# PROTECTION: INCOME PROTECTION INSURANCE

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Deciding what **type** and **level** of financial protection you might need **is the cornerstone of a sound financial plan**. Arguably your priority should be ensuring that you and your family are financially protected from the worst that may happen, before planning for the life you hope to live in the future.

Here we take a closer look at **Income Protection Insurance**, and what you need to consider before taking out a policy.

Please refer to our note giving an Overview of Protection policies for details of other types of cover available.

# SUMMARY

The purpose of an Income Protection Insurance (IPI) policy (also known as PHI or Permanent Health Insurance) is to provide a **replacement income** to the policyholder in the **event of disability**, caused by sickness or accident, **which prevents the policyholder from earning a living**. The benefit would normally be payable up to the normal retirement age specified in the policy document or, if earlier, the date at which the policyholder is medically able to return to work.

Please note that the comments below refer to individual IPI policies, rather than group schemes.

# TYPES OF IPI POLICIES

Traditionally, IPI has been written on a pure protection basis, with much the same features as term assurance. However, it is also possible to obtain cover on a unit-linked basis, in the same way as unit-linked whole of life policies. Please see the Whole of Life and Term Assurance Research Pages for further details.

# FEATURES OF IPI POLICIES

Clearly, there is a cost associated with each of the policy options, the premium increasing for higher sums assured, shorter deferred periods, and greater rates of benefit escalation.

## PERMANENCE OF COVER

Regardless of how many claims are made or for how long they last, the insurer cannot terminate the contract so long as the premiums continue to be paid. Policies usually expire at age 60 or 65.

## DEFERRED PERIOD

The income benefit commences at the end of a deferred period, selected by the policyholder at inception to generally coincide with when (for employed people) their employer stops paying their salary if they are unable to work. The usual deferred periods are 4, 8, 13, 26, or 52 weeks.

 

# FEATURES OF IPI POLICIES

## INCREASING BENEFITS

The benefits under an IPI policy can either remain level or escalate annually both before and during a claim, although some policies may only permit escalation prior to a claim, the benefit then remaining level in payment. Insurers now offer a variety of bases on which they will increase benefits, e.g. a fixed increase of 3% or 5% per annum, or escalation in line with an index such as inflation or average earnings. The advantage of an increasing rather than a level benefit is that it provides partial or full protection against the effects of inflation, which is particularly important over the long term.

## INSURABLE OCCUPATIONS

The occupation that an individual follows and the type of work involved will have a bearing on the likelihood of disability through accident or disease and for this reason occupations are risk classified into four broad groups. Class 1 is the lowest risk (administrative and professional occupations), and Class 4 is the highest (heavy manual work). There are also a number of occupations that are uninsurable.

## DEFINITIONS OF DISABILITY

Insurers apply different definitions of disability for claims purposes, which must be fully satisfied for a claim to be paid. These range from the claimant's ability to carry out his or her own occupation through disability, to doing any job for which you are reasonable suited, through to being unable to perform basic functions of living e.g. washing and dressing. The more restrictive the definition, the higher the premium cost.

## PROPORTIONATE BENEFIT

If the claimant is able to take a lower paid or part time job, the benefits paid will be reduced accordingly.

# TAX TREATMENT

Benefits from new IPI policies are paid free of liability to income tax and National Insurance, hence the maximum benefits payable are considerably less than full salary. The maximum benefit usually payable by insurers is either 50% of salary plus any state benefits payable, or 60% of salary less benefits payable. The maximum is also reduced by benefits from other disability policies.

# RISK FACTORS

Please be aware that the term based contracts have no cash-in value at any time and that nothing is payable in the event of you reaching the end of the term without making a claim. Therefore you should evaluate whether you consider that such a policy would offer value for money.

The costs quoted will be based upon an assessment of your health, which assumes that you will be accepted on ordinary rates of premium. In order to implement the cover, you may have to undergo a medical assessment, which will formally determine the eventual premiums.

**Important Information:** Our views are based upon our understanding of current legislation in England, unless stated otherwise. Levels and bases of, and reliefs from, taxation are subject to change and their value to you will depend upon your personal circumstances.

**Risk Warning:** The past is not necessarily a guide to future performance. The value of your investment and the income from it can fall as well as rise and is not guaranteed. You may not get back the full amount invested. This document is provided for information only and does not constitute advice. You should not act on any of the information without seeking professional advice.