RE-KINDLING THE INVESTMENT BOND

Investment bonds have not been front of mind for many advisers in the past 20 years but are slowly coming back into vogue. **Jassmyn Goh** finds out what has changed, and what is encouraging advisers and clients to use them.

UNLIKE MANY THINGS we once loved in the 80s that are now a cringe-worthy reminder of the past, investment bonds are coming back into favour with renewed interest from advisers and clients.

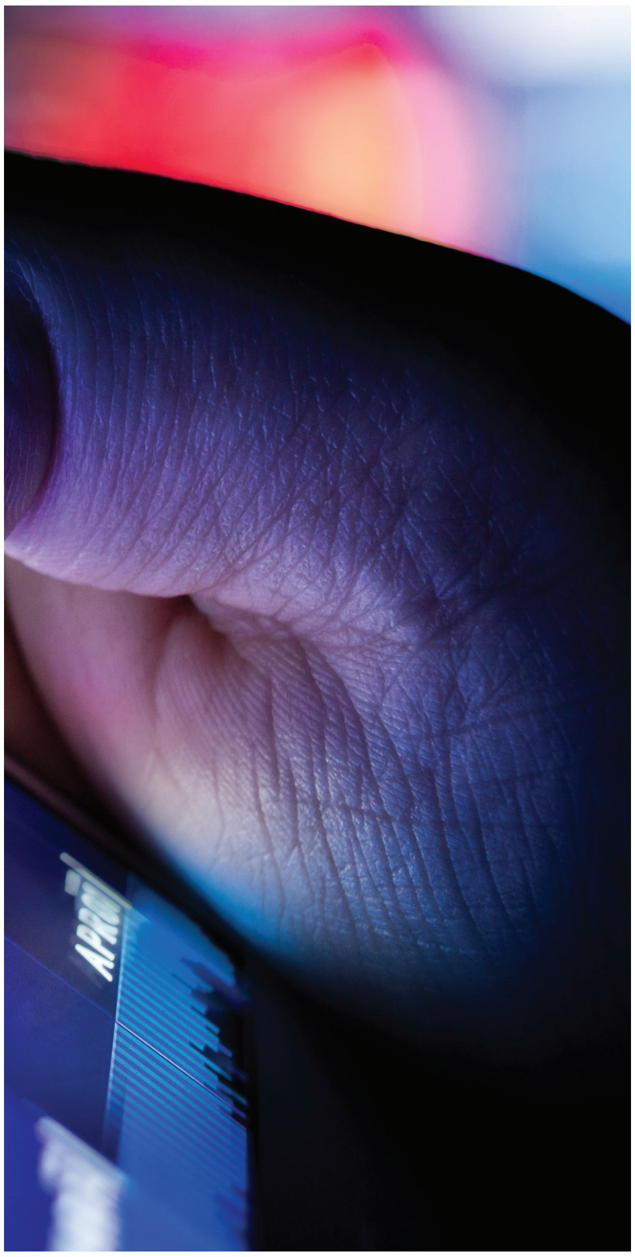
Once a popular strategy, investment bonds fell off the radar when compulsory superannuation came in and became the new tax structure for clients to invest in.

To put it simply, investment bonds are a tax-paid investment issued by a friendly society. Similar to insurance bonds that are issued by insurance companies, they follow the same tax law where the bond itself is tax-paid on the earnings of the fund, at 30 per cent.

The funds can be drawn from any time, and after 10 years the growth is tax-free.

AMP and wealthpartners financial planner, Andrew Heaven, noted the tax rate for the bond can actually be less than that because of franking credits.

"From a tax perspective, it's ideally suited for investors who are on higher taxable incomes as the earnings on the fund are taxed at 30 per cent within the fund," Heaven said.



EVOLUTION

Despite the product structure not changing for the past two decades, investment bonds have in fact evolved, according to Australian Unity Lifeplan Funds Management national business development manager, Greg Bird.

"There are advisers who used investment bonds previously but haven't used them for a very long time. They tend to think of them as old fashioned," Bird said.

"They haven't joined the dots that just as superannuation has evolved over the last 20 years so have investment bonds. Certainly the reason you would use an investment bond 20 years ago is very, very different for using them today."

IOOF WealthBuilder investment specialist, Sue Herrald, said there is an opportunity now to re-educate advisers about something that has simply been forgotten about.

"When we do sit with advisers and do strategy sessions with them the advisers have an absolute light bulb moment," Herrald said.

Commonwealth Bank's head of annuities, George Lytas, said the bank has been seeing growth in interest. He said solutions were needed for the growing longevity highlighted in the 2015 Intergenerational Report.

"It's the same demographic impacting annuities… you can buy a lifetime annuity with an investment growth bond to complement the annuities, and gives the estate planning benefit to provide a good retirement strategy," he said.

Heaven agreed and said people were increasingly becoming more receptive to the strategy.

"I wouldn't say there are a lot of people asking about investment bonds, it's a niche structure, but there is more interest than 10 years ago," he said.

WITH COMPLEMENTS

Where some of the opportunities lie are in the frustrations around the constant changes around super legislations, Bird said.

"There are advisers saying clients want tax-effective investments but are really cautious about putting money into super because of the rules, and when they get their money out, the rules would probably be very different from today," Bird said.

Centuria Capital's general manager of investment bonds, Neil Rogan, said many of

NEIL ROGAN

their clients are looking for strategies to complement their superannuation.

"Where they have reached their concessional caps many are investing in investment bonds because it is a tax-effective structure. Then you have others using it as an income stream product, and those for estate planning purposes, and for aged care," Rogan said.

Bird agreed and said in terms of super, the main users for investment bonds were clients who were either too old, too young, or had too much.

Herrald noted that there were two main demographics that use investment bonds, the first being pre-retirees.

"They may have paid off all their non-deductable debt so they don't have a mortgage anymore, and are looking to really ramp up their retirement savings. So they use investment bonds as a vehicle once they've maxed out their deductible or concessional contributions to super," she said.

"On the other end are those too old for super, maybe they downsized a family home and bought a smaller property but over 65 and no longer working so they'll use the

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structure of the investment bond because they can't get into the structure of super."

Heaven said investment bonds were also a popular way to fund education, and for children over 10 who had typically received an inheritance as "tax rates for minors is pretty horrible".

Tax arbitrage and tax planning were also big drivers for investors to use investment bonds.

"It's a great alternative to other non-super investments such as a family trust or in managed investments because after 10 years all the growth is tax-free," Rogan said.

Bird said Centrelink pensions and peripheral benefits like the family tax benefit, health cards, health insurance rebates were all treated as taxable income and a lot of investors were looking to maintain these benefits.

"The money effectively is very liquid but doesn't add to their taxable income," he said.

ALL INTEREST BUT SLOW GROWTH

Despite the general consensus that investment bonds were becoming increasingly popular, according to Plan for Life's investment bond data, the strategy has been slow to increase funds under management (FUM).

The data found investment bonds accounted for 0.96 per cent of all retail FUM in Australia at $7.15 billion as at March 2015, and has started to increase since June 2013.

In terms of FUM market share, Australian Unity Group holds 25.1 per cent, followed by IOOF Group at 12.1 per cent, and Commonwealth/Colonial Group at 11.8 per cent, according to Plan For Life's March 2015 Investment Bond report.

The data also showed that net funds flow has remained negative since 1992 but is slowly edging closer to positive figures at -$33.8 million as at March 2015. This is compared with the lowest point of -$10.68 billion in September 1996.

"In the short-term, it is not unrealistic to expect that the overall sector will remain relatively flat from a FUM and net flow perspective, simply due to the institutions pulling out of sector creating a legacy FUM issue. However, the active players are now balancing that effect with growing inflows," Bird said.

"Going forward, over the next three to five years, we would expect the sector to continue to grow from an inflow perspective, and at that time it would not be surprising to start to see modest increases in overall FUM."

Rogan also expected growth in the strategy over the next two to three years and said "we see increased regulatory uncertainty around super… and to be used as a complement to super".

"Change management with advisers around this is the key piece of success: helping advisers understand benefits and versatility of this kind of investment structure," Rogan said.

ADVISER PRESSURE POINTS

With not a lot of marketing going out to clients about the strategy it is up to the advisers to understand it and raise it with clients, Herrald noted.

"As soon as you write a client's date of birth, an adviser is already considering which structure they should be going into," she said.

"I always encourage if super is the right structure that is where the funds should be. If not, then investment bonds become a real structure to look at and that's what advisers are recognising."

Heaven said a major trigger point for advisers was the need to consider the timeframe.

"Typically you want it to be 10 years plus… and ask 'what do you want these funds to do?', and how simple the investor is looking to make things for the future tax wise," he said.

Bird said advisers should be motivated to look at investment bonds if there was client dissatisfaction with current strategies.

"The definition of retirement today is different to the traditional retirement of 10 to 15 years ago… They want to retire on their terms and not when the government says they can touch their super," he said.

"That's a key motivator and now clients are looking for other options rather than accessing their super at 65." MM

Busting the myths

As investment bonds have not been front of mind for many advisers in the last 10 to 15 years, the biggest hurdle clients and advisers have is overcoming the myths and negative stigma, according to Australian Unity Lifeplan Funds Management national business development manager, Greg Bird.

Myth #1 – They always pay 30 per cent tax inside

"Instead the reality is just the same as super, as investment bonds can use franking credits and depreciation on LPTs [listed property trusts] and things like that to lower the effective rate of tax they pay," Bird said.

Myth #2 – You will be penalised if you make a withdrawal before 10 years

Bird said this would be the case if a client was on a very high income but sometimes it is actually more tax-effective to make a withdrawal within the 10 years because of the 30 per cent tax credits attached to it.

"Very little of the income is taxable even from the first year. That's one of the biggest eye-openers when we're explaining to advisers is that you don't have to wait 10 years for an investment bond to be tax-effective," he said.

"It can be tax-effective from day one. Ten years is important if you're using a bond to build wealth."

Myth #3 – Lack of investment choice

Like superannuation, investment bonds have also evolved and now have a wide variety of investment choices.

"In our product we have an investment menu of 39 options and a couple of other providers have menus almost as big as that as well. So it's been a very long time since investment bonds offered three options," Bird said.