PROTECTION: TERM ASSURANCE

APRIL 2024

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 **Term Assurance**, 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

Term assurance is a **straightforward life assurance** providing a **guaranteed death benefit (sum assured)** at a known, usually guaranteed, premium, and over a **set term**. It is therefore suitable for protection needs during the **specified period only**.

Examples of where it is commonly used are:

- For a family **until the children have grown up**.
- To **pay off a mortgage or other debt** in the case of the borrower's death before repayment, where it is preferred that the home or other assets are not sold to repay the debt.
- To provide **cover against potential inheritance tax liability in the seven years** after making a potentially exempt transfer.

Most term assurances are **relatively cheap**, as the insurer will only have to pay out on a proportion of the cases insured. If term assurance is all that can be afforded, then the **renewal** and **conversion** options described below can give **guaranteed ongoing insurability** up to older ages, e.g. 60 or 65, although will not protect against the rising premium costs due to age. In addition, **increasing** term assurance can be used to protect the sum assured against the effects of inflation.

Most policies also include **terminal illness cover**, which will pay the sum assured on diagnosis of terminal illness (where you are given less than 12 months to live). This cover usually does not apply during the last 12 – 18 months of the policy term.

TYPES OF TERM ASSURANCE

LEVEL TERM ASSURANCE

The amount payable on death remains level throughout the policy term, i.e. in real terms inflation will reduce its value. This may not be important for short term contracts, but for longer term contracts inflation can make a significant difference. For example, inflation of 3% over 20 years will reduce the value of the sum assured by almost half.

Of course, if the policy is designed to match a debt that also remains level, for example an interest only mortgage, then the loss in value in real terms is not an issue.

DECREASING TERM ASSURANCE

These are generally the cheapest forms of life cover, as the amount payable on death falls over the policy term until it reaches zero by the end of the term. The fall is usually on a fixed scale, designed to match the repayments on a loan, for example.

Mortgage Protection Assurance is probably the most common type of decreasing term assurance, and is based on an assumed mortgage interest rate. Providing the mortgage rate does not exceed this assumed rate, then the policy will at least match the outstanding liability.

Gift Inter Vivos Assurance is another type of decreasing term assurance, and is designed to match possible inheritance tax (IHT) liabilities for potentially exempt transfers, for the seven years after gift. However, the interaction between the IHT nil rate band and potentially exempt transfers means that it is often better to take a 7 year level term policy.

CONVERTIBLE TERM ASSURANCE

The conversion option allows you to convert your policy into a permanent insurance policy, i.e. a whole of life policy or endowment policy, at any time before the end of the term, without providing further medical evidence. The conversion option will be quoted at the life company's standard rates for your age at conversion, but no further underwriting would be required on your life. This could be beneficial if, for example, your health had deteriorated significantly during the term of the policy.

The conversion option usually costs around an extra 10% on the standard premium cost, and so can often be a valuable inclusion. However, it can be difficult to find suitable policies for longer policy terms than 5 or so years.

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TYPES OF TERM ASSURANCE

FAMILY INCOME BENEFIT

This is a form of decreasing term assurance, where the benefit is paid as a regular income, rather than a lump sum. However, the beneficiaries usually have the option to take the lump sum should they wish.
The policies are designed to replace the lost income on the death of a breadwinner, and are generally related to a specific need, e.g. the length of time until children reach adulthood.

RENEWABLE TERM ASSURANCE

This is much the same as the conversion option above, except that the option is to renew the policy as another term assurance. The renewal option will be quoted at the life company's standard rates for your age at conversion, but no further underwriting would be required on your life. This could be beneficial if, for example, your health had deteriorated significantly during the term of the policy.

The renewal option is usually only available for terms of 5 years or less, and only for policies expiring before age 60 or 65. This option can be combined with the conversion option.

INCREASING TERM ASSURANCE

These policies offer the possibility of an increase in the sum assured each year. This option is useful if you wish to maintain the real value of the sum assured by increasing it by inflation each year.

When increases take place, the premium usually increases by the equivalent amount based upon the life assured's age at that time.

TAX TREATMENT

Most term assurance policies provide only death benefits, and do not provide a surrender value. For these policies, all proceeds are free of income and capital gains tax. Inheritance tax could be payable if the policy is not written under trust.

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.