PROTECTION: WHOLE OF LIFE COVER

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 **Whole of Life Cover**, 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

Whole of Life (WOL) policies provide for a sum to be paid on the death of the **life assured, whenever it occurs**. They do not have a fixed term but rather **continue throughout life** and are therefore **suited to delivering a lump sum**. Many (but not all) WOL policies will also deliver a lump sum if they are surrendered during the lifetime of the life assured. This is known as the **surrender value**.

Examples of where WOL is commonly used are:

- To give family and other dependants **permanent protection against the loss of income on your death**. Whereas children may need only temporary protection (term assurance) until they reach adulthood, a spouse or a dependant adult may need protection throughout your life.
- To **meet costs of death** such as funeral costs, costs of settling your estate and paying any debts outstanding.
- To **create a lump sum in trust** on your death. This can provide tax-free funds to pay for an anticipated IHT liability, thus enabling the executors to settle and distribute the estate with the minimum of delay.

TYPES OF WHOLE OF LIFE POLICY

Whole of Life (WOL) cover is either available as pure life insurance cover, or combines pure life insurance with an investment element that is used to cover some or all of the increasing cost of the life insurance as you get older. The different types of policy reflect the differing amounts and types of investment element within them. The basic main types are:

- Pure insurance.
- Investment linked policies:
  - Unit linked investment policies.
  - With profits policies.
  - Low cost policies.

PURE INSURANCE

These policies are the simplest type of WOL cover to understand, and consequently one of the more commonly purchased types. They provide a guaranteed sum and guaranteed premiums, but no investment value on an early surrender - if the policy is surrendered early, it simply expires. The policies suit individuals who are keen to provide a lump sum with which their beneficiaries can settle an IHT bill, but who are very unlikely to want to surrender the policy at any time. Due to the fact that there is no investment value, premiums can be very competitive when compared to Unit Linked Balanced, Maximum and Minimum cover.

UNIT LINKED INVESTMENT POLICIES

Unit Linked policyholders accept the investment risk on the underlying fund, and therefore potentially receive greater returns, making the contracts potentially cheaper than traditional with profits policies. A wide range of investment funds are available, including cash, gilt, corporate bond and various equity funds, and also unit linked with profits.

The death benefit is usually the guaranteed sum assured, or the value of the fund if greater. Each month, units are encashed to pay for the cost of the life insurance. Additional benefits are also available, such as critical illness cover.

There are three levels of cover:

- Maximum.
- Minimum.
- Balanced.

Maximum, Minimum and Balanced cover policies are reviewable after a set period, usually 10 years.
At this stage, premiums can be increased or insurance reduced if pre-set investment returns have not been achieved. As a consequence, policyholders may face an unexpected and often substantial increase in premiums if investment performance has been worse than forecast.

TYPES OF WHOLE OF LIFE POLICY

UNIT LINKED INVESTMENT POLICIES

Unit Linked - Maximum Cover

These policies provide for maximum insurance and minimum investment. Therefore, they are generally the cheapest whole of life available, but are unlikely to have much of a value if surrendered early. Furthermore, to maintain the original level of cover and premiums throughout life many life offices have assumed that underlying investment growth on premiums would be higher than have been actually experienced. Consequently, many policies have been reviewed and premiums increased sharply to maintain the original level of cover.

Unit Linked - Minimum Cover

These policies provide for minimum insurance and maximum investment. Therefore, they are generally the most expensive, but may have a reasonable value if surrendered early. There is a possibility of a premium increase on review after 10 years, although this is less likely than with maximum cover policies

Unit Linked - Balanced Cover

These policies provide a balance between investment and insurance. Therefore, premiums are normally somewhere between the premiums for maximum and minimum cover. There is likely to be some value on early surrender although this will probably not be significant. Indeed, many balanced policyholders may also face increased premiums on review after 10 years.

WITH PROFITS POLICIES

The sum assured on death is guaranteed, and in addition the policyholder is entitled to a share of the profits of the underlying with profits life fund. In the last couple of decades, these policies have been superseded by unit linked contracts, which are designed to give the client more flexibility and control over benefits.

LOW COST (WITH PROFITS) POLICIES

This type of policy combines a guaranteed sum assured with a decreasing term insurance. The idea is that the sum assured is increased each year by the addition of annual bonuses as the term insurance decreases. Low Cost With Profits policies have become much less popular in recent years as they tend to be far more expensive than the unit-linked versions outlined above. Nonetheless they still have a place for some individuals who want the security of a guaranteed pay out for their beneficiaries, which none of the unit-linked policies can provide.

TAX TREATMENT

The policy death benefits are often written under trust meaning that there is unlikely to be any Inheritance Tax (IHT) when the policy "pays out", as the death benefits were not part of the deceased's estate immediately before death. Income tax is also normally avoided. Policies are divided between those that are:

- **Qualifying**
  For tax purposes - no income tax is due on death, but if the policy is surrendered before death the investment return will have suffered tax at basic rate.

- **Non-qualifying**
  Theoretically income tax is due on death but only if the surrender value immediately before death exceeds total premiums paid which is unlikely for regular premium WOL policies.

PREMIUMS AND IHT

In most cases, the premiums on a WOL contract will be covered by one of two relevant IHT exemptions:

- Annual exemption which covers gifts of up to £3,000.
- Normal expenditure out of income exemption.

If premiums are not covered by an IHT exemption, they will probably be treated as Potentially Exempt Transfers and therefore will escape IHT providing the payer of the premium survives for 7 years from the payment date. However, premiums paid to a policy held in a relevant property trust will usually be treated as chargeable lifetime transfers and may be subject to Inheritance Tax at the lifetime rate.

WHOLE OF LIFE VS. TERM ASSURANCE

Many years ago, WOL was often a fundamental component of financial planning. As premium costs rise with age, the policy was often started as early as possible to ensure that sufficient cover was available when needed in the future, no matter whether that meant having surplus cover now.

However, as the term assurance industry has become more competitive, it may now be beneficial to separate the pure insurance element of the contract and the investment element, in order that the best provider for each element can be chosen. The insurance needs could, for example, be met by a succession of renewable term assurances. Investment needs can be met by a potentially better performing investment manager, and by using potentially more tax efficient vehicles such as ISAs and unit trusts rather than life insurance funds.

As ever, there is no right answer. For those who are able to afford the premiums and, as important, maintain regular contributions over the long term, WOL can provide a guaranteed benefit for the future. However, the guarantee comes at a price, which may be considered too high. Those who may surrender the policies early or who are not buying the policy purely for protection may find their needs served better elsewhere.

RISK FACTORS

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

These policies are designed to provide a lump sum payment upon death, whenever it may occur.
The premiums are fixed for a set number of years and after this time may be reviewed up or down by the insurance company. Should you discontinue the policy, you would lose the benefits provided and it may have little or no cash-in value. For with profits policies, the return on the investment depends upon the profits made by the life office and on its policy as to their distribution (whether on early encashment or in adverse market conditions or other circumstances).

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.