Protection

Learning Outcome 2

By the end of this learning material you will be able to demonstrate an understanding of the need for protection planning and the main sources of financial protection.

2. Introduction

This chapter looks at the needs for protection planning and the various types of personal protection available.

2.1 Personal and Family Income and Capital Protection Needs

Financial Protection Products

Life Assurance	Provides a lump sum on death of a life assured
Critical Illness Cover (CIC)	Provides a lump sum on diagnosis of a specified critical illness
Income Protection Insurance (IPI)	Provides a regular income if the life assured is unable to work due to accident or illness
Mortgage Payment Protection Insurance (MPPI)	Provides a regular income to pay the mortgage repayments if a life insured is unable to work due to illness, accident, redundancy or unemployment
Payment Protection Insurance (PPI)	Provides a regular income to pay loan or credit card repayments if a life insured is unable to work due to illness, accident, redundancy or unemployment
Personal Accident and Sickness Insurance (PAS)	Provides a lump sum or regular income if a life insured suffers an accident or illness
Accident, sickness and unemployment insurance (ASU)	Provides a lump sum or income benefits if a life insured suffers an accident or is unable to work due to sickness, redundancy or unemployment
Long Term Care Insurance (LTCI)	Provides payment towards the cost of long-term care in old-age or infirmity
Private medical insurance (PMI)	Provides cover towards the costs of private medical treatment

- Some products may contain a mix of different types of cover e.g. a product may include life assurance and critical illness cover.

2.2 The Relationship between Insurance and Assets and Liabilities

Protection Needs

Death

Income, mortgage or other debts

Incapacity, health or accident

Business Protection

Asset protection

Death

Insurance may be needed to provide money to support a dependent family or spouse in the event of the life assured's death. Where there would be a financial impact - then there is a need for insurance.

- In the case of dependent children - income may be needed to support them through school years and on to further education – the most commonly used end age of dependency is age 21 for the youngest dependent child.
- The protection need for a dependent spouse/relative may be for the lifetime of the spouse/relative.
- For a couple in a long term relationship or married/civil partnership where one party would be dependent on the partner's earnings – there could be a protection need for each other against the death of the other.
- The dependent person may not be in a position to make financial decisions for themselves and there may be a need for a Lasting Power of Attorney

Income, mortgage and other debt

Where there is a mortgage or other debt it is important to protect the repayments in the event of illness or repay a capital sum in the event of death. A mortgage or a substantial loan is a large financial commitment - and if income dries up during an extended period of illness then the impact can be catastrophic – even resulting in losing the home.

Another situation to consider is the death of one of the parties to the mortgage/loan or if they suffer a critical illness – there are products which combine the death and critical illness cover needed to make sure the mortgage/loan is repaid in the event of death or critical illness. This would mean that the surviving partner would be able to stay on in the house/have the loan repaid.

Redundancy can also cause financial difficulties. Because this can be difficult to predict – redundancy insurance cover is normally limited to cover for the mortgage or loan/credit card repayments. The maximum period of cover generally available is 2 years. Redundancy payments from an employer can help with maintaining financial commitments and state benefits may also help.

Incapacity, health or accident

Losing the source of income due to incapacity, ill-health or accident can mean financial problems. There is more chance of being off work due to sickness than death.

It is impossible to predict when you may be off sick or how long the ill health will last. There may be benefits paid by the employer but these may not be paid through the whole period of ill health. There is a need for insurance products to provide the financial support required to maintain the normal lifestyle.

Consider:

- How much employer benefit is available and for what time period.
- If self-employed – income may stop immediately or be reduced if income is coming in from commission on past sales
- Family situation i.e. do you only have you to support or have you got a family or dependents
- What state benefits – if any – would you be entitled to? It is becoming more difficult to claim state benefits – and this re-enforces the need to make personal provision.
- Critical Illness – there is a very real risk of suffering a critical illness – statistics show that the likelihood of contracting cancer is 1 in 3. However, many who contract a critical illness will survive for a number of years – some may never work again and others may eventually recover and go back to work. Protection against loss of earnings and the need for a capital sum to repay a mortgage or loans or to adapt a home or provide specialist care needs to be considered.
- Long Term Care may be needed because of prolonged illness or old age. This may involve the costs of domestic help or changes to the house e.g. stair lifts. Residential nursing care may be required.
- While some state benefits are available e.g. disability living allowance (DLA) and attendance allowance – these will not meet the costs of long term care.
- From 8 April 2013 Personal Independence Payment (PIP) started to replace DLA, for people aged 16 to 64. The Department of Works & Pensions will contact those affected at, to ask them to make a claim for PIP instead.
- Entitlement to benefits may be restricted due to means testing.
- Private Medical Insurance can be used to access medical attention quickly and at a hospital of your own choosing. The element of speed and choice can be particularly attractive to the self employed

2.3 Business Protection

- The need for protection applies to businesses as well as individuals.

- Small businesses may rely totally on the owner's wealth and the success of the business may be dependent on their skills and application.
- Newly formed businesses with few resources and no reserves are at risk.
- Many businesses rely on key individuals so Key Person Insurance would be vital.
- Key Person Insurance can be Life Assurance, Critical Illness or Income Protection.
- The protection need for the business can depend on how the business is set up
- Partnerships may have their own protection needs.
- Business Protection is covered in detail later (Chapter 10)

<u>Asset Protection</u>

An individual's death may result in an IHT liability for their beneficiaries and there may be a need for protection against this. IHT and trusts are not in the scope of this text but you should be aware that protection may be required in the following circumstances.

Death. If the estate is more than the Nil Rate Band (NRB) (£325,000 in 2017/18 tax year) then there could be an IHT liability of 40% of the excess. Certain exemptions exist e.g. Transfers between spouses including being able to transfer unused NRB allowances between spouses. The estate may also benefit from the residence nil rate band of £100,000 (2017/18).

Potentially Exempt Transfers (PETs). A lifetime gift made to an individual may be a PET. If the donor dies within 7 years, there can be an IHT bill of 40% of the excess over the NRB. The IHT is payable by the recipient.

Chargeable Lifetime Transfers. If a lifetime gift is made to a trust (other than a bare or disabled trust) and the gift exceeds the available NRB there is an immediate tax charge of 20% of the excess. If the donor dies within 7 years, there can be an extra tax charge of up to 20%. The IHT is normally payable by the trustees. (If the settlor pays the tax on a lifetime gift, the amount gifted must be grossed up to include the tax paid).

Other Protection needs to be considered

When any relationship breaks down it may trigger the need to review the existing protection needs and solutions and what is required in the new situation.

In the case of divorce – the Court can make decisions as to the future ownership of property including existing policies. It can order the transfer of a policy from one party to the other – or that payments are maintained by one party for the benefit of the other. It also has the powers to change the terms of an existing trust (e.g. a trust associated with a life policy).

It is important to note that divorce in itself does not change a person's " interest" in a policy i.e. if the ex-spouse is one of the policyholders, is the life assured or a beneficiary under trust of the policy – then this will continue unless the Court orders otherwise.

Divorce may mean that existing cover is no longer needed or appropriate and it should or could be cancelled – or it may mean that new protection requires to be put in place.

Some Life companies will allow policy splitting on divorce – and this could be of real benefit if the health of one of the lives assured is not good and could lead to difficulties/policy loading in the case of a new policy.   This could be especially important if the original policy had Critical Illness cover included – many of the critical illness definitions have changed over the years and indeed many situations are no longer deemed "critical" and thus are not covered in current policies.

Divorce can also lead to new situations that require protection e.g. if one party is due to pay alimony to the other or if child maintenance is to be paid – a policy may be needed to protect the "payments" in the future in the event of death during the period of responsibility.
Remember the rules of Insurable Interest – so the "ex" can only take out cover to the extent that it covers the future payments.

Existing Assets and Protection Needs

Having established the "need" then what the client already has in place or can reasonably expect to receive must be considered to arrive at the gap to be filled.

Money from all sources must be considered:

Y	Monies due from policies or arrangements **YOU** have put in place
E	Monies that would be paid by an Employer e.g. Death in Service benefits
S	Monies that would be paid by the State e.g. various state benefits

Sources of Financial Protection

Y

- Existing Life Assurance policies
- Existing Income Replacement polices
- Existing Investments
- Existing Pension arrangements

E

- Death in Service Benefits (maximum available is generally 4 x salary)
- Sick Pay (the amount and term may vary with different employers)
- Pension arrangements (conditions for eligibility for ill health retirement can vary with different employers/companies)
- Private Medical Insurance (the amount and terms can vary with different employers)

S

- Income support – payable to eligible applicants aged between 16 – pension credit qualifying age
- Jobseeker's allowance – payable if actively looking for work
- Child Benefit – payable to a person responsible for a child up to age 16 (or 18 if in full time education)
- Bereavement Payment – lump sum payable on death of spouse/civil partner
- Bereavement Allowance – weekly payment (up to 52 weeks) on death of spouse/civil partner
- Widowed Parent's Allowance – taxable weekly benefit to surviving spouse/civil partner
- Carers' allowance - taxable weekly benefit payable to people who spend at least 35 hours a week caring for a person with substantial caring needs.
- Statutory sick pay – paid to employees who pay class 1 NICs
- Employment and Support Allowance – (ESA) paid to individuals who cannot work due to sickness but are unable to claim statutory sick pay. This benefit replaced incapacity benefit.
- Disability Living Allowance (DLA) / Personal Independence (PIP) - payable to people under 65 who need help with personal care
- Attendance Allowance - payable for people over 65 who need help with personal care.

Other Considerations

If the adviser is considering advising the surrender or lapse of existing polices and then replacing them with new ones – then it has to be in the client's best interests and the client must be benefitting from this action. The benefit must be evidenced and documented. Cancelling a policy and replacing with a similar new policy would be considered "churning" i.e. an action that would only benefit the adviser by them receiving commission on the new sale.

In most cases this will mean that existing arrangements are undisturbed. Examples of change being acceptable would be a Term Assurance policy which could be replaced at a cheaper premium. Care should be taken that the client does not cancel the existing policy until the new one is in force – in case of underwriting issues. The terms and conditions of the new policy must be no worse than the existing policy – and that can present issues where the existing policy includes critical illness cover or with Income Replacement plans.

Protection Learning Outcome 2 (PROT2) – End of Module Test

Multiple Choice Questions

Question	**Answer**	
2.1 - Which of the following best describes the carers' allowance?	A.	Tax free weekly benefit payable to people who spend at least 16 hours a week caring for a person in receipt of disability living allowance or attendance allowance.
	B.	Tax free weekly benefit payable to people who spend at least 35 hours a week caring for a person in receipt of disability living allowance or attendance allowance.
	C.	Taxable weekly benefit payable to people who spend at least 16 hours a week caring for a person in receipt of disability living allowance or attendance allowance.
	D.	Taxable weekly benefit payable to people who spend at least 35 hours a week caring for a person in receipt of disability living allowance or attendance allowance.

2.2 - Which of the following products will NOT provide cover against redundancy?	A.	Accident Sickness and Unemployment Insurance
	B.	Payment Protection Insurance
	C.	Mortgage Payment Protection Insurance
	D.	Income Protection Insurance

2.3 - In the case of dependent children, which is the most commonly used end age of dependency?	A.	Age 18 for the oldest dependent child.
	B.	Age 21 for the oldest dependent child.
	C.	Age 18 for the youngest dependent child.
	D.	Age 21 for the youngest dependent child.

2.4 - What is the maximum pay out period following a claim in respect of redundancy insurance cover?	A.	24 months.
	B.	18 months.
	C.	12 months.
	D.	6 months.

2.5 - Which of the following statements most accurately describes the tax treatment of a Potentially Exempt Transfer?	A.	No immediate IHT liability. If the donor dies within 7 years of the date of the gift, then IHT of up to 40% is payable by the recipient on the excess above the nil rate band.
	B.	No immediate IHT liability. If the donor dies within 7 years of the date of the gift, then IHT of up to 40% is payable by the settlor's estate on the excess above the nil rate band.
	C.	Immediate IHT liability of 20%, payable by the settlor. No further IHT liability.
	D.	Immediate IHT liability of 20%, payable by the settlor. If the donor dies within 7 years of the date of the gift, then a further IHT charge of up to 20% is payable by the settlor's estate on the excess above the nil rate band.

2.6 - Which of the following best describes Personal Accident and Sickness Insurance?	A.	Provides cover towards the costs of private medical treatment
	B.	Provides payment towards the cost of care in old-age or infirmity
	C.	Provides a lump sum or regular income if the insured suffers an accident or illness
	D.	Provides a regular income if the life assured is unable to work due to accident or illness

2.7 - Which of the following best describes Long Term Care Insurance?	A.	Provides payment towards the cost of care in old-age or infirmity
	B.	Provides cover towards the costs of private medical treatment
	C.	Provides a regular income if the life assured is unable to work due to accident or illness
	D.	Provides a lump sum on diagnosis of a specified critical illness

2.8 - Transfer of assets between spouses for IHT are considered as	A.	a potentially exempt transfer
	B.	a chargeable lifetime transfer
	C.	exempt
	D.	a chargeable gain

2.9 - Which of the following best describes Employment and Support Allowance?	A.	paid to people under 65 who need personal care
	B.	paid weekly on death of spouse/civil partner
	C.	paid to people over 65 who need help with personal care
	D.	paid to individuals who cannot work due to sickness but are unable to claim statutory sick pay

2.10 - If an adviser is considering advising the surrender / lapsing of existing polices and then replacing them with new ones – then it has to be	A.	in the adviser's best interests
	B.	nearly the same as the existing product and if the adviser benefits that is acceptable
	C.	in the client’s best interests and the client must be benefitting from this action
	D.	excluded from underwriting

- End of Questions -

Answers

Question	Answer	
2.1 - Which of the following best describes the carers' allowance?	D	Taxable weekly benefit payable to people who spend at least 35 hours a week caring for a person in receipt of disability living allowance or attendance allowance.
2.2 - Which of the following products will NOT provide cover against redundancy?	D	Income Protection Insurance.
2.3 - In the case of dependent children, which is the most commonly used end age of dependency?	D	Age 21 for the youngest dependent child.
2.4 - What is the maximum pay out period following a claim in respect of redundancy insurance cover?	A	24 months.
2.5 - Which of the following statements most accurately describes the tax treatment of a Potentially Exempt Transfer?	A	No immediate IHT liability. If the donor dies within 7 years of the date of the gift, then IHT of up to 40% is payable by the recipient on the excess above the nil rate band.
2.6 - Which of the following best describes Personal Accident and Sickness Insurance?	C	Provides a lump sum or regular income if the insured suffers an accident or illness.
2.7 - Which of the following best describes Long Term Care Insurance?	A	Provides payment towards the cost of care in old-age or infirmity.
2.8 - Transfer of assets between spouses for IHT are considered as	C	exempt
2.9 - Which of the following best describes Employment and Support Allowance?	D	paid to individuals who cannot work due to sickness but are unable to claim statutory sick pay.
2.10 - If an adviser is considering advising the surrender / lapsing of existing polices and then replacing them with new ones – then it has to be	C	in the client's best interests and the client must be benefitting from this action.