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12 August 2011

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

Email: superamendments@treasury.gov.au

Dear Manager,

RE: Draft Regulations – Streamlining Deductions for the Cost of Disability Insurance through Superannuation

The Association of Superannuation Funds of Australia (ASFA) would like to lodge this submission with respect to the Draft Regulations designed to streamline the process for claiming tax deductions for the cost of total and permanent disability (TPD) insurance provided through superannuation.

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, plus self managed superannuation funds (SMSFs) and small APRA funds through its service provider membership, represent over 90% of the 12 million Australians with superannuation.

General comments

As stated in our submission to the Consultation Paper dated 1 July 2011, ASFA supports the proposal to enable superannuation funds to claim deductions for a portion of the cost of certain TPD policies based on prescribed percentages. We are supportive of the removal of the requirement for funds to obtain an actuarial certificate, whilst still giving funds the option of doing so where they are of the view that the prescribed percentages do not appropriately reflect their particular circumstances.

We are pleased that Treasury has listened to feedback and incorporated many of our suggestions into the drafting of the regulations, including:

- Inclusions for any or all of loss of limb, cognitive loss and the inability to perform activities of daily living resulting in the same deductible portion as the base or primary TPD definition they are attached to.
- The inclusion of a definition for 'cognitive loss' within the Draft Regulations.
- Clear specification that the Draft Regulations also apply to funds that self-insure.
- Increases to some of the deductible portion percentages.

However, whilst the percentages in the Draft Regulations are a considerable improvement over those in the Consultation Paper, ASFA's view is that there are still a few areas of concern. These are discussed below.

Specific comments on the Draft Regulations

(i) Own occupation percentage

In ASFA's view the 'TPD own occupation' percentage (67%) is still too low. As stated in our 1 July 2011 submission, we agree that the deductible portion should be less than 100%, however we believe that an appropriate deductible portion for a TPD own occupation policy should be somewhere in the range of 70% to 80%.

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 (i.e. that encourages funds to adopt the deductible portion of premium percentage) without being overly generous such that there is a significant cost to revenue.

However, discussions that ASFA has had with insurers indicate 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%.

That said, we do 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. On this basis, and recognising that there is no right answer to the question of what is the correct deductible portion for TPD own occupation policies (given the variety of occupations and the requisite skills for those occupations), ASFA's view is that an appropriate (i.e. 'best fit') TPD own occupation deductible percentage is somewhere closer to 75%.

(ii) Issues regarding the definitions

Feedback received from ASFA's Insurance sub-committee is that there is an issue with the definition of 'activities of daily living' being a lot tighter than the industry average, which to a degree invalidates the 100% deductibility percentage for funds that apply a broader definition. For example:

- Some funds include as one of the 5 conditions for activities of daily living the individual's capacity to use the toilet, whereas the comparable condition in the 'activities of daily living' definition in the Draft Regulations is "continence, to the extent of being able to control bowel and bladder function".
- Similarly, the Draft Regulations define mobility as being determined with reference to a person's ability or otherwise to "…move from place to place without using a wheelchair", whereas some funds also include the use of walking frame in their definition (as opposed to just a wheelchair).

ASFA's view is that the definition of 'activities of daily living' in the Draft Regulations is too restrictive in its current form and needs to be broadened to ensure that common definitions currently used by the majority of funds to assess a person's ability to perform activities of daily living are not excluded.

For example, the definition of 'activities of daily living' could be amended to "…an additional component of a disability insurance policy that insures against a disability that results in a member's total and irreversible inability to perform at least 2 basic activities of daily living without the assistance of another person. Examples of these are set out below… ".

Also, we note the following issues with respect to the definition of 'bundled' in the Draft Regulations:

- Paragraph (a) does not appear to be tight enough – even if an insurance policy specifies a single unit rate for death and TPD or a single set of age rates (which is common), funds can usually obtain underlying death only rates from their insurer and calculate separate TPD rates by subtraction. In such situations, where the death and TPD rates are not (but can easily be) separately identified, is the policy deemed to be bundled or unbundled?
- Paragraph (b) also appears to be problematic. If an individual is underwritten and declined for TPD cover above the fund's Automatic Acceptance Limit (AAL) but accepted for death cover for the higher amount, the amount payable to the insured person will be different for death and for TPD under the policy. Does this mean the whole group policy is no longer bundled?

ASFA's view is that the definition of 'bundled' needs to be amended to clarify that, where the combined TPD and death (life) premiums are included in the policy, the premiums can be treated as bundled. If such situations cannot be treated as bundled, this will result in significant system changes and additional administration costs for the industry.

Finally, we note that a definition for 'home duties' has been omitted from the Draft Regulations. As with 'cognitive loss' (which has been included), this common add-on is included in Regulation 4 of the *Income Tax (Transitional Provisions) Regulations 2010*, which sets out the variety of TPD circumstances for the purposes of the transitional relief applicable until 30 June 2011. It therefore seems logical to also include a definition for 'home duties' in the new regulations.

(iii) Absence of 2 medical certifications

'TPD any occupation' is defined in the Draft Regulations as "…insurance against the liability to provide benefits within the meaning of a disability superannuation benefit in the Act". Disability superannuation benefit continues to refer to two medical certificates specifying the required level of disability. This is different to the definition used for explanation in the original Consultation Paper, which was much more aligned with the usual definition of TPD in insurance policies.

As identified by ASFA in our 1 July 2011 submission on the Consultation Paper, insurance policies generally do not define TPD by reference to two medical practitioners. Rather, they generally rely on the insurer to assess the claim based on the available evidence. We note that draft sub-regulation 295-465.01(2) allows a deduction if the conditions in the fund's insurance policy are at least as restrictive as in the definitions that apply in the Draft Regulations. It could be argued that not requiring two medical certificates in all cases is less restrictive, in which case many funds' policies would not meet the definition of 'TPD any occupation'.

Our understanding is that this problem also affects funds that self insure. Based on advice received from our members, very few (if any) self insured defined benefit funds have a definition of TPD which requires a specific number of medical certificates to be obtained, regardless of the nature of the disability.

Noting that the draft ATO ruling (at paragraph 141) indicates that the policy/rules do not need to specify certification by two 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.

(iv) Issue regarding the "at least as restrictive" requirement

In addition to the specific issue raised in section (iii) above regarding the requirement for two medical certificates, ASFA's view is that draft sub-regulation 295-465.01(2) is problematic in a more general sense. The reason being, in order for funds to be able to use the deductible percentages set out in the Draft Regulations, the definitions in their insurance policies must be "at least as restrictive" as the relevant definitions in the Draft Regulations in all instances.

ASFA contends that very few funds will be in a position to comply with this requirement, particularly given the restrictiveness of many of the definitions in the Draft Regulations (as discussed previously). This will result in a significant reduction in the ability for funds to adopt the new simplified approach, which in our view is not the intention of the Government's proposal to streamline the process for funds claiming deductions for the cost of TPD insurance provided through superannuation.

We believe that the "at least as restrictive" requirement is overly onerous and should be replaced with more flexible terminology. For example, ASFA is aware of the work that Mercer have done in respect of this issue and we are supportive of their recommendation in relation to possible alternative wording to replace "at least as restrictive" in sub-regulation 295-465.01(2). Alternatively, if the "at least as restrictive" terminology is not amended, it may be appropriate to 'grandfather' existing policies in order to minimise the potential negative impact of this requirement.

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Should you have any questions on any of the matters raised in this submission please contact our Policy Adviser, Jon Echevarria, on 02 8079 0859.

Yours sincerely

David Graus
General Manager, Policy & Industry Practice