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Financial independence 2

You need to be able to ...

1. **Explain the basic features of Australia’s superannuation retirement savings system**
2. **Identify some key issues to consider when choosing a superannuation fund**
3. **Explain the process of consolidating multiple superannuation accounts into one fund**
4. **Explain the ways to get money into super**
5. **Explain the ways to get money out of super**
6. **Explain some key superannuation strategies for graduates and those aged over 50**
7. **Identify some principles for choosing an adviser**

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Retirement savings in Australia

Think and discuss

Superannuation gets a lot of “bad press” in the media.

What do you think are
2 good things
and 2 bad things
about the
superannuation system.

The role of superannuation

Retirement savings system in Australia is called 'superannuation'

- 'superannuate' means to retire with a pension (regular income stream)

They are usually called 'pension plans' in other countries

Your super is kept separate from your other finances

- You can't use it on holidays and cars while you are young!

Your employer makes regular contributions for you as a percentage of your gross salary

- Contribution rate is 9.50% of gross salary in 2015/16

Contributions usually taxed at just 15%

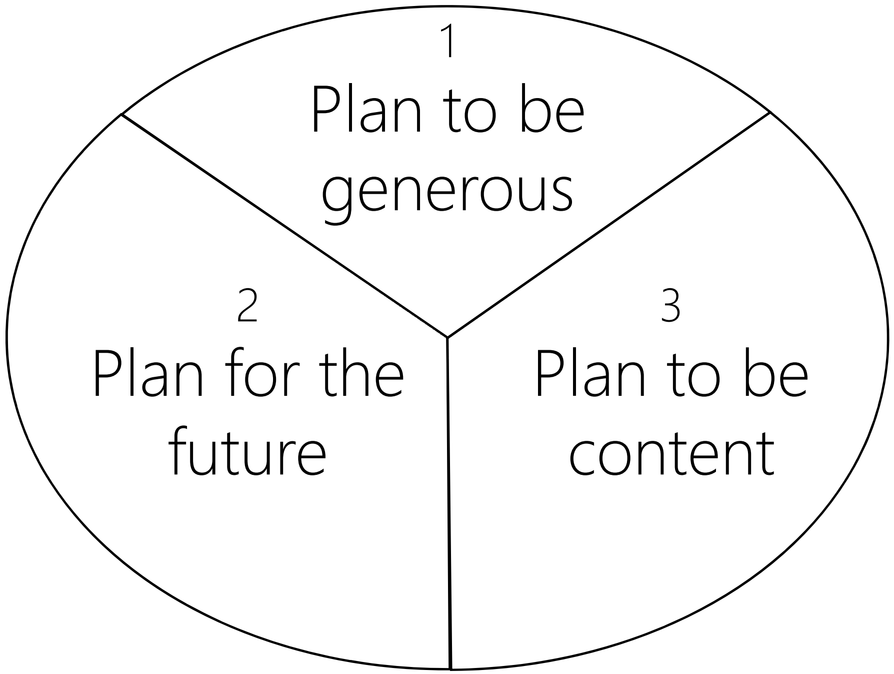
The role of superannuation … continued

Your super investments build up over 40+ years through contributions (personal income) and returns (investment income). The returns are also concessionally taxed.

When you stop work (no more personal income), your superannuation investments generate cash flow (investment income) to cover your living expenses. This regular cash flow from your super investments is almost tax-free in many cases.

Superannuation and the pie

Your pie is your
total income
each month



Investment income covers all three
Personal income is not required

The good

Regular savings paid for you by employer

Low tax on money going into super

Low tax on investment returns while inside super

**Low tax withdrawal of superannuation after age 65
(or age 60 if you have retired)**

**Good investment options that stop people gambling on
stupid investments**

The good … continued

Good investment returns

You can’t usually withdraw super until you turn 60! The rules help Australians to be self-controlled and not to dip into it!

The government is trying to make super more attractive because they can’t afford the Age Pension in 10 years.

The bad

The superannuation rules are very complicated and can be confusing.

But have been greatly simplified recently!

A lot of super funds are available leading to confusion.

It is difficult to compare and choose the best fund.

It can be very difficult to consolidate multiple accounts into one fund.

The bad … continued

Some super funds have high fees and poor returns.

Some funds make you have life insurance when you don’t need it.

You can’t usually withdraw super until you turn 60!

The Government keeps changing the rules which can make it confusing.

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Case study

Meet John

John will soon graduate as an engineer.

He is aged 20 and expects to live to 81

His “preservation age” is 60. This is the age when he is allowed to withdraw money from his super to pay for living expenses.

He plans to stop paid work at age 60.

**He wants $31,020 per year from his super when he stops work at age 60
(adjusted for inflation).**

Any other savings outside super will simply provide extra spending money.

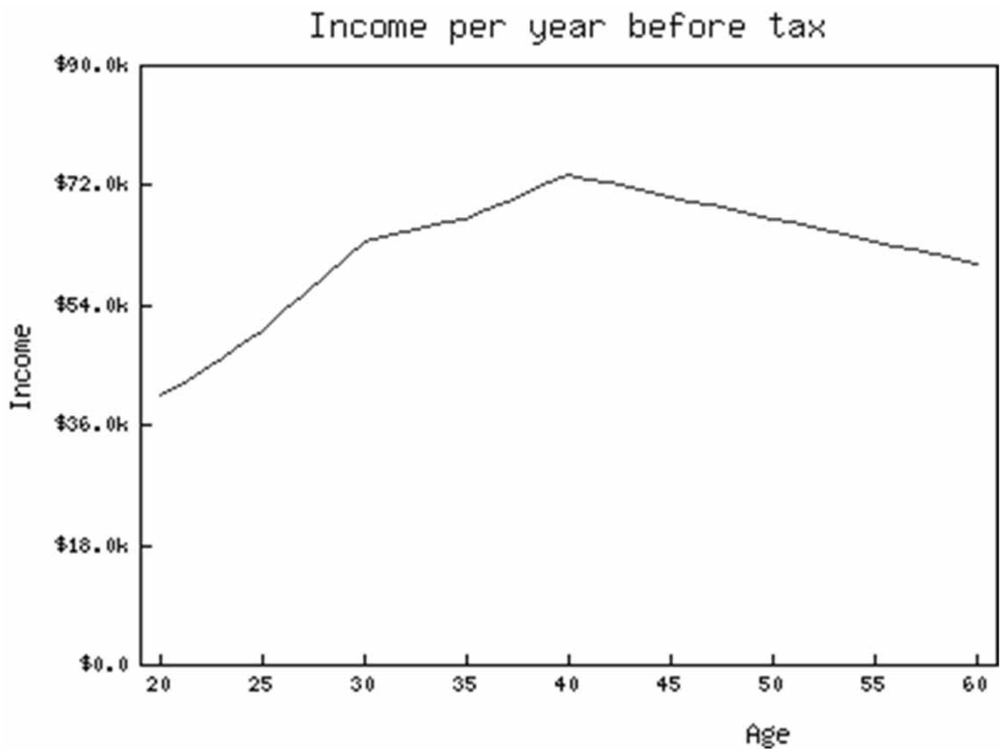
Salary estimate

Salary estimations are kept conservative for a graduate.

This salary estimations are indexed upwards by the expected rate of wage rises (3.5%pa)

Employer pays 9% of salary into John's super each year.

Government takes out 15% contributions tax out of each employer contribution.



This is less tax that the 30%+ income tax that John would pay if he took this money as salary.

Willingness to take “risk”

For a quality, diversified investment portfolio:

risk does not mean “the risk of losing all your money”

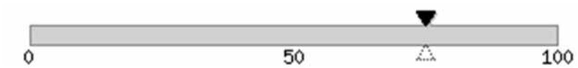
risk means “how much returns can vary from the average”.

Eg. Low risk investment return = 5% +/- 1% per year

Eg. High risk investment return = 8% +/- 20% per year

Better to have higher returns and risk over 30 years.

Assume expected nominal returns are 7.01% p.a.



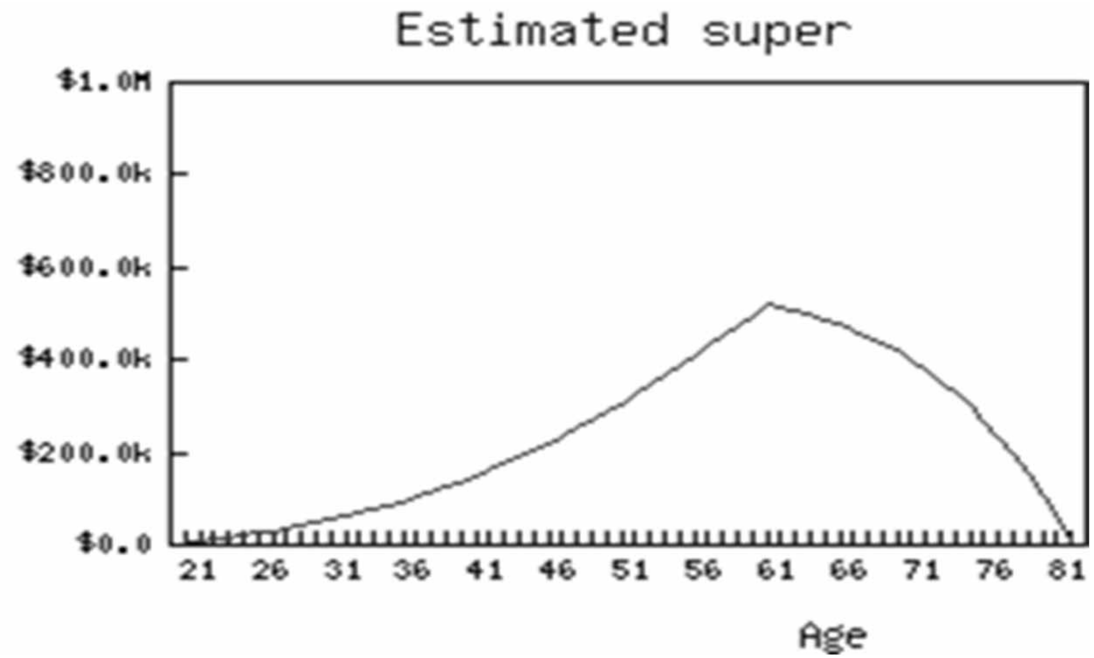
Steady increase in super **but** may not be enough for financial independence in the long term

Possibility of much more super in the long term **but** in some years your super will go down in value

Superannuation projections

John should have $511,400 in super at age 60

This amount has been adjusted for the effects of inflation at 2.5% p.a. (he actually will have a LOT more but it will buy less).



What happens at age 60

John stops full time work and declares himself to be retired (still has the option to return to work later!).

He keeps his money in the "superannuation system" but converts it into an "allocated pension".

This allocated pension pays a regular income of $30,600 per year into John's bank account (paid monthly) tax free. Investment returns are tax free.

He can increase or decrease this regular amount and can also make lump sum withdrawals at any time.

His superannuation should last to about age 81.

Boosting super: Investment option

1. **Pick the high-growth investment option**

   Increasing the riskiness of his portfolio will cause his super to fluctuate more from year to year.

   However, he should also have a lot more super in the long term.

   Bonus: $23,700 at age 60 … which means …

   Bonus: extra $1,680 income per year after age 60

Boosting super: Salary sacrifice

2. **Salary sacrificing $4,000 per year for 5 years now**

   John can choose to voluntarily save an extra part of his salary or wage into super.

   Not only will he pay less tax, but it will also help him achieve your long term goals.

   Bonus: $80,700 at age 60 … which means …

   Bonus: extra $4,260 income per year after age 60

Boosting super: Stop work later

3. **Planning to stop work at 65.**

   Working for an extra 5 years can make an enormous difference to his super - especially when combined with the above factors.

   Bonus: extra $157,100 at age 65 … which means …

   Bonus: $14,290 income per year after age 65

   BUT … five years less to enjoy your retirement!

5 tips for John right now

1. **Consolidate all of his super into one superannuation fund to cut down in administration fees and unnecessary insurance premiums.**
2. **Make sure his super is invested in the "growth-option" and not the default option.**
3. **Work towards a 5 year goal of building up at least $22,300 in his super.**
4. **Provide his fund's details to his new employer whenever he changes jobs.**
5. **Consider salary sacrificing for a few years to jump-start his superannuation.**

What happens to John’s super if he dies?

Superannuation is held “in trust” by the super fund on behalf of John. It is not directly owned by him so he can’t give instructions via his will.

The trustee of the fund will pay his super to his dependants or next of kin or the beneficiaries he nominated on his application form. If none can be found then it will be paid to his estate.

If super is paid to spouse or dependant child then they get it tax free.

If paid to someone else then tax is taken out of balance.

What if John’s super fund goes bankrupt?

This is very unlikely to happen because super funds are closely regulated by APRA.

Superannuation investments are held in a “trust” which is completely separate from the financial institution’s own accounts and assets.

These “trusts” do not have any significant debts or liabilities so it is not really possible for them to go bankrupt.

If financial institution goes bankrupt then trust remains separate and liquidator will sell off trust to another superannuation fun to administer.

Bottom line – DON’T WORRY!

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Choosing a fund

When choosing a superannuation fund …

Some things to consider:

- Product alternatives
- Investment options
- Fees
- Insurance (options and cost)
- Readability of brochures, forms, paperwork
- Website features

Source of good information about funds:

- www.selectingsuper.com.au

Product alternatives

Not-for-profit funds (eg. REST)

Can be good … but often don't disclose their investment fees and can have poor features and poor service.

Retail Funds (eg. BT Super for Life)

Administered by financial institutions. Good features, investment options and service but check the fees!

Employer Funds (eg. AMP Custom Super)

Administered by financial institutions. Your employer chooses the fund. You normally must leave fund when you change employers. Watch out for high fees and unnecessary insurance!

Product alternatives ... continued

Corporate Funds (eg. Telstra Super)

A fund that your company has set up for staff many years ago. Usually administered by a financial institution (eg. William Mercer). You normally must leave the fund when you change employers.

Master Trusts (eg. Asgard)

Give you the options of choosing between managed funds.

Usually sold by advisers. Watch out for high fees and commissions!!

Investment alternatives

Investment options

- You are given “options” with names like “conservative”, “balanced”, “growth” and “high growth”
- The super fund chooses managed funds into which each option is invested.
- Choose “growth” or “high growth” option and leave it there for 30 years!

Managed funds

- Retail Funds and Master Trusts often let you choose managed funds directly (rather than a generic investment option)
- Watch out for higher fees and higher hassle!

Fees

Entry Fees are usually paid to financial planners. NEVER pay an entry fee!

Administration Fees are usually about $100 per year (fixed). (Consolidate your funds!!!)

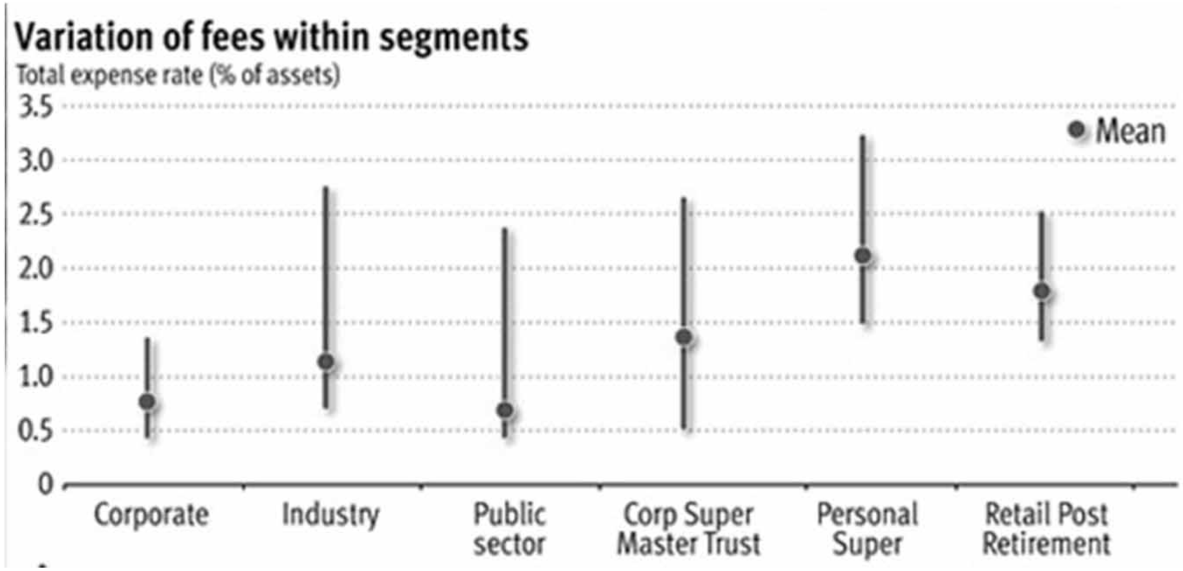
Investment Manager Fees (or MERs) are paid to fund managers. Can be between 0.3% and 1.8%. Any fund that says that the only fee is “$1 per week” is hiding the MER of their fund managers.

Exit Fees should normally be less than $100. They can be higher than $2,000 for some old funds.

Fees … continued

Source: Australians "Super choice pushes fees up", 24/5/2007

http://www.theaustralian.news.com.au/story/0,20867,21784188-643,00.html



Insurance

Death cover

- Pays lump sum when you die
- Usually much cheaper because insurance companies cover all members as a group.
- Cost can vary significantly between funds
- Much cheaper than buying it outside super

Total & Permanent disability (TPD)

- Pays lump sum when you become TPD
- Can be a waste of money.
  See if there's a "death only" option.

Insurance … continued

Salary Continuance

- Replaces 75% of salary for a maximum of 2 years if cannot work
- Can’t claim tax deductions on payments
- Can be better to obtain this outside super because of tax deductions and greater flexibility
- Some funds are now allowing benefit period more than 2 years

Forms

Clear application forms

Clear explanation of superannuation system

Clear explanation of fees

Clear explanation of insurance

Clear explanation of investment options!

Self-managed superannuation funds

A special, small fund for up to five members

Also called DIY super funds

Gives you more flexibility with investments

- **Example: property investments**

BUT

- **There are still a LOT of investment restrictions**
- **Cannot borrow money to buy investments (eg. property)**
- **Expensive to set up ($1000+)**
- **Expensive to run ($2500+ per year)**

Not for people with less than $100,000 in super

See your accountant about setting up a fund

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Consolidating your super into one fund

Why consolidate your super into one fund?

Because it's your money and you may lose it!

Because your super is important!

You can save a lot of money in fees.

You can stop being sent statements and junk mail from 5 funds!

Because approx 50% of Australians are too lazy to consolidate their funds – don't be a sheep!

What jobs didn't pay super?

Part-time employment below the age of 18 working less than 30 hours a week.

A job that paid less than $450 per month.

Any work done while older than 70 years old.

Contract work when you were not a direct employee.

Self-employed work (when you are not an employee of the company).

The steps for moving your super into 1 fund

1. **Decide which fund into which you would like to consolidate your super**

   www.selectingsuper.com.au

2. **Obtain a “Transfer Authority Form” from them that allows you to roll money INTO that fund.**

   Download from their website or call them

3. **Search for lost superannuation accounts at the ATO’s SuperSeeker website**

   http://www.ato.gov.au/superseeker

4. **Locate any superannuation statements in your bedroom**

The steps … continued

5. **Confirm account details and confirm rollover procedure with each fund.**

    If account is closed, ask where the money went

    If account is still active then:

    Check/update name, address, contact details

    Confirm account balance

    Confirm what life insurance you'll lose

    Confirm what exit fees you'll pay

    Ask if you need to give them copies of ID

    Ask if they need any special form

The steps ... continued

6. **Complete a separate "Transfer Authority Form" from your new fund for each of your old funds.**
7. **Staple any special forms or id that your old fund requested to the corresponding Transfer Authority Form.**
8. **Send the Transfer Authority Forms off to your old funds.**
9. **Wait and 'tick-off' receiving the following:**

   Rollover confirmation from each of your old funds

   Confirmation of receipt of each rollover from your new fund

   ... within 4 weeks

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Putting money into super

4 ways to put money into super

1. **Employer contributions**
2. **Salary sacrificing**
3. **Personal contributions**
4. **Government co-contributions**

1. Employer contributions

Employers required to place X% of salary into your super

- **Slowly increasing from 9% to 12% between 2013 and 2020.**

They are usually required to let you choose your own fund

Government takes out 15% contributions tax.

- **Note that this is less than your marginal rate of tax which will probably be 30% plus 1.5% Medicare Levy.**

Employers now have to pay your super quarterly as a minimum (most do it monthly).

Maximum contributions (that are tax deductible)

- **$30,000 per year if you are under 60** (after 1 July 2014)

2. Salary sacrifice

Also called ‘Concessional contributions’

You tell your employer to pay an extra X% of your salary (on top of their 9.5%) into your superannuation.

The money is taxed at 15% rather than your marginal rate of tax (30% or more).

Young people are usually discouraged from doing this because they need to save for mortgage.

However, salary sacrificing a small amount can make a BIG difference in super by age 65.

Try salary sacrificing 100% of your salary for one month and live off your savings!

NOT eligible for co-contribution payments (see later)

3. Personal contributions

Also called 'non-concessional contributions' or 'undeducted contributions'

You own "after-tax" money that you pay into super from your savings account.

No tax deductions going in so it is usually much better to salary sacrifice instead.

Usually older people make these contributions when approaching retirement to give their super a boost.

POSSIBLY eligible for government co-contribution.

Maximum contribution per year is $180,000 or $540,000 if only one contribution made in 3 years (after 1 July 2014)

4. Government co-contribution

The government will add $0.50 for every $1 of Personal Contributions that you make (up to $500).

This means there is little benefit of putting in more than $1,000 per year yourself.

The amount gradually reduces from $500 to zero between a taxable income of $28,000 and $58,000.

You must earn >$1 of wage income, have PAYG Statement from employer and submit a tax return.

More than 10% of income must be from wages.

Superannuation fund organises this for you and it is usually received 3-6 mths after you submit tax return.

Good strategy for non-working spouses or uni students!

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Getting money out of super

What we will cover …

1. Preservation (when you can withdraw)
2. Withdrawal
3. Drawing a regular income
4. Permanently leaving the country
5. Compassionate grounds
6. Financial difficulties
7. Death

Preservation

Preservation is all about when you can withdraw your superannuation from the superannuation system.

> **It is NOT about when you can move your superannuation between super funds … you can do this at any time!**

All of your superannuation will likely be "preserved" which means it cannot be withdrawn until you turn 60 and you have "permanently retired" or age 65.

Your parents may have some restricted or unrestricted components which may be able to be withdrawn earlier (before age 60 or age 55 if born before 1 July 1960)

Your statement divides your balance into various components.

Withdrawals

Since July 2007, your parents are able to withdraw their superannuation as soon as they reach age 60 and have permanently retired and pay no little or no tax on withdrawals.

If not retired then they will need to wait until age 65.

However, probably best to leave it in the superannuation environment because there are ways to get tax-free investment returns!

Drawing a regular income

If your parents have reached age 60 but have not stopped working, they can rollover part of their superannuation into a non-commutable pension.

- **Non-commutable means cannot be converted into a lump sum. Must take payment of between 0% and 10% each year.**
- **Once reach age 65, balance can be withdrawn at any time.**

After retirement, can also keep your money in superannuation but convert it into “Allocated pension”.

- **Regular monthly income**
- **Can make lump-sum withdrawals at any time.**
- **Investment Returns are often tax free.**
- **Regular Allocated Pension income is often tax free.**

Temporary residents

If you are a temporary resident and you earn superannuation in Australia then you can withdraw it when you leave.

You pay tax on the benefit when it is withdrawn (30%).

- **But have already paid 15% contributions tax**
- **Adds up to marginal tax rate of 45%!!!**

Apply online at the ATO website:

- **www.ato.gov.au under Superannuation.**

Financial difficulties

You can apply for release of between $1000 and $10,000 of your superannuation if you have severe financial difficulties if:

- **you are in receipt of a Commonwealth income support payment, and have been so, continuously, for the last 26 weeks; and**
- **you can satisfy your fund that you are unable to meet reasonable and immediate family living expenses.**

For more info see www.apra.gov.au website.

Compassionate grounds

You can also apply to APRA for early release for other compassionate grounds for:

1. **medical treatment for you or a dependent for a life threatening illness or injury, to alleviate acute or chronic pain, mental disturbance or where such treatment is not readily available through the public health system;**

2. **modifications to the family home and vehicle to meet the special needs if you or a dependent are disabled; or**

3. **palliative care or death, funeral, or burial expenses for you or a dependent.**

For more info see www.apra.gov.au website

Divorce

Superannuation assets are NOW included in the asset pool to be distributed to each party in a divorce.

If ordered by the Family Court, superannuation funds can pay part of your super to your ex-spouse.

Note: Relationship counselling is usually cheaper than a divorce!!

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Superannuation strategies

A strategy for graduates

- Consolidate your superannuation into one good fund.
- Ask your parents to “go halves” with a personal contribution of $500 if you can get the co-contribution.
- If you are a good saver, salary sacrifice all of your graduate salary for a month to boost your super
- Choose a growth investment option.
- Select appropriate insurance and salary sacrifice to cover the premiums.
  - Nominate zero death/TPD if you don’t need it and the fund automatically gives it to you.
  - Consider salary continuance if you are working full-time.

Possible strategy for Mum & Dad

See a good financial planner by age 50

Pay off 100% of mortgage by age 50

Salary sacrifice large part of salary after age 50

- **Up to $35,000 per year maximum if aged under 60**

At age 60, boot out any remaining children, sell home, buy smaller home and invest difference into super

- **Limited to $180,000 per year per person**

... continued

Age 60 – start drawing income from superannuation

- **Can do this while still working part-time or full-time**
- **Under "Transition to Retirement" rules**

Age 60 to retirement

- **Salary sacrifice any income above $37,000 into superannuation (as long as it doesn't exceed $35,000 in total)**
- **Yes! ... While also drawing and income from superannuation!**

Work part-time as long as possible but scale down hours

Upon final permanent retirement, convert superannuation into allocated pension (income stream) and enjoy life.

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Choosing an adviser

The financial planner’s dilemma

You have a financial planning business with these costs:

- $40,000 - Office rental, insurance, licensing costs
- $45,000 - Personal assistant
- $90,000 – Your salary
- $175,000 - Total

It takes 6 hours to develop a financial plan for a client

- whether you are seeing a 21 year old or a 60 year old!

Your customers always want “free advice”

- They are not willing to pay more than $500 for a plan
- Not willing to pay more than $300 a year for annual reviews

How do you make your business profitable?

Solution to the problem

Don't accept any clients below the age of 40 since they don't have much money to invest!

Accept commissions from fund managers

- **1% on all new investments … Eg. $200,000 = $2,000**
- **Plus charge $1,000 fee for doing plan = $3,000 total upfront**
- **0.6% p.a. trailing commission … Eg. $200,000 = $1,200 per year**
- **Plus charge $500 "review fee" = $1,700 per year**

Sometimes also a "performance fee"

- **Extra 1% plus trailing commission if returns > 15%**
- **This is really dodgy since this will happen in 2 out of 5 years anyway even if the adviser gives ordinary investment advice!**

Finding alternatives

Financial Planning Association has online directory:

www.fpa.asn.au

Yellow pages

Referrals from friends with financial planners

Most will give a free "first meeting" so try several

Usually better if close to work or home

Criteria for choosing a financial adviser

Bachelor or Masters of Commerce (better is bachelor!)

- **Major in accounting (for better tax advice) or**
- **Major in finance (for better investment advice)**

Member of the Financial Planning Association (FPA)

Attained industry Certified Financial Planner (CFP) from FPA

More than 5 years experience as financial planner

Have preferably been with current company for 3+ years

Receive majority of income from fees rather than commissions

- **Preferably not more than 0.5% per annum ongoing commissions**

Do not recommend any investments where the total ongoing fees (advisor, administration and MERs) total more than 2% per year

You need to be able to …

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