DIY DECIDER

Get extra good insurance advice

DIY super

■ Monica Rule

Quite a few readers have sent emails asking for information about the new rules on insurance for self-managed superannuation funds.

Many wanted to know whether my book explains this law. Yes, it is in the third edition of The Self-Managed Super Handbook — Superannuation Law for Self-Managed Superannuation Funds in plain English.

But, just so we are all on the same page, I thought I would explain this new requirement to give everyone some peace of mind.

The new insurance requirement is not about taking out an insurance policy for your SMSF in case of loss, fraud or theft, nor is it about insurance for SMSF assets such as collectables and artwork purchased after July 1, 2011.

The rule is about a trustee's obligation to consider whether insurance for life, total and permanent disability, income protection or trauma, should be taken out for the members of the fund. The trustee is required to weigh this up when formulating or regularly reviewing the investment strategy for the SMSF. The rule came into force in July.

It is outlined in Regulation 4.09 (2) of the Superannuation Industry (Supervision) Regulations 1994, and requires trustees of SMSFs to consider whether they need to hold insurance cover for their members as part of the SMSF's investment strategy.

However, there is no actual obligation to take out cover and it is not compulsory to have insurance.

If your SMSF is selected for an audit by the Australian Taxation Office, you will need to provide evidence that the trustees of your SMSF considered whether their members require insurance.

> It does not mean that your SMSF must take out any insurance. But it does mean that trustees must be able to show that it was considered.

The way you may want to support this is by documenting your reasons and decisions either in your investment strategy or the trustees' meeting minutes.

This will provide evidence that the new requirement has been addressed. Of course, if your SMSF did take out insurance for its members then evidence of the cover, as well as the documents supporting this decision, should be provided instead.

Please remember that the new law requires you to "consider" insurance for your members. It does not mean that your SMSF must take out any insurance. But it does mean that trustees must be able to show that it was considered.

The penalty for trustees who intentionally or recklessly do not comply with this new law and are guilty of an offence is a fine not exceeding $17,000 for individual trustees and $85,000 for a corporate trustee.

On the question of whether your SMSF should take out insurance cover for fund members, please seek advice. This is because the kinds of insurance policies that an SMSF can take out will change from July 1 next year.

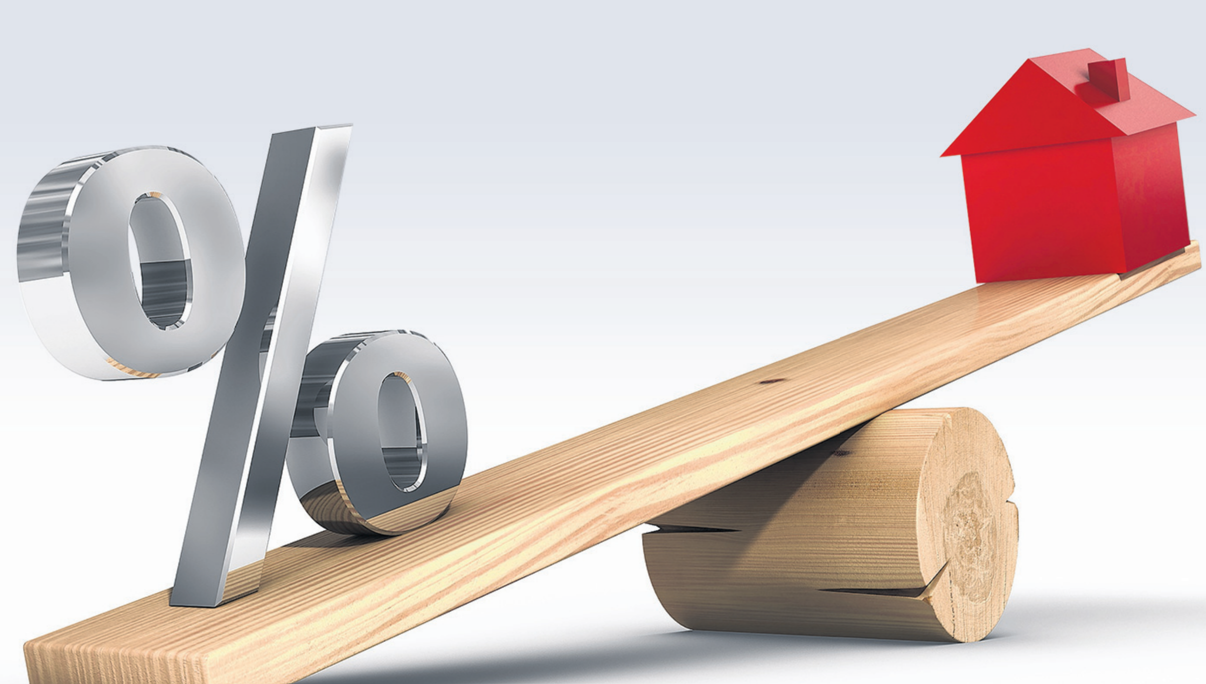
For example, SMSFs will no longer be able to take out new insurance policies that do not meet conditions of release in the superannuation law — such as "own occupation" disability insurance policies instead of "any occupation".

Remember, the law requires that trustees consider whether insurance for SMSF members is required. You do not have to have it, but you must consider it and document your decision.

■ Monica Rule worked for the Australian Taxation Office, the SMSF regulator, for 28 years. She is the author of The Self-Managed Super Handbook — Superannuation Law for Self-Managed Superannuation Funds in plain English. www.monicarule.com.au

BUY OR RENT? WHAT HAPPENS TO YOUR MORTGAGE AS RATES RETURN TO NORMAL

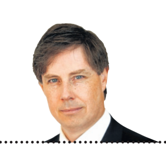
MORTGAGE	5.2%	6.7%	7.4%
$250,000	$1490	$1719	$1831
$300,000	$1789	$2063	$2196
$350,000	$2087	$2407	$2564
$400,000	$2385	$2751	$2930
$450,000	$2683	$3095	$3296
$500,000	$2982	$3438	$3662



*MONTHLY REPAYMENTS BASED ON STANDARD VARIABLE RATE OF CURRENT, IF RATES GO UP 1.5 PERCENTAGE POINTS, AND IF THEY GO UP 2.2 PERCENTAGE POINTS

Brace for a return to higher interest rates

■ Shane Wright
Economics Editor



Australians are paying record low interest rates on their mortgages. But they simply won't last.

With the Reserve Bank holding official rates at a 54-year low of 2.5 per cent, many homeowners are paying rates that would make their parents cry with envy.

These uber-low rates are bringing people into the housing market, with building applications growing strongly, particularly in WA.

The conventional advice that there's never been a better time to buy is trotted out over and over. "Rent is dead money", is another chestnut.

But it's all predicated on a 2.5 per cent cash rate which is translating into mortgage rates of less than 5 per cent.

A year ago Australians were paying a full percentage point more in interest. And banks are supposed to take the chance of a rate rise and changes in household income into account when working out if a potential homeowner can pay their mortgage.

If a borrower can afford a mortgage rate 1.5 percentage points higher than they are signing for, they'll get the green light.

On a $300,000 mortgage, the monthly difference between what you pay now and what you would pay is $320, or a little over $3800 a year.

However, a 1.5 percentage point increase would only take the official cash rate to 4 per cent.

Even when former prime minister John Howard promised to keep interest rates at record lows, the cash rate was 4.25 per cent. But 4 per cent is not normal.

If the Reserve Bank takes rates back to 4.75 per cent, the pain for mortgage holders is even greater.

Instead of paying an extra $320 a month on that $300,000 mortgage, monthly repayments rise $477, or an extra $5724 a year.

And that's the problem. Many potential homeowners are not prepared for a return to normal interest rates.

Since official rates were 4.75 per cent, almost 170,000 people have taken out a mortgage for the first time.

That's a lot of people who really have not had their ability to service a mortgage in the face of so-called normal interest rates tested.

Many are just 18 months into the first phase of a mortgage that could run for 25 to 30 years.

Yes, lower rates helped them get ahead. But somewhere over coming years they will have to find the extra cash to pay for higher rates.

The banks know it, the Government knows it. Whether homeowners know it is another story.

Flexible retirement with account-based pension

■ Michael Heffernan

Two out of three working Australians expect to run out of retirement savings by 70. Four out of five anticipate running out before age 80, according to the Mercer Superannuation Sentiment Index.

Out-living your retirement savings is a very real risk for many Australians, but it is a risk that can be managed with the right post-retirement products.

The best way to turn your superannuation lump sum into an adequate and sustainable income in retirement will be different for everyone. Account-based pensions, through superannuation funds, is one option that offers flexibility and there are good reasons for its popularity.

You can draw down regular pension payments from your super account or take a lump sum when you need one.

While your savings stay in the super system, you can choose how your money is invested in the fund. This allows you to tailor your investment to suit your risk profile and personal circumstances.

You do not have to pay tax on the money you use to start an account-based pension or on any investment earnings.

Once you turn 60, you do not pay tax on any income or lump sum drawn down and you do not have to declare that income in your tax return.

However, if you are over the so-called preservation age — currently 55 — but not yet 60, you do have to pay tax on the income you get but some may be tax free. You are also eligible for a 15 per cent tax offset that will reduce your tax liability.

You can get access to your account-based pension while you are still working, assuming you have reached the minimum preservation age.

You can get access to up to 10 per cent of your account, which may allow you to work part-time and open up other planning opportunities.

It is important to remember there is no one-size fits all approach. You need to make sure you get the right advice for you well before you retire. A portfolio of different products works well for many retirees.

The government sets the rules for account-based pensions.

You need to ask yourself what your financial position will be when you stop working, what your expenses will be and what sort of investor you are. You need to be clear about what sort of risk you can cope with without getting financially stressed. If you are clear about all of these, an account-based pension may help you maintain your lifestyle through your retirement."

■ Michael Heffernan is a financial adviser with Mercer