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Scary facts about under-assurance are not a sales ploy

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People often respond to research sponsored or undertaken by the life assurance industry that shows how under-assured most South Africans are by saying that this is just another sales ploy by the life industry and that the situation is not as dire as is made out.

People's responses to me when discussing the issue following the life industry's first study into under-assurance three years ago included these remarks:

- My retirement fund provides me with group assurance;
- The chances of my dying prematurely or of being disabled are fairly slim, and I have more pressing issues on which to spend my money; and
- I checked about seven years ago, when my second child was born.

Very few of the people to whom I speak know how much life assurance they actually have or need.

Peter Dempsey, the deputy chief executive of the Association for Savings & Investment SA, says that middle- and high-income earners in particular are usually quick to dismiss the statistics provided by the research, "believing mistakenly that low-income earners are likely to be the only group hard hit by the loss of an earner due to death or disability. This thinking is fundamentally flawed.

"Our research shows that consumers earning more than R16 700 a month will leave their families with the biggest financial shortfall when they die or become disabled. The higher an earner's income bracket, the more life cover is required to maintain living standards."

The research is based on averages, so some people will require more assurance and others less.

And while the research shows that, as a percentage of their needs, low-income people have the worst levels of assurance cover, in rand terms it is people who earn more than R16 700 a month who are worse off. If you fall into this group, you need a lot more money to cover the needs of your family.

The number-one issue you need to take into account in financial planning is assurance against the unexpected.
No one can predict whether tomorrow or the next day they will be involved in an accident that will leave them seriously injured or dead, or whether they will contract a terminal or debilitating illness.

If you have dependants – and these can include parents, as well as children or even grandchildren – you need life assurance. The only exception is if you are filthy rich.

You may not need much life assurance if you are single. In fact, research shows that because of the group life assurance attached to occupational retirement schemes, many single people are over-assured against early death.

But you will need quite a bit of disability cover if you are young and single, because a disability may well result in your having to support yourself for the rest of your life, and probably your future dependants too.

Here is a quick little calculation for you:

Step 1. Take the value of your assets (excluding retirement savings, because life assurance is designed to provide cover up to the age of 65) that could generate an income after your death or if you become disabled, and add to this any life assurance you already have. For example:
Investments: R250 000
Plus life assurance: R1 000 000
Total: R1 250 000

Step 2. Subtract any debts.
R1 250 000
Less home loan: R500 000
Total: R750 000

Step 3. Calculate how much money your dependants would require every year (in the event of your death), or how much you and your dependants would require if you were disabled and unable to work. For the purposes of this example, let us say the amount required is R25 000 a month, or R300 000 a year.

Step 4. Multiply the annual amount by 15 and by 20. On average, you require a lump sum of at least 15 times, but preferably about 20 times, your annual income to provide a sustainable income until retirement.
15 x R300 000 = R4 500 000
20 x R300 000 = R6 000 000

Step 5. Subtract the total in step 2 from the total in step 4 to work out your life assurance shortfall.
R4 500 000 – R750 000 = R3 750 000
R6 000 000 – R750 000 = R5 250 000

If your shortfall is as bad as that in the example, you need help – and fast. Obviously, the above calculation is only a rough rule of thumb. Various factors affect exactly how much additional life assurance you need to buy. These factors include how much assurance you already have, how many dependants you have and how long you can expect them to be dependent on you, and, importantly, how old you are.

The only place to start to assess exactly how much life assurance you need is by having a skilled financial adviser undertake an analysis of all your financial needs, from life assurance to retirement planning. And this should not be a once-off event. Every few years and every time there is a significant change in your life, whether it is the birth of a child or a major salary increase, you should check your life assurance requirements.

And you may even find that, when you reach your fifties and do not have dependent children and have accumulated more assets, you will be able to reduce your cover, enabling you to save more for your retirement.

Our feature "Buying the right risk life assurance" provides you with a lot more information on how to go about ensuring you have the right amount of life and risk assurance. Be assured that this is not a life assurance industry con trick. You must establish how much life assurance you need, and you must do this today – not tomorrow or, even worse, next month or next year.