The fine line between security and losing it all

by Craig Harding

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Craig Harding, Managing Director of Altrisk provides a comprehensive yet extremely userfriendly overview of the various issues surrounding income protection. This can be a useful tool when answering basic questions from your clients.

There are very few people who don't need to work to pay the bills. Your bond repayments, credit cards, electricity and water, taxes, school fees and grocery bills won't stop arriving just because you're sick or injured to the point that you are unable to work and function normally.

Without a regular income, the chances are you would struggle to get by and most likely lose your hard earned assets and take a serious demotion in your standard of living. While you may get by for a short period of time by dipping into your savings, few could cope with being off work for a few months or, even worse, being permanently disabled due to illness or injury with no hope of returning to work.

With the plethora of products available on the market in terms of lifestyle and income protection, Altrisk provides some insights into what's available and how the different offerings work…

Q: What is the difference between income protection and lifestyle protection?

A: Asset protection is when an insurance policy is used to cover the value of an asset or a debt linked to an asset in the event that something should happen to the life insured and they want to ensure that their capital obligations are still met. The most common example of this is taking out a life policy to cover outstanding debts such as a mortgage in the event of the death of the insured.

An income replacement benefit provides a specified monthly amount in the event of the life insured becoming disabled due to an illness or as a result of a disability, and protects the life insured from the risk of not being able to meet their regular and recurring financial obligations. Altrisk's income replacement benefit currently has the highest entry age in the industry at age 65 as many people now work longer than the average retirement age. The expiry age can be 60, 65 or 70, depending on the client's requirements.

Lifestyle protection benefits provide protection from the financial consequences associated with the impact on your lifestyle as the result of a critical illness or disability, for example, losing a limb, suffering a heart attack or stroke; examples of the impact include such things as home renovations, long-term care, and even motor car changes.

Death Income Benefit provides a monthly income on the death of the life insured, suitable for clients who don't want the risks associated with interest rates and inflation changes. Benefits of a nominated amount are available for either 12 or 24 months, the latter can be extended to what would have been the life insured's 60th, 65th or 70th birthday.

Accidental Death Cover provides cover on the death of the life insured as the result of an accident.

Impairment covers the insured for specific physical and/or functional impairment events of a permanent nature, regardless of whether or not the insured can perform their occupation.

Disability Cover pays the insured a specified lump sum in the event of disability or impairment. These benefits contain a core impairment portion and are available 'for life' or to the age of 65. If the 'for life' option is selected, the occupational disability, functional impairment and disability income benefit portions respectively, will taper from the age of 65 to 70 at 20% per annum.

Critical Illness Cover provides the insured with cover for a range of specified diseases and or events, which are an unfortunate fact of life.

Crisis Waiver benefit waives the premium due on the policy for a specified number of months in the event of disability; the death of a spouse; hospitalisation; divorce; retrenchment; or insufficient funds on a debit order request. Two variations are available – one based on occupational disability and the other based on the inability to perform specified daily activities in the event that the client is not eligible for occupational disability. Plus, if no claims are made during a 5-year period, the insured will receive cash-back on each successive 5th year policy anniversary. The benefit is calculated using 5 times the average premium on the entire policy over the 5-year period.

Q: What is the main difference between critical illness and functional impairment benefits and the different roles each benefit plays in financial planning?

A: 'Functional Impairment' is an attempt to define medical illnesses that would leave an insured unable to work, without considering their ability or inability to work. The traditional occupational disability definition says that we will pay you if you can't do your job while under Functional Impairment, we will pay if you have a serious illness that would usually leave you unable to work. This creates certainty about payment rather than uncertainty so common in evaluating whether or not someone is able to work. An important difference is that some people will still be able to work following a Functional Impairment claim.

Q: How much critical illness cover do I need?

A: Statistically 75-90% of critical illness claims revolve around cancer, heart disease and stroke – given this, consideration needs to be given to whether you are at a risk for any of these diseases due to a family history of pre-existing conditions and plan accordingly. So, in order to determine the amount of cover needed to consider family history, any pre-existing conditions and then look at possible scenarios if you were to contract any of these illnesses, what would the potential financial and medical implications be?

Q: How do products such as critical illness and disability cover help with retirement planning?

A: Poor risk planning could negatively affect your retirement planning from a funding point of view – in the event that you become ill or disabled and are unable to pay the monthly premiums for your retirement products. An income replacement or disability plan would assist in mitigating this risk and ensure that your retirement planning does not become impacted by your inability to service the monthly premiums due to illness or disability.

The other scenario could occur once you are in retirement and you suffer a serious medical condition. The potential costs of care and treatment will cost more than you had originally budgeted for in terms of a 'healthy retirement'. This is where a 'whole of life' critical illness plan would be of great benefit to safeguard against the cost of an illness or disability eating into your retirement funding. Essentially consider two scenarios – before retirement consider the impact of not being able to fund your retirement planning due to illness or disability, and post retirement consider the impact of potential medical/health conditions and their associated costs on your retirement funds.

Generally, retirement planning begins as soon as one starts working by setting aside money in retirement annuities, pension schemes and various savings policies. But even the best laid plans can be derailed by unforeseen life circumstances. Given the statistics around lengthening life expectancies, it's not unrealistic for a number of us to be to be 'retired' for as long as we have worked. Given the already severely overburdened and strained public healthcare system, chances are that a bad turn in a client's autumn years could leave them dependent on their spouse, children, grandchildren or other relatives who may not be in a financial position to support them. Altrisk's newest benefit – Long Term Care – caters for this exact eventuality. Benefits are payable after 65 and may be paid either directly to the insured or ceded to a care provider. Children who have a particular interest in supporting their parents in need of care can take this cover out on behalf of their parents. In addition, a death benefit is available before or after the life insured's 65th birthday.

Q: How do I as a breadwinner secure an income for my family in the event of death?

A: You need to evaluate what the impact of the loss of a spouse is on your financial planning. Once established, you need to find the products and benefit structures that best meet your needs such as lump sum capital to settle debt/financial obligations and create fund for future income or income benefits to meet expenses on a monthly basis. An intermediary's role is to help determine the most cost effective way of structuring benefits to achieve your planning goals.

Simply demonstrated, if a breadwinner dies or becomes permanently disabled, what funding would a spouse or partner need to cover key debts such as the house, cars and other assets? This is where a lump sum benefit is important. Then, consider how much cover you would need to meet monthly expenses – an income benefit would come into play here. In a dual income household, you could base the required cover needed for each partner based on their relevant contribution to the household income and plan accordingly.

Q: Discuss the best way to fund lifestyle protection benefits.

A: There are two scenarios and I believe they apply equally whether you are looking at disability or life cover. The lump sum benefit should be used to fund 'asset protection', essentially protection of your assets such as your house and other debts that will need to be paid off. The Income Replacement benefit should be used to fund monthly running costs.

In terms of life cover, having a monthly income benefit also alleviates a lot of the risk and stress experienced by a beneficiary in having to invest a large lump sum of money and being concerned with interest rate changes for example.

Q: There has been much debate in the marketplace about the benefits of monthly disability against lump sum disability products. Is there a place for both within client's portfolios?

A Lump Sum Disability is paid upfront to replace lost future income in the event of permanent and total occupational disability. A monthly disability is a fixed amount paid monthly. In each instance the amount is assessed on the basis of your occupation, the nature and severity of the impairment and the policy options selected.

Lump Sum Disability is generally cheaper from a premium cost point of view and depending on the definition you select. For example:

· "Own' definition – The total and permanent inability of the life insured, due to sickness, injury, disease, illness or surgical operation, to perform his/her own occupation

· 'Own or similar' definition – looks at the total and permanent inability of the life insured, due to sickness, injury, disease, illness or surgical operation, to perform his/her own occupation or any other occupation for which he/she is suited in terms of training, education and experience.

· 'Any' definition – looks at the total and permanent inability of the life insured, due to sickness, injury, disease, illness or surgical operation, to perform any occupation.