



Broaden your horizons

How do you tell if your dependants are properly protected? **Lesley Parker** does the sums on life insurance.

The conventional wisdom is that Australians are under-insured but researchers and advisers say that behind the broad statistic is another group of people who actually have too much life insurance.

This group includes young people automatically paying for "default" life insurance through their superannuation fund even though they have little need of it; people who are doubling up because they haven't factored in their insurance via super when buying insurance privately; and older people who have paid off the mortgage and waved goodbye to the children but haven't revised their cover.

Research conducted for the Australian Institute of Superannuation Trustees (AIST) and the Industry Funds Forum concluded last year that 15 per cent of the 2000-plus people surveyed were over-insured by \$100,000 or more. Nearly 40 per cent were over-insured "to some degree".

On the flipside, 51 per cent were at least \$100,000 short in their death cover.

Financial advisers, who frequently work as insurance brokers, are well aware of the issue of under-insurance but say that doesn't mean over-insurance doesn't exist.

"The [insurance] industry is currently complaining of an under-insurance problem and they're correct," says Darren Johns, a certified financial planner (CFP) with Align Financial. "But are some people over-insured? Yes they are. There are some whose individual levels of insurance are too high."

AIST chief executive Fiona Reynolds says its research found young singles are the most likely group to fall into the over-insured category.

Many simply have no need for the insurance, because they have no dependants to provide for, she says. Others may have too much insurance because they have more than one job, picking up several lots of default

The economic afterlife

IF YOU fit the description of "married, kids and mortgage", how much life insurance might you need?

Life insurance places an economic value on the person who has died, says Mark Kachor, the managing director of research firm DEXX&R.

The theory is that it should replace the income the person would have earned, so their dependants are left no worse off than if the person had lived a full life.

That money should pay out all debt – money borrowed on the basis that it could be repaid out of that person's income – and in a city such as Sydney or Melbourne that might involve a \$500,000 mortgage.

Now add the children. Their upkeep might come to \$20,000 a year for 10 years – each.

And that's before optional extras

such as private school fees. Then there's the actual income loss. If the person was earning about \$80,000 a year you'd need to earn about 7 per cent a year on a capital sum of \$1.1 million to replace that income, Kachor says.

The idea is to keep that capital sum intact, rather than drawing on it, as a guard against inflation and perhaps to replace the retirement savings the person would otherwise have accumulated, he says.

"You end up with \$2 million in cover as the economic value of someone 30 to 40, married, with a couple of kids and a mortgage," Kachor says. "If you've got that level of cover, you're fully insured."

If you have a spare couple of million outside the family home, "maybe you don't need insurance".

insurance through multiple super funds along the way.

CFP Andrew Rocks, director of the Announcer Group, says its financial advisers come across younger people who have life insurance based on a multiple of their earnings rather than on their circumstances.

They might have something like \$350,000 in cover through employer super even though they have no dependants. Meanwhile, the greater risk of loss of income through illness or injury may not be covered.

"Quite simply, the individual could direct the premiums away from the life cover – given they have no dependants and don't intend to have ice sculptures and fireworks at their funeral – and into income protection," Rocks says.

Some super funds now offer good-quality income protection insurance, with benefits payable to age 65. Rocks

says young people should ask to be moved out of life insurance and into income protection.

While you're automatically signed up for default life insurance cover in super, you can ask to "opt out", he says.

Reynolds says funds may permit you to reduce your cover, even if they don't allow you to opt out altogether.

However, she points out that insurance within super tends to be cost-effective, because funds can negotiate group rates, so if you need insurance, it's a good source.

Johns says younger clients have little need of life insurance until they hit the trigger points of marriage, mortgage and children. "Prior to that there tends to be little need for life insurance, because no one depends on you," he says.

One caveat is that it can be simpler and cheaper to obtain insurance when you're young and healthy, before you

develop conditions that could increase your premiums or even affect your insurability. Policies are generally "guaranteed renewable", which means the insurer has to renew your policy annually regardless of changes in your health.

"The number of clients who go straight through [without medical examinations] under 35 must be four to five times as many as those that get straight through among the over-35s," Johns says.

"Once they're 35-plus, most people have something wrong with their back, their neck."

At the other end of the spectrum are older people who have had life insurance for some time but have neglected to review it.

"Once people start paying insurance premiums, they tend to accept them and don't often question the amount or level of cover it provides," Johns says.

Many of the 60-plus age group are mortgage and child-free, he says. What's more, they may have accumulated sufficient assets for their spouse to live comfortably when they're gone.

"Yet they'll put money into insurance premiums, often quite happily, each and every month," he says.

Johns tells clients insurance is not for profit but for protection.

"We tell them not to expect a 'return' on this money, on their insurance premiums," he says.

"If that isn't the initial mindset, they'll hang in there because they want a return on their outlay."

High levels of insurance a few years from retirement doesn't make sense, he says. "Life insurance is designed to replace 'forgone future earnings'. If you earn \$100,000 and plan to retire at the end of the year, why would you have life insurance for \$450,000?"

"In this case the person – or, rather, their dependants – would be better off if they were dead, which isn't the role of insurance."