# Insurance: Inside Versus Outside Super

**Protection against the unknown**
From cars to home contents to travel, virtually everything we own is insurable. For most people, protecting their ability to earn an income or provide for their family are top priorities. Life insurance is one of the best ways of doing this, as it provides financial security for a person's dependants in the case of an unforeseen event.

There are countless permutations of policy ownership on offer including 'self ownership, cross ownership, trust ownership, corporate ownership and super fund ownership.' However, where insurance is taken out by an individual, there are two main options: inside or outside superannuation.

When insurance is held inside super, the trustee of the super fund owns the insurance policy on behalf of the super fund member. Premiums are paid through super contributions or the account balance of the fund. In the event that the proceeds of any insurance policy are paid out, these are paid into the member's account in the super fund and must meet certain conditions before they are remitted on to the member or their beneficiaries.

In contrast, where insurance is owned by an individual, there are fewer restrictions surrounding payments. A person will pay a premium themselves or through their employer, with the proceeds paid directly to the policy owner or a nominated beneficiary once an event occurs.

The most appropriate type of insurance to hold and ownership structure to use is the subject of perennial debate. It is important to understand the pros and cons of insurance held inside versus outside super, as well as the implications on a cashflow, tax and access to benefits.

**Insurance inside Superannuation**
The main types of life insurance that can be held within super include:

1. Term life/death cover that provides a lump sum benefit in the event of a person's death.

2. Total and permanent disablement (TPD) that provides a benefit if a person becomes totally and permanently disabled and is unable to work.

3. Income protection/salary continuance or disability insurance that provides a regular income payment of up to 75% of a client's regular income if they are unable to continue to work due to illness or injury.

4. Trauma that provides a lump sum benefit or instalments if a person is diagnosed with a specific illness or meets a certain medical condition such as stroke, heart attack or cancer.

Whether these policies are held inside or outside super will affect the way they function. Each type of insurance is examined in greater detail below.

**Term life insurance**
Term life insurance or death cover is designed to ensure a person's dependants are financially secure following their death. The proceeds of the policy are generally paid to the owner of the policy on the death of the life insured. The owner of the policy could be the life insured person; it can also be jointly held between a life insured and a third party or it can be held by a third party completely.

For life insurance inside super, the owner of the insurance policy is the super fund trustee. Any claims paid out by the life insurer will be paid into the super fund, then remitted on to the dependant(s), in accordance with the Trust Deed and conditions of release under the Superannuation Industry (Supervision) Act 1993 (SIS Act).

It is possible for a superannuation fund member to nominate one or more beneficiaries to receive their death benefit — including any insurance cover paid. This may take the form of a binding or non-binding nomination. 'If there's a [valid] binding nomination [the payment] will go to the nominated beneficiary or if there is no binding nomination, the trustee uses their discretion to pay it according to what the trustee deems will be the rightful beneficiary. Where no nomination exists, the trustee will use their discretion to determine the appropriate recipient of the death benefit in accordance with the governing rules of the superannuation fund.

**Total and Permanent Disability**

TPD can be purchased in combination with term life insurance or on its own. There are two main definitions of TPD that can be held inside super: 'any occupation' and 'own occupation'.

Under any occupation TPD, a benefit is paid if the insured person is unlikely to regain employment in any business or occupation for which they are qualified through their education, training or experience due to their physical or mental health.

Under own occupation TPD, a benefit is only paid if the insured person is unlikely to ever be gainfully employed in their own occupation as a result of the event they have suffered.

Generally, own occupation TPD is more expensive than any occupation although a benefit payment is more likely to occur in circumstances where a claim is made. However, if own occupation TPD is held inside super, clients may find it difficult to have their proceeds released, as the event that triggers the TPD payment may not match the definition of permanent incapacity under the SIS Act.

It's quite a dangerous position to be in, especially if actually suffering some sort of TPD event. This is because the benefit may not be paid out until another condition of release is met, such as reaching preservation age or no longer being gainfully employed.

**Trauma Insurance**

No longer able to be held inside a superfund

**Income Protection**

Income protection insurance offered through super is often referred to as 'group salary continuance insurance'. Proceeds are generally paid as an income stream after a designated waiting period has been met, usually between 30 and 90 days. Disability benefits must be paid under the SIS Act as a non-commutable income stream so that it can be paid to the member or the legal person or representative of that member in certain circumstances.

Previously, superannuation funds were only permitted to claim a tax deduction for premiums relating to income protection policies which provided for a maximum two-year benefit period, and as such most funds only offered this limited type of cover. Recent changes mean that the tax deduction extends to all eligible income protection policies, meaning that clients can elect a longer benefit period, including one which extends until age 65. Holding income protection inside super can be useful for those who don't want to use their disposable income to pay for premiums, which can be quite expensive.

When you compare income protection inside super to income protection outside super the tax outcome is actually exactly the same; you don't have advantages on either. However, you can use your account balance that you already have in super to pay for the premiums for income protection inside super.

However, as super is primarily designed to build retirement savings, this may mean funds offer 'no frills' income protection policies. Whenever a fund trustee offers something through their fund, they need to be aware of the sole purpose test. That means for some insurance policies you may have a pared down version of the policy they would offer outside super just to ensure there are no extra features that may breach the sole purpose test.

For instance, where clients hold income protection outside super, they may be able to gain ancillary benefits that top up a client's income beyond 100% of their pre-disability income, whereas clients may not be able to select or receive these extra benefits where the policy is held through superannuation.

In addition, clients who are unemployed, on sabbatical or maternity leave may not be able to receive benefits under an income protection policy held in superannuation due to the provisions in the SIS legislation regarding payments.

**ADVANTAGES AND DISADVANTAGES**

**Advantages**

The main advantage of insurance inside superannuation is tax efficiency. As premiums are paid from a client's contributions from pre-tax income, and super funds can claim a deduction for most premiums, this is more affordable and less disruptive to a client's cash flow. This means clients are simultaneously getting tax advantages and using less of their gross income to pay for insurance.

One can actually pay for the premium from benefits within the superannuation fund, from SG contributions being made by my employer and I get that additional tax advantage in that those premiums that have been paid are being paid pre income tax.

Another consideration to take into account is that where personal non-concessional contributions are made, clients may also qualify for a Government co-contribution of up to $1,000. This can help compensate for the cost of insurance premiums reflected in a reduced account balance.

The following case study outlines how using a policy within superannuation can make insurance cover more affordable both for clients on a high and a low income.

*Case Study:* Insurance inside versus outside super for high-income earners

David is 42 years old and earns a salary of $85,000 p.a. He wants to take out life insurance so his wife, Helen will be protected in the event that he is to pass away. As Helen meets the definition of a dependant under the Tax and SIS Acts, she would be able to receive this payment as a tax-free lump sum.

The level of cover David would like to take out will require an annual premium payment of $1,200. The amount David pays will differ depending on whether he takes this inside or outside of super.

| | Out | In |
|---|---|---|
| Pre-tax income needed | $1,951 | $1,200 |
| Post-tax income needed (38.5% marginal tax rate) | $1,200 | $ 738 |