Look outside super

STORY VITA PALESTRANT

Your fund may no longer provide the best deal for that important life and TPD cover

IT'S NO LONGER THE CASE that life insurance premiums are always cheaper when bought through a super fund. Premiums have shot up in recent years, which means consumers may find better value and flexibility outside superannuation.

A big benefit of the super system has been its low-cost life and total and permanent disability (TPD) cover, which members receive automatically on joining a fund. This is especially valuable for members with health problems who would otherwise struggle to get affordable cover elsewhere.

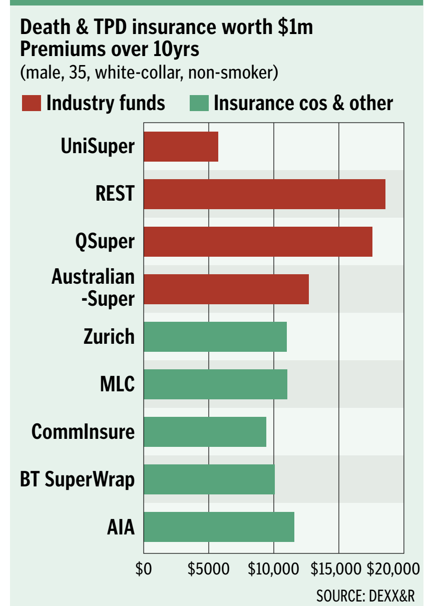
But the life insurance landscape is changing, not only on price but also on the flexibility of products both inside and outside super. "You can often get a certain amount of life cover without undertaking a medical check," says Kirby Rappell, research manager at SuperRatings. "And you can pay for it out of your before-tax super contributions, which may help some people but obviously that will come out of your retirement balance."

He says with group cover, as via a super fund, risk is spread across a bigger pool, which theoretically at least can result in cheaper rates. "But people need to do their sums. There has been an increase in claims across the industry largely driven by mental health claims. It has put upward pressure on premiums. Some funds have reduced the level of cover you can apply for without medical evidence."

Rappell says TPD policy definitions have also been tightened, so it is harder to make disability claims.

Members typically get $200,000 to $300,000 in death and TPD cover. But for anyone living in an expensive Australian city with an eye-popping mortgage and young family to raise, $1 million-plus will be closer to the mark. It means they will need to top up their default cover. That's where comparing costs inside and outside super is worthwhile, as it may give surprising results.

WHERE'S THE VALUE?



SOURCE: DEXX&R

Mark Kachor, the managing director of research firm DEXX&R, says: "If you only require a small amount of cover, let's say $300,000 to $400,00, then probably the cheapest way to do it is through the cover you have inside super. The way individual [non-super] risk works is that you pay the premium and you pay a policy fee, which is $80 to $90 a year. Although the premium is cheaper, once you add the policy fee it's probably the same or dearer for small sums insured."

DEXX&R compared the premiums for $1 million worth of cover, paid over 10 years, for a non-smoking white-collar male turning 35 next birthday. Its research showed super fund REST's total premiums of $18,564 were almost double those of the Commonwealth Bank's CommInsure. However, UniSuper had the cheapest rates, at $5730, underlining the importance of taking nothing for granted.

"The conventional wisdom has been that super is the cheapest way of getting cover because there is no commission involved in the premium and you get the benefit of bulk rates. But the reality now is many super funds

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Portable policy gives fund members greater choice

Lack of portability can be an issue with default life cover. If you want to set up a business, work overseas or start a self-managed super fund you may have to leave enough money in your old fund to pay ongoing premiums or face starting a new life policy with all the underwriting hassle that entails. Even moving insurance between super funds can be extremely difficult.

But there is a solution that enables fund members to buy their own stand-alone life and TPD cover and pay the premiums from their super balance.

Insurance specialist Roy Agranat, a director of Fairbridge Financial Service, says that apart from portability, there may be other benefits including better rates, less onerous TPD definitions and tax advantages.

"The value of group insurance has diminished dramatically in recent years as a result of significant losses. One well-known fund – which had the lowest rates – [its rates] rose 100% over the last two years, with no guarantee that these rates will not be further increased in future years."

He says a number of insurers now offer the consumer the ability to take a Life Super (life and TPD) policy funded from any complying super fund. This allows the cover to continue to be held within the super environment.

"In the past consumers had no choice which insurer they could use. Members were forced to use the fund's provider. This has changed, giving consumers greater choice. This means an individual can change super fund providers and keep their insurance cover with the same insurer."

Clients benefit by paying premiums with before-tax dollars, which can help with cash flow. To ensure the super balance isn't eroded by premium payments, clients are advised to salary sacrifice extra into super within their maximum cap.

"Over time if a client wishes to change their cover from super to non-super this can be done with nil underwriting. This is particularly useful if circumstances change and a client wishes to nominate non-tax dependants (adult children, charities) as beneficiaries," says Agranat.

Dependent children and spouses get the death benefit tax free in super but non-dependents (adult children and others) pay 31.5% tax. With non-super insurance the death benefit is tax free for all beneficiaries.

Super's TPD terms and conditions can be restrictive. A member can inadvertently lose their benefit if the number of hours they work falls below a minimum requirement, typically 15 a week. Agranat quotes the case of a single mother whose claim was knocked back because she could work only 12 hours a week.

Paying premiums with before-tax dollars can help with cash flow

Within super, the TPD rules are restricted to an "any occupation" definition (a benefit is paid only if the insured person is unable to work again in any occupation they are reasonably suited to) as well as the requirement to meet the rules of release from super. Agranat says with the ability to now hold a policy independently of their super fund, the consumer can access the better quality "own occupation" definition (a benefit is paid if they are unable to work again in their current occupation) while still funding most of the premium from super.

are dearer than using the typical individual contract," says Kachor.

The shifting landscape is the result of insurers underbidding each other to get super fund business but subsequently being hit by hefty TPD claims. As a result some funds' premiums, having first dropped, have shot up, some as much as 70%.

At the time, rather than the fund passing on the cuts to premiums, members received more life cover, says Kachor. "So when premiums went up they were paying a higher premium on a higher amount of default cover, so it was a double whammy. If you need more than your fund's default cover you may be better of going down the full-advice path."

The odd thing is that buying cover directly from an insurer is the most expensive way to go. "Direct cover will be even dearer because the insurer spends a fortune on advertising and they have to maintain a call centre," says Kachor. "Distribution costs are higher for direct business than for adviser business." The key, of course, is to find good financial advice.

The challenges

Last year the Australian Securities and Investments Commission (ASIC) took a special interest in life insurance "because it is of critical importance to the long-term financial wellbeing of Australian consumers".

But a survey ASIC conducted found more than a third of consumers received advice that failed to comply with the law, including failure to set appropriate sums insured, poor record keeping and weak reasons for policy replacements.

It found poor compliance was more likely to happen where upfront commissions were paid to the adviser. Upfront commissions can be as high as 130% of the first year's premiums, with an ongoing annual commission of about 10%.

The report builds on actions ASIC has previously taken to remove adviser licences where consumers faced "considerable detriment as result of their advice" and where it found evidence of "unnecessary or excessive switching of clients between policies to maximise commission income".

Kachor says, by law advisers now have a duty to act in a consumer's best interests, and in most cases you will be well served. However, "there is no doubt there are advisers out there who replace business primarily to improve their own financial situation and not that of their clients".

For older consumers it's even more critical

Cover adapts to life stages

Super life insurance has come a long way from the days when the typical default fund offered members a fixed amount of cover that would reduce with age. Many funds now recognise people are buying homes and starting families later in life.

Super funds, such as REST, have introduced life-stage cover as their default product. It aims to provide an appropriate level of cover reflecting different life stages, rising when liabilities are at their peak and declining when they diminish.

Kirby Rappell from SuperRatings says members need to check their super to see what type of life cover they have.

"A lot of funds have a life-stage option that allow members to increase their level of cover without medical evidence for specified events like buying a home, getting married and the birth of a child. But you need to apply within 60 to 90 days of the event. It can be a good way to increase your insurance."

Apart from life-stage cover, some super funds offer fixed cover (such as term insurance) where the sum insured remains the same but premiums rise with age (HOSTPLUS, HESTA and MTAA); others have an option that links cover and premiums to salary (HOSTPLUS Executive, QSuper).

"Fixed sums insured can be useful to ensure you have the required amount of cover but it will become more expensive as you age. It can be a better option but keep an eye on the costs," says Rappell.

to get a competent adviser. So how can you tell if your adviser is up to it?

Aim for the best advice

Kachor says you shouldn't have to read the life policy yourself. "I don't think anyone who pays for advice should have to go to those lengths. It will be couched in legal and insurance-specific terminology. It's up to the adviser to explain to you what it means - that is a core part of what advice is about."

The adviser will issue you with a statement of advice which should provide you with the

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research on which he based his recommendation to switch providers. "The adviser has to, by law, identify what you gain and what you lose by making the change. The statement should summarise what items are the same, what are better and what are worse. There must be a reasonable basis for the advice and it must be in your best interest."

Kachor recommends you take it away, read it and see whether it makes sense. "If it doesn't, ask him to explain it, particularly if the premium you pay as a result of the recommendation is less than the premium you are currently paying. Ask him to point out what you would lose by making the change.

"Not verbally, it must be in writing. If it turns out his advice was incorrect, you have a copy of it. You're not arguing the toss who said what. So if you read it and cannot understand it, get him to explain it to you in writing. What you should get back is something along the lines of, 'The client asked me to explain the difference between the two definitions of TPD. The two definitions differ materially this way ...' That's what it should do."

Get in early

Kachor says the incidence of disease and death increases every year after 35. "The younger you are when you take out life cover, the more likely you are to qualify for standard rates. The beauty of term insurance is its guaranteed renewal. It doesn't matter how much your health later deteriorates, you stay on standard rates."

If you are 35 and applying for, say, $1.5 million, the insurer will rely on the answers you provide to decide whether to insure you. If you tick all the boxes indicating a clean bill of health, it will issue a standard policy. For higher amounts it may ask for a medical, ask your doctor for your medical history or demand a stress test, ECG and thorough medical check.

But if you take out cover when you have impaired health you might be asked to pay a loading of 50%-100% on the standard rate.

Should your health improve, you can ask to be rerated. For example, if you had cancer before you took out the insurance but have been clear for 10 years and have the medical evidence to back it up, you can argue the loading should no longer apply.

But, most importantly, you need to answer all the questions honestly when applying for life cover. "If you consulted a doctor about something, tell them. One of the consents you sign is to allow the company to search the Medicare database to verify the information you provided. They mostly don't search it at the time they issue the policy but if a claim comes in that's the first thing they do. They check all the information you provided at the time of commencement against all the digital records about your health. Medicare ties everything together in the national databases."

Another thing about term insurance is that companies offer guaranteed free upgrades if improved terms and condition are introduced.

Time on your side

There's a section in the Insurance Contracts Act about what an insurer can do if there has been a misstatement of a material fact in the underwriting process. This often referred to as the non-disclose penalty period.

"Let's say you took a policy out today and in 10 years' time suffer a melanoma that's covered by the contract," says Kachor. "You may have had evidence of it that was noted by your GP who recommended you see a skin specialist. But you didn't follow it up.

"If you were diagnosed with melanoma in the first three years, they could probably avoid paying you by saying, 'You had symptoms you didn't disclose. You were advised to see someone but did nothing about it. We would've asked you to be examined and that would've influenced whether we issued the policy or not.' If it's 10 years, they cannot void the contract. They would have to prove that you deliberately and fraudulently didn't disclose it.

"So if have a policy in force for 10 years and the adviser says 'let's change to this company', that period on which the insurance company can deny the claim, if you didn't make full disclosure, starts all over again."

And don't cancel your existing policy when switching providers until the new policy has been issued. "This is where advisers get caught out," says Kachor. "They've told the client that it's OK to drop their existing policy, and then the new one gets denied. Under current law, the adviser will be found at fault if it goes awry later. You want to make sure it's been accepted first. Inevitably if you're older and buying more cover, that's always going to be looked at more intensely."

Standard premiums don't differ that widely among life insurers over time. "There's not a huge variation in the premiums. The bottom line is, over 10 years they pretty much get the same amount of money," says Kachor. ***M***