



KEY GUIDE

Financial protection for you and your family

Introduction

PROTECTING WHAT MATTERS MOST

Financial resilience is the ability to recover quickly from unexpected financial shocks. Many of us insure our homes and cars without really thinking about it, but far fewer insure their lives and incomes. And yet, if you were to die, how would those you leave behind be able to manage financially? If you were unable to work due to illness, how would you find the money to pay your household bills? Savings can and do help in the short term. But what happens when they run out? What happens if an illness goes on for three, six, or even 12 months? What then?

The ongoing Covid-19 pandemic has focused many people's minds on the need for a rainy day fund and financial protection, particularly in the light of greater awareness of the meagre nature of State support. In a recent survey of financial advisers, 75% reported an increase in willingness by clients to talk about financial protection. While nothing can ease the emotional distress the virus has caused and is continuing to cause, creating your own safety net can lessen its financial impact if you or your loved ones are directly affected by it. Life and health insurance protection underpins most good financial planning. These types of insurance can ensure that, should you or your family need it, the right amount of money will reach the right hands at the right time.

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The main types of insurance

There are three main forms of financial protection to consider:

- Life insurance - ensuring those left behind have funds after the death of a parent or guardian with financial dependents and that debts can be repaid.
- Health insurance - making sure that you have enough money if you fall seriously ill.
- Medical insurance - helping you to afford the cost of private medical treatment if you need it.

This guide gives a brief insight into the importance of financial protection and the different forms of protection to consider.

Planning point

What type of insurance you should take out depends on your goals and needs, but appropriate financial protection forms the basis of a strong financial plan.

LIFE INSURANCE NEEDS

Life insurance puts money in the hands of those who need it when a person dies. There are many reasons why this money might be needed. It's not just for parents with young families. A need could arise at any age and the nature of that need could change as you get older. As such, regular reviews of your financial protection needs are essential.

Customer scenario

John is 37. He is married to Jane and they have three children. Jane does not work at present. They have a large mortgage.

Possible needs

John might need to consider insurance for the mortgage (and any other loans). He might also need to look at insurance to provide for Jane and the children's on-going needs. Equally, they might need to consider the financial impact of Jane's death. Would John be able to continue to work? Would the mortgage need to be repaid?

Mary is 72 and widowed. She has a large estate worth well in excess of £1.5 million which she wishes to leave to her children. She does not wish to take any action that would reduce her access to her assets during her lifetime, but likes the idea of planning to put the right money in the right hands at the right time to pay the inheritance tax (IHT) bill.

Mary might want to consider life insurance to provide for this requirement. By taking out life insurance and placing this in a trust arrangement, Mary can ensure that the money is available to her beneficiaries when they need to pay the IHT bill.

Derek is 82 and his wife, Mavis, is 79. They have modest assets and no real savings. They do, however, have a reasonable pension income. They want to ensure that when the time comes, their family is not left financially responsible for their funerals.

Life insurance might be appropriate. This can ensure that a lump sum is available when the time comes for their family to meet the cost of their funerals.

Kristina and Marius are friends who run a successful catering company. The business is a limited company and they each own 50% of the shares. They are concerned that, in the event of either of them dying, the other's shares would pass to their family and that the family would contribute nothing to the business.

Life insurance can ensure that the deceased's family is compensated whilst allowing the surviving business partner to take over the entire business.

If your income would stop upon your death, and you have people who depend on you financially, you should have life insurance cover. If you live with a spouse or partner and their earnings would also stop at death, they too should have insurance cover. However, if you do not have financial dependents, you may not have a need for life assurance.

Planning point

Life insurance can provide the money your family needs to deal with the costs of raising a child, a mortgage, a funeral, running a business or many more things, at the time when they may need it the most.

Quantifying the need for life insurance

The life insurance needed to cover a loan is relatively simple to assess. You need enough insurance for the amount of the loan, and the cover should last for the time that the loan is outstanding. If you pay off some of the loan, you should be able to reduce the amount of cover earmarked for this purpose. However, if you took advantage of loan or mortgage

repayment deferrals as a result of Covid-19, you should review the cover you have in place as it may no longer be sufficient, unless you subsequently make overpayments. Most people also need insurance cover to replace their income if they were to die. The same principles apply but the calculations are a little more complicated.

EXAMPLE Calculating needs

Sandeep and his wife Aasha have a son of five who is about to start school. They have decided to send him to a fee-paying school and expect him to be there until he is 18. Sandeep and Aasha are now considering life insurance to ensure that the fees could continue to be paid for the next 13 years. The first thing to do is therefore to quantify the total cost of school fees over the next 13 years, taking inflation into account.

The approach to insuring other needs is roughly the same. For example, you could calculate how much your family would need to cover the general household and other expenses, and how long they would need the funds.

You can arrange for life cover to pay out a series of annual amounts over a set period, which is a simple approach to replacing an annual income, but most life cover pays out a lump sum. If you want a lump sum to provide £1,000 a year for 10 years, you would need life cover of about £10,000 because even if you invested a lump sum it wouldn't have long to grow before you needed to spend it. If you needed the income for 20 years, however, you might only need about £18,500 because you could invest some of this for the longer term and benefit from growth and income.



It is sometimes hard to work out how much life cover you would require for your family, because of the difficulties of assessing your family's needs after one or both parents have died. Your usual pattern of expenditure provides a good starting point for these estimates. Then you would have to consider the other costs that might be involved, like childcare. It can be especially difficult to assess the potential financial impact of the death of a parent who spends most of their time looking after children and the household. A good starting point is to estimate the costs of buying in these services.

Over time, your circumstances change. Children grow up and mortgages and other loans are repaid. Your income may rise or fall, stop and restart. The same goes for your expenditure. You may take on more debt. It's therefore a good idea to review the amount of cover you have on a regular basis, to ensure that it is still appropriate for your needs and that you are not under or over-insured.

THE RIGHT LIFE INSURANCE POLICIES FOR YOU

Term assurance is the right sort of life cover for most types of family protection needs. It can provide insurance at the lowest cost for the period that it is required.

It is rare that you would need other types of life insurance for family protection, because they generally involve much higher costs than term assurance for comparable levels of cover. Whole of life assurance provides cover for the whole of your life, as the name implies, and its main uses are in inheritance tax planning and provision for funeral expenses. Whole of life policies can have substantial investment values that you can cash in, unlike term assurance policies.

Term assurance is the simplest form of life insurance, working in a similar way to your home insurance. The policy will pay out if you die during the term, but if you survive to the end of the term, the contract simply ends and there is no pay-out.

The cost of term assurance varies considerably according to factors such as your age and state of health. The cost of 10-year term assurance for a 30-year-old is about a tenth of the same cover for a 60-year-old. A person's state of health is also important; poor health could mean increased premiums or even the possibility that the individual cannot be insured. Although term assurance is a simple product, there are variations that suit different needs.

Planning point

You should decide what you want your insurance to provide for and take the time to work out what that means, and how much money would be needed to meet the goal.

Types of term assurance

Policy type	Description
Level term	These policies pay out a fixed sum if you die during the term of the policy.
Renewable or convertible term	Some policies are renewable, so that you can extend them for an additional period of cover at the end of the term regardless of your state of health at the time, while others are convertible to a whole of life policy regardless of your health. These policies cost more than level term.
Increasing term	Some policies have an element of inflation proofing. You either have the option to increase the cover from time to time by a set percentage or, in some cases, the amount of cover increases automatically by a set percentage, or perhaps the rate of inflation. These policies also cost more than level term assurance.



Decreasing term This is like level term, but the amount of cover reduces each year. Decreasing term is typically used to cover a liability that you expect to decrease year on year, such as paying school fees until a child reaches the age of 18. The cost of this cover is less than level term assurance because the overall amount of insurance provided over its lifetime is lower.

Mortgage protection This is a type of decreasing term assurance, but the cover reduces in line with the outstanding capital on a repayment mortgage where you pay off some of the capital every month. The higher your mortgage interest rate, the more slowly the outstanding mortgage capital falls each year. It is important to ensure that the interest rate specified in the policy matches the mortgage it is intended to cover, or that the rate is higher than the interest rate you expect at any time during your mortgage.

Family income benefit These policies pay an annual sum if you die during the term of the policy and the payments continue until the end of the term. Family income benefit can provide a higher initial cover for a lower cost because it is effectively a form of decreasing term assurance.

EXAMPLE Family income benefit

Mark has twin children, aged five. He wants to ensure that if he died, his family would be protected until the twins reach 21. He feels they would need £30,000 a year for this and takes out a family income benefit policy to cover the liability. If he were to die in year one, the policy would pay £30,000 a year for 16 years – a total of £480,000. If he were to die two years before the end of the term, it would pay £60,000 in total.

Life cover from your employer or pension scheme: If you are employed, you may well have life cover from your employer and you might want to take this cover into account when deciding how much insurance you need. However, you need to bear in mind that you will probably lose this cover if you leave your employer. At which point, you'd need to consider taking out additional cover.

Relevant life policies: Employers can take out these policies on the lives of employees. They are not part of their pensions, but they have many of the same tax advantages.

Joint life policies: There may be situations where you would want to take out a policy on more than one life. The policy



could then pay out after both the insured people have died – this is sometimes used for inheritance tax planning. Alternatively, the policy might be arranged so that it pays out when the first of the insured people dies. This could be suitable for financially interdependent people, but would mean that the second person would no longer be covered by the policy after the first of the couple dies.

Planning point

There are many types of insurance policy available, which you can use to provide the specific protection you need.

Ensuring the right people get the money

Generally, the best way to ensure that the proceeds of a life policy are paid to the people you intend to benefit is to arrange for the policy to be in a trust. Some types of trust give the trustees discretion or flexibility about how they distribute the benefits, but it is a good idea to get advice about this. If you die, the policy proceeds will be paid to the trustees and then the beneficiaries, not into your estate. This arrangement could save them IHT and should speed up the payment to the beneficiaries.

There are other ways to set up life policies. The person you want to benefit could take out the policy themselves – the so-called life of another basis. In some circumstances this can be a wise arrangement, especially if the potential beneficiary wants to be certain that the premiums on the policy are being paid. But mostly it is preferable to arrange for a policy to be in trust.

Covid-19 and life insurance

Many life insurance providers have reassured those with existing policies that they will pay out in the event of a claim resulting from a coronavirus-related death. However, because

each insurer has different terms and conditions, you should check your policy to ensure that pandemics are not excluded.

Applications for life insurance from new customers continue to be accepted, but if an applicant is currently experiencing Covid-19 symptoms, the insurer is likely to postpone processing their application until they have fully recovered. Telling an insurer that you are in a good state of health when you are not will invalidate your policy, meaning that it will not pay out in the event of a claim.

HEALTH INSURANCE

The purpose of health insurance is to provide money if you fall seriously ill or have an accident, potentially affecting you for many years. In this case, you would probably stop earning, although your financial needs might well be greater than ever. The state benefits you would receive would be relatively low and would be most unlikely to provide sufficient income to meet your needs, especially if you have substantial rent or mortgage payments to make. You might also need capital, for example to make adaptations to your home or to pay off debt. A rainy day fund can help in the short term here, but it's not a complete solution. The precise level of fund required can vary from person to person, but, as a minimum, three to six months' expenditure could be used as a guide.

Virtually everyone who is working therefore needs some kind of health insurance to provide financial protection if their earnings are affected by serious illness or disability. Even if you have no financial dependents, it is very likely that you will need health insurance if you are responsible for paying your own bills.

Income protection insurance

Income protection insurance – sometimes called permanent health insurance – pays a weekly or monthly income if you cannot work because of illness or disability. You may think that you do not need to worry about this kind of cover, but the fact is that in the UK there are just over 14 million people with a limiting long-term illness, impairment or disability. The prevalence of disability rises with age. Around 8% of children are disabled, compared to 19% of working age adults and 44% of adults over state pension age.

You can generally be insured to receive a monthly benefit of up to about half to two-thirds of your pre-tax income. If you have no income, you may still be able to take out a policy, but the maximum payout will be limited, generally to an income of about £20,000 a year.

Some employers provide income protection insurance, but a very large number do not. Employers are only legally obliged to pay employees, in the form of statutory sick pay, for the first 28 weeks of their being unable to work because of an illness or injury; even then not everyone will qualify, and the employer does not have to pay the full salary. It is worth specifically checking the position with your employer. If your employer provides cover, the benefit generally continues to be subject to income tax and national insurance contributions, at least initially, but you won't usually have to pay tax on the premiums. If you take out the cover yourself, the benefit is tax free.

Planning point

It is important to consider what happens if you are unable to continue working, and how income protection insurance can provide security for you.

Income protection insurance pays after a waiting period on each claim and can usually continue to pay you up to retirement age, unless you recover and return to work sooner. The cover normally lasts until you are aged 60 or 65, but you can arrange the insurance for much shorter periods – say five or ten years – and this cover is much cheaper because it is substantially less valuable. The chances of having a serious illness or disability increase substantially as you grow older.

During the Covid-19 outbreak, insurers have experienced a rise in queries regarding income protection insurance. Generally people who are simply self-isolating are unlikely to be covered. However, a small number of providers will consider claims for self-isolation where it is medically advised. Those with severe coronavirus symptoms that continue beyond the waiting period will start to receive their monthly payout if those symptoms mean they meet their insurer's definition of incapacity (e.g. they are unable to work at their own occupation). Some providers are restricting cover for respiratory conditions for new customers.



Income protection can appear relatively expensive but can be very valuable if you fall seriously ill. If you are considering taking out a policy these are some of the things you should consider.

Consideration	Possible issues
Exclusions	<p>Check the conditions and exclusions on income protection insurance policies as terms vary between different insurance companies. Almost all illnesses are generally included in the cover, but most have exclusions, for example if the illness is caused by drugs or alcohol abuse.</p> <p>There is an important difference between cover for being unable to work at your own occupation and cover for being unable to work at ANY occupation. It is much better to have the first type of cover, though it is likely to be more expensive. Otherwise, if you cannot work at your own occupation, under the wider definition the insurer could insist on your undertaking other work.</p> <p>Insurers will generally only pay a proportion of recent earnings as benefits, which can be hard for people who are self-employed or have fluctuating earnings.</p>
Inflation protection	<p>It is normally advisable for income protection insurance to be inflation protected. You should be able to increase the level of cover periodically regardless of your state of health, or the cover should increase automatically in line with inflation or a fixed percentage. It is also important to ensure benefit payments keep pace with inflation. If benefit payments never increase after you fall ill and cannot work, their real value will be gradually eroded over the years.</p>
Underwriting	<p>Insurers are careful when people first apply for income protection insurance. If you have, or have had in the last few years, a health issue, the insurance company may exclude your particular problem, increase the premium or possibly decide not to insure you.</p> <p>Insurers also pay attention to your occupation. You will get the best terms if you work in an office, mostly indoors and do little or no manual work. The cover is much more expensive for people who work with machinery or in relatively hazardous places like factories and farms.</p>

Claiming

If you have to make a claim, the insurance company will continue to pay you the benefit until you are well enough to return to work. If your illness recurs they should start paying the benefit again. Unsurprisingly, they will want to check from time to time that claimants are genuinely incapacitated.

EXAMPLE

Income protection cover

David works as an IT manager. He earns a good salary and lives a comfortable lifestyle. In the event of being unable to work due to illness, he would receive full pay for up to four weeks, but would then only receive statutory sick pay and, later, state benefits if he is eligible for them. He would not be able to continue to meet his commitments and may have to sell his flat should the illness continue long term. David might consider income protection to provide an ongoing income after his employer stops paying him. This could continue until his selected retirement age or, if he needed to keep premiums down, for a limited term of, say, five years.

Accident, sickness and unemployment insurance

Accident, sickness and unemployment (ASU) insurance pays a monthly income for up to one or two years only, if you cannot work because of illness, disability or unemployment. These policies typically have a shorter waiting period than income protection policies, meaning they may pay out to those suffering severe Covid-19 symptoms which leave them unable to work sooner. Some policies pay off any loan if you die. People often take out ASU insurance in conjunction with a loan. Policies usually last for the term of the loan or up to retirement age. The unemployment part of the insurance may be limited to employees; self-employed workers may not be able to take out this part of the cover. Given the impact of the Covid-19 pandemic on the economy, most providers are not offering unemployment cover at present, although accident and sickness cover is still available.

Critical illness insurance

Critical illness insurance pays a lump sum if you are diagnosed as suffering from a specified illness. Over 30 conditions may be covered, including serious cancers, heart attack and stroke. Some providers may cover significantly more – even up to 100 different conditions.

The advantage of critical illness insurance is the benefit is paid very early, shortly after diagnosis of the illness, without any significant delay – unlike the usual longer waiting periods of income protection. It is also in the form of a lump sum that can allow you to make rapid adjustments to your lifestyle and pay off loans. The main drawback is that this type of health insurance only covers a limited set of conditions. These are common disabilities, but critical illness insurance generally does not cover some important conditions, such as musculoskeletal pain and most mental illnesses.

Planning point

Critical illness insurance is generally paid very early – typically earlier than income protection insurance – so can allow you to react to a diagnosis more quickly.

People often take out critical illness insurance to cover a mortgage or other loan. Because you are significantly more likely to have a critical illness than die whilst you are of working age, it is more expensive than life insurance. But this reflects the likelihood of needing to claim on the policy.

Critical illness is an important and valuable addition to income protection, but it should not normally be regarded as a replacement for it.

Whereas an income protection policy will pay out to those suffering from severe Covid-19 symptoms beyond the waiting period where the insurer's definition for incapacity is met, Covid-19 itself is not covered by critical illness policies. However, if the coronavirus leads to one of the conditions listed on your policy, for example a heart attack or a stroke, and you survive the waiting period, the policy would pay out.

Some providers have made changes to their underwriting requirements as a result of the pandemic, meaning that fewer applicants are required to provide medical evidence for both life and critical illness cover. This speeds up the application process which was being slowed down by the understandable delays experienced in obtaining GP reports in the current environment.

MEDICAL INSURANCE

The final area to consider is medical insurance. These policies help you to afford the cost of private medical treatment.

Private medical insurance (PMI) pays for private health treatment. Depending on your budget, you choose what you want covered – just in-patient or day-patient treatment, or out-patient consultations and medical tests. PMI pays for the treatment of acute conditions only. It does not cover chronic conditions (except, generally, at onset) and pre-existing conditions may also be excluded. As part of the response to the Covid-19 outbreak, providers are continuing to delay non-urgent treatments to free up beds for the NHS. Treatments will be delivered and funded by the provider once the beds are no longer required.

Health cash plans pay for everyday health costs, typically 75%–100% of costs for dentistry, optical and consultation costs, plus a small sum for each day spent in hospital, subject to an annual limit. Other dental options include capitation (maintenance) plans, which are agreed with your dentist and cover likely costs over the next year, and dental insurance. Plans may require an initial waiting period to stop people taking out cover for known treatment then cancelling the policy.

Planning point

It's worth checking conditions and exclusions on income protection insurance policies. Policies vary to some extent between different insurance companies.

The value of investments and the income they produce can fall as well as rise. You may get back less than you invested.

Tax treatment varies according to individual circumstances and is subject to change.

The Financial Conduct Authority does not regulate inheritance tax advice, funeral planning, estate planning, will writing, trust and taxation advice.

HOW WE CAN HELP

Insurers are constantly looking at new ways to meet people's needs, such as through life insurance that includes critical illness and/or income protection insurance, which may be cheaper than taking out separate policies. It is important to look at your options – what do you need most now? How much cover do you need? Can you defer some cover until a future date? What can you do to protect yourself and your loved ones financially in light of the Covid-19 pandemic? Our role is to do four things:

- **Know enough about you to make the right recommendations.** We take the time to understand your financial situation, your needs, preferences and views. Whether for example, you would feel comfortable accepting that premiums may rise, or if you want a guaranteed solution.
- **Help you to identify priorities.** If you were insured against absolutely everything, like most people you may find premiums unaffordable. We don't expect you to be an expert on life insurance, but we need to know your attitude to risk. Working out how things might change in the future and prioritising matters could be a sensible thing to do.
- **Recommend solutions to meet your needs.** The right policy is important, but a will or writing policies in trust could be too.
- **Review.** Your financial protection needs change over time. Regular reviews are essential to ensure your plans continue to meet your needs.

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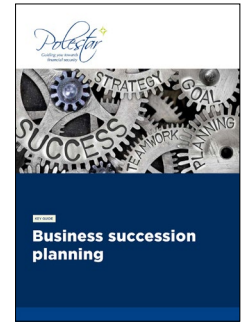
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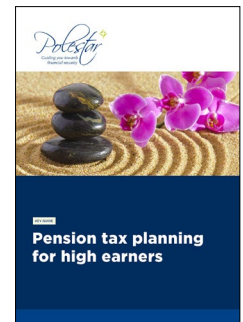
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Call us now for further information or advice

01252 626200

or email

contact@polestarwealth.co.uk



www.polestarwealth.co.uk

► **Polestar Adviser Office**

Hurdcott Barn, Cricket Hill Lane, Yateley, Hampshire, GU46 6BB
T (01252) 626200

► **Polestar Administration Office**

26 Tower Road, Peatmoor, Swindon, Wilts, SN5 5BG
T (01793) 881602 F (01793) 879163
E contact@polestarwealth.co.uk

► **Cavendish Wills & Trusts**

26 Tower Road, Peatmoor, Swindon, Wilts, SN5 5BG
T (01793) 881602 E office@cavendishwillstrusts.com
W www.cavendishwillstrusts.com