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BKI INVESTMENT COMPANY

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BKI INVESTMENT COMPANY LIMITED

INVESTOR UPDATE

Responding to the Labor Party's Franking Credit Policy

We provide an update on the Labor Party's proposal to abolish cash refunds of excess franking credits. This is an issue causing angst among Australian investors. We provide a number of options for those concerned to have their say.

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Responding to the Labor Party's Franking Credit Policy

In recent months, Contact has met with hundreds of BKI shareholders. We conducted information sessions in major capital cities as part of the June Entitlement Offer and again following the release of BKI's FY18 results. We have also presented at a number of industry and SMSF events. We have been overwhelmed by the level of angst in the investment community regarding Labor's proposal to eliminate cash refunds of excess franking credits.

We share our concern again below.

The Boards of BKI and Contact are actively agitating against this proposal for our fellow shareholders. In March, we dedicated a Quarterly Report to the issue titled *"Leave Our Franking Credits Alone!"* In it, we stressed how important it is for investors to be confident policy makers will not constantly move the goal posts. The report was picked up by The Australian newspaper in an article titled *"Investment firm attacks Labor's proposed dividend changes".* We also expressed concerns verbally to Federal MPs.

Below, we share details how you can add your name to the list of submissions against the proposed policy.

What is the proposal?

In short, the ALP plan to abolish the ability for individuals and superannuation funds to receive cash refunds on surplus franking credits, where refundable credits are greater than tax payable. The policy would be effective from 1 July 2019.

As it stands, there would be no grandfathering.

The bottom line is that retirement income will reduce. In general terms, members of Industry Superannuation Funds will not be impacted. Some will be protected by a "Pensioner Guarantee". However, the majority of investors and SMSFs will be worse off. The policy would effectively discriminate between two similar individuals – one of whom is in a SMSF and the other who is in an Industry Super Fund.

This isn't just about a Robin Hood policy of taking from the rich and giving to the poor – a huge number of Australians will be negatively impacted

We struggle to understand why policy makers would discourage Australians to self-fund their retirement. With welfare such a significant proportion of the Budget expenditure, why add greater financial stress to those Australians who wouldn't normally be reliant on Government subsidies in retirement? Many Australians prudently prepare for retirement and make astute financial decisions based on the existing rules and regulations. The current legislation has been in place since 2001, when the Howard Government extended the dividend imputation policy to allow cash refunds of surplus franking credits. Potential changes to policy such as this creates significant uncertainty. And uncertainty is an enormous threat to confidence and economic stability.

The uncertainty is exacerbated as Self-Managed Super Funds have already come under regulatory change in recent years. Those super fund members with pension balances in excess of $1.6 million were penalised in 2017 with retrospective changes to levels of tax-exempt status.

The ALP will argue that the franking credits proposal is a tax on the wealthy and that over the next decade the change in policy will boost Government coffers by almost $60 billion. However, it is not just the "super-wealthy" who will be disadvantaged. In fact, it is SMSF members with less than $1.6 million who could suffer the most – and there are over 600,000 retirees in this category – that is a lot of votes!

Members on retirement pensions (that is, those with a 0% tax rate) would completely lose their franking credit cash top ups. It is believed that over half a million existing cash refund recipients report an income below the tax free threshold – existing incomes would be impacted. In a recent note (that we found useful in writing this piece) *Refundable Franking Credits and Retirees*, Morgans Equity Research comments that some Lobbyists suggest the proposal would remove around 10% or $5,000 of income from the median SMSF which earns $50,000 per annum.

We also flag there are second order effects and unintended consequences of changes to long-established policies. For example, will there be a flight of capital to offshore investments as franking credits from Australian company dividends become less valuable? Morgans Equity Research state:

Cash returns from the overall Australian stock market are currently running at around 5.7% including 1.5% in franking credits. Without the franking credits, the cash income from a broad investment portfolio would be reduced to the unfranked 4.2% dividend yield, which is a drop of around 25% in the cash yield of a portfolio.

This is a threat but the Proposal is yet to be legislated

We stress that, while this proposal is a concern for investors, it is not yet set in stone. For it to be enacted, the ALP needs to win the next election and then successfully legislate it through Parliament. That process is likely to involve some twists and turns and the current policy may need to be watered down.

And of course, if this proposal becomes a vote killer, the ALP may walk away from it altogether.

The current Federal Government is launching a Parliamentary Enquiry into the proposal to examine the financial impacts of the proposal. Many in the Coalition Government are calling this a tax on the savings of retirees.

BKI and Contact Asset Management are not in the business of giving financial advice. We caution making any investment decisions based on changes to legislation that may not occur. Please consult your Financial Advisor if you need more advice.

However, we do suggest you consider joining us as we advocate to abolish this proposal. A few options are discussed below.

What can you do?

We encourage you to also have your say ahead of the Parliamentary Enquiry on November 2.

- Make your own submission directly https://www.aph.gov.au/economics
- or by emailing economics.reps@aph.gov.au

Some industry associations also allow a forum to take action. One such forum is the Alliance for a Fairer Retirement.

- Make your own submission directly http://fairerretirement.com.au

Finally, BKI is a member of two LIC Associations. Australian Listed Investment Companies Association (ALICA), and the Listed Investment Companies and Trusts Association (LICAT). These two associations represent the interests of listed investment companies (LICs), listed investment trusts (LITs) and their investors. There are over 100 LICs and LITs listed on ASX which make up a sector that accounts for over $41 billion in market capitalisation and has over 700,000 investors. Both ALICA and LICAT will be making submissions on investor's behalf before the closing date of 2 November.

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