



Friendly Societies
of Australia

Review of WA code of practice for pre-paid funerals – Submission of the FSA

11 July 2018

www.friendlysocieties.org.au



Executive Summary

- The draft new WA Government code of practice for pre-paid funerals contains inconsistencies with existing federal government (Commonwealth) legislation.
- The draft code appears to cover funeral investment being placed in a funeral bond and it defines a financial product as being a financial product under the Corporations Act 2001, yet funeral bonds or funeral benefits are specifically not deemed to be financial products under the Corporations Act 2001.
- The process of developing a new code of practice must avoid duplication and unnecessary additional regulation and administration for friendly societies on the basis that friendly societies are already highly regulated under the Australian Prudential Regulation Authority's prudential standards regime.
- To reduce the risk of consumer/client detriment surrounding cooling-off periods, payment of the funeral investment amount to the investment manager should take place within seven days, regardless of the cooling-off period.
- The proposed draft definitions of "funeral services" and "memorials" are too prescriptive and they should be consistent with the existing definition of funeral expenses according to the Australian Taxation Office.
- To meet the requirement for the sole-purpose test for funeral bonds/pre-paid policies, early release of funeral investments should not be permitted.
- Should a pre-paid funeral contract be cancelled at any time (other than in the cooling-off period), the funds would remain invested, but would be assigned directly to the client, rather than being assigned to the funeral provider.
- The treatment of GST under a pre-paid contract is the subject of GST law which requires any GST must be paid at the time of signing the contract.

Members of the Friendly Societies of Australia (FSA)



Introduction

On behalf of the friendly societies industry, the FSA is pleased to provide the following submission to be considered as part of the consultation the Government of Western Australia is conducting (through the Department of Mines, Industry Regulation and Safety) to develop a new code of practice for pre-paid funerals in WA.

Many organisations in the friendly societies industry, which has been in existence for over 150 years, continue to be member-owned mutual organisations, with members or customers at the forefront of our thinking, together with consumer protection.

Therefore, the FSA supports the focus and intention of the development of a new code of practice.

About the FSA

The FSA is the industry association representing Australia's friendly societies regulated by the Australian Prudential Regulation Authority (APRA).

Friendly societies in Australia provide financial services to more than 800,000 members. Collectively, our industry manages approximately \$7 billion in funds and annually, more than \$675 million in benefits are paid out by friendly societies.

Our members offer financial products for life events, including investment bonds, scholarship plans for school education, higher education and training, funeral bonds and risk insurance.

About funeral bonds

Funeral bonds are investment bonds where tax on earnings is paid from money in the bond fund, but without specified limits on contribution amounts, other than for means-testing for social security pensions and a "reasonable purpose" limitation (where the amount of the bond is paid only on the death of the bond-holder).

All funds are paid on behalf of the estate to a nominee or directly to the estate or to a funeral director via assignment. Generally, tax is payable by the estate – on the assessable earnings component of proceeds received (which is grossed-up to its pre-tax value under a tax concession) – or tax is payable by the funeral director on proceeds received.

Funeral bonds and funeral insurance are not the same – if a consumer invests in an account-based and non-risk funeral bond, they will receive funds when the term of the bond expires, however, for most funeral insurance policies, ongoing payments are required if funds are to be received.

Applicability of the code to investments in funeral bonds and friendly societies

On behalf of its members, the FSA has reviewed the draft new code of practice, a process which has identified inconsistencies between its content and the regulatory environment for friendly societies, notably federal government (or Commonwealth) legislation.

The FSA is unsure about the applicability of the draft new code to investments in funeral bonds made with a friendly society. While some sections of the draft code appear to be

giving consideration to the funeral investment being placed into a funeral bond – in particular, Section 14 (b), which specifically refers to “a friendly society as defined in the Life Insurance Act 1995 (Commonwealth)” section 16C – other sections seem to contradict this.

In section 2 of schedule 1, division 1, “financial product” is defined as a “financial product (which) has the meaning given in the Corporations Act 2001 (Commonwealth) section 763A”.

While this section does provide a general definition of a financial product, a funeral bond or funeral benefits are specifically deemed to not be a financial product under section 765A(w) of the Corporations Act 2001.

Appropriate regulation

It is the submission of the FSA that during this reform process, the WA Government considers the potential for duplication of regulation of funeral bonds, given investments in funeral bonds through friendly societies are already highly regulated under the APRA prudential standards regime.

The outcome of a recent review of a similar code of practice in NSW resulted in an exemption for friendly societies from having to comply with the code on the basis that existing prudential regulation was stringent enough. The NSW Government concluded that introducing a second, separate regulatory regime was unnecessary and would place an unfair administrative and compliance burden on the friendly societies industry.

When considering reform in this policy area, the WA Government should be mindful of implementation of recommendations made in the Wallis financial system inquiry in the 1990s where regulation of all friendly societies (that offer funeral bonds and other financial products) was transferred from the states/territories to the Commonwealth (on 1 July 1999). From 1 July 1999, friendly societies had to be registered under the Corporations Act 2001 and be prudentially regulated by APRA.

Cooling-off period

The definition of the cooling-off period in the draft new code of practice refers to the period “starting when the client signed the contract; and ending on the day that is 30 days after the day (the) client is given a signed copy of the contract”.

Section 7 (2) of division 2 refers to the timeframes in which the funeral investment must be lodged with an investment manager. It appears that what is being proposed is the funeral investment would be held by the funeral provider for at least 30 days during the cooling-off period prior to lodging with the investment manager, but for another pre-payment, the funeral investment must be paid within seven days.

This approach appears inconsistent between the two types of payments being received from the client. While the intention of retaining the funds during the cooling-off period appears reasonable, it may put the security of those funds at risk and therefore, this raises the potential for consumer and/or client detriment.

Funeral bond products also have a cooling-off period – usually 30 days – and in practice, funds are generally received from the funeral provider as soon as they are received from the party who is contributing to the cost of the funeral. Should there be a cooling-off of the pre-paid contract, friendly societies are able to provide a refund within the cooling-off period and therefore, a consistent approach of payment of the funeral investment

amount to the investment manager within seven days, regardless of the cooling-off period, is more appropriate.

Definition of funeral services and memorials

The definitions of “funeral services” and “memorials” in the draft new code of practice appear limited and do not reflect the extent of services that may be delivered by a funeral provider under a pre-paid contract, nor give scope for the range of service requests that are received now or will be in the future.

The existing definition is too prescriptive and should be consistent with the existing definition of funeral expenses according to the Australian Taxation Office (ATO). The ATO definition should also be considered in relation to social security and other exemptions.

Limitation on release of funeral investments

To meet the requirement of the sole-purpose test for funeral bonds/pre-paid policies under income tax law to be eligible for special tax treatment, the funeral investment must be specifically made for the purpose of meeting the future expected costs of a funeral.

This requirement means that the early release of funeral investments should not be permitted and the funeral investment can only be released after the client has passed away. This is because variable costs could go up and down multiple times during the period of the contract. There would be also be uncertainty about exactly when variable costs would be re-assessed during the contract.

The exempting assets and income test concessions under social security law require funds to be only released after death – to qualify as an “exempt funeral investment”.

Variation or termination of a pre-paid funeral contract

As previously stated in this submission, the early release of a funeral investment is not possible. Should a pre-paid funeral contract be cancelled at any time (other than in the cooling-off period), the funds would remain invested, but would be assigned directly to the client, rather than being assigned to the funeral provider.

This would also apply in the instance of a variation to a pre-paid contract. For example, should there be a reduction in the cost of the pre-paid contract, any refund for that reduction is not released from the funeral investment and the treatment of these funds would need to be considered further. Conversely, should the funeral investment increase as a result of a variation, then those additional funds can be placed with the existing funeral investment.

GST details in a pre-paid funeral contract

The FSA has identified that GST does not appear to have been included in a pre-paid funeral contract under the draft new code of practice. The treatment of GST under a pre-paid contract is the subject of GST law which requires any GST must be paid at the time of signing the contract, rather than at the time of the delivery of the services contained in the contract. Therefore, the timing of this payment and the cooling-off provisions in the proposed new code should be revised.



Conclusion

On behalf of our members, the FSA looks forward to providing further information in relation to our submission through meetings and/or other forms of formal engagement.