marks, said:

"I spend a great deal of my personal time trying to figure out one thing, which is, at a given point in time, how should you balance aggressiveness and defensiveness in your portfolio."

For example, stock markets in Australia and overseas kicked up strongly last week, in the hope that the pace of interest rate increases would slow. The S&P/ASX200 was up 4.5% last week, its best few days for two years. According to **Calastone**, managed equity funds in Australia enjoyed $3.5 billion of net inflows between July and September 2022, well up on the previous quarter. Overseas, **BofA Securities** reported:

"Last week, during which the S&P 500 rallied 1.5% off recent lows, clients were big net buyers of US equities ($6.1B; third largest inflow in our data history since '08 and the fifth consecutive week of inflows). Our view? More volatility likely ahead."

Exhibit 8: All clients were net buyers, led by Institutional clients
BofA client net buys by client group ($ mn)



Source: BofA Securities

Get that. **The biggest net buyers of equities since 2008.** At the same time many are protecting their portfolios with cash, as central banks confirm further interest rate rises, as recessions loom and as Federal Treasurer **Jim Chalmers** appears on the news each night looking like he's swallowed a lemon, investors are piling into equities. The **IMF** update this week trimmed economic growth by 0.2% to 2.7% next year, and said:

"More than a third of the global economy will contract this year or next, while the three largest economies - the United States, the European Union and China - will continue to stall. In short, the worst is yet to come, and for many people, 2023 will feel like a recession."

What is the answer if someone asks, "Is it a good time to buy ***CBA*** *[or another stock]?*" We all have different investment horizons. It can vary from a day trader who wants to know what's happening at that moment to trade CBA over a few hours. Then all the way to someone investing for a retirement lifestyle and income over 30 years, which involves a broad assessment of long-term markets and CBA's position in Australian banking.

So spare a thought for the financial adviser asked to give a single piece of advice, which legally they are not supposed to do anyway. We would not expect a doctor to recommend heart surgery without a lot of tests and a knowledge not only of personal health history but that of the patient's family. In recent weeks, **ASIC's Financial Advisers Registry** (FAR) has recorded a loss of about 500 experienced advisers bringing adviser numbers below 16,000 from a peak of double that. Most of the losses were due to advisers failing exams. There's a lot involved in answering what seem like simple questions.

And everyone is desperate for some expert guidance on where markets are going. In recent presentations, among the first questions directed to me have been, "*What do you think of physical gold?*" and "*Where is the Australian dollar going?"* I prefer to talk about long-term asset allocation and portfolio construction, and the audience wants my macro guesses. Someone arranging a conference recently asked me to present but then lost interest when I said I do not pick stocks. Some people get what they deserve.

While I might think someone is looking in the wrong place for their investments, something else is top-of-mind for them. I am reminded of a joke:

"One night, a policeman sees a drunk searching under a streetlight and asks what he's looking for. He drunk says he lost his keys, and the policeman starts searching under the light. After a while, the policeman asks if the drunk is sure he lost the keys there. The drunk replies, "No, I lost them over there in the park." The policeman asks why he is searching over here, and the drunk replies, "This is where the light is."

In this week's edition ...

The **Optus** hack has raised the fear of identity theft, and at the same time, market participants are frustrated that financial market processes seem stuck in the dark ages, with many managed funds not changing their ID and application processes for decades. At a recent **Connect Forum** arranged by **Calastone, Annick Donat**, CEO of **Clime Investment Management**, said:

"This industry is highly regulated, but not to its benefit, not to anyone's benefit in the value chain or the ecosystem. And I sit here over three decades, and we're having the same conversation that we were having three decades ago. We've changed nothing, nothing at all. We've created more friction, not less. And we're supposed to be an advancing industry looking after people other people's money."

We take a look at 'tokenisation' (terrible word) as a potential solution to the confidentiality problems faced by Optus and all financial institutions. How do we make investing easier without compromising the identity checks which are essential for public confidence and to prevent cyber crime? It's part of the blockchain revolution relevant to all of us as we seek to reduce friction without damaging our security.

Regardless of our market expectations, we need a place to invest our super, and **Annika Bradley of Morningstar** takes an independent look at the likely structure of the coming **Vanguard** offer, and how it compares with a similar fund currently available from the largest super fund in the country, **AustralianSuper**. These are valid alternatives for every SMSF investor (and look out next week for **Meg Heffron**'s take on when an SMSF should be closed and the money moved to a public fund).

In the almost 10 years of Firstlinks, one of the most-viewed topics was our extensive coverage of the franking credit proposals before the 2019 Federal Election. Although nowhere near the same scale as a policy, a new franking credit proposal from the Government is attracting plenty of attention, and **Matthew Collins** explains what the fuss is about.

It's Year 12 exam time, and **Angus Dennis of Australian Ethical** checks the latest subject changes in the Economics exam, and finds far more focus on externalities, private versus public goods and sustainability. Pass his thoughts to anyone sitting the exam in coming weeks, and best wishes to all students.

Last week's article on homeowner-retirees not running out of money drew about 20,000 views and lots of comments, and we continue this theme with research by **Helen Baker of money.com.au** on the expectations and aspirations of Australians heading into retirement.

Back to security fraud and the obvious connection to cryptocurrencies. While superannuation is usually at the conservative end of investing as retirees seek to preserve capital, SMSFs have invested about $1.5 billion in crypto assets according to **ATO** data, up from only $240 million in two years. It's a small part of the $840 billion in SMSF assets but likely to rise as more younger people establish their own funds with investing freedom.

Some SMSFs have been subject to crypto fraud, such as reported by *The Australian Financial Review: "Queensland-based cryptocurrency, digital asset exchange and brokerage Mine Digital has collapsed and control handed to external administrators, amid a dispute where it is being sued for allegedly not doing enough to weed out scammers from its platform."*

Dr Paul Mazzola and Mitchell Goroch look at how regulators should control the rapid growth of crypto.

This week's White Paper from **VanEck** called *"In the Fed, we trust*" looks at how completely the **US Federal Reserve** is determining the direction of bond and equity markets, and the implications.

Graham Hand

Will tokens fix Optus hacks and investment paperwork?

Graham Hand

The cyber attack on Optus has focussed the minds of millions of Australians on the implications of a loss of private data and identity fraud more than any other hack. Optus revealed that data exposed included customer names, dates of birth, phone numbers, email addresses, home addresses and driver’s licence or passport numbers.

In its Financial Stability Review this week, the Reserve Bank highlighted the risks to financial stability from cyber attacks:

"There have been further high-profile cyber incidents in recent months, including the recent Optus data breach. A significant cyber event could undermine confidence in the financial system and have systemic implications. Financial institutions, governments and financial regulators continue to work together to enhance the resilience of the financial system to cyber risks."

While most of the attention has gone on telcos and banks, clients of many funds and brokers and administrators provide a significant amount of personal data with little regard for how their details are protected. Many processes still require a paper-based application form and personal identification and certification, despite the advances in the areas of fintech, regtech, roboadvice, AI, machine learning and blockchain.

Surely we can do better, and the new idea of 'tokenistation' offers promise for a more efficient future. But first ...

A painful and costly application process

Over the last couple of months, I have witnessed a family member become increasingly frustrated with what should be a straightforward account-opening process. Following the sale of a house, the family wanted to invest the substantial proceeds in bank term deposits, and their accountant recommended one of the aggregation sites that offers accounts from many banks. There is an incentive to split the money into $250,000 lots to gain the government guarantees under the Financial Claims Scheme.

After completing the paperwork of wet signatures, certification of copies by authorised agents and posting in the documents, follow up emails and phone calls were eventually answered with a confession that the paperwork had 'disappeared'. They were short-staffed and struggling to handle new accounts. The whole process started again and eventually the account was set up, and following further delays in accepting the fund transfers, the money was finally invested.

The accountant admitted many of his clients had experienced similar problems. The lost interest was in the thousands of dollars as the money sat in the transaction account of a major bank paying nothing.

We've been here before

Four years ago, Chris Cuffe wrote an article called '[Investing complexity is a massive industry failing'.]() I doubt whether Chris expected little would change for many years when he said:

"I have too many other priorities to be bothered filling out lengthy application forms. Yet I want to invest with some fund managers who only offer their products through unlisted managed funds with application processes which have changed little in 20 years. Sigh! Here comes the slog.

Section 1, Type of Investor, Individual must fill in sections 2 and 5. Trust or super fund, such as an SMSF, fill in sections 2, 4 and 5. Each different type of applicant fills in different sections. Is it the section for an Individual or an Individual Trustee? What if there are two trustees? OK, let's take a guess ...

Identify both trustees, including Tax File Numbers (TFN). Then it says, "You must attach certified copies of documents to this application form." Is that all documents? Choose Option A, or Option B Category 1 PLUS Option B Category 2 as forms of identification. Who are the beneficial owners? Which TFN does it mean? Identify them as well. Then identify the SMSF itself, including a certified copy of an 80-page trust deed. What! Is that the entire document or the cover page, and is it every page that needs certifying? And do they need any deed amendments too or just the original deed? ..."

Surely, we've come a long way from that?

The frustrations were obvious at a recent Connect Forum arranged by Calastone, which processes around 95% of managed fund transactions in Australia. Annick Donat, CEO of Clime Investment Management, speaking on a panel session, said:

"What keeps me awake at night? How do we get off this merry-go-round? This industry is highly regulated, but not to its benefit, not to anyone's benefit in the value chain or the ecosystem. And I sit here in three decades, and we're having the same conversation that we were having three decades ago. We've changed nothing, nothing at all. We've created more friction, not less. And we're supposed to be an advancing industry looking after people other people's money."

Harvey Kalman, Group Chairman of MSC Group, said the current set up was regulation-centric, not client-centric. To compete with other investment opportunities, the investor's decision and its implementation had to be achievable through a series of simple taps on a keyboard or other devices.

"What has been frustrating me for a long, long time, is the fact that we are still paper-orientated even if we think we're not paper-orientated. Having just filled out an application form for one of the nonprofits that I chair and I have to actually sign my name and then scan it and fax it back, and then get a call back from Macquarie Bank saying, "Please repeat all the information that you put onto your application form" and the telegraphic transfer tells me that we need something to solve this problem. By asking people to keep on repeating the data and re-identifying themselves – whether the fund is a complex structure or a simple one – we're not allowing unlisted managed funds to compete."

What is tokenisation and how might it work?

The Calastone forum addressed key questions on digital transformation and tokens:

- Can tokenisation usher in a new collective investment model built on next-generation infrastructure?
- How can we better connect with tomorrow's investors?

The mix of challenge and opportunity was set out when Ross Fox, Calastone's Head of APAC, stressed the need for the industry to act before it was '*pushed into disruption*' like the music, media or retail industries before it. Edward Glyn, Head of Global Markets at Calastone, said the traditional managed fund structure '*is not a recipe for success in a rapidly-advancing digital age*'. There are too many different participants playing a part for the supply chain. It is slow, costly, highly fragmented, difficult to service and certainly not 'value-centric'. Little had changed since the first managed fund in 1924.

In contrast, tokenisation – where a fund is represented digitally on distributed ledger technology (DLT) infrastructure – gives all players, from asset managers, distributors and platforms to the many different service providers, access and input within a single, technical ecosystem. Tokenisation converts something of value into a digital token on a blockchain application.

In 2019, Calastone launched a DLT-enabled distributed market infrastructure (DMI) and they hope to power collective investment products in a DLT-based platform covering the entire fund value chain.

Tokenisation also paves the way for innovative products that would not otherwise be viable. Examples include customised or personalised strategies giving differing exposures to a basket of assets, including private markets, illiquid and other non-traditional assets. The fractionalisation capabilities of tokenisation may further democratise wealth management by allowing people to access high-value assets previously out of their reach.

Younger generations demand investing is easier

Tokenisation can play a part in bringing the industry closer to a new generation of investors who demand a fully digital investment experience. These investors want a user experience on par with that offered by lifestyle apps – one that is easy to set up, allows instant purchases with clear and fair pricing, and offers the transparency to see whether the underlying investments align with their values.

Calastone argued that the industry must do its own disrupting before others step in. A major uplift in investor experience is required, take the regulator along on industry-wide automation.

Calastone's Chief Technology Officer, Adam Belding, provides more detail in this article on making tokenisation a reality.

"By representing the ownership of any asset, or pool of assets – for example, a portfolio of shares or a physical piece of art – as digital tokens, investors could have more efficient access to a broader range of investment solutions."

The implications of the Optus hack

There seems potential for the intense political and regulatory focus created by the Optus saga to go one of two ways regarding tokenisation:

1. Accelerate the move to tokens as a solution to identity theft, etc, OR
2. Impair the move to tokens because regulators will impose new laws which make innovation even more difficult.

Adam Belding gave me this response on the dichotomy:

"Tokens are by their nature more integrated into a security architecture, leveraging distributed ledger technology to operate. For example, Microsoft's Confidential Consortium Framework, which we are leveraging to operate DLT at scale, has strong protections in built against system corruption, data leakage, and tampering. With this in mind, financial services could look to DLT-enabled tokens to enhance their resilience and the positive reaction from regulators around the world towards token-based collective investments could accelerate that process."

Either way, investors need a more efficient way to identify themselves for account opening, encouraging more competition when it is easier to transfer between product providers, safe in the knowledge the personal details cannot be stolen. And throw away those paper application forms.

Graham Hand is Editor-at-Large at Firstlinks and attended the Connect Forum as a guest of Calastone. This article is general information only.

Some tips from the Commonwealth Bank website (Firstlinks has not checked these services and readers should make their own enquiries).

If you're concerned your ID may have already been compromised

IDCARE is an independent organisation that provides free support to individuals impacted by fraud or scams. You can contact IDCARE by calling 1800 595 160.

SavvyShield makes it easy to temporarily ban access to your credit report if you think your identity has been compromised. In the event someone tries to apply for credit under your name, the application will be blocked. You will need to download the Credit Savvy app and verify your identity to sign up to the service, or log in if you are an existing customer.

The super wars: Vanguard versus AustralianSuper

Annika Bradley

Vanguard recently received a superannuation licence, which will give it the ability to go head-to-head with the large superannuation funds. The 'Vanguard Super' offering will launch later in the year with details yet to be confirmed, but you'd expect it to look a lot like the new Vanguard Personal Investor product. The big question: Will it really be able to compete with the likes of AustralianSuper?

Vanguard is a global monolith with over $10 trillion of assets globally, but homegrown AustralianSuper is pretty sizable on the global stage with over $250 billion in assets. So let's take a look at the AustralianSuper Plan's Balanced Option versus Vanguard's Personal Investor Growth Index Fund (as a proxy for the super product) to see how they compare.

Objectives

An investment strategy's stated objectives can often prove a bit confusing, although understanding what each strategy aims to do is crucial when working out if a product is suitable for your needs.

Asset Allocations—Listed and Unlisted Assets

Bottom line? We can see that these two strategies are suited to a similar type of investor. But let's take a look at the asset allocations to be sure. The table below shows that the asset allocations are broadly comparable and are both categorised by Morningstar as multisector growth. Asset-allocation definitions can often be quite contentious, and AustralianSuper has categorised the growth/defensive split closer to 70% growth assets and 30% defensive assets on its website. But like anything to do with investing, it is better to be roughly right than precisely wrong, and these two strategies are roughly comparable from an asset-allocation perspective, enabling us to confidently compare the performance of each strategy.

Asset Allocation and Morningstar Category Comparison

	AustralianSuper Balanced Option (%)	Vanguard Growth Index Fund (%)
Morningstar Category	*Multisector Growth*	*Multisector Growth*
Domestic Equity	24	28
International Equity	32	42
Listed Property	1	0
Unlisted Property	6	0
Other*	16	0
Growth Assets	**79**	**70**
Domestic Fixed Interest	6	9
International Fixed Interest	11	21
Cash	4	0
Defensive Assets (rounded)	**21**	**30**

*Figures have been rounded to whole numbers and adjusted to sum to 100. Source: Morningstar Investor; AustralianSuper website – as at 31 July 2022 *Other – unlisted infrastructure exposure.*

One area where these strategies are very different is their holdings of listed and unlisted assets. AustralianSuper has around 28% of its portfolio in unlisted property, infrastructure, and private equity (see table, right). These assets are not listed on the Australian Securities Exchange or other global exchanges, often making it more challenging to know exactly what you are holding and at what price. From an investment merit perspective, there's nothing wrong with unlisted assets; in fact, returns have been favourable over the years for AustralianSuper. What's key to understand is that unlisted asset valuations tend to move around a little less than listed asset valuations. This means that the ups and downs of markets will impact the returns less than a fund with only listed assets. Unlisted assets tend to go up less in up markets and down less in down markets—generally because they are not revalued every day.

AustralianSuper Balanced Option's Allocation to Private Equity, Infrastructure, and Unlisted Property

	AustralianSuper Balanced Option (%)
Private equity	6%
Infrastructure	16%
Unlisted Property	6%

Source: AustralianSuper website – as at 31 July 2022.

The flip side is liquidity—that is, how easy it is to convert assets into ready cash. Stock exchanges (think the ASX or the New York Stock Exchange) are designed so that a lot of buyers and sellers can come together and exchange assets quickly and easily. As unlisted assets are not transacted on these exchanges, the sales process can be more protracted. Liquidity is important when a large number of members decide to sell out of the AustralianSuper Balanced Option (like we saw when COVID Early Release occurred), the Option needs to be able to sell assets to provide ready cash to these members. Given the majority of AustralianSuper's Balanced Option is liquid, liquidity shouldn't be an issue, and we saw AustralianSuper manage Early Release and other periods of market stress well from a liquidity perspective.

It's also worth pointing out that during periods of market stress, liquidity on global listed exchanges can come at a price. During the coronavirus selloff of March 2020, Vanguard increased the cost of exiting the Balanced Fund to 0.39% from 0.10%. This cost reflected market conditions, and the increase was important to protect the investors who remained invested in the fund. Panicking and selling out of liquid or illiquid investments during periods of stress is seldom advisable.

Can You Beat the Market?

Another important difference between the two strategies is their investment approach. Vanguard's strategy is not designed to "beat the market"—the fund simply tries to generate a return in line with some large indexes (think the S&P/ASX 300 Index). Vanguard's track record, when it comes to providing investors the return of an index, is impressive. Over long time periods, markets have delivered solid results, but don't expect anything more than market returns from this strategy. AustralianSuper, on the other hand, tries to beat the market. Beating the market is tough, but to date, it has been very successful across a number of assets. It is generally harder to beat the market at this sort of scale—AustralianSuper's size is $250 billion—but if you want to try, this strategy is more suited to your values. The obvious risk is that returns may end up lower than the market and quite often trying to beat the market involves higher fees (as we see below).

How Much Will It Cost?

Investment fees can't be ignored—a higher fee burden makes outperformance more challenging. And this next table shows that Vanguard is true-to-label in delivering a low-cost investment option compared with AustralianSuper. As we said, trying to beat the market comes with a price tag.

Administration fees and costs are the other big focus when it comes to comparing options. The value proposition can vary—members value different services, including access to an investment option; ongoing reporting; insurance; and investor education and support. In the case of AustralianSuper: An investor with $50,000 will pay $102 each year (or 0.20% per year) to be a member of AustralianSuper. Now the details of Vanguard Super are yet to be announced, but let's look at Vanguard Personal Investor—if you invest in Vanguard's funds, there is no cost for administration. A side note, though: Vanguard will earn 0.50% each year from any cash parked in the cash account.

Investment-Related Fees and Costs

	AustralianSuper Balanced Option (%)	Vanguard Growth Index Fund (%)
Investment Management Fees	0.37	0.29
Performance Fees	0.12	0
Total Investment Fees And Costs	**0.49**	**0.29**
Net transactional and Operational Costs	0.20	0.10

Source: Morningstar, AustralianSuper, Vanguard

Performance

We all know that past performance is not a guide to future performance, although as far as declaring 'success', long-term returns and results are an important yardstick. And ultimately net returns are what are most important to investors. So, how did the options stack up? AustralianSuper has it over Vanguard in terms of net returns over the long term, although AustralianSuper's higher allocation to growth assets would help. But, in reality, the returns from both strategies are strong—beating the Morningstar benchmark and the category average over 10 years.

Performance Returns as at 31 August 2022

	3 year annualised return	5 year annualised return	10 year annualised return
AustralianSuper Balanced Option (%)	5.9	7.6	9.3
Vanguard Growth Index Fund (%)	3.8	6.3	8.5
Morningstar Benchmark* (%)	3.9	6.4	8.3
Category (%)	3.6	5.3	7.1

*Source: Morningstar Investor; *Morningstar AUS Growth Tgt Alloc NR AUD.*

Who Is Winning the War?

AustralianSuper and Vanguard are investment powerhouses, and both offerings are compelling. It is important to understand the nuances between them and select the one most appropriate for your needs. We eagerly await the details of Vanguard Super so that we can make a more fulsome comparison. Safe to say, though, Vanguard is really throwing down the gauntlet to the industry. Vanguard's Personal Investor interface and setup process is seamless, and the arrival of Vanguard Super feels very much "game-on" in the super wars. Hopefully, the end beneficiaries will be the investors.

Annika Bradley is Morningstar Australasia's Director of Manager Research ratings. Firstlinks is owned by [Morningstar](). This article is general information and does not consider the circumstances of any investor. This article was originally published by Morningstar.

The danger in Labor's new franking credit proposal

Matthew Collins

We all remember the 2019 franking credit proposals that contributed materially to the Labor Party's election loss and helped to deliver Scott Morrison's "miracle". A major problem with that proposal was that it had many unintended consequences. The same can be said for Labor's new proposal to stop the payment of franked dividends funded by raising capital.

Paying company dividends

In basic terms, before a company can pay a dividend, it needs to:

- Make a profit and
- Pay tax.

The after-tax amount is credited to retained earnings and a dividend can be paid to shareholders. The situation may arise, however, where a company has spent its earnings on operating the business and, as a result, doesn't have the cash to pay a dividend. In such circumstances, where the directors consider payment of dividend important, they may seek to raise funds through borrowing money or issuing more capital.

According to Treasury documents, the new Government proposal purports to:

"… prevent companies from attaching franking credits to distributions to shareholders made outside or additional to the company's normal dividend cycle, to the extent the distributions are funded directly or indirectly by capital raising activities that result in the issue of new equity interests."

On the face of it, many would think this sounds reasonable. However, like with a lot of tax legislation, the problem rests in the detail and practical implications.

Devil in the detail

The proposal will make the job of a company director more difficult given its far-reaching application. Paragraph 1.33 of the explanatory documents states the following in relation to a capital raising:

"*It is not necessary that the relevant purpose be the sole, dominant or primary purpose, only that it is more than incidental to some other purpose."*

In other words, if it can be argued that the capital raising has some relationship to the dividend, then the entire dividend could be deemed unfranked.

Anyone who has watched how listed companies operate will see that their capital requirements are constantly changing. One minute they might be paying dividends and returning capital to shareholders. The next minute, due to a market change or business challenge, they may need to borrow money or raise capital to shore up their balance sheet. A few months later, they might be able to again return money to shareholders.

The Westpac example

An example quoted in the press in recent weeks is the November 2019 dividend paid by Westpac. A franked dividend of 80 cents was issued on the same day that the bank announced a $2.5 billion capital raising. The funds from the capital raising were received prior to the dividend being paid. But under the Government proposal, a dividend payment must be unfranked if funded from a capital raising even if the company has franking credits available for distribution.

Will Westpac be caught by this proposal, which is backdated to 2016? I think the answer is 'possibly'. There are some arguments for and against. What is clear, however, is if they didn't pay the dividend, then the capital raising could have been smaller.

But was Westpac undertaking a contrived arrangement? Was the bank carrying out some mischief that needs to stop?

I think most would agree that Westpac did nothing wrong. Banks have always balanced the paying of franked dividends to shareholders with the need to raise capital at times to secure their balance sheet.

This quandary that Westpac directors face if this new legislation is introduced will be repeated in boardrooms throughout Australia. There should be nothing wrong with a company raising capital to strengthen their balance sheet. There also should be nothing wrong with a company paying retained profits to shareholders as fully franked dividends.

A recipe for worse outcomes

Giving the Tax Office the discretion to question the motives of directors is likely to result in worse outcomes as decisions are made to meet legislative requirements instead of meeting the interests of the business and shareholders.

The Treasury document states that the purpose of these changes is to:
" … prevent entities from manipulating the imputation system to obtain access to franking credits".

It needs to be noted there is already strong anti-avoidance legislation in place to stop manipulation without intruding on the decision making of boardrooms.

It is clear that governments needs to be vigilant in relation to tax legislation as companies seek to exploit loopholes. However, it is my understanding that the 'problem' this legislation is trying to fix is not widespread. As a result, it is feared that business and shareholders will be worse off without any perceptible improvement to the tax system.

Matthew Collins is a director of [Keystone Advice Pty Ltd](#) and specialises in providing superannuation tax, estate tax and structural advice to high net wealth individuals and their families. This article is general information and does not consider the circumstances of any individual investor. It is based on a current understanding of related legislation which may change in future.

Recessions are usually good for sharemarkets

Ashley Owen

Nothing scares investors more than talk of a recession. However, history shows that economic contractions have been mostly good for share prices and the Australian share market has actually increased during the majority of economic recessions in Australia. The same is true for the US share market during US recessions.

Timing is key

How is this possible? The key is timing. What causes share prices to fall is the fear of impending recession, not the recession itself if, or when it finally arrives. Share markets have almost always rebounded out of the middle of recessions, while the economy is still contracting, while profits and dividends are still being cut, and while news headlines are full of gloom and doom, rising unemployment, corporate layoffs and bankruptcies.

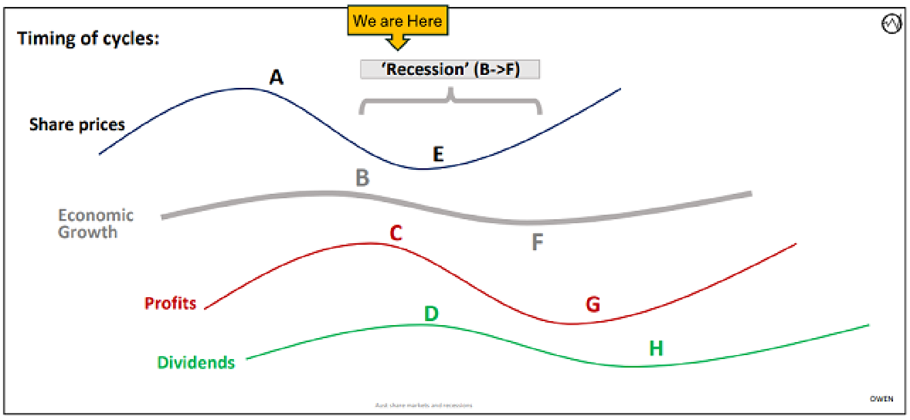
Recessions and depressions

First, some definitions. An economic 'recession' is generally, but not always, defined as two or more consecutive quarters of negative economic growth. The most recent exception to this definition was the 2020 Covid lockdown recession, when the US [National Bureau of Economic Research](#) (the body that calls US recessions) declared a 'recession' in the US lasting just two months (February-March 2020).

Before the 1940s, every economic slowdown was called a 'depression', but now the term is reserved for much deeper and longer economic contractions than mere recessions, accompanied by very high unemployment (say 20% or more), significant and sustained declines in aggregate incomes, commodities prices, trade and credit. In Australia, the main economic depressions were in 1930s, 1890s and 1840s, which were all global crises.

Timing between the start and the rebound

Share prices generally fall before economic contractions start and then start rebounding while economies are still contracting. This chart illustrates how the cycles work:



The timing of each part of the cycle almost always follows the following order:

A. Share prices start falling in anticipation of profits falling in an upcoming economic slowdown but while aggregate company profits and dividends are still rising.

B. Economic activity starts contracting (such as negative growth in real GDP). Because of delays in reporting national economic numbers, by the time negative growth is reported, the share market has already been falling for several months in most cases. Even the short, sharp 2020 Covid recession, when the March quarter economic contraction in Australia was announced in May, the share market had already started to rebound strongly from late March.

C. Aggregate company profits start falling due to slower revenues and often rising interest rates, usually well after share prices have started falling (A), and also usually after economic activity starts contracting (B). Often, some company profits are still surging well into economic contraction. Aggregate company profits fall by much more than the reduction in economic output because companies have operational and financial leverage, and narrow profit margins. For example, in a serious recession, GDP might fall by say 3%, but aggregate profits and share prices might fall by 30-40% or more.

D. Dividends start falling, but cutting dividends is usually the last resort of company boards in a crisis. Generally, companies try to maintain dividends in order to retain investor confidence and support the share price, even though profits have fallen. The fall in aggregate dividends is always less than the fall in aggregate profits.

E. Then share prices start rebounding, usually while economic activity is still contracting in the middle of a recession, while profits and dividends are being cut.

F. The economy starts growing again but well after the start of the rebound in share prices. In most cases, by the time the economy starts growing again, share prices have more than recovered their falls during the recession itself. As a result, the actual periods of recessions (when economic growth is contracting, from points B to F), share prices actually rose in the vast majority of cycles.

G. Aggregate company profits rebound, well after start of rebounds in share prices (E) and economic growth (F).

H. Dividends are finally raised, as balance sheets and profitability are restored – well after the start of the rebounds in share prices (E), economic growth (F), and profits (G).

The net result of this consistent pattern is that the share market has risen during the vast majority of economic recessions (point B to point F on the chart).

Where are we now on the chart?

The US (which drives all global markets) and Australian stockmarkets are probably around point B on the chart. Share prices have already fallen in anticipation of rate hikes cutting into consumer spending, leading to lower corporate profits and dividends, job losses and economic contractions. Whether or not there is a recession is not as important as the fear of significantly lower profits and dividends.

Although the US economy actually contracted in the first two quarters of 2022, the National Bureau of Economic Research is not yet calling it a recession as household spending and jobs remain strong. Also, corporate profits and dividends are still rising, albeit at slower rates than in 2021. Australia also has strong jobs, spending, profits and dividends. Even in Europe and the UK, economies are probably already contracting, but jobs, spending, profits and dividends remain strong, although China is contracting.

Large sections of the US share market in particular are still over-priced, although the Australian market is probably now around 'fair value'. When economic recessions do arrive, they will be marked by mass job losses and bankruptcies, as in numerous previous cycles. When sharemarkets rebound, it will be when doom and gloom is greatest, unemployment and corporate failures are rising, and companies are posting big cuts to profits and dividends. Rebounds have always been faster and stronger than investors expect, and they start when fear and uncertainty are greatest (when there is 'blood in the streets', says Warren Buffett).

21 recessions in 150 years

Australia has had 21 recessions since the 1880s, based on the conventional definition of at least two consecutive quarters of negative growth in real GDP.

The next chart shows changes in the share price index during each of the recessions since the 1880s in Australia. Almost all are in the upper sector of the chart – the broad sharemarket <u>rose</u> during the recessions.

In summary:

- The broad sharemarket index rose during 17 (81%) of the 21 recessions in Australia since the 1880s.
- Aside from the very short, sharp 2020 Covid sell-off, share prices rose during each of Australia's previous nine recessions, since the 1938-39 recession, when share prices fell by just 1.8%.
- In the recent well-known recessions, sharemarkets <u>rose</u> during each of them. These included: Keating's 1990-91 'recession we had to have', the long 1981-83 recession, the 1975 Whitlam inflation recession, and the 1971-72 mining collapse recession.

Aside from a couple of minor share price falls during the 1938-39 recession and the 1914-15 WWI recession, the only recession or depression in Australia that was accompanied by big share price falls during the period of the economic contraction was the 1929-31 depression when shares fell by 60% during the period of contraction.

In fact, some of the best years for shares are when the economy was contracting or still weak, including 1983, the best ever calendar year for Australian shares (up 60%), during the 1981-83 recession.

This is a reminder to ignore media scare mongering. In particular, by the time the recession hits, most of the share market fall is probably already in the past. The great share market surges start when the media headlines are full of doom and gloom, rising jobless rates, corporate bankruptcies, losses, and dividend cuts.

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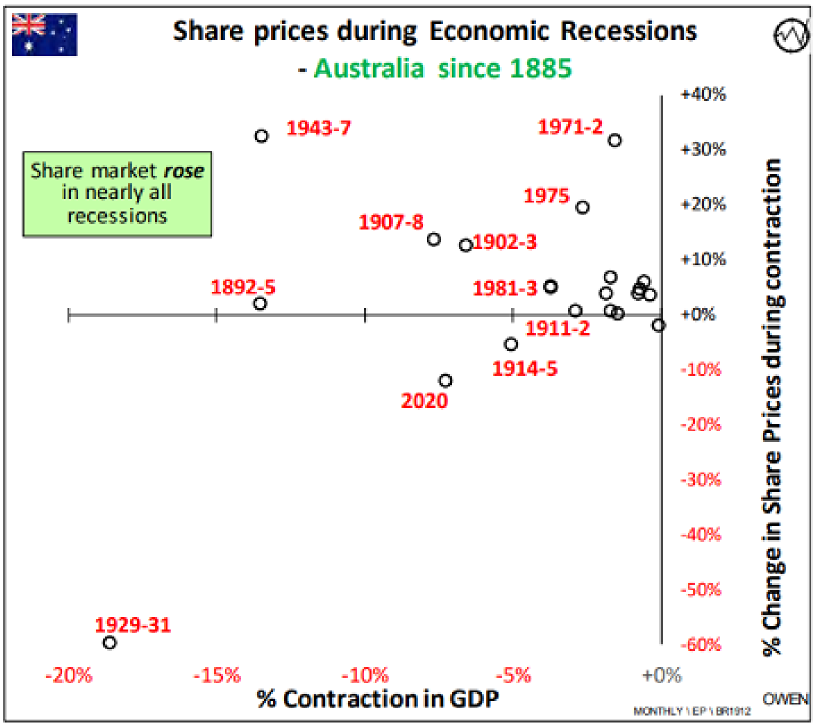
Recessions (contractions 2q or longer)

Australia since 1885

	Start		End		Qtrs / yrs		Real GDP fall	Share prices
1	Dec 1891		Dec 1895		4	yr	-13.5%	+2.2%
2	Jun-1900		Jun-1901		1	yr	-1.7%	+1.0%
3	Jun-1902		Jun-1903		1	yr	-6.5%	+12.9%
4	Jun-1904		Jun-1905		1	yr	-1.7%	+7.0%
5	Jun-1907		Jun-1908		1	yr	-7.6%	+13.9%
6	Jun-1911		Jun-1912		1	yr	-2.9%	+0.9%
7	Jun-1914		Jun-1915		1	yr	-5.0%	-5.1%
8	Jun-1916		Jun-1918		2	yr	-3.7%	+5.3%
9	Jun-1927		Jun-1928		1	yr	-0.5%	+6.2%
10	Jun-1929		Jun-1931		2	yr	-18.6%	-59.6%
11	Jun-1938		Jun-1939		1	yr	-0.0%	-1.8%
12	Jun-1943		Jun-1947		4	yr	-13.5%	+32.8%
13	Jun-1952		Jun-1953		1	yr	-0.7%	+4.7%
14	Jun-1961	qtr	Sep-1961	qtr	2	qtrs	-1.8%	+4.0%
15	Sep-1965	qtr	Mar-1966	qtr	3	qtrs	-0.3%	+3.8%
16	Dec-1971	qtr	Mar-1972	qtr	2	qtrs	-1.5%	+31.9%
17	Sep-1975	qtr	Dec-1975	qtr	2	qtrs	-2.6%	+19.7%
18	Sep-1977	qtr	Dec-1977	qtr	2	qtrs	-0.7%	+4.1%
19	Dec-1981	qtr	Jun-1983	qtr	7	qtrs	-3.7%	+5.2%
20	Sep-1990	qtr	Jun-1991	qtr	4	qtrs	-1.4%	+0.4%
21	Mar-2020	qtr	Jun-2020	qtr	2	qtrs	-7.2%	-11.8%
						count:	21	21
						median	-2.6%	+4.1%
						% Positive for shares:		81%



Lessons for our Year 12 economics students and investors

Angus Dennis

October and November are big months for Year 12 students across Australia. The next generation is completing its final school exams and the rite of passage into the outside world of work and further studies.

In an investment context, it is timely to consider the differing elements of the subject of economics being studied by our future leaders, and how it is changing.

The lessons from economics are expanding

Economics is about the allocation of scarce resources for production, distribution and consumption. For decades, the Year 12 curriculum has covered economic growth, unemployment, inflation, external trade and exchange rates, and then assessed available tools including fiscal, monetary, microeconomics and labour policy.

Progressively more evident in the school curriculum is that the natural environment is materially edging its way into the mix. Topics like sustainable development, externalities, market failures, public and private goods and environmental issues (including climate change and depletion of non-renewable resources) are now key areas studied.

And with good reason. Recent research by the Australian Conservation Foundation, supported by Australian Ethical, shows that roughly half Australia's GDP (49.3% or $892.8 billion*) has a moderate to very high direct dependence on nature, and indirectly every single dollar that flows through the economy depends on the health and survival of natural systems.

So, at the core of the lessons for students and for investors alike is how might we protect nature's fine balance and maintain its integrity to support a long-term healthy society and the linked economy and investment environment.

A new set of goals for nature is coming

This will be the subject of COP-15 to be held in December 2022. The [UN Biodiversity Conference] will convene governments from around the world to agree to a new set of goals for nature over the next decade with this objective in mind.

At Australian Ethical, we are aligned with the interest of the final year students in wanting to understand the economic paradigms around the environment – its strengths, weaknesses and challenges - and how we might position for long-term success.

1. Economics history and private goods

Economics has a multi-century history, with many high-profile contributors, including Adam Smith, Milton Friedman and John Maynard Keynes. It also has had a fair history of success, which in part is built on some bruising experiences of the past. Year 12 students can marvel on how effective application of monetary and fiscal policy might support more stable economic cycles, or how microeconomics can lead to improved productivity.

If we delve into this success, however, much of it has been around private goods, which are goods where the utility or benefit derives to its owner.

Private goods and linked markets by their very nature tend to be more efficient allocators of assets. Dating all the way back to Adam Smith in the 1700s and the 'invisible hand', free markets support effective production and pricing of products and services. While over the years a range of flaws have emerged (such as labour market exploitation and market concentration) that need regulations to address them, in general, competitive markets have supported strong global outcomes with innovation and international trade uplifting many communities around the world.

As investors, we too have tended to focus on the private markets and their success. There have been a breadth of companies available for investment selling private goods and services that have delivered strong investment returns over an extended period.

2. Challenges with public goods and especially the environment

The challenge for economics has been public goods. These are goods, like the environment, where one can't exclude a consumer from enjoying the benefit, even if they are not willing to pay.

The core of the problem is market failure, as the price mechanism only takes into account the private benefits and costs of production to consumers and producers and does not consider the wider cost (or externality) to the public good (in this case the environment).

To address this market failure, it has been up to the government to set up the system so that the environment is not overlooked in private transactions. And our year 12 students have seen plenty of evidence of success, such as:

- banning CFCs to protect the ozone layer
- making single use plastics and certain chemicals illegal
- using water rights to improve river water usage.

Unfortunately, the big global issues like climate change and biodiversity, where individual company and country action can seem minor relative to the issue, have been challenging. The preferred economic solution here is placing a tax or fee on production or consumption that approximates the environmental cost of this economic activity, and in effect internalising the externality.

But carbon taxes and levies have been politically problematic, with countries concerned around their relative positioning versus other countries not taking similar action. The rapid changes of political leadership (linked to proposed carbon taxes) and extended international negotiations, demonstrate the political complexity.

3. Identifying the need for a sustainable solution

With this economic division between private and public goods over the past several decades we have seen a dichotomy: strong businesses and market outcomes, but materially weaker environmental conditions.

While Australia prior to the pandemic had not had a recession for almost 30 years, Australia's recent State of the Environment report now rates our country as on a poor rating across a host of ecological metrics. And while over 1 billion people have lifted themselves out of extreme poverty in the last 25 years around the world~, over that same period our global temperature has increased by over half-a-degree to be 1.2 degrees higher than pre-industrial times^.

A sustainable approach towards economics is needed because we can't live with this dichotomy forever. Sustainable development requires a healthy environment to underpin long term multi-generational economic success. We need both strong economic and environmental outcomes.

4. Sustainable pathways for economics and investors

The core of the challenge has been addressing private transactions that are generating negative externalities, or what are sometimes called 'free riders'.

Fortunately, economics has many tools beyond taxes or levies which which can influence supply and demand and perhaps generate positive externalities.

We have seen governments put in place programmes to support supply and lower costs of products that are avoiding emissions in energy generation. Government initiatives including clean energy subsidies, financing incentives and renewable energy zones. Plus, there is also emission reduction funding and linked carbon credits.

Investors play a role as well. In Australia, where our superannuation assets are now larger than GDP, the role of investors can tilt the economic scales materially. And presently a shift to a more flexible renewable energy grid, is part of the superannuation sector conversation.

Back to our year 12 students and their teachers

We should be grateful for their broader focus and considering the environment more meaningfully in the syllabus. Our future leaders will think more creatively about our challenges and build solutions ranging from economic policy settings to new technology. But this is an urgent and complex challenge, and in the meantime, investors should also be aware of externalities and free riders and look for investments that drive long term strong sustainable outcomes with our scarce global resources in mind.

References

*Australian Conservation Foundation; *The nature-based economy: How Australia's prosperity depends on nature*; September 2022.

~World Bank: https://www.worldbank.org/en/news/press-release/2018/09/19/decline-of-global-extreme-poverty-continues-but-has-slowed-world-bank

^World Meteorological Organization (2021). WMO Statement on the State of the Global Climate in 2020. WMO-No. 1264. Geneva. ISBN 978-92-63-11264-4.

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For over 35 years, Australian Ethical has used its Ethical Charter to evaluate companies and the broader impact they play on the environment and society. We invest in portfolios that have a net benefit to this broader set of stakeholders, so we see an overweight in our listed equity portfolios to sectors like renewables and healthcare, and we avoid a range of companies with net negative contribution including fossil fuels, that can fit within the 'free rider' category. We also specifically target unlisted renewables via a range of strategies including catalytic private equity and infrastructure like equity and debt.

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Do Australians expect to have enough to self-fund retirement?

Helen Baker

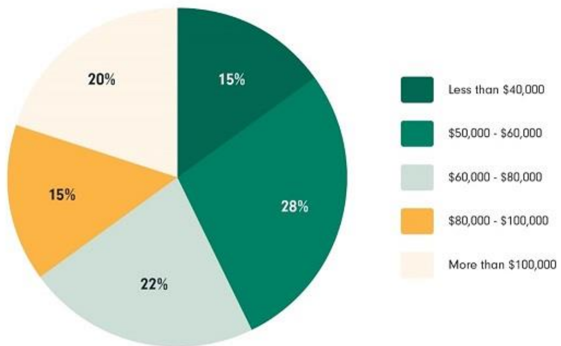
New research reveals the uncertain outlook Australians have for their future retirement: 60% admit they won't have the superannuation and cash to self-fund their retirement, nearly a third (31%) expect to carry debts into their retirement, and three quarters (73%) expect to receive the pension at some point.

The findings were derived from a survey of an independent panel of 1,018 Australians, commissioned by finance platform Money.com.au. The pool of survey respondents matches the age and geographical spread of the Australian population. More than half (573) were aged 35-60, and these respondents were asked the following questions.

1. What level of annual income do Australians want in their retirement?

Respondents were asked what income they want in their retirement:

- More than half (57%) of respondents want more than $60,000
- 35% want more than $80,000
- While a fifth (20%) want more than $100,000



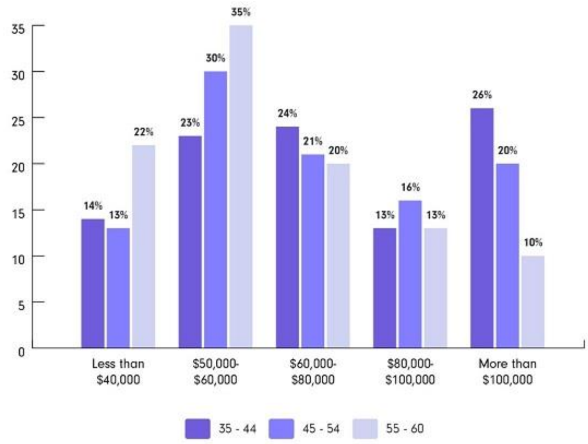
These income expectations are well above The Association of Superannuation Funds of Australia's (ASFA) Retirement Standard, which estimated for the June 2022 quarter that singles living a comfortable retirement will spend $47,383 per year, while retired couples will spend $66,725 per year.

While the Retirement Standard increased these figures by around 2% in the June quarter, the income levels that more than half of retirees expect to live on are still at least 27% higher. The Retirement Standard also assumes people don't carry debts into their retirement.

Respondents have lived through several months of fast-rising inflation and interest rates, which is forcing them to factor price and loan repayment increases into their retirement preparedness and income expectations.

People also have new desires – such as travel – after two years of COVID restrictions. A proportion of my own clients are purchasing campervans, cars and spending on travel.

Looking at the results across age groups, respondents that are further from reaching retirement age indicated they want a higher annual income than older respondents. Two-thirds (64%) of 35-44-year-olds and 57% of 45-54-year-olds want more than **$60,000** in their retirement compared with just 43% of 55-60-year-olds. More than a quarter (26%) of 35-44-year-olds want more than **$100,000** annually compared with 20% of 45-54-year-olds and 10% of 55-60-year-olds.

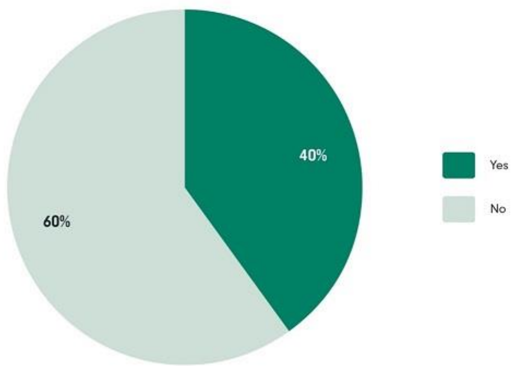


When analysing responses across the States, Queensland and NSW respondents want a larger income in their retirement. 40% of Queenslanders and NSW residents indicated they want more than **$80,000** in annual income compared with 27% of South Australians and 23% of West Australians. While 28% of Queenslanders and 26% of NSW residents also indicated they want more than **$100,000** compared with just 15% of South Australians, 14% of West Australians, and 13% of Victorians.

Response	NSW (%)	VIC (%)	QLD (%)	SA (%)	WA (%)	ACT (%)
Less than $40,000	11	15	16	12	23	13
$50,000 - $60,000	25	23	28	42	43	13
$60,000 - $80,000	24	28	16	19	11	40
$80,000 - $100,000	14	21	12	12	9	7
More than $100,000	26	13	28	15	14	27

2. Will Australians have enough super and cash flow to receive the income they want in their retirement?

There was a wide gap between people's income expectations and their preparedness for retirement, and 60% of respondents admitted they won't have adequate super, savings and cash flow from investments to receive their expected incomes.

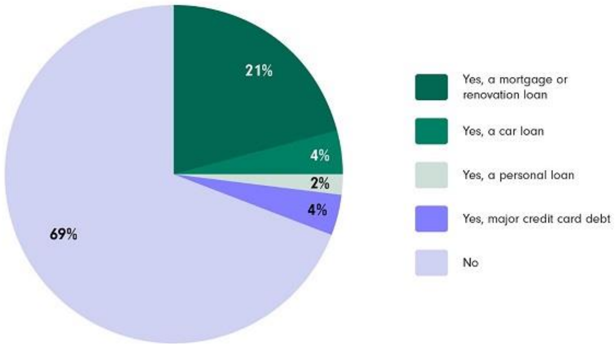


Similar proportions of respondents across the different age groups admit they will not have adequate assets and cash to meet their retirement income expectations:

Response	Age 35-44 (%)	Age 45-54 (%)	Age 55-60 (%)
Yes	37	40	42
No	63	60	58

3. Do Australians expect to have any debts when they retire?

A worrying 31% of respondents expect to carry debts into their retirement. Specifically, a fifth (21%) expect to retire without having paid off their mortgage or renovation loan, while a small proportion of respondents (an equal 4%) said they will still have major credit card debt or a car loan, while 2% expect to be paying off a personal loan.

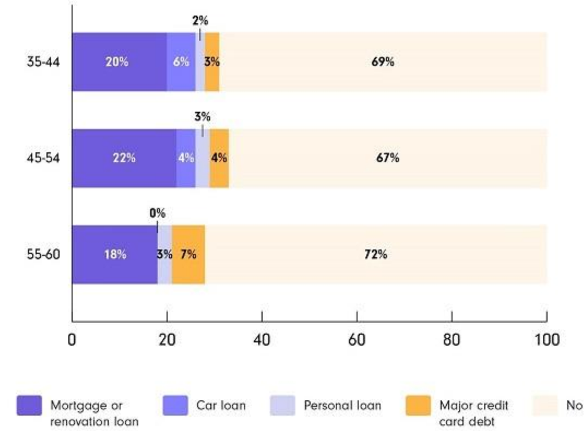


Across the States, more NSW and Victorian respondents expect to bring debt into their retirement:

- One third (36%) of NSW residents think they will have debt
- Followed by 34% of Victorians
- 29% of West Australians
- 26% of Queenslanders
- And 25% of South Australians

A quarter (24%) of NSW residents and 23% of Victorians expect to have a mortgage or renovation loan when they retire compared with 18% of Queenslanders, 17% of South Australians, and 14% of West Australians.

By age group, a higher proportion of younger respondents expect to have debt when they retire, suggesting they may have larger loans to pay off: 32% of 35–54-year-olds compared with 27% of 55–60-year-olds.

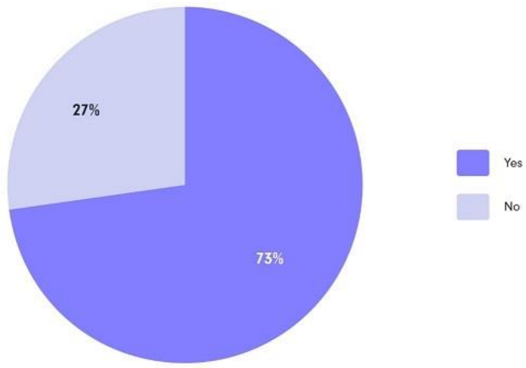


A higher proportion of younger respondents also expect to carry a mortgage or renovation loan into their retirement: 21% of 35–54-year-olds compared with 18% of 55–60-year-olds.

The unfortunate reality is that to meet their expected retirement incomes, a large segment of the population will need to work longer or make significant sacrifices. Those who are already retired are also facing challenges, as they are unable to build their super, while contending with constantly rising costs, from health insurance premiums to interest rates and energy prices.

4. What proportion of Australians will need to receive a pension during their retirement?

The survey found that three-quarters (73%) of respondents will need to receive a pension at some point to support their retirement. A larger proportion (78%) of over-55s believe they will need a pension, compared with 71% of under-55s.



The maximum pension singles can receive is $1026 per fortnight, while the maximum for couples is $1547 fortnightly. Those who retire with assets, savings or an income stream will receive a lower pension, or no pension at all.

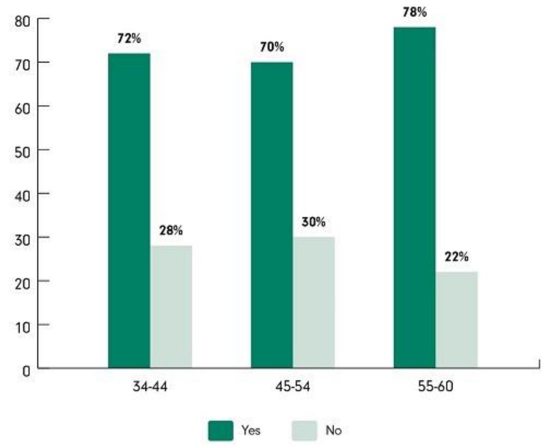
The pension also isn't keeping up with the inflation rate, nor is it a realistic amount for those who have debt, pay rent or have costly health expenses. There is also a risk that those who are factoring a pension into their retirement plan might not be entitled to it. For instance, couples will be evaluated together, not individually: if your partner has a high income or assets in their retirement, this could render the couple ineligible in the early stages of their retirement.

Without this guarantee, I urge individuals to implement a financial plan as soon as possible to manage debts, savings and super. Some individuals may plan to sell their property once they exhaust their funds, with the view to downsizing or renting and using the cash to live out the rest of their retirement.

There was also little difference in expectations among age groups:

- 78% of over-55s admitted they would need a pension to support them in their retirement
- Compared with 71% of under-55s

Interestingly, the high proportion of younger respondents predicting the need for such a support measure suggest the ability for the population to save for their future has been significantly impacted by rising costs of living.



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The full survey results, including age and State breakdowns, can be found here: money.com.au/research/savings-and-assets.

Taming the Wild West of crypto needs a global approach

Dr Paul Mazzola, Mitchell Goroch

The Australian regulatory regime covering the complex world cryptocurrency is about to take shape. Assistant Treasurer and Minister for Financial Services Stephen Jones, who describes it as a "very opaque market", recently confirmed this initiative as a major priority for the Federal Government. The current push is expected to bring Australia in line with the US and the UK, who are in the process of tightening regulations following a number of crypto disasters likened to traditional banking crises.

The Government is turning up the heat on Treasury to progress work on the regulatory framework to cover the cryptocurrency industry and this article argues for a more global regulatory framework.

Decentralised Finance (DeFi) - the new Shadow Banking Market

If it looks like a duck, quacks like a duck, and acts like a duck, then it is a duck. This applies to the new era of shadow banking.

The modern era of shadow banking involves crypto platforms which facilitate borrowings and deposits in cryptocurrency. This is known as Decentralised Finance (Defi). The deposits which are made in cryptocurrencies offer higher rates of interest than are available from traditional banks. The funds raised by the crypto deposits are then directly loaned to speculators in the cryptocurrency of choice who bet on the price of the crypto asset going up. This market came into prominence in 2017 and has since gained in popularity, particularly with users who mistrust the banking system and the excessive fees charged by banks.

Faith in the DeFi network is based on the use of smart contracts and software protected by complex algorithms. The algorithms ensure that money is not released until all terms and conditions of the contract are honoured. Is this protocol enough to protect investors?

Celsius – a case study of DeFi failure

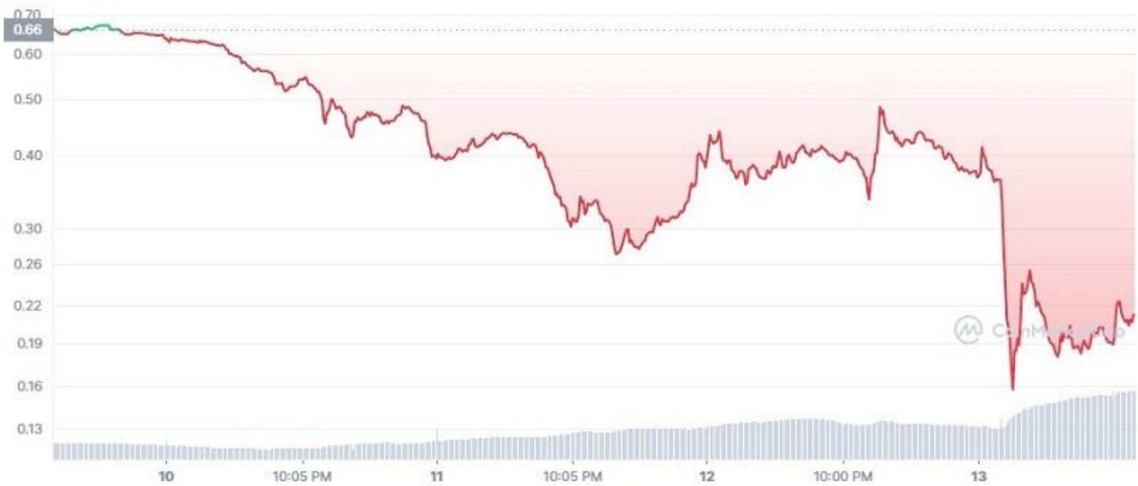
Celsius is a failed US-based DeFi company founded in 2018 by two fintech entrepreneurs, Alex Mashinsky, and Daniel Leon. It offered depositors lucrative interest rates of up to 17%. The company would advertise that:

"*the only things that are certain in life are death, taxes - and the weekly payment from Celsius*".

Here are the tweets where Alex Mashinky reassures investors prior to collapse.

Celsius filed for bankruptcy in July 2022. At its height, its volume of deposits peaked at $28 billion and the company boasted 1.7 million customers. The DeFi lender committed the major banking sin of mismatching the denominations of its crypto loans and collateral. So when the value of a borrower's collateral was hit hard relative to the face value of their loan by the recent crypto crash, their loans were called-in. The negative sentiment surrounding the company's financial situation sparked a 'bank' run and investors sold down their investments in Celsius as fast as depositors closed their accounts. The realisation by customers that Celsius was not a licenced bank and protected by the US system of deposit insurance, accelerated its demise.

Here are the prices of Celsius over a few days and also six months.



Celsius (CEL/USD) price from 10-13 June 2022 (Source: CoinMarketCap)

Celsius (CEL/USD) price for 6 months to 11 October 2022 (Source: CoinMarketCap)

The regulatory journey

Unfortunately, Celsius is not the only DeFi network that has failed. Others such as Babel Finance, Three Arrow Capital and Voyager Digital have suffered the same fate.

The call for regulation of the crypto market is deafening and has prompted government enquiries across a number of jurisdictions such as the current Senate hearings in the US. Nascent attempts at regulation, for example in the UK and US, have to date been found grossly inadequate as disasters such as the Celsius debacle persist.

However, some headway is being made, particularly in the US by the introduction of the Lummis-Gillibrand Responsible Financial Innovation Act (RFIA), a bill that would create the first comprehensive regulatory framework of digital assets in the United States. Additionally, the US publication of a recent report titled "Crypto Assets - Implications for Consumers, Investors and Businesses" identifies risks in the crypto markets and makes some further regulatory recommendations.

Australia is trailing the US in establishing a comprehensive crypto regulatory framework. Its first concrete efforts began in 2021. At this time, the Liberal Government undertook public consultation in respect to a licensing and custody regime for crypto asset secondary service providers. This initiative was a piecemeal approach which ignored an array of other market vulnerabilities.

The current Albanese Government is furthering this effort with a 'token mapping' exercise. Token mapping involves uncovering the characteristics of all digital asset tokens. This can only be seen as a first step in the regulatory process aimed at facilitating a more targeted approach. Public consultations will commence in November 2022.

Lessons from the banking industry

Similar to the banking industry, the crypto market is truly global. However due to its decentralised nature it allows participants to exploit regulatory differences between jurisdictions - that is, the practice of utilising more favourable laws in one jurisdiction to circumvent more restrictive regulation elsewhere.

The failure of DeFi businesses such as Celsius not only reveals flaws in the crypto ecosystem but the inability of regulation to protect the public. It's important to note that the systemic risks of the crypto world spread beyond jurisdictional boundaries. Citizens globally are at risk of harm.

Lessons could be learned from the global banking system in which a universal approach to regulation setting is adopted - specifically through the Basel Accord. A co-ordinated and collaborative approach between governments in addressing regulatory shortcomings should be a consideration.

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