



Advice Guide | Insurance

How to read this document

Managing your finances to meet your day-to-day requirements as well as your long-term goals can be a complex task. There are all sorts of issues you need to consider such as taxation, legislation, protecting your wealth and assets, associated costs and the inherent risks of investment. When undertaking a financial plan, it is important that you understand how these issues will impact on you and what you should expect over time.

This document contains general information about the benefits, costs and risks associated with certain product classes and strategies. It is designed for use in conjunction with a Statement of Advice that takes into account the circumstances and objectives of an individual. Before making a commitment to purchase or sell a financial product, you should ensure that you have obtained an individual Statement of Advice prepared by WARR HUNT Pty Ltd.

As legislation may change, you should ensure you have the most recent version of this document.

Please contact your Adviser if you do not understand anything or need further.

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Insurance

Below is an overview of the common types of Life and General insurance cover available.

Life Insurance

The common belief “it won’t happen to me” often results in many people having a sound plan for wealth creation but not an adequate plan to protect the very thing that generates the wealth – themselves!

How death, disability or illness affects your ability (or your family’s ability) to meet your financial obligations and realise your lifestyle goals and objectives depends on the wealth protection strategy you have in place.

By taking out insurance, you can provide some financial protection for your family’s personal needs. Insurance can be structured to provide for such things as the repayment of your debts upon death or disability, financial assistance for dependants and protection against the loss of income.

Death

Death Cover can be critical for a secure financial future. In simple terms, you insure yourself for a particular amount and in the unfortunate event you die, the insurer pays that amount.

The lump sum payment can be used to help with the repayment of debts, the covering of future needs (for example, the cost of children’s education or long-term care) and providing funds for investment to generate an income or to keep your business afloat.

Factors to be aware of

- *Death benefits received via a superannuation policy may be taxed.*

Total and Permanent Disability

Total and Permanent Disability (TPD) cover provides a lump sum payment should you suffer an illness or injury which totally and permanently prevents you from working again.

There are broadly two main definitions of Total and Permanent Disability:

Own occupation

The insured must show they have a total and permanent disability that prevents them from working in their own occupation which they disclosed when applying for this cover.

“Own occupation” is a more liberal definition of disability, because even if you can work in another occupation, you may still be eligible to receive disability benefits. Because it is relatively easy to qualify for benefits under this definition of disability, insurance companies are limiting the availability of this type of cover. Own occupation cover is often more expensive, and may only be available to individuals who have a clean medical history and work in a relatively risk-free occupation

Any occupation

The insured must show they are totally and permanently disabled and unable to work in their usual, or any other occupation for which they are reasonably suited by their education, training or experience.

“Any occupation” is often more affordable than “own occupation” however it can be more difficult to meet the requirements of this type of disability definition.

Some insurers have a third definition available to clients – a “homemaker” definition. Payment of benefits under this definition would be based on the proviso the insured, through sickness or injury, is unable to do any normal physical domestic duties and will never be able to do so again.

Factors to be aware of

- *There may be taxation consequences where a disability lump sum superannuation payout is made.*
- *Since 1 July 2014 ‘own occupation’ TPD cover cannot be purchased in superannuation.*

Income Protection

Income protection insurance (also known as salary continuance) is designed to provide a regular income in the event you are unable to work due to sickness or injury. Generally, income protection insurance provides a regular income during a period of disablement.

This type of insurance is important to ensure you continue to receive an income to meet your obligations such as mortgage repayments should you be unable to work.

Up until March 2021, there were two types of Income Protection definitions:

Agreed definition

An amount is agreed upon by the policyholder and the insurer based on the policyholder’s income at the time of application. Financial substantiation is supplied during the application process to support the benefit being applied for. Upon successful claim, the full entitlement is paid to the policyholder regardless of how their income may have changed since application.

An agreed income protection policy is no longer open to new business due to concerns raised by APRA regarding the sustainability of the insurance industry. Agreed policies are generally more costly than an “indemnity definition” as it provides greater certainty.

Indemnity definition

In comparison, an indemnity value policy means the policyholder is paid a percentage of the income earned at the time of making a claim (usually up to 70%). In practice, this means that if the policyholder’s income has dropped since the original application, the benefit paid at the time of claim will reflect the changed income.

Factors to be aware of

- *Most income protection policies offer a range of waiting periods before you start receiving your insurance benefit (with options normally between 14 days and two years).*
- *You can choose from a range of benefit payment periods, with maximum cover generally available up to age 65. The longer the benefit period, the more the insurance will cost.*
- *Income protection benefits are taxable at your Marginal Tax Rate, though policy premiums are tax-deductible.*
- *Income protection insurance is increasingly important when borrowing as it can help meet loan repayments if you are unable to work due to illness or injury.*
- *You should ensure your insurance cover is adequate for your needs. Under-insurance could result in serious financial difficulty.*

Critical Illness (Trauma)

Critical illness insurance (also known as trauma insurance) provides a lump sum benefit in the event the life insured suffers a “critical condition” as defined by the insurance provider. Critical illness cover is designed to help you financially recover from a trauma or crisis, such as a heart attack, stroke, cancer or other life-threatening conditions.

Factors to be aware of:

- *You should ensure your insurance cover is adequate for your needs. Under-insurance could result in serious financial difficulty.*
- *Critical illness cover cannot be held via superannuation.*

Stepped vs level insurance premiums

When taking out insurance, there are generally two ways you can pay your premium.

- **Stepped premium** – your premium increases every year with your age.
- **Level premium** – your premium generally does not change and is based on your age when the policy commences.
- **Hybrid premium** – a combination of the above structures, offered by some insurers only.

While stepped premiums are usually lower in the early years, level premiums can be a more cost-effective option if you retain the insurance over a longer period. If insurance cover is only required for a short timeframe, a stepped premium may be more appropriate and cost-effective.

Level premiums

Level premiums are higher than stepped premiums at the start (see graph below). However, as stepped premiums increase, level premiums can end up cheaper – often at the stage in life when you need cover the most. The premium savings in later years can make up for the additional payments in earlier years – saving you money over the life of the policy.

Level versus stepped

Combining stepped and level premiums

Just as you can opt for a combination of fixed and variable rate home loans, you may want to take out part of your insurance using stepped premiums and use level premiums for the rest. This way, the premium in the earlier years will be lower than if you opt entirely for level premiums.

Over time, you can reduce your stepped premium cover as you build up more assets and potentially need less insurance. As a result, you could end up paying level premiums on most (if not all) of your insurance in the later years and benefit from the lower premium costs associated with level premiums at that time.

Factors to be aware of:

- *The earlier you 'lock-in' the level premium the greater the potential long-term savings. This is because level premiums are generally lower if you take out the insurance at a younger age. However, as you approach age 65, the difference between the two premium structures diminishes for new policies.*
- *Level premiums can make budgeting easier because you know with greater certainty what your insurance is going to cost.*
- *Level premiums can make budgeting easier because you know with greater certainty what your insurance is going to cost.*
- *The maximum age you can start a policy with level premiums is generally lower than for stepped premiums.*

Tax deductibility of insurance premiums

The premiums payable on income protection policies are generally tax deductible however, the income payments received are considered assessable income and are taxed at your marginal tax rate.

Generally, when insurance is held for the purpose of family and personal protection, life, critical illness and TPD insurance premiums paid are not tax deductible but when a claim is paid, the benefits are not subject to tax.

Life Insurance in superannuation

Insurance held via superannuation is owned by the trustee of the superannuation fund for the benefit of the insured member. The trustee deducts the insurance premiums from either ongoing contributions or the member's account balance.

Generally, Death, TPD and Income Protection can be held in the superannuation environment (but not critical illness cover). The premiums for life and income protection insurances purchased through a superannuation fund are completely tax deductible to the fund. The premiums for TPD cover may be either fully or partially deductible to the fund, depending on the characteristics of the policy as follows:

TPD policy type	Deductible portion
Any occupation	100%
Own occupation	67%
Own occupation bundled with life cover	80%

From 1 July 2014, 'own occupation' TPD cover is unavailable within superannuation with the exception of policies already in force prior to this date. This is because insurance benefits must be consistent with the definition of 'permanent incapacity' under superannuation legislation.

You may be able to fund the insurance premiums via employer or salary sacrifice contributions made to your superannuation fund or a tax-deductible superannuation contribution if you are self-employed. Note the tax treatment of insurance premiums should never be the primary reason for holding an insurance policy under a particular structure.

Insurance benefits can be paid out as either lump sums or pensions (or a combination of both) based on your (or your beneficiary's) circumstances at the time. Insuring via superannuation can also assist with personal cash flow as the premiums are paid by the fund.

Preservation of superannuation

Generally, money in a superannuation fund is 'preserved' until you meet a condition of release (such as retiring from the workforce). Preservation age is currently between age 55 and 60 depending on your date of birth.

Conditions of release that may apply prior to preservation age include permanent incapacity, terminal illness and death. Other conditions of release that may apply prior to preservation age including temporary incapacity, compassionate grounds and severe financial hardship have "cashing restrictions" attached to them which either limits the amount that can be paid to you or compels the fund to release benefits in the form of a pension rather than lump sum.

Death benefits – tax dependent beneficiaries

In the event of your death, the policy proceeds are paid into your superannuation account. The proceeds together with your accumulated superannuation balance are paid tax-free to your nominated beneficiary(ies) either directly or via the estate. Alternatively, your beneficiary(ies) could choose to have some or all benefits paid as a tax-effective pension if they are eligible to do so at that time.

Death benefits – non-dependent beneficiaries

In the event of your death, the policy proceeds are paid into your superannuation account. The proceeds together with your accumulated superannuation balance are paid to your nominated beneficiary(ies) and/or your estate.

If your superannuation is paid to a non-dependent beneficiary on your death, it is anticipated tax will apply. The amount of tax payable will depend on the components of the superannuation benefit and whether the trustee has claimed the premium as a tax deduction.

Death benefit nominations

If you do not make a valid nomination, the rules of the superannuation fund determine how your death benefit is paid. The superannuation fund can use its discretion to determine who will receive the benefit which may be your estate.

You should ensure your Will is up to date to address the payment of superannuation death benefits if paid to your estate.

Life Insurance within a Self-Managed Super Fund (SMSF)

Insuring via superannuation can also be done within a SMSF. The insurance held via a SMSF is not owned personally by you but is owned by the trustees of your superannuation fund. You may fund the insurance premiums by contributing to superannuation or by paying the premiums from the balance of your SMSF. In most cases, tax deductions for insurance premiums paid by your SMSF are the same as other superannuation funds as detailed above.

Trustees of a SMSF must act in accordance with the fund's trust deed. Some SMSF trust deeds may not allow insurances to be held and so require amendments to implement the recommended insurance. It is also important to maintain minutes detailing decisions made that affect the fund's operations. Trust deed amendments and the preparation of minutes may include:

- ensuring the purpose of the insurance policies is documented
- establishing a process for payments
- ensuring the required payment options are allowed (such as a Pension), and
- binding nominations are made (where appropriate).

Reviewing your Life Insurance

The insurance industry and market is ever-changing, now more than ever, as evidenced by the shifts in definitions, terms and products as an outcome of APRA's findings in 2019 and as providers make changes to keep up with this.

You should ensure your insurance cover is adequate for your needs. Under-insurance could result in serious financial difficulty. Changes in your personal circumstances (ie taking on additional debt, birth of a child) often necessitate higher insurance levels.

General Insurance

Health insurance

All Australian citizens currently have a level of medical cover through the Medicare system. Under Medicare, the Commonwealth Government covers your accommodation and medical expenses in a public hospital. However, you do not have your choice of doctors and where your condition is not life threatening, you may experience lengthy waiting periods.

Private health insurance gives you the opportunity to choose your doctor and hospital, and can ensure you avoid waiting periods for elective surgery. Depending on the policy, private health insurance may also cover expenses relating to dental, physiotherapy, pharmacy and optical needs. To encourage the adoption of private health insurance, the Federal Government provides a health insurance rebate. From 1 July 2012, the extent of this rebate is means tested based on income. This rebate may be claimed in your taxation return or via a reduced health insurance premium. If you are a high income earner and you do not have adequate private health cover, your income may also be subject to the Medicare surcharge in addition to the general Medicare levy payable with your annual tax assessment.

Home and contents insurance

With burglaries and natural disasters a regular occurrence, home and contents insurance is important. Home insurance alone covers your home from damage. You can also structure this type of insurance to protect the contents within and around your home. Considerable discounts may be gained by combining home and contents cover in this way.

Car insurance

Each day, cars are involved in accidents or stolen. You can minimise the impact of such events by putting in place car insurance. Car insurance is generally offered at a number of different levels of cover. These include comprehensive, third party property damage, fire and theft. Comprehensive cover is preferred as this insures you for a wide range of events or occurrences. Third party insurance only insures you for damage caused to someone else's car or property.

Residential investor insurance

Investing in a property can provide substantial rewards through rental income and capital gains. This type of insurance protects both the property's income as well as the property itself.