Getting the edge with managed funds

Be prepared

During your lifetime, you'll probably take out a number of insurance policies to protect yourself and your family against the risk of loss. Even the most watertight plans aren't immune to unforeseen events, and insurance offers a safety net for the unexpected. If you were struck down by an out-of-the-blue illness or injury, could you maintain your mortgage repayments, car loan repayments, mobile phone bill, or financial support for your spouse and children? Insurance can help you ensure a tragedy is not further compounded by financial hardship.

How it works

Insurance involves the transfer of risk. This is done where an insurer agrees to compensate you for a loss rather than you having to shoulder the financial burden yourself. In most circumstances, the insurer assesses whether to accept the risk using information they collect from you.

Insurance usually works on a 'pay as you go' system, whereby you pay for the policy by making regular premium payments - cover continues as long as you continue to pay the premiums. The amount of premium you pay depends on several factors, including the type and level of cover you choose, and the level of risk that you bring to the life insurance pool. Most companies allow you to elect how you want to pay your premiums - monthly, quarterly, twice a year or annually.

Applicants are categorised according to the level of risk they represent. In the case of life insurance, applicants who are smokers will fall into a higher risk pool than non-smokers. This also means that smokers will generally pay higher premiums, as it has been proven conclusively that, as a group, they have an increased chance of suffering from heart disease, cancer, stroke and other diseases.

If something bad happens and you have an insurance policy, you can make a claim to receive a payment from your insurance company. The company will assess your claim. If your claim is accepted, you will receive an amount of money from the insurance company. This is known as a benefit or payout. You may receive this either all at once or as a regular stream of payments, depending on your insurance policy.

Around 6.3 million Australians are protected by life insurance policies, with claims in excess of $1 billion being paid by life insurers annually.

Types of life insurance

The main types of insurance which protect your earning capacity are:

Lump sum insurance

Lump sum life insurance is one form of personal protection purchased to insure against the economic or financial loss that would be suffered in the event of total and permanent disablement or premature death. Lump sum life insurance products provide a lump sum payment should the insured event occur. The amount of cover purchased is usually related to your level of debt and need to protect your lifestyle. The amount of cover chosen would include a sum of money that can be used to generate a replacement for your future income to provide for your dependants. Lump sum products include Term Life and Total & Permanent Disability.

One of the easiest ways to get lump sum life insurance is through your super fund. Often you are automatically accepted for cover, which means that you could be protected against death and/or disablement without knowing it. Check with your super fund or on your latest statement to find out the amount of cover you could have.

Dangerously under-insured

A recent study[1] has shown that many Australians don't have enough insurance. Life insurance cover of the average Australian is just **26%** of that required - equating to a massive **74%** under insurance.

To address this problem, Australians need to increase their level of cover. Ten times annual income is considered necessary for the average worker with dependants.

1. AXA/DEXX&R, Under-insurance Report, July 2004.

Income protection

This type of insurance provides a payment stream, usually 75% of your income, in the event that you are unable to work, due to an unforseen illness or accident. Sick leave or worker's compensation may not provide ample or extended cover in the event of any of these circumstances. Income protection allows you to maintain a reasonable standard of living if you are not able to continue earning an income for a period of time.

Similar to lump sum insurance, income protection can also be offered through your super fund - check with your super fund provider, or on your next statement, which will tell you if you already have this type of cover.

Critical illness

Also known as trauma or crisis insurance, this type of insurance offers financial protection in the event of a major catastrophe such as a medical trauma. Critical illness insurance covers specific conditions, such as blindness, coma, heart attack, stroke or cancer. These are defined in the policy, ensuring cover is well targeted to those conditions which may require a lifestyle change, or highly specialised medical treatment. In most cases, super funds do not provide critical illness protection. Critical illness also falls into the category of lump sum insurance.

For more information on life insurance see IFSA's factsheet *Life insurance basics*.

Safeguarding your privacy

When applying for most types of insurance, you will most likely need to provide personal information. The insurance industry is obligated to safeguard all of your personal details, including information about your health and medical records. The protection of your private information has been reinforced by the introduction of national privacy legislation, which is supported by the insurance industry. Each insurer provides a statement on privacy, within their product offering.

Tax benefits

Premiums are taxed differently, depending on the type of product and circumstances of purchase. Lump sum benefits are usually tax free although their premiums are not deductible, whereas income protection benefits are usually taxable while their premiums are tax deductible. Life insurance benefits when bought within the superannuation system may be taxable, whereas the premiums are usually tax deductible. For more information about the tax benefits available to you, speak to your accountant or tax adviser.

Regulation

In Australia, the operations of life insurers are regulated by the legal system, most of which is Commonwealth legislation. Two main regulatory bodies administer the legislation that governs the life insurance industry, the Australian Prudential Regulation Authority (APRA) and the Australian Securities and Investments Commission (ASIC). APRA is responsible for the administration of the Life Insurance Act 1995 while ASIC administers the Insurance Contracts Act 1984 and the Corporations Act. The Corporations Act was amended by the Financial Services Reform Act (FSRA) to better protect consumers whenever they deal with financial institutions, including life insurance companies.

If your claim is rejected

If your insurance company rejects your claim and you are unhappy with this decision, you can do something about it. You have the right to request that your insurer review your case. You may first want to get some legal advice though, because in some cases, there may be legal reasons why your insurer should pay. A legal expert can help you to assess the details of your case to see whether any of the reasons apply to you.

If your insurer has reviewed your claim and you're still unhappy with their decision, you can either go to court or use an alternative body to resolve the issue, such as the Financial Industry Complaints Service (FICS) or the Superannuation Complaints Tribunal (SCT), which have been set up by the Government for this very reason.

Protecting your rights

The Financial Industry Complaints Service (FICS) was set up to resolve policyowner complaints. The service is free of charge, and is generally available to most individuals or businesses. For more details, visit www.fics.asn.au or phone 1300 780 808.

In addition, the Superannuation Complaints Tribunal (SCT) is an independent tribunal that deals with complaints about super funds, annuities and deferred annuities, and retirement savings accounts. If your insurance is through your super fund you may be able to go to the SCT to resolve your complaint. For more information, visit www.sct.gov.au or phone 1300 884 114.

Insurance for different life stages

Insurance is not static, and your need for cover will change as you move through different stages in your life. The amount of insurance required will be influenced by your income, your assets, your liabilities, if you are married, and the number of dependants you have - all of which may change depending on your life stage.

You should also review your insurance needs at least once every two years to take into consideration any change in your earning capacity, the change in cost of living, increased liabilities like a home or personal loans or increases in disposable income. This will ensure that your level of insurance cover remains adequate.

A financial planner will be able to help you if you're not sure about the level of cover you should have - they can also help you review your insurance needs on an ongoing basis.

Speaking to a qualified financial planner will also ensure that the cover you choose will be best suited to your financial needs and objectives.

For more information

There are additional factsheets you can download on this topic. Simply log on to IFSA's website - www.ifsa.com.au

Six easy steps towards sound financial advice and your rights as a consumer

Life insurance basics

Life insurance in Australia

How life insurance works

Life insurance & privacy in Australia

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