Martin Breckon, technical services manager, IOOF

Breckon joined the IOOF TechConnect team in April 2012 and has over 30 years’ experience assisting advisers with legislative research and technical strategies. Prior to joining IOOF, he worked as technical manager of business development at MLC. He has worked as a technical marketing manager for Aviva Australia and held diverse management roles with AXA, dealing in both wholesale and retail sectors.

WHAT IS ON THE HORIZON FOR LIFE INSURANCE IN SUPER?

We are now operating in a post FoFA world and the philosophy of best interest duties has become a part of doing business. Though we can make a recommendation to hold life insurance cover in super, what really matters is the structure and justification for the recommendation.

A recommendation solely based on pricing/funding efficiencies is arguably not good enough. Exploring various options and their medium-to-long term impact on the client’s super benefit accumulation may be adequate. But is it best practice? This article explores some of the issues looming which should be considered not only from a best interest point of view but when you identify someone who gets pricing sensitivity confused with value propositions.

The challenge

How difficult is super to understand? How can a regulator expect a client to have an implicit understanding of the types of benefits, potential tax liabilities and nuances of super estate planning? For full time professionals it is hard enough. But there is an expectation that the financial adviser has to undertake an educator role not only at point of sale but arguably through-out the relationship with the client.

Then realistically, when does a client need to understand what is going on? It is at claim time? That is what life insurance is for, the sole purpose is to provide surety of funding contingent on an event such as death or disability happening.

Take for example a client’s death, where we have recommended insurance in super the following table encapsulates some of the more significant issues to be not only understood by the client but also the beneficiaries:

<table>
<thead>
<tr>
<th>RELATIONSHIP</th>
<th>SUPER DEPENDENT</th>
<th>TAX DEPENDENT</th>
<th>ANTI-DETRIMENT ELIGIBILITY</th>
<th>ANTI-DETRIMENT PAYMENT TAX FREE?</th>
<th>DEATH PENSION ELIGIBILITY</th>
</tr>
</thead>
<tbody>
<tr>
<td>Spouse</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
<td>Tax free</td>
<td>Yes</td>
</tr>
<tr>
<td>Former Spouse</td>
<td>No unless financial dependent</td>
<td>Yes</td>
<td>No unless financial dependent</td>
<td>Taxable</td>
<td>No unless financial dependent</td>
</tr>
<tr>
<td>Child &lt; 18</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
<td>Tax free</td>
<td>Yes</td>
</tr>
<tr>
<td>Child 18 to 25</td>
<td>Yes</td>
<td>No unless financial dependent</td>
<td>Yes</td>
<td>Taxable unless financial dependent</td>
<td>No unless financial dependent</td>
</tr>
<tr>
<td>Child &gt; 25</td>
<td>Yes</td>
<td>No unless financial dependent</td>
<td>Yes</td>
<td>Taxable</td>
<td>No</td>
</tr>
<tr>
<td>Disabled Child</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
<td>Tax free</td>
<td>Yes</td>
</tr>
<tr>
<td>Financial Dependent</td>
<td>Yes</td>
<td>Yes</td>
<td>No</td>
<td>N/A</td>
<td>Yes</td>
</tr>
<tr>
<td>except adult child</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Interdependent</td>
<td>Yes</td>
<td>Yes</td>
<td>No</td>
<td>N/A</td>
<td>Yes</td>
</tr>
<tr>
<td>except adult child</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

So why recommend placing life insurance in super?

According to a Rice Warner report commissioned by the Association of Superannuation Funds of Australia (ASFA) the majority of insurance is held in super, furthermore group insurance represents 71% of all death cover, 88% of all TPD and 59% of all income protection...
benefits. To many, it will be evident that these figures reflect purchasing decisions based on three factors:

- The pricing differential (the life cover is cheaper)
- Easy underwriting standards (high auto acceptance limits)
- Convenience

On the other hand financial advisers when tailoring retail insurance solutions not only recommend the best life insurance available, but also match the insurance funding efficiency to the client’s medium to long term super accumulation aspirations. Generally speaking there are five scenarios for funding the cover:

1. The insurance policy is self-owned and the premiums are paid with after-tax salary.
2. The policy is owned in super with premium funding by additional personal contributions equivalent to the actual premium cost. In this scenario, we assume the contribution is to the same fund receiving employer contributions. This scenario provides a marginally better result from a super benefit perspective compared to the first option due to the premium cost providing a tax deduction.
3. The policy is in super with the premium funded from accumulated benefits. This option optimises net income but over the long term retirement benefits would be compromised particularly if a stepped premium was involved.
4. The policy is in super and premium funding is by salary sacrificing an additional amount of pre-tax salary equivalent to the actual premium, hence employer contributions are increased. This not only optimises net income for the client but also minimises any compromise of retirement benefits.
5. The policy is in super with the premium funded by additional employer contributions equivalent to the pre-tax salary dollars required to fund the premium in after tax salary dollars, calculated as follows:

   Additional employer contribution =
   Cost of premium ÷ (1 – (MTR + ML))

   If the focus is to achieve the best overall outcome in terms of gross cash-flow plus increase in super benefits, the best approach would be scenario five because contributions have increased by the pre-tax dollars to fund the equivalent after tax premium. Thus the saving is the difference between the client’s marginal tax rate and the funds effective tax rate.

   Acknowledging each individual’s circumstances are unique, the financial adviser would make a recommendation appropriate to the client’s circumstances.

   To mitigate any price sensitivity a super fund platform offering fee aggregation by both product and family linking could be used. Doing this means not only can fees be reduced but one generation may subsidise another and quality advice funded for cash constrained family members, as follows:

   **Case study: Fee aggregation dilutes pricing sensitivity**

   To compete on a pricing basis, the financial adviser identifies opportunities arising from developing client relationships based on family units rather than individuals. A recommendation involving the transfer of their super and non-super investments to a common platform which offers fee aggregation and high quality life insurance locks in a number of advantages.

   By moving the family to the one platform a number of important outcomes are met specifically:

   - Providing quality product and benefit definitions
   - Cross subsidising children’s advice fees under a family advice fee service
   - Cross subsidising younger generations’ administrative costs to be as comparable if not cheaper than some industry fund offerings

   An actual outcome based on a current platform and product portfolio is as follows:

   **Savings available by aggregation over 12 months**

<table>
<thead>
<tr>
<th>RELATIONSHIP</th>
<th>PRODUCT</th>
<th>ACCOUNT BALANCE</th>
<th>NORMAL FEE</th>
<th>FEE WITH AGGREGATION</th>
<th>ANNUAL SAVING</th>
<th>DISCOUNT (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Father</td>
<td>Pension</td>
<td>$600,000</td>
<td>$3,200</td>
<td>$2,222</td>
<td>$978</td>
<td>31</td>
</tr>
<tr>
<td>Mother</td>
<td>Super</td>
<td>$300,000</td>
<td>$2,000</td>
<td>$1,111</td>
<td>$889</td>
<td>44</td>
</tr>
<tr>
<td>Son</td>
<td>Investment</td>
<td>$115,000</td>
<td>$805</td>
<td>$426</td>
<td>$379</td>
<td>47</td>
</tr>
<tr>
<td>Daughter</td>
<td>Super</td>
<td>$65,000</td>
<td>$480</td>
<td>$241</td>
<td>$239</td>
<td>50</td>
</tr>
<tr>
<td>Total</td>
<td></td>
<td>$1,080,000</td>
<td>$6,485</td>
<td>$4,000</td>
<td>$2,485</td>
<td>38</td>
</tr>
</tbody>
</table>

   The challenge many financial advisers face is though they are comfortable with a particular superfund, that fund’s actual insurance offering may not be a top quartile offering. To ensure that any insurance submitted or transferred is a prudent recommendation the adviser has to be satisfied with a number of things concerning the insurer such as:

   - Claims payment philosophy
   - Robust and sustainable benefit definitions
   - The quality of the underwriters and the underwriting process
   - Excellent client service
   - Cancellation and re-issue process and take-over terms are acceptable

   Bearing in mind the replacement policy requirements, it is a significant challenge to have to not only recommend quality superannuation but also quality life insurance. However it is timely to reflect on this.

   Both Helen Rowell in April and Ian Laughlin in June 2014 as senior representatives of the Australian Prudential Regulatory Authority (APRA) have made significant comments about insurance in super with a particular focus on group life arrangements. However these comments had been in the context of long term observations, a consequence of which was the introduction of the prudential standard covering a super funds insurance management framework, being a prudential standard (SPS 250) on 1 July 2013. It is mandatory and much wider than an insurance strategy.

   For instance, each trustee:

   - Must maintain at least five years data relevant to insurance such as claims experience, sums insured and premiums
   - Must effectively monitor and manage their insurance arrangements
   - Should consider sustainability objectives when tendering group life including product design and underwriting processes
   - Has to regularly test insurance processes
   - Has to demonstrate to APRA the appropriateness of the insurer selection process and how it is applied
   - Must focus on the claims payment philosophy of the insurer, this means being familiar with claim rejection rates and decisions over-turned by the Superannuation Complaints Tribunal, complaints data, claims in dispute and the reasonableness of premiums charged.
Ultimately, APRA is looking for evidence of procedural fairness and a transparent dispute resolution process within the insurance management framework. It must be working, just look at the industry fund premium rate increases narrowing of the gap between retail and group offerings.

Recently the independent research house SuperRatings announced there was a substantial divergence between sectors, which meant group life premium rate re-ratings went up on average 22.4% whereas retail funds went up 2.3%. The question is: do averages tell you much?

Remember back to March 2014 when some major industry funds increased their premium rates? For instance AustralianSuper increased their death and TPD premium rates by 35% and REST increased death by 45% and TPD by 38%. Furthermore, it has not stopped the Local Government Superannuation Fund has just informed members that as from October 2014 they will increase their voluntary death cover only and death and TPD cover premium rates by 43.5%.

The message really is that though some funds insurance cover is cheaper, it appears to be unsustainable and the pricing gaps between group and retail offerings are narrowing.

However this change will only impact current premium inflows and new business going forward but how will they manage existing life insurance claims experience?

Solutions could be a combination of a strict claims assessment process, ongoing premiums increases and utilising the changes to the duty of disclosure in the Insurance Contracts Act under which the insurer is now empowered to:

- Treat life insurance contracts as if they comprise two or more separate contracts hence adjust each type of cover separately
- Through Section 29 extend the ability to alter the sum insured beyond the three year limit where the insured fails to comply with their duty of disclosure, or, is found to have made a misrepresentation at anytime on discovery of the non-disclosure or misrepresentation

This is where the added value of the financial adviser is best displayed. In order to comply with the Corporations Act 2001, section 961B, he needs to consider the client’s best interest. Then, if the super fund is okay, but the insurance is average at best but cheap, has the adviser met the requirements of s961B(2)(e)?

Section 961B(2)(e) considers a ‘reasonable investigation’ for the purpose of determining when it is reasonable to recommend a financial product. Is providing cheap cover sufficient reason on its own? Does it really meet the needs of the client?