A E Thomson Ltd

Independent Financial Advisers

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GUIDE TO

PROTECTING YOUR FAMILY, YOUR BIGGEST ASSET

Life is unpredictable and filled with a multitude of potential risks

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Life is unpredictable and filled with a multitude of potential risks

Welcome to our Guide to Protecting your Family, your Biggest Asset

The harsh truth is that an unexpected serious illness, a debilitating injury or even a sudden death can drastically affect a family's financial stability.

Insurance is not just about numbers and premiums; it's about securing peace of mind. By implementing the appropriate insurance policies, you can rest assured knowing that you and your family have a financial safety net to fall back on if the unexpected should occur. This way, you prepare for the worst and ensure your and your family's future.

Life is unpredictable and filled with a multitude of potential risks. By understanding and selecting the right insurance policies, you can confidently navigate life's uncertainties, knowing that you've taken steps to safeguard your and your family's financial wellbeing.

Protecting your family in the event of something happening to you or a loved one

Life insurance

Life insurance serves as a financial safety net, promising a predetermined sum to your chosen beneficiaries should you pass away while the policy is still active. The cost of life insurance hinges on several factors, such as your age, health status, lifestyle and the extent of coverage you require, in addition to the specific policy type you opt for.

Securing the right life insurance policy is crucial in various circumstances. These include when taking out a mortgage, cohabitating with a partner or welcoming a new child into your family.

Moreover, life insurance can form part of estate preservation planning if your estate has significantly appreciated in value and you anticipate an Inheritance Tax (IHT) bill. By setting up a life insurance policy written in an appropriate trust, you could provide for this tax liability.

Typically, IHT applies at a 40% rate on the value of an estate above the 'nil rate' allowance of £325,000 (frozen until April 2028). This figure escalates to £500,000 if a primary residence is bequeathed to a direct descendant. Assets passed to a spouse or registered civil partner are exempt from this tax.

How life insurance works

Life insurance provides your loved ones with a lump sum payment upon your death, provided the insurance policy is still in effect. These payments are exempt from tax and can be utilised as needed, though they are commonly used to replace lost income or settle hefty debts like a mortgage.

Payments can also be arranged to go directly into a trust, enabling your family to access the funds more promptly. This arrangement ensures that the payment doesn't form part of your estate; thus, it's not subject to IHT.

Different types of life insurance

Life insurance comes in various forms, each tailored to meet specific needs and circumstances. One common type is term life insurance, also known as standard life insurance. Here, you determine the length of your cover or the 'term.' Should you pass away within this term, the policy pays out. However, if you survive beyond the term, the policy doesn't pay out any death benefit, and there's no return on the premiums you've paid.

Types of term assurance

Term assurance can be categorised into three main types: decreasing term, level term and increasing term insurance. Decreasing term cover is typically associated with a substantial debt like a mortgage. You set the payout size and term to match your debt. The payout aligns with the amount you still owe on your debt at any point during the term. Although your monthly premiums remain constant throughout the term, this type of cover is the least expensive.

Level term and increasing term policies

Level term policies, on the other hand, offer the same payout regardless of when you die during the term. Increasing term policies increase either by a fixed percentage or an inflation-linked index, such as the Retail Prices Index (RPI) or the Consumer Prices Index (CPI). Combining different policy types might work best for you, depending on your situation.

Family income benefit policies

Another way to financially secure your family is through family income benefit insurance. Unlike standard life insurance that pays a lump sum upon your death, this policy provides a regular monthly income to your beneficiaries until the policy's expiry date. This payout remains constant throughout the term, but as the number of months decreases, the total amount paid will be lower if you die later in the term. It's a form of decreasing term policy.

Whole-of-life policies

Finally, there are whole-of-life insurance policies. These ongoing policies guarantee a payout upon your death, provided you continue paying the premiums, typically until you reach the age of 90. Given the certainty of payout, these policy premiums are more expensive than term insurance policies, which only pay out if you die within a specific timeframe.

Income protection insurance

Income protection insurance is a safeguarding policy designed to provide financial assistance if you cannot fulfil your work duties due to injury or illness. This policy provides regular payments that substitute a portion of your income.

Formerly labelled as permanent health insurance, its primary function is to aid you in managing your household bills, mortgage repayments, credit card dues and daily expenses that may become burdensome without a steady income stream.

Providing monetary support

This type of insurance typically provides monetary support until retirement, death or your return to work. However, short-term income protection policies are available, which last for one to two years and come at a more affordable cost.

It's imperative to understand that income protection insurance is not synonymous with critical illness insurance, which offers a lump sum payment in the event of a severe illness, or mortgage payment protection insurance, which specifically covers your mortgage payments.

Cover and payment deferral period

Income protection insurance typically covers between 50-70% of your income, depending on the specifics of your policy. There is a 'deferral period' before you receive the first payment. The length of this depends on the terms of your policy and the premiums you've paid. Policies generally start paying out after a pre-agreed period, which can range from one to 12 months post the onset of your illness or injury.

The duration of the deferral period you opt for will directly impact your premiums – the longer the deferral period, the lower your premiums will be. Typically, the default deferral period is either 13 or 26 weeks, but it can be reduced to as low as four weeks.

Employer support and income protection insurance

Not all employers support their employees if they cannot work due to illness. On the other hand, income protection insurance guarantees payment for as long as you're ill and unable to work until your death or the policy term terminates, whichever occurs first.

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If you make a successful recovery, income replacement insurance often assists in your return to work. While some employers offer up to a year on full pay, others provide six months on full pay followed by a half-pay period before reducing to the statutory minimum. Your employment contract will detail your entitlements in this regard.

Consider some form of income protection

You might not require income protection insurance if you are nearing retirement, have substantial savings or have an employment contract that provides sufficient sick pay. However, given the limited state benefits available and the absence of statutory sick pay for self-employed individuals, those of working age should consider some form of income protection if it's financially viable.

It's important to note that neither income protection nor short-term income protection policies cover redundancy. However, they often include 'back-to-work' support if you're off sick.

Meeting the criteria laid out by the policy

When it comes to income protection insurance, understanding the terms and conditions is paramount. Specifically, you must meet the criteria laid out by the policy, including the definition of the occupation covered and your ability to do alternative work, if applicable. Insurers typically use three methods to determine these: Activities of Daily Living, Suited Occupation and Own Occupation.

Own Occupation Policy

An 'Own Occupation' policy provides coverage if you cannot carry out the job you hold when making a claim. Unlike a 'Suited Occupation' policy, the insurer won't assess whether you could take on a different, similar role and subsequently refuse to pay. This type of income protection offers the highest level of protection should you become ill and unable to fulfil your job duties. However, it's worth noting that these policies are generally the most expensive due to the extensive coverage they provide.

Suited Occupation Policies

With a 'Suited Occupation' income protection policy, your insurer acknowledges that you can no longer perform your current role but may not pay out when you file a claim if it concludes you can perform a similar job for which you are suited. A Suited Occupation policy provides better coverage than one that uses Activities of Daily Living to assess your ability to work, although an Own Occupation policy offers the best protection.

Activities of Daily Living

Certain older income protection policies use a method called 'Activities of Daily Living', also known as 'work tasks'. These tasks are generally basic, such as showering, getting dressed, using the toilet, brushing your teeth, walking, climbing stairs, and getting in and out of a car. If you could not perform three of these tasks, the policy would pay out. However, you might be so ill that you cannot work but can still walk, lift and write, and an insurer may turn down your claim, arguing that you could do some job.

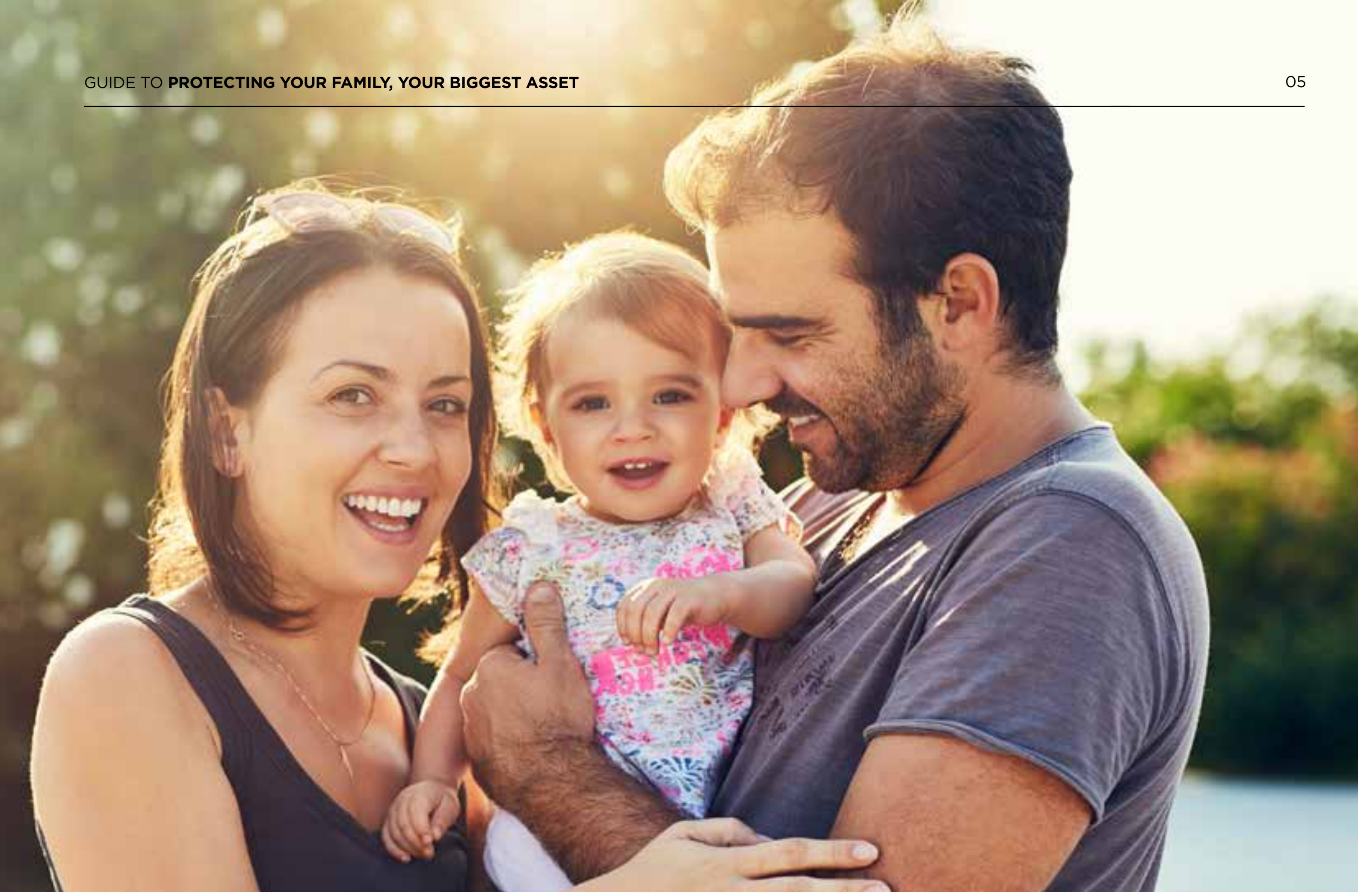
Critical illness cover

Being diagnosed with a critical illness can have a significant impact on your financial situation, particularly if you need to take time off work for treatment and recovery. If you were unfortunately diagnosed as suffering from a critical illness, this kind of insurance could make all the difference to how well you're able to cope financially. Especially as you might be too ill to work, someone else might need time off work to support you, you might face medical expenses or you might need to make household alterations.

Critical illness cover gives you a financial buffer that can be used however you need, freeing you up to concentrate on getting better. Ultimately, this type of insurance is designed to alleviate financial stress by providing a lump sum payment upon diagnosis of a specified condition covered by your policy.

Arranging cover

The cover can be arranged to clear your mortgage balance, settle other existing debts, take care of



household bills and account for new medical treatment costs, especially if you cannot work for several months or years during convalescence. You also have the option to increase the cover over the term to keep pace with inflation. Alternatively, if your primary concern is covering the cost of your mortgage, you can opt for decreasing cover.

Understanding the payout process

Critical illness policies pay out once and then end. The specific conditions covered can vary between providers, but most insurers cover standard illnesses such as cancer, heart attack, stroke, organ failure, multiple sclerosis, Alzheimer's disease and Parkinson's disease. For an additional charge, you may add specific diseases to your cover. Some insurers also extend the coverage to your children.

Tax implications of critical illness payouts

When you make a successful claim, the money is paid out in a lump sum and is not classed as income, meaning you won't have to pay any Income Tax. However, your loved ones could potentially face an Inheritance Tax (IHT) bill. If you have a joint life insurance and critical illness policy and make a claim but do not receive the money before passing away, the payout forms part of your estate. This can be avoided by writing your policy in an appropriate trust and classifying it as outside your estate.

The reason for taking out critical illness cover is to provide for you and your family if the unexpected should happen. Critical illness and life insurance cover, while being two separate types of insurance policies, are frequently combined by some insurance companies. This has led to a prevalent trend of consumers opting for a combined purchase of both critical illness and life protection coverage.

Bounce back from health adversities

Critical illness insurance holds significant value, particularly for those who are the primary breadwinners of their families. This policy is conceived as a benefit that assists you during your lifetime, helping you to bounce back from health adversities. The ramifications of a diagnosis go beyond just health; they often carry a substantial financial load.

This cost is not limited to the loss of income due to absence from work but can also include various other expenses. These could range from childcare needed during your treatment phase, alterations required in your home for better accessibility, increased heating bills during your convalescence period and multiple hospital visits. ■

ARE YOU SAFEGUARDING YOURSELF AND YOUR LOVED ONES IN THE EVENT OF UNFORESEEN CIRCUMSTANCES?

We recognise that family is paramount, and we all strive to provide the best for them, even when we are no longer around. This guide is a resource outlining how we can assist you in safeguarding yourself and your loved ones in the event of unforeseen circumstances. For more information or to address any worries, please contact us.

WANT TO UPHOLD YOUR LIFESTYLE, SHIELD YOUR LOVED ONES AND SECURE YOUR FUTURE?

Successful financial planning revolves around safeguarding what matters most to you – be it your health, life or career. Regardless of where you stand on your financial journey, we can help devise a protection strategy.

To find out more, please contact us today – we look forward to hearing from you.

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