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Protecting your most valuable asset

Car insurance? Check. Home and contents insurance? Check. But what about insurance for your ability to earn an income? Establishing a comprehensive risk management plan to protect your family and your lifestyle should form a key part of your overall financial strategy.

It's a fact – life is full of risks. And regardless of whether you shy away from danger or consider bungie-jumping an enjoyable sport, no one is immune from the unexpected and often unpleasant events that life throws our way.

When it comes to living life to the full, the one thing we all rely on is our income. It enables us to afford the basics such as bills and food, and occasionally indulge in the finer things. So imagine the hardship and sacrifices you would suffer if you, or your partner, were suddenly unable to earn an income due to a debilitating illness or disability, or even unexpected death.

A financial adviser can show you how the right insurance risk management plan can provide you with peace of mind.

The 'under insurance' trap

Despite the risk, up to three quarters of Australians are classified as 'under insured'.[1] Not surprisingly, many experience severe financial adversity following an unexpected death, injury or illness – an added burden at an already difficult time.

But this financial distress can be avoided by arranging adequate insurance to protect your family and lifestyle.

Myth busting – the truth about insurance

Myth 1 – It just won't happen to me

You could be right – but did you know that every working Australian has a **one in three** chance of becoming **disabled** for more than three months before turning 65?[2] Not only that, but:

- **One in eleven** Australian women will develop **breast cancer** by the age of 75[3]; and
- Around 48,000 Australians have a **debilitating stroke** each year. That's one person affected every **11 to 13 minutes**.[4]

Myth 2 – Insurance is only for the rich

Not true. Insurance is relevant for anyone who relies on their salary to support their lifestyle. In fact, if you're living from pay-day to pay-day, or have limited savings, you are carrying a high degree of risk on your ability to earn an income.

Similarly, don't forget to insure the homemaker, as the financial worth of their day-to-day duties often works out to be far more than you may expect!

Myth 3 – All insurance is the same

There is a large degree of variance in insurance products, most commonly within the 'definitions' of the policy. When selecting your insurance policy, you should check carefully to see that your needs are fully covered, with no exclusions on the important things. Your financial adviser can help you sift through the information to ensure you make the right choice.

Myth 4 – I have insurance through my superannuation

Many Australians have automatic cover through their superannuation (super) fund, but it's important to consider whether this level of cover is adequate for your personal situation. Often the minimum cover is quite basic, so you should ask yourself whether you could go three months without an income, or if your family could live on a one-off payment of $150,000 if you passed away.

Myth 5 – Insurance is a 'set and forget' thing

Putting insurance in place is not enough. It's important to regularly review your risk management plan, especially if your circumstances have changed. Events such as a salary increase, giving up smoking, a new mortgage or the birth of a child should all trigger an insurance review.

There are many good insurance options in the marketplace ... so why take the risk?

In this issue ...

- Protecting your most valuable asset
- Self managed superannuation funds
- Superannuation ... it's not a case of 'set and forget'
- When was your last financial review?

What types of insurance are available?

Life insurance

Life insurance is probably the most well known type of cover. It is designed to help alleviate the family's financial burden should the key income earner pass away. Usually paid as a lump sum, dependants can use this money at their discretion to pay the mortgage, meet living expenses or invest the funds to help finance their future with an ongoing income stream.

Income protection insurance

In the event that you are unable to work due to prolonged illness or injury, income protection insurance provides you with a monthly benefit payment of up to 75 per cent of your salary. Depending on your level of cover, this may be paid while you are unable to return to the workforce, up to age 65.

An added bonus of this type of insurance is that the premium you pay is fully tax deductible.

Total and permanent disability insurance

Total and permanent disability (TPD) insurance is generally taken as an optional extra within a life insurance policy, but can also be taken as a stand-alone policy.

As the name suggests, this type of cover provides you with a lump sum in the event that a permanent disability prevents you from returning to your normal full-time employment. In most cases, your level of TPD cover will be linked to the value of your life insurance.

Trauma insurance

Trauma insurance is designed to financially assist those who suffer a traumatic medical condition – and survive. Generally paid as a lump sum upon diagnosis of an eligible condition, the funds can be used at your discretion to cover the costs of recovery such as a full-time nanny or housekeeper, rehabilitation, or installation of disabled facilities in your home.

Your premium will often be determined by the range of conditions for which you wish to be covered.

Business protection insurance

Also known as business expenses insurance, this product can help you meet your ongoing business expenses, such as wages, overheads and rent, while you are temporarily unable to work due to a disability or illness.

This can help to cover your fixed business costs and keep your business afloat while you are recovering.

Seek professional advice

A professional financial adviser can help you determine the most appropriate insurance types for your life-stage and the level of cover that you will need.

1 Investment and Financial Services Association (IFSA)

2 Institute of Actuaries of Australia

3 Cancer Council NSW

4 National Stroke Foundation

Self managed superannuation funds

The term 'self managed superannuation fund' – otherwise known as an SMSF – basically refers to 'do-it-yourself super'. Having an SMSF means simply having control of how your super is being invested, and recently it has become a popular method of saving for retirement.

If you choose to go down this path, it's essential that you are aware of precisely what will be required of you from an SMSF administrative and compliance perspective. The information below should answer many of the questions and obligations specific to managing your own SMSFs.

Before you think about leaving your current public superannuation fund to obtain increased returns or greater control from your own super fund you should discuss your options in detail with your financial adviser.

What is a SMSF?

An SMSF is a trust where funds or assets are held and managed on behalf of a maximum of four individuals to provide future retirement benefits. Subject to certain exceptions, all members of a SMSF must be trustees of the fund or directors of the fund's corporate trustee.

What are the benefits of establishing an SMSF?

The main rationale for creating your own SMSF is it increases your control, investment choice and flexibility. You become the trustee of your account and therefore make decisions on your fund investment strategy and what you fund's assets are invested in.

Your SMSF can also invest in almost anything, including investments usually not available in a public super fund, although the investments are subject to certain limitations and legal restrictions. This will allow your fund's investments to be customised to suit the precise requirements of members before and after retirement.

Furthermore, similar to all super funds, an SMSF is taxed at a concessional rate. The top tax rate for investment earnings from your SMSF is 15%. However this tax concession is only available for a 'complying funds' which are SMSFs that fulfil all the rules set out by the ATO and the Superannuation Industry (Supervision) Act 1993 and Regulations (SIS).

Gearing with superannuation

It is now possible to borrow funds (use gearing) to increase your SMSF. The borrowing must be set up on a 'limited recourse' basis and you should still be wary of the risks associated with gearing strategies.

But, there is potential, to accelerate the level of funds you have in your SMSF.

Things to consider

Who are the governing bodies?

The Australian Taxation Office (ATO) is responsible for overseeing the regulation of SMSFs. While the ATO's regulatory approach to SMSF is focused mainly on education and information, it is fast becoming more aggressive in its stance for fund compliance.

Understanding the obligations and rules associated of a SMSF

As an SMSF investor, you need to consider your fund's investment philosophy – like any other super investment, you will need to establish what the acceptable rate of return is and how much risk you are going to take with your retirement savings.

These are areas where professional management can be a good idea.

Many investors who open a SMSF employ the services of specialist administrators to take on the difficult compliance activities on behalf of their fund, this is beneficial as they can still enjoy the investment control and flexibility without the added burden of administration.

Your fund's compliance with superannuation law is vital and you are legally accountable for ensuring your fund complies with all the rules – even if you pay for professional management.

The main components of compliance for an SMSF relate to:

- How and when an is a SMSF permitted to borrow;
- In-house asset rules;
- Acquisition of assets from related parties; and
- Conducting all dealings at arm's length.

Sole purpose test

The foundation of the SMSF regulatory system is the sole purpose test – the sole purpose of your fund should be to provide retirement benefits to fund members. In line with this, trustees will have an investment strategy which they invest in accordance with.

Separation of assets

The assets from the fund must be separate to those of a business which one or more of the trustees involved. For instance if the trustee is declared bankrupt or if their business is placed in receivership and the assets are held in the name of that trustees, rather than being clearly held as a part of the fund, the fund risks the loss of the asset. The failure to separate assets is a clear contravention of SIS.

Investments

To assist in making sure the assets in an SMSF will be available to produce retirement funds, SMSFs are limited in the investments they can make. However, one of the concessions that the SMSFs enjoy is their ability to invest up to 100% of the funds assets in the business real property but the disadvantage of this being lack of investment diversification.

Although there are no restrictions in place on SMSFs investing in collectibles such as art, the ATO has ensured the sole purpose test means that members cannot enjoy the benefit from the investment prior to reaching their preservation age. This means that unless strict conditions are met – like in the case of leasing the art to a member or related party in line with the in-house asset and arms-length rules – the art cannot be displayed in the trustee's home or office.

The in-house asset rules suggest that the particular investment can makeup a maximum of 5% of the fund's entire assets and the arms-length requirement means that it should be leased to the related party at commercial rates.

Fiduciary responsibilities

It is of utter importance to meet fiduciary responsibilities, especially in regards to the SMSF holding its own bank account not personal accounts and ensuring this account isn't overdrawn.

SMSFs that comply with all regulations are showing the ATO that they are appropriately managed. Although the cost of good management of an SMSF, including ensuring the compliance with all the regulations, generally means that fund members collectively need between $200,000 and $250,000 to invest in an SMSF to make the exercise worthwhile. This does not include the initial set up costs involved.

Seek professional advice

Speak with your financial adviser to find out what is required to start a SMSF and if it is a suitable strategy for your circumstances.

Superannuation … it's not a case of 'set and forget'

Whether you are an employer who has set up a corporate superannuation fund for your employees, or an employee building your retirement nest egg through Superannuation Guarantee Contributions (SGC) into a corporate fund, you should be aware of the importance of knowing how your superannuation is growing.

As a super fund member it is your responsibility to manage your contributions (over and above the SGC), regardless of whether they are being invested into a retail fund, corporate fund or your own self-managed super fund.

Super is simply another investment vehicle and as with any type of financial asset, the fundamental principles of financial planning prescribe that individual tailoring, based on your needs, objectives and personal circumstances, is paramount to ensuring you have enough money to enjoy your retirement years.

It's a recipe for disaster to think that once you have established a superannuation account and your employer's contributions are flowing in, you can forget about it for the rest of your working life. Financial markets will change, your own financial position will change and your objectives and retirement plans will change, so it's important you review your super plans at regular intervals.

Additionally, it's very foolish to believe that a 'one size fits all' approach with no personal advice on contribution levels or transfer issues will help you achieve your goals.

Although employers are responsible for the education of corporate super fund members, you, the member, must take responsibility for determining what your needs are and working towards meeting them.

That could mean making increased contributions after a certain age to bolster your retirement savings, or making decisions on who your beneficiaries will be if you don't make it through to retirement.

This might sound pretty basic, but did you know that you may attract additional tax liabilities by making substantial contributions to superannuation? Exceeding your Contribution Cap (the maximum contributions to which superannuation fund tax concessions apply) could see part of your super contribution being taxed at a higher rate instead of super's concessional tax rate.

These are critical issues that you must take the time to discuss with your financial planner.

Superannuation is your investment in your future, individual advice and tailoring is essential.

To find out more, please call Equity Financial Services on 03 9820 8666.

When was your last financial review?

The months seem to fly by in a blink of an eye and each Christmas feels like it was only celebrated a few months ago. Every year we see dramatic changes announced for our superannuation system, interest rates, the stock market and property both up and down – depending on where you are.

All of this emphasises the need for regular reviews of your financial strategy and investment portfolio. A full review should take place on an annual basis and cover such topics as:

- Have your financial objectives changed as a result of altered business or family circumstances?
- Are you on course to achieve your objectives in the planned timeframe or are adjustments needed?
- Has there been new legislation, or taxation changes, which you need to factor into your plan?
- How have your investments performed and are they appropriate for current market conditions, or would you benefit from rebalancing your portfolio?
- Are you adequately protected against changing financial and personal risks?

If you're looking after your own investments, it might be time to ask a professional to take a look at your strategy and portfolio to ensure it's continuing to meet your changing needs now and into the future.

To find out more, please call Equity Financial Services on 03 9820 8666.

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