Super Guide:
What is Superannuation?

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THE SMSF CLUB

This guide is brought to you by THE SMSF CLUB

About The SMSF Club

The SMSF Club is a membership program designed specifically for anyone who has or wants a SMSF.

“Business and investing are team sports. The average investor or small business loses financially because they do not have a team. Instead of a team, they act as individuals who are trampled by very smart teams.” **Richard Branson**

With an extensive network throughout Australia, The SMSF Club integrates a tailored education program with administrative, compliance, and investment support. We help members throughout every stage of the SMSF process. This includes the establishment of a SMSF, full ongoing bookkeeping, ongoing accounting, legal and compliance support, plus investment education. We ensure our members are informed, responsible, and compliant trustees of their SMSF.

Having the right team to support you in meeting your obligations is critical to the success of running your own SMSF.

With the guidance of The SMSF Club you can be in control of your retirement savings for yourself – not by yourself.

What is Superannuation?

Superannuation is a forced savings vehicle with a sole purpose to provide you with an income in retirement. That is, the aim of superannuation is to ensure you save and invest money during your working life so that you can live off the earnings in retirement.

As superannuation is likely to be your major source of retirement income, super is an investment in your and your family's future.

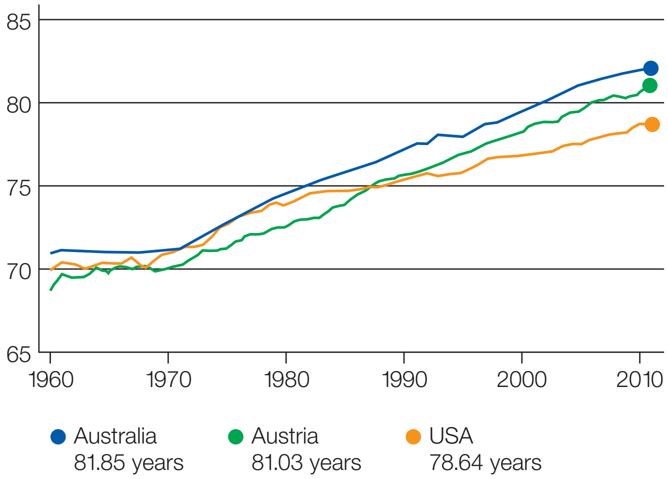
Why invest in super?

Many Australians avoid thinking about retirement because they associate retirement with facing old age or possibly death. These are two confrontations we all like to avoid, but in reality, life expectancy figures show that you may experience retirement for nearly as long as you were working, especially if you plan to stop work before 65 years of age.

Australian Life Expectancy

81.85 years (2011)

Australia, Life expectancy



Source: World Bank

If you were to retire at 65 this would mean you have an average of 17 years worth of additional costs to cover without an income. This leads to you having two options when it comes to your retirement. Firstly, accumulated assets in your superannuation or secondly, the old age pension.

Is the old age pension an option?

The current old age pension for a couple at the maximum rate including rebates is $32,416.80p.a. or $21,504.60p.a. for an individual. Is it possible to have the lifestyle you want on less than the minimum wage?

The aged pension is designed for those who are unable to build their own retirement nest egg and to give them the basic amount necessary to *survive.* Anyone under the age of 45 should not be depending on the age pension to fund their retirement. The age pension will either not exist at all, or the age upon which you will be entitled to the pension will increase. What that means is that you will be forced to work for longer, from 1 July 2017, the qualifying age for Age Pension will increase from 65 to 65.5 years. The qualifying age for Age Pension will then rise by 6 months every 2 years, reaching 67 by 1 July 2023. This trend is expected to be continued as life expectancy continues to rise.

The long-term benefits of superannuation

You don't have to earn a million dollars per year to retire a millionaire.

By investing in superannuation early in life, you can enjoy the benefit of the magical wonder called compounding.

The benefit of compounding and taking superannuation seriously is something you should be teaching your children, because one thing they have more of than us is time. When it comes to superannuation, time is very powerful.

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Why does the government insist we have superannuation?

The answer to this question is also simple. It is because with an ageing population in Australia, the Government cannot afford to fund our retirements through the traditional method, the age pension. If all people aged over 65 were to be entitled to the full age pension, the ongoing economic consequences to Australia would be dire. If you are wondering how this applies to you, or why this makes investing in superannuation so important, look at the statistics below. Remember the main way the Government funds the age pension is through income tax collected from the working population.

By 2047, the Australia's population is expected to change considerably:

- The total population is expected to increase by 38%
- The proportion of people aged 65 and over is expected to nearly double to 25% of the population.
- The number of people of working age (15-64) to support every person aged 65 and over is expected to decrease from five people in 2007 to only 2.4 people in 2047.

Source: Treasury projections, Intergenerational Report 2007.

Given this changing landscape as a result of the baby boomers approaching retirement and people living longer, the cost to the government would be astronomical to keep the age pension intact.

To overcome this problem, the Government was forced to introduce a mechanism where individuals became responsible for funding their retirement themselves.

When can you access your superannuation?

As the main aim of superannuation is to provide you with an income in retirement, the Government provides many incentives for you to make contributions to super and many rules to keep it there. The Government wants to ensure you save the funds for retirement rather than spend the proceeds prior. You can access your super as a lump sum or to draw an income stream depending on your age and whether you have retired.

If you are 60 or older

Once you reach 60 you can access your super without meeting any other condition of release. You can still be working and draw your superannuation as a lump sum, or take an income stream. As you have reached 60 you can do whatever you like with your superannuation completely TAX FREE!

If you are older than 55 but younger than 65 and retired

Once you reach your preservation age (currently 55 years old) and you have ceased work permanently you can access your superannuation as a lump sum or draw an income stream. Once again if you meet both these criteria the choice is yours.

If you are older than 55 but younger than 65 and NOT retired

While retirement has traditionally been a big leap for many Australians, with the flexibility of a gradual transition to retirement the 'one day you're working, the next day you're on the golf course' scenario is becoming less common.

Since July 2007 there has been a wide range of options available for Australians thinking about retiring. You may prefer to retire gradually, or intend to keep working for many years beyond 65. With the flexibility of the transition to retirement rules the choice is yours.

Transition to retirement

Transition to retirement is a tax effective way for you to access your super before you totally retire. The benefit of the transition to retirement rules is that you can maintain the same level of income in a tax effective way, but reduce your working hours. If you are over 55 years old and still working you can access part of your superannuation as an income. What this means is that you can draw an income stream from your superannuation while you're still working. This gives you the capacity to reduce the number of hours you work to travel, play golf, renovate your house, spend time with the grand kids, basically do whatever you desire and supplement your lost income as a result of working less by drawing the shortfall from your super.

Transition to retirement benefits you if you have reached preservation age, you are still working but thinking about retiring, and you have a superannuation balance that is of sufficient size to meet your income needs. Not only do you work fewer hours and have the capacity to maintain your income, but you will also save tax.

Accessing your super prior to 55

If you suffer from severe financial hardship or serious illness or injury it may be possible to access part of your super savings prior to preservation age. To access your super prior to reaching preservation age you require approval by the Australian Prudential Regulation Authority (APRA). The amount APRA may enable you to withdraw will be usually limited to pay for the treatment of the life threatening illness, prevent the forced sale of your family home, or pay for medical transport, funeral or burial expenses. Remember, super is there to provide you an income in retirement, not bail you out prior.

Access to your super isn't always a good thing

While you can access your entire superannuation savings and withdraw those proceeds as a lump sum in certain circumstances, once you take the funds out of the tax effective paradise that is superannuation, you will lose many of the benefits super offers. If your aim is to invest those proceeds and live off the income you will be significantly better off leaving the funds in super, as once you reach retirement all capital gains and any income derived will be tax free. The tax benefits of super will be discussed in detail within chapter two. All you need to know for now is that for most of the Australian population we should be leaving as much money as possible within superannuation, even once we retire.

Preservation age

The term used for money in superannuation that cannot be accessed until you reach a certain age and cease work permanently is your 'preserved benefit'. Almost all superannuation proceeds are preserved benefits. The current preservation age is 55. This means that you cannot access your superannuation until you are at least 55 years old and retired. The preservation age is being slowly increased with the aim of having all benefits preserved until the age of 60 by 2025.

Below is the preservation age schedule:

Date of birth	Preservation age
After 1964	60
June 63–July 64	59
June 62–July 63	58
June 61–July 62	57
June 60–July 61	56
Before 1960	55

What this means is if you were born on 1st September 1962 you will have reached the preservation age and therefore have access to your super when you turn 58 years old, provided you have retired from the work force. Likewise if you were born on the 5th March 1979 you will currently have to wait until 60 to access your super benefits. People aged 32 or over as at 1st July 1992 are not affected by this increase and can access their super either as a lump sum or draw an income stream when they reach 55 years old and have retired.

With all these benefits why do the majority of Australians dislike superannuation?

When superannuation comes up in general conversation I often hear "the rules keep changing", "there are too many taxes", or "by the time I retire the government will take my super". These excuses used to defer taking superannuation seriously are most are merely myths. Below are the main reasons why the majority of Australians fail to take superannuation seriously. In reality these limiting beliefs are now redundant. Now is the time to stop coming up with excuses why you should not to take superannuation seriously and start planning for retirement immediately. After all super is your money!

Myth 1 – Superannuation is a necessary evil

Superannuation is something we are forced to have. It is something that the Government has imposed on us – 9% of our salary is paid as superannuation. This could otherwise be paid as income improving our lifestyle right now. It is because of this short-term attitude to investing that the Government makes superannuation a compulsory savings vehicle. The Government realized that if they left the job of saving money for retirement to us as individuals, the majority of Australians would not have the required discipline to resist the temptation of spending the funds early.

I often ask investors if they had the opportunity to spend their superannuation today, would they? The majority answer "yes!" This is because the majority of Australians like to have the cash in their hands today and worry about the future tomorrow. After all, who knows what could happen in the future? The investors who answer "no" to my question are generally those who are closer to retirement, those who value the long term forced savings that superannuation has provided them as they can access the money in the foreseeable future.

Myth 2 – The rules keep changing

Another reason many Australians often criticise superannuation is simply because the Government keeps changing the rules. Granted, the government has changed the rules many times, however, generally the majority of these changes have made superannuation an even more attractive vehicle to build and even accelerate long-term wealth. In the last five years we have seen the abolishment of reasonable benefit limits, abolishment of superannuation surcharge tax for high income earners, and the introduction of a completely tax free income in retirement. When the changes have involved a small step backwards the Government has ensured all prior superannuation funds are not disadvantaged by such legislation amendments. For instance, when the new contribution limits were introduced in July 2007, the Government provided a window of opportunity for people to make one-off contributions of up to $1 million at the time. The Government also introduced transitional limits that enable people closer to retirement (age 50 and above) to make larger contributions into super for a period of time.

Myth 3 – Superannuation involves high fees

Another myth about superannuation developed back in the 1970s and 80s when superannuation had little regulation. High fees and high exit penalties ensured performance was minimal. Sometimes as these fees eroded the first few years' of contributions, coupled with life insurance premiums that were often embedded into superannuation. Many Australians had their entire superannuation fund eroded by these expenses. With the new superannuation regulation those days are over. Fees are transparent; Super Choice legislation means you are free to choose your own fund; and you can move your super quite quickly without the high penalties of the past.

Myth 4 – I cannot access my superannuation until I reach retirement

Another common complaint about superannuation is that it is tied up for long periods of time. This is in fact one of superannuation's greatest benefits. To generate wealth you need to understand the concept of compounding. This involves time. You are forced to be a disciplined long term saver and investor. For the majority of Australian's if we were not forced to keep the funds in the superannuation environment we would spend the proceeds early and therefore be forced to rely on the pension in retirement. So the fact you can not access your superannuation proceeds until retirement is actually one of superannuation's greatest strengths.

Myth 5 – The performance of my superannuation has been at best ordinary

The only other main complaint about superannuation is based on performance. Not just the bad performance back in the 70s and 80s due to high fees but more recently in 2001-02 and throughout 2008. The poor performance during these times has been directly related to the performance of the share market and the decline in property assets across the globe. So while the majority of Australians had their superannuation decline in value during these times, the reason behind the fall had nothing to do with superannuation itself, but where you chose to have to your superannuation invested.

Throughout 2008 the media loved the headlines 'Billions of dollars lost in superannuation', and 'Retirees lose billions'. This creates further distrust when it comes to superannuation with the suspicion confirmed when we receive our annual superannuation statements. When this occurs the typical reaction for the majority of Australians is that "they could have done a better job themselves". With a little education the majority of Australians in fact probably could achieve a higher return than many professional fund managers and financial planners.

What many fund managers and financial planners often fail to realise is that their job in managing money is not just to provide a return to investors but also to protect the investor's capital. More on protecting your superannuation assets later. For now it is important to remember superannuation

is just the investment vehicle, not the asset class. Do not criticise the vehicle, but do ask your financial planner what steps they have implemented to protect your wealth – just in case the asset classes your superannuation is invested in depreciate in value.

Throughout 2008 the average superannuation fund lost almost 30%. For Australians this equates to a loss of over $300 billion in super. This is not a huge concern for younger Australians, who have many years to rebuild their superannuation wealth, but for those Australians who have worked hard their entire life and are approaching retirement, the consequences of such a poor performance are huge.

Those Australians that were considering retirement are now faced with two alternatives because of the poor performance throughout 2008.

1. To work longer, or
2. To reduce their lifestyle in retirement.

The decline in your superannuation funds throughout 2008 should not mean you pull your money out of superannuation at all, but what you probably should consider is reassessing your risk tolerance, investment goals, and consider whether you should stop paying fees for poor performance and maybe start taking control of your super which should be your most important investment vehicle.

Additional benefits of super

Tax savings

One of the main benefits of investing via superannuation is the significant tax benefits. The tax incentives provided within superannuation will be explained in the "When it comes to Tax, Superannuation is an Investor's Paradise" guide.

Saving on insurance premiums

Many superannuation funds provide members with insurance cover. The types of insurance that can be held through a superannuation fund are:

- Death cover – provides cover upon a member's death to help dependants remain financially secure;
- Total and Permanent disability insurance (TPD) – provides cover upon a member's total and permanent disablement; and
- Salary continuance/income protection insurance – provides a regular income payment of up to 75 per cent of pre-disability income upon temporary cessation of work due to ill health.

Insuring through superannuation can be very effective compared to holding cover outside of superannuation for the following reasons:

- It is usually cheaper because the fund is able to buy in bulk and so negotiate a lower rate with the insurance provider.
- The premiums are paid for out of contributions made by your employer or from personal contributions and are tax deductible to the super fund.
- Basic cover often doesn't require a medical check, with some funds also providing additional cover without the need for a medical.
- Upon death life insurance proceeds are treated like superannuation benefits and do not form part of your will.

Protection from bankruptcy

Any assets or benefits that you have in superannuation are protected from bankruptcy. This means that, generally, your superannuation won't become part of the property that is divided between creditors in the event of bankruptcy. Generally speaking your superannuation benefits will remain safe if the trustee in bankruptcy is satisfied that you had an established pattern of contributions going into superannuation and you haven't made one-off contributions into your superannuation immediately prior to becoming bankrupt.

So for some people establishing a regular pattern of contributions early may help ensure that your superannuation assets remain protected until you begin drawing a tax free income from superannuation in your retirement.

Estate planning

You work very hard for your money, so it is important that you have control over what happens to your money when you die. Your superannuation benefits (including any life insurance proceeds) do not automatically form part of your estate and therefore may not be disposed of through your Will. This provides an added layer of protection if you believe that your Will may be contested upon your death.

There are also special tax arrangements for superannuation death benefits paid after your death, depending on your beneficiary's ages, relationship to you and how the benefits are paid (i.e. lump sum or pension). These tax arrangements can result in significant tax savings, as opposed to if the inheritance was received from non-superannuation monies.

It is important that you never 'set and forget' your superannuation death benefit nomination to ensure that it remains suited to your circumstances. It is strongly urged for you to consult a solicitor and review your death benefit nominations.

Summary

- Superannuation is a forced savings vehicle with the sole purpose to provide you with an income in retirement.
- At the moment Australians are faced with two alternatives to fund their retirement;
  1. Accumulate assets, or
  2. The aged pension
- By investing in superannuation early in life you enjoy the benefit of the magical wonder called compounding. The earlier you start taking superannuation seriously, the more time it has to grow.
- Most Australians simply do not understand superannuation.
- The greatest benefit of superannuation is that the funds are tied up until you reach retirement age.
- Superannuation is just the investment vehicle – it is not a separate asset class.
- Under the current superannuation rules and for the majority of Australian baby boomers, you can access your super once you reach 55 and retire.
- There are a number of advantages to accumulating assets within superannuation. The main benefits are:
  - To increase your standard of living in retirement.
  - Significant tax incentives.
  - Estate planning.
  - Protection from bankruptcy.
  - Savings on insurance premiums.
  - When it comes to superannuation it is even more important to seek professional advice. Investment decisions should be based on an individuals' own goals, time horizon, and tolerance for risk.

What Can I do now?

"Opportunity is missed by most because it is dressed in overalls and looks like hard work." **Warren Buffett**

The Next Step

The SMSF Club is not designed for everyone, nor is it meant to be. The SMSF Club provides ongoing education or general advice only. Our aim is to empower our clients with the education so they can make informed, compliant, and hopefully successful investment decisions. Whether you are already a share market investor, have a SMSF or are considering a SMSF, it is critical you understand the obligations of being a trustee of a SMSF and the risks of any investment strategy adopted.

If you would like to find out more information about The SMSF Club please arrange a complimentary meeting with a SMSF Club coach on 1300 760 397 or visit our website www.thesmsfclub.com.au to register for an upcoming event.

An Investment in knowledge pays the highest dividend"

Benjamin Franklin

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