An SMSF guide to life insurance

sequoia ASSET MANAGEMENT

Information guide for Trustees and members
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Introduction

SMSF and life insurance

Superannuation and life insurance are similar in that they both provide for you financially when you may not be able to provide for yourself.

Most people with an industry or retail super fund will have some level of life insurance that is provided automatically as part of the super fund. However, when setting up and running a Self-Managed Super Fund (SMSF), you need to consider the need to apply for insurance yourself.

The good news for SMSF holders is that you can include life insurance simply and easily as part of your investment and risk mitigation strategy. There are a number of benefits to holding your insurance within your SMSF, but there are also a few things to look out for.

Aim of this guide

This guide provides some of the background and basic information you should be familiar with when managing an SMSF and considering your life insurance needs, from both a Trustee and member perspective. **The information presented in this guide is of a general nature and is believed to be correct at the date of publication. It does not take into consideration individual circumstances, in particular an individual's objectives, financial situation or needs. Readers should consider the information presented in this guide having regard to their objectives, financial situation and needs.**

Readers should consider consulting with a professional adviser before acting or not acting in relation to any of the information presented in this guide.

Insurance changes to SIS

In August 2012, the Superannuation Industry (Supervision) Act (SIS) was amended based on the Government's Stronger Super recommendations. The key change starting in the 2012/13 financial year is that:

- **Trustees of SMSFs now have to consider, as part of the fund's investment strategy, "whether the trustees of the fund should hold a contract of insurance that provides insurance cover for one or more members of the fund."**

The new regulation expects that Trustees will consider this need and minute the outcome through their SMSF's investment strategy documentation (refer to Appendix 2 for a template).

This is a significant addition to the previous provisions, and has been prompted by the Super System Review panel noting that (at that time) less than 13% of SMSFs had insurance.

While one might assume many SMSF members will be older Australians with higher super balances, and may not need as much insurance, it is consistent with the high level of underinsurance of the Australian population.

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SMSF Trustee obligations

The role of the Trustee

Becoming a Trustee of an SMSF is an important decision that carries certain duties and responsibilities (next page), with your primary concern being the management of the fund for the benefit of members for their retirement.

All Trustees are equally responsible for managing the fund and making sure it complies with the law.

This is the case even if:

- one Trustee (or Director) is more actively involved in the day-to-day running of the fund than the other(s), or

- you use a professional to do certain tasks on your behalf – e.g. an accountant, lawyer, investment adviser, super fund administrator or tax agent.

Trustee obligations

All Trustees are responsible and accountable for running the fund and making decisions. You must always put your obligations and responsibilities as a Trustee of the fund before your wishes as a member. Whenever a conflict occurs between your wishes as a member and your legal responsibilities as a Trustee, you must comply with your Trustee obligations.

If, for example, a breakdown of a relationship between members occurs, you must continue to act in the best interest of all members at all times, and in accordance with the super laws and Trust Deed of your fund.

Qualified professionals

If you use a professional to help you manage your fund, it is important you select one that is right for you and your circumstances. It is essential that any financial, investment and legal advice you receive comes from a qualified professional, as your decisions will have an impact on the retirement income of members.

Segregation of affairs

You must separately manage the affairs of the super fund and your own personal or business affairs. This means you must keep super fund assets (including money) separate from your personal and business assets and ensure they are used solely for super fund purposes.

Preservation of benefits

You must not allow members' benefits (money or other assets) to be accessed earlier than is legally permitted. As a general rule, a member's benefits must be preserved in the fund until they reach their preservation age (currently age 55 for members born before 1 July 1960, increasing to age 60 for those born after 30 June 1964) or until they retire after reaching preservation age.

Early release provisions

A member's benefits can only be accessed before the member reaches their preservation age in very limited circumstances – for example:

- In cases of severe financial hardship (subject to specific criteria being met)
- On tightly restricted compassionate grounds
- On diagnosis of a terminal medical condition, or
- In the event of temporary or permanent incapacity.

NOTE:

It is illegal to set up an SMSF to gain early access to your super savings. If benefits are unlawfully released, significant penalties, including fines and jail terms of up to five years, can apply to you. Significant adverse taxation consequences may also arise for your fund and the recipient of the super benefits.

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Your duties and responsibilities

Your Trustee duties and responsibilities include:

- Making sure the purpose of the fund is to provide retirement benefits for members
- Preparing an investment strategy and making investment decisions
- Accepting contributions and paying benefits (income streams and lump sums) in accordance with super laws and the fund Trust Deed
- Advising your Insurer of any changes in Trustees, Directors or members within 28 days of the change occurring. You may also need to notify the ATO and ASIC
- Ensuring an approved auditor is appointed for each income year, and
- Undertaking administrative tasks, such as record-keeping and lodging annual returns.

You must also ensure the fund's Trust Deed and investment strategy are regularly reviewed and updated in accordance with the law and the needs of members.

Over time your circumstances may change, possibly in a way that affects your ability to effectively manage the fund and undertake your obligations as a Trustee. Throughout the fund's life cycle, you must consider the individual circumstances of each member and the general condition of the fund. You need to continually reassess whether an SMSF is still the appropriate option for your retirement savings.

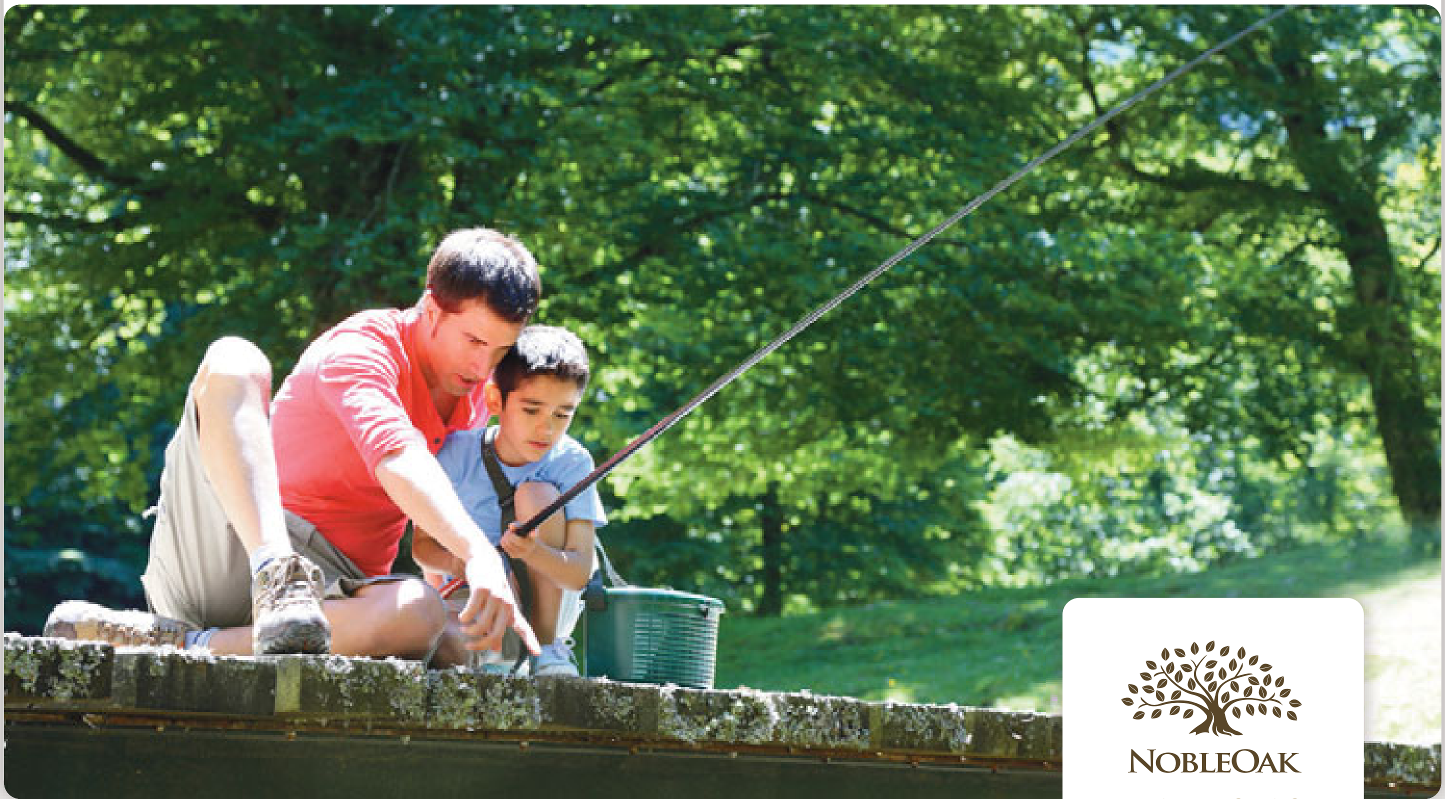
Your investment strategy

The ATO requires that SMSFs have a documented investment strategy* that considers:

- investing in a way to maximise member returns, taking into account risk associated with the investment
- diversification and the benefits of investing across a number of asset classes, such as shares, property, insurance and fixed deposits, in a long-term investment strategy
- the ability of your fund to pay benefits as members retire and pay other costs incurred by your fund, and
- the needs of members, depending on, for example: age, income level, employment pattern and retirement needs.

* Source: http://www.ato.gov.au/super

NOTE:
To avoid penalties, make sure you understand and comply with your duties and responsibilities as a Trustee under super laws.



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How insurance works

What types of insurance can be held in SMSFs?

Under superannuation law, only certain types of insurances can be held which will satisfy the early release provisions outlined on page 4.

Primarily, these insurances relate to death (i.e. Life Insurance) and total permanent disablement (i.e. TPD Insurance). Furthermore, only certain definitions of permanent disablement meet the superannuation provisions.

1. Life Insurance

Life Insurance pays your dependants the insured amount if you die or become terminally ill. This money can be used to pay for your funeral, eliminate personal and business debts, and provide a future source of income for your family.

2a. Total and Permanent Disablement (TPD) Insurance

Add TPD Insurance to your plan for an additional premium, and you will receive the insured amount if you become totally and permanently disabled as a result of injury or illness. You can use this money to eliminate personal and business debts, modify your home, and pay ongoing care and medical costs.

The amount of money you receive will depend on the amount of cover you are accepted for. In order to meet the superannuation early release provisions, **the TPD policy will need to have an 'Any Occupation' definition and not an 'Own Occupation' definition (see page 7).**

2b. Activities of Daily Living (ADL) TPD Insurance

ADL TPD Insurance is specifically for people who are:

- engaged in 'domestic duties'
- gainfully employed and working less than 25 hours per week
- unemployed at the time of injury or illness, or
- employed in a hazardous occupation.

A benefit for ADL TPD Insurance is payable where, as a result of injury or illness, the member is totally and irreversibly unable to perform at least four of the five 'Activities of Daily Living': bathing, dressing, eating, toileting and transferring.

Where insurance is normally held

Insurance cover	Inside super	Outside super
Life	✓	✓
TPD (Any Occupation)	✓	✓
Trauma*	✗	✓
Salary Continuance (Income Protection)+	✓	✓
Business Expense	✗	✓

* Trauma Insurance is often cited as being able to be held in super. However, upon claim, it's unlikely that the Trustee can release the proceeds to the member unless the member meets a condition of benefit release largely defeating the purpose for having the insurance in the superannuation fund. For the same reason, there are no tax benefits to the SMSF or members in doing so.

+ In addition to Life and TPD Insurance, you can also consider adding a Salary Continuance (Income Protection) policy within an SMSF.

Considerations for insurance in super

The benefits of holding insurance within your SMSF

There are a number of benefits to holding insurance in super – including increased personal cash flow and the effective tax-deductibility of the insurance premiums to the Trustee of the super fund.

Because your insurance premiums are paid for by your SMSF, you no longer have to come up with the money yourself. This is great for anyone who needs to maintain their after-tax cash flow, but still understands the importance of personal risk insurance.

Premiums for Life Insurance and TPD Insurance are generally not tax-deductible when held personally (outside of your SMSF). However, when they are paid for using the money in your SMSF, they are effectively tax-deductible to the Trustee of the super fund against other taxable income of the super fund (such as tax deductible contributions made to the super fund).

What should you look out for?

Life Insurance (i.e. cover for death only) on its own is fairly straightforward, as any claim for death or a conclusive diagnosis of a terminal illness would meet the requirements for early release of your super.

However, there are some things to look out for when it comes to TPD Insurance within your SMSF.

1. Any Occupation TPD

The 'Any Occupation' definition of TPD meets the requirements under the Superannuation Industry (Supervision) Act 1993 (SIS). That means any benefit paid into your SMSF can be released from super in the event that you are permanently disabled and unable to perform any form of work, be it your actual occupation or any other employment.

2. Own Occupation TPD

If your policy has an 'Own Occupation' definition of TPD, these funds will still be paid to the SMSF. However, the SMSF may not be able to release the money to you until you reach retirement age – especially if you are still capable of working in some other capacity. That's because superannuation law isn't meant to extend to such claim circumstances.

For example, if you are a surgeon who becomes unable to perform surgery, you may still be able to work as a consultant, teacher or administrator. While you might qualify for an Own Occupation claim, you may find you can't access the claim proceeds until retirement as you are still capable of working in some capacity.

However, if the accident was so debilitating as to be permanent under an Any Occupation definition, and you are unlikely to ever work again in any occupation, the SMSF could release the claim proceeds to you immediately.

3. Your level of retirement savings

As your premiums are paid directly from your retirement savings, the amount you will have left when you retire will gradually be eroded by the ongoing premium payments. To combat this, it is generally recommended that you make additional contributions to your SMSF to offset the premium costs.

Holding your personal risk insurance within your SMSF can be a great strategy. However, it is important to consider whether or not this strategy is right for the fund members' unique needs and objectives.

What is the cost of your insurance?

The insurance premium you need to pay will depend on certain 'risk factors' – including your age, gender, smoking status, sum insured, medical and/or family history, occupation and pastimes.

There are discounts on your premium rates if you are a non-smoker, pay your premiums annually in advance, and, often, for large sums insured.

Generally, premiums are lower when the risks are low and applicants are healthy, and climb for more risky lifestyles, or older ages, when illnesses and injuries become more common. Your premium will be determined during assessment of your application for cover by the insurer's underwriters.

For Life Insurance, cover of $500,000 and over can be bought from around $1,000 per year – around the same price as a typical family car insurance policy.

TPD Insurance premiums start lower when the risks are low, but climb steeply at older ages, when illnesses and injuries become more common. A policy with an Any Occupation TPD definition is cheaper than one with an Own Occupation definition.

The combined premium for Life and TPD Insurance could well be under your health insurance costs.

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Your life insurance needs

Do you need life insurance as an SMSF member?

To decide whether you (or other SMSF members) need life insurance, simply ask how people are dependent on you and would survive if you were to pass away, or become seriously ill or injured. That includes how household bills would be paid, and how any debt would be managed or extinguished.

If you, and the other members, have sufficient assets and superannuation savings over and above your total debts, which are readily available (i.e. liquid), then you/they may not need life insurance. Your families may simply drawdown on those savings to meet their ongoing needs and into retirement.

If you, and the other members, are unwilling to rely on their assets and savings, it would be wise to supplement the need with life insurance.

Some important facts to consider are:

1. 95 per cent of Australian families do not have adequate cover.
2. 1 in 5 families will be hit by a serious event in their working lives, that could have been covered by life insurance.
3. 1 in 6 women and 1 in 4 men are expected to suffer from disability from the age of 35 to 65, resulting in more than 6 months off work.

(2010 the National Centre for Social and Economic Modelling (NATSEM) - the University of Canberra).

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How much life insurance do you need?

There are a number of methods people use to calculate how much life insurance they need:

1. Rule of thumb

There is an old 'rule of thumb' for life insurance: buy enough cover to replace your salary for five to seven years. While this is a useful starting point, it doesn't take into account debt levels, the number of dependent children, or other factors that could affect someone's life insurance needs inside an SMSF.

It also doesn't account for the fact that many people who have no income at all still require life insurance. For example, non-employed mothers, fathers and guardians often contribute to a family in such a way that if they were injured or died, significant costs would be incurred to replace some of their skills and activities.

2. Online calculators

Searching for life insurance calculators online will produce dozens of different results. You need to be careful when using online calculators to determine your life insurance needs, as many of them do not collect sufficient information to give a proper calculation.

3. A better method

A better more comprehensive way of calculating your life insurance needs is to first determine exactly what you want to happen in the event of your death. For example:

- Do you want your SMSF to be debt free?
- Do you want your family to be mortgage-free?
- Do you have any business debts which need to be cleared?
- For how long do you want to provide an income to your family?
- How much income will they need each year?
- Are there private school fees that need to be paid?

Your answers to these questions will form the basis of how much life insurance you need.

For example, if you want to provide an ongoing income for ten years, you need to calculate the size of the lump sum to be invested to provide that ongoing income.

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Application and underwriting

Once you've established who needs cover, and the amount of cover required, you need to apply for the insurance.

The underwriting process means that some members may have 'loadings' (additional premiums) or 'exclusions' (where you are not covered for pre-existing conditions) applied to their policy, reflecting their less-healthy status or lifestyle. Some members will also be declined for being too risky, such as those with acute heart problems or a history of cancer.

The good news is that most members of SMSFs are working, between the ages of 18 and 65, and generally healthy, many are accepted by Insurers.

The underwriting process and time it takes differs substantially between Insurers. However, you should expect that applying for insurance will be straightforward, and the process will be clear and communicative between the Insurer and the Trustee(s).

Claims, administration and annual statements

Once set up, most insurance policies need little ongoing maintenance. Premiums are usually deducted from your superannuation account monthly, and once a year they may or may not increase in line with inflation. Also at that point, the Insurer should send you an annual statement showing what's been paid in over the year, to help with your superannuation returns.

If the Trustee needs to add or remove a member, or increase or decrease cover, the Insurer should facilitate this online or over the phone. Otherwise, the policy can be left to run its course.

Claims should be initiated by the Trustee on behalf of the deceased or disabled member. The Insurer will then request relevant evidence of the event leading to claim. Generally, the faster these claim requirements are supplied correctly and completely to the Insurer, the faster claims are paid.

Note that claims are paid from the Insurer to the Trustee upon admittance. It is the Trustee's responsibility to release the claim proceeds to the member or nominated beneficiaries in accordance with the Trust Deed and superannuation laws.

Appendix I

A little about NobleOak's SMSF Direct Life Insurance

There are a number of reasons why we believe the NobleOak SMSF Direct Life policy is so suitable for SMSFs.

1 Value.

When compared with other direct products available in the market, NobleOak's cover and rates are very attractive. For instance, a 50-year old male non-smoker could pay around 25% less for our Life and TPD Insurance product than if he went directly to one of the leading life insurance providers. NobleOak does not invest heavily in mass-marketing, which allows them to pass these savings directly back to our members and customers.

2 Comprehensive cover.

NobleOak's SMSF Direct Life Insurance provides the comprehensive cover to best protect you and your family's needs. NobleOak's product has been tailored to specifically meet superannuation requirements, including terminal illness and TPD definitions that help ensure an early release of claim proceeds.

3 Flexibility.

You can apply to increase or decrease the level of cover you have, or move your insurances out of your SMSF, if your needs and circumstances change without cancelling your policy and reapplying for cover. This ownership flexibility is unique to NobleOak and could be particularly beneficial if your health deteriorates.

4 Simplicity and speed.

NobleOak's Life and TPD Insurance products are simple and clear, with no hidden tricks or fees. You can enquire for cover online, over-the-phone, with tele-underwriting often taking only around 20 minutes, and only needing to answer a few questions or alternatively by contacting Sequoia Asset Management

5 135 years of helping Australians.

NobleOak has been delivering insurance and investment solutions to Australians as a friendly society for over 135 years, and it prides itself on providing comprehensive and competitive insurance products. NobleOak is an independent and Australian life insurer with no ties to the big banks.

6 Local Claims Service.

NobleOak's friendly experienced claims and service agents are based here in Australia.

7 All genuine claims paid.

NobleOak is an APRA-regulated life insurer. All genuine claims in the past have been paid and will continue to be so in the future.

NobleOak Life insurance policies are protected by the third-largest reinsurer in the world and it is a proud member of Abacus - Australian Mutuals, the industry body for the Australian mutual financial services sector.

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Peace of mind in three simple steps

1. Get a quote

Sequoia friendly staff will provide an immediate obligation-free quote. Simply call now on **1300 522 644** or email **insurance@sequoia.com.au** and provide the following information:

- ✓ Full Name
- ✓ Telephone Number
- ✓ Male / Female
- ✓ Smoker / Non-smoker
- ✓ Date of Birth
- ✓ Occupation
- ✓ Type of Cover Required
- ✓ Amount of Cover

2. Apply

If you're happy with the quote, you can apply immediately by completing a simple application form.

3. NobleOak asses your application

Your cover starts as soon as your application is accepted. On some occasions medical tests may be required to complete the application. However, we will pay the bills for these if needed.

Please refer to the SMSF Direct Life Product Disclosure Statement (PDS) which contains important information you should know about SMSF Direct Life, including the benefits, risks, limitations, costs and exclusions. The information provided in this document is of a general nature and does not take into consideration your objectives, financial situation or needs. You should consider the information having regard to your objectives, financial situation and needs. You should read this PDS and consider whether this product is right for you. SMSF Direct Life is a sub-plan of NobleOak's successful My Protection Plan.

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Appendix 2

Example investment strategy template

Investment strategy for ________________________ SMSF

Background:

The investment strategy outlined below represents an expansion and clarification of the investment strategy agreed at the formation of ________________ Superannuation Fund. This investment strategy replaces the investment strategy document dated _________________________.

Objectives:

The objectives of the fund are to:

- Provide superannuation benefits to members and their dependants to meet their retirement needs.
- Ensure that appropriate mixes of investments are held by the fund to support these needs.
- Ensure the fund has sufficient liquidity at all times to meet all commitments.
- Maximise the tax-effectiveness of fund investments, thereby delivering the best long-term after-tax return for members.

The investment objective of the Trustees is to aim to achieve real medium to longer-term growth. In recognition of the [____] year investment time frame of members, the fund will have a [low/high] proportion of growth assets in the portfolio.

Investment choice:

The Trustees have determined the fund's Investments may include, but not be limited to, all or one of the following:

- Direct equities, stocks and derivatives, including participation in dividend reinvestment programs, right issues and the like, including the use of geared instalment warrants
- Property trusts and associated investments
- Managed investments and associated products
- Direct residential, industrial, and commercial property investment
- Bank and other financial institution securities, including term deposits, debentures, secured and unsecured notes, and bonds
- Any other investment that the trustees may feel prudent to achieve the objectives of the fund.

The Trustees may from time to time decide to seek professional advice from accountants, solicitors and/or financial planners in the formulation of their future investment strategy.

In formulating this strategy, the Trustees have taken into consideration relevant features of the various investments, in accordance with both the fund's objectives and appropriate legislation.

While drafting this investment strategy, the Trustees have taken into account all of the circumstances of the fund, including:

- The risks involved in making each investment
- The likely return from making each investment
- The range and diversity of investments
- Any risks coming from limited diversification
- The liquidity of the fund's investments
- Expected cash flow requirements, and
- The ability of the fund to meet its existing and prospective liabilities, such as paying benefits to its members.

Policies:

The policies adopted by the Trustees in order to achieve these objectives are:

- Regular monitoring of the performance of the fund's investments, to oversee the overall investment mix and the expected cash flow requirements of the fund
- Balancing the fund's investment portfolio, by further sale and purchase of investments, in response to changes in market conditions.

The Trustees will always aim to ensure that they follow the investment strategy. However, the Trustees will at all times reserve the right to change the investment mix, depending on the market situation and the opportunities available to strengthen the fund's performance in line with its objectives.

A copy of the fund's current investment strategy will be made available to all members of the fund.

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Risk profile and risk tolerance:

The fund has a relatively long-term investment horizon. The members are prepared to endure a reasonable level of volatility of returns, in expectation of long-term growth. [The members have existing equity and property investments outside superannuation, and are familiar with the variability of both returns and capital values which are associated with such investments.]

Members understand:

- The trade-off between investment risk and long-term capital and income growth, and have indicated that growth is a priority, rather than capital stability
- Investment risk is borne by the members, as fluctuation in investment returns will affect the level of the members' benefits on withdrawal.

Liquidity:

The members of the ______________________ Superannuation Fund are aged [___ & ____] and have [no/significant] assets outside of superannuation. At the present time, neither expects to access their superannuation prior to age [65]. Accordingly, there is no anticipated benefit payment in the next [_____] years. Cash in excess of the anticipated liquidity requirement will be invested in accordance with the fund's investment strategy.

Life insurance:

The Trustees have considered whether to apply for and hold insurance cover for the following members of the fund:

Member Name	Need	Life Insurance	TPD Insurance
	Yes / No		
	Yes / No		
	Yes / No		
	Yes / No		

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About Sequoia Asset Management

Sequoia Asset Management Ply Ltd ABN: 70 135 907 550 holds an Australian financial Services License (AFSL No 341506) and is licensed to provide General Advice only.

About NobleOak Life Limited

NobleOak Life Limited ABN 85 087 648 708 is the Insurer (Australian Financial Services Licence Number 247302) and also referred to as "NobleOak" in this document.

NobleOak has been protecting Australians, as a friendly society, for over 135 years. We pride ourselves on providing comprehensive, competitive insurance products, supported by a prompt and personalised claims service.

NobleOak Life Limited Risk Fund No.1 provides the benefits of your insurance cover for SMSF Direct Life (the Plan) in accordance with the approved rules of that Fund, and as detailed in this PDS through a wholesale master insurance policy issued to the Trustee. Noblelink Financial Services Limited ABN 66 112981718 (Australian Financial Services Licence Number 286798) holds the wholesale master insurance policy issued by NobleOak, as Trustee.

NobleOak Life Limited reinsures with Hannover Re of Australasia, a subsidiary of the Hannover Re Group worldwide. Hannover Re Group is top 3 global reinsurer. The life insurance business of Hannover has been operating in the Australian market since 1958. Hannover's financial strength is visible in Standard & Poor's rating of "AA- (very strong)".

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