Prepare for Life

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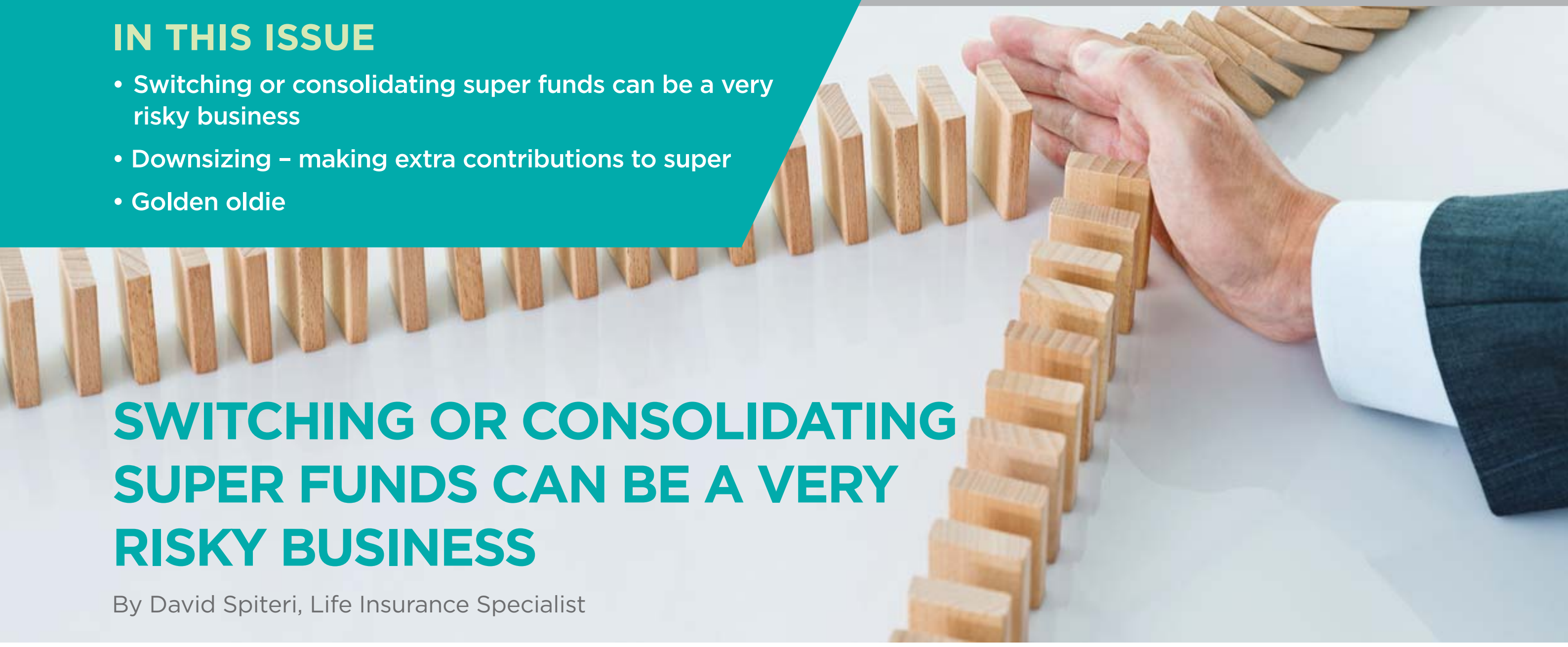
IN THIS ISSUE



SWITCHING OR CONSOLIDATING SUPER FUNDS CAN BE A VERY RISKY BUSINESS

By David Spiteri, Life Insurance Specialist

Super fund members are regularly encouraged to consolidate their super accounts into one account to reduce paperwork and avoid paying multiple administrative fees and charges for accounts they don't need.

But, in my experience, making unadvised financial decisions – no matter how simple they appear on the surface – is a very risky business.

Let me demonstrate the dangers of consolidating super accounts without seeking professional financial advice through a client story I was recently involved with.

The client was a 31-year-old woman who was diagnosed with motor neurone disease (MND) in September last year. MND is a progressive and terminal disease that attacks the motor neurones, or nerves, in the brain and spinal cord. She was due to be married in the middle of the following year but brought the marriage forward due to her progressive deterioration.

> *"Making unadvised financial decisions – no matter how simple they appear on the surface – is a very risky business."*

The woman, who has a one-year old son, wanted to get her affairs in order, so the night before she was scheduled to meet with a financial planner, she decided to consolidate her three separate superannuation accounts into one account online. What she failed to realise was that by doing this, she would lose all default insurance cover in the super accounts she was rolling over.

So, by rolling her REST super and SA Super into her HESTA account, she immediately lost $365,000 in death cover and $185,000 in total permanent disablement cover that she had in her REST super account.

She was not aware of this until she met with a financial planner the following day. Both she and the adviser were horrified by what had happened, and the financial ramifications of her actions.

Numerous phone calls were made to REST superannuation, who, while sympathetic, advised they couldn't do anything to rectify the situation as it had to be a guaranteed payout and they were acting on the client's authority. REST then rang back and said they were willing to take the case on board as long as they received a statement of good health on the client, which obviously wasn't going to happen.

I spoke to AIA who do the group insurance for REST, and they put me onto someone who looks after the group cover for REST. After numerous calls and numerous dead ends, we continued to escalate the case within REST. AIA eventually came back and said they would reinstate the death cover and the TPD cover.

Legally there was no onus on AIA to overturn the client's decision and reinstate the cover. They did so out of compassion and understanding, and at a significant loss to themselves given the client's terminal illness.

This will obviously make a huge difference to the client and her family going forward. The client's husband had just lost his job after 12 years of service, and AIA's compassion means a guaranteed payout of $365,000 which will pay off their mortgage and give them some extra to live on.

So, the moral of this story is while there are certainly benefits in consolidating accounts, it is important to check whether you will be able to get the same level of insurance cover in your chosen fund.

DOWNSIZING – MAKING EXTRA CONTRIBUTIONS TO SUPER

By Peter Kelly, Retirement Strategies and Solutions

In November 2017, the Government passed legislation that will allow certain individuals who sell their main residence to contribute up to $300,000 of the sale proceeds to superannuation, without being constrained by the usual restrictions that otherwise apply to contributions - including contribution caps.

The legislation is designed to reduce the pressure on housing affordability.

Contributions made to superannuation under this arrangement are referred to as 'downsizer contributions' and are subject to specific rules. Downsizer contributions are treated separately to concessional and non-concessional contributions.

How it works

To be eligible to make downsizer contributions, several conditions need to be met, including:

1. Contributions may only be made by an individual aged 65 or over;
2. The contributions arise from the sale of a residence that has, at some or all the time of its ownership, qualified as the individual's main residence for Capital Gains Tax purposes;
3. The residence has been owned by the individual and/or their spouse for at least ten years;
4. The contribution of up to $300,000 is made from the sale proceeds of the residence within 90 days of change of ownership (settlement);
5. The contract for sale of the property was entered into on or after 1 July 2018;
6. An election to make a downsizer contribution is made in the approved form; and
7. The individual has not previously made a downsizer contribution.

Qualifying residence

To qualify as a downsizer contribution, the sale proceeds from which the contribution is to be made must be in respect of the sale of a property that has, at some time during its ownership, qualified for a Capital Gains Tax exemption as the individual's, or their spouse's main residence.

Therefore, the proceeds from the sale of a commercial property, or an investment property that has never qualified for the main residence Capital Gains Tax exemption, do not qualify as a downsizer contribution.

Furthermore, a qualifying residence does not include a houseboat, caravan or mobile home.

Making a downsizer contribution is contingent upon selling a qualifying residence. However, there is no requirement that a replacement residence must be purchased. For example, a person selling their home and planning to rent a property, relocate to a retirement village or residential aged care facility, or move in with family, may still make a downsizer contribution.

How are contributions treated?

A downsizer contribution will be treated as part of the contributor's tax-free component of their superannuation. Therefore, it will not be subject to tax at the time the contribution is made to the super fund.

Contributions to superannuation by individuals aged 65 or older can only be made where the individual meets a work test. Furthermore, contributions can generally only be made to age 75.

However, individuals wishing to make downsizer contributions are not subject to the work test or age 75 requirements.

While non-concessional contributions are subject to several restrictions including an annual limit of $100,000, and cannot be made by people with more than $1.6m in super, these restrictions do not apply to downsizer contributions.

> **“Contributions made to superannuation under this arrangement are referred to as ‘downsizer contributions’ and are subject to specific rules.”**

Downsizer contributions are counted towards an individual’s total superannuation balance. This may impact on their ability to make future non-concessional contributions and receive other Government benefits such as the Government co-contribution and a tax offset for contributions they may make for an eligible spouse.

Transfer balance cap and taxation

The superannuation reforms that were introduced from 1 July 2017, restrict the amount that an individual may transfer to a superannuation pension account. This is known as the transfer balance cap. The transfer balance cap is currently $1.6m.

Consequently, even though an individual may be able to make a downsizer contribution, the contribution may not be able to be transferred to a pension account where the individual has already exhausted their transfer balance cap.

Whether it is worth retaining downsizer contributions in a superannuation accumulation account, as opposed to investing the surplus funds outside super, will depend on the individual’s personal tax position.

Social Security

An individual’s main residence is generally exempt from the assets and income test when assessing entitlement for Social Security and Department of Veterans Affairs benefits, including the age pension or service pension.

However, selling the main residence and depositing the surplus sales proceeds to a bank account, allocating to other investments, or making a downsizer contribution to superannuation may result in amounts that have previously been exempt from the assets and income tests now being assessed under these tests. This may result in the loss of, or a reduction in the amount of pension being paid.

Example

Fred and Francis are aged 68 and 66 respectively. They have owned their family home for more than 10 years. They list their home for sale in May 2018 and enter a contract to sell the home for $900,000 in July 2018. They are planning to buy an apartment for $500,000. The surplus arising from the sale of their main residence is $400,000. They could each make a downsizer contribution of $200,000, or any other combination, subject to a maximum of $300,000 per individual.

If Fred and Francis are receiving an age pension, the surplus proceeds from the sale of their main residence ($400,000) will be treated as an assessable asset and will result in their age pension reducing or ceasing to be payable, depending on their overall financial position.

Conclusion

Making a downsizer contribution to super as a result of these changes will be a viable strategy for some, and perhaps not so viable for others.

Whether it is suitable or not will depend on personal circumstances, including the current amount held in super, personal tax position, and whether an individual is receiving social security or DVA benefits.

Superannuation can be extremely complex. Therefore, before embarking on making downsizer contributions, suitable advice should be sought from a licensed financial planner.

GOLDEN OLDIE

By Ventura and Russell Investments

By rights, the current market cycle should be shuffling into retirement, putting its feet up and taking things easy. It is, after all, nearly nine years old - the second-longest bull market on record and positively geriatric by the standard of these things.

But this cycle belongs to the baby boomer generation, and like them, refuses to succumb to dotage. It's having a vigorous later life while frittering away the next generation's inheritance.

This raises a critical issue: how to make the most of late-cycle returns while preparing for the inevitable downswing? Late cycle can be the most challenging phase. Valuations are stretched, central banks are taking away the punch bowl and fundamentals look long in the tooth. But markets may surge as investors, buoyed by their recent success, become overconfident and start believing (again) that this time is different.

A well-defined investment decision-making process helps deal with this challenge. We step back from the current market psychology and have the discipline of breaking each decision into three building blocks: is this asset class cheap or expensive, is the cycle a tailwind or headwind, is sentiment overbought or oversold?

Without a solid process, there is the very real risk of being drawn into euphoria at the market peak and capitulating with despondency at the cycle bottom. Investors can't afford these mistakes. Particularly given the grim outlook for longer-term returns told by high equity market valuations and low government bond yields.

We spend a lot of time talking about the low-return imperative. For most investors, the market returns available in coming years likely won't be high enough to achieve their retirement goals.

To have a chance of overcoming this, we believe investors need to respond in three ways:

1. Diversify their sources of returns;
2. Have effective implementation capabilities; and
3. Use a robust dynamic asset allocation process to guide tactical positioning.

In other words, they need to squeeze every basis point out of their portfolio using smart strategies, implemented in a cost-effective manner, backed by a dynamic process that leans into opportunities and away from risks.

We're not especially bullish or bearish about 2018. 2017 delivered better returns than most industry analysts expected, but the cycle is old and the U.S. Federal Reserve (Fed) is about to step up the pace of rate hikes. Our central view is that equity markets can push higher over the first part of the year, before facing headwinds later in 2018 as markets factor in rising risks of a 2019 recession.

Enjoy this energetic old cycle while it lasts, but remember that the Fed Reaper (or Jay Powell[1] as he is known to his friends) is getting ever closer...

[1] Jerome Powell, a member of the U.S. Federal Reserve Board of Governors since 2012, was nominated in November 2017 to serve as the next Chairman of the Federal Reserve.

NEWS UPDATE

Living the Betweenage

The baby boomers are now rewiring their life in retirement. With improvement in medical science and increasing health awareness, people are living longer and healthier. And the baby boomer generation is now starting their 'second-round' of teenage years at age 65!

The baby boomer generation is one of the wealthiest generations of all time. Now, it seems that another boom is happening in their life; and these babies of the post-war generation are diving head first into a second teenage phase with a 'boom'.

The 'Betweenager' is the new teenager aged between 65 and 80 who wants to enjoy life to the fullest. With accumulated super money and increased health, they are ready to enjoy their retirement beyond just 'retiring'. It is as if the baby boomers are taking a 'short detour' between quitting from the workforce and being contend enjoying their old age. This phase is typically signalled by trying new experiences and maintaining an active and healthy lifestyle.

The challenge lies in managing their finances during this period. Ideally the accumulated retirement money is sufficient for their own second-round of teenage years of the baby boomers, as well as leaving money for the real teenagers of the family (grandchildren).

Best wishes,
Michael Kakaras

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