NEWS AND VIEWS

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September 2008

Holding insurance in super is now better than ever!

With the onset of tax-free superannuation (super) for people aged 60 and over since 1 July 2007, super couldn't be a more attractive investment vehicle for you to retain your savings.

With that in mind, it's time to think about some of the benefits of housing personal insurance in your super fund.

Benefits of holding insurance in super

Armed with this knowledge, it may be beneficial for you to start considering holding life, total and permanent disablement (TPD) and income protection insurance within your super fund to benefit from the new simplified super changes. Key benefits of holding insurance within your super fund are detailed below.

Deductibility of premiums – your super fund can claim a deduction on the expense incurred for funding your insurance premiums. This can assist in reducing the tax paid within your fund and therefore increase your super benefits.

Reduced cost – insurance provided within your super fund often benefits from group rates, which reduces the amount of premiums you pay.

Having the premiums paid directly from your fund also assists the cost-conscious person who wants to avoid paying premium costs out of their own pocket. In this scenario, you would be less likely to feel the cost of incurring the premiums, but can be secure in the knowledge that you're protected in the event of death or disability.

Tax-effective payment of benefits – housing your personal insurance within your super fund means that upon your death, your dependants (for tax purposes) can receive your death benefit as a tax-free lump-sum payment.

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Case study

Noel, aged 30, is a graphic designer and on a salary of $80,000 per annum, excluding the superannuation guarantee (SG). Noel decides he needs income protection insurance with the maximum income protection benefit of 75 percent of his salary up to age 65, with a waiting period of 30 days.

His income protection insurance premium is calculated to be $1,166 per annum, which Noel elects to direct debit at $97.17 per month from his bank account. This reduces his disposable income by just under $100 each month (based on the 2007/08 financial year tax rates).

Noel claims the cost of the premiums in his tax return in the following financial year, which gives him a tax saving of about $484. His effective cost of insurance is therefore $682.

If however, Noel holds his income protection within his super fund, he can utilise his employer SG contributions of $7,200 per annum to cover the income protection insurance premium of $1,166.

Look at the benefits:

1 Noel will not have to fund the monthly premium of $97.17 from his after-tax dollars, thereby increasing his disposable income.

2 There will be no contributions tax payable on the employer (SG) contribution that funds the income protection insurance premium, as Noel's super fund is able to obtain a tax deduction for the insurance premium, which effectively offsets any contributions tax that would otherwise be payable by Noel.

Subprime crisis – what's it all about?

Stories about the US subprime crisis are still dominating the news. But what's it all about and why does it impact us?

The literal definition of 'subprime' is 'below optimum'. In other words, it's a catchy label given to a large number of loans which shouldn't have been granted. Under normal circumstances, these customers' poor credit history would have made them blatantly ineligible for a mortgage.

Low interest rates and a booming US property market, however, saw many banks and other lenders in America relax their criteria and approve a slue of subprime mortgages.

Not surprisingly, over time many of these loans proved difficult (if not impossible) to service.

Things reached critical mass mid 2007, when many subprime customers' low interest rate ('honeymoon') periods came to an end. What's more, construction of new houses outpaced housing demand and, as a result, prices began to fall. Many borrowers found that not only were they unable to repay their loan, their houses were now worth less than what they owed the bank.

As large numbers of subprime borrowers defaulted, lenders were forced to sell houses in an already distressed market. As a result, outstanding debts could not always be recovered and several large US banks reported substantial losses.

But what has this got to do with us in Australia?

The level of exposure to the subprime loan market i.e. low doc loans, in Australia is not as significant as in the US. Locally we have stricter criteria and lending practices especially for this type of loan. However, when the large US banks reported losses, this led to a weakness in bank shares across the globe.

What's more, the losses weren't limited to US retail banks. Investment banks had repackaged subprime mortgages and sold them on to investors worldwide. A common way to raise funds for home loans is 'loan securitisation', which is a bundling of a large number of loans to form a new type of investment vehicle.

When loan defaults began in the US, these repackaged mortgages fell in value and investors lost money. Many investors were able to return these subprime-backed securities to the investment banks, causing further damage to the lenders' bottom line.

Listed companies with large revenue exposure to the US and high debt levels saw their share price drop. And as investors got nervous, this further fed share market volatility.

What's to come?

The impact of the US sub prime market crash isn't over just yet. It's generally accepted that the worst subprime loans were the 2006 vintage whose honeymoon rates will end throughout this year.

But while the potential US recession centres on problems in the subprime lending market, it is also impacted by the US' large budget deficit, and slowing economic growth, fuelling fears of a global slowdown.

So what can we expect in the coming months?

The biggest issue facing world markets is the US recession debate. Will the US enter a recession or will they manage to avoid it by, for example, aggressively cutting interest rates?

If it does enter a recession, the next question is whether emerging markets can take up the slack in the global economy.

Over the last eight years or so, emerging markets (such as China, India, Russia and Brazil) economies' have grown at a more rapid rate than the developed world. Interestingly, most world savings in recent years have come from emerging markets, while developed countries (such as the US) have been running budget deficits.

As a result, many economists are debating that if the US economy does enter a recession, the world may not follow. However, this economic decoupling debacle does not mean a market decoupling. Because of globalisation and the sheer volume of US corporate operations worldwide, a downturn in the US share market will at some point affect the rest of the world.

On a positive note, domestic economic fundamentals are considered sound, corporate earnings are at record highs and we have the lowest unemployment rate in decades. So, while short-term market volatility is to be anticipated over the next 6 to 12 months, the long-term outlook is positive.

Financial peace of mind

The best approach to weather out the storm is sticking to your long-term strategy. Your financial adviser has the expertise to develop a personalised financial plan which, through diversification and analysis of your objectives, can continue to work towards your long-term goals.

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Conclusion

When addressing your long-term lifestyle needs, objectives and financial goals, the importance of insurance should not be forgotten. With the super environment thriving as a result of the new super reforms, the benefits of holding insurance within your super fund should go hand-in-hand.

To find out more about the super changes and how it may affect your insurance cover, please call [insert name of adviser or phone number as applicable].

Hitting the jackpot

If you dropped $20 on the street and a big gust of wind blew it further down the street, you'd chase after it. Yet it is surprising the number of people who have lost money through forgotten bank accounts, superannuation (super) accounts, deceased estates, share dividends and unpresented cheques.

In 2006 there was $204 million lying unclaimed in accounts around Australia. Nearly 161,000 bank, building society and credit union accounts have been forgotten and all these accounts have more than $500 in them.

Bank accounts

If there is more than $500 in an account, and it has not been accessed for seven years, the money is transferred to the Federal Government and held by the Australian Securities and Investment Commission (ASIC) in consolidated revenue.

The best way to find lost accounts is to go to ASIC's web site www.fido.gov.au/unclaimedmoney and do a search. If your name comes up, you can apply to your local bank branch to get the money.

Records for savings bank accounts go back to 1989. Some trading bank accounts go back to 1959 and credit unions and building society records go back to 2000. There is no fee to use the web site and you get back money that belongs to you.

It's important to note that ASIC is responsible for unclaimed money held by banks, building societies, credit unions, friendly societies, insurance policies and company shares.

Super

The Australian Taxation Office (ATO) estimates lost super at around $9.7 billion.

If you've moved house or changed jobs frequently, you may have lost track of your super or your old super fund/s may have lost track of you. To help you locate your old super accounts, the Government provides a free **SuperSeeker** service where you can find your super. Simply call **13 28 65** with your Tax File Number to request a search or visit www.ato.gov.au/superseeker

In Australia, complying super funds (funds which meet Government requirements) are required by law to notify the ATO of 'lost members'. A lost member occurs where two written communications are returned to the super fund unclaimed. Lost members' details are given to the ATO and their account balance is held by the super fund until claimed, or it is transferred to an Eligible Rollover Fund (ERF).

ERFs are special funds set up to look after the super monies of lost members. They must protect the account balances of all their members from being eroded by fees and charges, whenever the account balance is below $1,000.

Your super fund will list contact details for its chosen ERF in the annual report that it sends to you so that you can keep track of your benefit and contact the ERF if necessary.

Consolidating your super

Do you have other smaller super accounts, perhaps from a legacy of past jobs that you have simply forgotten about?

If so you could be paying unnecessary administration fees on each of these accounts, which is eating into your retirement savings. So it makes sense to consolidate your super into one super account, saving on management fees, decreasing the amount of paperwork you receive and boosting your super savings.

Your financial adviser can help

If you need help locating your lost super or consolidating various super accounts, speak to your financial adviser. They can help ensure your super savings are in the best possible shape to provide you with a financially secure retirement.

Avoiding the credit crunch

A survey by the Financial Literacy Foundation[1] has found most Australians are confident at managing debt, despite the fact that debt and bankruptcy levels continue to climb.

It seems that the gap between personal perception and financial reality is widening.

According to the Reserve Bank, credit card debt in Australia has blown out to a record $41 billion. The average card now has an outstanding balance of over $3,000[2].

In the financial year to June 2007, a record 32,000 Australians went bankrupt – a jump of 17 per cent on the previous year. Another 6,500 people entered formal debt agreements with their creditors – up about 30 per cent on the previous year.

When it comes to gender, research by credit reference agencies, Veda Advantage and Dun & Bradstreet, have found men are more likely to miss repayments on their loans than women.

More worrying is that younger Australians seem to be struggling with credit.

Veda found that 45 per cent of all debt defaults occur among people aged 18 to 30.

The basics of borrowing

Borrowing money is easy – it's making the repayments that can sometimes be difficult. If you get into debt trouble, don't ignore the problem because it won't go away.

What to watch out for

Debt problems don't strike without warning. Here are some of the signs:

- Do you worry about checking the mailbox for fear of finding another bill?
- Are you still paying off credit card bills from last Christmas?
- Have you gone through two or more mobile phone providers?
- Are you only paying off the minimum monthly credit card balance?
- Do you have outstanding personal loans that you used for holidays?
- Have you maxed out all your credit cards and applied for another?
- Is there nothing left in your pay once your debt repayments have been made?

Managing debt effectively

If you've borrowed money and have not yet repayed the loan in full, then you're in debt. However this isn't necessarily a bad thing. Debt is an accessible tool to help you achieve long-term financial goals such as owning a home or car. As long as you remain in control of your debt – that is, you stay on top of your repayments – it shouldn't be a problem.

Rather than trying to dig yourself out of a debt hole, it's a much better idea to follow some simple rules when talking to lenders so you don't get into trouble in the first place.

Before taking out a loan check:

- The term of the loan.
- The interest rate that will be charged and how often the payments must be made.
- The way the rate is determined – is it variable (the lender can move the rate up and down) or fixed?
- Fees over and above the interest payments, such as monthly 'service' fees.
- The actual amount, in dollar terms, that will be paid over the life of the loan. On a house, over 25 years, this will be several times the actual price.
- The type of security required – for example, a mortgage on a house may involve the lender having title over the property.
- Can you repay the loan early? Is there a penalty for early repayment?
- What happens if you experience short-term financial difficulties or are unable to repay the loan?
- Is the contract covered by the Consumer Credit Code?

Keeping your debts under control

When taking on a debt of any kind, it's important to remember that unexpected things can occur that may impact your ability to pay off your debts. If you were unable to work due to injury or illness, would you be able to keep up with your financial commitments and protect the assets you've worked hard to accumulate?

It's estimated that less than 10 per cent of Australians have insurance against loss of income, yet it's often considered to be the most important type of insurance cover needed for income earners. Before taking on a large debt, speak with your financial adviser about preparing for the unexpected through risk management strategies such as income protection insurance.

Consider these tips for paying off your debts

- Modify your budget to make sure it accounts for your debt repayments.
- Pay off debts with the highest interest rates first, as these can cost you more in the long run.
- Credit cards require you to pay a minimum amount each month. Consider paying more than the minimum required amount so you can pay off the debt faster and pay less interest.
- Think about consolidating your debts if you have more than one, but only do so if it will help minimise your overall interest payments and the fees and charges you pay.

The importance of professional advice

If you're having trouble managing your debts or think there might be a better way, ask your financial adviser for help. Your financial adviser can develop a debt management plan and advise on whether consolidating your debts is in your best interest.

Speak to your financial adviser today and look forward to a debt-free future.

1 Financial Literacy, Australians Understanding Money, September 2007

2 www.rba.gov.au

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