Death planning doesn't kill

NOEL WHITTAKER

The earlier you take out life insurance, the more you will save – and sleep.

THE tragedy of MH17 is a reminder that the future is promised to nobody. Death or unexpected illness can strike without warning, and the consequences can be horrific. Unpleasant as the topic may be, it highlights the importance of having adequate insurance.

Three in four Australians will be diagnosed with a serious illness in their working life, more than 1600 people, most aged between 26 and 59, die on the road every year, and one third of women, and a quarter of all men will suffer cancer at some stage in their lifetime. More than half of these will live for longer than five years after diagnosis.

Too many Australians believe insurance is too expensive, too complex or something that can wait until next week. The solution is to resolve to act, because there are significant advantages in seeking advice and acting earlier.

For example, if you consider getting appropriate cover from say, your late 20s to your early 40s, your financial adviser could show you how to save possibly tens of thousands of dollars in premiums over the life of a policy by locking in affordable cover when your risk of claim is statistically lower.

The earlier in life you do it, the more you'll save. And let's face it, this is the time when you are more likely to need heaps of insurance if something went wrong.

Adequate cover need not cost the earth.

Case study: A family has total debts of $250,000; Jack, the husband, is the sole breadwinner, and they would need $55,000 a year to replace his take-home pay.

His life insurance should be about $1.2 million, as they would require $900,000 to invest after paying the debts. Naturally the sum assured needs to take into account the family's situation. One may have very young children while another may have children who are about to leave home or a spouse that could readily find work if necessary.

The proceeds of a life policy are not taxable and the premiums are not tax deductible. However, by arranging the insurance through superannuation, considerable tax savings could be made as the superannuation contributions are made from pre-tax dollars and the proceeds are tax free if paid to a dependant.

If Jack was 39, and a non-smoker, he could buy $1.2 million of death cover for just $700 a year.

Of course there is a possibility that he may suffer a serious accident or illness that leaves him unable to work again. The life insurance policy won't pay out because he is not dead, but for a small extra premium he can add TPD (total permanent disablement) to his life cover.

This policy would then pay the full sum insured on his becoming disabled. Then all debts could be liquidated, the home renovated if necessary, and a sum invested to give the family an income. The extra cost to add $1.2 million of TPD cover to his life policy would be about $600 a year.

But what happens if he suffers a serious illness, such as cancer, stroke or a heart attack, but does not qualify as being totally and permanently disabled? This is the benefit of trauma insurance as it pays an agreed sum as soon as the critical illness is diagnosed to help the family cope with such a tragedy.

The good news is that most people recover from such illnesses and so live to enjoy spending the proceeds of their own insurance. For Jack, the premium for $100,000 of trauma cover is about $350 a year.

Yes, the cost of peace of mind is surprisingly low – just $1650 a year in the above example – and even lower when you consider that $1300 of the $1650 cost is coming from pre-tax dollars as it is being done by salary sacrifice.

Noel Whittaker is the author of *Making Money Made Simple* and numerous other books on personal finance. His advice is general in nature and readers should seek their own professional advice before making any financial decisions. Email noelwhit@gmail.com.

Q I have been working from home as a machinist for a company for the past 10 years. I go on the age pension shortly and apparently income earned this way is not eligible for the $250 a fortnight allowance. The company I work for is happy to change my work status to part-time casual on wages, but I would continue working from home using my own sewing machines. Would this make me eligible for the allowance?

A Centrelink advises that your question highlights the distinction social security law makes in what is considered employment income and what is considered business income. The Work Bonus applies to gross employment income. However, in some cases, someone who thinks they're self-employed may be considered to be earning employment income and therefore able to take advantage of Work Bonus. Each case is assessed on its merits, so talk to the financial information people at Centrelink.

Q My wife and I have reached retirement age. Our adviser asked why we were paying compulsory superannuation contributions with after-tax dollars. I was told that compulsory super contributions may be paid with pre-tax dollars, attracting only 15 per cent tax, as opposed to paying the marginal tax rate. When did the Australian Tax Office introduce the rule that allows pre-tax dollars to pay compulsory super contributions? How do employees find out if they are paying their compulsory super contribution with pre- or post-tax dollars? How do they go about changing to pre-tax dollars if they are currently using post-tax dollars? Why has this been kept so secret?

A There is nothing secret about it – salary sacrifice with pre-tax dollars has been publicised for years. Keep in mind, too, that under the superannuation guarantee legislation, 9.5 per cent of the gross amount (i.e. pre-tax) of ordinary times earnings must be paid to a superannuation fund. However, under an industrial agreement, there can be a requirement to pay either pre-tax or post-tax contributions. For example, some defined benefit funds require a certain amount of pre-tax or post-tax contributions to receive final superannuation benefits. The trustee of your fund should be able to explain it to you.

Fixing your rate worth considering in this time of cheap money

By **CLANCY YEATES**

THE Reserve Bank has not moved interest rates for almost a year, but that hasn't stopped banks slashing the cost of fixed-rate mortgages.

Borrowers can now lock in an interest rate of less than 5 per cent for up to five years, since the Commonwealth Bank, National Australia Bank and Westpac all cut fixed rates last week. Standard variable rates are also close to, or below, 5 per cent once the discounts that banks give most customers are taken into account.

Without doubt, it is very cheap money. But how long can variable rates stay this low?

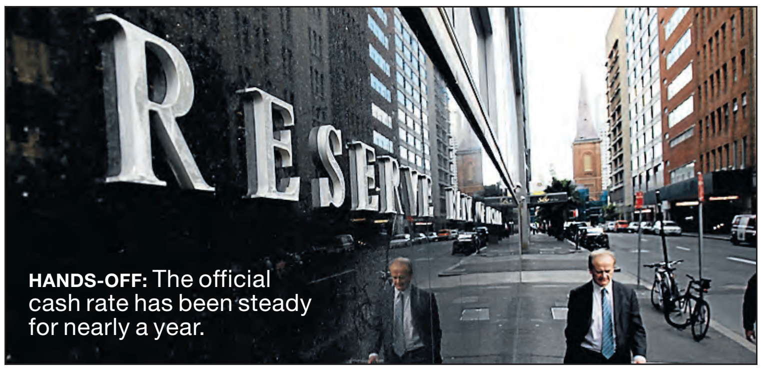
It would be extremely unusual for rates to remain at these levels for five years – which is the average lifespan for a mortgage before people either sell their home, repay the loan, or refinance. If you want your repayments to be predictable, fixing can be a good option.

But taking out fixed-rate mortgages also involves some risks. So before rushing to lock in a rate, what should borrowers consider?

The big advantage of a fixed-rate home loan is certainty. If your budget is tight and even a small rise in interest rates would be uncomfortable, fixing while rates are at record lows can make good sense.

The downside is that fixed loans are, by definition, more rigid.

Variable-rate loans allow borrowers to make repayments ahead of schedule, for instance. This means you pay down your debt more quickly and pay less interest overall. Fixed-rate loans generally don't allow this.



HANDS-OFF: The official cash rate has been steady for nearly a year.

There can also be break costs if you change your mind and want to switch to a variable-rate loan. But the good news is these would only apply if interest rates fell further – and any such movement would probably be small.

Finally, there is the risk that rates fall even further.

"With a fixed rate you are betting against the bank that rates stay where they are," said RateCity's Peter Arnold.

Money markets reckon there's a 50-50 chance the Reserve Bank will cut the cash rate again. If you fix now you might miss out on some savings, if they eventuate.

But even if the Reserve Bank does cut interest rates again, it's unlikely to be a drastic reduction. Even the most pessimistic market economists predict a relatively small cut of 0.25 percentage points.

So if you're someone who wants certainty, the experts reckon now is probably a good time to lock in a competitive rate. If you want to hedge your bets, an increasingly popular option is to fix part of the loan.