

1 August 2002

Ms Sue Morton
Secretary
Senate Select Committee on Superannuation
Parliament House
CANBERRA ACT 2600

Dear Ms Morton

SUPERANNUATION AND STANDARDS OF LIVING IN RETIREMENT

I refer to your letter of 24 July 2002 and provide the following advice regarding salary continuance insurance offered in conjunction with superannuation arrangements.

1. 'Salary continuance' insurance and the 'sole purpose test'.

'Salary continuance' or 'income protection' insurance provides income to a person in the event of being unable to work due to illness or injury.

Provision of benefits payable in respect of cessation of work due to ill-health is listed as an ancillary purpose under the 'sole purpose test' in SIS. Thus regulated superannuation funds are able to offer such insurance within the confines of the test.

Many funds provide a minimum level of death and total and permanent disability insurance payable out of employer contributions in respect of each member. Higher levels of cover and other types of insurance may be offered on an optional basis.

As provision of salary continuance benefits is an 'ancillary purpose' for a fund, a requirement under a fund's rules to make application and payment for such benefits compulsory at more than a minimal level would be inconsistent with the sole purpose test.

Provision of salary continuance benefits may be 'within the fund' or 'outside the fund', and examples of both were provided during the Committee's public hearings on 18 July. As an example, a representative of C+BUS indicated their fund currently provides this insurance option outside the fund, that is a member who wishes to obtain such cover must pay the premium separately to any superannuation contributions made. However, C+BUS will offer this benefit within the fund later this year and the premiums will be paid via contributions to the fund.

The SIS legislation does not limit the term of payment of benefits in respect of temporary incapacity including payments generated through income protection or salary continuance insurance. However where payments are made beyond two years there are taxation implications in relation to the deductibility to the fund of the insurance premiums (*Taxation Determination TD 98/27*). Hence some funds may choose to arrange this insurance outside the fund.

Background information on the sole purpose test is provided in the Attachment.

2. Limits to the level of premium payments (and insurance payments) for death and disability from superannuation contributions.

The level of premium payments and cover provided should be considered by trustees in relation to the fund as a whole, including the member profile of the fund. Explicit limits related to contribution rates would cut out funds that provide 'death only' benefits. This would also further complicate the superannuation system.

There are grounds for a view that 'excessive' premiums or cover would breach the sole purpose test where the cost of the premiums is at the expense of the ability to accumulate retirement savings. An extreme example would be where, at one end of a spectrum, say 90% of a member's contributions went towards insurance premiums while, at the other end, only 2-5% was earmarked for insurance.

In our view, regulation of the levels of cover or the proportion of compulsory contributions expended on insurance would impose unnecessary restrictions on funds and create additional complexity for supervision. Trustees have their fiduciary duties to consider when developing and offering any fund feature or benefit, as well as the advantages or disadvantages of a particular commercial activity. Some points to consider in deciding how much or what sort of cover to offer could include:

- What is 'excessive' in relation to member profile, market norms and the ability to negotiate group rates?
- What benefits are provided for the premium paid?
- Does the insurance strategy provide a means for members to 'self select' where they might not get such cover outside the fund, or at such advantageous rates?
- Whether the insurance is provided by a related party of the fund, and if so – how are the conflicts of interest disclosed and dealt with?
- How clearly are the insurance features of the fund disclosed to members, including cessation of premium payments in event of cessation of contributions so that account balances are not run down?

3. Health accounts within superannuation or payment of private health insurance premiums from superannuation contributions or account balances.

It has been suggested that savings for health expenses or provision of health insurance through the superannuation system be considered as a means of advancing the provision of sufficient income to fund members in their retirement.

Under the current legislation, superannuation funds are not permitted to provide health insurance benefits.

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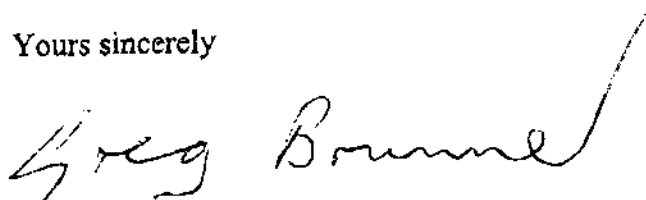
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A possible alternative may be the provision of a Retirement Savings Account (RSA) type savings product, outside the superannuation system, to meet health costs. Any preservation requirements imposed as a trade off for concessional tax treatment or rebate could be tailored specifically for such purposes rather than attempting to fit it on to the superannuation system.

I trust this information will be of assistance to the Committee.

Yours sincerely

A handwritten signature in cursive script that reads "Greg Brunner". The signature is written in dark ink and is positioned above the typed name and title.

Greg Brunner
General Manager, Policy Development

ATTACHMENT**THE SOLE PURPOSE TEST**

The sole purpose requirements contained in section 62 of SIS (the "sole purpose test") limit the provision of superannuation benefits by regulated superannuation funds to a range of prescribed or approved retirement or retirement related circumstances. The test is the legislative expression of the retirement income objective which is the key rationale for superannuation savings.

The sole purpose test operates in conjunction with the payment, contribution and accrual standards set out in Parts 6 and 7 of the SIS Regulations.

The sole purpose test and the associated standards prohibit the use of concessional tax superannuation savings for purposes such as providing pre-retirement benefits to members, benefits to related parties or facilitating estate planning. The sole purpose test, with the prescribed SIS investment restrictions, ensures that the retirement income objective is paramount.

The sole purpose test provides that a regulated superannuation fund must be maintained solely for at least one of the legislated core purposes or for at least one of those core purposes and for one or more of the prescribed or approved ancillary purposes.

Essentially the "core purposes" are the provision of benefits on or after the member's retirement, reaching age 65 or earlier death.

Similarly, the "ancillary purposes" are the provision of employment termination insurance, salary continuance (on a member's cessation of work because of ill health), reversionary benefits and other approved benefits on or after an appropriate condition has been met.

APRA Superannuation Circular No III.A.4 "The Sole Purpose Test", revised February 2001, provides further information