

The Association of Superannuation Funds of Australia Limited  
ABN 29 002 786 290  
ASFA Secretariat  
PO Box 1485, Sydney NSW 2001  
p: 02 9264 9300 (1800 812 798 outside Sydney)  
f: 02 9264 8824  
w: [www.superannuation.asn.au](http://www.superannuation.asn.au)



1 July 2011

Manager  
Benefits and Regulation Unit  
Personal and Retirement Income Division  
The Treasury  
Langton Crescent  
PARKES ACT 2600

Email: [superamendments@treasury.gov.au](mailto:superamendments@treasury.gov.au)

Dear Manager,

**RE: Consultation paper – Deductions for the cost of total and permanent disability insurance provided through superannuation**

The Association of Superannuation Funds of Australia (ASFA) would like to lodge this submission with respect to the above Consultation Paper on the Government's initiative to improve the operation of the income tax law for funds that claim tax deductions for the cost of total and permanent disability (TPD) insurance policies

The Association of Superannuation Funds of Australia (ASFA) is a non-profit, non-political national organisation whose mission is to advance effective retirement outcomes for members of superannuation funds through research and advocacy. We focus on the issues that affect the entire superannuation industry. Our membership, which includes corporate, public sector, industry and retail superannuation funds as well service providers some of whom deal with self managed superannuation funds (SMSFs), has over 90% of the approximately 12 million Australians with superannuation as members. ASFA members manage or advise on the bulk of the \$1.3 trillion in superannuation assets as at September 2010. ASFA is the only organisation that represents all types of superannuation funds and associated service providers.

#### **General comments on the Policy**

ASFA supports the proposal to enable superannuation funds to claim deductions for a portion of the cost of certain TPD policies based on percentages prescribed in regulations.

ASFA also supports the inclusion in the regulations of a provision that clearly states that where there is an additional criteria to be satisfied by the member, that criteria may be

disregarded for the purpose of claiming deductions in accordance with the percentages in the table where the additional circumstances are at least as restrictive as those listed in the table.

ASFA understands that the aim of the policy is to remove the requirement for a fund to obtain an actuarial certificate, whilst retaining the right of a fund to obtain an actuarial certificate where it is of the view that the prescribed percentage does not appropriately reflect their particular circumstances.

ASFA notes that the policy driver is to improve the operation of the tax law in this area. In this context, ASFA considers that successful implementation of the policy will require the establishment of percentages that strike a balance such that the majority of superannuation funds will adopt the prescribed percentage and not see a need to go through the not-inexpensive exercise of engaging an actuary in order to achieve a higher deductible percentage.

The task for Government is to ensure that the percentages reflect the types of Death and TPD policies or self-insurance arrangements within the industry and that the percentages are set at a level that reflects industry experience and encourages their usage. ASFA considers that if this is not achieved then the Government's aims for the measures will also not be achieved, as funds would revert to the use of actuarial certification, with all of the resultant administration costs and complexity. To this extent we recommend that loss of limb, inability to perform activities of daily living, domestic duties and cognitive loss be treated as a singular add-on, not cumulative, and that the inclusion of any or all results in the same deductible portion (which ASFA recommends to be 100%).

To this extent, ASFA considers it critical that the percentages be set at levels that the industry will consider likely to be at least equivalent to those that would result from obtaining actuarial certifications, so that the measures are not rendered redundant.

It is anticipated that, with careful design of the deductible portion table, over time the definitions in the table will be reflected in the design of insurance policies and most funds will be able to adopt the prescribed deductible portion percentages.

ASFA notes that the consultation paper is silent on the question of whether the regulations will also apply to funds that self insure, although we understand that this is the intent. ASFA requests that the government's response to the consultation process and the subsequent regulations clearly specify that equivalent treatment applies to both funds purchasing insurance and funds that self insure.

### **Comments on the proposals paper**

ASFA's initial view is that the definitions are incomplete, the proposed table is overly simplistic, the table does not reflect the practical realities of the structure of insurance policies and the deductible portion is set too low.

ASFA also considers that in considering this topic, the opportunity should be taken to address the impracticality of the current requirements for insurer and actuary certification.

Below are detailed comments on each of the above matters.

### **The definitions**

ASFA is concerned at the omission from the table of two common add-ons:

- mental/cognitive loss
- inability to perform normal domestic duties

As these items are included in Regulation 4 of *Income Tax (Transitional Provisions) Regulations 2010*, which sets out a variety of TPD circumstances for the purposes of the transitional relief applicable until 30 June 2011, it seems logical that they would also be included in the new regulations.

It should be noted that for some funds, either or both of these are included in the *inability to perform activities of daily living insurance* definition:

### **The structure of the table**

ASFA is concerned that the structure of the table assumes that a TPD insurance policy is a stand alone policy with or without add-ons. In fact, many policies are composite policies providing death, terminal medical condition, TPD and add-on cover with no split between the components.

Additionally, even where the insurance policy provides a split between the components, the split premiums are generally not reflected in administration systems which would typically only hold the combined premium.

This leads us to the conclusion that to be effective in achieving the policy objective the table needs to facilitate the determination of the deductible portion with respect to the full possible ranges of composite policies.

To this extent we are surprised that *inability to perform activities of daily living* is only listed in the table as a stand alone item. In practice, this definition is often included in combination with the any (or own) occupation definition and loss of limbs. The reason for the inclusion of the 'daily living activity' definition in a group life policy for a superannuation fund is to cover those superannuation fund members who are either not working or are working on a casual basis only. In this context, while the definition might be applied on a stand alone basis with respect to those members, the policy with such a definition is not purchased on a stand alone basis. Also in this context, in many policies

the definition includes the rider "... and is unlikely ever to work in any occupation for which the member is so qualified....".

Technically, there is a need to structure the table such that it covers, as far as is possible, the typical insurance arrangements that exist across the industry.

ASFA has identified ten broad policy groupings and 40 policy combinations that we consider would cover the majority of the insurance arrangements in the industry. It should be noted that we have assumed that mental/cognitive impairment and domestic duty definitions are included in the daily living activity definition:

Group 1

Death plus any occupation (100%)  
Death plus any occupation plus loss of limbs  
Death plus any occupation plus loss of limbs plus daily living activities  
Death plus any occupation plus daily living activities  
Death plus daily living activities plus loss of limbs  
Death plus daily living activities

Group 2

Death plus terminal medical condition plus any occupation (100%)  
Death plus terminal medical condition plus any occupation plus loss of limbs  
Death plus terminal medical condition plus any occupation plus loss of limbs plus daily living activities  
Death plus terminal medical condition plus any occupation plus daily living activities  
Death plus terminal medical condition plus daily living activities plus loss of limbs  
Death plus terminal medical condition plus daily living activities

Group 3

Death plus own occupation (100%)  
Death plus own occupation plus loss of limbs  
Death plus own occupation plus loss of limbs plus daily living activities  
Death plus own occupation plus daily living activities

Group 4

Death plus terminal medical condition plus own occupation (100%)  
Death plus terminal medical condition plus own occupation plus loss of limbs  
Death plus terminal medical condition plus own occupation plus loss of limbs plus daily living activities  
Death plus terminal medical condition plus own occupation plus daily living activities

Group 5

Any occupation (100%)  
Any occupation plus loss of limbs  
Any occupation plus loss of limbs plus daily living activities  
Any occupation plus daily living activities

Group 6

Any occupation plus terminal medical condition (100%)  
Any occupation plus terminal medical condition plus loss of limbs  
Any occupation plus terminal medical condition plus loss of limbs plus daily living activities  
Any occupation plus terminal medical condition plus daily living activities

Group 7

Own occupation  
Own occupation plus loss of limbs  
Own occupation plus loss of limbs plus daily living activities  
Own occupation plus daily living activities

Group 8

Own occupation plus terminal medical condition  
Own occupation plus terminal medical condition plus loss of limbs  
Own occupation plus terminal medical condition plus loss of limbs plus daily living activities  
Own occupation plus terminal medical condition plus daily living activities

Group 9

Daily living activities  
Daily living activities plus loss of limbs

Group 10

Daily living activities plus terminal medical condition  
Daily living activities plus terminal medical condition plus loss of limbs

ASFA concedes that the above looks cumbersome and later in this submission addresses ways in which the table could be considerably simplified through the making of some sensible decisions in relation to both the structure of the regulations and the specified percentages.

**The percentages**

*Daily living activities add-ons*

ASFA has particular concerns with the percentage proposed for the daily living activities add-on.

The consistent message that insurers give to fund trustees is that there is no additional premium incurred by including this add-on. Inclusion of the add-on does not result in a noticeable increase in risk to the insurer. The inclusion is mere window dressing on the policy designed more for the benefit of any rating agencies that may publish a view on the fund and its features.

This view is backed up by information provided by ASFA member funds currently providing this add-on to members. Their advice is that in all but a very few instances, claims are decided on either the any occupation definition and without resort to the daily living activities definition.

The consensus view is that where this add-on exists as part of a TPD only policy (i.e. no death cover), the deductible percentage should be in excess of 99% and generally 100%

is the appropriate figure.

Significantly, the ATO in its Draft Tax Ruling 2010/D9, states that, in its view, persons with disabilities impeding their capacity in respect of daily living activities will almost always be TPD within the usual definition. The ATO also came to the same conclusion with regard to the specific *inability to perform domestic duties* risk.

ASFA considers that the advice from insurers and funds, and the support for this view given by the ATO in its draft ruling, is sufficient reason to specify as 100% the deductible portion of an 'any occupation' TPD policy with either or both of those exclusions.

We are also aware that many policies provide a combined policy including death, any occupation, loss of limbs, daily living activities and terminal medical condition provisions for most members however the any occupation definition is removed for those who are working less than 15 hours a week, are working casually or are not in the workforce.

#### *Loss of limbs*

Information provided to ASFA indicates that an appropriate deductible portion for this add-on is very small (perhaps 1% or less). We note that insurers will generally not reduce premiums if such a definition is removed from a policy. In effect it is a no-cost add-on. As such we expect that actuaries and insurers would be able to certify a policy with any occupation and loss of limbs as 100% deductible.

#### *Own occupation policies*

A separate issue is the deductible portion of an own occupation TPD policy.

ASFA agrees that the deductible portion should be less than 100%. We are also of the view that while for some funds 60% or a lower portion may be appropriate (e.g. certain extreme occupations (such as police, other emergency service workers and military personnel), for most funds the portion should be greater than 60%.

Apart from police and other emergency service workers, military personnel and a few other occupations (perhaps airline pilots and teachers who might mentally lose the nerve to stand in front of classroom), it is difficult to arrive at examples of other industries or jobs where the own occupation distinction is of actual practical importance. ASFA considers that, outside of that limited range of occupations, it would be reasonably rare that a disability would be such that it removed the person's ability to work in their own occupation but would not also make it:

....unlikely that the person can ever be gainfully employed in a capacity for which he or she is reasonably qualified because of education, experience or training.

ASFA recognises that the challenge for the Government is in setting a rate such that it achieves the policy objective of simplifying the operation of the provisions (that is encourages funds to adopt the deductible portion of premium percentage) without being overly generous such that there is a significant cost to revenue.

ASFA considers that, due to the variety of occupations and the requisite skills for those occupations there is no right answer to the question of what is the correct deductible portion of premium for an own occupation TPD policy. The task therefore becomes one

of 'best fit'. That is, what is the figure that will best achieve the policy outcome of simplifying the administration of the provision for the most funds.

Discussions that ASFA has had with insurers indicates that for most TPD-only policies the loading for an own occupation definition is between 25% and 40%, with the actual figure depending on the occupations of the members covered by the policy. This suggests that an appropriate deductible portion of the premium for a TPD own occupation policy should be somewhere in the range of 70% to 80%

ASFA acknowledges that the correct deductible portion for some occupations may be less than this 70% to 80% range. However, ASFA would not support the creation of a range of occupationally-based percentages as this would run counter to the aims of the measure, being simplicity and ease of administration, particularly as the industry consolidates and the range of occupations of fund members' within a single fund increases

ASFA notes that those occupations where the correct deductible portion may be less than we are recommending be set are typically in critical public sector occupations such as police, emergency service workers and military. As such, the Government would need to then take into account that the costs associated with any additional loss of deduction would be borne by these critical employees, or by their State and Federal Government employers.

A separate issue that needs to be mentioned here, but not fully addressed, is the issue of revenue leakage due to poor claims management by funds. That is, the fiscal impact where policy definitions are not strictly applied and cases not appropriately managed. ASFA considers that this issue should not form part of the debate around what is an appropriate percentage but is a separate issue to be addressed by ATO compliance programs.

In conclusion on the issue of own occupation policies, it is noted that, by retaining the option to obtain actuarial certification, funds have the opportunity to seek another answer should they consider the deductible portion of premium listed in the regulations to be too low.

#### *Absence of 2 medical certifications*

ASFA is aware of a small number of funds whose definition of TPD is broadly in accordance with the definition in section 995-1 of the *Income Tax Assessment Act 1997* ("ITAA97"), but where the claim requirements within the fund's rules requires only 1 medical certification rather than the two specified in section 995-1.

Many insurance policies also do not refer to the need for 2 medical certifications but rely on the insurer to assess the claim based on the available evidence.

The Consultation Paper is silent on the extent, if any, of the reduction in the deductible portion of premiums (or in the otherwise available self-insurance deduction) in these circumstances.

Noting that the daft ATO ruling (at paragraph 141) indicates that the policy/rules do not need to specify certification by 2 medical practitioners, ASFA considers that this issue

should be addressed by the regulations so that it is clear whether a scale back is required in these circumstances, and if so, the quantum of such scale back.

*Suggestions for table format*

In the interest of simplicity and ease of application ASFA suggests the following be considered when formatting the table listing the policy type and of deductible portion of premium:

- That consideration be given to the inclusion of two tables, one for the primary events (Death, terminal medical condition, any occupation TPD and own occupation TPD) and a separate table for the add-ons (loss of limb, inability to perform activities of daily living, domestic duties and cognitive loss plus any other add-ons identified in other submissions as being commonly used in the industry).
- That the regulations include a provision that in determining the final deductible portion, the deductible portion for a primary event is first reduced by 100 minus the deductible proportion of the add-on.
- That a note be added to the table to the effect that where a policy is a composite, or bundled, policy and the premium split has not been specified (either in the policy or otherwise) for a listed event, and the policy includes both death and TPD and or terminal medical condition cover and or add-ons, the deductible portion of the total premium is set at 50% of the sum of the deductible portions. (For example where the policy is death plus any occupation and the any occupation deductible portion in the table is 70% the deductible portion would be 85% (50% of 100 + 70).
- That loss of limb, inability to perform activities of daily living, domestic duties and cognitive loss be treated as a singular add-on, not cumulative, and that the inclusion of any or all results in the same deductible portion (which ASFA recommends to be 100%).

Adoption of the above suggestions could result in the following structure. Note that the percentages in the table are for illustrative purposes only and, for example do not represent our view that loss of limbs coverage should also be 100% deductible:

**Table 1 primary events**

<b>Event</b>	<b>Deductible portion of premium</b>
Death	100%
Any occupation TPD	100%
Own occupation TPD	75%
<b>Percentages used in the tables are for illustrative purposes only</b>	

Note 1

In determining the final deductible portion, the deductible portion for a primary event is first reduced by 100 minus the deductible proportion of an add-on that is specified in Table 2:

Note 2:

Where a policy is a composite, or bundled, policy and the premium split has not been specified (in the policy or otherwise) for a listed event, and the policy includes more than one event in Table 1, the deductible portion of the total premium is set at 50% of the sum of the deductible portions. (For example where the policy is death plus own occupation plus loss of limbs the deductible portion is 87%:

$$((100 + (75 - (100-99)) / 2 )$$



**Table 2      inclusions (add-on events)**

<b>Event</b>	<b>Deductible portion of premium</b>
One or more of inability to perform activities of daily living, domestic duties, cognitive loss	100%
loss of limb	99%
<b>Percentages used in the tables are for illustrative purposes only</b>	

**Note 1**

Where the policy includes an item in Table 2, in determining the final deductible portion for an item listed in Table 1, the deductible portion for the primary event listed in Table 1 is first reduced by 100 minus the deductible proportion of the item as specified in Table 2:

The above proposal would need to be modified slightly where the policy includes death and loss of limbs and daily living activities without an any or own occupation definition.

ASFA considers that using the above format would simplify the process, cater for both composite and stand alone policies, facilitate the consideration of additional add-ons that may emerge in policies. Additionally, by arriving at a single deductible percentage for a composite policy it would remove the need for funds to redesign administration systems to cater for split premiums. However, as indicated above, our recommended approach is that loss of limbs coverage be also 100% deductible particularly as we expect that many funds will be able to obtain actuarial certification or specification by the insurer of such deductibility.

This would not only simplify the table but would also remove the need for most funds to make significant modifications to administration systems which would otherwise be necessary to pass the relevant value of any loss of tax deduction to each member where the loss is such a low proportion of the premium.

**Requirements for actuarial and insurer certification**

The requirements for actuarial certification are considered to be somewhat impractical.

The key concern raised by actuaries is the requirement for the actuary to certify a dollar amount. The actuary is prohibited from specifying a percentage. The effect of this is that the certificate cannot be prepared until after the end of the relevant financial year.

ASFA is of the firm view that much greater flexibility needs to be allowed in both the timing of the report and its format.

Similarly the requirement for the insurer to specify the deductible amount/portion in the insurance policy is considered to be somewhat impractical.

Rather than require the amending of the policy, ASFA urges that more practical alternatives be identified and included in the provisions. One such alternative could be to permit the insurer to issue a letter to the trustee in respect of the policy and containing the prescribed information. This is particularly important where the policy covers both death and own occupation.

For compliance purposes, the ATO would have access to the letter and the capacity to

validate with the insurer the basis on which the advice was made.

ASFA would appreciate clarification of the question as to whether the provision of the actuarial certificate and the letter from the insurer constitutes tax advice for the purposes of the Tax Agent Services Act.

Should you have any questions on any of the matters raised in this submission please contact our Principal Policy Adviser, Robert Hodge, on 02 8079 0806.

Yours sincerely

A handwritten signature in black ink, appearing to read 'D. Graus', written in a cursive style.

David Graus  
General Manager, Policy & Industry Practice