Did you know?

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Death is certain – but is it guaranteed?

One of the issues facing elderly clients (and their advisers) is mortality and investment risk. In other words, uncertainty about how long an investment will continue, together with its volatility, may lead clients and advisers towards cash or 'non-growth' investments, regardless of whether these investments are to be used as an income stream or left as a legacy to beneficiaries. Is there an alternative?

CommInsure's Investment Growth Bond (the bond) is generally a longer term tax-effective investment. However, as a life insurance product, it also has advantages in the areas of estate planning and wealth transfer, again, in a tax-effective manner. One of these advantages is the bond's Death Benefit Guarantee, which we understand is unique in the industry.

The Death Benefit Guarantee

CommInsure guarantees that if the last surviving life insured dies on or prior to his or her 99th birthday, it will pay the greater of the following amounts as at the day all its claim requirements are met:

a) The cash value of the bond. (The cash value is the number of units held in the bond multiplied by the unit price applicable at the relevant date).

OR

b) The total value of all deposits less any withdrawals that have occurred. (Deposits are the initial contribution plus any subsequent contributions, less any contribution fees paid on each deposit. Withdrawals include any fees that have been deducted.)

Example:

a) 50,000 units x $2.50 unit price = $125,000

OR

b) $120,000 (initial contribution less contribution fees) + $50,000 (additional contribution less contribution fees) - $10,000 in withdrawals = **$160,000**

In the above example, CommInsure would pay $160,000 as the greater of the two amounts. The $35,000 difference represents the Death Benefit Guarantee.[1]

How could this Death Benefit work in practice? Take Mary, a 78-year old widow, who has a lump sum of $500,000 to invest. Apart from this lump sum, Mary has other investments to draw on to cover her living expenses. Mary has a life expectancy of 11.35 years[2], and has a conservative investment risk profile. She also has two adult children, whom she consults regarding her investments, and five grandchildren. In reality, her children would like Mary to have a more aggressive investment risk profile – as they are likely to inherit this asset upon Mary's death – but they understand that a growth investment would be subject to a downturn in the economy, potentially leading to a loss of capital, which may not be recouped if Mary died prematurely.

[1] Page 16, CommInsure Invest Growth Bond Product Disclosure Statement, preparation date: 12 February 2010
[2] Australian Life Tables, 2005-07

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After discussing her situation with her financial adviser and her family, Mary decides to invest her $500,000 in growth investment options of CommInsure's Investment Growth Bond. If Mary meets or exceeds her life expectancy, the likelihood is that an investment in growth assets will generally outperform conservative or defensive investments over the long term. If Mary unfortunately dies soon after the commencement of her bond investment (or in fact anytime), the de facto guarantee of capital under the bond's Death Benefit Guarantee will ensure that any market downturn since commencement will not affect Mary's capital and the proceeds will pass to her beneficiaries or estate tax free, thus providing both her and her beneficiaries with peace of mind.

In addition, the Death Benefit Guarantee provides a living benefit to some of our older clients. If the last surviving life insured reaches his or her 99th birthday, the bond owner may request a full withdrawal of the bond and the Death Benefit Guarantee would still apply. The effective date of the Death Benefit Guarantee calculation will be the date of the last surviving life insured. Where the last surviving Life Insured dies after his/her 99th birthday, the cash value of the bond will be payable. The Death Benefit Guarantee does not apply.

Estate planning

How should Mary structure her bond investment? Here Mary has a number of options, and her choice would depend on her estate planning wishes, as follows:

1. If Mary is happy to pass on the bond proceeds to her two children, she may nominate them as bond beneficiaries in equal shares, and they will receive the proceeds tax free as a result of Mary's death, regardless of whether the 10-year eligible period has been satisfied, and these proceeds would not generally be subject to challenges to Mary's estate.

2. If one of Mary's children has a marriage at risk and she requires a level of asset protection from a current or future spouse, Mary may decide to be both sole life insured and policy owner within the bond, thereby leaving the proceeds to her estate and including the creation of a family trust in her will, for the benefit of her child and family.

3. If Mary's children are fighting and bickering over her future estate, or if in fact she wishes to disinherit one of her children, but nonetheless provide for her grandchildren, she may decide to set up the bond as a series of child advancement policies. Under these policies, Mary would be the bond owner and each grandchild would be the life insured. Ownership would automatically transfer to the grandchild at a stipulated age (any age from 10 to 25), without capital gains tax consequences and without incurring any fees or charges.

Use of insurance/investment bonds has also received increasing focus recently with the introduction of superannuation caps on non-concessional contributions and continuing tax implications for superannuation death benefits paid to non-dependants such as adult children.

The decision for clients, particularly upon the death of a spouse, is either to keep investments within the more tax-effective superannuation environment and risk a tax of up to 31.5 per cent on proceeds paid to non-dependants (if there is an insurance component), or to deposit funds into a bond, leave proceeds tax free to any beneficiaries, bypass the deceased's estate, and with CommInsure's Investment Growth Bond – have a guarantee on capital.

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