Cuffelinks
Connecting investors with ideas

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Is there an Uber or Amazon of wealth management?

Graham Hand

"Even well-meaning gatekeepers slow innovation. When a platform is self-service, even the improbable ideas can get tried, because there's no expert gatekeeper ready to say 'that will never work!' And guess what – many of those improbable ideas do work, and society is the beneficiary of that diversity. I see the elimination of gatekeepers everywhere."

Jeff Bezos, quoted in *The Everything Store: Jeff Bezos and the Age of Amazon*, page 315.

"Spend the vast majority of your time thinking about product and platform. Many large, successful companies started with the following:

1. *They solved a problem in a novel way.*
2. *They used that solution to grow and spread quickly.*
3. *That success was based largely on their product.*

In the Internet Century, all companies have the opportunity to apply technology to solve big problems in new ways … if you focus on your competition, you will never deliver anything truly innovative."

Eric Schmidt, CEO of Google from 2001 to 2011, quoted in *How Google Works*, pages 91-93.

Over the holidays, I read *'The Everything Store'*, *'How Google Works'*, and Walter Isaacson's biography of Steve Jobs and Apple. The creation of these three extraordinary companies in a short time from the vision of a few individuals left a nagging question in my mind at almost every page: can any company do to the Australian wealth management industry what Amazon did to Borders, what Apple did to Nokia, what Google did to all other search businesses? They are all remarkable stories of redefining how business is done, breaking the traditional rules and in the process, destroying much of their competition.

Markets where anything seems possible

It's the same with Uber, the ride-sharing service with operations in 53 countries and a market value of about US$40 billion. There are 5,500 taxi licences in Sydney worth about $400,000 each or $2.2 billion. In Melbourne, metro licences have fallen in value from $515,000 a few years ago to $290,000 on a combination of new licences and Uber drivers given access to the market. Uber has fought legal battles all over the world, as it is in NSW, but there's no denying the public demand.

It's a good example of a change in the way the global economy operates. It's a platform business that matches customers with drivers, turning employees into 'entrepreneurs', in a similar way to the thousands of businesses run from home using ebay as a distribution platform. And there are 'ubers' for all types of services such as cleaning and massage, and of course human resources with sites like Freelancer and Elance.

Amazon is portrayed in the book as a brutal competitor. When diapers.com (owned by a company called Quidsi) was gaining market share among mothers but refusing a takeover offer, Amazon reduced the price of diapers by 30%, and then launched a new service called Amazon Mom, with additional discounts. Quidsi executives estimated that Amazon lost $100 million in three months on diapers. Then Wal-Mart made a bid for Quidsi, and Amazon threatened to drive prices to zero if Wal-Mart won the bidding. The diapers.com founders sold to Amazon out of fear.

"The money-losing Amazon Mom program was obviously introduced to dead-end Diapers.com and force a sale, and if anyone had any doubts about that, those doubts were quickly dispelled with by Amazon's subsequent actions. A month after it announced the acquisition of Quidsi, Amazon closed the program to new members." The Everything Store, page 299.

Of course, the Federal Trade Commission investigated the deal but gave its approval. If Amazon and Uber can take such actions in the face of legal hostility, anything seems possible in the age of the internet.

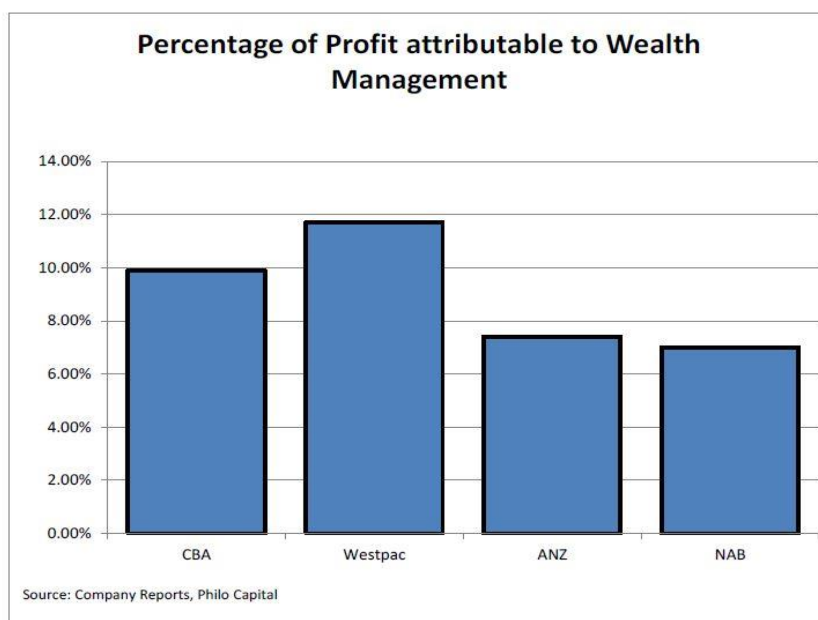
Australia has its home-grown examples of severe market disruption, the most public being the turmoil created for newspapers from the success of realestate.com.au, seek.com.au and carsales.com.au, almost bringing the once mighty Fairfax to its knees.

Unlike Facebook and Twitter which have invented new 'social media' activities, companies like Uber and Amazon are killing off competitors. When Jeff Bezos convinced publishers to allow him to put their books on the Kindle, they thought he would charge a margin over the usual wholesale price of books of around $16. But by retailing books online for $9.99, Amazon reinvented the price point. It did not take long for booksellers like Borders and Angus & Robertson to go out of business. Despite the fact that Amazon made a loss in 2014, the market has spoken: its market cap is about USD170 billion.

The defining characteristic of these great American companies moving into retailing, mobile communications, social media, search, taxis, employing contractors and booking B&Bs is that they break the mould for the way business is done. New methods are often not appreciated by the incumbents until it is too late, and it is fanciful to predict what future disruptions will occur. When Mark Zuckerberg developed Facebook, he did not have a notion that it would become the way a billion people shared their most intimate secrets, and he certainly he had no idea how to make money from it.

What is major disruption in Australian wealth management?

By disruption, I don't mean somebody developing an online 'robo-advice' model (such as GuidedChoice, eMoney, Betterment and Wealthfront in the US or Stockspot and BigFuture in Australia) and collecting $1 billion in funds in a few years, although that would be considered a great success and will happen. With $2 trillion in superannuation, real disruption is at least $100 billion within a few years, which is only 5% of the market. Such numbers would worry the four major Australian banks, which are not only almost 30% of the market capitalisation of the ASX200, but wealth management is significant to them all. They also control the majority of financial advisers in Australia.



Where can disruption happen in the value chain?

Wealth management is usually broken into at least three parts:

* financial advice
* administration platforms
* asset management

Let's consider what happens if an investor uses a platform such as Colonial First State's FirstChoice Wholesale, the most popular among financial advisers. It requires a minimum of only $5,000 so it is a retail product. On a typical and popular fund such as the Schroder Australian Equity Fund, CFS charges a fee of 1.02%, and splits it with Schroder. Call it 0.50% for CFS administration and 0.50% for Schroder asset management. CFS also has an Australian share index option for only 0.40%, where the asset management costs only a couple of basis points (0.02%). So we can generalise that major platform administration costs about 0.4%-0.5% with asset management on top of that. Financial advice costs are additional: it may be fee for service, say $350 an hour, or a percentage of funds, say 0.5%.

In simple terms, there's the Australian wealth management value chain. If a market disruptor comes in, they can easily remove the asset management cost by using index funds; they can automate advice based on an internet-based, self-service model; and investments can sit on a simple and inexpensive administration platform. Would it be the equivalent of Amazon charging $9.99 for a book that previously retailed for $30, and destroying other booksellers?

I'm not looking here for the disruption of SMSFs holding $600 billion or one-third of all super. They are serviced by thousands of advisers, accountants and administrators as well as being users of the products of major banks, fund managers and the ASX. My focus here is on a single company coming in with a game-changing, disruptive product offering.

What would the disruptor have to do or look like?

1. It will not attack one part of the value chain, it will be end-to-end with a complete investment solution. For example, it will not be sufficient to only offer 'great asset management', as plenty of companies claim that. A disruptor could hardly 'out-Vanguard' Vanguard (or State Street or BetaShares) and provide cheaper and better asset management through ETFs. Broad-based domestic or global equity portfolios can already have negligible costs, less than 0.1%. These ETF providers are successful, well-capitalised companies with overseas parents or partners who already have the capacity to take large shares of the Australian market. Although their growth has been impressive, they only have $15 billion, less than 10% of the money managed by Colonial First State.

2. It will be price-led. I cannot see how anyone can convince enough people that a superior product is worth paying up for because that will depend on a promise (guarantee) of outperformance over time. Amazon can set up systems to deliver a book next day and Telstra can have the best phone coverage in Australia but nobody can promise to outperform the market consistently, whatever their resources. This 'game-changer' will be index-based or with some type of 'beta' engine, not a bunch of superb stock pickers making company visits all day. They are too expensive.

Similarly, the portfolio will not include alternatives or unlisted investments, as they have higher fees and are more expensive to manage, even if done internally. The portfolio is likely to be dominated by cash and term deposits where the 'fees' can be hidden in the product margin.

(Of course, Apple's success is far from price-led, its phones are the most expensive on the market. They have achieved this through beauty of design and creating massive desirability and arguably the best product. But in my wildest dreams I cannot see people queuing up around the corner to invest in a managed fund based on its beauty and desirability).

3. It will need to be well-capitalised and carry a great deal of market trust. This is not like buying a book with a secure credit card charging system. People will be handing over their future, their life savings, and the company must be beyond reproach. Whatever they do, they will need to buy time and spend a lot of money on marketing and disrupting and delivering results, plus ongoing R&D specifically for the Australian market.

4. It will be technology-based and self-service. Investors will input their own characteristics into an engine and it will recommend a portfolio of investments, selected according to the risk appetite and demographics of the client. This 'robo-advice' is already being embraced by major players in the US, such as Charles Schwab and Fidelity's acquisition of eMoney).

5. It must break established distribution networks. An estimated 70% of financial advisers are already 'tied' to the four major banks, AMP and IOOF. At the moment, eight out of every ten people default to the super fund selected by their employer and $10 billion a year automatically flows into default super funds. Whereas everyone selects their own phone, most people do not engage with their superannuation.

A new winner would need to capture the hearts and minds of investors in the way no financial product has done before. The only alternative to making the product 'sexy' is 'fear', but how would that gain traction? As David Blanchett, Morningstar Head of Retirement Research, said:

"We all know most people aren't on track for retirement. I think surveys that talk about poor savings in the US, or the fact that people haven't saved enough for retirement, are relatively worthless. Kind of like saying, 'The sky is blue'". (Yahoo! Finance, 8 February 2015)

Severe disruption is unlikely

The growth of superannuation assets in Australia is assured by the SG regime, making it a highly desirable industry to be in. It must attract new competitors. There's no denying wealth management will change significantly over the next ten years, just as every industry driven by technology has. There will be surprises, developments nobody has thought of, perhaps from a couple of young computer geeks in the proverbial garage. Some will do well and drag in a few billion. But that's not disruption like the executives of Kodak, Blockbuster, Nokia and Borders experienced.

Based on the short and glorious histories of Amazon, Google and Apple and their impact on established businesses, how can anyone conclude that wealth management will not face a similar massive overhaul from a new competitor? Yet that's my conclusion: I don't see how any company can make wealth management sufficiently exciting for enough people to grow a market share of 5 to 10% in the next few years. To use Google's test, what problem will the disrupter solve in such a novel way that hundreds of billions will divert from incumbents? I hope I'm wrong because it would be fun to watch.

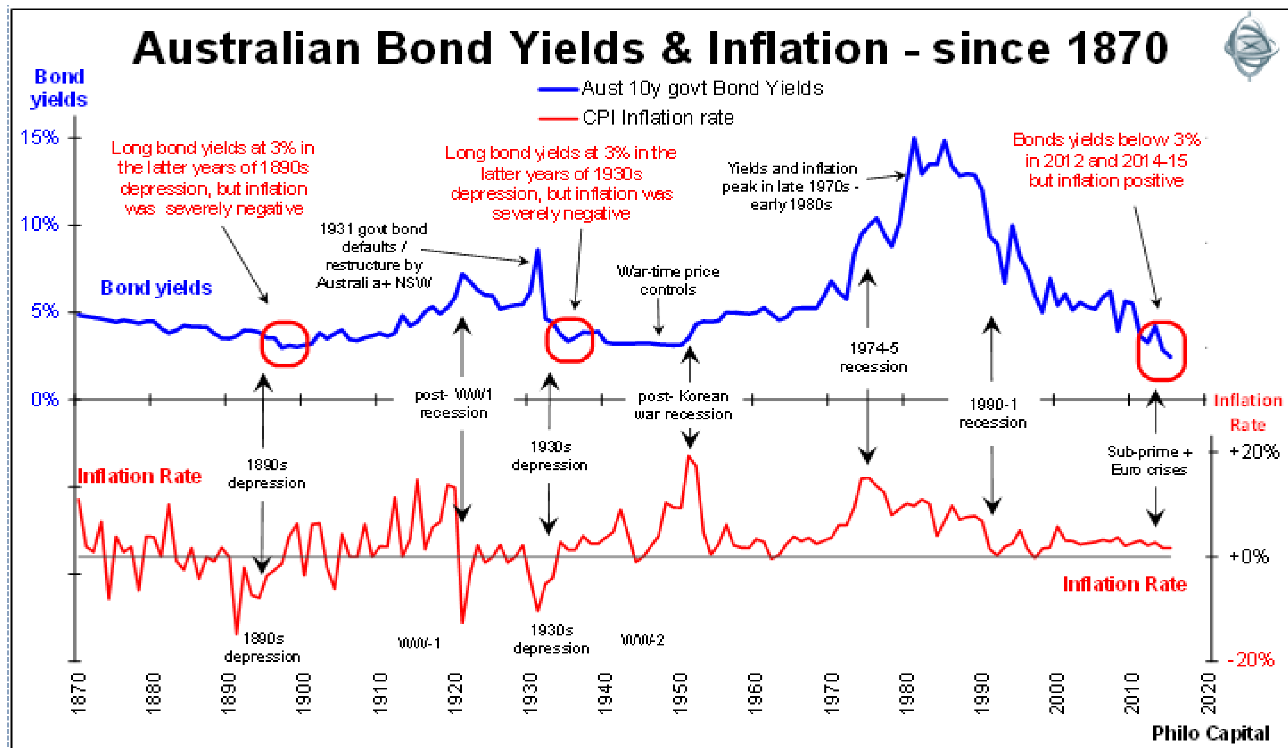
In part 2, we take a closer look at which parts of value chain are most vulnerable and who are the likely winners over a longer 'slow burn' time frame, say the next decade.

Graham Hand has worked in banking and wealth management for 35 years and is Editor of Cuffelinks.

Australian bond yields and inflation

Ashley Owen

Australian government bonds are trading at extraordinary high prices and low yields. The only times yields were anywhere near this low were in the 1930s depression and in the 1890s depression, but in both of those depressions inflation rates were severely negative (deflation). Today, inflation is positive.



Unless you believe Australia is heading for another depression in the next 10 years, bonds appear over-priced at current levels. Yields may fall even further due to the weight of foreign money, but real returns for bond holders are likely to be very poor over the medium to long term from current levels.

Although the cash rate in Australia is at record lows, yields all across the curve up to 10 years are even lower, down to as low as 2% for 1 to 5 year terms. Even 20 year bonds are yielding less than 3%. Australian inflation-linked bonds are now trading at such high prices and such low yields that they imply inflation will average just 2% per year for the next 10 years. Again, these are depression-type levels. The most obvious conclusion is that the 'safest of all assets' in Australia – inflation-linked government bonds with very little risk of default – are in a speculative bubble like other 'risky' assets.

Thanks to the declining yields, recent returns from bonds have been good. However, even with yields at such low levels, they are still attractive to global investors. Foreign investors look at yields in countries like Canada, a similar market to Australia, and see yields on Australian bonds are more than 1% higher than on Canadian bonds. The only government bonds trading at higher spreads are in Greece, as it lurches toward another likely default. Unlike any era in the past, foreign investors now own the bulk of Australian bonds on issue and the flood of foreign yield-chasing funds is likely to continue to keep yields low for some time yet.

This cycle is usually halted only by a sudden currency collapse which turns the inward flood of speculative money into a rapid race for the exits. Sometimes these turnarounds are triggered by external crises, like the Russian default in 1998, and at other times triggered by domestic crises, like the current account crisis in 1986. This time the trigger for a sudden turnaround may be a Russian default once again, or it could be the worsening federal budget crisis (along with the Liberal party chaos and the volatile Senate), which is starting to seriously alarm many foreign investors.

In the current environment the catalyst for a sell-off in the AUD and bonds is most likely to come from an external source, with many economies and geopolitical situations balancing on a knife-edge. Many investment markets are hovering at over-priced levels, supported only by central bank money-printing.

Ashley Owen is Joint CEO of Philo Capital Advisers and a director and adviser to the Third Link Growth Fund. This article is for general educational purposes and is not personal financial advice.

Why empty nesters won't downsize

Adele Horin

Downsizing seems the rational and ethical thing to do if you're an empty nester rattling around in a big house. But Australians have an aversion to downsizing. When it comes to our homes, most of us aren't governed by reason and sense. We're governed by emotion.

A new report from the think tank Per Capita makes it clear older people are generally loath to 'free up' houses for the younger generation. They're staying put in homes that in some cases may be unsafe for them. Removing the financial barriers to downsizing doesn't seem to hold the answer.

And that's because most people stay put for psychological reasons. They don't respond to Treasury's cold language of 'under-occupation' and 'efficiency'. They love their homes and garden; they've invested time and energy in them. The home is a repository of memories and precious possessions. For some, it's the last bulwark of independence. At this very moment some elderly Australian is protesting, "I'll leave here in a box."

"Public policy needs to grasp these complexities," says the report author, Emily Millane, "rather than focusing solely on … whether older people are seen to be … making an 'efficient use of housing stock.'"

Because so many older people want to stay put, it may be time for the government to bite the bullet, and provide more help to make their homes safer. Ms Millane wants the government to set up a scheme to help older Australians retrofit their houses. It's one of many interesting recommendations in her report, The Head, The Heart & The House. 'Ageing in place' is what governments want us to do because it's cheaper than subsidising a move to a nursing home; and it's what most older Australians prefer. But stairs, unmanageable gardens, narrow doorways, and tricky bathrooms can imperil people's safety. Alternatively, some older people are stuck in denial, pretending they can manage these impediments when it's clear to their children they're one day away from a fall.

A government scheme to reimburse older Australians for home modifications would have to be carefully implemented. Given a lot of older Australians have valuable homes destined for their children's inheritance, such a scheme could easily become a home improvement rort.

"It wouldn't be a case of here's $50,000 because you're over 70," Ms Millane said. "There would need to be regulations about what constitutes appropriate grants and for what purpose; and Government could not be directing funds to people who were able to fund their own renovations."

Small modifications could make a big difference: ramps, handrails, chairlifts; and repairs to make a house safer, drier, and healthier. Bigger changes, like creating a space for a live-in carer, might also be possible. But grants would not necessarily be confined to physical improvements. Technology has advanced in ways that make it safer for older people to live independently. Sensors that monitor people's movements in the home might suit some; or technologies that remind people to take their medication might qualify for a grant.

As well as making homes physically safer, there's the human element. A burgeoning older population living at home will require a big home care workforce to help them. How to pay for quality care, and ensure it's no longer rationed? Ms Millane says the government should facilitate a home equity release

scheme. Asset-rich Australians should be obliged to borrow against their home to pay for home care. They would get a loan payable back to the government once their house was sold. What do you think?

A lot of my friends have been talking about downsizing but hardly anyone's taken the plunge. Instead these empty nesters have consciously decided to stay put. What they've done is smarten up or renovate houses they've lived in for 20 years to make them fit for another 20. In their 80s perhaps they'll revisit the downsizing question, or perhaps not.

Despite the perception that downsizing is commonplace – what with sea-changers, tree-changers, and the inner city apartment boom – the percentage actually making the move is surprisingly small, as I've written before; only 9% of Australians aged 50 and over moved into a smaller place over the five-year period from 2006 to 2011.

Will baby boomers adopt a different attitude to downsizing as they get older? The idea of being asset-rich and cash-poor like many in their parents' generation may not appeal. I know 60-somethings who plan to sell the home 'when they're old', find an apartment, free up some cash, and enjoy life. Not for them a frugal existence in the family home on the pension and some measly super. It remains to be seen whether, when the crunch comes, they'll feel any less attached to the family home than did their parents.

In the meantime, there's research for the government to do. The Housing Help for Seniors pilot was introduced by the Labor government but axed in Tony Abbott's first budget. It protected the age pension for people who sold their homes to downsize. The scheme had low uptake but it ran for barely six months. Worth another look?

We need a national housing policy responsive to the ageing population, including a growing number of renters. Initiatives to encourage downsizing will succeed only if they address the psychological barriers to moving. But for the majority of elderly who'll probably stay put, we also need policies to make their houses safe.

Adele Horin was the social issues journalist with the Sydney Morning Herald for 18 years prior to her 'retirement'. This article was first published on Adele's Coming of Age blog (adelehorin.com.au), and is reproduced with her permission.

Investing and bike riding share similar cycles

Harry Chemay

Cycling, whether for commuting, recreation or fitness, has never been more popular. It crosses the gender divide and can be enjoyed across the age spectrum, from the young on training wheels to MAMILs (middle-aged males in lycra) astride carbon-fibre rigs costing more than some compact cars.

Road cycling has garnered an enthusiastic following amongst the corporate set, particularly within the investment community. Some say it's the new golf. Attending the recent Tour Down Under professional cycling event in Adelaide I was struck by the number of bankers, brokers, fund managers and advisors who have embraced road cycling culture. This confluence of cycling and investing started me thinking about important parallels between the two.

1. Keep pedalling in tough conditions

Cycling enthusiasts, like investors, must deal with variability. Every seasoned rider knows that conditions at departure will rarely hold for an entire ride. Many a time I have been out in ideal conditions, rolling with a gentle tail breeze, only for the weather to shift unexpectedly. Confronted by brooding skies and a block headwind, what minutes earlier seemed effortless suddenly becomes difficult.

When faced with headwinds seasoned cyclists hunker down and push steadily on, if not quite as rapidly. They accept cycling's intrinsic variability and are prepared to persevere when conditions deteriorate. More often than not, things change and the pedalling gets easier again. There's a lesson there for investors.

2. The difference between risk and uncertainty

Cyclists often have their favourite training rides mapped out: the route, the departure time and the expected ride duration. Route information is commonly shared amongst riders, each adding to the collective knowledge of traffic conditions, known road hazards and low or peak vehicular activity. This is risk management, with the historical frequency of negative events informing judgements about a ride's riskiness.

Risk, however, is not uncertainty. Risk is measurable whilst uncertainty isn't. Risk is akin to analysing historic data for a particular climb and adjusting your route based on cycling accident statistics. Uncertainty is descending such a climb and diving into a blind hairpin bend only to discover sand across your cornering line. Time spent rationally analysing route information now counts for naught. The response is instead instinctive, relying on 'gut feel' rather than analysis. Feather the brakes, pick your line and with luck on your side you may ride home unscathed. Panic, grab at the anchors and a world of pain awaits.

Prior to the global financial crisis many investors thought they were prudently managing risk, only to be blindsided by 'unknown unknowns'. This schism was neatly summarised in a 2010 Reserve Bank speech: *"One of the contributing factors to this mis-assessment was an over-reliance on a model-based approach to risk management, which focussed too much on measurable risk without taking full enough account of unmeasurable uncertainty."*

3. Passive and active approaches

In competitive road cycling riders generally bunch together in a formation called a peloton. By so doing riders can swap turns up front, with those sheltering behind enjoying a reduction in effort of up to 30%.

Whilst the peloton saves overall effort, it is common for individual riders to take a risk and break away, expending enormous energy in the hope of beating the pack to the line. Mostly these attacks (particularly solo efforts) prove futile. Occasionally however the extra effort pays off and a lone rider finishes ahead of the peloton. Seldom does the same rider succeed at consecutive breakaways. Breakaways are, in essence, a high effort, high payoff strategy with a low probability of repeated success.

In the world of investing the breakaway rider is akin to the active investor; one who is prepared to expend extra resources in order to beat the market. Active investors believe that markets are inefficient enough to allow them to get ahead and stay ahead. As with racing cyclists, active investors are buoyed by the prior success of other active participants, and although they rarely succeed in winning the tour, they have their moment in front of the cameras. Active strategies appear to work *just often enough* to encourage others to do the same.

4. Data, data everywhere

Road cycling today is a highly data-driven activity. Real-time data is generated from both rider and machine including power, cadence, heart rate, speed, rate of vertical ascent and other metrics too numerous to list. And so it is with investing. Investment data is now available in a 24 hour cycle at the click of a mouse or tap of a smartphone app.

This data reliance by both cyclist and investor stems from the same assumption; that if some information leads to improved decision-making, a great deal of information must result in *optimal* decisions, and thus superior performance.

Data availability is, however, a two-edged sword. When fatigued, trying to make sense of, and act coherently on, the multiple data sets spinning on my bike computer becomes problematic. And so it is with investing. Beyond some point, additional data only complicates the task of separating valuable investment signals from useless noise.

Come in spinner

Cycling and investing have much in common, moving forward as efficiently as possible on the road journey or the wealth journey. Both activities deal with dynamic systems (weather/markets) and both

involve an element not just of risk, but of uncertainty. For the competitive there's always the thrill of beating others and taking the top step on the podium.

As for me, I've mellowed from my speed-seeking younger days to embrace a more cyclo-tourist philosophy. Once addicted to the rush of high peaks and plunging descents, I now prefer gently rolling terrain. Sure, the destination's important, but let's enjoy the journey along the way.

Harry Chemay consults across superannuation and wealth management, focusing on post-retirement outcomes. He has previously practised as a specialist SMSF advisor, and as an investment consultant to APRA-regulated superannuation funds. Harry's two decades of experience in finance and investments is exceeded by his three decades as a cycling tragic.

What might the Tax White Paper say on franking and CGT?

Gordon Mackenzie

A tax question to Cuffelinks from Julie

I believe that the forthcoming Tax White Paper may address issues such as franking credits and capital gains discounting for taxation purposes.

Please can you tell me if you think these issues are under review?

I have heard that it is more than likely that franking credits will be abolished along with the 50% discount afforded to personal and business capital gains. These two items are of great interest to me and I was rather taken aback at the expectation these would be made redundant.

I have been reading your weekly newsletters since your inception. Fantastic!

Any thought on the eventuality of these two events and the response of the markets and various investments would be greatly appreciated.

Kind regards, Julie

The Financial System Inquiry noted many tax issues which need to be addressed by the forthcoming Tax White Paper. It was expected before the end of 2014, but its release has been delayed. If the current political malaise results in such a cautious policy approach that any controversies are avoided, then a wide range of issues that David Murray's Inquiry wanted addressing will be left on hold indefinitely.

We asked Gordon Mackenzie, Senior Lecturer in taxation and business law at the Australian School of Business, University of New South Wales, for his personal opinion on Julie's question.

Australia is the only developed country that still has a full dividend imputation system. In the more common and classic corporate tax system, the company pays tax and then the shareholder also pays tax on any distributions, which means:

1. two lots of tax on the same corporate profits

2. debt finance is cheaper as interest is tax deductible but distributions to shareholders are not

3. there is an incentive not to distribute dividends because of the second tax.

I believe adverse changes to imputation credits on company dividends would be politically unwise as they are very popular among mum and dad investors and super funds. Traditionally, although the value of imputation credits is not included in equity valuations, they are greatly appreciated by retail investors, who chase them to improve their yield after tax. Change to capital gains tax is also unlikely to go ahead as most countries differentiate between regular income and capital gains.

Gordon referred us to his 12 December 2014 article from The Conversation (edited here slightly to avoid duplication) for a broader overview of current taxation issues.

David Murray's Financial System Inquiry called for the removal of superannuation tax breaks but the government's tax discussion paper is unlikely to advocate similar changes.

The FSI report recommends articulating the overarching purpose of the superannuation system so that future tax changes can be measured against the objective.

It says the purpose of superannuation is to "provide income in retirement to substitute or supplement the age pension". This then prescribes, in theory at least, the tax breaks individuals can get from the system.

In this case, the maximum tax break an individual should get from superannuation would be roughly equal to the net present value of the age pension paid from age 65 to the median life expectancy.

The age pension is designed to keep people out of poverty after they leave the workforce. Yet how does the Inquiry's definition of superannuation fit with financial planning theory which says that people need to aim for 70% of pre-retirement income to maintain their lifestyle?

It makes redundant any discussion about whether the current compulsory contribution limit of 9.25% provides an adequate retirement income. It also implies that superannuation should attract few tax breaks.

However, this raises the question of whether the tax system should be used to encourage saving, either through superannuation or outside it. There are four reasons why the tax system should not be used for this purpose.

The theory is don't use taxes to incentivise saving

First, the tax revenue forgone through the concession is borne by all taxpayers, while only those using the concession benefit from it.

Second and third, tax benefits only go to the wealthy who have disposable income to save and who have access to information to maximise the benefits of saving, such as accountants and lawyers.

Finally, tax concessions don't increase savings, they just move preferences to where people save. But the reality is that they are used.

The report observes that superannuation tax breaks distort behaviour and favour the wealthy. However, a number of its observations will be difficult for the government to implement.

The inquiry report endorses Ken Henry's tax review recommendation to reduce the tax benefits of popular negative gearing investing as well as the over-taxation of income from deposits. It also advocates that income from large superannuation balances should attract more tax, however this has a whiff of retrospective tax about it.

Another suggestion that post-tax contributions should be further limited is also unlikely to be adopted by the government. Few people use these concessions and they benefit empty nesters who are selling down to enjoy a hipster inner city lifestyle rather than those trying to minimize their tax obligations.

The report says the system that taxes super earnings at 15% in the accumulation phase but not in the retirement phase, leads to asset allocation distortions, tax arbitrage and prevents funds offering "whole-of-life" financial products. However, it is doubtful whether any of these problems are tangible and important enough to warrant changing the system.

Finally, the report suggested removing the company share dividend imputation system and reviewing the capital gains tax discount. Interestingly, the report argues these incentives distort asset allocation yet both these measures were introduced with the intention of removing tax distortions. Imputation credits were introduced to lower the cost of capital towards equity rather than debt funding. The capital gains

tax discount was introduced to prevent the over-taxation that potentially arises from capital gains all being taxed in one year at higher marginal tax rates.

Government unlikely to implement super tax changes

Should these tax observations be included in the tax issues paper? They seem to warrant considered discussion but with two overarching caveats.

First, superannuation is a very long-term savings vehicle and changes reduce confidence in the system.

Second, savings in the system are there based on the good faith continuance of existing tax laws. In the past 35 years there have been only minor changes that adversely affected existing superannuation account balances.

However, the chances of the government implementing these tax changes are slight.

Though Treasurer Joe Hockey backed the report's recommendations to lower fees for super funds, it is unlikely that many of the report's observations in terms of tax will go ahead.

Adverse changes to the superannuation system are off the table for the first term of this government apparently. If superannuation tax breaks are measured against the age pension, a significant proportion of the population will be adversely affected.

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