

18 September 2015

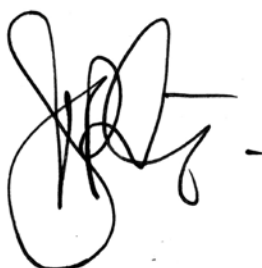
Ms Karen Chester
Commissioner
Productivity Commission
Level 20, 175 Pitt Street
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Dear Karen,

Thank you for your time on 1 September 2015 to discuss the Centre for International Finance and Regulation's insights and suggestions for the ASIC Capability Review. Further to our discussions, I have reached out to CIFR's 70 lead researchers requesting their input and feedback. Due to the tight timeframe, some of the researchers were unfortunately unable to submit, while others have already submitted to the ASIC Capability Review Panel directly, such as Mike Aitken from the CMCRC. At this stage we have had 7 submissions, which I hereby attach.

I hope that these submissions are useful to the Panel. Please let me know if CIFR can help further or if we can facilitate you contacting any of the researchers to discuss their submissions further.

Best regards,



Professor David R. Gallagher
CEO, Centre for International Finance and Regulation

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To Whom it May Concern,

Re: CIFR Feedback for ASIC Capability Review

The following observations about the collection of information and the protection of consumers are provided as an offshoot of an FSI submission on the costs and benefits of removing red tape. I write as the team leader of CIFR project E003, with a background in central banking. I claim no expertise concerning ASIC.

In general independence is desirable when elements of an environment that influence each other, or are joined together in some way, are helpfully separated. Since regulators collect information and make decisions along many dimensions, it is necessary to be specific about what things are to be unlinked in any quest for regulatory independence.

Information collection independence takes advantage of the power of independent sampling to generate rapidly declining probabilities of errors. The greater the quality of information collected the fewer policy mistakes regulators in general and ASIC in particular are likely to make.

The quest for independent information raises such questions as:

- Should ASIC Direct Boards to ask consultants to use original data and not summarized data given to them
- Should ASIC encourage ‘mixed teams’ to investigate issues, both within ASIC but also in organizations being supervision? By maximizing, not minimizing, professional overlap, the chance of the same issue being investigated by people of ‘independent outlooks’ may reduce the chance of mistakes and increase the quality of information collected. This is a different mindset to straightforward specialization and cost minimization. Any ‘efficiency drives’ for regulators should be carefully scrutinized.
- When is the right time to share information with other regulators, or share information within different departments of ASIC? Too early sharing may inhibit independent views emerging; sharing that is delayed too late might preclude developing an accurate ‘big picture’.
- Can financial institutions game the information collection process?

With regards to the protection of consumers, the regulator is in essence assuring a high quality product which taps into the extensive literature on quality control.¹ Some of this literature is more appropriate for factory processing contexts, but in an increasingly service-dominated economy, this evolving literature has many potential lessons for those concerned with the ‘quality control’ dimension of financial products.



Gordon Menzies
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University of Technology Sydney

¹ For example see Evans, J. and W Lindsay, (2011), *Managing for Quality and Performance Excellence*, South-western.

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ASIC Capability Review Points for discussion

- ASIC does not seem interested in the role of rigorous “economic” research in informing regulation. This contrasts heavily with SEC approach
- SEC works closely with leading academic associations (AFE, AEA, AAA) to staff its own research capability (Office of Chief Economist, Office of Chief Accountant) and to support and engage with external research
- This approach is “endemic” to US – see PCAOB research capability as another example
- Absence of research capability (stark contrast with “legal perspective”) harms decision making or at least raises suspicions about motivation – see 2009 short-selling ban as a case in point – justified via means of “ASIC research” – contradicted results in papers published in top finance journals and in some cases supported/produced by SEC, yet not made publicly available.
- Why has ASIC Office of Chief Economist been changed to “Strategy and Intelligence”?
- Example of accounting surveillance – no real interest in engaging with researchers, nor in “targeting” review on the basis of likely issues.
- CIFR support for Non-GAAP – this took ASIC 5 years to progress from Discussion Paper to RG 230!
- AFAANZ is a one stop shop across markets and reporting – very keen to engage with ASIC.

16 September 2015

Feedback for Capability Review of ASIC

This feedback is provided based on the following:

- Research project E039 'Elements of Risk Governance and Culture' 2012-15
- Reading of ASIC's Corporate Plan dated 31/8/15
- Attendance at recent ASIC Senior Executive Forum on Culture and participation in panel discussion
- Recent meetings with ASIC staff

Financial regulators are increasingly understanding the importance of corporate culture in creating an environment that permits or even encourages misconduct in financial institutions. ASIC's most recent Corporate Plan mentions culture at numerous points indicating that ASIC accepts the need to consider culture as part of its surveillance reviews.

For the finance industry, this focus on culture is a relatively new development and few institutions or regulators are well equipped to address it. Staff have typically been educated in the disciplines of Business, Commerce, Accounting, Economics or Law; very few have formal training in fields such as Organisational Behaviour and Organisational Psychology which might equip staff to assess culture or to modify it.

Recommendation: a) Employ staff with substantial expertise in organisational culture e.g. registered organisational psychologists b) Ongoing training for ASIC staff in the area of culture should be a priority.

Related to the above, there is a danger that regulatory culture assessments conducted by ASIC may not reflect best practice. Culture assessments will only be effective if conducted using assessment instruments that have been rigorously validated. It is unclear whether the 'Culture Calculator' recently developed by ASIC staff is a reliable and valid indicator of culture.

Recommendation: Ensure that ASIC uses evidence-based techniques for culture assessment.

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Understanding of culture in financial institutions is still growing and research emerging. The CIFR-funded research project E039 has been ground-breaking, placing Australian researchers at the forefront of the field and making an impact internationally.

Recommendation: Collaborate with researchers in the field of culture research. This strategy will allow ASIC to be at the forefront of best practice and to build in-house expertise.

Associate Professor Elizabeth Sheedy



16 September

David R. Gallagher
Chief Executive Officer - Centre for International Finance and Regulation
Professor of Finance - UNSW Australia, Business School
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Dear David

Thank you for the opportunity to provide feedback for the Capability Review of the Australian Securities and Investments Commission.

I advocate an open and strong relationship between the ASIC and academia, not unlike that between the SEC and US academics (both directly and via the AAA and AFA). While the SEC has the benefit of scale, it would be of enormous mutual benefit to establish similar avenues for engagement in Australia including channels of communication & feedback mechanisms, avenues for data procurement, commissioned research, and the like. The ASIC would find rigorous research in finance, accounting, law and economics to be of enormous benefit in informing the formulation of regulatory policy. The data collected by the ASIC is a valuable public good which most academics have struggled to access due to cost or an inability to identify what is available. Many of us can access SEC data much more readily without ever contacting the SEC for access permission. This is a contributing factor for many researchers in this country focusing away from the local market depriving our policy makers of rigorous empirical evidence. Should any part of the ASIC's databases be sold (e.g., the Business Register), it is important to ensure that academics have unimpeded and free access.

ASIC is doing a good job within the Australian business community to ensure the social benefits of fair and transparent markets. It is somewhat constrained from doing a better job by the resources that it has at its disposal. In some senses the release of data to academics (with appropriate safeguards) would give ASIC the opportunity to leverage its resources since they represent a cost effective (usually free) and highly qualified resource.

The above comments are offered in a spirit of cooperation and continuous improvement. I trust you and the Panel will find them helpful.

Best wishes,

Baljit Sidhu
Professor of Accounting
Editor-in-Chief, Australian Journal of Management

15 September 2015

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David R. Gallagher
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Dear David,

RE: FEEDBACK TO THE PANEL CONDUCTING THE ASIC CAPABILITY REVIEW

I thank CIFR for the opportunity to provide feedback to the Panel conducting the Capability Review of the Australian Securities and Investments Commission (ASIC), which has come out of the recent Financial System Inquiry (FSI).

ASIC has a number of objectives such as financial market integrity, corporate registry and financial literacy. I believe that the following issues are worth considering:

- **ASIC Focus on financial market integrity:** Financial market integrity is a core competency of ASIC. Other service areas such as corporate registry and financial literacy may be covered by external providers.
 - ASIC is currently working on a private sector solution for the corporate registry.
 - Financial literacy may be provided by industry groups such as FINSIA or Australian universities.
- **Consistent ASIC risk measurement framework:** ASIC regulates entities (e.g., registered companies) that differ, next to many other criteria such as industry, by the likelihood and severity of risk. Entity risk assessment is a key element in ASIC's regulatory framework where entities with higher risk profiles receive higher levels of supervision. ASIC considers information asymmetries, market structures, business conduct, economic trends, market trends, demographic shifts, investor and consumer behaviour and technological developments. ASIC may ensure consistency for its risk measurement approach by defining risk along a number of dimensions:
 - Definition of risk outcomes: examples may include losses to consumers, losses to unsophisticated investors, or losses to the general public (e.g., Australian taxpayers);
 - Weighting of risk factors to ensure consistency over industries and business models;
 - Aggregation of weighted risk factors;
 - Distinction between idiosyncratic (i.e., entity specific), systematic risk (i.e., economy specific) and systemic risk (i.e., ability to cause economy wide systemic stress);
 - Separation of likelihood and severity of losses for given weighted risk factor combinations.
- **Development of benefit model for ASIC regulation:** ASIC may develop a benefit model that is based on such a rigorous risk framework by identifying distributions of economic losses pre and post regulation. Other prudential regulators have developed such benefit models.

- **Impact analysis of alternative options for ASIC funding model:** ASIC is currently discussing a change of its funding model: ASIC would continue to be funded from the Commonwealth Budget, with a greater proportion of its budget offset by charging industry levies and fees. ASIC may analyse the impact of the suggested funding model on individual entities. Generally speaking, the transfer of costs to the entities creating such costs may increase industry efficiency and transparency. Important aspects may include:
 - The proposed rules may be more complex than existing ones implying additional indirect compliance costs to entities.
 - Fixed costs may be converted to variables fees based on size and risk of entities and various competing allocation mechanisms may be considered.
 - ASIC may have community service obligations and various allocation mechanisms for such obligations may be considered. A default option would be the funding of such services by the Commonwealth Budget.
 - Existing entities and future entrants may be impacted in different ways and an impact analysis may distinguish between these categories.
 - It is likely that cross-subsidies continue to persist and identification and quantification of such cross-subsidies may be helpful to facilitate future improvements of efficiency.
 - The consideration and impact of alternative costing concepts (market prices, production costs) and reference periods (e.g., historic, spot, and future) may be helpful.
- **ASIC data collection and research:** ASIC may collect a data base of past loss events that is made available for academic researchers to improve our understanding of factors driving such events. Similar databases are common in financial institutions and data share consortia between such institutions.

Best wishes



Harry (Harald) Scheule

Appendix Dr Harald Scheule

Bio

Harry (Harald) Scheule is Associate Professor of Finance at the University of Technology, Sydney. He is a regional director of the Global Association of Risk Professionals. His expertise is in the area of Banking, Financial Risk Measurement and Management, Insurance, Mortgages, Prudential Regulation, Securities Evaluation and Structured Finance.

His award-winning research has been widely cited and published in leading journals including the European Financial Management, European Journal of Operational Research, International Review of Finance, Journal of Banking and Finance, Journal of Financial Research, Journal of Futures Markets, Journal of the Operational Research Society and the Journal of Risk and Insurance. He currently serves on the editorial board of the Journal of Risk Model Validation. He is author and editor of four books.

Harry has worked with prudential regulators of financial institutions and undertaken consulting work for a wide range of financial institutions and service providers in Asia, Australia, Europe and North America. These institutions have applied his work to improve their risk management practices, comply with regulations and transfer financial risks.

Reference projects

Project Travel Compensation Fund: From 2006 to 2011 Dr Scheule has advised the Australian Travel Compensation Fund (a scheme implemented by the Australian government to cover losses of travellers in relation to travel agent defaults) on risk-based premiums and options to cover concentration risks by large travel agents. This project analysed the impact of various industry funding models on existing and new firms. Furthermore, ways on how to efficiently transfer costs to smaller firms were analysed with a focus on minimising indirect compliance costs to smaller firms.

The expertise applied in this project may be relevant to ASIC as the funding model is based on size and risk of entities which may require a rigorous impact analysis. Dr Scheule developed size and risk based premium structures and analysed the impact of such structures on firms.

Project Australian Prudential Regulation Authority (APRA): In 2007 to 2008, Dr Scheule validated the Probability and Impact Rating System, and the Benefit Model of APRA. APRA uses these models to allocate supervisory resources to banks in Australia and to assess the impact of prudential regulation. The project identified major risks, assessed the reasonability of risk weights and the functional linkages between these. Furthermore, the project analysed the mapping of weighted risk factor combinations to economic measures that are the basis for the quantification of the benefits of prudential regulation.

The expertise applied in this project may be relevant to ASIC as the regulation efforts and future funding are based on multi-factor risk models. ASIC may substantiate its costing through benefits provided. Dr Scheule has vetted such a risk based framework and benefit model for APRA.

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16.09.2015

Dear David,

Re: Feedback for Capability Review of the Australian Securities and Investments Commission (ASIC)

This feedback relates to two specific areas of ASIC's current operations; oversight of the auditor switching process and market surveillance. The feedback to the panel reflects early stage results of empirical capital markets based research being conducted within the Accounting Discipline Group at UTS bearing relevance to these distinct aspects of ASIC's operations.

1.0 Resignation, removal and replacement of auditors

Early stage empirical research being conducted in the area of capital market reactions to auditor switches is relevant to ASIC's oversight of the auditor resignation process. A recent working paper by Ferguson, Lam and Ma (2015) examines market reactions to a sample of 713 auditor switches in Australia over the period from 1999-2010 applying the event study methodology approach. The study sample coincides with a time period under which the process of auditor resignation was documented in the initial version of Regulatory Guide 26 (RG 26) issued in June 1992. Under the initial version of RG 26, the market is informed of most auditor resignations via announcement of Annual General Meeting (AGM) agenda items to the Australian Securities Exchange (ASX). The research finds no significant market reaction to announcements of auditor resignations in Australia with the authors acknowledging that one reason for the null result could be information leakage. Auditor resignations under RG 26 require the auditor to apply for ASIC consent to resign, suggesting the process can be prolonged with a number of parties potentially privy to the consent process.

Under the initial version of RG 26, auditor resignations can take place outside the AGM framework, but only under exceptional circumstances (failing health of an auditor, loss of independence of the auditor, the company is not audited by the auditor of the parent, or relocation of the company or auditor's business). Another potential reason for not observing a market reaction under this framework is announcement noise, with many agenda items typically included in AGM agenda items disclosures. Despite these experimental limitations, the lack of a market reaction is more likely due to the removal of information from the market through the ASIC consent process. That is, due to the consent process, the market is largely uninformed of two key attributes of auditor switches in Australia. Firstly the capital market is unaware of the real initiator of the auditor resignation (auditor or client). Secondly the market receives nothing in the way of reasons for the auditor resignation.

Thus, under the initial version of RG 26 (which is the ASIC practise guide in light of the now Section 329 of the Corporations Act 2001), ASIC is the gatekeeper of information regarding the auditor resignation process, not the capital market. The finding of no significant market reactions can be contrasted with other jurisdictions such as the United States (US), where a number of studies identify material stock price changes around auditor resignations. The key difference between the US setting and the Australian approach is the US reliance on simple disclosure to capital markets as the means of information delivery, as opposed to a process driven bureaucratic consent approach.

The ASIC auditor resignation consent process under the initial RG 26 has a number of conceptual inconsistencies. Firstly, it is non-transparent with information and filings warehoused within ASIC and not publically available to the capital markets. In other words, the lack of transparent information being provided to the market constrains efficient pricing. Secondly, by ASIC assuming an information gatekeeper role, the market is denied potentially material information which serves to undermine the effectiveness of ASX's Listing Rules 3.1 and 3.1A pertaining to continuous disclosure. Continuous disclosure requires any information that may have a material impact on stock prices must be released to the market immediately. Continuous disclosure is an underlying principle promoting informed markets. It is possible to argue auditor resignation information could be material based on US studies of market reactions to resignations. Thirdly, it is unknown whether any ASIC consent approvals have subsequently proved to be flawed. In such circumstances, the consent approach may expose ASIC and thus the Australian taxpayer to litigation risk.

In a recent development, ASIC released Consultation Paper CP 209 (CP 209) in May 2013 relating to auditor switches. CP 209 called for professional input into the process of updating ASIC's approach to the resignation, removal and replacement of auditors. CP 209 provided the basis for an amended version of RG 26 released in June 2015. There are two main changes in the amended June 2015 version of RG 26. Firstly, ASIC has removed timing restrictions on when an auditor resignation can occur, effectively permitting resignations outside of AGMs. In the past, these non AGM resignations were governed by the prior exceptional circumstances provisions. Secondly, if the resignation occurs outside of the AGM process, disclosure to ASIC and the capital market is required. Thus the amended RG 26 sees effective deregulation of the timing of auditor resignations and more relevant and timely information disclosed to the capital markets. However, whilst the initiative is positive, it is likely disclosures will be fairly benign since the auditor resignation process remains under the ASIC consent framework. That is, the market will arguably be uninformed about both the real initiator of auditor change (client or auditor) and the reason(s). In addition, there is no disclosure required, where the resignation occurs around the AGM. Note that for auditor removals, the consent provisions are not required as removals take place under provisions of the Corporations Act and are done through member votes at the AGM or through an Extraordinary General Meeting (EGM). In order for better information flow to occur, both the auditor resignation and dismissal process needs to be brought under the same disclosure umbrella. Shareholder protection from agency costs of managers appointing auditors exists in the form of capital market monitoring.

In summary, whilst ASIC's amended RG 26 represents a move in the right direction, it is possible to argue there has been change in the 'form' of the amended RG 26, with the substance remaining

much the same. The problem is ASIC consent requirements, which remain in place owing to their legislative backing. The Deloitte submission to CP 209 stated:

“Whilst we recognise that a fundamental change in the process may not be a legislative priority for Treasury at this time we believe Treasury should consider abolishing ASIC’s responsibilities regarding the approval of a change in auditor. As this requires legislative change, we recommend that roundtables be held to discuss possible options.”

Interestingly, the approach in amended RG 26 remains consent based, but overseas regulators (Canada, the European Union, the United Kingdom and the US) do not require regulator consent to auditor changes (CP 209, pp. 23-24). The KPMG submission to CP 209 stated:

“We believe that benefits in the form of efficiency for ASIC, the audit industry and its clients would be optimised through legislative reform aligning the Australian regime with international practice. That is, removing the obligation for ASIC to consent to resignation, removal and replacement of auditors. Instead we believe ASIC should be notified of any change, including reasons for change.”

Overall, the consent approach is arguably bureaucratic and process driven with the capital market denied timely information. Ferguson, Lam and Ma (2015) report no market reaction to auditor resignations announced as part of AGM agenda items. These findings suggest that legislative change to remove ASIC’s consent responsibility might be the best solution. A move towards a deregulated, disclosure based model of both auditor resignations and removals would cut compliance costs and result in more informed capital markets. In other words let market forces perform the job of ASIC and allow the market’s view of timely information regarding auditor changes to be reflected in security prices. This suggestion is relevant to listed companies. Roundtables may address needs in relation to unlisted public companies in Australia.

2.0 Informed Trading and the trade-off between disclosure and surveillance

Informed trading is defined as the phenomenon of trading a security based on material information not generally available to most traders. A recently completed PhD thesis by Alex Feigin at UTS and supervised by Andrew Ferguson (UTS), Doug Foster (Sydney University) and Alan Blair (UNSW) examines informed trading detection prior to material mining stock progress report announcements. Material mining stock progress report announcements are chosen due to the high information asymmetry setting offered by the mining industry, the common business objectives and relative homogeneity of mining companies, the large number of sample constituents and the materiality of returns around many progress report announcements. In addition, anecdotal evidence suggests the industry is prone to insider trading. These announcements are filtered to examine only observations where the event window stock return is +or-10% or greater. Using a Bayesian methodological approach, two informed trading metrics including Probability of Informed Trading (PIN) and limit order book slope are applied to microstructure data prior to the progress reports. The thesis reports no ability of PIN to detect informed trading and limited usefulness of limit order book slope, which is blind to the direction of informed trading. Whilst the sample is a small subset of the overall equity market in Australia, the implication is that using these methods, little or no informed trading can be reliably detected prior to large share price movements. Interestingly, the inability of PIN and limit order book

slope to detect informed trading meaningfully suggests the paucity of insider trading prosecutions may reflect the possibility that there is less insider trading on Australian capital markets than is popularly believed.

There may be surveillance implications in these findings. For example, if informed trading is difficult to detect in a setting where the economic incentives to engage in informed trading are high then it is possible that at some point, surveillance costs may exceed benefits. Of course, a benchmark level of surveillance is required to present a suitable deterrent to illegal insider trading. From a policy perspective relating to the capability review, ways to incorporate more market disclosure may offer potential for surveillance cost savings, mindful of the surveillance cost versus market integrity trade-off. For example, one can conceive a natural pool of 'insiders' within publically listed firms on the ASX. This pool consists of directors, executives, employees and potentially contractors of listed companies. Within the universe of illegal insider trading, it is likely that information emanates from this group of actors in many cases. One obvious exception might be actors privy to incomplete contracts in firms dealing with ASX listed entities, who then trade on that information.

As suggested, a slightly different approach to the presence of 'insiders' and information asymmetry is to view the problem as one able to be minimised by better disclosure. Policy makers know that a part of the illegal insider trading problem relates to 'insiders' possessing knowledge of potential value that others do not. Thus, requiring 'insiders' to anonymously disclose their trading intentions in their employers securities ex-ante to the market (for example between half an hour or an hour prior to the market open) may be an option. This approach would result in a better informed market incorporating the future trading intentions of all 'insiders'. This process would likely be quite simple. A dedicated 'insiders' interphase can provide options to disclose insider status (board members, executives, employees, contractors) on electronic buy/sell forms and automatically compile aggregate 'insider' trade buy/sell volumes within these status categories prior to market opening. Such disclosure would result in greater market transparency, better price discovery and potentially enable some cost savings in ASIC's surveillance role.

To the extent markets are better informed and more efficient, the potential gains from illegal insider trading are reduced. The market would be informed of the intentions of insiders ex-ante or before the trades occur, as opposed to the current disclosure mechanisms which allows a period of time to elapse before an insider's ex-poste disclosure is required. This disclosure based solution would by no means be a panacea for all possible illegal insider trading for many reasons such as information conveyance to actors outside the firm or 'insiders' seeking to use others to trade on their behalf by way of examples. However, better 'insider' disclosure may enable ASIC to concentrate its efforts to achieve better enforcement outcomes in other areas. In addition, to the extent that there is better price discovery and market efficiency from ex-ante 'insider' disclosure, there could be less to gain from illegal insider trading and thus lower overall levels of insider trading in aggregate.

Sincerely,

Andrew Ferguson

Professor Andrew Ferguson

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**DEPARTMENT OF
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*Faculty of Business
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Dear David

Thank you for inviting me to comment on ASIC's performance. There is a matter that should inform ASIC's policies, going forward. Back in 2008 ASIC appears to have given a quasi-endorsement of a model financial plan, prepared under the auspices of the FPA--see in particular the second-last paragraph of the attached paper by me. My paper contends that the plan was probably too risky for the hypothetical elderly couple that was its focus. The plan also represented poor value for money, except for its tax advice. Accordingly, I suggest that ASIC should avoid such quasi-endorsements in the future.

Regards

Geoff Kingston

Financial Plans for Baby Boomers: How Much Risk?*

Geoffrey Kingston¹

In June 2008, the Financial Planning Association issued an “example” financial plan. The hypothetical clients are John and Joan, a married couple. The plan would reduce the couple’s tax bill from \$38,000 to \$22,941 per annum, a good outcome. More questionable is a recommendation that the percentage of financial assets invested in growth assets be raised to 70 per cent. An aggressive asset allocation could well suit if the couple were aged either 37 or 77, but John and Joan are 57. The long investment horizon faced by the couple is actually a reason for caution on the cusp of their retirement.

Keywords: financial plans, asset allocation, risk management, out-of-the-money put options, horizon effect.

1. Introduction and Summary

A financial planner’s recommendations must include reasons and be available to the client, in written form and at any time. This document is called the Statement of Advice (SOA). The peak body for financial planners in Australia is the Financial Planning Association (FPA). The FPA has released an “example” SOA, dated 24 June 2008,² which seeks to explain “a complex scenario in a concise and comprehensible manner.” The name of the hypothetical planner is John Planner, and his hypothetical clients are John and Joan Randall, a middle-class boomer couple with a teenage daughter. I summarise and appraise the FPA document.

The document is indeed concise and comprehensive. It conveys in just twelve pages some sophisticated recommendations about a fairly complex household budget. The document homes in on questions that are difficult yet central to successful financial management for middle-class boomer households. By disseminating this document the FPA has raised the level of the debate. Its recommendations would reduce the Randall’s direct taxes from \$38,975 to \$22,941 per annum (pa) until July 2012, a handsome saving.

¹Department of Economics, Macquarie University

²SOA must carry a date.

*An earlier version of this paper was presented at the Financial Integrity Research Network’s Symposium on Superannuation and Retirement Planning, Sydney, 25 November 2008. The author thanks the symposium participants, along with Andrew Hingston, Adrian Pagan and Carol White, for helpful comments on earlier drafts. Students in the Superannuation and Retirement Benefits course at the University of New South Wales came up with shrewd comments on a lecture notes version of this paper. Two anonymous referees made constructive comments on a subsequent version. The Australian Research Council helped in funding this research. The author retains the responsibility for this paper.

JEL classifications: G23, G28

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My main objection to the model plan concerns its recommendation of a fixed 70 per cent allocation of the Randall's financial assets to "growth" (risky) investments. The plan's explanation for the proposed level of risk is inadequate, given that each member of the couple is fifty-seven years old. An aggressive strategy could well suit if the couple were aged either thirty-seven or seventy-seven – but perhaps not in the case of these two fifty-seven-year-olds. I give reasons for this criticism, and suggest various possible improvements in advice.

The model plan refers to a companion document (FPA, 2008b). That document elaborates on the model plan's view that risk management is about trading off prospective high returns against prospective low volatility of returns. Popular and useful as the trade-off perspective is, it needs to be supplemented with the insurance perspective: risk management is about protection against lower-tail outcomes that bring on financial stress. In other words, risk management involves the purchase or synthesis of out-of-the-money put options,³ as advocated by, for example, Stulz (1996) for companies and by Bateman *et al.* (2007) for households. Out-of-the-money puts have strikes below the current price of the underlying asset, and are therefore analogous to insurance policies with a deductible. The insurance perspective is at least as intuitive and accessible as the trade-off perspective.

The cost of an option generally rises with its time to expiry. Because retirements tend to span two decades or more, Bateman *et al.* (2007) find that protecting even a modest lifestyle for the expected duration of a retirement is expensive. Homemade insurance, against a family's lifestyle ever dropping below some pre-specified standard, can therefore necessitate a conservative portfolio in early retirement, even if the protected lifestyle seems modest relative to the lifestyle projected if returns turn out as expected. Advice on this horizon effect should be incorporated into future model plans.

The FPA plan sections out its advice under the following main headings: scope, recommended tax and investment strategy, and costs of the advice and recommended products. I examine each of these in turn.

2. Scope

Here are some more financial particulars concerning the Randalls. In addition to being fifty-seven, John is the sole wage earner for the family. He plans to retire in eight years' time. The Randalls have largely paid off the family home; just \$30,000 remains owing. They plan to maintain the home as their principal residence for the foreseeable future. John's gross salary is \$125,000 pa and his tax bill is \$38,975 pa. Family assets outside the home are John's super, totalling \$562,700 and spread across five funds, and Joan's investment of \$164,350 in a managed fund. John's "deductible" (employer) contribution to super currently appears to be the compulsory 9 per cent mandated by the Superannuation Guarantee.

The Randalls require \$57,000 pa in order to maintain their current lifestyle. As well as enabling John to retire at sixty-five years of age, they need a plan to reduce tax, streamline the administration of their investments and save enough to retire on an income of \$70,000 pa in today's dollars.⁴

³A put option confers the right to sell an asset at a preset "strike" price (but not after a preset expiry date) in exchange for paying a premium upfront. As the term "premium" suggests, buying puts is analogous to buying insurance. This paper confines attention to homemade options, as a comparable traded instrument is not currently available in Australia. In the United States, in contrast, there is a deep market for Guaranteed Living Income Benefits (GLIB). These GLIB incorporate a type of long-term put option, and are market instruments that perform a function similar to the homemade retirement income insurance strategies described here.

The risk concept endorsed here is related to the literature on shortfall risk, which is concerned with returns falling below some preset minimum. However, the preset minimum here is time varying. Notably, I recognise that a given percentage loss typically does more damage early in retirement than later on. In other words, the risk concept endorsed here is for a household, which is concerned to prevent its expenditure ever falling below some fixed "habitual" minimum rate.

⁴Thus, the Randalls want more disposable income in retirement than now, although their daughter is still a dependent and John is still in the workforce. This is puzzling.

3. Tax Strategy

The first couple of recommendations are to reorganise John's super funds. The plan sensibly clears the decks for John to start a transition to retirement (TTR) pension in conjunction with salary sacrifice into super. This strategy will deliver the bulk of the tax savings. The TTR pension needs to be big enough to replenish salary that formerly went towards living expenses but will now go towards salary sacrifice. The plan downsizes yet retains John Randall's Employer Super Fund, in order to receive his deductible contributions, including salary sacrifice ones. Continued membership of the Employer Fund ensures that valuable insurance cover remains in place, and saves having to pay an entry fee into some other fund. John Planner is to be paid out of the Employer Fund.

The next few recommendations concern the establishment and functioning of a so-called *Blue Fund*, with assets of \$550,000. Joan is nominated as its beneficiary in the event John Randall passes away. The Blue Fund is to receive salary sacrifice contributions of \$84,000 pa until July 2012, at which time John's deductible contributions will need to be reduced to \$50,000, in order to avoid tax penalties for excess contributions that will have become operative. Accordingly, the model plan flags a need for review before July 2012.

In the meantime, deductible super contributions will total just under \$100,000 pa. Direct taxes will fall from \$38,975 pa to \$22,941 pa, a big saving. The plan comes up with two main sources of tax relief for the Randalls. The first is a reduction in John's marginal PAYE rate from 41.5 per cent to 15 per cent.⁵ The second is a switch in the bulk of John's super balance, that is, the Blue Fund, into decumulation mode.⁶ This turns off two earning taxes, namely, a 15 per cent on fund income and a 10 per cent tax on capital gains realised after the relevant asset has been held for at least a year. The TTR pension from the Blue Fund covers expenses previously met by after-tax salary income. A drawdown rate of 5.5 per cent pa delivers $0.055 \times 550,000 \approx \$30,000$ pa, that being sufficient to ensure that about \$57,000 pa remains available for consumption.⁷ The first \$9600 of the TTR pension is tax-free, and the remainder is taxed at 15 per cent. Once John turns sixty years, his entire TTR pension will be tax-free.

The plan's final recommendations concerning tax efficiency are to change Joan's assets. Withdrawal of \$30,000 from Joan's managed fund pays out the family's mortgage. A key consideration here is that interest payments on the family home are not tax deductible. The plan also proposes to cease family contributions to Joan's managed fund, contributing instead \$3000 pa to Joan's super fund. This change facilitates a claim of the spouse tax offset (up to \$540 pa). All cash is to be kept in Joan's name.

4. Investment Strategy

4.1 The Blue Fund

It is time for a closer look at the Blue Fund, a fund of funds assembled by "ABC Financial Planning," described in the model plan as John Planner's "Licensee" (p. 8). There is diversification across different fund managers and investment styles. The nine funds include "Cash" (weighted 20 per cent), "Boutique Australian Shares" (weighted 17 per cent), "Australian Active Equity" (weighted 10 per cent), "Australian Equity Long/Short" (weighted 8 per cent) and a "Global Value Fund" (weighted 10 per cent). Overall, a fixed 70 per cent of the fund is allocated to "growth" assets, that is, equities or commercial property. This particular constant-mix strategy is apparently to remain in force for the duration of the plan.

⁵Deductible contributions inside the transitional caps are currently taxed at 15 per cent, as is one's slice of assessable income between \$6001 and \$34,000 pa.

⁶"John's Employer Super fund does not provide TTR pensions, so you'll need to set up a new fund to establish the TTR pension" (FPA plan, p. 4).

⁷John is required to draw down between 4 per cent and 10 per cent pa of the balance in his TTR pension account.

I have concerns about the Blue Fund apart from its aggressive asset allocation for two fifty-seven-year olds. Scant information is given about its provenance – not even a web link to a Product Disclosure Statement, or a list of trustees. Similarly, there is scanty information on the nature of the “income” assets, such as associated credit risks (if any). The bulk of the growth assets appear to be actively managed, with correspondingly sizeable fees. In this way, the model plan implicitly dismisses the view that active management could well be a zero-sum game in Australia, as our active managers compete mainly against other active managers and investors.⁸ “Forecast fees for the Blue fund are higher than for both the Employer super fund and the existing D super fund” (p. 4). Yet, John Planner provides scant evidence of outperformance by the Blue Fund relative to a benchmark, for example, a graph showing the Blue Fund’s historical performance alongside that of an index corresponding to a comparable passive fund.⁹

I have two concerns about the Global Value Sub-Fund. One is that there are no other international investments, although the Australian stockmarket is only about 2 per cent of the world stockmarket. A 10 per cent weighting to international shares amounts to an above-average case of “home bias,” even allowing for the fact that dividends from offshore companies do not carry franking credits.¹⁰ My other concern is that the international fund selected is a valued one, although franking credits would be valuable to the Randalls. Value funds tend to have high dividend yields. So if 10 per cent of the Randall’s portfolio is to be allocated to a value fund then it would make more sense for that fund to be Australian.

4.2 The Case for More (and Fixed) Risk

The reasons for an aggressive asset allocation are laid out under the model plan’s subheadings relating to “the new fund” (p. 4), an “appropriate portfolio strategy to meet your objectives” (p. 4) and “risks” (p. 7):

Within the Blue fund, there is a higher allocation to growth assets than is currently the case in your super funds. This will allow you to more effectively take advantage of market opportunities and your investment time horizon.

Increasing your exposure to growth assets is made more attractive by the fact that all investment income earned in the Blue fund will be tax-free. ...

Everything we do in life has some level of risk attached to it. With investment, there’s the risk that returns won’t meet expectations or that that we might incur short-term losses. If we want to reduce this investment risk, the trade-off is usually reduced returns.

Some level of risk has to be accepted if you’re to meet your objectives. We have discussed these and agree that the strategy recommended is appropriate for your needs. ...

Each of the recommended investments, except cash, is subject to market fluctuations.

This passage includes a judicious allusion to a prior discussion in which John Planner clearly sought to comply with the so-called suitability rules, whereby a planner must know both the client (e.g. the client’s risk tolerance) and the recommended products.

⁸Drew and Stanford (2003) study monthly Morningstar data on retail funds over the period 1991–1999, net of fees. They estimate alphas (excess returns) by means of the Fama–French technique. They find that managers underperform the market on average, by between 50 and 93 basis points pa.

⁹A companion document notes that three-year returns to 31 December 2006 for the new super fund were 15.05 per cent, compared with 12.10 per cent for the Employer Super Fund (FPA, 2007, p. 8). But this does not really amount to a value proposition as the new super fund is “100 per cent growth” whereas the Employer Super Fund is “100 per cent balanced”. Apples need to be compared with apples. Also, three years is a short span for the purpose of comparing mean returns.

¹⁰According to APRA’s Annual Superannuation Bulletin for June 2007, the weighting to international equities in accounts allocated on a “default” basis (by far the most common basis) was 24 per cent. For some reason, the companion FPA document has a 19 per cent weighting to international equities rather than 10 per cent (FPA, 2007, p. 3). This is mysterious as the companion document generally matches up with the model plan.

John Planner considers the long-time horizon faced by the Randalls to be a reason for an aggressive asset allocation. Moreover, in saying that “I have allocated approximately 30% to cash and income funds to cover pension payments” (p. 4), he suggests that the allocation to growth assets would have been higher in the absence of this administrative impediment.

A companion document comes up with two further arguments for a riskier allocation. First, “the current asset allocation of ‘balanced’ does not suit current economic conditions.” Second, there are “advantages of franking credits available from Australian shares”¹¹ (FPA, 2007, p. 4).

4.3 The Case for Less (and Managed) Risk

One flaw in John Planner’s case for more risk concerns the following argument: “Increasing your exposure to growth assets is made more attractive by the fact that all investment income earned in the Blue fund will be tax-free.” This tax consideration will amplify the *volatility* of risky returns within the Blue Fund as well as their expected size.¹² It should therefore have a second-order impact on asset allocation, at most.

Of more concern is John Planner’s tendency to downplay the persistence of changes in the prices of risky assets, by means of phrases such as “short-term losses,” and “market fluctuations”.¹³ The evidence for mean reversion in returns to stock indices in the United States during the twentieth century is reviewed by Cochrane (2005). He finds “some interesting mean reversion, especially in the 2–4 year range” (p. 413), but the evidence overall is “quite weak” (p. 414).

What Cochrane does endorse is significant medium-term forecastability of US stock returns when the conditioning variable is dividend yield rather than past returns. However, the model plan makes no mention of dividend yields or any other financial ratio that might help predict stock returns. In this and other ways, the model plan appears never to deviate from a recommendation of a fixed portfolio proportion in growth assets.¹⁴ Is asset allocation really that simple?

A troubling issue in investment risk before retirement is that the Randalls appear to have little room for compensating adjustments in household labour supply if ever share-markets dropped sharply. Survey data collected under the auspices of the Melbourne Institute for Economic and Social Research suggest that the average age at retirement for Australian males has recently been sixty-one years. Yet, John Randall is planning to soldier on for four years past that age. He could be retrenched or succumb to a chronic illness before sixty-five years of age,¹⁵ even if investment markets held up. Joan gives every impression of having retired already. The long horizon faced by the Randalls involves more exposure to upside *and* downside – along with limited opportunities to work harder or longer if returns disappoint.

What about risk management once John Randall retires, if he does end up retiring at sixty-five years of age? The model plan does not put a number on the relevant horizon after retirement. But

¹¹According to APRA’s Annual Superannuation Bulletin for June 2007, the weighting to growth assets in accounts allocated on a default basis was somewhere between 65 and 75 per cent. This is close to John Planner’s weighting. Yet it includes investors younger than the Randalls, for whom there is a stronger case for a 70 per cent weighting to stocks. Moreover, investors well into retirement might also benefit from an aggressive allocation, depending on their wealth relative to their core income needs (see next).

¹²Hamilton (1987) appears to have been the first to make this point in academic literature.

¹³FPA (2008b) contains similar reassuring material. For example, its chart with subtitle “United States Sharemarket” (p. 12) restricts data to the period 1937–2003. Any revision of this chart should go back to 1929 and forward to 2008.

¹⁴A companion document says in general terms that the economic conditions of November 2007 were such that a move from balance to growth was warranted (FPA, 2007). But there are no specifics about what was propitious for stocks in November 2007.

¹⁵Farhi and Panageas (2007) find that the “real option” to retire is typically valuable, necessitating substantial portfolio rebalancing through the point of retirement. For example, an individual with complete flexibility in choice of retirement age and with a coefficient of relative risk aversion equal to 4 should allocate about 10 percentage points more to risky assets immediately before retirement than immediately afterwards, or compared with an individual with no such flexibility. Future model plan should address the question of labour supply flexibility.

Table 1. Allocation to Growth Assets (Per Cent). Lump Sum at Retirement Aged Sixty-Five Years: \$1,500,000; Protected Spending: \$60,000 pa

Risk aversion coefficient (equal to the absolute curvature of the couple's utility function)	Couple's average expected age at death			
	81 years		90 years	
	Initial allocation	Expected final allocation	Initial allocation	Expected final allocation
1	46	57	27	43
2	23	26	13	17

Source: Adapted from Bateman *et al.* (2007, table 7.1).

a companion document projects a net superannuation position for John Randall of \$1,840,699 in future dollars, which translates into \$1,453,065 in terms of today's dollars, given the model plan's assumed inflation rate, namely 3 per cent pa (FPA, 2007).

Bateman *et al.* (2007) investigate the interplay between horizon effects, protected spending and risk aversion in the case of an individual retiree aged sixty-five years. That individual's lump sum was \$500,000, and her protected spending was \$20,000 pa.¹⁶ Triple both the lump sum and the protected spending rate in order to shed light on the asset allocation needed by the Randalls if they have retired on \$1,500,000, and think about risk in terms of a substantial floor under their retirement income stream (i.e. not just a trade-off between expected returns and the volatility of returns). Accordingly, Table 1 puts numbers on the required percentage allocations to growth assets at the beginning and end of the time spent in retirement by investors similar to the Randalls, assuming returns to turn out of risky assets as expected.

The protected spending rate in Table 1, namely \$60,000 pa, can be compared with the expenditure required by a home-owning couple for a "comfortable" lifestyle according to the Westpac-ASFA Retirement Standard (2008). They estimate that an income of \$50,561 would have sufficed. At the level of detail, though, the corresponding lifestyle is not opulent.

Derivations of the figures in Table 1 are given in Bateman *et al.* (2007). Compared with the FPA plan, allocations of Table 1 are conservative, to protect spending at a minimum \$60,000 pa for the expected duration of a couple's retirement. Allocations to growth assets are expected to rise over time instead of remaining fixed, as the burden of protected spending progressively lightens. To the extent that growth assets perform less well than expected, however, allocations need to remain conservative. If the couple's average expected age at death equals ninety years, the initial allocation to growth assets needs to be very low.

The generic annuity formula, namely,

$$A = \frac{rx}{(1+r)[1-(1+r)^{-L}]}$$

sheds light on the allocations in Table 1. In this formula, A is the level-payment constant-dollar annuity that can be purchased with an accumulation x in order to finance a retirement spanning L years, given a real return r on investments.¹⁷ Take the case when the planning horizon is $81 - 65 = 16$ years. The real interest rate is assumed to be 3 per cent, so the amount that initially needs to be set aside in "escrow" is given by $60,000 \times [1 - (1 + 0.03)^{-16}] / 0.03 = \$753,666$. The

¹⁶Bateman *et al.* (2007) also investigate the case of protected spending equal to \$9000 pa per individual, in order to explore possible effects of the age pension on asset allocation.

¹⁷Of course, the Randalls would not necessarily draw down the same amount each year. In the age bracket 65–74 years, the Randalls must draw down at least 5 per cent pa of their account balance. Between age brackets 75–79, 80–84, 85–89, 90–94 and 95 and over, the minimum annual drawdown rises to 5, 7, 9, 11 and 14 per cent, respectively.

remaining initial balance of $1,500,000 - 753,666 = \$746,334$ is “play money” that can be invested in growth assets.¹⁸ If the investor’s risk aversion is low relative to her outlook for the risk premium and for the inverse of volatility, then the actual allocation to growth assets is greater than $\$746,334$; the investor finds room in her play-money portfolio for geared instruments such as warrants or hedge funds. If, on the other hand, the investor’s risk aversion is high relative to her outlook for the risk premium and for the inverse of volatility, then the actual allocation to growth assets is less than $\$746,334$; the investor finds room in her play-money portfolio for safe income assets. It is this latter situation that applies to Table 1. If, for example, the investor’s risk aversion coefficient is unity,¹⁹ then the initial play-money portfolio contains roughly $746,334 - 690,000 = \$56,334$ of safe income assets, a comparatively small amount. In the case under discussion, then, initial play-money consists largely of ungeared growth assets. In other words, the overall portfolio strategy approximates buy-and-hold. As a consequence, the expected final allocation to growth assets, namely 57 per cent, is moderately higher than its initial counterpart, namely 46 per cent.

The horizon effect refers to the initial conservatism of allocations that is necessitated by some protected spending level for the expected duration of a retirement. It is actually less of a problem for the Randalls than most comparable couples, for two reasons. First, the expected duration of their retirement is only 19.4 years, as a consequence of John Randall’s intention to retire at age sixty-five, compared with the recent male average of sixty-one years. Second, Joan is the same age as John, rather than younger.²⁰

5. Costs

5.1 Advice

John Planner charges the Randalls an initial fee for service equal to $\$8227$, after netting out a tax credit equal to $\$2173$. He also charges an “ongoing” fee that is “paid from product.” It is equal to 0.60 per cent pa of the balance in the Blue Fund, and “is intended to cover the costs of ongoing advice” (p. 9). Thus, for example, the ongoing fee is $0.006 \times 550,000 = \$3300$ in year one, rising to $0.006 \times 1,453,065 = \8718 in year eight, in terms of today’s dollars, and assuming that John Planner’s projections turn out as expected (FPA, 2007, p. 7).

5.2 Benefits, Interests and Associations

John Planner, ABC Financial Planning and the Blue Fund are interconnected (FPA, 2008a, p. 8):

ABC Financial Planning may receive sponsorship payments from the Blue fund. Annual sponsorship per product provider is typically between $\$10,000$ and $\$20,000$. ABC Financial planning may use these payments to pay for the costs of conferences, training or professional development for your financial planner. ABC Financial Planning may also receive additional ongoing remuneration from the Blue fund for recommending their products. This amounts to 0.2% of the funds invested ($\$1,115$) in the first year and is paid out of the management fees charged by the Blue fund.

¹⁸For details, see Merton (1971).

¹⁹The allocations in Table 1 are for risk aversion coefficients equal to either 1 or 2. Bateman *et al.* (2007) also consider the case of a risk aversion coefficient equal to 0.5, which produces an aggressive form of “portfolio insurance”, a strategy requiring investors to buy the active asset in rising markets, and sell in falling markets. That case is not reported here as it unduly strains underlying assumptions about the absence of gap risk and portfolio rebalancing costs. In short, it is only of academic interest.

²⁰Moreover, the model plan does not address longevity risk. Milevsky and Young (2007) propose an appealing compromise whereby retirees make a late-life switch of their account-based pension into a life annuity, noting that rates payable on life annuities improve with increasing age, as does subjective knowledge of one’s likely age at death. A further argument for delaying annuitisation in Australia is that active retirees may want to retain a lump sum for as long as possible so as to maintain maximum flexibility in the face of considerable uncertainty about government policies towards nursing home access and fees.

This statement addresses the legal requirement that soft-dollar benefits received by a financial planner from a portfolio manager be disclosed to clients.

5.3 Product Annual Fees

The nine funds comprising the Blue Fund have management expense ratios ranging from 1.13 per cent, in the case of the Cash Fund, to 2.24 per cent in the case of the Australian Equity Long/Short Fund. One of the two "Income Funds" has a management expense ratio of 1.92 per cent, which is a surprisingly high figure. It is presumably an actively managed bond fund. John Planner does not recommend any index funds among the six growth ones, as was mentioned earlier. The management expense ratio for the Blue Fund as a whole is 1.89 per cent. In year one, then, the cost of the recommended products totals $0.0189 \times 550,000 = \$10,395$.²¹

5.4 Discussion

The annual cost of the model plan to the Randalls amounts to $3300 + 10,413 = \$13,713$ in year one, rising to an estimated $(0.006 + 0.0189) \times 1,453,065 = \$36,181$ in year eight (the projected retirement year), and probably declining thereafter. This year-eight total appears sizeable, compared either with the plan's projected \$70,000 pa average drawdown or its unsophisticated risk management, even allowing for the fact that the Randalls have the right to obtain free follow-up advice from John Planner at any time. The bulk of the fees will evidently come from the ongoing 0.6 per cent annual fee on assets in the Blue Fund, provided the Randalls stick with John Planner for at least a few years.

The incentives inherent in this fee structure are not obviously compatible with a recommendation of an initially conservative asset allocation for couples like the Randalls. The solution might lie in an option-type structure of remuneration for the investment component of the overall advice. Specifically, John Planner could receive the bulk of his remuneration from a fixed percentage each year of the *cushion*, defined as the balance in the Blue Fund less the present value of remaining guaranteed annual drawdowns. This type of fee structure would mesh better with an insurance-based approach to risk management.²²

So much for the normative economics. Stoughton *et al.* (2008) shed light on the positive economics of this type of fee structure. They predict that portfolio managers will subsidise advisers, as a means of price discrimination. In their set-up, high net worth individuals tend to have comparatively inelastic demands for financial advice. Subsidies help in extracting economic surplus from these individuals. The FPA's model plan conforms to the prediction by Stoughton *et al.*

6. Concluding Comments

The FPA's model plan is based on a trade-off concept of risk management that should be supplemented by an insurance concept. The model entails unsuitably high levels of risk for clients who want a significant floor under the periodic payments from their accounts-based pensions and are on the cusp of retirement. Whereas the model allocates a high and fixed percentage of the account-based pension to growth assets, guaranteed minimum payments typically require conservative asset allocations in the early years of retirement, while allowing increasing scope for aggressive allocations in later years if earlier returns have met or exceeded expectations. In short, what needs to be avoided is the big hit early on.

A model plan's discussion of suitable risk should therefore include a passage along the following lines:

²¹This estimate, namely \$10,395, differs slightly from the estimate reported on page 9 of the model plan, namely \$10,413.70.

²²The term "cushion" comes from the literature on portfolio insurance. The Randalls could implement this fee structure themselves simply by retaining the present value of the remaining guaranteed annual drawdowns in low-risk interest-bearing securities, such as cash and term deposits within a self-managed super fund, while letting the cushion to be invested each year in growth assets managed by John Planner.

Another way to manage your risk in retirement is to choose some minimum acceptable lifestyle for the expected remainder of your lives. The annual drawdown from your account-based pension could then consist of the guaranteed minimum plus a top-up that depended on the state of the investment markets.

Rather than being fixed, your percentage allocation to growth assets would probably increase as you moved through retirement, unless markets performed badly early on, in which case you would probably retain a low allocation to growth assets for the rest of your lives. Managing your allocation to growth assets in this way would mean taking less advantage of market opportunities early in retirement. It could even result in higher volatility of returns, depending on selection of the growth assets that would fund your top-ups.

There is a public interest in a model plan with the alternative strategy proposed here. On 20 September 2008, the rate of payment of the Age Pension was up to \$24,414 pa for a couple, depending, among other things, on income and assets. A home-owning couple was entitled to a part pension so long as its non-home assets stood at less than \$873,500. Public retirement income insurance can be expected to encourage aggressive asset allocations, as the taxpayer becomes in effect a part guarantor of the client's core retirement income stream. In other words, the Age Pension in effect promotes moral hazard in asset allocations.

The FPA reports that it liaised with the Australian Securities and Investment Commission in the course of revising its example SOA, although Australian Securities and Investment Commission (ASIC) stopped short of a formal endorsement. ASIC (2005) is a model plan. But ASIC's example couple were generation Xers, rather than boomers, who have less labour supply flexibility. Moreover, the scope of ASIC's model was limited, as it freely acknowledged; ASIC's example couple did not seek advice on superannuation, and received no advice on tax efficiency. In contrast, the FPA model dealt with both these critical issues. On the other hand, it sidestepped the important question of justifying the switch of the bulk of the Randall's super assets into a fund associated with the planner, by the expedient of assuming that "John's Employer Super fund does not provide TTR pensions" (p. 4). More often than not, however, a financial planner will lack such a convenient rationale for a tied sale.

The ASIC model plan was not only limited in scope but predated 2007's ultra-low taxes on the account-based pensions of the over sixties. It only just post-dated the introduction of TTR pensions. Accordingly, now might be a good time for ASIC to consider a follow-up. Like the FPA, they could address tax efficiency and asset allocation in the context of super. More easily than the FPA, they could place due weight on both the private and public interests served by avoiding aggressive allocations for clients on the cusp of retirement.²³

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²³An encouraging straw in the wind is that Ross Jones, Deputy Chairman of The Australian Prudential Regulation Authority and Deputy Chairman of the OECD Working Party on Private Pensions, is on record as saying that lowering investment risk profiles as people get close to retirement is something the government might want to consider (Boyd, 2008).

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