

THE LIFEWISE / NATSEM
UNDERINSURANCE REPORT

Understanding the
social and economic cost
of underinsurance

SUMMARY RESEARCH REPORT

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PREPARED FOR

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This report should be read in conjunction with the
full research report under the same name.

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THE LIFESTYLE YOU CREATE FOR YOUR FAMILY IS RELIANT ON YOUR INCOME. IT IS USUALLY THE FIRST CASUALTY WHEN THE WORST HAPPENS.

Most of us know someone, or know of someone, who has been impacted by tragedy or hardship – the death of a parent, a friend in a serious accident, the diagnosis of cancer or a mental illness. These events create enormous strain on individuals and families, often made worse by the substantial financial burden that results when someone is unable to work for an extended period of time. In many cases, this financial burden could have been avoided with adequate levels of insurance.

This report quantifies, for the first time, the number of families who will be impacted by underinsurance during their working lives. It looks at the financial impact on the typical middle- income family with young children and the expected cost to government over the next 10 years. The results are startling:

- **One in five** families will be impacted by the death of a parent, a serious accident or illness that renders a parent unable to work;
- The typical Australian family **will lose half or more of their income** following a serious illness, injury or the loss of one of parent as a result of underinsurance;
- **95% of families** do not have adequate levels of insurance; and
- Underinsurance is expected to cost the federal government **\$1.3 billion over the next 10 years.**

This research has been commissioned by Lifewise – a public awareness initiative of the Australian life insurance industry aimed at encouraging Australians to take appropriate steps to protect themselves from the financial hardship that can result from accident, sickness or death.

IT CAN HAPPEN TO ANYONE

Based on 2008 statistics, 18 Australian families lose a working age parent every day. Every year, 235,790 working age parents suffer a serious illness or injury and over 17,000 of them are forced to stop working, either permanently or for an extended period of time. Over one million working-age parents with dependents will be impacted by death, serious accident or illness.

These figures mean that more than one in five families will be impacted by an insurable event in their working lives. Most of these people will have some level of insurance, usually death cover, within their superannuation. Often the level of cover is inadequate. Income protection is also only offered as an option by the minority of funds and again, these levels are not sufficient for most families to maintain their lifestyle. While a concerted effort by the superannuation industry means this situation is improving, the fact is most Australian working families will not have adequate levels of cover to protect themselves from financial hardship and secure their way of life.

Lifestyle is determined by income, where people live, whether a dwelling is owned or rented, where children go to school, where and how often people eat out and if holidays are taken. Beyond the basic need for food, clothing and shelter, lifestyle defines who you are and the opportunities created for family members. It is usually the first casualty when the worst happens, and it can often lead to devastating consequences for affected families.

MEASURING THE IMPACT ON THE TYPICAL AUSTRALIAN FAMILY

An analysis of the impact of underinsurance on a statistically typical Australian family paints a concerning picture of vulnerability. The typical family's parents are in their 30s with two children, are purchasing their own home and have a mortgage. They also have typical levels of superannuation and life insurance (see p.8. in the full report for exact vital statistics).

To measure their level of exposure, NATSEM calculated the financial impact in dollar terms of having typical versus recommended levels of three types of insurance – life insurance, total and permanent disability (TPD) insurance and income protection (IP) insurance. Four scenarios are modelled and the impact is examined one, five and ten years after an event has occurred.

The four possible scenarios include:

- **Scenario 1:**
Husband dies prematurely
- **Scenario 2(a):**
Husband is temporarily unable to work
- **Scenario 2(b):**
Husband is never able to work again
- **Scenario 3:**
Wife dies prematurely
- **Scenario 4(a):**
Wife is temporarily unable to work
- **Scenario 4(b):**
Wife is never able to work again

THE TYPICAL AUSTRALIAN FAMILY WILL LOSE HALF OR MORE OF THEIR INCOME AS A RESULT OF THE SERIOUS ILLNESS, INJURY OR LOSS OF ONE PARENT.

THE TYPICAL AUSTRALIAN FAMILY WILL BE FINANCIALLY DEVASTATED IF TRAGEDY STRIKES

A family with young children, with typical levels of insurance, faces financial disaster as a result of the serious illness, injury or loss of one of the parents.

In three variations of the scenarios above (temporarily disabled/sick husband, death of the wife or temporarily disabled/sick wife) the family's income drops by half or more after childcare and mortgage repayments (see page 17 of the full report to see the effect over time). The family originally had \$1,224 per week to live on after paying childcare and the mortgage. Now they must live on about \$600 per week in most cases.

In scenario 1, where the husband dies, the income drops to just one third of the original level, even after government benefits are taken into account.

This will involve very significant changes to the family's way of life. Most will have to sell their homes. Dreams of the best education for their children are mostly lost. Family holidays will no longer be possible. And over the long term, the income situation gets worse rather than better in most cases.

HAVING THE RECOMMENDED LEVELS OF INSURANCE REPLACES PREVIOUS INCOME

With recommended levels of insurance, the family's financial circumstances (and lifestyle) are maintained.

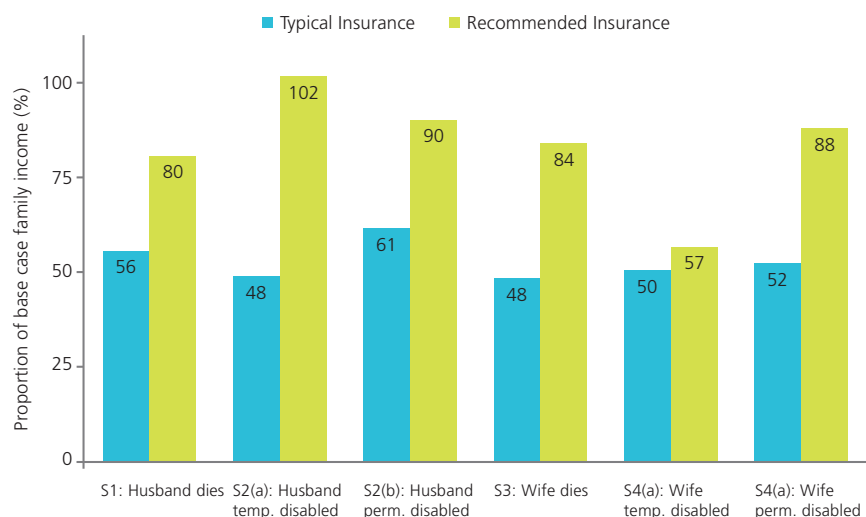
In most scenarios, the family is able to maintain an income after tax, mortgage repayments and childcare, that is at least four-fifths of the family's income before the event. The exception is where the wife is temporarily disabled. In this case, there's a sharp decline in the family income despite income protection insurance providing 75% of her previous income. This is due to a reduction in working hours of the husband to care for his wife.

Longer-term, the projections show that if the hypothetical family had recommended levels of insurance, they could still maintain 75-80% of their remaining income over the next five or 10 years. For those with typical insurance (ie. they are underinsured), the average levels of income remains at just half of what they previously enjoyed.

IMPACT ON FAMILY: Remaining income under the four scenarios with typical and recommended levels of insurance, 2009-10.

Note: The percentages shown are the proportion of the base case family disposable income after childcare and mortgage repayments have been made and include the impact of income from invested insurance payouts.

Source: NATSEM calculations.



UNDERINSURANCE IS EXPECTED TO COST THE TAXPAYER \$1.3 BILLION OVER THE NEXT DECADE

Applying the typical family's reliance on the government to the total population of working families reveals the total cost to the taxpayer of underinsurance equals \$131 million every year. That means, if current trends continue, underinsurance is expected to cost the federal government \$1.3 billion over the next 10 years.

This figure is calculated by comparing government spending under the scenarios against the net revenue of \$15,690 (in taxes) the government received from our typical family before the event, which shows the government must increase spending by between \$22,000 and \$36,000 per family per year. And this is just the cost for working age couples with children.

If our typical family has the recommended level of insurance, government outlays are reduced by 64.5% following the death of the husband (scenario 1).

How does this saving occur? In the normal course of events, our typical family pays more tax than it receives in government benefits, that is, they pay \$15,690 net. After scenario 1 the family with typical levels of insurance *receives* government benefits of \$14,350 net. Compare this to the family with recommended insurance which receives only \$5,090 net government benefits. Therefore, government outlays are \$9,260 less.

WHERE TO FROM HERE?

This groundbreaking research shows more than one in five families will be impacted by the death of a parent or a serious accident or illness that renders a parent unable to work during their working lives. Most of these families will experience some amount of avoidable financial hardship due to underinsurance at an already difficult time in their lives. In fact, the typical Australian family will lose half or more of their income following the serious illness, injury or loss of one parent – a financially devastating result.

In addition to the, at times, tragic personal costs, underinsurance is expected to cost the federal government \$1.3 billion over the next 10 years.

This avoidable outcome highlights the importance of every Australian making a conscious and informed decision about protecting their most important asset – their ability to earn an income. It also highlights the broader economic consequences of underinsurance and the need for the federal government to explore policy options that encourage Australians to protect their financial future and, in turn, their way of life.

For more information about Lifewise visit www.lifewise.org.au

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