Best of both worlds

TPD cover in super has serious shortcomings but a back-up plan will ensure you are properly protected

STORY VITA PALESTRANT

Getting married, starting a family and buying a new home often prompt people to check their life insurance. It's a time when financial responsibilities are at their peak and money is tight. Having premiums deducted from a superannuation account can provide welcome relief.

Not only does it help with cash flow, it is paid with pre-tax dollars. Even so, people need to know they have the appropriate level of protection. Unfortunately, many assume their group cover inside super will do the job should the worst happen.

While members may automatically get life and total and permanent disability (TPD) cover of about $300,000 when they join a fund, it is unlikely to be enough for those on median to high incomes. It is also basic cover with restrictive TPD definitions. And if you do qualify for a lump sum disability payout, the death benefit will be reduced by the same amount.

There are other disadvantages. If you want to switch super funds you may not get the same insurance deal, especially if your health has deteriorated. The new fund might "take over" your cover but exclude pre-existing conditions.

While premiums inside group insurance used to be cheaper compared with the cost of retail life policies outside super, this is not always the case now.

So where does that leave the consumer who wants flexibility, superior benefits and the ability to fund their insurance from their super account? They might look to insurance companies that offer more individual cover.

All life insurance companies have a super-compliant policy that allows you to fund life and TPD cover from your super account. Once your individual policy has been underwritten you can cancel your fund's group cover. With your insurance no longer tied to your super fund, you have the freedom to move super providers without having to worry about insurance.

Plus there is an additional TPD advantage: the definition of disability inside super has more onerous terms and conditions – you can only get a payout if you can't work again in "any occupation". So the insurers use a little-known solution called "policy linking" or a split policy.

Under this solution they link your policy to the more comprehensive TPD cover available outside super, which has an "own occupation" definition. Under this definition, the benefit may be payable if the insured is unlikely to ever work again in their own occupation.

As this TPD component is held outside super, it can only be paid with after-tax dollars.

"Virtually all major life insurance companies have released this concept of a linked benefit. It has become a standard benefit combination and has been available for about five years," says Mark Kachor, managing director of research firm DEXX&R. "It involves issuing two plans – one being a TPD benefit payable inside super and the second with a TPD benefit definition payable outside super. You get the best of both worlds this way."

HOW IT WORKS

Roy Agranat, a specialist in personal and group benefit insurance and director of Fairbridge Financial Services, says the set-up allows you to hold life cover inside super with TPD cover held both inside and outside super.

"Approximately two-thirds of the TPD premiums can be paid inside super with a third of the TPD premiums paid outside super," he says. "It's commonly known as split TPD. The insurer will assess any claim under the 'any occupation' definition inside super first, and if the definition cannot be met they will look to utilise the 'own occupation' definition outside super."

BENEFITS OF RETAIL POLICIES

- Guaranteed renewability – so long as the premiums are paid, the life cover cannot be cancelled or changed to your detriment. Within super fund group cover, the trustee has the right to alter the terms and conditions or cancel the cover at any time.
- You will be able to access the more comprehensive "own occupation" TPD definition that is not available inside superannuation.
- Flexibility – your insurance will not be tied to your super fund so you will be free to consolidate or move super funds without impacting your insurance cover.
- Competitive premiums – the ability to compare premiums across the market and use the most competitive insurer without being restricted to the (sometimes higher) premiums your super fund is offering.
- Funding options – ability to pay the majority of the premiums as a rollover from any super fund, or personally from available cashflow which will be eligible for a tax deduction.
- Comprehensive cover – the TPD "own occupation" definition is the most comprehensive on the market, and includes the ability to remain covered during periods of unemployment.

Source: Fairbridge Financial Services

All the cover held within the super environment can be paid as a rollover from your super fund, or paid personally and a tax deduction claimed. The remaining third of TPD "own cover" held outside super will need to be paid for from your bank account with after-tax dollars.

"Remember, to get your money out of super, you have to meet the condition of release," says Agranat. "How it works in practical terms, if you become disabled and you meet the super definition, they pay it as a super disability. If you are not disabled enough, and don't meet the definition, they will say, 'OK, we will pay you the benefit as a non-super, own occupation definition because you paid a third of your premium outside super.' But you don't get a choice.

"You have to first see if you meet the definition inside super. If you do, they don't pay it as non-super. The first port of call is super," he says. If the TPD benefit is paid within super there may be tax payable.

This is a complicated arrangement and advice should be sought so it is correctly set up.

HOW AN ADVISER CAN HELP

"An adviser is essential to discuss the various options, including the differences between the products and insurers in the market," says Agranat. "Any recommendation should include a detailed consideration of your needs and objectives with appropriate levels of cover." There should be consideration given to all product providers in the market, not simply a recommendation made for one in-house product, or a restricted list of providers.

"If existing cover is being replaced, a comprehensive analysis comparing the new and old policies needs to be provided, highlighting any benefit that may be lost or reduced," he says.

As your circumstances change, you may want to restructure the cover so it is no longer held in superannuation. You may have adult children who would otherwise be taxed on the death benefit. If not done correctly, it could result in unintended tax consequences, warns Agranat.

"You might keep it inside super until they turn 18, and then turn it into non-super after they turn 18. You don't have to go through any underwriting to do that, you still have the same cover – you are just changing it from super to non-super."

Or you might be divorced and don't want to leave your money to your ex-spouse or new partner, only your adult children, and therefore want to change it to non-super.

The insurer will reissue the policy if you so wish, says Kachor: "Say, for instance, you had a terminal disease and you had $1 million cover inside super. Before getting your terminal illness benefit, you could ask the company to move the policy outside of super, and provided they don't apply pre-existing condition exclusions and you get their agreement in writing, you can then move it outside super.

"Once it's outside super, it depends on what your will says. If you are getting a terminal illness benefit and you will likely die within the next 24 months, then you would be paid. There's no tax on it and you could gift it any way you like before your death," he says.

An adviser will also take you through any claims process. "The majority of clients that have disputes with an insurer at claim stage do not have the benefit of having an adviser acting on their behalf. The percentage of claims paid is much higher when an adviser is used compared to when an adviser is not involved," says Agranat.

HOW MUCH IT COSTS

If you go to an insurer directly and want to buy $1 million worth of cover, they are going to charge you the standard rate, which includes commission, says Kachor. "So you might as well go to a suitably qualified adviser because you are not going to get it any cheaper.

"The only way of getting it cheaper – say the premium is $10,000pa – is when the adviser might say I will dial down your premiums by 10% [by forgoing some of their commission]. In the process, you will pay 90% of what you would have paid had you gone directly to the insurer.

"If premiums are only $4000pa, given the cost and all the things the adviser has to do to be compliant, then you are probably going to be paying the standard rate. Which is no more than you would've paid anyway if you didn't have an adviser involved."

Kachor says that "getting a policy under advice will be superior to group cover and in most cases it will be at the same or less cost". M

AVOID THE TRAPS

All cover held within super has restrictions on who may be nominated as the beneficiary, with differing tax treatments being applied. Children under 18 and your spouse will get the death benefit tax free. Adult children are taxed up to 32%, including the Medicare levy.

If the TPD cover is paid within the super environment under the "any occupation" definition, there may be tax payable.

When going through the underwriting process, ensure that there aren't any new exclusions placed on the cover before cancelling any existing cover.

Any premiums paid personally to super will be counted towards your annual concessional contributions cap of $25,000 if you claim the tax deduction in your personal capacity.

If possible make extra concessional contributions to your super balance to make up for the premiums paid – but don't exceed the cap overall.

Source: Fairbridge Financial Services