

Financial Protection Fact Sheet



Introduction

In financial planning the highest priority should be given to replacing income if this stops, or is reduced, due to a sudden and unforeseen event, as it is income that pays the mortgage, all the bills (heating, lighting, food, running the car etc.) as well as providing for holidays, other luxuries and your savings for the future. In short, both your current standard of living and your long term financial plan depend on your income.

Sudden and unforeseen events could be:

- death
- accident, illness or disability
- diagnosis of a serious or critical illness.

Arranging policies that can help protect you from the financial consequences of these events is usually a relatively low cost form of financial planning.

Replacing Income Following Early Death.

Most of us recognise the sensible step of arranging a low cost life assurance policy to repay our mortgage in the event of death. This in effect 'replaces' income as the monthly mortgage payment is no longer needed; however, the remaining bills and cost of living continue.

Life assurance is usually taken out by people with dependents who are reliant on the insured person for financial or practical support. To ensure that any payment under a policy is made speedily it is important that the policy is arranged correctly. This may be for the benefits to be paid either into a trust for named beneficiaries or directly to the dependents, if appropriate and possible. If this is not done, the benefits will be paid to the personal representatives of the insured person as part of their estate, which can cause delays in the money reaching the dependents.

Term Assurance Policies

There are a number of different types of term assurance contracts as follows

- **Level Term.**
This guarantees to pay out a specified sum of money if the person whose life is insured dies during the period covered by the policy.
- **Reducing Term.**
This guarantees to pay out a sum of money if the person whose life is insured dies during the period covered by the policy. The sum to be paid on a death claim is the selected figure at the start of the policy, which reduces during the term. This is usually taken out in conjunction with a repayment mortgage, so that as the outstanding debt reduces the amount of life cover decreases by the same amount. This type of policy is cheaper than Level Term but less flexible if you subsequently move house and / or increase your mortgage.
- **Family Income Benefit.**
The benefits are paid in the form of regular income, rather than as a lump sum. The income payments are only made for the remainder of the term covered by the policy after death, whereas with a Level Term policy the same lump sum would be paid out whether death occurred on the day after the policy was taken out or the day before it expired. However, the Family Income Benefit Policy is cheaper than the Level term Policy and provides regular, tax free income.

It is also important to note that all term policies cease to have any value when the period to which they relate expires. However, some term policies can include the option to renew or convert cover without the need for further medical evidence.

Replacing Income When Unable to Work Following an Accident, Illness or Disability.

Income Replacement Insurance.

This pays out a replacement income if the insured person is prevented from working following an accident, illness or injury. The income paid during a claim will be tax-free provided that the premiums have been paid out of taxable earnings. Income Protection is particularly valuable to people who do not have the benefit of a full company sickness scheme or where company 'sick pay' is for a limited time, i.e. only 1, 3, 6 months or one year.

The maximum amount of replacement income available from such a policy is approximately equivalent to 'take home' pay net of income tax and National Insurance Contributions.

In the event of a claim the replacement income is paid until you return to work or retire and ceases on death. If you return to work on a lower income than previously, the majority of policies will pay the difference between your pay just before the absence from work and the lower earnings.

Accident & Sickness Policies

These are short term policies which provide a limited amount of benefit. They are sometimes offered with unemployment benefit (ASU or Mortgage Payment Protection Plans). Care should be taken with such policies as they are frequently expensive and in our view represent poor value for money compared to long term Income Replacement Policies as described above.

Critical Illness Insurance

Dependents will also suffer if the person on whom they are reliant suffers a Critical or Serious Illness, which in addition to preventing them from working might also give rise to medical and nursing expenses. In fact, the likelihood of being diagnosed with a critical illness is estimated to be four times greater than the risk of death. Partly for this reason, insurance that provides cash payments in the event of diagnosis of a critical illness is more expensive than life insurance, but it should always be considered, particularly for protecting mortgage loans.

With critical illness, unlike life insurance, the insured person stands to benefit from the policy; however, this policy does not cover all illnesses only those defined in the policy terms.

Whole of Life Assurance

As the name suggests, this type of policy will provide insurance throughout your life rather than providing cover for a specified period (i.e. Term Assurance). Because these policies are bound to pay out at some time (whereas term policies can expire before any payment has been made) they are more expensive. Some policies are subject to periodic review which may result in the premium being increased, sometimes substantially!

A Whole of Life policy providing a lump sum on death is often used for estate planning, being written in trust for named beneficiaries, perhaps to enable them to pay part of all of an Inheritance Tax bill.

Do You Need Financial Protection ?

To understand whether financial protection is required, it is important to ask the following questions:

- who would 'suffer' financially and therefore, needs the protection ?
- against what events is the protection needed ?
- what is the most suitable type of policy for the purpose ? And,
- Which policy options are available and what are their merits ?

As independent financial advisers we are pleased to provide our clients with the benefit of our expertise on these matters.

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No responsibility can be accepted for the accuracy of the information in this facts sheet and no action should be taken in reliance on it without advice.
Please remember that past performance is not necessarily a guide to future returns.

The value of units and the income from them may fall, as well as rise. Investors may not get back the amount originally invested

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