forward thinking

THE SECRET TO SATISFIED CLIENTS

FALLING OIL PRICES a global perspective AGE PENSION CALCULATOR a useful tool FOREIGN PENSION SCHEMES top tips for transferring funds
We all know that you won’t succeed in business if your clients are dissatisfied; and it can be difficult to grow your business if you don’t appreciate the value of leveraging positive client relationships.

But understanding the roadmap to successful client relationships can be mystifying; which is why Macquarie commissioned the Propensity Project.

By measuring and analysing client engagement and benchmarking practices against their peers, we were able to benchmark the performance of those practices across the adviser population.

The results deliver some surprises and challenge some common assumptions about building, and growing, client satisfaction. You can read all the details in our lead story, The secret to satisfied clients (page 4).

Continuing our theme of protecting client relationships, in The simple rule for business growth (page 12) we explore the often delicate balancing act of pursuing business growth without losing the trust of existing clients. Success depends on credibility, trust and respect and is something we should all aspire to achieve.

Our story Accountancy 2.0: a new generation (page 16), looks at how firms can gain a competitive edge by introducing cloud-based technology platforms. Another approach focuses on encouraging the next generation of accountants to challenge traditional methods and develop new ways of thinking. And I think you’ll be surprised at the recruitment strategy one accountancy practice uses to ensure it stays revitalised.

As always we have some valuable insights and advice from our MAStech team. Following on from the last issue of Forward Thinking, there is a useful review of how to use our age pension calculator; and the 10 Top tips for overseas pension scheme transfers (page 30) provides helpful examples to explain the complex process.

Impact investing is the latest buzzword in investment circles, and Making an impact (page 48), looks at this new approach to delivering a positive social impact whilst generating a commercial return.

The NSW Government is already embracing this asset class, with its recently released Social Impact Investment Policy, and has clear indications of supporting this new investment market.

I hope you find this issue full of useful tips and information that will help you build your business, while pursuing strong relationships with your clients.

Challenging perceptions drives better client relationships

BILL MARYNISSEN Head of Macquarie Wealth Management
This issue of Forward Thinking has been accredited for continuing professional development (CPD) points by the Financial Planning Association of Australia. Accreditation number 007182 for 1 point.

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ISSN 1838-5435
[ COVER STORY ]

THE SECRET TO SATISFIED CLIENTS
Outstanding client relationships are at the centre of every successful advisory business. But while we all understand the importance of client satisfaction, identifying the activities that have the greatest impact on engagement can be more challenging. According to Sherise Mercer, Head of Market Development for Macquarie’s Virtual Adviser Network, the problem for most practices is simply a lack of reliable information.

“Often advisers lack the data they need to accurately measure current client engagement levels and identify the factors that could drive them higher in the future,” she says. “That’s important, because there is a very clear link between higher satisfaction and improved business outcomes, especially retention, referral and share of wallet. Without accurate data, it can be very hard to target business improvement initiatives where they will be most effective.”

“Essentially, you can end up spending a great deal of time and money on activities that simply don’t have the impact you expect.” To help solve that problem, Mercer and her team created the Propensity Project – an in-depth analysis of advice practices and their clients across Australia. By measuring client engagement and benchmarking practices against their peers, the project aimed to give advisers the insights they needed to make more informed strategic decisions and achieve a higher return on investment.

The results not only highlight the importance of satisfaction for sustainable success, they also reveal that the true drivers of satisfaction are often very different to those on which advisers have traditionally focused.

**UNDERSTANDING WHAT MAKES CLIENTS TICK**

The Propensity Project was based on an in-depth survey of 1,283 clients across 21 financial advice and accounting practices in June and September 2014. The Project team measured client engagement across multiple aspects of each practice’s service offering. Then, using advanced statistical analysis, they identified specific drivers of engagement and key factors in creating stronger client relationships.

New Macquarie research reveals the surprising truth behind client satisfaction, with important insights for every advice practice.
As well as measuring overall performance across the adviser population, the project also identified benchmarks for key service attributes, representing the best score achieved by any practice for that individual measure. By identifying best practice benchmarks, the Project team was able to uncover the characteristics that made the best performers stand out from the rest – with valuable insights for every advice business.

**HOW MUCH DOES SATISFACTION MATTER?**

“Our analysis makes it very clear that improving customer satisfaction is the key to better business performance,” says Mercer. “Highly satisfied clients have a much higher propensity to stay with your practice over the long term, recommend you to others and invest more of their money with you.”

For example, Macquarie’s research found that 90 per cent of clients who were highly satisfied with their advisers said they were likely or highly likely to refer them to others, compared with just 18 per cent of moderately satisfied clients and 1 per cent of less satisfied clients. The results for other key business metrics were equally compelling.

**HIGHLY SATISFIED CLIENTS ARE SIMPLY MUCH MORE LIKELY TO STAY WITH YOUR PRACTICE OVER THE LONG TERM, RECOMMEND YOU TO OTHERS AND INVEST MORE OF THEIR MONEY WITH YOU.**
DRIVING CLIENT SATISFACTION: THE FOUR Ps

So where should you target your efforts to increase client satisfaction? To answer that question, the Propensity Project measured 26 separate service attributes across four different dimensions of the client experience: People, Process, Personalisation and Perception of Value.

By asking clients to rate their adviser’s performance for each attribute, then comparing those ratings to satisfaction scores, the Project team was able to determine the relative importance of each attribute in driving engagement and performance. “We found that the less tangible aspects of a high quality client experience are often more important to client perceptions than concrete financial results,” says Mercer. “It isn’t that financial performance doesn’t matter, more that clients seem to regard a good financial outcome as a baseline expectation, rather than a differentiator. As a result, intangibles can play a decisive role in driving up overall satisfaction levels.”

For example, portfolio performance and fairness of fees both ranked outside the top 10 drivers of satisfaction, in eleventh and fourteenth place respectively. Instead, advisers who scored highly on attributes such as understanding client needs were most likely to have highly satisfied clients – and better growth potential.

THE LESS TANGIBLE ASPECTS OF A HIGH QUALITY CLIENT EXPERIENCE ARE OFTEN MORE IMPORTANT TO CLIENT PERCEPTIONS THAN CONCRETE FINANCIAL RESULTS.

IT ISN’T THAT FINANCIAL PERFORMANCE DOESN’T MATTER, MORE THAT CLIENTS SEEM TO REGARD A GOOD FINANCIAL OUTCOME AS A BASELINE EXPECTATION, RATHER THAN A DIFFERENTIATOR.

The Four Ps of client satisfaction

**People**
Fundamental to doing business, clients will only work with people they like and respect

**Process**
Clients are most satisfied when their expectations of timing and process are managed and delivered upon

**Personalisation**
Clients expect the personal information they provide to their adviser to enable proactive interactions between formal reviews

**Perception of value**
In a service industry, tangibles such as documentation and communications act as proof of the value delivered

90% of highly satisfied clients said they were likely or highly likely to refer their adviser to others.
PEOPLE
The People attributes measured clients’ perceptions of the competence and expertise of staff, and the quality of their personal interactions with the practice. Here, the Project team’s analysis showed that while clients value knowledge and strong communication skills, it is their advisers’ ability to inspire confidence that makes the greatest difference to overall satisfaction, together with their attention to detail.
“The advice relationship is based on trust, so maintaining confidence is enormously important. It’s not enough to simply be good at your job – you also need to actively demonstrate your diligence and expertise through every interaction with your clients,” Mercer says. “In other words, communicating effectively and demonstrating expertise and knowledge is the key to building the client’s trust and confidence.”

PROCESS
The Process attributes measured clients’ perceptions of the practice’s processes, from first meeting to ongoing interactions with staff. They revealed that clients place a high degree of importance on fast and efficient service from their main contact within the practice, both in delivering advice and implementing recommendations.
“We often tend to think of Process attributes as hygiene factors – necessary, but of secondary importance,” observes Mercer. “However, our research very clearly demonstrated that setting clear expectations around delivery, then meeting those expectations, plays a large part in shaping the client’s impression of their main adviser and making them feel valued. While high quality support from other people in the practice certainly matters, it’s the main adviser and the attention they give to the client that makes the biggest difference.”
**PERSONALISATION**

“Of all the dimensions, Personalisation turned out to be the most important,” says Mercer. “But true personalisation requires more than high quality needs analysis and individually tailored service. Clients are looking for advisers who will take the initiative and proactively manage their affairs, contacting them regularly with ideas and information to make them feel confident and empowered.”

**PERCEPTION OF VALUE**

The Value attributes reflect clients’ overall perception of cost and value for money in the relationship – and they show that communication is key. Clients place a high priority on being kept informed, underscoring the importance of frequent and clear communications and high quality reporting. Other attributes more commonly associated with cost, such as the transparency and fairness of fees, had much less impact as drivers of client satisfaction.

“High quality communications are a concrete demonstration of the value you provide, in an industry based largely on service. In our discussions with advisers, we’ve found that a number of high performing practices make a point of ensuring clients never leave a meeting without something tangible – a welcome pack, a portfolio report, a whitepaper, whatever it might be,” says Mercer.

“Above all, these findings suggest that demonstrating clear value is critical. If clients feel well informed and have confidence in their adviser, then they are much less likely to focus on fees and the cost of advice.”
MEASURING SATISFACTION ACROSS CLIENT SEGMENTS

While the Propensity Project demonstrated that high client satisfaction is the key to strong business performance, it also found that high overall satisfaction levels are not always enough on their own.

“We typically found very significant differences in engagement between client segments, even within the same practice,” says Mercer. “It’s also clear that client engagement does not always translate into positive results unless advisers take concrete steps to capitalise on the goodwill they have worked so hard to build.”

The Project team segmented the results across multiple client categories, including age, tenure and profession. They found that the clients most likely to rate their advisers as outstanding (with a satisfaction rating of nine or 10) included older clients (72 per cent), retirees (73 per cent) and clients with a tenure of 10 years or more (67 per cent). But professionals (51 per cent), midlife clients between 30 and 45 (49 per cent) and new clients with a tenure of one year or less (47 per cent) were relatively hard to please.

“Time-poor professionals and those in the highly pressured accumulation stage between 30 and 45 are among the most demanding,” says Mercer. “That underscores the importance of efficient service and proactive management, and highlights the need to tailor your advice and communication style for different segments and stages in the advice lifecycle.”

Average satisfaction levels by age, tenure and profession

Clients most likely to rate their advisers as outstanding (with a satisfaction rating of nine or 10) included older clients, retirees and clients with a tenure of 10 years or more.
GAINING CLIENTS FOR LIFE

Variations across the client lifecycle can be particularly important for advisers seeking to create sustainable success over the long term. Unsurprisingly, Macquarie’s research found that the longer clients stay with their adviser, the longer they are likely to stay in the future. Yet it also revealed some dangerous dips in retention levels at key points across the lifecycle.

“We found intention to stay was at its lowest among 30-45 year olds, with around one in five unwilling to commit to using their adviser over the long term. In the midst of the accumulation phase, this age group is often under a lot of financial pressure, so they are particularly likely to make decisions about staying with their adviser based on results.”

In contrast, clients under 30 and older clients showed a strong sense of loyalty to their chosen adviser, with 86 per cent of clients in both segments agreeing that they expect to be using their adviser for many years to come.

Perhaps more alarmingly, the team found that intention to stay falls among clients with a tenure of four to nine years, before climbing to a peak of 86 per cent in the 10 year plus segment. These findings suggest that, without targeted action, advisers risk losing mid-term clients, even if they maintain the same high levels of service as in earlier years.

“It’s clear that the four to nine year period can be a critical phase in the client relationship,” says Mercer.

“Making a referral requires a positive act from a client, so satisfaction and good intentions on their own are not enough. Without a structured program to cultivate and track referrals, even the most client-focused practice can find it difficult to convert goodwill into tangible results,” says Mercer.

“The key is to target your program at the most productive client segments – both those with a high willingness to recommend, and those with a higher propensity to take action.”

The team’s research also suggested that intra-family recommendations are a potentially rich source of new clients, with 69 per cent of clients agreeing that it’s a good idea to introduce your family to your adviser.

PUTTING THE CLIENT’S EXPERIENCE FIRST

Overall, Mercer says the key lesson from the team’s research is to focus on the client’s overall experience, rather than simply financial outcomes.

“If focusing on the most important aspects of the client experience, from the client’s point of view, can have a measurable impact on building and sustaining your business. That means sustainable success isn’t simply built on great service and strong results – it’s also about the way you demonstrate your competence and diligence from day to day.”
The simple rule for business growth
All too often in financial advice firms, there’s a balancing act between maintaining successful client relationships while growing the business and managing staff.

So what’s the best way for financial advice practices to maintain exceptional relationships with their clients, deliver outstanding advice, and at the same time free up senior advisers’ time to focus on growth opportunities?

Trust is at the heart of the relationship between advisers and their clients. Clients must have a core belief that their adviser is focused on delivering sound advice that will assist to protect and grow their wealth. Without that, the relationship will flounder.

“That’s the part of the relationship that’s absolutely sacrosanct,” says Craig Griffin, Head of Sales and Performance at Macquarie Banking and Financial Services.

Advice firms differ from other businesses in that the owners of the business must be able to manage the practice, and at the same time be technically skilled at delivering advice to garner clients’ respect.

“The credibility, trust and respect senior managers have comes from their ability to both lead the business and provide advice to clients,” explains Griffin.

With this in mind, transferring client relationships from principals to other members of the firm to free up time to build relationships with potential new clients has to be skilfully managed so that existing relationships with clients remain robust.

“The ideal approach is to change the nature of the client relationship so that the principal of the advice firm remains in the trusted adviser role, but the advice component of the relationship is performed by other members of the practice and trust is transferred,” suggests Griffin.

To maintain client trust, there needs to be a compelling reason for the advice component of the relationship to be successfully transferred from the principal to other members of the firm.

One way to do this is to ensure the practice develops advisers with specialist skill sets, so that clients receive the benefit of dealing with an adviser who has genuine insights about an area of practice, for instance high net worth client needs or a particular industry.

“The principal’s role then becomes one where they are focused on ensuring the client is satisfied with the level of service they are receiving,” Griffin adds.

For instance, initial meetings with a client might involve both the principal and team of specialist advisers who can assist the client across the full spectrum of their requirements.

Future meetings may involve only the advisers who can address the client’s specific need.

“So you’re effectively giving the client access to the ideal people to manage their unique needs, leaving the principal more free time to focus on growing the business. The adviser is accountable for the relationship and advice and the principal is still involved in client satisfaction and the relationship with the practice,” says Griffin.

Taking this approach also allows the business to offer better quality advice, taking on board client feedback to help make the relationship more productive. Because there is a separation...
between the client service and advice components of the relationship, the principal may have an opportunity to find out whether the client is satisfied with the quality of the advice they are receiving and help find referrals.

Principals can directly ask clients about their experience with the firm, giving them the opportunity to raise, and ultimately resolve, any issues. This reduces the risk that a client will become dormant because they are dissatisfied with an aspect of the relationship, but don’t have an avenue through which to express this.

Griffin suggests principals use a tool to gauge how happy clients are with the quality of the advice they receive: simply ask them to rate on a scale of one to 10 how likely they would be to recommend the practice to their network. This information can be used in two ways. If the score is low, the principal can delve into why with the client and use this information to coach advisers so they can offer better advice. They can also probe more deeply when clients name a high score and, if appropriate, ask for referrals, helping them to meet their obligation to bring more business into the firm.

This way of managing an advice business changes the role of the principal. Instead of the business owner being fully focused on running the enterprise and dealing with clients, they instead spend up to 40 per cent of their time coaching the advisers within the business on the values and ethics of the firm, to help them maintain excellent relationships with clients.

“The principal then needs to consider how they can best find the right people within the firm whom they can coach about things such as what integrity looks like in the business,” he says.

So what’s the client’s role in all this? Griffin stresses that it’s essential to have an open and honest conversation with clients when they first engage with the firm about the scope of the relationship. This includes detailing how they will interact with the principal, and also the specialist services with which they are likely to engage.

The idea is to build a client engagement model right from the outset that meets the needs of the client and gives them access to the specialist advice they require, ensures client relationships are properly monitored and managed, and also helps ensure the ongoing sustainability of the firm.

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ACCOUNTANCY 2.0
A new generation
The need for accounting practices to continually evolve is not just about driving efficiencies. It’s an important part of the process of retaining the business’s most important asset, its staff.

Now more than ever, it’s essential for more traditional accounting practices to engage with younger staff and clients to avoid a situation in which the younger generation set up in competition with their former employers.

“It’s critical for partners to develop a mindset whereby they are genuinely engaging with younger staff,” says David Clatworthy, Accounting Segment Head at Macquarie Group.

“Some firms have recognised the need for this engagement and, for example, have made a younger member of the practice accountable for technology. This is a great idea from which other firms could learn,” he says.

According to Clatworthy, other firms are inviting younger members of the practice to contribute to the decision-making process in management meetings, to help challenge old ways of thinking.

Taking steps such as these can help to address the succession planning issues many businesses are facing. “Engaging the younger generation and getting them excited about the future directly correlates to how likely they will be to buy into the business,” Clatworthy argues.

More forward-looking practices are also taking an intergenerational approach to their business, matching advisers to clients based on demographics. They are engaging their clients’ children when they start work and putting them in touch with people in the practice of their own age.

“Smart firms are linking the right clients with the right accountants based on skill set, demographics and style. This will pay dividends long-term,” he says.

Clatworthy acknowledges it can be challenging for older firms to embrace new business models if they feel doing so will result in a reduction in profits. To address this, he suggests setting up a small incubator that sits alongside the main firm, where younger staff have permission to test new ways of doing business.

“Doing this gives the younger generation an outlet to try new things, but also allows the business to control the cost base and maintain profitability,” he explains.

As the business model in accounting practices is changing, so too are the services clients appreciate. While they acknowledge they still require services such as the preparation of tax returns, what they value is advice.

“Young practices that aren’t lumbered with legacy systems and processes are more
able to focus on the advice component of the services they offer,” says Clatworthy, explaining that younger practices are more likely to have invested in new technologies to automate the more procedural aspects of providing accounting advice. In addition, these practices are focused on outsourcing administration, allowing more time to focus on client engagement.

“Younger advisers are much more future-focused than previous generations of accountants,” he says, adding that they are more inclined to use software to produce dashboards about clients’ future expenses and cash flow forecasts with which to start discussions. This effectively elevates the way they engage to the advice realm.

One practice that has successfully achieved this is technology-led accounting business mi-fi Accountants + Advisers. “I don’t think of myself as a career accountant,” says co-founding partner Campbell King. “We’re interested in the business of accounting. We saw that the way things were being done in most practices could be done better.”

King agrees an important catalyst for the shift currently taking place in accounting has been the advent of cloud-based technology platforms through which accounting practices can be run. “We’re trying to capitalise on the opportunities this delivers. Everything is changing so quickly and to be at the forefront of this is what drives us. Of course, we would much rather spend time with clients than crunch tax returns, although that’s still an important part of what we do as a firm.”

His advice to established businesses that want to engage their younger staff is to give them responsibility to pique their interest in taking over ownership of their firms.

“I believe that more senior partners should ask younger staff about what’s changing and give them ownership over projects to modernise the firm. It’s important to understand you don’t have to change everything in one go. Do one part of the business at a time and see how it goes,” he advises.

When King and his partners developed the business’s technology strategy, they spent considerable time assessing the different
options available and how they would assist the business to develop over the longer-term.

“For us, it’s all about using technology to drive efficiencies and economies of scale. We decided to use a single accounting platform because we wanted consistency across our systems and procedures, rather than to have people use and learn multiple systems,” he says.

King acknowledges one of his firm’s biggest advantages is that it isn’t encumbered by legacy systems. But at the same time, it also doesn’t have the established fee base of the older firms. He also says there’s a place in the market for both larger, more established firms and new upstart firms.

“The market is so big there’s room for everyone. But there is a generational change happening at the moment and older firms need to acknowledge that if they want to attract younger staff,” he says.

Another business run by Gen Y practitioners is Accodex. Founding partner Chris Hooper says he was fortunate in that when one of his peers acquired his father’s bookkeeping firm, he was able to join the business and build an accounting practice from it. At the core of the enterprise is a commitment to being at the forefront of emerging accounting technologies. “The first mover advantage is hardwired into our DNA,” he says.

Hooper says there’s a real risk to businesses that don’t migrate their operations to new, cloud-based technology platforms. “Firms are moving to the cloud because of client demand. Accounting practices will either adapt to this or clients will leave them to go to firms that do offer the solutions they want.”

Interestingly, Hooper says it’s not the technology itself, but the propensity to accept change, that’s essential. “Firms need to be mindful of change management principles and use a consultant to help manage this process if necessary.”

The average age of the people who work in Hooper’s practice is 23 and the business has a KPI of keeping the average age of staff and partners below 30, Which means Hooper is already planning his transition out of the business. “There needs to be a constant stream of new blood to challenge the status quo,” he says.

Hooper agrees with King that one of the keys to engaging younger staff is to promote them quickly. “It’s important to promote people on merit; but all too often partners promote people who are like them, rather than looking for people who could add a diversity of views to the practice. It’s also important to ask the next generation what they want from their careers and meet that need. Promote earlier to avoid people leaving the business in their 30s and 40s.”

There is a range of different approaches more established businesses can take to ensure they are not left behind in what amounts to a revolution happening in the accounting sector. The idea is to explore the available options and start with one project that will help the firm retain younger staff and clients and remain at the forefront of technological developments.
Not all income is equal
Understanding and choosing the most appropriate investment or combination of investments to meet a particular investor need has its challenges.

To assist with the education and decision-making process, we have provided a simple and insightful comparison and ranking of the major income producing assets. The results are interesting and perhaps a little surprising.

**RANKING CRITERIA**

We ranked income producing assets according to the following five traits that investors are likely to value. These are:

1. Highest possible return;
2. Stability of income;
3. Certainty of income, which will allow budgets to be made with confidence;
4. Insensitivity to the economic cycle (or counter-cyclical) – beneficial because when the economic cycle is weak other assets are less likely to make capital gains;
5. Ability to grow with or faster than inflation especially if the income is to be used to pay for living expenses.

Unfortunately, some of these characteristics clash. For example, assets with the highest possible income are likely to have the highest risk, or the lowest certainty.

In the table on the following page below we have ranked each asset class against the above five criteria.

As a starting point we have weighted each criterion equally, however, this may vary depending upon each individual’s risk tolerance. Different investors have different risk tolerances and this will lead to an individual investor rating the income criteria to suit their personal objectives.

For several years now, investors have been increasingly drawn to investing for income, particularly those looking to fund their retirement lifestyle.
The table ranks each asset class against the assessment criteria. The information is based on Macquarie Investment Management’s Fixed Income and Currency team’s internal analysis and opinions. The table contains opinions, conclusions, estimates and other forward-looking statements which are, by their very nature, subject to various risks and uncertainties. Actual events or results may differ materially, positively or negatively, from those reflected or contemplated in such forward-looking statements.

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<th>Asset Class</th>
<th>Income Assessment Criteria</th>
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<td></td>
<td>Returns</td>
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<td>Investment Grade Bonds</td>
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<tr>
<td>Residential Property</td>
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1 | HIGHEST POSSIBLE RETURN
Cash is the least volatile asset and produces the lowest expected return, especially in the current low interest rate environment. However, it does not produce the lowest immediate income. Inflation-linked investments followed by indexed annuities and residential property produce the lowest income, but that income increases over time with inflation. Presently, high yield bonds produce the highest income, followed by high dividend equities and diversified equities.

2 | STABILITY
Surprisingly, of all the asset classes considered, the one that produced the most variable income was cash. Chart 1 shows the income provided to a cash investor over the past 10 years.

In contrast, the income from annuities and bonds is extremely stable. The dividends from high dividend equities are biased to be more volatile than broader equity indices because the higher payout ratios reduce their ability to smooth earnings when paying dividends.
3 | CERTAINTY
The probability of receiving the interest due on a cash deposit is extremely high. Likewise, because most inflation-linked bonds are government issued, their coupons are almost completely certain. The income from equities is less certain. They can only be paid from retained earnings, and can be reduced or frozen at the company’s discretion.
Annuities rank in the middle for certainty, after portfolios of bonds. This is because, although they have a high probability of being paid, and are a contractual obligation, the underlying income is generated by a statutory fund with a range of assets.

4 | INSENSITIVE TO THE ECONOMIC CYCLE
When economic growth falls, cash rates are usually lowered and income from cash falls. When economic growth recovers, rates often go back up. Surprisingly perhaps, income from cash investments is therefore very sensitive to the economic cycle.
Bond yields also usually fall in a weak economic environment, but the coupons remain largely static. This leads to capital gains in times of economic weakness. Annuities rank slightly after bonds’ income insensitivity, because their capital gains are less accessible due to penalty surrender rates on early redemption.
5 | GROWING AT OR ABOVE INFLATION

Cash does surprisingly well because when inflation is high, cash returns are usually high as well. Nominal bond coupons change only very slowly with inflation and are a poor asset for providing inflation-protected income, with the exception of inflation-linked bonds. Nominal annuities rank last, for they will not grow at all with inflation, while indexed annuities rank equal first with inflation-linked bonds, because they are directly tied to inflation.

For equities, the fact that dividends are variable has been a negative until now, but the fact that dividends can vary means they can also go up, not just down, and tend to do so over time in normal economic conditions.

[ CONCLUSION ]

On average, high yield bonds and investment grade bonds had the best average rank, indicating the best result for the trade-off between income stability and level.

Perhaps surprisingly, the three asset classes with the worst average ranks were property, cash and high dividend equities.

While annuities ranked almost as well as traditional fixed income products, these ranks assume that the annuities are redeemed after 15 years.

The relatively low ranking of cash (including term deposits) highlights that as well as providing lower possible returns, its income is relatively unstable and sensitive to the economic cycle.

As we noted in the introduction, different investors have different risk tolerances and this will lead to an individual investor rating the income criteria to suit their personal objectives.
How to use

The MAStech age pension calculator
Recognising those ABPs that have grandfathered treatment under the income test will be important in any strategies recommended. It will be particularly important where a prospective client has a grandfathered ABP in a product that may not be suitable for their long-term needs or where the establishment (or wind-up) of a self managed superannuation fund may be appropriate.

The MAStech age pension calculator has been designed to analyse the impact changes to clients' ABPs may have on their social security entitlements.

HOW TO USE THE CALCULATOR

To demonstrate, let's use the calculator to look at Lawrence and Caroline, who are prospective clients looking for a review of their current situation.

Lawrence is age 70, Caroline is 68, they are homeowners, each receives a part age pension and both have existing ABPs grandfathered for social security purposes.

Start by entering Lawrence and Caroline’s dates of birth, homeowner and couple status in the client information section.

Next, enter the details of their ABPs. Starting with Lawrence, his ABP commenced prior to 1 July 2014, so we need to enter the account balance at this date, which was $300,000 (see Figure 1). He is drawing income of $22,000. Being a grandfathered ABP, we need to enter a deduction amount ($16,189) for Centrelink purposes.

The age-based minimums and Centrelink assessable income amounts are calculated based on the data entered. The calculator shows the amount of income currently counting towards the income test is $5,811.

To ensure the calculator gives the ABP grandfathered treatment under the means tests, select ‘Yes’ for Lawrence in the ‘Pensioner at 31 December 2014’ section.

On 1 January this year, new rules for the treatment of account-based pensions (ABPs) for social security purposes came into effect.
We follow a similar process for Caroline, clicking the check box and opening the data entry fields. Caroline’s ABP was valued at $500,000 at 1 July 2014, she will draw $28,000 income and her deduction amount is $30,065.

The final step is to enter any other financial information that may be relevant. Lawrence and Caroline have Centrelink assessable asset values of $20,000 for personal effects, a $10,000 vehicle and $15,000 in cash.

Once all the data is entered, we can see how they are assessed currently (both ABPs not deemed) compared to a situation where both ABPs are deemed.

Chart 1 shows there is no impact on their social security benefits using this set of assumptions from their current situation (blue line), compared to a situation where both of their ABPs are deemed (green line). This is because the assets test is the dominant test.

By hovering the cursor over the graph, the calculator output shows the impact of ABP drawdown level on age pension entitlements under both scenarios. The calculator also gives the option of seeing the impact if only one of the pensions were to be deemed.

For a grandfathered ABP, as a client’s ABP drawdown level increases, more income will be assessed under the income test. Eventually this will cause the income test to become dominant over the assets test. In Lawrence and Caroline’s case, they would need to be drawing over 22 per cent of their account balances for the income test to become dominant, as shown in Chart 1. However, if the ABP is deemed, assessed income is unaffected by the actual income drawn.

We can also see a detailed breakdown of how their entitlements are calculated under the scenario details tab (Figure 2).
So, for Lawrence and Caroline, should a change to their ABPs cause either or both to lose the grandfathered treatment, they will see no immediate change to their Centrelink entitlements.

However, some additional factors should be considered before any change is made:

- the impact of higher deeming rates
- the impact of proposed lower deeming thresholds
- any change to their current assets or income levels.

We can see what effect the first two points above may have by clicking on ‘rates and thresholds’ at the top of screen and changing the assumptions. We will increase deeming rates by one per cent for both the below and above threshold rates, as well as reducing the couple threshold to $50,000 (which is proposed to apply from 20 September 2017 but is not yet law).

Returning to the graph, we see these changes have no impact. Their entitlements are reduced by the assets test to such an extent that relatively small changes to the income test do not alter their age pension entitlements. Under this modified scenario their age pension entitlement under the income test is $20,236 – a decrease from $24,533 under the original scenario. This compares with their entitlement under the assets test for both scenarios, which is $11,706 (Figure 3).

This difference means there will be no change to their entitlements unless deeming rates were to increase to 4.85% for the below threshold rate and 6.35% for the above threshold rate – an increase of 3.1 percentage points.

The third factor mentioned above is what would happen should Lawrence and Caroline’s assets or income change dramatically.

Let’s assume (under current deeming rates) that Caroline receives an inheritance of a property valued at $300,000, generating net assessable rent of $400 per week.

This creates a significant decrease in their age pension entitlements, with Lawrence and Caroline now receiving the ‘minimum pension entitlement’ of $1,856. Checking the scenario details tab, we see they are still assets tested – the age pension payable under the income test is still significantly more than that payable under the assets test, even with the increase in non-deemed income.

---

**FIGURE 2**

**FIGURE 3**
Alternatively, we could assume Lawrence is working part time, earning $35,000 per annum. This income will see a reduction in their age pension entitlements should their ABPs be deemed, as shown in Chart 2.

While individual client circumstances will vary, these scenarios show the effectiveness of the calculator in helping you determine the possible impact of forgoing the grandfathered treatment of a client’s ABP, taking into account changes in a range of client circumstances.

**WHAT ARE THE NEW RULES?**

Here’s a summary of the changes

ABPs will be assessed using deemed income based on the ABP’s account balance, instead of the previous method of income calculated based on actual drawdowns, less a deduction amount representing return of capital.

**ABPs will be deemed under the income test if:**

- the commencement date was on or after 1 January 2015
- the pension commenced prior to 1 January 2015, but the recipient was not in receipt of a social security income payment on that date
- the pension commenced prior to 1 January 2015, but the recipient, since that date, has not been continually in receipt of a social security income payment.
TOP TIPS FOR OVERSEAS PENSION SCHEME TRANSFERS
Clients who have lived and worked overseas will often have benefits accrued in foreign superannuation or pension schemes. Transferring these funds back to Australia is an opportunity for Australian financial services professionals to add value on the Australian side of the transfer, including advising on issues relating to the receiving superannuation fund and the Australian tax consequences.

Often the issues involved in a transfer are not straightforward. This article provides a number of tips for advisers when advising in this area. Appendices 1 and 2 provide a quick refresher of the basic rules applying to foreign superannuation fund transfers.

1. **TEMPORARY RESIDENTS**

Those who are treated as ‘temporary residents’ for Australian tax purposes are exempt from Australian tax on certain foreign sourced income, generally including payments from foreign superannuation or pension schemes. It may be attractive to transfer foreign scheme benefits to Australia before a client’s temporary resident status ceases.

2. **UNCERTAINTY OF RESIDENCE IN AUSTRALIA**

Additional tax implications may arise if a temporary resident’s benefits are transferred and subsequently withdrawn because of permanent departure from Australia. Although the Australian tax consequences may be minimal, if the benefit has been transferred from the United Kingdom (UK), the payment may be an ‘unauthorised payment’ subject to additional tax in the UK. Similarly, additional UK tax may apply if a client voluntarily withdraws benefits after retirement (or some other condition of release is met) from an Australian fund that includes benefits transferred from the UK (see also Tip 8).

Clients who are uncertain whether they will remain in Australia may prefer to leave their benefits in the existing foreign scheme until they have more certainty.
OVERSEAS PENSION SCHEME TRANSFERS

There are a number of Australian taxation and superannuation consequences of a benefit that is paid from an overseas superannuation/pension scheme in respect of an individual who is a resident or temporary resident for Australian tax purposes. Note that this chart does not cover benefits paid from a New Zealand KiwiSaver scheme, which are subject to separate rules.

1. Is the client a temporary resident?
   - Yes
   - No

2. Is the overseas scheme a foreign superannuation fund?
   - Yes
   - No

3. Timing of transfer
   - Yes
   - No

4. Applicable fund earnings
   - Yes
   - No

5. Does client meet the Australian superannuation contribution eligibility conditions? (see Appendix 2)
   - Yes
   - No

6. Tax treatment of lump sum payment
   - Tax free
   - Applicable fund earnings taxed at individual’s marginal tax rate. Balance of transfer tax free
   - Applicable fund earnings taxed at 15% in fund. Balance of transfer tax free

7. If benefit transferred to an Australian super fund...
   - Australian superannuation contribution eligibility conditions apply (see Appendix 2)
   - Whole transfer amount treated as NCC
   - Whole transfer amount treated as NCC
   - Applicable fund earnings not an NCC or CC. Balance of transfer treated as NCC.
3. DETERMINE WHETHER THE OVERSEAS SCHEME IS A ‘FOREIGN SUPERANNUATION FUND’

Payments from entities which are ‘foreign superannuation funds’ for Australian taxation law purposes may attract concessional tax treatment (see Appendix 1). Otherwise the tax consequences may depend on the nature of the transferring entity (see Tip 10). Note also that transfers from New Zealand KiwiSaver schemes are subject to separate rules.

The Australian Taxation Office (ATO) generally takes the view that a foreign fund is a ‘superannuation fund’ if it exclusively provides a narrow range of benefits, generally in relation to retirement, invalidity or death of the individual or otherwise as specified in Australian superannuation law.

Schemes that facilitate non-retirement savings or allow withdrawals for non-retirement purposes (for example housing, education and medical expenses) are generally not considered foreign superannuation funds.¹

For example, the ATO determined that a foreign fund which included a ‘Medisave’ account (used to fund hospitalisation expenses and approved medical insurance) was not a foreign superannuation fund.² Singapore’s Central Provident Fund incorporates a Medisave account. Consider applying for a private ruling if there is uncertainty whether an overseas scheme is a foreign superannuation fund.

4. ATO GUIDANCE ON FOREIGN CURRENCY CONVERSION OF ‘APPLICABLE FUND EARNINGS’

Payments from foreign superannuation funds that occur more than six months after an individual becomes an Australian resident (assuming the individual is not a temporary resident) may involve taxation of the ‘applicable fund earnings’. Applicable fund earnings are measured in Australian dollars ($A), requiring conversion from the foreign currency. The ATO recently released ATO ID 2015/7 which sets out its view of the calculation methodology and removes the previous uncertainty around this issue.

The ATO’s view is that applicable fund earnings should be calculated as the difference between the fund balance at the time of transfer and the balance immediately prior to the fund member becoming an Australian resident. Both amounts are converted to $A at the exchange rate applicable on the day the payment is received by the Australian superannuation fund.

This approach produces the same applicable fund earnings as the approach taken in a number of older private rulings, but conflicts with results from more recent private rulings.³ In the most recent private rulings, the ATO calculated applicable fund earnings using two exchange rates (that is, the rate immediately prior to the individual becoming an Australian resident and the rate at the date of transfer).

Let’s look at an example to illustrate how the different calculation methods (both in the ATO ID and in the later private rulings) work in practice.

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¹ ATO Private Rulings 101219733530 and 10115333387986.
² ATO Private Ruling 1011911615567.
³ For example ATO Private Ruling 1011456480322.
Henry, age 53, became an Australian resident on 1 February 2013, at which time he had £250,000 in a pension plan in the UK. On 2 February 2015, Henry transfers his UK entitlements to his Australian superannuation fund. At the time of transfer, his UK entitlements had increased to £275,000. No contributions or transfers have been made to the UK scheme since he became a resident.

What is the Australian dollar value of Henry’s applicable fund earnings?

**METHOD 1**
Conversion rate based on transfer date (ATO ID 2015/7)

Convert vested benefits to $A using the exchange rate at date of transfer

- UK benefits prior to residency = $485,000 (ie £250,000 x $1.94 = $485,000; £/$A equals 1.94 as at 2 February 2015)
- UK benefits at transfer date = $533,500 (ie £275,000 x $1.94 = $533,500; £/$A equals 1.94 as at 2 February 2015)

Calculate applicable fund earnings in $A

Applicable fund earnings = $48,500 (ie $533,500 - $485,000)

**METHOD 2**
Conversion rates at valuation dates (certain ATO private rulings)

Convert vested benefits to $A using the exchange rates at relevant dates

- UK benefits prior to residency = $380,000 (ie £250,000 x $1.52 = $380,000; £/$A equals 1.52 as at 31 January 2013)
- UK benefits at transfer date = $533,500 (ie £275,000 x $1.94 = $533,500; £/$A equals 1.94 as at 2 February 2015)

Calculate applicable fund earnings in $A

Applicable fund earnings = $153,500 (ie $533,500 - $380,000)

Applicable fund earnings are $105,000 more with Method 2.

Given the guidance in ATO ID 2015/7, the calculation process in Method 1 above should be adopted generally.
5. QUIRKS WITH THE TAX ELECTION

Clients can elect for the applicable fund earnings of a foreign superannuation fund payment made to an Australian superannuation fund to be taxed within the Australian fund at 15 per cent, instead of being included in their personal assessable income and taxed at marginal tax rates. For a client to be eligible to make the election, the entire balance of their foreign superannuation fund must be transferred. The election must be made in writing by submitting an approved form (ATO form NAT 11724) to the Australian superannuation fund before the client lodges their tax return for the year of transfer, or earlier if required by the fund. The ATO’s view is that an election cannot be revoked or varied once it is made.4

6. ALLOW A BUFFER FOR FLUCTUATIONS IN THE EXCHANGE RATE

The amount transferred to an Australian superannuation fund from a foreign superannuation fund is subject to Australian superannuation contribution eligibility conditions (see Appendix 2). In addition, that part of a transfer which is treated as a non-concessional contribution (NCC) may be subject to penalty tax rates if the individual’s NCC cap is exceeded. Legislation has recently been enacted to allow withdrawal of excess NCCs made after 1 July 2013, plus 85 per cent of associated earnings. The associated earnings will be taxed at the individual’s marginal rate less a 15 per cent tax offset. Excess NCCs not withdrawn from superannuation will be taxed at the highest marginal rate. Although this legislative change may provide relief from the NCC cap problem for foreign superannuation fund transfers, careful planning of the amount transferred to the Australian superannuation fund will still be required to manage the fund-capped contribution limit issue (see Tip 7 and Appendix 2). Note also the issue in Tip 8 in relation to transfers from the UK. As the actual exchange rate at the transfer date will be unknown at the time of planning, it may be prudent to allow for currency fluctuations by transferring an amount less than the relevant NCC cap to provide a buffer.

[ EXAMPLE ]

Fund-capped contribution limit

Returning to Henry, assume that the $A depreciates and his UK benefits convert to approximately $555,500 (based on an assumed GBP/AUD exchange rate of 2.02), resulting in applicable fund earnings of $50,500 using Method 1 on the previous page. As the transfer value exceeds the fund-capped contribution limit of $540,000, his Australian fund will not be able to accept the transfer as a single payment.

4 ATO ID 2012/27.
CONSIDER MULTIPLE TRANSFERS FROM THE FOREIGN SUPERANNUATION FUND

As Australian superannuation funds are unable to accept single contributions which exceed the fund-capped contribution limit ($540,000 in 2014/15 if the client had not reached age 65 on 1 July 2014, otherwise $180,000), multiple transfers may be required.

[ OPTION 1 ]

Henry requests two separate transfers

Henry requests that the UK scheme transfer his benefits to an Australian superannuation fund in two separate payments: $180,000 in 2014/15, with the balance (currently $375,500) to be transferred in 2015/16.

The ATO\(^5\) treats the applicable fund earnings as part of the first transfer of $180,000 if a lump sum or annuity may be subsequently paid from the foreign scheme.

However, as Henry has an interest remaining in the foreign scheme, he is prevented from making the tax election for applicable fund earnings associated with the first transfer (see Tip 5).

<table>
<thead>
<tr>
<th></th>
<th>Transfer 1 (2014/15)</th>
<th>Transfer 2 (2015/16)</th>
</tr>
</thead>
<tbody>
<tr>
<td>UK benefits at transfer date</td>
<td>$555,500</td>
<td>$375,500</td>
</tr>
<tr>
<td>Transfer amount</td>
<td>$180,000</td>
<td>$375,500</td>
</tr>
<tr>
<td>Applicable fund earnings included in transfer</td>
<td>$50,500</td>
<td>-</td>
</tr>
<tr>
<td>Eligible to make tax election</td>
<td>No</td>
<td>Yes</td>
</tr>
<tr>
<td>Australian tax payable</td>
<td>$24,745 (ie $50,500 x 49% MTR)</td>
<td>-</td>
</tr>
<tr>
<td>Contribution amount/type</td>
<td>$180,000 NCC</td>
<td>$375,500 NCC</td>
</tr>
</tbody>
</table>

\(^{5}\)ATO ID 2012/48

Forward Thinking

Download the free Forward Thinking app to your iPad or Android device.
Henry transfers $180,000 from his original UK scheme to another UK scheme, then transfers this amount to his Australian superannuation fund in the 2014/15 income year. The remaining $375,500 in the original UK scheme is subsequently transferred to his Australian fund also in 2014/15. Henry seeks UK advice, especially in relation to an appropriate UK scheme to receive the first transfer. Henry can make the tax election for the applicable fund earnings related to the $180,000 transfer, as he will have no remaining interest in the transferring UK scheme. This strategy reduces his overall tax liability on the applicable fund earnings by $17,170.

<table>
<thead>
<tr>
<th>UK benefits at transfer date</th>
<th>Transfer 1 (2014/15)</th>
<th>Transfer 2 (2014/15)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Original UK scheme</td>
<td>$375,500</td>
<td>$375,500</td>
</tr>
<tr>
<td>New UK scheme</td>
<td>$180,000</td>
<td>-</td>
</tr>
<tr>
<td>Transfer amount</td>
<td>$180,000</td>
<td>$375,500</td>
</tr>
<tr>
<td>Applicable fund earnings included in transfer</td>
<td>$50,500</td>
<td>-</td>
</tr>
<tr>
<td>Eligible to make tax election</td>
<td>Yes</td>
<td>Yes</td>
</tr>
<tr>
<td>Australian tax payable</td>
<td>$7,575 (ie $50,500 x 15% fund tax)</td>
<td>-</td>
</tr>
<tr>
<td>Contribution amount/type</td>
<td>$129,500 NCC</td>
<td>$375,500 NCC</td>
</tr>
<tr>
<td></td>
<td>$50,500 applicable fund earnings (not an NCC or concessional contribution (CC))</td>
<td></td>
</tr>
</tbody>
</table>

Note that some foreign schemes may be unwilling or unable to facilitate multiple transfers out of the scheme. Where this occurs, consider transferring the client’s entire benefits to a new scheme that allows multiple transfers to implement the above strategies.

In this situation, and in general with transactions that involve foreign licensing jurisdictions, financial services professionals with expertise and licensing in the relevant jurisdiction should advise clients on the overseas scheme and the foreign tax consequences.

Issues specific to UK transfers

Generally, an individual who permanently leaves the UK may transfer their UK pension scheme benefits to an overseas scheme/fund that is a Qualifying Recognised Overseas Pension Scheme (QROPS). A QROPS is a superannuation or pension scheme outside the UK that agrees with Her Majesty’s Revenue and Customs (HMRC) to meet certain reporting obligations in relation to payments made out of the fund.
Payments from schemes that are not foreign superannuation funds

If the overseas scheme is not a ‘foreign superannuation fund’, the tax treatment of a payment to an Australian resident may depend on an assessment of the type of entity making the payment. Certain ATO private rulings\(^\text{6}\) indicate that if the overseas scheme is a foreign trust, the payment may be considered a trust distribution and any income accumulated in the scheme since the individual became a resident may be subject to tax at the individual’s marginal tax rates. In another private ruling, the ATO indicates that the overseas scheme is not a foreign superannuation fund, and while the ruling does not identify the entity type, the ATO concludes:

*There is no other provision in the Australian taxation provisions that apply to your pension fund payment. Therefore the payment is not regarded as assessable income.*\(^\text{7}\)

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\(^{6}\) ATO Private Rulings 1011911615567 and 1012219733530

\(^{7}\) ATO Private Ruling 1012069531857
APPENDIX 1

Recap on tax treatment of foreign superannuation fund transfers

Australian tax applying to foreign superannuation fund transfers varies depending on when the benefits are transferred and whether a tax election has been made in relation to applicable fund earnings. Broadly, applicable fund earnings is the growth in the value of the benefit since the client became an Australian resident, less transfers and contributions made to the overseas scheme in that period. For clients who have had broken periods of residency, the calculation is more complex.

For Australian residents who are not temporary resident visa holders, transfers will generally be taxed as follows:

<table>
<thead>
<tr>
<th>Transfer occurs</th>
<th>Amount</th>
<th>Contribution type</th>
<th>Tax treatment</th>
</tr>
</thead>
<tbody>
<tr>
<td>Within six months of Australian residency</td>
<td>Entire transfer amount</td>
<td>NCC</td>
<td>Tax free</td>
</tr>
<tr>
<td>After six months of Australian residency – tax election made</td>
<td>Applicable fund earnings</td>
<td>Does not count towards CC or NCC caps</td>
<td>Taxed at 15% in super fund</td>
</tr>
<tr>
<td></td>
<td>Balance of transfer</td>
<td>NCC</td>
<td>Tax free</td>
</tr>
<tr>
<td>After six months of Australian residency – no tax election</td>
<td>Applicable fund earnings</td>
<td>NCC</td>
<td>Included in individual’s assessable income and taxed at marginal rates</td>
</tr>
<tr>
<td></td>
<td>Balance of transfer</td>
<td>NCC</td>
<td>Tax free</td>
</tr>
</tbody>
</table>

APPENDIX 2

Recap on contribution eligibility

Superannuation contributions (including payments from foreign superannuation funds to Australian superannuation funds) are subject to the following contribution eligibility conditions.

<table>
<thead>
<tr>
<th>Australian superannuation contribution eligibility conditions</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Work test</strong></td>
</tr>
<tr>
<td><strong>Age limit</strong></td>
</tr>
<tr>
<td><strong>Fund-capped contribution limit</strong></td>
</tr>
<tr>
<td></td>
</tr>
<tr>
<td></td>
</tr>
<tr>
<td></td>
</tr>
<tr>
<td><strong>Tax file number</strong></td>
</tr>
</tbody>
</table>
Global crude oil prices fell sharply in the second half of 2014, bringing to an end a four-year period of stability around $US105 per barrel.

The plunge in oil prices is a net positive for the global economy, but the impact is not evenly distributed, undermining arguments that markedly lower oil prices will add a substantial stimulus to the global economy and business cycle.

**THE RECENT PLUNGE IN OIL PRICES IS A SIGNIFICANT EVENT**

Compared to previous episodes of oil price declines during the past 30 years, the fall in oil prices in the second half of 2014 is a significant event. Between 1984 and 2013, five other episodes of oil price declines of 30 per cent or more in a six-month period occurred, coinciding with major changes in the global economy and oil markets: an increase in supply of oil and change in the Organisation of the Petroleum Exporting Countries (OPEC) policy (1985-86); US recessions (1990-91 and 2001); the Asian crisis (1997-98); and the global financial crisis (2007-09).

When placed in historical perspective, the recent episode has some interesting similarities with the collapse in prices in 1985-86. Following the sharp increase in oil prices in the 1970s, technological developments made it possible to reduce the intensity of oil consumption and to extract oil from various offshore fields, including the North Sea and Alaska. After Saudi Arabia changed policy in December 1985 to increase its market share, the price of oil declined by 61 per cent, from $US24.68 to $US9.62 per barrel between January and July 1986. Importantly, following this episode low oil prices prevailed for more than 15 years.
In assessing the implications of the recent episode, it is notable that most commodity prices peaked in the first quarter of 2011. Since then, prices of metals and agricultural and raw materials have declined steadily as a result of weak global demand and robust supplies. In contrast, oil fluctuated in a narrow band around $US105 per barrel until June 2014, but an unexpected shift in policy at the OPEC meeting in late November intensified the plunge in prices. By the end of 2014, the cumulative fall in oil prices from the 2011 peak was much larger than that in non-oil commodity price indices.

**CHANGES IN OIL PRICES HAVE PROFOUND ECONOMIC AND FINANCIAL IMPLICATIONS**

As the benchmark for global energy prices, oil prices play a pivotal role in determining cost and price movements across the world. Not surprisingly, sharp changes in oil prices often have a profound effect on economic and financial conditions. Broadly speaking, oil prices feed into growth and inflation through three channels, which then play a fundamental role in determining the relative incidence/impact of these price changes:

- **Input costs** - lower oil prices reduce energy costs generally, as prices of competing energy materials are forced down too, and oil-fired electrical power is cheaper to produce. In addition, since oil is the feedstock for various sectors, including petrochemicals, paper and aluminium, the decline in price directly impacts a wide range of processed or semi-processed inputs.
- **Real income shifts** – oil price declines generate changes in real income benefiting oil-importers and losses hurting oil-exporters. The shift in income from oil exporting economies with higher average saving rates to net importers with a higher propensity to spend generally results in higher global demand in the medium term. However, the effects may vary significantly across countries and over time: for example, some exporting economies may be forced by financial constraints to adjust both government spending and imports abruptly in the short term.
- **Monetary and fiscal policies** in oil-importing countries where declining oil prices may reduce medium-term inflation expectations below target, central banks could respond with additional monetary policy stimulus (that is, cutting interest rates), which in turn supports growth. In oil-exporting countries, however, lower oil prices might trigger contractionary fiscal policy measures, unless buffers are available to protect expenditures from the decline in tax revenues from the oil sector.

Despite the increasingly globalised and inter-linked nature of business cycles, these transmission channels operate at different strengths and lags across countries. However, it is widely agreed that oil price declines generally have smaller output effects on oil-importing economies than oil price increases.

**SO HOW DOES THE GLOBAL SCORECARD READ?**

From a global perspective, recent analysis by the International Monetary Fund (IMF) suggests that a 30 per cent price decline in oil prices (as expected between 2014 and 2015) driven by a supply shock would be expected to boost world gross domestic product (GDP) by around 0.5 per cent in the medium term. Nevertheless, given the disparate impact of falling oil prices and policy-related factors, it is likely that the pattern of growth will remain uneven.

In terms of prices and costs, lower oil prices will temporarily reduce global inflation. The impact across countries will vary significantly, reflecting in particular

**AS THE BENCHMARK FOR GLOBAL ENERGY PRICES, OIL PRICES PLAY A PIVOTAL ROLE IN DETERMINING COST AND PRICE MOVEMENTS ACROSS THE WORLD.**

**THIS PRICE FALL HAS BROUGHT TO AN END A FOUR-YEAR PERIOD OF STABILITY AROUND $US105 PER BARREL.**

$US105/
the importance of oil in consumer baskets, exchange rate developments, stance of monetary policy, the extent of fuel subsidies and other price regulations. Overall, the IMF’s aggregate world estimates suggest that a 30 per cent decline in oil prices, if sustained, would reduce global inflation by about 0.4-0.9 percentage points through 2015.

For key oil-exporting countries, including Russia, and some in the Middle East and North Africa, estimates suggest that GDP growth could decline by 0.8-2.5 percentage points in the year following a 10 per cent decline in the average price of oil. The slowdown would also compound fiscal losses in oil-exporting countries with fiscal break-even prices, which range from $US54 per barrel for Kuwait to $US184 per barrel for Libya, exceeding current oil prices for most oil exporters.

By contrast, in oil-importing countries a 10 per cent decrease in oil prices is estimated to raise growth by some 0.1-0.5 percentage points, depending on the share of oil imports to GDP. In China, for example, the impact of lower oil prices is expected to boost activity by 0.1-0.2 per cent because oil accounts for only 18 per cent of energy consumption, whereas 68 per cent is accounted for by coal. Other large oil-importing emerging market economies also stand to benefit from lower oil prices. In Brazil, India, Indonesia, South Africa and Turkey, the fall in oil prices will help lower inflation and reduce current account deficits – the major source of vulnerability for these countries.

For Australia, falling oil prices are a case of betwixt and between for the economy given its status as a net energy exporter. Over the next few years, energy exports are set to become increasingly important to Australia’s economy, while the economy already exports as much energy – oil, coal and natural gas – as it does iron ore. Importantly, as oil prices fall, natural gas prices follow (although with some lag) due to the linkages incorporated into the supply contracts underpinning Australia’s major Liquefied Natural Gas (LNG) projects. At current prices, the impact on lower LNG prices is equivalent to 1 per cent of GDP in 2015, rising to a sizeable 2 per cent in 2017. So, lower oil prices can be expected to compound the current downturn in Australia’s terms of trade and hence the income-recession that is currently afflicting the economy.

Given the current low levels of business and consumer confidence, it is likely that the positive effects of lower petrol prices will be largely offset by the dampening effects of the decline in Australia’s national income via the decline in global energy prices. That said, much will depend on the extent of the ‘tailwind’ effect on the key oil-importing economies of Asia and in turn their capacity to expand domestic demand.

A solid recovery in activity in Australia’s major trading partners would certainly increase the prospects of a net positive effect for the economy.
As technological services develop at an exponential level, industries are feeling the pressure from ‘game changers’ like Uber.
INTERVIEW WITH IAN POLLARI, PARTNER AND NATIONAL SECTOR LEADER FOR BANKING AT KPMG

Disruption in financial technology: Friend, not foe.

KPMG released a report Unlocking the potential: The Fintech Opportunity for Sydney discussing how fintech financing activity, currently estimated at $US3 billion, is expected to double by 2018.

We talked to Ian Pollari, National Sector Leader for Banking at KPMG, to learn why everyone’s talking about financial technology (or ‘fintech’) right now and just why there is so much expected growth.

WHAT IS FINTECH?
There’s always been a strong connection between financial services and technology. What’s different now is a shift in focus from innovation occurring in middle and back office IT functions (to deliver resilience, security and operational efficiency) to the delivery of the consumer experience. Front-office activities, like payments, sales and wealth management, are rapidly evolving as technology is increasingly prominent in our day-to-day interactions with the modern interconnected global economy.

We now have a well-established funding culture, like in Silicon Valley. We see many ‘serial entrepreneurs’ now, like Jack Dorsey setting up Twitter and then Square. Success is leading to more investment which, in turn, is leading to new success; a chain reaction of rapid growth.

WHY IS THERE SO MUCH BUZZ ABOUT THIS AT THE MOMENT?
The rapid growth in the internet, social media, data and mobile devices has led to reduced ‘information asymmetry’, where consumers are more powerful in their decision-making than ever before with the ubiquitous nature of information availability.

Fintech start-ups are capitalising on consumer desire to hold on to this power. At the same time, the cost of computing and software development has plummeted, opening up industries that previously had high technical barriers to entry. Dealing in fintech is much easier and cheaper than five years ago.

Within the industry, we’re seeing two types of ventures emerging across the financial services spectrum: those seeking to dis-intermediate or develop new business models that challenge the traditional forms of finance, and those looking to provide products and services to established firms to act as partners improving existing business models together.

WHAT’S DRIVING THE CHANGE?
At the moment, it’s quite simply supply and demand. In the US and the UK, particularly London, which are the fastest growing fintech centres, negative consumer sentiment rose against large institutions during the
global financial crisis (GFC). Consumers started looking for alternative ways to handle their money and achieve their financial goals, like peer-to-peer lending or social funding.

During the turbulent economic climate, we also witnessed many talented people exit the industry and look to do something different. With limited options, the majority of fintech innovators were driven to start up their own organisations through frustration with the status quo and recognition that key parts the economy were just simply not well served.

**WHY ARE LARGE INSTITUTIONS GETTING INVOLVED?**

They recognise they need to invest in initiatives that sit outside their regular corporate culture, and are empowered to explore innovation while avoiding legacy processes.

At KPMG, we describe a ‘safe to fail’ environment, a large-scale version of trial and error. While we understand risks involved with our operations, we recognise that failure can happen; but it should be fast and cheap, and allow for the quick accumulation of experience.

The world has changed, and a bolder new approach is needed to keep up. Products developed internally over a long period of time are a notion of the old world. We need iterative processes which engage the consumer and promote creation and creativity to deliver a more ‘frictionless’ customer experience.

The new world is about an ever-changing product which develops on the go, according to real-time consumer feedback. This ‘minimal viable product’ mentality is the underlying idea of fintech today.

**‘GAME CHANGERS’ APPEAR ALL THE TIME. ISN’T IT LIKELY THAT SOMETHING UNPREDICTABLE MIGHT DRASTICALLY AFFECT THE INDUSTRY?**

Uncertainty and risk are quite high, but it all comes down to ‘strategic optionality’. It’s very hard to pick the ‘winners’ per se, so corporates and venture funds are putting down money in a series of small bets to manage risk across a breadth of opportunities. They hope their portfolio will breed some key successes. Of course, they are not just dumping money blindly into start-ups. These financial decisions are always coupled with a set of networks, capabilities and expertise. Most large institutions also provide tacit support like regulatory guidance to their venture partners to make their investments viable.

**WHY WOULD INSTITUTIONS WANT TO PARTNER WITH SERVICES CHALLENGING EXISTING OPERATIONS?**

The most important point I can make is: digital disruption is not solely a competitive threat. Originally, it was believed that digital enhancement was going to fundamentally alter the industry. Any panic was based on fear of change rather than a deeper understanding of how the system at large can grow. Digital innovation is about fostering collaboration more than anything.

Most fintech start-ups want or need to partner with existing institutions. They recognise that large organisations have expertise, capital, data, distribution, and consumer and regulatory knowledge that is vastly superior to their own. It’s in the collective interest of the industry to develop our financial services offerings together, for all clients and service providers.

Think about the ‘under-banked’, those who can’t get access to quality banking solutions, particularly in emerging markets. Large banks have only recently been able to reach these people through new payment capabilities coming from fintech developments like online transaction accounts and credit cards backed by large consumer corporates (like Woolworths). A digital shift allowed the larger population to become more educated in financial services and slowly grow their understanding of what’s available for their personal needs. These people are now aware of more traditional banking services, like mortgages and personal loans. These are positive developments for the industry as a whole.

**HOW DO YOU THINK THIS WILL APPLY TO WEALTH MANAGEMENT?**

I think wealth management will mirror this in the coming years. ‘Robo-advice’ and online wealth solutions are growing rapidly because a big part of the population aren’t getting any financial advice, for reasons like lack of reach or cost.

Online solutions are a cost-effective, simple and transparent way to disseminate wealth advice on a large scale, but this isn’t a bespoke experience. I believe we’ll see technology push people from a segment not currently engaged with wealth to one where clients are enthusiastic about a face-to-face personalised service. Using an automated model is great for overall wealth decisions, but it doesn’t allow for someone to maximise their individual financial potential, given their exact complex situation.
The technology will ‘grow the pie’, as it were, showing that professional financial advice is valuable and warranted, in turn enticing those interested to seek out real advisers to discuss their personal circumstances, goals and financial aspirations.

**SO WHAT CAN BE DONE TO SUPPORT THE FINTECH INDUSTRY?**

We need support from the entire community to foster a strong fintech environment. The UK aligned policy and regulators with companies, start-ups, and academic and research institutes, in both public and private sectors, to set up an excellent ‘fintech ecosystem’, a financial services industry that operates harmoniously to promote technical innovation and growth for all parties involved.

During our research, we had local fintech entrepreneurs meet with David Murray and the Financial System Inquiry Secretariat on the topic of innovation, policy and regulation. We found that government support can come from capital development within funding and taxation reform. For example, changes to employee share scheme taxation arrangements and the Significant Investor Visa program can free up cash flows for new ventures and attract greater levels of venture capital funding.

In Australia, our regulators are looking into this at the moment, preparing an environment for strong fintech expansion and growth. It’s good to see regulators making room for experimentation. Their challenge is to support this while avoiding any systemic risks; because, as you know, finance and wealth products are very sensitive, they involve people’s lifetime savings and livelihoods.

Also, most start-ups are looking for distribution. This is a great opportunity for financial planners to help introduce new products and services to your clients. In Australia, we’ll see wealth used as a channel more than in other global fintech industry, given the prominence of superannuation here. I think we’ll see many self-directed solutions develop, so there will be massive opportunity for financial planners to use this as a pipeline to reach new clients while providing exciting new options to their existing ones.

**HOW DOES AUSTRALIA’S FINTECH ENVIRONMENT COMPARE GLOBALLY?**

From a broader financial services perspective, we have work to do. Sydney, as a financial centre, was ranked in the top 10 of the world in 2008. Furthermore, we came out of the GFC relatively well, compared to other countries, so you’d intuitively expect our ranking to now be higher. However, we’ve actually slipped to 23, with Melbourne following at 24, relative to other international financial centres.

We need to focus on fintech to keep up, because that’s where the global economy is primarily growing. Finance is the biggest part of our economy, employing over 400,000 people and contributing over $11.5 billion in tax annually. There’s a lot at stake here. If we get complacent, other countries will dominate our markets and push us further behind with their technical developments.

The good news is that right now in Sydney we’re working to develop a world-class fintech ecosystem to compete with the US and the UK, called Stone and Chalk. We want to provide high-quality start-ups and innovative programs with the best opportunity to succeed, grow and go international. Our initiative launches later this year, supported by a number of government, regulatory and corporate partners, including KPMG and Macquarie. We’ll provide support in the form of capital, networking and expertise for start-ups, and an open forum for large corporates to share ideas and developments. Anyone interested can look forward to a range of events scheduled to pop up later this year.

**WHO ARE THE CURRENT FINTECH TRAILBLAZERS?**

KMPG with Australasian Wealth Investments Limited (AWI) and the Financial Services Council released a report showcasing who we believe are the 50 best innovators in fintech for 2014.

As a start-up, Lending Club has been phenomenally successful in such a short time. It didn’t exist seven years ago, but managed to raise $US800 million in December, placing it as the 15th largest bank in the US with its market valuation of about $US9 billion. That should give you a sense of the investment and world focus fintech is attracting at the moment.

Interestingly, out of our 50 best innovators, over 80 per cent didn’t exist before the GFC and 10 per cent are from our Australia and New Zealand financial network, with Xero, Society One and Stockspot being some shining examples.
Making an impact
Mobilising capital to make a meaningful social return as well as a commercial return is at the heart of the relatively new investment approach known as impact investing.

People need to recognise this isn’t about philanthropy, it’s about harnessing capital to make a commercial return as well as a social return.

“People need to understand that impact investing is not a philanthropic activity nor is it a silver bullet that is going to solve all social ills. However, impact investing does seek to create social, environmental and cultural benefits alongside a financial return and, importantly, measures the achievements of both.

While the impact investing market in Australia is developing rapidly, Mr Gales says the market is nowhere near as mature as those in the UK and Europe. It has been “hyped”, he says, but lacks capacity building, infrastructure and funds to set up social impact bonds and investment readiness.

The market will take time to mature and develop in a way that suits Australian conditions, he thinks.

“I hope people are not trying to import ideas from the UK or elsewhere because the capacity building and infrastructure for the market need to reflect local conditions such as geography and government structure,” he said. “Ours are quite different.”

Increasingly, governments cannot meet the growing demand for social services while philanthropy and generosity are insufficient to fill the gap. This can be where impact investing steps in but it should not be considered as a replacement for grants or philanthropic activities.

“Impact investing has its part to play, and we need to recognise what it can do,” Mr Gales said.

“But people need to recognise this isn’t about philanthropy, it’s about harnessing capital to make a commercial return as well as a social return, and this is the way to get it from a fringe activity to a mainstream activity.”

The Macquarie Group Foundation has been a supporter of impact investing organisations like SEFA and Social Ventures Australia (SVA) for several years.

The Foundation has supported SEFA, a social lender that connects investor funding with social enterprises and entrepreneurs and provides financing solutions to encourage expansion, since its inception in 2011. SEFA’s establishment and growth has been forged by David Rickards, who was the then Head of Equities Research at Macquarie.
In 2011, SEFA required bridging funding after losing the backing of a large equity investor, and Macquarie stepped in to provide this funding. SEFA was then able to receive a grant from the Federal Government.

David Bennett, Chairman of SEFA, a former Treasurer of Macquarie Group and a Board member of the Macquarie Group Foundation, said that without the bridging funding “it would have been very difficult for SEFA to receive the grant from the Government and get started”.

Mr Bennett says SEFA competes with grant giving because organisations would prefer to receive money than borrow money.

“While this makes sense, from the overall sector’s point of view, organisations that are capable of borrowing to increase their capacity should leave grants to organisations that are not in a position to borrow,” he said.

The Macquarie Group Foundation has also provided capacity building support by offering Macquarie employee expertise and mentoring to organisations in order for them to be investment-ready before SEFA signs over a loan.

The Foundation has also supported SVA over its decade-long experience of raising different forms of social investment and venture philanthropy in Australia. SVA has led impact investing in this country and, in 2009, helped coordinate Australia’s largest example of social finance investing, the $165 million GoodStart Childcare transaction. SVA also manages Australia’s first social benefit bond with UnitingCare and the NSW Government.

Mark Peacock, Impact Investing director at SVA, described the GoodStart transaction as a landmark one that was “really the first of its kind”. It had 41 investors contributing $22.5 million into the transaction, which showed there was a large amount of capital ready to be deployed into the sector. “It also showed impact investing does work, because the investors received notes that have continued to pay a coupon of 12 per cent each year, which has been an exceptional return,” Mr Peacock said.

He thinks the impact investing sector has been progressing well over the last five to 10 years, moving from a negative screening approach to positive screening when making investment decisions.

The NSW Government is developing the impact of this asset class through the launch of its Social Impact Investment Policy in early February this year. The policy builds on the success of NSW’s social benefit bonds and sets out the Government’s intent to support a broader social impact investment market in NSW.

The Government aims to deliver two new social impact investment transactions to market each year, which will only be available to wholesale and institutional investors.

The transactions will focus on four priority areas: managing chronic health conditions, supporting offenders on parole, managing mental health hospitalisations and preventing or reducing homelessness among young people.

“The GoodStart Transaction had 41 investors contributing $22.5 million.”

41 $22.5M
## Corporate Directory

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