Your money Your future

FINANCIAL PLANNING NEWSLETTER SPRING 2007

Taking cover in super can be tax-effective

With the introduction of new superannuation legislation on 1 July 2007, your super savings now provide you with additional cash flow for purchasing life insurance and Total and Permanent Disability cover (TPD).

Your super fund can tax-effectively cover insurance premiums in a number of ways. These include using pre-tax dollars from salary sacrifice or employer contributions, and using existing super savings.

In addition, financial dependants may benefit from tax-free lump sum death benefits. Under the now-abolished reasonable benefit limits, there was a limit on the amount of tax-free benefits payable to financial dependants.

In general, your spouse, child aged less than 18 years, any other person who is financially dependent on you, or in an interdependency relationship with you, can now receive tax-free death benefits from your superannuation.

Benefits of purchasing insurance through your super fund

- Increasing your cash flow – by paying your insurance premiums from your super savings.
- A tax-effective option – you can pay your insurance premium from your pre-tax salary.
- Peace of mind – purchasing life or TPD cover via your super fund can provide you and your family with peace of mind.

Diamond Financial Solutions

Diamond Financial Solutions
34 108 249 565

65 Hume Street
CROWS NEST
NSW 2065

Melissa Gilbert CFP® B.A (Econs), Dip FP
Authorised Representative

Phone: 02 8437 3562
Fax: 02 8437 3563
Mobile: 0405 387172
Email: melissa@diamondfinancial.com.au
Web: www.diamondfinancial.com.au

AXA Financial Planning

Ensuring insurance is on your shopping list

Right now the Australian family budget is being stretched from all sides and fitting personal insurance onto the family shopping list is becoming more difficult.

An AXA study[1] conducted by TNS Research in March 2007 examining Australian attitudes towards life insurance found that while most people understand the necessity of insuring everyday items like their home, car and medical health they regarded life, income and trauma insurance as a lower priority.

The study found the following to be the main reasons for the generally low level of interest Australians have when it comes to personal insurance:

- the emotionally confronting nature the topic
- an uncertainty about what constituted an adequate level of life insurance, and
- the perception that life insurance doesn't give them any immediate tangible benefit.

Not surprisingly, people don't like to contemplate their own passing or that of loved ones. But the study also found that once people were alerted to the importance of insurance, they were inspired to take action and ensure their level of cover was adequate.

Peace of mind you can't touch

No one likes to imagine injury, death or illness happening to themselves or their family. But the truth is that insurance can be a great way to gain some peace of mind and help alleviate the financial worry associated with some of life's uncertainties.

While it's true that insurance isn't a product you buy for immediate use, it can help answer some of life's great questions. Consider, for example:

- Who will be there to look after your family or pay your outstanding debts if something happens to you? Alternatively, what would you do if something happened to your partner?
- How can you protect your family from the financial impact of you becoming totally and permanently disabled?
- What are the financial consequences if you suffer a serious trauma, such as a heart attack?
- How would your family cope if an injury or illness prevented you from earning an income? How would your life change if your partner suffered an injury or illness which prevented them from either working or undertaking home duties?

Insurance should be an odds-on favourite

When it comes to the age-old question of 'How much insurance is enough?', the answer turns out to be a very personal one. The level of insurance that suits your individual needs and those of your family will ultimately depend on your individual circumstances.

This is how we, as professional financial advisers, can help. We're able to independently asses your needs and, using our experience and knowledge of the industry, provide a detailed recommendation on the right level of insurance for you.

The table below highlights the importance of including personal insurance on your family's shopping list.

More information?

For more information on how to obtain and assess the right level of insurance for you and your family, please contact us.

Situation	Statistics[2]	Outcome without insurance	Insurance solution	Insurance description
Premature or accidental death	Of the 132,508 deaths reported in 2004, around 25% of male deaths and 15% of female deaths were of people aged less than 65.	Without insurance, your family could be left to pay outstanding debts in their hour of need.	Life insurance	In the event of your death, or the diagnosis of a terminal illness, your life insurance will be paid to your nominated beneficiary.
An injury or illness that prevents you from working	In 2003/04, more than 370,000 people were admitted as inpatients to Australian hospitals as a result of injury.	If you are unable to earn an income, you may have trouble paying any outstanding debts or ongoing living expenses.	Income insurance	Provides you with a replacement income of up to 75% of your income (net of business expenses, but before tax), if you are totally disabled and unable to work due to either sickness or injury.
A total and permanent disability that prevents you from ever working again	In 2004, the Australian Bureau of Statistics reported that 1 in 16 Australians have a severe or profound core activity limitation.	The resulting loss of income means it may be difficult for you to pay outstanding debts and living expenses.	Total and Permanent Disability insurance	Provides a lump sum payment in the event that you become totally and permanently disabled.
You survive a trauma such as heart attack, cancer or stroke	In Australia, it is expected that 1 in 3 males and 1 in 4 females will be diagnosed with cancer before the age of 75.	Your family and loved ones must cope with the increased financial burden of your recovery costs, as well as the probable reduction in family income for an unknown period of time.	Trauma recovery insurance	May ease the financial burden of trauma by paying you a lump sum in the event that you suffer one of a comprehensive list of trauma events, including heart attack, stroke and cancer. The lump sum payment will help to give you financial peace of mind.

1 'Australian attitudes to underinsurance', TNS Research, March 2007.

2 All statistics are sourced from Australia's Health 2006 (Australian Institute of Health and Welfare 2006. AIHW catalogue number AUS 73. Canberra: AIHW).

Increase your investment options through mortgage reduction

A focused approach to mortgage reduction could save you thousands in interest repayments and free up equity to capitalise on other investment opportunities.

For many Australians, driving their mortgage down is a key focus of their financial activities. There are a number of good reasons why – first and foremost the dream of debt-free home ownership.

Key to driving your mortgage down is paying off the principal component (the original amount you borrowed minus the interest) as quickly as possible. Here are some simple strategies to help you achieve this goal:

Make extra repayments – The most obvious and effective way to pay your mortgage off quicker is to simply make additional repayments. Since any principal repayments immediately reduce the amount of interest you pay, even small contributions will add up over the long run.

Switch to fortnightly payments – Rather than repaying your mortgage on a monthly basis, typical of most lenders, pay your mortgage fortnightly (26 repayments annually). Each year, you'll make the equivalent of 13 monthly repayments instead of the standard 12!

Convert to a 100 per cent offset account – When you deposit your earnings into an offset account linked to your home loan, the amount is treated as a deduction from the principal when interest is calculated, effectively reducing the interest accruing. If your loan repayments are set up as interest only, this will also reduce your loan repayments. Channel the saved interest back into your loan or keep all additional funds in the offset account.

Consider a professional package – Some lenders offer special packages to 'low risk' professionals with loans of around $100,000 and upwards. Professional packages offer a reduced interest rate, typically 0.3 – 0.7 per cent lower (and in some cases more), though the annual fees are generally higher than standard loans. Most professional packages also include a fee-free transaction or offset account and a credit card, among other concessions.

Use a line of credit – Line of credit mortgages allow you to channel additional funds directly into your home loan, reducing the principal and the interest charged. A credit card with an interest-free period can be used to meet monthly outgoings, which is then repaid from the line of credit at the end of the month. Discipline and organisation are essential to use this product to maximum effect.

Mortgage reduction is easy – all it requires is a mix of diligence and planning, matched with the right product. Owning your own home outright is an enormous milestone – not only does it offer security and peace of mind, but it also opens up another world of investment opportunities, with very lucrative returns.

Respond to rate rises – fixed or variable?

With a potential rate rise always around the corner, be prepared by considering the benefits of fixing part or all of your mortgage's interest rate.

With inflation threatening to push interest rates up, borrowers are mulling over the merits of the fixed-rate loan. Mortgages aren't designed to be 'one-size-fits-all'; while fixing your interest rate offers an effective means to combat further rate hikes, there may be other options that better suit your needs.

Fixed vs. variable – what's the difference? A fixed rate refers to a loan with a pre-determined interest rate set for a given period, usually between one and five years. This differs from a variable rate, which changes according to decisions made by the Reserve Bank of Australia (RBA).

When choosing between a fixed or variable-rate loan there are a number of key features to keep in mind:

Variable rates – Advantages

- generally lower than fixed rates; should market rates go down you may also see a decrease in your monthly repayments
- offer flexibility should your circumstances change; easier to increase or decrease monthly repayments and typically feature a low or no penalty for early discharge of the loan, and
- commonly offer more features such as redraw and 100 per cent offset

Variable rates – Considerations

- less certainty when planning your long-term financial aims and objectives, and
- if interest rates do go up, will you still be able to cover your repayments?

Fixed rates – Advantages

- offer certainty for borrowers who would have trouble managing a higher rate, and
- ideal for those working to a tight budget, as repayments won't change should rates rise.

Fixed rates – Considerations

- typically less flexible, with possible heavy penalties if you pay out early or refinance the mortgage
- no benefit if interest rates go down
- switching to a fixed-rate loan may have associated fees and charges
- not usually available for construction loans, and
- in some cases, the rate offered at the time of application may not be the rate you finally get unless you elect to 'rate lock' (sometimes at an extra cost) at application time.

Best of both worlds – split rates

While both fixed and variable-rate mortgages have their benefits, there is a hybrid loan that lets you have the best of both worlds: the split-rate loan. This divides your loan into a fixed and variable rate component, allowing you to take advantage of the lower variable rate and flexibility for part of your loan, while maintaining the security of a fixed rate for the other component. You can usually choose the proportion of your loan on fixed and variable to suit your circumstances. You may even select more than one fixed-rate term, so that the fixed-rate loans mature at progressive intervals.

Get the right mix to maximise your retirement income

When it comes time to enjoy retirement, having enough income to support your lifestyle is paramount. So it's vital that you put in place a plan to ensure your retirement income can fund your desired lifestyle.

For many Australians, a government pension is the foundation on which they build their retirement income. So when the government announced changes to the assets test, a lot of Australians took notice.

The assets test for government pensions is changing on 20 September 2007

Even if you assume that you may not be eligible for a pension, it may be worth examining the changes to see if you qualify. Two important changes apply from 20 September 2007:

1. the 50 per cent assets test exemption will no longer be available for complying income streams purchased on or after that date, and
2. the pension assets test taper rate will be halved from $3.00 to $1.50 per fortnight for every $1,000 of assets above the lower assets test threshold.

These changes to the rules for government pensions mean that:

- if you currently receive a reduced government pension, you may be entitled to an increased payment, and
- if you are currently ineligible for a government pension, you may qualify to receive a payment.

Importantly, these changes relate only to the assets test. Eligibility for a government pension is determined on the basis of separate income and assets tests. The test that results in the lower rate for your individual circumstances will apply.

What's a complying income stream?

Complying income streams include lifetime annuities, life expectancy annuities and Term Allocated Pensions (TAPs).

Life expectancy and lifetime annuities provide a regular guaranteed income with:

- fixed terms between 1 and 25 years – or for life
- a fixed rate of return commensurate with a low level of risk, and
- the option to increase income payments by an annual percentage or by the Consumer Price Index to counter inflation.

TAPs invest superannuation benefits to provide a regular income stream with exposure to a range of assets (such as shares, property, fixed interest and cash) and a choice of payment frequencies (including monthly, quarterly, half-yearly or yearly).

Identifying the opportunity

The change to the assets test taper rate means that the thresholds for a government pension will increase. People who currently receive a pension that is impacted by the assets test may receive an increase in their pension payment.

Prior to 20 September 2007, some people may find it advantageous to purchase a complying income stream. Doing so can reduce the level of their assessable assets for social security purposes. This may assist some people to qualify for a pension or to receive an increase in their pension payment.

The examples below show how people can benefit from the new rules.

Currently retired, receiving a pension – increased Government pension payments

John and Jenny are retired and currently receive a pension based on the assets test. Apart from their home, they have assessable assets totalling $438,000 for social security purposes.

The value of their total assets exceeds the assets test threshold for a full pension by $201,500. Because of the current assets test taper rate they receive an Age Pension of $278.30 (combined) per fortnight. From 20 September 2007, thanks to the change to the taper rate, their pension payment will increase to $580.50 (combined) per fortnight.

In addition, Jenny and John each purchase a complying income stream valued at $80,000 before 20 September 2007. Because 50 per cent of the money used to purchase the complying income stream is exempt from the assets test, they will increase their pension payment by an additional $120 (combined) per fortnight.

The result means that John and Jenny now receive $700.50 (combined) per fortnight.

Not yet retired – planning for maximum retirement income

Tony, aged 64, and Sue, aged 63, both currently work full time, although Sue has been contemplating retirement. Although they don't own their home, they have assets totalling $950,000.

This level of assets will exclude them from receiving a government pension on retirement, even after taking into account the new assets test taper rates (the government pension threshold for couples who do not own their own home is $946,500 from 20 September 2007).

However, if Sue retired before 20 September 2007, she would have access to her superannuation, meaning she could purchase a complying income stream and lower the value of their assessable assets.

If Sue purchases a complying income stream before 20 September 2007 and their assessable assets are less than $946,500, they could both receive a part Government pension once Tony also retires and turns 65.

For more information on how you can ensure that your retirement income can fund your desired lifestyle, please contact us.