

## CASE STUDY: INSURANCE OWNED BY SUPER



### Ownership of Insurance by Super – Impact on Super Balances

#### Ownership of Insurance by Super at a glance

It is possible and appealing in certain circumstances to own life risk insurance policies via a super fund as opposed to owning them personally. This can generally be a public offer fund, an industry super or a Self Managed Super Fund (SMSF), however the individual super fund is able to determine the types of protection and policies that they may offer to their members. The premiums for the insurance are debited from your super account balance or the earnings of the investments. It is also possible to own a life risk insurance policy via the insurers superannuation fund and have the premiums paid via rollovers from another super fund, which the insurers super fund is generally able to process via an enduring rollover request that you sign once and which allows them to request a rollover the other super fund each year when the premium is due. As the trustee of the super fund owns the insurance policy, any proceeds paid in the event of a claim are paid to the super fund in the first instance and are generally combined with any account balance in the fund (other than for policies owned by the insurers own super fund), although there may be other options available, particularly to SMSFs.

Once paid to the super fund, the second step is that a superannuation Condition of Release must be met if the insurance policies proceeds are to be paid from the super fund to you or your dependants. This differs from insurance policies owned personally where once the claim is satisfied the proceeds will be paid directly to the policy owner which can often be you or your spouse or to beneficiaries you have nominated.

In general terms, the applicable superannuation Conditions of Release are:

- » Retirement after preservation age
- » Termination of an arrangement of employment at or after age 60
- » Attaining age 65
- » Death
- » Permanent incapacity – defined to an ‘any occupation’ TPD definition
- » Temporary incapacity – resulting in inability to work

Upon payment by the super fund trustee there are also potential taxation consequences that may apply depending on the Condition of Release that applies and the dependant to whom it is paid. The

#### General Advantages Super Ownership

- » Cash Flow – as premiums are debited from your super you do not need to pay them from your personal cash flow.
- » Lapse prevention – the above may allow you to maintain insurance if your personal cash flow is unavailable, for instance due to financial hardship
- » Pre-Tax Premiums – you may be able to make either pre-tax or tax deductible contributions to super to pay the premiums thereby reducing your after-tax costs
- » Tax – premiums for certain types of insurance for which they are not tax deductible if you own them personally may be able to be claimed as a tax deduction by your super fund & therefore reduce your premium costs
- » Co-contribution – lower income earners may be able to use the government co-contribution to pay insurance premiums
- » Asset Ownership in Retirement – if a claim is paid, you may wish to retain insurance proceeds within super and utilise non-super assets prior to meeting another Condition of Release eg retirement

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discussion of these tax consequences is beyond the scope of this paper.

The purpose of this Case Study is to demonstrate the potential impact of owning insurance via super on, and therefore paying premiums from, the super account balance. We also provide an analysis of a smart strategy to mitigate this impact and which often provides improved outcomes.

If you would like further information relating to owning insurance via super, and related strategies, please contact our office.

### What types of insurance can be owned via super?

- » Life insurance including terminal illness
- » Total and Permanent Disablement (TPD) – any occupation provided this aligns with the super law definition of disablement (which is a higher level of disablement than a non-super Any Occupation TPD policy)
- » Income Protection insurance

Personal Risk Management strategies require specialist advice at all times, however this is especially true if any insurance is to be owned, and therefore paid for, by a super fund to ensure it is appropriate for your personal circumstances and your objectives, including that the achievement of your risk management objectives does not unreasonably detract from the achievement of your other objectives, including those relating to retirement. We consider this is especially the case with considering Income Protection insurance to be owned by a super fund as there are, in our opinion, generally benefits to owning that type of protection personally. Having said that, we certainly consider that it is generally preferable to have Income Protection owned via super than not to have any Income Protection insurance at all.

Prior to 30/06/2014 it was also possible to have Own Occupation TPD and Trauma insurance via super, and in certain cases these types of policies established prior to that date may be able to be maintained or adjusted, however this requires detailed consideration.

### Who can benefit from owning insurance within a super fund?

Owning insurance via super can work for you if you:

- » Like most Australians, you have identified a requirement for insurance and have sufficient balance and/or contributions to super to pay insurance premiums and contribute to the achievement of your retirement objectives, or
- » Wish to provide funds for your spouse and/or children, especially when they're under 18, or
- » Do not wish to pay insurance premiums from your cash flow, or
- » Wish to reduce the chance of policies lapsing due to non-payment of premiums, or
- » Have the capacity to make additional super contributions, or
- » Wish to utilise insurance to provide for your and/or your family's retirement

### General Disadvantages of Super Ownership

- » Reduced super balance
- » Extended time to receive claim proceeds – due to having to satisfy the super rules as well as the insurance claim requirements
- » Limits on Access – there is the potential that the event may meet the insurers claim requirements but not satisfy a super Condition of Release thereby resulting in the funds being unable to be accessed

Contribution Caps – you may wish to maximise your contributions to the allowable limits however insurance premiums will effectively detract from those contributions that are actually invested

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## Case Study: Ownership of Insurance by Super – Impact on Super Balances

**Meet Judy:** Judy is 45, earns \$100,000 pa plus super working as an accountant. Judy does not current make any additional contributions to super. As Judy has a family and a mortgage, she has discussed her insurance requirements with Mammoth Financial and they have agreed that as part of her Risk Management Program her objectives to care for her family and reduce debt can be met, in part by, Life and Any Occupation TPD insurance for which the premium in the first year is \$1,750 on a personally owned policy.

Throughout their discussions, Mammoth Financial discusses the following options with Judy:

- 1. Personal Ownership** – Judy takes out a Life and TPD policy on her life owned by herself. The premiums are paid from her personal cash flow and are not generally tax deductible. To pay the premium in the first year Judy needs to earn gross income of \$2,868, pay tax at her marginal tax rate of 39% (2018/19) to be left with the \$1,750 required to pay the premium.
- 2. Super Ownership with no additional contributions** – Judy takes out a Life and TPD policy owned by her super fund (for the purposes of this case study, it does not matter whether this is a retail, industry, insurers own super fund or Self Managed Super Fund). Mammoth explains that tax may be applied to the life insurance claim proceeds (depending on to whom the benefit is paid) and will be applied to the TPD claim proceeds. Mammoth estimates that increasing the sum insured to account for this tax so that the after-tax claim proceeds are approximately the same as from a policy owned personally would result in a premium that was \$2,000 pa in the first year. The premiums are paid from her super account balance (via one means or another) and are tax deductible to the super fund. Judy makes no additional contributions to super over and above her super guarantee contributions

Judy is interested in considering this however she wants to understand the potential impacts on her super account balance over time before she proceeds.

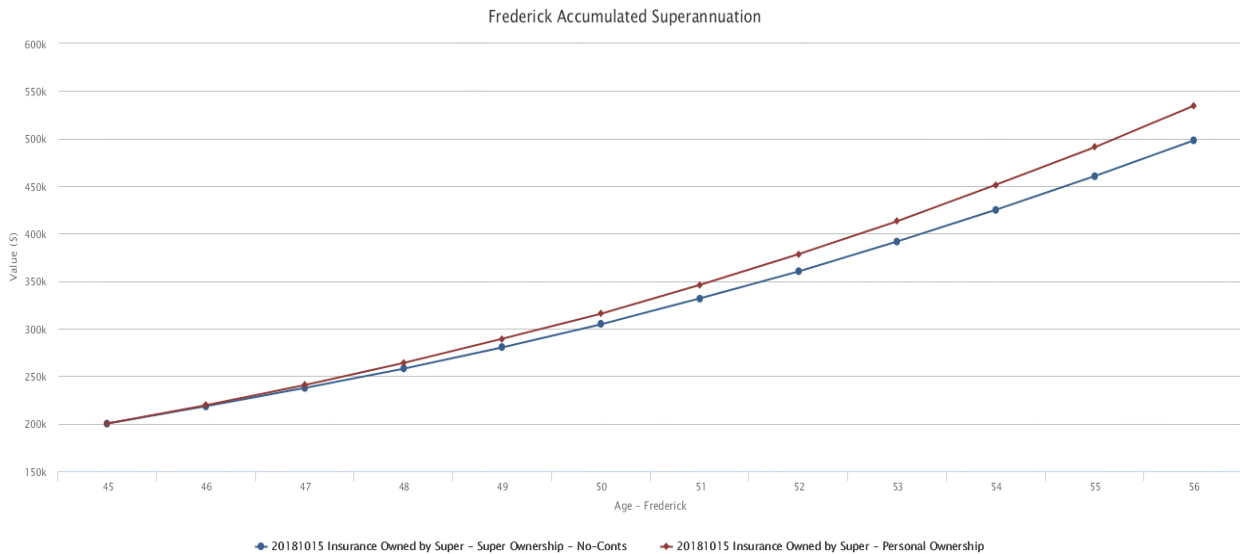
### Assumptions:

- » Timeframe: 10 years for illustrative purposes
- » Salary increases: 3.5% per annum (pa)
- » Inflation – 2.3% pa
- » Insurance Premium Structure: Stepped
- » Insurance premium increases: 8% pa for illustrative purposes
- » Super Contributions – super guarantee only – 9.5% pa in the first year & increasing to 12% as legislated
- » Current legislation
- » Existing super balance - \$200,000
- » Advice & Investment Fees – 2.0% pa assumed for illustrative purposes
- » Investment returns (after fees) for super – Balanced Growth Profile:
  - Income: 3.79% pa (Franking: 18.07%)
  - Growth: 2.71% pa
  - Total: 6.50% pa

### What is the impact of the insurance premiums on the super account balance?

The graph below shows the value of Judy's super account balance over time to age 55 where the **red line** is the Personal Ownership strategy and the **blue line** is the Super Ownership with No Additional Contributions strategy:

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Over this 10-year period, the impact of the insurance premiums on Judy's super account balance is shown below:

|   | Personal Ownership Strategy | Super Ownership with No Additional Contributions | Impact of Insurance Premiums on Super |
|---|-----------------------------|--|---------------------------------------|
| Gross Super Contribution – Year 1       | \$9,500                     | \$9,500  | \$0                                   |
| Insurance Premiums Deducted from Super  | \$0                         | \$2,000  | -\$2,000                              |
| Gross Super Contributions less Premiums | \$9,500                     | \$7,500  | -\$2,000                              |
| Super Balance in 10 Years               | \$491,373                   | \$460,373  | -\$31,000                             |

Judy is concerned about the scale of this impact, especially given that she expects to work until at least age 65 (i.e. a further 10 years from the date of the balance in the table above) and also understands her insurance premiums would increase more quickly as she ages from 55 to 65 than from age 45-55.

Mammoth therefore discusses the following strategic alternative with Judy:

- 3. Super Ownership with salary sacrifice or personal tax-deductible contributions to super** – as with #2 above however Judy salary sacrifices \$3,278 in the first year (i.e. the same amount of her pre-tax income required to pay an after-tax premium of \$2,000 pa in the first year) super instead of taking this as salary income or pays personal tax-deductible contributions to super of the same amount (both of which are a Concessional Contribution to super), and increases these contributions each year to match the pre-tax income that would be required to pay the increased insurance premium from her after-tax income. The Concessional Contribution amount is taxed at 15% upon entry to the super fund resulting in a net contribution of \$2,786.30 in the first year. This tax applies instead of Judy's marginal tax rate of 39%. Judy's take home pay is the same in this strategy as it is in either of the two earlier strategies, however as with strategy #2, Judy doesn't then have to use \$1,750 of her take home pay to pay insurance premiums as she would in strategy #1.

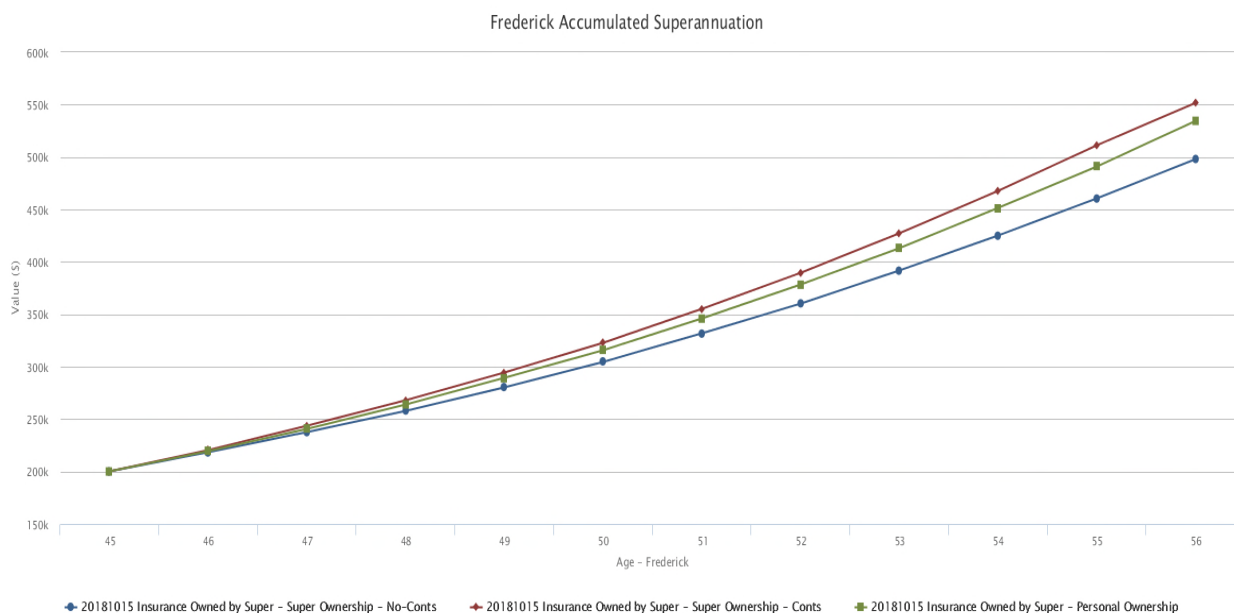
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### What is the impact of the insurance premiums plus additional super contributions on the super account balance?

The graph below shows the value of Judy's super account balance over time to age 55 where the **green line** is the Personal Ownership strategy, the **blue line** is the Super Ownership with No Additional Contributions strategy, and the **red line** is the Super Ownership with Additional Contributions strategy:



Over this 10-year period, the impact of the insurance premiums plus additional super contributions on Judy's super account balance is shown below:

|  | Personal Ownership Strategy | Super Ownership with Additional Contributions | Impact of Insurance Premiums on Super |
|--|-----------------------------|---|---------------------------------------|
| Gross Super Contribution               | \$9,500                     | \$12,778                                      | +\$3,278                              |
| Insurance Premiums Deducted from Super | \$0                         | \$2,000                                       | +\$2,000                              |
| Gross Super less Premiums              | \$9,500                     | \$10,778                                      | +\$1,278                              |
| Super Balance in 10 Years              | \$491,373                   | \$511,191                                     | <b>+\$19,818</b>                      |

In summary, the Super Ownership with Additional Contributions strategy allows Judy to protect her family against the financial impacts of premature death or total permanent disablement while nearly \$20,000 more to her super balance, **without altering her net cash flow/take home pay**

### Summary

Owning insurance via super can provide an array of advantages that may or may not outweigh the disadvantages in your case. It is imperative that you consider your particular circumstances as the outcomes will vary depending on a number of factors, including your particular insurance premiums, your

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ability to make additional contributions and the amount you are contributing or intend to contribute to super.

One of the key disadvantages of owning insurance via super is that it will reduce your super account balance over time. As the case study illustrates, this impact can be significant if smart financial strategies are not employed to mitigate this effect in the first instance and take advantage of the opportunities super affords in the second instance. Given that it is widely accepted that the current super guarantee contribution rate is insufficient to provide a 'comfortable' lifestyle in retirement, the consequences of any further reduction to your super can have a significant impact on your options in retirement.

***The bottom line is that, in the majority of cases, it is vital that if you have insurance owned via super, then you consider making additional super contributions to cover the premiums.***

If there are times when this is not affordable, it is imperative that 'make-up' contributions are made sooner rather than later. As the majority of industry and corporate super plans, and many personal plans, include insurance, you should always be aware of how much is being deducted for insurance premiums so that you can consider making additional contributions to cover them and ensure your retirement objectives are not adversely affected.

It is also imperative to consider various other impacts the ownership of any life risk insurance policies have on your outcomes and those of your intended beneficiaries. In particular, care needs to be given to the suitability of each different form of insurance policy ownership in light of the beneficiaries you wish to receive the benefits provided in the event of a claim as these can be quite different for certain types of beneficiaries depending on whether an insurance policy is owned via personal and super ownership. As always, Ongoing Planning is of the utmost importance to ensure that any arrangements continue to suit not only your position and objectives, but also those of your intended beneficiaries.

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### **Need more information?**

If you wish to discuss how this strategy can apply to your situation & potentially increase your ability to achieve your objectives, please feel welcome to contact Mammoth Financial on:

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