PATRON *Financial Advice*

Money Matter$

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Transition to retirement

The nature of retirement is changing and so are the rules. If you want to reduce your working hours or pay less tax without sacrificing your income, 'transition to retirement' could be the answer.

Longer life expectancies mean many Australians are spending more time in retirement than ever before[1] – increasing the burden on our social security system and the importance of accumulating superannuation (super).

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As a consequence, the Government is encouraging us to remain in the workforce beyond the traditional retirement age. A recent incentive is the option to access your super before you fully retire, through a transition to retirement pension.

You can access a transition to retirement pension of between 4-10 per cent of your account balance if you've reached preservation age (currently 55) and you are still working.

A better lifestyle on the same income

Transition to retirement provisions allow you to supplement your income by drawing a regular pension payment from your super fund. There are two principal ways you can benefit:

- convert to part-time work without decreasing your income, and spend more time doing the things you want to do; or
- continue to work full-time but reduce your tax by taking a pension and salary sacrificing more of your income into super (or your spouse's super).

Should you continue working past 65, you also benefit from ongoing employer contributions to super which ultimately increases the value of your retirement nest egg.

[1]http://www.aihw.gov.au/mortality/data/life_expectancy.cfm

Tax treatment

If you are under 60, part of your pension payments will be taxed, but you may receive a 15 per cent tax offset on the taxable component. Once you have reached age 60, all pension payments are tax-free including lump sums.

Your financial adviser can help you structure your pension to legally minimise your tax.

How does the Transition to Retirement strategy work in practice?

Case study

Ted, who is 57, has a salary of $80,000 per annum (plus 9% superannuation). He wishes to continue to receive his current net income but maximise the effectiveness of his super. He currently has $400,000 in super and decides to commence a transition to retirement pension of $30,000 p.a.

As the table illustrates, Ted has not changed his cash income at all, but has saved over $4000 in tax each year which stays in his superannuation account. If he retires after turning age 60, all benefits including the tax saving are tax free.

Note about salary sacrificing

Although salary sacrificing into superannuation is a great strategy for increasing your retirement savings, not all employers offer this feature to their employees. Also under these arrangements your 'salary' decreases and this could have a flow on effect to other employment benefits you receive – e.g. compulsory super contributions may be determined using actual (reduced) salary and can also take into account salary sacrifice contributions.

Seek professional advice

Transition to retirement provisions can mean reducing your working commitments and pressures without necessarily reducing your standard of living. There are, however, various levels of complexity and the strategy is not suited to all investors.

Only a financial adviser can help you determine the best approach for you. Ensure your retirement planning is on track by seeking professional advice.

	Without strategy*	With strategy*
Gross salary	$80,000	$42,000
9% super contributions	$7,200	$7,200
Salary sacrifice into super	–	$38,000
Super pension drawn	–	$30,000
Tax paid plus Medicare Levy (less offsets)	$20,300	$12,280
Net cash	$59,700	$59,720
Superannuation asset*	$430,962	$435,207
Increase in super due to strategy	–	$4,245

*Earnings are 6% p.a in a superannuation account (net 15% tax) and 6.5% a pension account (nil tax). Salary sacrifice and 9% superannuation contributions are taxed at 15% in super. Earnings and super contributions are credited monthly.

Protecting what's most important

For most of us, our income from paid employment is one of the most important factors in determining our quality of life. 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?

You might already have insurance to protect your home, car or valuable possessions from damage or theft, but if you become seriously ill or injured those assets could still be lost if you are unable to work.

It's estimated that less than 10 per cent of Australians have insurance against loss of their income, yet it's often considered to be the most important type of insurance cover needed for income earners.[1]

A lack of income protection cover is a real issue. In 2005-06, the Australian Bureau of Statistics reported 43% of people suffering a work-related injury did not receive any financial assistance for time off work.[2] Those who become ill or injured away from work cannot even access workers compensation, making their financial situation even more precarious.

Income protection insurance

Income protection insurance can help support you financially if you suffer an illness or injury that prevents you from undertaking your normal employment. It provides you with an income based on your usual earnings, so that you can continue to support yourself and your family financially.

Income protection is important for all working Australians but is considered to be an essential type of insurance for those under age 50, who are generally more reliant on their salary than someone who has been able to build up assets over the course of their working life.

Income protection can ensure you are paid up to 75% of your normal salary if you are disabled and unable to work. A good policy should also;

- pay for rehabilitation programs,
- provide cover if you are overseas, and
- supplement your income if you are only able to return to work in a reduced capacity.

Should you be injured or too ill to work, income protection insurance can provide you with pre-determined, regular payments based on your income. It's different to health insurance which covers medical expenses, but does not compensate you for time spent recuperating at home. Unlike other forms of insurance, you can access income protection benefits when you most need them, not only upon your death. Put simply, it's 'insurance for living'.

Why you need it

You should consider this type of insurance if the loss of your salary or wage would cause you or your family significant distress, and you couldn't get by on government benefits alone. For example, if you are paying a mortgage, or your partner is reliant on your salary, income protection could be an important consideration for you.

One way you may be able to access income protection cover is through your superannuation (super) fund. Income protection (or 'salary continuance cover' as it is often called) offered by super funds is usually cheaper than purchasing an individual policy as the super fund trustee/s normally arrange cover at concessional (group) premium rates. You also have the convenience of having the premiums deducted from your super account automatically, eliminating the need to make arrangements to pay your premiums separately.

It can be difficult to find an insurance policy that covers everything you might need at a reasonable price. Your financial adviser can offer expert advice and take the time to gain a full understanding of your situation to ensure they recommend the most appropriate policy to match your needs and budget.

[1]MoneyManagement.com.au article, refer: http://www.moneymanagement.com.au/Articles/A-matter-of-life-and-death_0c037a25.html

[2]ABS, refer: http://www.ausstats.abs.gov.au/ausstats/subscriber.nsf/0/4C1F7A19EF4AEEA9CA2572490018107D/$File/63240_2005-06.pdf

Putting your eggs in one basket

Conventional wisdom dictates that when it comes to investing, you should never put all of your eggs in one basket. We tend to agree but with one important exception.

When it's OK

If there's ever a case for getting your 'eggs' together in one place it's when you're organising your super. Having one 'nest' for your superannuation 'egg' makes a lot of sense – and it can save you thousands of dollars.

If you've had a few job changes and haven't thought much about your super, there's a good chance you have multiple super accounts – and you're losing money. And the longer you leave it, the more you're going to lose!

Having several super accounts usually means your money is parked in low earning accounts that can slowly but surely be eroded by fees. It's likely that previous employers have transferred your super to an 'Eligible Rollover Fund', a fund that's mainly invested in cash. While cash is a relatively stable and 'safe' investment, it nevertheless limits your opportunity to earn higher returns as would be anticipated if your money was invested in growth assets like shares and property.

This means you're hit with a 'double whammy' because your fund's not earning a great deal and you're paying for the privilege! Not a great combination. Consolidating your super accounts is probably the best example of where it's OK to put your financial eggs in one basket.

When it's not

While it's wise to consolidate your super into the one account, it's another story when it comes to how that money is invested. One asset 'basket' is generally not recommended.

Superannuation products commonly offer you investments across a range of asset classes like shares and property. Your money is allocated across a variety of assets according to the risk profile you have discussed and agreed with your financial adviser. This 'asset allocation' helps you minimise your exposure to risk because at any given time, one or more of those asset classes, such as international shares, might be performing well, while others could be underperforming. In addition, some assets are regarded as more volatile than others.

It would have been tempting, for example, to put all your money into Australian shares over the past couple of years, given how well this asset class has been performing. However this decision would be based on the popular investment misconception that past performance is a good predictor of future performance. The Australian sharemarket has been doing very well but no-one can predict what will happen in the future. All we need is a 'scare' or worse, a sign of sustained trouble, in one of the world's major or emerging economies and our sharemarket could take a significant downturn.

Unless you're an investor with sufficient time and/or experience to keep track of movements in the markets, along with the ability to quickly change your investment strategy as appropriate, you're generally better off with an investment portfolio that features a number of asset 'baskets'.

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