

Protection Planning Fact-sheet

Your Guide to Life & Health Insurance

There are a variety of ways of protecting yourself and your family in the unfortunate event of long term or serious illness and death. The correct choice for you will depend on

- Your personal circumstances.
- The options available.

This fact-sheet has been prepared to provide an outline of the available options for personal protection.

It describes how each option works in practice and we hope this will help you establish the most appropriate type of cover. We recommend that you read this before discussing your detailed and individual requirements with your Adviser. It covers:

1. Life Assurance
 - Term Assurance
 - Pension Term Assurance
 - Whole of Life
2. Critical Illness Cover
3. Income Protection

1. Life Assurance

The need for life assurance stems from the certainty that everyone will die, but that the timing is unknown. There is no way of ensuring absolutely that everything has been taken care of before you die. Life Assurance will provide your family or other dependents with a capital lump sum or regular income. Life Assurance can also be used to minimise the effect of Inheritance Tax in the event of death. In most cases, payments from these policies will be paid tax-free to the person nominated to receive the benefit.

Insurance companies will require the completion of medical questionnaires, and occasionally medical examinations before agreeing to insure someone. This is to enable them to determine the level of premium. In the event that the applicant has had previous health problems, or a family history of health problems, the likelihood is that the premiums will be higher. In some cases, the insurance company may refuse cover or only offer limited cover, as the risk is too great. There are specialist providers who offer preferential terms to applicants who have been refused cover elsewhere. Your adviser will help you find the most suitable provider.

TERM ASSURANCE

Term assurance comes in various forms. Term plans guarantee to pay out some form of benefit in the event of death within a specified time. At the end of that time, the plan will cease without any return. In the event of death after that date, no benefit will be payable. There is no investment. The premiums are known at outset and, in most cases, guaranteed throughout the selected term. This type of cover is commonly used where the period for which cover is required can be easily determined e.g. to repay a loan or to pay school fees. The insurer will not accept policies until the applicant has been medically assessed – known as underwriting. If underwriting highlights a problem that will reduce the applicant's life expectancy - and therefore the greater likelihood that the plan will have to pay out - the premium will be increased or exclusions applied. Term assurance can be written on single life or joint life bases. It is most common for these to be taken out on a joint life first death basis, as they tend to provide protection for the surviving partner.

Level Term Assurance

This type of plan offers Life Assurance of a fixed amount, payable only in the event of the death during the term of the policy. The benefit and premiums will remain constant throughout the term. It must be noted that inflation will have an effect on the eventual purchasing power of the benefit, and also that, at the end of the specified term, the plan will cease without any money back.

Decreasing Term Assurance

This is commonly used in relation to the repayment of a loan or a capital repayment mortgage. The level of cover will gradually reduce over the specified period, in line with the reduction of borrowing. This type of cover is generally the cheapest available and, again, the premiums will remain level throughout the term of the contract.

There are exceptional circumstances whereby the life cover will fall at a faster rate than the outstanding capital of the loan. Each individual policy will warn of this, and the most common circumstance is where interest rates for mortgages increase above 10%. At the end of the term the plan will cease with no money back, as there is no investment element included within the contract.

Family Income Benefit

This is a slightly different form of protection and is a variation on the decreasing term assurance described above. Instead of a lump sum being paid out in the event of death, this plan will pay out an income each year for a specified period of time. As the name suggests, this is most commonly used for family protection to ensure sufficient income for dependent children.

Benefits can be increased annually to counteract the effect of inflation throughout the term. If this option is selected, the premiums will also increase. In addition, most plans have an option whereby the benefit can be paid as a reduced lump sum after the life assured has died.

Increasing, Renewable and Convertible Term Assurance

Each of these contracts is a variation on the Level Term Assurance detailed above and they all carry slightly higher costs. Increasing term assurance allows the benefit to increase over the specified term. This can help to counteract the effect of inflation. The premiums will also increase in conjunction with the benefit.

Renewable term assurance offers the option to renew the policy at the end of the specified term. Premiums may increase but fresh medical evidence is not required. This can prove to be an expensive way to renew cover, as a new plan with new medical evidence is often a cheaper option. However, it can be very valuable where the health of the applicant has deteriorated since commencement of the original plan.

Convertible Term Assurance allows an element of investment linking to be included within the plan. This can effectively turn the contract into a Whole of Life contract or an Endowment plan. Again the premiums will increase to take account of the on-going cover, but this can be offset to a certain extent by the inclusion of the investment element. Medical evidence will not be required when the conversion takes place, which again can increase the relative cost of the plan.

Pension Term Assurance (PTA)

It is possible that you may have an old life assurance contract, which was set up on a “pension” basis. This means that the monthly premiums attract tax relief in the same way as a pension contribution. (For every £8 of premium paid, you actually buy £10 worth of life cover, with potentially a further 20% of relief available if you are a higher rate taxpayer). A new, more flexible version was introduced in April 2006 but due to concerns by the Chancellor about the amount of tax relief that could possibly be granted after the contracts were heavily advertised, the decision was taken in December 2006 to remove tax relief on any new applications. This effectively ended their sale.

Any policies already set up should continue to receive tax relief on contributions. In most circumstances they would ideally be retained due to their lower cost.

WHOLE OF LIFE

This is the most comprehensive form of life cover, and usually the most expensive. In return for a monthly premium, the insurance company will pay out a pre-determined lump sum in the event of death, whenever it might occur. Cover might either be provided for a fixed Sum Assured on premium terms established at the beginning or flexible terms are available that permit increases in cover once the policy is in force. This caters for changing personal circumstances.

As the insurance company must pay the benefit for each policyholder, assuming the payments are maintained, an element of investment is built in to each contract. Over the years, this investment should grow and help to subsidise the more expensive premiums in later years. Equally, the investment growth can be used to maintain a lower level of life cover, in the short term, if premiums reduce or cease. If a policyholder should decide to surrender the policy completely, any investment growth that has built up will be paid to the policyholder.

Premiums

As with most protection plans, premiums are determined by age, health and gender. In addition the cost will depend on the level of investment risk that you are prepared to take, and also the basis of the contract. Policies can be written on minimum, standard and maximum bases. If minimum is selected, this means that the minimum amount of the premium is paid towards life cover and the majority is paid into the investment. This is the most expensive option at outset, and provides the highest chance that premiums will not have to be increased in future. Conversely, the maximum basis will be the cheapest option. This provides the highest level of life cover for the premium paid, but only a minimal amount of the premium will be allocated to the investment element. This means that there is unlikely to be sufficient investment growth to maintain the premiums in future.

Premiums are usually subject to a review every five or ten years. At these reviews, it is possible that the premiums required will be increased. This will happen where the investment growth has been insufficient to cover the increased cost of cover. The increase will depend on the age and sex of the applicant and the investment growth that has occurred. Once an insurer has accepted a plan, no further medical evidence is required, on the assumption that the sum assured remains constant.

Policies can be written on joint or single life bases. Joint life plans guarantee to pay out a specified lump sum following the death of one of the policyholders. They will either be written to pay out following the first death, or the second death. The latter is commonly used for Inheritance Tax purposes and the former for family protection.

Investment

The investments selected will depend upon your attitude to risk and circumstances. There is a range of investments available, including Cash, Fixed Interest, With Profits, Equity and Specialist funds. Most companies will permit switches between some funds at various times.

Charges

The charges are all included in the premium you pay each month. With Profit investments have hidden charges that are calculated as and when annual bonuses are declared. Unit linked investments will have explicit charges that will be clearly documented in the paperwork provided. In addition to these charges, there are additional options such as waiver of premium, and guaranteed insurability (see below) that will be offered for a small additional premium.

2. Critical Illness Cover

This contract is designed to pay out a tax-free capital lump sum in the event of diagnosis of a critical illness. It is available in the form of both Term Assurance and Whole of Life, the latter being considerably more expensive than the former. The illnesses covered are defined within the policy schedule provided by the Insurer. The definitions and range of illnesses vary from company to company. The applicant will have to satisfy medical underwriting requirements, and this will determine the level of premium payable. The Whole of Life contracts will have an investment element like the life cover detailed above.

Critical Illness cover is available as a stand-alone contract as well as being linked to life cover, and endowment plans. Where it is included as an added option, most contracts will pay out in the event of critical illness or death whichever is first.

The majority of Critical Illness contracts include payment in the event of total permanent disability and many will pay smaller amounts where a lesser disability arises. The option of “buyback” can also be included. This enables the policyholder to retain the plan following a claim without further medical evidence. This will often incur increased premiums. In some cases, certain illnesses may be excluded from the policy and therefore a payment will not be made in the event that the policyholder suffers from the illnesses specified.

Critical Illness Cover, when provided alongside Income Protection, offers valuable additional protection reducing the impact of lost future earnings and helping to cover expenses such as home modification, which often follow a serious illness.

3. Income Protection

Income Protection is also known as Permanent Health Insurance. This benefit will replace a proportion of your income in the event that you are unable to work due to ill health for a certain length of time. Payments will continue until such time as you return to work or retire. Some providers will take account of the state invalidity benefit and reduce the benefit where this is payable while others will pay a benefit in addition to this. On the provision that premiums continue to be paid, the insurer cannot cancel cover irrespective of the number of or length of claims made.

Premiums

Premiums are determined by the level of benefit selected, age, sex, health, family history and also the period before which benefits will be paid. It is possible to arrange for benefits to commence between 4 and 104 weeks following illness. The longer the period before benefits are required, the cheaper the premium. Premiums can often be significantly higher for women as statistics demonstrate that women are more likely to claim than men.

Benefits

Benefits will be paid after the policyholder has been unable to work for a specified period of time. For all plans that commenced after 1996, payments will be made as regular tax-free income and will continue until retirement or earlier return to work. In the event that a lesser job is taken as a consequence of the illness or disability, a proportion of the benefit can sometimes be payable to cover the shortfall in earnings. Benefits can be written on two bases, "own occupation" and "any occupation". The former will be more expensive and is a valuable benefit for people employed in specialist roles. "Any occupation" means that the benefit will only pay out if the claimant is unable to undertake any employment, this might not bear any relation to the current occupation. In addition to this, it is possible to write the plan so that the benefits (and therefore premiums) increase each year to take account of inflation. There is also the option for these increases to continue once the plan is in payment. Most plans will have some policy exclusions and these vary from provider to provider. Additional exclusions and loadings (increased premiums) may be applied where the applicant has or has had health problems.

ACCIDENT AND SICKNESS INSURANCE

This is a relatively simple form of cover. The tax free benefit will be payable if the policyholder is off work due to accident or sickness. Most contracts are only available on an annual basis, and the Insurance Company will reassess their offer of cover each year on the basis of up-to-date medical evidence.

In general, a lump sum will be payable in the event of death, permanent disablement, loss of one eye or loss of one limb, or permanent total disablement. Cover for temporary disablement and medical expenses will also be available for an additional premium. In the event of temporary disablement, a weekly sum will be payable for a defined period if the policyholder is unable to carry out his own occupation for a time.

Payments in the event of sickness will also be made on a weekly basis for a maximum specified number of weeks. A deferment period will be included as with Income Protection; however, as the premiums tend to be cheaper a shorter deferment period may be affordable.

Policies such as these are commonly used for travel insurance, or to bridge the gap between an employer's sick pay ceasing and the Income Protection benefit coming into force.

CONTRIBUTION INSURANCE

The plans detailed above will offer this benefit subject to satisfactory medical underwriting. In return for a small additional premium, the insurance company will maintain premiums as having been paid in the event that the policyholder is unable to work through sickness or injury. Premiums will continue to be paid until a claim is made, the policyholder returns to work, or until retirement. The availability of this option will depend on the age and health of the applicant.

GUARANTEED INSURABILITY

This option is available to applicants aged 45 and younger. It offers the option to increase the benefits payable under the above contracts, within certain limits, without additional medical evidence being required. As with the “buyback” option for Critical Illness cover, it will increase the price of the plan, and where the applicant is in good health, it may be possible to secure superior benefits elsewhere for a lower cost.