

Good Policy

The good news about insurance

Macquarie Life



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FORWARD thinking

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Insurance

The price of prosperity

We have subtitled this brochure, "The good news about insurance". Why the good news? Because if you need insurance, it means you have **something of value** – a car, a house, an income. So insurance is the price you pay for prosperity – to protect the things that matter to you.

So what is insurance? It's all about risk

Risk is the chance of an event resulting in loss – something valuable getting stolen or a person suffering injury. Insurance doesn't remove the risk of accident, illness or injury but it provides compensation and financial security for the policyholder – you and/or your family – if something bad happens.

There is a significant underinsurance problem in Australia. Industry bodies such as IFSA (the Investment and Financial Services Association) believe much of this underinsurance is the result of a poor understanding of how life insurance works and of the financial risks we face throughout our lives.

Good Policy looks at some of the basics. Why you need insurance, which kind and how much. It also examines some of the things you should consider when you set out to safeguard your family's future.

The Great Fire

In 1666 the Great Fire of London destroyed thousands of houses. In the aftermath of the disaster, Nicholas Barbon established "The Fire Office" to insure brick and frame homes. At that time, insurers also provided the fire department. Every house that had insurance would have a plaque and the fire department would give priority to those houses.

"I detest life insurance agents; they always argue that I shall some day die, which is not so."

Canadian economist & humorist Stephen Leacock (1869 – 1944)

The benefits of insurance

Protecting you and your family

The risks you face are not identical to those faced by others.

Risks grow out of your particular situation, such as your job, your health, the size of your family, your existing savings and other assets, your income and your age. The risks in your life will change as your circumstances change.

When you are young the biggest risk you might face is the loss of your car. As you get older you are more likely to need insurance because you typically take on more responsibilities such as buying property and having a family.

Insurance can replace a financial asset if it is lost. One of your most important financial assets is your **income earning capacity**. So if you are injured or ill and cannot go to work, the right cover (whether that's life cover, trauma cover, disability income cover or TPD cover) will replace lost income (via lump sum or regular payments) as well as help paying doctor's bills and other immediate expenses.

When bad things happen

Because insurance is intended to cover you for an unexpected event, you are less likely to need to spend your savings, borrow money or sell investments to meet your financial obligations. If you and/or your family are taken care of financially you can focus on recovery. At a time when finances are the last thing people want to think about, insurance helps them get back on their feet.

Insurance – is there an alternative?

To understand the true value of insurance it is useful to consider the alternatives. Let's say, instead of using insurance you wanted to build up a lump sum of money to take care of your family should illness, injury or death affect your ability to meet mortgage payments and put food on the table.

Firstly, you'd need to build up a substantial sum of money (see page 9 for a guide to how much) and that could take a long time. Secondly, you'd have to invest your money where you could get at it easily – such as a bank account. So your ability to earn a high return on that money would be reduced. You'd need serious willpower to save all that money even though there were more enjoyable ways to use it. Most importantly, one year of disability could easily wipe out ten years of savings – and where would that leave your long term financial plans?

A life story

The first life insurance company established in America was chartered in 1759. It was called the Corporation for the Relief of Poor and Distressed Widows and Children of Presbyterian Ministers.

Fail to plan or plan to fail?

Why underinsurance matters

Research released by IFSA reveals that the average life insurance payout was worth just \$91,000 in 2008.¹

When you consider that the average Australian family with young children has debts of over \$160,000² it is obvious that many Australian families are underinsured.

Many families may be relying on the insurance cover they receive through their employer superannuation fund. However, Rice Warner Actuaries estimate that life insurance cover within super typically amounts to around 20% of what is required.

The bottom line? Many Australian families would not be able to meet crucial costs – mortgage repayments, daily expenses – if the main income earner were to die or become disabled.

One year only

According to TNS research conducted for IFSA in 2005, on average only 4% of families with dependent children have life insurance equal to more than 10 times earnings – the level recommended by some actuarial firms. Indeed six in 10 of those families did not have enough life insurance cover to look after their family for one year after their death.

Source: IFSA/Rice Warner, Underinsurance Key Facts, 2005

“There are risks and costs to a program of action. But they are far less than the long-range risks and costs of comfortable inaction.”

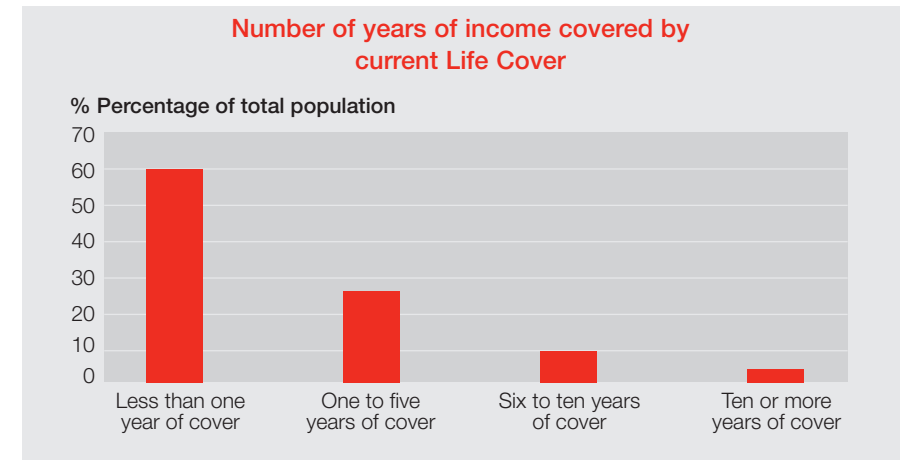
US President, John F. Kennedy (1917 – 1963)

¹ \$91,000 not enough to cover lost life, IFSA/Lifewise Media release 30th April 2009

² ABS, Australian Social Trends, Household Debt, cat. no. 4102.0, 2009

The balance sheet burden

As the newspapers keep reminding us, family finances are now under heavy pressure. In May 2009, the average loan size on an owner occupied property was over \$266,000³. According to IFSA, for around a dollar a day, most people can protect their family against being unable to meet their mortgage commitment. According to their research, the premium for a life insurance policy worth \$500,000 can be as low as \$30 per month for a 35 year old non-smoking male. Cover is even cheaper for women of the same age.



Source: IFSA/Rice Warner, Underinsurance Key Facts, August 2005

³ ABS 5609.0 – Housing Finance, Australia, May 2009.

Super insured

Insurance and your superannuation

Thanks to the introduction of the Superannuation Guarantee in 1983, most working Australians now contribute at least 9% of their salary to superannuation. Often a portion of that money is automatically allocated to buy some life insurance, (and/or total and permanent disability insurance) and some salary continuance insurance.

Is this compulsory insurance a good thing? Many say yes, arguing that it provides at least some cover for those who need it most.

However, others argue that insurance cover provided by super creates a false sense of security. The insurance you buy via your super may be well short of your needs. Rice Warner Actuaries suggest that the typical employer super insurance covers is only 20% of people's needs. Unless you supplement that cover with additional insurance you could be putting your financial security at risk.

Work it out

One of the most important first steps you can take when it comes to your insurance needs is to work out exactly what your company superannuation fund covers you for. You can then compare those figures against what you need and cover any shortfall via extra insurance.

Naturally your financial adviser is the best place to start when working out these numbers. Your accountant, personnel manager and the trustees of your company super fund may also be useful sources of information.

So why do we go without cover?

According to insurance company AAMI⁴, more than 80% of Australian drivers say they have car insurance. Yet many people fail to realise that their family's most important asset – the ability to earn an income – is something which may also be at risk. In 2006, only 31% of Australians had income protection insurance.⁵

There are plenty of reasons for this failure. Some of them are irrational – the idea that talking about disaster can make it happen. According to one insurance company survey, nearly a third of Australians found it difficult or unpleasant to discuss insurance with their partner.⁶

One other factor that stops people taking out adequate insurance is the belief that other safety nets will do the job.

Government benefits, Workers Compensation and sick leave can alleviate some of the burden of illness or injury, but they are not designed to replace an income (as Disability Income insurance is). Government benefits often come with strict qualification criteria – including residency, income and assets tests.

Workers Compensation only covers work-related injury. It's also important to note that self-employed workers may not be covered by Workers Compensation and that the amounts paid out are often limited.

While many company super plans have limited salary continuance benefits, those benefits might not be enough to protect a family with significant debt or expenses.

Relying on a superannuation payout to meet family commitments after death may also be fraught with danger. Many Australians will not have enough in super to cover their retirement needs even if they contribute till they're 65. So they're unlikely to have built up a nest egg capable of paying off a mortgage and looking after their family's financial needs if they're cut off in their prime.

⁴ Shopping for Car Insurance, AAMI Fact Sheet, September 2008.

⁵ Investigating Income Protection Insurance in Australia, TNS/IFSA research, July 2006.

⁶ ING Australia, Attitudes Towards Life Insurance, December 2008.

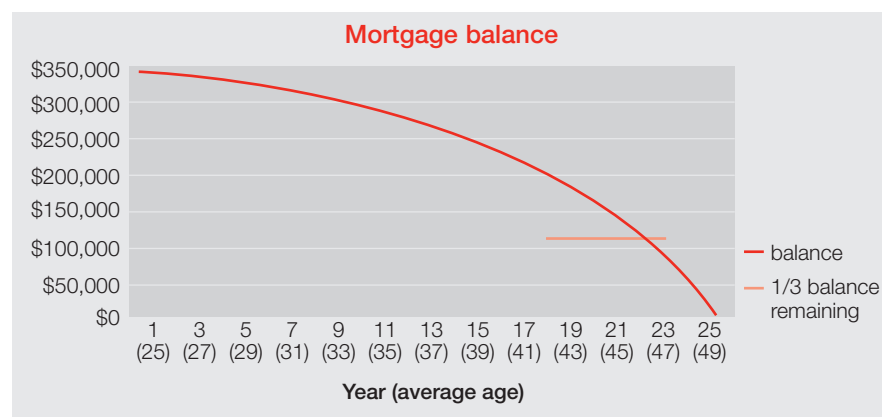
The debt burden

Paying it off may be harder than you think

In May 2009, the average loan size on an owner occupied property was over \$266,000. That's a huge burden on a family balance sheet.

As the graph below illustrates, it takes time to significantly reduce the balance of your mortgage. So if anything were to happen within 20 years of taking out your mortgage, you're likely to have a considerable debt still owing.

Unfortunately the early years of a mortgage are often when Australian families have other major expenses – particularly their children's education. That makes mortgage payments almost impossible to meet if anything reduces the cash coming into the family finances.



Source: Macquarie Bank, assumes an interest rate of 7% p.a.

A small price to pay

By insuring your income and your life and protecting yourself against major medical costs and the risk of permanent disability, you could dramatically reduce the stresses involved in carrying large levels of debt.

“A hundred load of worry will not pay an ounce of debt”

George Herbert, English Poet, 1593 – 1633

The sleep easy challenge

How much do you need to sleep at night?

IFSA and Rice Warner Actuaries have suggested that full time working couples in their mid thirties with young children need life insurance cover ranging from 10 to 13 times their taxable income. However their research suggested that many couple's insurances are well below this level.

Don't forget the housework

There is more to insurance than protecting the main breadwinner. IFSA Research suggests that the childcare and home help provided by a 'stay-at-home' spouse could be worth more than \$75,000 a year⁷. That's why many experts emphasise the importance of insuring beyond the main income earner.

How much do you need?

You can get a clearer picture of how much insurance you need by drawing up your own personal balance sheet. Here is a basic one. Your financial adviser would be able to better map your financial position, and recommend an insurance package to cover your specific needs.

Remember, both partners should go through this exercise (and the one on the next page) to make sure the risks to both partners are included.

What are your current liabilities?		What are your current assets?	
Mortgage/rent		Property value	
Car loan		Superannuation	
Other loans		Share portfolio	
Credit cards		Savings	
Children's education		Other assets	
Other debts			
Total liabilities		Total assets	
Estimate the level of cover you require			
Total liabilities – Total assets =			

⁷ Australian mothers – undervalued and underinsured, IFSA Media Release: October 2005

A series of solutions

The cashflow challenge

While life insurance can help to pay out major expenses such as a mortgage, calculating your need for insurance also involves thinking about your regular cashflow needs. Should one of the main income earners be injured or disabled it's important that meeting regular expenses such as school fees, food and entertainment does not put too great a burden on the family's finances.

It's also crucial that a financial setback does not ruin your long-term financial plan. When you consider the vital expenses you have to meet each month you may not include regular savings. But if you don't have the ability to save, how can you plan for retirement?

The following table can help you establish the regular costs you need to meet each month and may be particularly useful when discussing disability income cover with your adviser.

Your monthly cashflow needs	
Mortgage/rent	
Debt repayments (monthly)	
Car Insurance	
Medical Insurance	
School fees	
Groceries	
Entertainment	
Savings	
Holidays	
Car Expenses	
Total monthly expenses	

The options available

Selecting the right insurance cover is an important exercise; and a financial adviser can help you get the cover you need. The table below outlines some of the basics.

Need	Suitable insurance cover?
How could I pay the bills and care for my family if I was injured and had to stop working?	Disability Income Insurance could give you a monthly payment of up to 75% of your income if you became disabled and unable to work.
Who would take care of my family financially if I wasn't around?	Life Insurance can provide your family with a lump sum payment to help them maintain their financial position in the event of your death.
How could I take care of myself and my family if I was injured and wasn't able to work again?	Total and Permanent Disability Insurance can pay you a lump sum if you suffer total and permanent disability and are unlikely to be able to work ever again.
If I were to fall ill, how could I focus on getting better, and not worry about my finances?	Trauma Insurance helps reduce your financial worries by paying a cash lump sum if you develop certain conditions or suffer certain medical events.

It's up to you and your adviser to decide which of these insurances suits your needs and how much of each you need given your age, job status, health, number of dependents, debt and assets.

Another pair of hands

Disability Income Insurance

The average Australian could earn nearly two and a half million dollars⁸ in their lifetime. Yet most don't insure their largest asset – their income earning capacity. Protecting your income is particularly important for those who are self-employed – and Disability Income cover is tax deductible!

The basics

Disability Income Insurance helps provides financial security in cases where your ability to earn an income is reduced or temporarily ceases due an injury or illness. Disability Income insurance can cover you for short periods whilst you are unable to work as the disability does not have to be permanent. However it is possible for the monthly payments to continue until age 65 if your disability is ongoing or permanent.

Disability Income policies typically pay up to 75% of your normal gross income. That monthly benefit can help:

- Meet your mortgage or rent payments whilst you are not earning an income
- Cover day to day living expenses whilst you cannot work
- Ensure you can take the time you need to fully recover, without being driven back to work by financial pressures.

Disability Income premiums are generally tax deductible, but the payments received are considered income and are subject to tax. Disability Income payouts can sometime be reduced if you are receiving benefits from another source – such as government payments or workers compensation.

Once again it is important to remember the contribution a non-working partner, or one who works part-time, makes to the overall financial situation within a family. Many Disability Income products now offer cover for this situation.

Features

Depending on the cover you choose, Disability Income can provide you with a range of additional features. An indexation feature can boost your monthly payout in line with inflation. You can also have additional benefits that cover the cost of home care or of accommodation for family members if they need to be near the insured when they are in hospital. In addition, you can often choose whether your Disability Income cover is an indemnity policy or agreed value. An indemnity contract means the benefit is based on your income immediately prior to claim and therefore may differ from the insured amount if your income has reduced. A guaranteed agreed value contract means the income benefit is based on your income at time of application.

Some questions to ask when selecting disability income

- How long must you be disabled before benefits become payable?
This is the waiting period
- What is the maximum period for which the income benefit is payable?
This is the benefit period
- How and when are benefits paid?
- Are there any specific injury and/or trauma benefits applicable to the Disability Income policy?
- Can the monthly income benefit be reduced for any reason?
- When does cover start and end?

⁸ Based on full-time adult average weekly ordinary times earnings multiplied by 40 years of continuous employment
Earnings Source: *Average Weekly Earnings, Australia*, February 2009, ABS, Category number 6302.

For your family's sake

Life Insurance

Life Insurance offers financial protection for your family at a time when they shouldn't have to think about money. In the case of death, or if the insured is diagnosed with a terminal illness and has less than 12 months to live, the dependents receive a lump sum payment.

One of the common mistakes people make in considering life insurance is that it is only required by the family's main income earner. The home maker is also a significant contributor – without them the income earner may not be able to continue working.

A lump sum life insurance payout can help your family:

- stay in the family home by paying out the balance of the mortgage;
- maintain the same standard of living by providing an amount that can be invested or drawn down over a period of time; and
- cover future planned expenses such as children's education.
- Life Insurance premiums are generally not tax deductible for individuals, but the benefit is generally free of tax.

Obviously, the risks associated with insuring your life increase as you get older. By taking out life insurance at an earlier age you may be able to get a policy where you won't be required to undergo a medical in later life to increase your cover.

Amount of Life Insurance

The amount of life cover you need will depend on a range of factors – such as your debt levels or the amount of existing assets.

Some questions to ask when selecting life cover

- How and when can you increase existing life cover?
- What is the minimum increase?
- How and when are life cover benefits paid?
- When does cover start and end?

Out of the workforce

TPD Insurance

TPD Insurance provides a lump sum payment if you are totally and permanently disabled before retirement age and are unlikely to be able to ever work again.

TPD Insurance pays the nominated benefit as a lump sum which can be used for the same purposes as life insurance and for:

- Covering any gap costs for medical treatment
- Paying for rehabilitation and ongoing care
- Paying for any home modifications that may be required.

Type of TPD Insurance

If the person to be insured is gainfully employed for a minimum of 20 hours per week at the time of application, then they can apply for TPD cover. In most cases your insurer will distinguish between "own occupation" and "any occupation" definitions and you can choose the cover that suits you best.

You receive a benefit under the 'own occupation' definition if, after becoming disabled, you are unlikely to work again in your current occupation. You receive a benefit under the "any occupation" definition if you are unable to work again in any occupation that you are suited to because of your education, training and experience. "Own occupation" is only available to certain professions. Your adviser can help you determine which type of cover is most suitable for you.

TPD cover is often highly important for a partner who does not go to work. The work they do in the home can be crucial to the family balance sheet and many TPD insurances offer domestic duties cover as well.

Beating illness and injury

Amount of TPD Insurance

The TPD sum insured that you choose could be based on a range of factors – debt levels, existing assets, your household budget etc. Your adviser will be able to help you decide on the right amount.

Some questions to ask when selecting TPD Insurance

- How and when can you increase existing TPD insurance?
- What is the minimum increase?
- How and when are TPD insurance benefits paid?
- When does cover start?
- When does cover end?

Trauma Insurance

Trauma Insurance covers you against a range of specified life-threatening illnesses or injuries, such as cancer or stroke.

It can help take away the financial worry and let you focus on recovery. Trauma Insurance provides you with a tax free lump sum payment and there are no restrictions on how it is spent. It can be used:

- To cover additional costs such as out-of-pocket medical expenses, home nursing and specialists' bills
- To meet expenses you can't cover due to being off work
- For a lifestyle change – such as a sabbatical or changes to your home – that make recovery easier.

Amount of Trauma Insurance

With Trauma Insurance, you apply for a specified amount of insurance. Your adviser can help you decide on a sum insured as they will have information on the costs people incur as a result of serious illness.

Some questions to ask when selecting Trauma Insurance

- How and when can you increase existing Trauma Insurance?
What is the minimum increase?
- How and when are Trauma benefits paid?
- What specific conditions are covered?
- When does cover start?
- When does cover end?

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GPO Box 5216 Brisbane QLD 4001



macquarielife.com.au



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insuranceclaims@macquarie.com