TRAC

The Retirement Advice Centre

Retirement Advice Glossary

"Understanding Money"

By David Reed

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Understanding Money

The A-Z guide of financial terms designed to make your life easier

In the field of finance, particularly within superannuation, there is a host of words that are unique to everyday language.

While we endeavour to make the complex simple when communicating with you, sometimes it is difficult to avoid financial terms in documents, particularly from government and financial institutions.

The aim of this glossary is to provide you with a reference that includes terms for which you may encounter, accompanied with an explanation that may make more sense.

The Retirement Advice Centre

Disclaimer
The information (including taxation) is general in nature and may not be relevant to your individual circumstances. You should refrain from doing anything in reliance on this information without first obtaining suitable professional advice.

A

Age Pension:

The Age Pension is a safety net income stream for retiree's payable by the Australian Government. It is means tested for eligibility, *i.e. both an income test and an asset test.*

The age eligibility is currently 65 for men, and 64.5 for women (soon increasing). From 2017, the eligibility age will be increased by 6 months every 2 years and it will reach age 67 by 2013.

Allocated Pension:

A specifically structure investment held within the superannuation platform that delivers periodic payments within limits prescribed by law. Earnings are entirely tax free, and after age 60 all income is considered tax free.

Annuity:

A regular income stream paid to an individual from a lumpsum investment, usually for the purpose of retirement income. This can be paid for a fixed term (i.e. 3,5,10 years) or for a lifetime.

Asset:

An asset can be a physical asset, such as property, or a financial asset, such as bonds or shares. There are four main asset classes for investment products – cash, shares, fixed interest and property.

Asset and Income Test:

Two tests used to assess entitlement to the Age Pension and other social security benefits.

ASFA:

ASFA stands for Association of Superannuation Funds of Australia. ASFA is a national, not for profit, non party political organisation that represents the interests of Australia's superannuation funds, their trustees and their members. For more info see www.superannuation.asn.au.

Assessable Income:

Income that can be taxed provided that the earning is enough to exceed the tax-free threshold.

Asset Allocation:

The mix of assets in an investment among various asset classes or sectors.

B

Behavioural Risk:

The idea that the performance of an investment can be affected by the actions of the individual investor. Examples of this can be selling growth assets in market downturns (i.e. fear) and buying at peaks (i.e. greed).

Beneficiary:

A person who is entitled to a payment possibly from a super fund or life insurance company. Beneficiaries of a superannuation fund are the members and in the event of death, their dependants.

Bonds:

A debt asset that an investor (lender) purchases from the government, semi-government, or a company (borrower) in return for cash. The borrower uses the investor's money, issues the investor with a bond as proof of the loan, and, subject to any specific payment terms, pays interest and principal back to the investor in return for the loan.

C

Capital Gain (Loss):

Increase (decrease) in the value of an asset or investment between the purchase price and sale price of an asset.

Capital Tracking:

Monte Carlo Capital Tracking uses a historical portfolio rate of return and standard deviation to determine a framework of potential outcomes and to guide future decision making with your portfolio.

It is not a tool of forecasting market performance or determining a sustainable withdrawal rate during retirement, but rather a statistical tool to model uncertainty and developing realistic expectations of possible outcomes.

Commutation:

The process of converting some or all, of a future income stream into a lump sum payment. For an allocated pension this simply involves withdrawing some or all of the remaining account balance.

Contingency:

A potential negative economic event which may occur in the future. In finance, managers often attempt to identify and plan for any contingencies that they feel may occur with any significant likelihood.

Concessional Contribution:

These are before-tax contributions that can include employer contributions, contributions made under a salary sacrifice arrangement and tax-deductible contributions by an individual.

Consumer Price Index (CPI):

The Australian Bureau of Statistics uses this index to measure the change in the price of a fixed basket of goods bought by households. The CPI is designed as a general measure of inflation.

Contribution:

The monies put into a superannuation fund or RSA by an employer or an individual.

Co-Contribution:

An amount contributed to your superannuation account by the Government that you may be eligible for when you make an after-tax contribution to your super. Eligibility depends on your income level.

Compound Interest:

Interest calculated not only on the initial principal amount, but also on the accumulated interest. Compound interest is different to simple interest which is only calculated as a percentage of the principal amount, not on the interest accrued. Compounding is where the value of an investment increases exponentially over time.

Contribution Cap:

This is the limit (cap) on the amount of contributions that can be made for an individual. Contributions in excess of the cap will be subject to excess contributions tax. Concessional and non-concessional contributions have different cap amounts.

Contribution Tax:

It is a tax of 15 per cent on before-tax contributions made into the concessionally taxed superannuation platform.

D

Death or Disability Pension:

This is a pension paid in the event of the permanent incapacity of the pensioner or the death of another person.

Deductible Amount:

The non-assessable portion of the pension for the social security income test. Any pension payments above this deductible amount will be considered toward the income test.

Deeming Rates:

Deeming rates are set by the Minister for the Department of Social Services and should reflect returns across a range of investment choices available in the market.

Defensive Asset:

Generally, defensive assets (also known as 'conservative assets') have lower returns, but the returns are more stable due to lower risk. Defensive assets include cash and fixed interest.

Defined Benefit:

A fund where the benefit is calculated based on a formula which takes into account the person's years of employment and salary at retirement. The employer or the sponsor of the fund carries the investment risk, not the member.

Dependant:

A dependant for tax purposes is generally a spouse, or a de facto spouse or ex-spouse, or a child under the age of 18, or other person financially dependent. However, the word is often used in superannuation to refer to a spouse, children of any age and financial dependants.

Derivative

A security whose price is dependent upon or derived from one or more underlying assets.

The derivative itself is merely a contract between two or more parties. Its value is determined by fluctuations in the underlying asset.

Diversification:

Diversification means spreading your investments among different types of investments and asset classes, which may reduce your overall investment risk and/or volatility of performance.

Dividend:

A payment made to the shareholders of a company out of profits made by the company.

Dollar Cost Averaging:

A strategy where you buy a set dollar value of an investment at regular intervals (e.g. with a monthly direct debit).

This is a strategy designed to smooth overall performance, rather than attempting to second guess the market, and results in the purchase of more shares and units when prices are down and less shares and units when prices are up.

Dynamic Withdrawal Strategy:

The strategy of changing your withdrawals during retirement phase dependent on the probability of failure rather than drawing a fixed amount.

Each year this strategy considers the achieved rate of return, life expectancy, legacy aspirations and targeted probability of failure.

Blanchett, et al (2012) have shown that a Dynamic Withdrawal Strategy may have up to a 28.6% outperformance when compared to other types of withdrawal methods of income in retirement.

E

Equity:

The difference between what you owe and the value (on today's market) of what you own. Negative equity means you owe more than the total value of what you own.

Executor:

The person you nominate in your will to carry out the provisions of the will.

F

Fee Disclosure Statement:

An FDS details the fees paid and the services received by the retail client for the past year.

Fixed Interest:

Interest paid on investments such as bonds and debentures, paid at a predetermined and unchanging rate for a specified period.

Floor of Safe Income:

When building a portfolio for retirement, we have an objective of targeting a certain level of 'Safe Income' through investments into defensive assets.

This income is not reliant upon volatile market fluctuations, to ensure that necessary living expenses are provided through income from low risk asset classes.

Once this Safe Income Floor is achieved, additional assets may then be exposed to asset classes such as shares and property so as to outpace inflation and to make your money last as long as possible.

During accumulation phase, our focus is on building capital growth. As you approach pension phase, our strategy is centered on building this floor of Safe Income.

Franked Dividend:

A dividend distributed by an Australian company out of profits on which company tax has been paid.

Future Value:

The value of an asset or cash at a specified date in the future that is equivalent in value to a specified sum today.

G

Gearing:

(1) A measure of the debt ratio, which is the amount of borrowing compared with the equity in an asset.

(2) Borrowing to invest, such as when purchasing a house using a mortgage or purchasing a share portfolio using a margin loan.

Growth Assets:

A term given to assets such as shares and property which are expected to provide strong investment returns over the long term.

H

Hedge Fund:

A managed investment where the fund manager is authorised to use derivatives and borrowing with the aim of providing a higher return.

This can be done by making an investment to reduce the risk of adverse price movements in an asset through an offsetting position in a related security.

Hedged Currency:

Protecting an international investment from changes in the exchange rate between the two currencies.

An unhedged investment can be affected by changes in the value of the Australian dollar compared with that countries currency.

For example if the Australian dollar declines against the US dollar, a US dollar asset rises in value in Australian dollar terms, and vice versa.

I

Income Protection Insurance:

Provides income replacement where the insured is unable to work due to certain defined events. This insurance will provide you a percentage (generally 75%) of your lost income after the specified waiting period for a specified period of time (or until the insured is able to return to work).

Indirect Cost Ratio *(also Management Expense Ratio):*

An industry-standard measure expressing the management fees and certain other expenses of a managed fund as a proportion of the net asset value of the fund.

Index:

A statistical measure of the change or performance in an economy or a securities market. For example the S&P 50 is an index of the top 50 companies in Australia.

Index Funds:

An index fund (also index tracker) is an investment fund (usually a mutual fund or exchange-traded fund) that aims to replicate the movements of an index of a specific financial market, or a set of rules of ownership that are held constant, regardless of market conditions.

Inflation:

It is a measure of increases in the cost of living usually measured by the Consumer Price Index (CPI).

Inflation Risk:

Inflation risk, also called purchasing power risk, is the chance that the cash flows from an investment won't be worth as much in the future because of changes in purchasing power due to inflation.

Insurance:

Insurance provides financial protection against a future possible event. Insurance involves payment of money (the premium) in exchange for the insurance cover. The terms under which benefits are paid are specified in the policy document.

Interest:

The price of money. The price a bank or other lender charges for the money it lends you, or the return you get for the money you lend someone else.

Investment:

Using your money to make it grow, for example, by buying property or shares.

J

K

L

Life Insurance

Provides a lump sum in the event of the insured's death or diagnosis of a terminal illness.

Liquidity:

The ability to convert an asset into cash quickly and without any price discount.

Longevity Risk:

The risk to which a pension fund or life insurance company could be exposed as a result of higher-than-expected payout ratios. Longevity risk exists due to the increasing life expectancy trends among policy holders and pensioners, and can result in payout levels that are higher than what a company or fund originally accounts for.

Lump Sum:

A one-off payment of money from a superannuation fund rather than an ongoing pension, which is a periodic payment.

M

Managed Fund:

A professionally managed investment where your money is pooled with other people's money and professionally managed. You receive units for your money and a share of the returns, whether they are positive or negative. Unit prices take into account market prices of the assets the fund purchases.

Market Risk:

The possibility for an investor to experience losses due to factors that affect the overall performance of the financial markets.

Marginal Tax Rate:

The marginal tax rate is the rate of tax applicable to the last dollar of your taxable income. To find out what yours is, go to www.ato.gov.au.

Your average tax rate on your entire taxable income will generally be lower than your marginal tax rate.

Minimum Required Withdrawals:

You will have to withdraw a minimum amount each year, depending on your age, and if you are using a transition to retirement pension you will be limited to withdrawing a maximum of 10% each year.

Age	Minimum %
Under 65	4.00%
65-74	5.00%
75-79	6.00%
80-84	7.00%
85-89	9.00%
90-94	11.00%
95 and over	14.00%

These figures are up to date as of July 2014.

N

Non-Concessional Contribution:

Non-concessional contributions include:

- After-tax contributions you make to your super and you do not claim a tax deduction
- After-tax contributions you make on behalf of your spouse
- Other money contributed to superannuation such as an inheritance

O

Opt-In:

Government introduced disclosure obligations surrounding the fees of a client. The law created requires advisors to provide additional disclosure information on fees and renewal notices for greater ongoing fee clarity.

P

Pension:

Payments made periodically (usually fortnightly or monthly) as an income stream provided for by a superannuation fund that was purchased using your accumulated superannuation benefits.

Pension Reboot:

Once a super accumulation account is moved into pension phase, further contributions cannot be made. The concept of re-booting a pension is the process of closing a pension account and opening a new pension account with additional funds transferred from an accumulation account. This is an effective strategy for an individual implementing a transition to retirement.

Personal Contribution:

Contributions made by an individual rather than by the employer, which count toward the concessional or non-concessional contributions cap.

Any personal contributions claimed as a tax deduction by the individual will count towards the individual's concessional contribution cap.

Any personal contributions not claimed as a tax deduction by the individual will count towards the individual's non-concessional contributions cap.

Portfolio:

A collection of investments owned by an investor. This can include direct equity, cash, property, term deposits, managed funds etc.

Premium:

The regular payment made to an insurer in exchange for its promise of protection and help against unexpected events. Generally, the higher the risk of loss, theft, damage, destruction or injury, the higher the insurance premium.

Present Value:

The current value of a future sum of money given a specified rate of return.

Simply put, $1,000 now is worth more than $1,000 in five years, because this money could be invested and receive an additional return over the five years.

Preservation Age:

The age at which a member can gain access to preserved benefits provided that they have permanently retired from the workforce or otherwise as a non-commutable income stream.

Date of birth	Preservation age
Before 1 July 1960	55
1 July 1960 – 30 June 1961	56
1 July 1961 – 30 June 1962	57
1 July 1962 – 30 June 1963	58
1 July 1963 – 30 June 1964	59
From 1 July 1964	60

These figures are up to date as of July 2014.

Product Disclosure Statement:

An important document from the issuer of a financial product which provides you with information about the issuer, benefits, risks and costs of the product.

Q

R

Rate of Return:

Refers to the measurement of a gain or loss on your money over a period of time (generally 12 months). A 'net' rate of return refers to your return after all costs and taxes are taken into account.

Record of Advice (RoA):

A less detailed, less comprehensive document than a Statement of Advice. They are a simple and effective way of providing ongoing personal advice to existing clients.

Residual Capital Value:

The amount of the original purchase price of an annuity that is returned to the purchaser, either at the end of the term in the case of a term pension or annuity or on death in the case of a life annuity. For example, a term annuity with 100% of the purchase price at the end of the agreed term is called a 100% RCV annuity.

Return of Capital:

This refers to your original money or investment, being returned back to you.

Reversionary Pension:

A pension payable to a spouse or other nominated person on the death of the original recipient of the pension. To arrange a reversionary pension, the original pensioner must nominate this when the original pension commences.

Risk:

In investment terms, risk is a measure of volatility. Volatility is a measure of the variability of returns and is the standard deviation of investment returns over a specific period of time. The higher the standard deviation, the higher the level of risk associated with that investment.

Risk Profile:

A client's tolerance to investment risk.

Investments with low risk (lower level of volatility or uncertainty) are usually associated with lower returns, whereas investments with high risk are associated potentially higher returns.

Rollover:

The transfer of superannuation benefits between two superannuation funds or from a superannuation fund to a pension or annuity.

S

Safe Income:

See 'Floor of Safe Income'

Salary Sacrifice Contributions:

Contributions made into a complying superannuation fund that are taken out of your pre-tax wages or salary. These are considered part of your concessional contributions.

Self Managed Super Fund:

A Self Managed Super Fund (SMSF) is a super fund controlled by its trustees and regulated by the ATO. SMSFs can have no more than four members and must be run for the sole purpose of providing death or retirement benefits for the members or the members' dependents.

Sequence Risk:

The risk of receiving lower or negative returns early in a period when withdrawals are made from the underlying investments.

Simple Moving Average (SMA):

The simple average of a security over a defined number of time periods. It is a widely used indicator in technical analysis that helps smooth out price action by filtering out the 'noise' from random price fluctuations by using an average of past prices.

Statement of Advice (SoA):

A document that sets out the advice given to a consumer by their licensed financial planner or adviser. It must include the basis on which the advice is given, details of the providing entity, and information on any payments or benefits the adviser or licensee will receive.

Superannuation:

An investment vehicle which operates primarily to provide benefits for retirement. Superannuation savings are usually made through trust funds and if these funds meet prescribed government standards they are eligible for tax concessions.

T

Total and Permanent Disablement Insurance:

Provides a lump sum payment in the event that the insured becomes totally and permanently disabled as per the policy definitions.

Transition To Retirement Pension:

A Transition to Retirement Pension (TTR) enables any Australian who has reached preservation age to access his or her superannuation benefits in the form of a pension (income stream) without retiring or satisfying an additional condition of release.

A TTR cannot be taken as a lump sum, and you are required to draw between 4% and 10% of your pension balance per year.

This strategy can be used in two ways:

- As a tax effective strategy to boost retirement savings whilst maintaining your current level of cash flow.
- To increase your level of cash flow prior to retirement *(note that this option may potentially erode your retirement savings).*

Trauma Insurance:

Provides a lump sum payment in the event that the insured suffers, in the first instance, a defined trauma event. This may include a heart attack, stroke, multiple sclerosis or cancer.

U

Unit Price:

The price of each unit in a managed fund.

V

Value Stocks:

A stock that tends to trade at a lower price relative to its potential value (based on dividends, earnings, sales, etc.) and thus considered to be undervalued.

W

Will:

A legal document that instructs the executors you nominate on matters to do with your estate, such as how to distribute your property and assets upon your death.

Withdrawal Rate:

The rate of withdrawal from an investment each year based on the capital value.

This helps you to understand how much of your invested assets you are spending each year.

Wrap Platform:

An account made available to consolidate and manage a portfolio of investments.

It functions as an administrator, and generally charges a fee for the service offered.

X

Y

Yield:

The income return on an investment.

Generally described as the dividend, or interest rate, on an investment expressed as a percentage of the price.

Z