

Income protection (also named as permanent health Insurance)

What is it?

Income protection is a policy designed to give you a regular tax-free benefit, if you are injured or too ill to work resulting in a loss of earnings. Your income protection insurance will keep your income coming in. If you have mortgage, debts and regular bills to pay, income protection could be an important form of insurance.

How does it work?

If you are an employee and you fall ill, your employer might pay you your full pay for a few weeks or months. By law, an employer must pay most employees statutory sick pay for up to 28 weeks, though this will probably be a lot less than your full earnings. After that, you would probably have to rely on state benefits. State benefits are not generous. There are limited and means-tested which you won't qualify. You would probably see a substantial drop in your income if you were out of work for more than a few months because of illness or disability.

However, some large employers arrange group income protection insurance for their employees as a perk of their job, which can pay out an income after the statutory sick period. So check what you are entitled to. If you are working for a small firm or self-employed, you won't have this option.

Insurance aims to put you back to the position you were in before you suffered a loss. But it does not allow you to make a profit out of your misfortune. So the maximum amount of income you can replace through insurance is broadly the after-tax earnings you have lost less an adjustment for State benefits you can claim. This usually translates into a maximum of, say 50% to 65% of your before-tax earnings.

Example of working out how much cover you need:

Sue earns £26,000 a year before tax and other deductions. She estimates that, if she was ill for a long time, her budget would be affected as shown in the table below.

Sue's budget calculations in the event that she couldn't work	Her estimates
Income she would lose her take-home pay	£18,000
<i>Deduct</i> income she would gain e.g. approximate long-term incapacity benefit	(£4,000)
<i>Deduct</i> expenses Sue would save e.g. work-related costs on traffic and food	(£3,000)
<i>Add</i> extra expenses she would pay e.g. allowance for heating her home for more time	<u>£2,000</u>
EXTRA INCOME NEEDED	£13,000

Sue reckons she would need around £13,000 a year to maintain her lifestyle. This is half her before-tax pay of £26,000. If she is not entitled to long-term incapacity benefit, she will need £17,000. That is equal to 65% of her gross salary.

Sue also works out that as a perk of her job, her employer will pay her half a salary for 52 weeks after the statutory sick pay period of 28 weeks. She therefore arranges for her policy to pay out after 80 weeks of incapacity (see waiting period below).

More details on how protection insurance works are set out below:

Cost

You pay a monthly premium throughout the term of the policy. Cost depends mainly on:

- Your age – at the time you start the policy. Older people are more likely to suffer an illness, so pay more.
- Your health – at the time you start the policy. If you have existing health problems you might be refused cover or have to pay more.
- Your job – some jobs are more likely than others to contribute towards illness. For example, a bank clerk is deemed to have a very safe job but a deep sea diver runs high risks and so would have to pay more.

- Hobbies and lifestyle – for example, smoking makes you more likely to become ill, so you'll pay more.
- Waiting period – once you claim, there is a delay before payments start. You can choose how long this is - for example, from 4 weeks up to 104 weeks. The longer the waiting period, the less you pay.

Access

- If your health is poor or your lifestyle is considered risky, you may be refused cover or have to pay more than normal.

Terms

- Most policies would pay out until you reach age 65 (retirement age) or when you have chosen the cover to end.
- Check whether you already have protection in place in case you get incapacitated, and for how long that protection would last. For example your employer may have an income protection scheme in place you can benefit from, or you may have a mortgage payment protection insurance that covers your mortgage.
- Check whether the policy reduces what it pays out if you receive state benefits or claim money under any other insurance policy.
- Some policies only pay out if you can't do any work, but you would have to be seriously incapacitated for you not to be able to work at all. Others cover being unable to do any work for which you are suited. The best pay out simply if you can't do your normal job, but premiums tend to be more expensive. .
- Does the cover increase in line with inflation?

Do I need income protection?

The likelihood of being unable to work due to an illness or injury is greater than you think.

The following figures show how many people aged 20-64 had been claiming State Incapacity Benefit for more than six months who were incapacitated on 28 February 2005.

167,900	between 6 months and 1 year
258,000	between 1 and 2 years
219,300	between 2 and 3 years
361,100	between 3 and 5 years
<u>1,149,300</u>	for over 5 years
2,156,400	A total of 2,156,400 people were claiming for more than six months

Of these 1,729,700 had been incapacitated for more than two years (over 80% of the total)

Source: IAD Information Centre (DWP)

By comparison 81,960 people aged between 20 - 64 died in the UK in 2005.

Source: National Statistics 2005 edition.

The unexpected event can happen to every people.

Just think about the following situations: You are unlucky diagnosed with serious illness.

What will happen to you and your family?

- You cannot work and have no income.
- You need to pay existing mortgage and normal expenses, they won't stop. How much is it?
- You may need to struggle for existing payments.
- You may need to worry additional expensive medical expenses.
- You cannot rest physically or mentally. Will these help your health recover?
- Imagine the likely daily life at that period!
- Any help available from family or Government?

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