

Friendly society financial product offerings

Investment Bonds (also known as 'Insurance Bonds or '10-year Bonds')

An investment bond is a type of life insurance policy and is provided by either a friendly society or life office that is registered with the *Australian Prudential Regulation Authority* (APRA). A friendly society bond is subject to benefit fund rules approved by APRA.

Friendly societies (as well as life offices) have a long history of offering this product as a tax-concessional and medium to long-term investment to help meet various 'life-event' situations.

An investment bond does not 'distribute' regular income to the investor. Instead, growth is allocated to the investor's bond account periodically (either each year as "bonuses", or daily if the bond's value is expressed as a unit price), and the growth is effectively reinvested to achieve a compounding effect. This means that the investor is not taxed on the growth annually (provided no amount is part-withdrawn each year). Instead, the friendly society is taxed on bond growth at the corporate tax rate (currently 30%). Regular bond growth will therefore not affect the investor's taxable income. Normally after 10 years, any bond growth component in a withdrawal (or part-withdrawal) will be tax-free in the investor's hands.

Even in the case of a withdrawal within 10 years – when the bond investor is normally assessed for tax on the growth component - a compensating tax rebate (currently at 30%) will be attracted, to offset the impact of tax already paid at entity level.

If a bond withdrawal occurs in certain circumstances such as death, accident, disability or financial hardship, the growth component will be tax-free in the investor's hands, even in the case of a withdrawal within 10 years.

The on-going tax shelter for the investor while the bond continues to be held, and also the ability to switch between investment options without any personal tax impact, means the bond operates very much like superannuation. However, a bond is not locked away like superannuation, as it can be withdrawn at any time, and for any purpose, subject to the tax implications noted above. Also, unlike superannuation, nominated beneficiaries under a bond investment can be anyone, including adult or working children, wider family members, etc. Further, payments are tax free in the hands of the nominated beneficiaries.

A bond can also be assigned (or have its ownership transferred) from the investor to another investor, without necessarily creating any a tax event for the first investor.

Another important feature of investment bonds is that the investor can make contributions in each subsequent year of up to 125% of the previous year's contributions without re-commencing the 10-year tax period (ie. if \$10,000 is invested in year one, \$12,500 may be invested in year two, and so on).

A popular estate planning feature of a bond is that it can continue to be held after the lifetime of the investor, if the nominated 'life insured' under the bond survives the investor. In such a case, it would continue to be held by the trustee of the investor's estate.

Also, under current bankruptcy laws, where the 'life insured' is the investor or the investor's spouse, any bankruptcy affecting the investor will generally protect both the bond and its proceeds from creditors.

The bond is arguably one of the most flexible investment products in Australia, enjoying unique arrangements under different laws – and is designed to encourage medium to long-term savings for any purpose.

Education Savings

An education savings plan (or 'scholarship plan') is also a type of life insurance policy, which can only be provided by a friendly society that is registered with APRA and is subject to benefit fund rules approved by APRA.

Modern education savings plans have been offered by friendly societies since the 1970s, and have encouraged parents and grandparents to set aside savings with the specific purpose of meeting the future education expenses of nominated student children and grandchildren.

The friendly society providers of education savings plans are prudentially regulated by APRA and their product disclosures are regulated by the *Australian Securities and Investments Commission* (ASIC).

Friendly societies have been very active in working together with educational institutions, to help promote the discipline of education savings and to act co-operatively to provide education benefits for nominated children – for primary, secondary and tertiary education.

Industry research indicates that over 90% of Australian children undertake some form of post-secondary education. However, this participation rate does not mean sufficient savings are set aside to realise the full educational potential of our children – such as advancement to appropriate courses of further study, taking advantage of the option to pay discounted up-front fees, choosing timely overseas electives, etc.

During the past 30 years, over a 324,000 education savings plans have been established by friendly societies for Australian students – representing some \$1.5 billion of funds under management.

Funeral Bonds

A funeral bond is also a type of life insurance policy, which can only be provided by a friendly society that is registered with APRA and which is subject to benefit fund rules approved by APRA.

Funeral bonds have long been offered by friendly societies and are designed to help their individuals to set aside monies for the purpose of meeting their future funeral expenses. Benefits payable under a funeral bond are only payable on death and must be used towards meeting funeral expenses. Most bond rules allow residual proceeds (after meeting funeral expenses) to remain in the estate of the bondholder.

Although it doesn't have to be, a funeral bond can be used in conjunction with a pre-paid funeral plan entered into with a funeral director. Under such an arrangement, a funeral director is normally given entitlement to receive full bond proceeds upon death, in exchange for fixing the price of the future funeral.

Like an investment bond, on-going bond growth is not taxed in the hands of the bondholder.

The tax rules were amended for new funeral bonds issued from 1 January 2003, so that the growth component of bond proceeds are -

- (a) assessable in the hands of the estate, in the year of payout (after death) – in the case of a bond that is *not* involved with a pre-paid funeral; and
- (b) non-assessable in the hands of the estate, in the year of payout (after death) – in the case of a bond that *is* involved with a pre-paid funeral.

A funeral bond normally also enjoys exempt status for a person who receives a means-tested pension or other benefit from Centrelink or the *Department of Veterans Affairs* (DVA).

The means test rules require certain exemption conditions to be met. Among them is the requirement that total contributions not exceed a prescribed amount, which is \$5,000 up to 31 December 2007, and is \$10,000 from 1 January 2008 (and subject to annual indexation every 1 July thereafter). An exception applies to a bond where a funeral director will be entitled to proceeds, in conjunction with a pre-paid funeral, in which case, no maximum limit applies.

Income bonds

An income bond is also a type of life insurance policy, but can only be provided by a friendly society that is registered with APRA and which is subject to benefit fund rules approved by APRA.

An income bond is very much like an investment bond, only that growth distributions are taxed in the investor's hands each year. There is no 10-year tax rule, and further contributions are not limited to the 125% ceiling.

Note:

The product summary information set out above is based on a general understanding of relevant laws and guidelines that are believed to be currently applicable. It does not represent 'financial product advice' as defined by the Corporations Act 2001 (as amended by the Financial Services Reform Act 2001), and no specific financial product is recommended. AFSA would encourage appropriate and independent professional advice be obtained before making any decisions based on the summary information above.