How the $1.6m cap works for SMSFs

MEG HEFFRON

Many retired SMSF members with large superannuation balances adjusted their pension accounts to $1.6 million on June 30 last year.

This was done to reflect new rules at the time that placed a limit, called the transfer balance cap, on pension accounts.

Twelve months on, at least some of these pension accounts have grown above $1.6m. It's a natural consequence of taking as little as possible out of the pension account and investing in assets that produce a lot of income, growth or both.

Particularly for younger retirees, it is entirely possible that the combination of income and growth can be enough to completely replace (and more) the amounts that have been drawn out as pension payments.

So what happens now? Does another adjustment need to be done to reduce the pension accounts back down to $1.6m at June 30, 2018?

In short, no.

The transfer balance cap is not a cap on the amount in super or even the amount in a "retirement-phase" pension (generally speaking, a pension being paid to someone who has retired).

It is a limit on the amount that can be used to start retirement-phase pensions.

The reason it prompted a lot of people who already had pensions to take action at June 30 last year was that there was a special once-off check when the new rules came in.

In future, retirement-phase pensions will only be checked against the limit when they start. (There are also some special rules that ensure the test is carried out when someone inherits a super pension from a spouse.)

So in 2018-19 and onwards it will be entirely possible and in fact common to see pension accounts above $1.6m.

Will that create problems for those wishing to wind up their SMSF and move their super to another fund such as an industry fund?

Again, no. When a pensioner moves their super from one fund to another, the process technically involves ending one pension (in the SMSF) and starting a brand new one (in the new fund).

In fact the law is smart enough to recognise that this is a common transaction.

The way it works is that the Australian Taxation Office knows that the member had a $1.6m pension back on June 30, 2017 because it was reported to them by the SMSF.

The SMSF will also report "switching off" the old pension (let's say it's worth $1.7m at the time — the SMSF will report that figure to the ATO).

The new fund will report a new $1.7m retirement phase pension.

The ATO will do the sums : $1.6m (the 30 June 2017 pension) minus $1.7 million (reversing back out the amount "switched off" now) plus $1.7m (the new pension) and end up exactly where we started, $1.6m.

To get the figures right, the ATO really needs to hear about the end of the old pension before it processes the commencement of the new one.

Meg Heffron is head of SMSF education services at www.heffron.com.au

How to protect your super in the era of bank gouging

A single authority should regulate retirement savings

JAMES KIRBY
WEALTH EDITOR

How do you protect yourself from the rip-offs in super unveiled this week by the royal commission?

We see where the banks are charging people for doing nothing; we hear of outrageous fees on cash savings ... at worst the banks continue to clip the accounts of dead customers.

In dollar terms the biggest rip-off so far appears to be the so-called "fee for no service" scandal.

This week it engulfed NAB, but the Melbourne-based bank is not alone — AMP has already paid compensation in this area along with a range of less prominent institutions such as Yellow Brick Road.

Regulators have already estimated that the bill to the banks in compensation for wrong charges will top $850 million.

How appalled you are by these infringements is probably linked to whether you believe your own savings might be caught up in this web. In reality, every investor is at risk in the wider system where fees and charges appear to be running out of control.

It's a pity the superannuation segment has come so late in the royal commission hearings because it is the crucial passage of play — every working Australian is legally compelled to put their super somewhere. And it turns out you can go very wrong indeed if you make the wrong decisions.

This week the commission interrogated a handful of NAB executives at length. The counsel assisting the commission, Michael Hodge QC, spent two days interrogating just two senior NAB executives: Paul Carter and Nicole Smith.

What the commission excavated from just one bank is alarming. Within a culture where cat-and-mouse games with regulators and delaying tactics to retain high fees were evident, perhaps the definitive issue at NAB centred around what the bank called its "plan service fee", which was charged for access to investment advice.

After intense examination it turned out that customers might never actually get advice from this plan though they paid for it.

Worse still, customers could have the "service" turned off and avoid the cost if they wished, but then again customers simply were not to know of this facility.

The NAB plan service fee captures modern banks at their worst, a sophisticated, ambiguous arrangement the majority of bank customers never fully understood.

What can you do?

The first line of defence for any investor has to be your own readiness to read the documents you get from your super fund manager.

The downside of what they call "lack of engagement" with super is a lack of vigilance and it's against this backdrop of neglect that the shocking rip-offs now being revealed at the commission have emerged.

Taking it one step further, investors should be prepared to pick up the phone to get an explanation of anything that is not clearly appropriate — inertia is the enemy of the investor and friend of the fee chaser.

What next?

Once the fee-for-no-service issue is covered, another major area for the commission could be how fees are embedded across the system, especially in contentious areas such as cash.

On the first day of hearings at NAB we heard of a customer who earned $1013.95 on a cash investment and then found themselves facing charges of $892.90.

This is on a "cash" investment where the manager does very little compared with picking stocks for a managed fund.

There may be a lot more to come in this area — cash holdings are most popular with retired investors. Trouble is already brewing across the wider investment landscape on the issue of investment platforms and how fees are actually charged on the big platforms such as BT Panorama, Macquarie wrap, NetWealth and Hub 24.

In a recent report, stockbroker Bell Potter raised eyebrows when it assessed some recent platform fee reductions announced by BT Panorama with a report headed: "Panorama's new fees don't compare favourably".

What became clear in the Bell Potter report is that fees are endless in the financial advice system and it is exceptionally difficult to compare terms and conditions.

Investment platform fees are a major issue because they are what advisers use to access investments — in the end, everyone paying a financial adviser pays the platform fees. David Wright, managing partner at Zenith Investment Partners, says: "We watch this area closely, for example where there is performance fees charged for the management of cash we believe that is not consistent with what investors would reasonably expect."

Just how the platforms create their charges and how they charge for cash management is a key question for regulators.

Similarly, how money flows between super funds and fund managers who actually invest the money is also a relevant issue — the subject emerged yesterday as IOOF managing director Chris Kelaher took the stand.

Whatever the commission uncovers in the days ahead, two things are already clear: investors need to act for themselves and the government needs to act for investors. A startling gap revealed by the inquiry is the lack of clear regulatory oversight of super — it may seem there is endless regulation in the space: certainly there is no lack of regulators.

There are three agencies with power in super — the Australian Securities & Investments Commission, the Australian Prudential Regulatory Authority and the Australian Taxation Office (which runs SMSF super). But there is no single authority with total and unimpaired power over super — it's time there was.

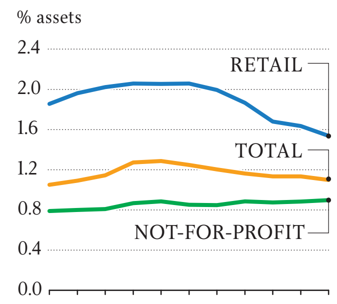
Earlier this week the Greens suggested the ACCC move in and take over the consumer protection in super.

The idea is gaining support, notably from Professor Allan Fels, a doyen of the regulation sector.

The situation could be improved, because one thing is for sure — the system is not working.

Super fund fees

% assets



Source: Productivity Commission

Five steps to claiming compensation

Are you entitled to any of the estimated $850 million in compensation the major banks face for wrongly charging superannuation accounts and for financial advice? Xavier O'Halloran, the policy adviser at consumer advocate CHOICE, has put together a five-step guide for concerned investors.

What are my rights?

The Financial Ombudsman Service has a useful guide on its website of the types of disputes it can handle. It's not an easy system to navigate, so the National Debt Helpline (1800 007 007) can give advice and referral to a free lawyer from Legal Aid or a community legal centre. ASIC also provides a list of organisations providing free legal advice. If you can afford the legal fees, think about hiring a lawyer.

Get evidence in order

Depending on the advice, you'll need to get your evidence in order. Consumers have a right to request documents from a financial service provider (FSP) under the National Credit Act, Privacy Act, and Code of Banking Practice.

Lodge your complaint

Lodge a dispute with the bank or FSP and include relevant supporting documents. The FSP has 45 days to respond to the dispute before you can escalate to an external ombudsman.

The big four and some other banks have "customer advocates" to escalate complaints internally. The option is there, but the banks should be dealing with problems the first time around, so you can bypass them and go external.

Resolution scheme

If your FSP hasn't responded or you're not satisfied with the outcome, lodge a dispute with an external dispute resolution (EDR) scheme. You may use the Financial Ombudsman Service, the Credit and Investments Ombudsman or Superannuation Complaints Tribunal. You can contact one of these bodies and be redirected to the right one.

Escalate the complaint

EDR is free, but you'll have to spend some time going through the process. EDR decisions are binding on the FSP but not the customer (you don't have to agree to the outcome, but the bank does).

To fix the confusing array of EDR services available, the Australian Financial Complaints Authority will come into effect in November as a one-stop shop for escalated complaints.

O'Halloran says: "We think the whole process could be easier and we are calling for bigger penalties where our regulators are misled.

"Unfortunately, some financial service providers go broke before people who are harmed can be compensated.

"That's why CHOICE has been calling for a compensation scheme of last resort as part of the royal commission's recommendations."

Great unwinding begins as 'greater fool' departs

ROGER MONTGOMERY

After a combination of apartment oversupply and the Financial System Inquiry resulted in APRA capping growth of investor loans and limiting the proportion of interest-only new mortgages, I have been warning property investors of an imminent decline.

Back in March last year, I noted in this column former treasury secretary John Fraser's 2015 description of Sydney and Melbourne property as "unequivocally" in a bubble.

We then had the International Monetary Fund urging Australia's regulators to double down on their efforts to ensure the nation's banks were resilient enough to "withstand a significant housing market correction". There were also concerns that negative gearing was pushing property prices to extremes.

Property prices are now falling at their fastest rate in half a decade.

For the financial hardship being imposed on many young home borrowers, a recent article tried to blame the banks.

In that article, a former banker and founder of an online mortgage site observed that financially stressed millennials "are being forced to cut back on dining out" because they had taken out mortgages without comparing products and rates, and without obtaining advice.

Generations before, the young were forced to cut back on a lot more than "dining out" to buy a house, raise the kids (which millennials aren't doing) and "get ahead".

Markets are indifferent to the age of those who pay a high price to lock in a low return.

Nobody should think they are immune to the vicissitudes of markets.

For anyone who has bought a residential "investment" property in the past few years, returns will be low simply because a high price was paid and net income is negative.

It's a simple rule of investing — the higher the price you pay, the lower your return.

A more nuanced rule for Australian property investors is — if the income yield is negative, your return can only come from a capital gain so you must be speculating on a "greater fool" coming along to give you that capital gain. That is gambling, not investing.

Most recent investors in apartments have failed to generate a positive return. In one recently reported anecdote — which is not atypical and will become much more common — a one-bedroom apartment in the Melbourne suburb of Richmond has failed to appreciate after being purchased off the plan eight years ago.

With Australia's household debt-to-income ratio at record highs, most investors have borrowed to fund their purchases. They are now discovering that interest rates can go up.

Many are also being moved on to significantly more expensive principal-and-interest loans as their original interest-only loans are refinanced upon maturity: about $480 billion of interest-only mortgages are due to migrate to P&I in the next five years.

So, the unwinding of the prior debt-fuelled property boom is only just beginning.

Many more stories of financial stress will emerge not only because less credit is being extended to would-be buyers who might rescue vendors in difficulty, but also because would-be buyers are less abundant through lack of desire to buy in a falling market. Capital losses on vanilla, established-residential property investment is only one source of loss for investors.

Some off-the-plan purchasers will also experience the failure of a developer unable to complete a development because other off-the-plan buyers have been unable to complete their purchase due to an insufficient deposit, rising mortgage rates or other unfavourable term changes. The developer is forced to discount properties to move them on — if they can sell them at all — simultaneously reducing area sales valuations and perpetuating the downward cycle.

ASIC data showing construction-related companies entering administration still remains low in absolute terms and lower than at the same time last year but the pattern of property price declines, reduced credit from banks and failed purchase completions, as well as rising input costs for developers, such as interest rates and contractor costs, indicates this number will rise.

Housing prices are falling quickly

Investors need to be confident that the developer of their off-the-plan purchase will remain in business after taking their deposit.

Meanwhile, banks are countering the expected increase in developer failures by reducing interest rates for new borrowers. While the strategy is essentially designed to maintain market share and grow credit in a falling market, the strategy also works to assist developers to find new customers.

This behaviour — luring new customers with attractive rates at the expense of existing customers — is precisely the kind of behaviour the royal commission is seeking to dissuade.

It is hoped by many that the regulators and banks can work in concert to ensure an orderly, and preferably shallow decline, that borrowing to invest has risks and that future speculative manias can be contained.

Hope springs eternal but the hope of quick profit and the fear of missing out will always trump rational behaviour ... and millennials are not immune.

Roger Montgomery is founder and chief investment officer of the Montgomery Fund.

www.montinvest.com

Tarnished banking's future looks to be one of open warfare and, gulp, Amazon

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off this mortal coil and ceased to be in need of NAB's services. CBA had been doing the same thing, as well as helping mobsters with their money-laundering problems. NAB had misled ASIC as well. So had AMP.

And we learnt this week from CBA's annual report that its executives had lost some $100 million in bonuses. A hundred million bucks? You mean they would have got that much if they hadn't been bad?

So next year, the banks will have to start handing over customers' data and making it available to competitors, on request, including through application program interfaces (APIs) that will make it super easy for those customers to be spirited away. APIs will allow competitors to offer specific, narrow banking services and cherry-pick the most profitable bits of the banks.

Who will take advantage of the "open banking" regime and compete with them?

For an answer, I spoke to David Duffy, CEO of CYBG, the British bank that is dual listed on the ASX and the London Stock Exchange, having been hived out of NAB two years ago (the C stands for Clydesdale and the Y for Yorkshire, the two prongs of NAB's ill-fated attempt to bestow its vast banking expertise on the rest of the world).

Britain has had open banking for a few months, and Duffy's sixth-ranked bank is now using it to vigorously attack the five above him. As part of that, CYBG is in the process of buying Virgin Money to be used as the brand for its digital bank.

But he said that most of all, the British banks, including his own, are preparing for a siege against new competitors, from outside their ranks.

Who from? Amazon, that's who.

Duffy told me: "What I'm focused on is the Amazons of the world who are talking to banks and talking to regulators about becoming part of the banking system in some way.

"They've yet to make that a very specific move, but the dialogue between an Amazon or an equivalent large tech firm is very significant and I think what you're looking at is a big tech entrance to the marketplace over time and that could have dramatic consequences in terms of the infrastructure activity of banks versus the cost to provide the same by those tech firms."

Duffy believes open banking in Britain and Europe is producing an inflection point for the industry.

"I think what you should be looking at in terms of an inflection point is the combination of an open banking environment and the threat of large tech companies, disintermediating banking services, either in the payments industry aspect of the banks or in other parts of the service model or in parts of the scaled infrastructure. Those forces coming together over the next five years is where I think you're seeing a fundamental shift in how banking is provided to the customer versus the past."

> 'What you're looking at is a big tech entrance to the marketplace'
>
> DAVID DUFFY
> CYBG CEO

In Australia, of course, there is another force of nature, in the person of royal commissioner Ken Hayne, and the orgy of customer neglect, and worse, that he has brought forth.

The combination of open banking in Australia and the royal commission is one of those freakish coincidences that defines history.

The process of bringing Europe-style open banking to this country was kicked off by Scott Morrison on July 20 last year when he commissioned an Open Banking Review from a panel chaired by Scott Farrell, a partner of law firm King & Wood Mallesons.

Ironically, it was part of the Treasurer's defence against the ALP's calls for banking royal commission: the Turnbull government, he said, was reforming the system and doing the things that would come of a royal commission anyway. But that was before CBA was done for thousands of breaches of money laundering laws, which was the final straw.

Morrison and -Malcolm Turnbull threw in the towel on November 20 and announced a royal commission.

Scott Farrell, meanwhile, produced his report in December.

There followed a period of consultation and no one with whom he consulted thought it was a bad idea, although the response of the banks and the Australian Banking Association could best be characterised as: "Yes, but".

In fact, the ABA submission might have been written by Antony Jay and Jonathan Lynn, the writers of *Yes Minister* of blessed memory (Jay died in 2016; Lynn is 75 and lives in Bath).

Morrison produced his response to the Farrell Review on May 9 this year and it didn't get a lot of attention, coming, as it did, during one of the royal commission's public hearing hunting seasons.

The April hearings into financial advice had been spectacular, and everybody was still reeling.

Cornered, Morrison revealed a 12-month phase-in period, saying: "Open Banking will also allow entrepreneurs to develop new services and products tailored to customers' needs, disrupting those existing business models within the banking sector that do not put customers first."

That would be all of them, I believe.

Alan Kohler is publisher of The Constant Investor.