MacKay ON MONEY

BY FINANCIAL ADVISER CHRIS MACKAY

I'm not so sure Australia is the "lucky country". After the recent horrific floods in Queensland, NSW, Victoria and fires in Western Australia, it's definitely not good fortune that has rained on our Aussie cousins. And you would have to feel a certain sympathy for those hapless Ockers who were unable to buy house and contents insurance that extended to flood cover. Apparently if one lived in a low lying area, then flood insurance wasn't available.

I understand Californians have the same trouble buying earthquake insurance because of their issues, sitting right on the San Andreas fault.

I've written before in this column about the origins of insurance.

To repeat, the guts is, before a disaster strikes, a whole lot of people pool together and put some dough aside so if one or some of them experience some bad event, then they can recover their loss. Of course under this regime, no-one is quite sure who or what may experience the bad fortune but statistics and the law of averages says someone or something will go wrong and create a financial loss.

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Imagine this simple scenario. There are 100 houses in a small town. Historically on average there has been a random fire in the village every two years resulting in a total loss of the particular house. Houses cost $100,000 to rebuild. So some bright spark (not the village arsonist) suggests everyone pays $500 per year into a jointly owned fund ($500 x 100 = $50,000). In two years there is $100,000 available.

Mrs Jones is visiting her sister at another village and Mr Jones decides to get out on the town. He has one too many lagers, comes home and has a fry up, falls asleep, the fat ignites and the house burns down. Mr Jones luckily is dragged out by his faithful Labrador before he too becomes brown bread. Mr Jones is $100,000 out of pocket, but the mutual fund pays up, rebuilds the house and all is well.

It's actually a form of socialism but one where you pay your own way and don't bludge off the State (or by definition bludge off your fellow citizens).

Since those early days, a few enhancements have developed, but the principle remains the same.

Pool together and do it **before** the disastrous event.

Unlike California, in New Zealand we have a very efficient system of earthquake cover. Fire and General Insurance companies offer house, contents and car insurance and part of your premium automatically goes to the Earthquake Commission. They pay up to $20,000 if an earthquake causes a loss to your furniture, furnishings, appliances, carpets, curtains and light fittings. And they pay up to $100,000 for earthquake losses to houses and land. But if you don't have house or contents insurance, tough luck – you don't have earthquake cover.

Actually part of your house and contents premium pays a fire service levy too, which funds the fire brigades. In the old days in Britain, you used to have some sign over your door saying you had fire insurance with XYZ Company and if you didn't, the fire brigade wouldn't put out the fire. Interesting concept. Perhaps we should bring it back.

One of the other efficient insurance systems relates to the Life Insurance companies. They offer Life, Trauma, Income Protection and Disablement cover. New Zealanders by international standards are very under insured. Perhaps we believe Mother State should provide. And I suppose to some extent, there is a State initiated safety net. Not too many of us are starving even after disaster strikes. But it's how well you want you or your family to live following a disaster that will determine how much of a believer in Life and related insurances you are.

I had an ex client who told me recently he was comfortable leaving his wife and young baby with a $200k mortgage if he died because she could work and still pay it off. I don't want clients who don't appear to love their families and was pleased to see him go. My prediction based on three decades in the business. The marriage will fail.

New Zealand obviously had a couple of pretty unlucky major disasters as well last year. The Christchurch earthquake and aftershocks and the Pike River coal mine disaster.

Like many Kiwi companies, our firm sent cheques off to various relief funds for both.

However, there is a school of thought that says "why should most people insure their houses and contents for example and do the right thing, when other people make a deliberate decision not to insure their house or contents and expect some sort of charity payout if something goes wrong?"

Likewise, on the life insurance side.

I heard a tragic case on the radio about one of the Pike River Coal contractors who hadn't been paid and was probably unlikely to be paid because of the receivership, and his wife or partner was saying how terrible it was because she and the kids still had a mortgage and bills to pay etc.

There is a simple answer to all this. The solution is life insurance.

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It costs peanuts and it means if someone does die prematurely, as sadly was the case of the Pike River miners, then an insurance company takes the loss on the chin and looks after the widows, partners and families.

A 40-year-old male non-smoker for example, can buy $1,000,000 worth of insurance for about $16 per week or three or four coffees. Pretty cheap eh?

Worth thinking about!

(The above are generalised comments only and should not be taken as personalised advice. A Disclosure Statement is available on request and free of charge.)