Disability cover depends on your needs

Disability assurance is one of the most complex types of assurance, and disputes often arise because of misunderstandings over benefits covered or policy definitions and limitations, the life insurance ombudsman's office has said. At the recent Personal Finance/Discovery Life Risk Protection seminars, Peter Temple (left), the managing director of General Reinsurance Africa, discussed the different types of disability assurance on the market and how you should go about choosing the right option for you.

The most important thing to keep in mind when choosing disability cover is that it's about your needs, Temple says. Every person has different needs. You should work out what you would need to live on after becoming disabled and what your dependants would need to live on after your death.

Your decision should also be based on your financial circumstances (how much you have in savings, and your expenditure and budget) and your personal circumstances (whether you are married and have children or dependants).

Beyond this, you should also consider your preferences.

"There is no right or wrong decision when it comes to choosing your disability cover. It boils down to your personal preferences," he says.

There are many types of disability cover, including capital disability, physical impairment, functional impairment, income protection and dread disease.

When choosing disability cover, there are two important considerations. The first is whether you want to receive the benefit as a lump sum or as an annuity, which is what you get if you go for income protection cover. The second consideration is around the definition of disability.

Your choice of disability cover will be determined by these key considerations.

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1. LUMP SUM OR INCOME PROTECTION

◆ Lump sum: Capital disability, physical impairment, functional impairment and dread disease assurance are all names for types of policies that offer you a lump-sum payout on disability.

◆ Income protection: Benefits are paid out as a regular income (or annuity) and can be provided for anything from six months to the rest of your working life until retirement age. Income protection can, therefore, be a good option if you also want to enjoy cover for short-term illnesses. For example, if you're self-employed and need cover against loss of income while you recover from an illness or operation.

You should, however, watch out for the waiting period stipulated on the policy. This is the period you will have to wait before the life assurer will start paying the benefit.

Temple says the length of the waiting period should be chosen relative to your personal circumstances. People in formal employment can generally afford to have longer waiting periods because they have paid sick leave, but self-employed people should generally have shorter waiting periods. "There are products now available that have a waiting period of only seven days," he says.

With income protection policies, be careful about the definition of earnings, which is usually based on the earnings you disclose to the taxman. You should also check that the income benefits will not be eroded by inflation. Your policy should provide for an annual escalation in the monthly benefit.

2. DEFINITION OF DISABILITY

The second major difference between the types of cover is the way in which they define the disability that qualifies you for benefits.

"The definition of disability is key in each case," Temple says.

The definitions may be based on medical conditions or your ability to work.

Occupation-based disability

With capital disability assurance and income protection assurance, the disability that will qualify you for benefits is usually occupation based. You may have cover that entitles you to benefits if you are unable to perform:

◆ Your own occupation;

◆ Your own or a similar occupation; or

◆ Any occupation.

With income protection assurance, the definition of the disability is usually occupation based. However, sometimes the disability is defined in terms of the activities of daily living you are unable to perform (such as being unable to feed yourself or to dress yourself) or it may be based on activities of daily work (such as being unable to walk up stairs, to sit for a certain length of time or to concentrate for longer than a certain period).

Medically defined disability

◆ Physical impairment assurance pays out benefits based on the disability you have suffered, such as the loss of the use of a limb due to an accident or illness. So you could get paid out a certain amount of money if you had to have your right arm amputated.

◆ Functional impairment assurance pays out benefits based on bodily functions that you have lost and the proportion of the loss in relation to the rest of your body. For example, a body system malfunction, such as a heart attack, will impair your functionality and would qualify you for benefits under such a policy, Temple says.

◆ Dread disease benefits are usually based on your being diagnosed with a particular disease or condition, such as cancer.

Temple says in South Africa some insurance companies cover as many as 30 to 35 dread diseases. Others cover only four to five dread diseases. "Four conditions – cancer, heart attack, stroke and coronary artery bypass surgery – account for 80 percent of claims under dread disease cover. If you choose to insure yourself against only these four conditions, you will have taken cover against 80 percent of your risk at a lower cost than the person insuring themselves against a full range of 35 conditions," he says.

Be aware that dread disease cover may be for a particular illness only if your illness is severe enough to qualify for benefits. For example, if you have been diagnosed with cancer, you will be paid a percentage of your sum insured, depending on the severity of the cancer. The more severe the cancer, the higher percentage you will be paid.

KEY DECISIONS

Temple says there are three key decisions you need to make when you buy disability cover. They are:

1. Do you want a lump sum or income benefit?

"Remember that lump-sum products can only approximate the income you would have lost. Income benefit products are more likely to closely match your needs," he says.

You may have expenses because of the change in your lifestyle as a result of your disability. A lump-sum payout would take care of one-off expenses, such as wheelchair ramps in and around your home, while an income benefit would take care of ongoing expenses, such as a daily nurse or caregiver.

If you have debts, there are two ways you could settle them. You could use a lump-sum payout to pay them off or you could use an income benefit to cover debt repayments.

2. Do you want cover based on an occupational or medical definition of disability?

Disability assurance based on a medical definition of disability may cover you for specific expenses even if you can still work, while an occupational definition of disability means you would have to be unable to perform either your own occupation or a similar occupation or any occupation to enjoy a benefit.

"Look at your reason for taking out disability cover. If you want cover for when you can't work, then you should choose cover that uses an occupational definition of disability. If you want cover for specific expenses even if you can work, then choose cover that uses a medical definition of disability," he says.

3. Do you want cover that pays out either if you are disabled or die, or do you want cover that pays out when you are disabled as well as when you die?

Policies that have accelerated benefits pay you out if you are disabled, but this exhausts your benefits and unless you take out more cover, your dependants will not receive any benefits when you die.

"For example, you might have life and disability cover for R1 million. Assume you are disabled and six years later, you die. On the accelerator option, you will get R1 million when you are disabled and nothing when you die. On a non-accelerator option, you will get R1 million when you are disabled and a further R1 million when you die," he says.

Temple says the non-accelerator option is more expensive to buy but it does offer better cover.

Three things to think about

There are three other issues you should consider when you buy disability cover, Peter Temple says.

1. Clarity

You should understand both the way your disability cover works and the language in the policy document.

"I suggest you favour simple products over complex ones," he says, adding that you would not buy a television set that you don't know how to operate.

You should be able to compare the product you are buying with those of other insurance companies and shop around for the best deal, as you would if you were buying a television set or washing machine.

2. Guarantees

When you buy disability cover you should look for guarantees on your premiums.

If you do not have a guarantee that the increase in premiums won't exceed a certain maximum, your life assurer can increase the premiums at any rate. This, Temple says, would be like a furniture retailer asking you for more money six months after you bought a washing machine at a set price.

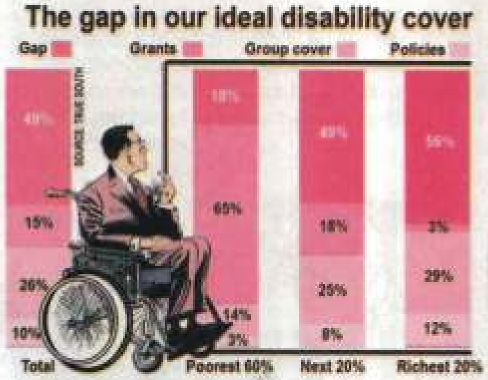
3. The value of your cover

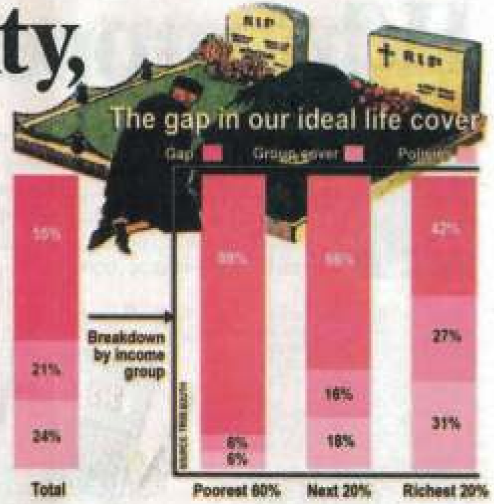
Temple says you shouldn't underestimate the value of your insurance policy. For example, if as a 35-year-old you took out a life policy with a premium of R400 a month and you died or were disabled tomorrow, the benefit could be as much as a R60 000 lump sum.

After buying cover of that size you should feel excited, whereas people tend to view it as a grudge purchase, he says. In effect, you have bought something worth R60 000. If you bought anything else worth that amount, such as a 2006 VW Citi Golf 1.4, or a 10-day skiing trip for three to Argentina, or a full range of electronic goods, including a plasma TV, a digital camera, an iPod, two computers, a DVD player and Bose surround-sound speakers, these purchases would "fill you with excitement", Temple says.

You may have only half the disability, life cover you need

Research confirms there's a massive gap between the life and disability cover most South Africans have in place and the cover they require if they want to maintain their standard of living should the family breadwinner die prematurely or become disabled. Francois Hugo (left), an executive director at True South, spoke about the implications of this shortfall at the Personal Finance/Discovery Life Risk Protection seminars, which were held in Cape Town and Johannesburg this week. **Laura du Preez** reports





Wealthy South Africans have on average a 56-percent shortfall in the amount of disability cover they require and a 42-percent shortfall in the amount of life cover they need.

This is according to a study commissioned by the Life Offices' Association (LOA) and undertaken by True South Actuaries and Consultants. The study found that South Africans are woefully underinsured to the tune of R10 000 billion.

Francois Hugo says the study showed that the gap between the average required cover and the average existing cover for all South Africans was 49 percent for disability cover and 55 percent for life cover. This statistic was based on an analysis of South Africans who earn an average income of R60 000 a year, or R5 000 a month.

The study showed that the average South African should have life cover of R530 000 to maintain his or her family's lifestyle after his or her death. It also showed that the average person should have disability cover of R830 000 to maintain his or her own and his or her family's lifestyle after he or she is disabled.

Information on what life cover South Africans have in place was obtained from life assurance companies that are members of the

Usually, disability benefits are paid as a monthly income, on which you pay tax at your marginal rate. Hugo says the tax implications of life cover depend on the way in which the benefits are paid out, but these benefits usually attract less tax.

SHORTFALLS BY INCOME GROUP

Hugo says "the average South African" does not in fact exist, and it is therefore more useful to consider the average shortfalls in cover within each income group or within each age group.

He says an analysis of the different income groups shows that the poorest 60 percent of South African households – those with combined earnings of less than R3 800 a month – have hopelessly too little life cover.

only 18 percent in the average of R234 500 in disability cover they need to preserve their lifestyles.

However, wealthier individuals usually do not qualify for government grants and thus need more cover so they can maintain their current lifestyles, Hugo says.

But, he says, the actual cover they currently enjoy through life and disability policies and group life schemes provided by their employers or retirement funds falls far short of what they need.

Earners in the richest 20 percent of South African households – those with combined household earnings of more than R8 200 a month – each require an average R2.2 million in disability cover, Hugo says.

The policies wealthier individuals currently have provide 12 percent of the disability cover they need, while group life cover provides another 29 percent.

Hugo says the gap in the disability cover wealthier individuals require, after taking into account the limited government grants for which they may qualify, therefore amounts to 56 percent.

Earners from the next 20 percent of South African households ranked in order of their income – that is, households with combined earnings

20 percent of households require on average R1.3 million in life cover.

But these people on average have enough life cover through insurance policies to provide for only 31 percent of their dependants' needs after their death, Hugo says.

Their dependants will on average receive group life benefits amounting to 27 percent of what they need, but the average gap in their life cover amounts to 42 percent of what they need, he says.

Hugo says earners from middle-income households have enough life cover through insurance policies to provide for only 18 percent of their dependants' needs, and their group life cover will provide another 16 percent of what they need.

He says the gap in the cover they need is thus a whopping 66 percent.

BELT-TIGHTENING

Hugo says death and disability are life-changing events, and after such

current standard of living.

Hugo says similarly the average South African family would need R620 000, as opposed to R830 000, for disability cover if it were prepared to tighten its belt.

Under such a scenario, he says, there is still a 32-percent gap between the amount of disability cover the average South African needs and what he or she has. And there is still a 42-percent gap between the amount of life cover the average South African needs and what he or she has in place.

UNDERESTIMATES

Hugo says the calculations in the study are based on what people need to provide for themselves until retirement at age 65 and assume that at that stage they will have sufficient money on which to live.

However, in addition to being underinsured, it is a known fact that only six percent of the population

excluded some types of cover, particularly those that could provide short-term relief, such as payouts from short-term insurance policies, the Workmen's Compensation Fund and the Road Accident Fund.

The calculations were also based on the size of the average family and assumed that children would be self-supporting at age 18, which in many families is not the case.

The calculations in the study are based on data obtained for various age groups, which are then combined to produce averages for all income earners.

However, the number of years you have until you retire (assumed to be at age 65) and therefore over which you will need to provide for your family in the event of your death, or provide for yourself and your family if you are disabled, may mean your required cover is quite different from the average.

If you are younger or older than

on average 53 percent, and among 46- to 55-year-olds, it is on average 45 percent. For 55-year-olds, the gap narrows to an average 15 percent.

Hugo says the average gap in life cover reduces in the older age groups because a large portion of their life cover is of a fixed nature – such as group life cover that is a multiple of your salary.

The average gap in disability cover is more consistent over the age groups, ranging from 46 percent (for 31- to 45-year-olds) to 52 percent (for 46- to 55-year-olds).

Hugo says the average gap is relatively stable over the age groups because most disability cover is in the form of income replacement.

DISASTER LOOMS

The important message of the True South study for you is that you may be one of the many South Africans who is underinsured. This could have disastrous consequences for

How to decode disability assurance

In the "How to" series last week we looked at the many aspects of life assurance. This week, we delve deeper into disability cover – a vital component of risk life assurance and one that is all too often overlooked and misunderstood.

By **Bruce Cameron**

Disability assurance takes over where health assurance leaves off. Health assurance covers your medical expenses when you are ill or injured. Disability assurance is designed to provide you with an income when you are too ill or injured to continue to earn a living.

Very few South Africans have sufficient disability assurance to ensure that they and their dependants can maintain their standard of living if incapacitated by a serious illness or accident.

Independent research undertaken this year by True South Actuaries & Consultants on behalf of the Life Offices' Association (the body that represents the life assurance industry) showed that most South Africans would face a substantial reduction in their standard of living if they were unexpectedly unable to earn a living.

The average amount by which the average household should be assured against disability is between R645 000 (if you tightened your belt) and R833 000 (if you wanted to preserve your current standard of living). But actual disability cover ranges on average between R427 000 and R438 000.

The average household has an annual income of R60 000 (R5 000 a month). So, if you are Mr or Ms Average and the breadwinner in your household is disabled today, you would have to cut your standard of living by up to half.

The only thing that saves most households struck by disability is the government's disability grant for low-income earners and group risk assurance attached to many occupational retirement funds.

Disability assurance is important because it covers you as well as your dependants. You may not need life assurance against dying until you have dependants. But every working person needs disability assurance from the day he or she starts work. After all, you could be disabled on your first day on the job, and whether or not you have dependants you will still need an income for the rest of your life.

Disability assurance is also known as income protection assurance, sickness assurance and impairment assurance. It is one of the most complex types of assurance and often leads to disputes because of misunderstandings over the benefits covered and policy definitions and limitations.

As with life assurance, you need a basic level of disability assurance to see you through your working life. The amount of disability assurance should vary according to your changing circumstances.

Before you start looking at all the bells and whistles of disability assurance, you need to understand the different types of cover. Next week we'll look at all the issues you need to take into account when you