Survey reveals South Africans are dangerously under-insured

DISABILTY COVER: Assessing the efficiency of the South African insurance market in its provision of disability cover by True South Actuaries and Consultants (March 2013)

Key findings from survey

- **Too little disability cover sold relative to life**
- **Within disability, temporary disability is the blind spot**
- **When it comes to permanent disability, sales are skewed in favour of lump sum benefits, with income replacement benefits making up less than 5% of total insurance cover sold in 2011, or 17% of permanent disability cover sold**
- **Quality of permanent disability poor:**
  - too much lump sum (leaving consumers with risk they may not be aware of)
  - too much accelerated cover

An independent survey conducted in March 2013 by True South Actuaries & Consultants (www.truesouth.co.za) and commissioned by FMI (www.fmi.co.za) revealed that the South African disability insurance gap currently stands at R11.1 trillion. That means in South Africa, almost 2 million self-employed and commission workers are dangerously under-insured when it comes to disability.

Background

"FMI decided to partner with True South to assess the current status of disability in South Africa today," says Brad Toerien, CEO at FMI. "As an industry, we need to be careful not to sell insurance based on emotion, but rather on facts. Sometimes we are not as efficient in assessing the client's real needs and we then leave them facing an alarming shortfall against actuarially probable eventualities."

True South Actuaries have become one of the country's most-respected and quoted actuarial consultancies in the financial services sector. Their consultants were briefed by FMI to investigate the market for disability cover in South Africa and report on any inefficiency. "There was no brief to reach a particular conclusion, FMI just wanted the facts," says Paul Zondagh, Executive Director at True South Actuaries.

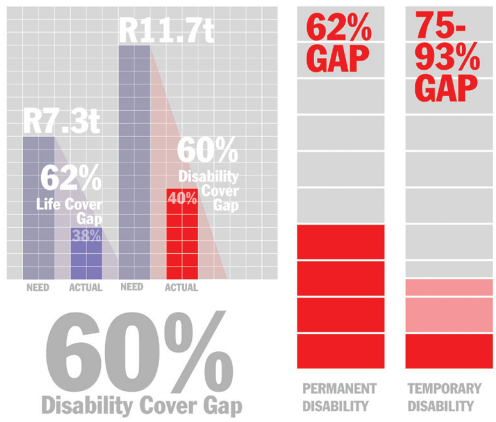
Serious gaps in disability cover

According to the survey, the gap in the South African temporary disability cover market is at best 75% and at worst 93%. That represents an alarming situation. "Temporary disability is the thing that most self-employed South Africans will need cover for, and yet the insurance industry is not giving them what they need. I don't need to spell out the massive economic and social consequences of this shortfall – without properly insured income streams, thousands of people, particularly self-employed individuals, business owners, their employees and dependants could find themselves in catastrophic circumstances."

"We know clients can't close the disability gap out of their own resources. Self-insurance is not an option as most consumers are in debt and not keeping up with their debt payments," says Zondagh. "The Momentum Wellness Index shows most South Africans are unwell or marginally unwell, and according to the Credit Bureau Monitor, only 38% of consumers in debt are up-to-date with their payments. So they need insurance, but they don't have enough. Insurance is still a grudge purchase and levels of disposable income are low."

True South quantified the disability cover gap at 60% which means only 40% of the required disability cover is in place. Putting that in rand terms, the insurance industry has sold R7 trillion of disability cover and the market needs R18 trillion. That's an R11 trillion shortfall.

Currently the three providers of disability cover are government, employer group schemes, and retail companies. Realistically, the retail sector is the only one of these three that can or will cover this gap.



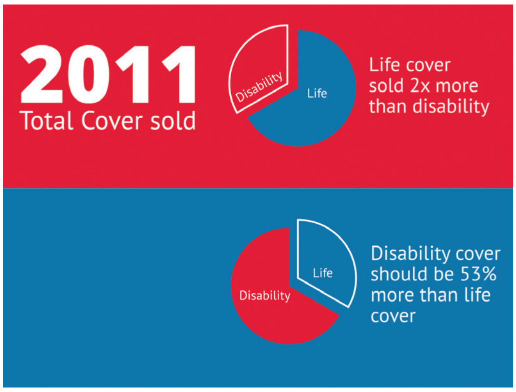
Gaps in South African disability cover

Too little disability cover sold relative to life cover

"The True South research shows that retail life cover is being sold at 60%, disability cover at 30%, and critical illness at 10%. According to the survey life cover is sold at double the level of disability cover. Theoretical reasons exist why we would have expected the relativity to be the other way around. We should be selling disability to double the value of life cover as, in the disability cases, the life insured remains a member of the household," adds Toerien.

"According to recent FMI research, temporary disability is as much as 40 times more likely to occur than permanent disability. 90% of disability claims last for less than 90 days and yet we are only giving South Africans 7% of the temporary cover they need."

"Temporary disability does not only cover the serious illnesses or accidents we typically associate with disability, but includes common conditions such as pneumonia, bone fractures, mumps, sprains, and strains. So we have established actuarially that life and critical illness is oversold compared to disability cover, and, within disability, permanent is oversold compared to temporary," explains Toerien.



Comparison between Life and Disability cover

Permanent disability cover skewed in favour of lump sum

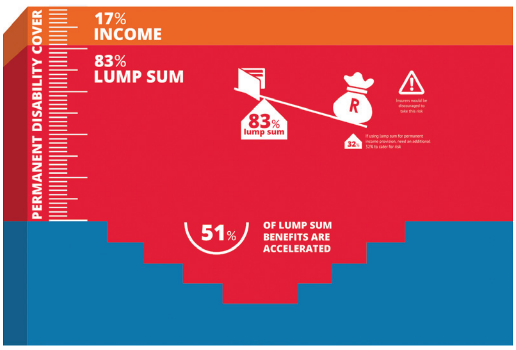
Another important factor in this disability space is lump sum pay-outs versus income replacement benefits. True South's assessment is that new sales of permanent disability cover indicate a heavy skew in favour of lump sum benefits. In 2011, only 17% of permanent disability sold was income protection. This points to consumers buying lump sum benefits for use as income replacement, which is inherently risky because many individuals do not have the skills or the discipline to manage large amounts of cash (what some call 'the Lotto winner effect'). With a lump sum pay-out, a number of risks are being passed to the individual including interest, inflation, longevity, and currency.

True South has quantified the true cost of this risk. If an insurance company were to use a lump sum to provide for a future income stream, they would be required to hold an additional 32 - 41% of capital to allow for this risk. In other words, financial industry regulations oblige insurance companies to behave in a particular way on investments like these and yet those same companies sell lump sum cover to individuals without pointing out the identical quantifiable risk of a shortfall.

For example, if a client wants to achieve a lump sum pay-out of R5 million to cover long-term needs they would need to take cover to the value of an extra 32% at minimum to safely cover the risk in the lump sum according to industry regulations. In other words, if a client would like to achieve a lump sum pay-out of R5 million, the actual value of the pay-out would only be worth approximately R3.4 million and that is where the real risk lies.

"The important point is that if a client gets a lump sum pay-out and thinks that will provide for their long term income needs, they are taking on major investment and inflation risks – whereas with a monthly income payment, that risk sits with the industry – which is where it should sit – and the client is secure. Insurers should not be passing these types of risks onto unwitting consumers," says Toerien. "Even if the individual uses the lump sum to purchase an annuity and eliminate some of these risks, they then face additional fees. In addition, income protection premiums are tax deductible and by only purchasing lump sum, consumers are not getting this benefit."

"We cannot afford to be selling policies on the basis of emotions, tradition, trends, institutional imperative, intuition or even demand. Just because a client asks for a particular policy, or is reassured by one, does not mean we should be selling it. Our job is to work from the demonstrable need and the proven outcome."



Permanent disability cover comparison

Closing the disability cover gap

So what should be done to start closing the disability gap? The first action is to critically assess all life cover. Twice as much life cover is sold in comparison to disability - that is not rational - especially for younger people with no dependants and no debt. True South say that any rational client would need at least 50% more disability cover than life cover especially given high levels of debt, coupled with low savings, which means insurance is the only way to ensure an uninterrupted income stream in the event of any disability.

The second action is to assess the amount of critical illness cover bought in the industry today. It is worth considering the risk of up-weighting critical illness over other more common forms of disability.

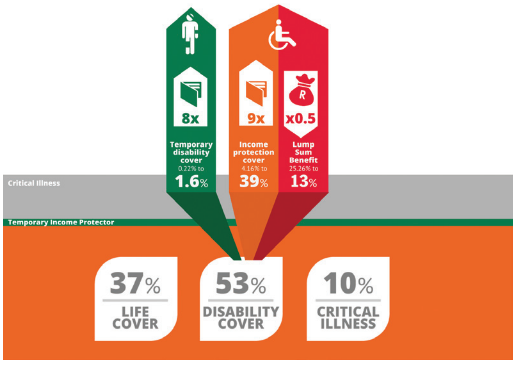
The third action is making sure that cover really is cover. "There is a lot of what I call 'bells and whistles' cover about at the moment that claims to cover everything – an omnibus life/disability/critical illness policy. We need to ask ourselves, are we selling the right mix of cover? We need to work out the core benefits for our client first and then think about the relevant additional benefits that will support the core benefits. This is not a spread bet game – income protection should be just that – protection of income first," says Toerien.

The fourth action – once we've established the need for proper disability cover – is to engage with our client in what True South calls 'sensible buying behaviour in an unconstrained scenario'. "We need to ensure that we sell quality products to our clients instead of quantity," adds Toerien.

Conclusion

In conclusion, True South estimates that without changing the size of the overall insurance market, the income protection market in South Africa should be nearly 10 times bigger – it should grow from R57 billion to R524 billion which represents a very big business opportunity for advisers and the industry as a whole.

"We can improve the quality and amount of cover that clients have whilst saving them money – safe in the knowledge that acting to fill that gap is in the very best interests of clients and advisers," concludes Toerien.



Correct mix of disability cover

For more information please contact our FMI Financial Advisers Distribution Team on 0860 10 52 08, sales@fmi.co.za or www.fmi.co.za

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