TOPIC 19

Protection advice

LEARNING OBJECTIVES

By the end of this topic, you should have an understanding of the following:

- framing protection recommendations;
- identifying budgetary and other considerations;
- the importance of regular reviews;
- selecting a suitable protection provider.

THINK . . .

Before you start work on this topic, take a moment to think about what you already know about the provision of protection advice.

For instance:

- What is a pure protection product?
- What is an honest and reasonable misrepresentation by a customer?
- How can an adviser assess a client's capital and income needs?
- Why is flexibility crucial in a package of recommendations?
- What aspects of good service can a customer expect from a protection provider?

19.1 Providing advice

The following insurance products are 'pure' protection products and the rules for providing advice and sales are contained in the Insurance: Conduct of Business sourcebook (ICOBS):

- term insurance;
- income protection insurance (IPI);

- critical illness cover (CIC);
- accident, sickness and unemployment (ASU);
- mortgage payment protection insurance (MPPI).

In simple terms, a pure protection product provides protection against one or more perils but does not contain an investment element. So, term insurance is a pure protection product but most whole-of-life plans are not because they are investment linked. Buildings and contents insurance policies are also regulated under ICOBS.

Firms and advisers operating under Mortgages and Home Finance: Conduct of Business sourcebook (MCOBS) rules are subject to ICOBS rules for any advice given relating to pure protection products. We consider aspects of ICOBS in this topic.

IN BRIEF

INTRODUCTION TO ICOBS

- **Authorisation**: to offer advice on insurance products, the firm must be authorised by the FCA.
- **Training or qualifications**: the FCA stipulates that all those involved in the distribution of insurance products possess appropriate knowledge and ability to perform their duties. As part of this, individuals complete a certain amount of relevant continuing professional development (CPD) per year.
- **Suitability**: the adviser/firm must take reasonable care to ensure that advice given is suitable for the customer, based on their identified demands and needs and other relevant information, including details of existing cover.

Advice can provide a vital service to customers considering financial protection. It helps them to understand the extent of their protection needs and what products are available to meet them.

CONSUMER CHOICES

Consumers have access to insurance cover through a variety of providers and should seek valuable information in making their decision.

Comparison sites collect data from multiple providers to find insurance quotes based on information the customer inputs. Each site works with specific insurers rather than comparing the whole market. Comparison sites offer a useful general overview of the coverage available but there is no advice element, so customers must be confident in what they are looking for.

Protection advice is available from free and impartial sources, such as Citizens Advice and MoneyHelper. General written information is also available from these sources and others. Consumers can also seek advice from an adviser (or broker or planner), such as through Unbiased.co.uk, the Chartered Institute for Securities & Investment, or an advice finder site. Advice may be particularly helpful for clients in unique or complex circumstances.

19.2 Pre- and post-contract disclosure

Disclosure of relevant facts is crucial to all parties entering into an insurance contract. Policy documentation helps with the fact-gathering process, and disclosure of the right information is also key when considering cancelling a policy.

19.2.1 Disclosure requirements

The Consumer Insurance (Disclosure and Representations) Act 2012 came into force on 6 April 2013, making changes to the existing duty of disclosure applying to consumers entering into, or renewing, an insurance contract. The Act:

- provides **better protection** for consumers, who can no longer have claims rejected by insurers if the insurer didn't ask the consumer for all required information;
- removed the requirement for **utmost good faith** in relation to applicable insurance contracts;

- replaced the duty for consumers to disclose all material facts with a duty to **take reasonable care** not to make a misrepresentation, known as fair representation;
- enables the insurer to **take a range of actions (ie remedies)** if a consumer makes a misrepresentation.

IN BRIEF

UTMOST GOOD FAITH IN INSURANCE

Utmost good faith required both applicant and insurer to disclose accurately, honestly and completely any information (ie material facts) that might influence the other party's decision to enter into the contract. This put too much onus on the consumer to disclose factors they may not have realised were relevant.

The Act reflects what was already seen as good industry practice. In effect, consumers are protected unless they deliberately mislead or are careless when providing information to an insurer. The consumer must sign a declaration that the information they have supplied is true to the best of their knowledge and belief, ie it is a fair representation.

The Act applies to personal insurance contracts, including primarily personal contracts with a business element. Life assurance, IPI, health insurance and CIC all fall under the Act's provisions. The Insurance Act 2015, effective from 12 August 2016, made similar changes for non-consumer insurance contracts, including business protection.

Misrepresentation

Consumers are required to answer questions on an application form accurately and without misrepresenting information. If they fail to do so, they may be in breach of their duty to take reasonable care. The insurer may be able to apply a remedy, the nature of which depends on the nature of the misrepresentation. Distinctions are made between:

- **honest and reasonable** misrepresentation: the consumer took reasonable care but made an honest mistake;
- deliberate or reckless misrepresentation:
  - — **deliberate** misrepresentation, where the consumer knew they should disclose information but did not;
  - — **reckless** misrepresentation, where the consumer acted without care or regard for the truth of an answer;

- **careless** misrepresentation, where the consumer made a statement they believed to be true but without sufficient care to check the facts.

Remedies can be applied in event of deliberate, reckless or careless misrepresentation.

TABLE 19.1 REMEDIES AVAILABLE TO THE INSURER

Deliberate or reckless misrepresentation	Treat the contract as if it never existed	Refuse all claims	Retain all premiums paid, unless this would be unfair
Careless misrepresentation	If the insurer would not have entered into the contract if it knew the information, all claims can be refused but premiums must be returned	If the insurer would have entered into the contract on different terms (eg at a lower level of cover) the different terms are taken as applying to the contract	If a higher premium would have been charged, the insurer can make a proportionate reduction to the amount of any claim
Honest and reasonable misrepresentation	None: the insurer must pay any claim		

19.2.2 Policy documentation

Several pieces of documentation are issued to the customer when setting up a protection plan.

- **Key features document (KFD)**: also known as an illustration, normally issued when the recommendations are presented to the customer. It sets out the key features of the specific plan and may be in the form of a brochure. For a pure protection contract, a policy summary can be used instead to serve a similar purpose.
- **Acceptance letter**: issued after the application is underwritten, confirming the exact terms and conditions under which the insurance is offered. These terms may differ from those specified on the KFD, eg if health issues are discovered during the underwriting process that lead to an increased premium.
- **Cancellation notice**: sent to the customer around the same time as the acceptance letter. It sets out their rights should they decide to cancel the plan.

- **Policy document**: also known as an illustration, confirming the details of the plan, the cover provided and the terms under which the cover is provided. It serves as a certificate of insurance and the client should keep it safe.

FACTFIND

For most insurance contracts, under ICOBS 7: Cancellation there is a short cooling-off period during which the customer can cancel without penalty. This is generally 30 days for life assurance, CIC or IPI, and 14 days for home insurance. The period starts when the policy begins or when the customer receives their policy documents, whichever is later. Find out more about cancellation rights:

www.citizensadvice.org.uk/consumer/insurance/insurance/cancelling-an-insurance-policy/

ICOBS 5: Statement of demands and needs

ICOBS 5 states that before an insurance contract is put in place, the insurer must specify the customer's demands and needs based on information from the customer (FCA, no date).

- Information can be gathered face to face, through a questionnaire and/or through the proposal form.
- The details must be communicated to the customer in writing via a clear and accurate statement of demands and needs, which cannot be generic.
- For sales involving advice, the firm must take reasonable care to ensure its advice is suitable for the customer.
- Any insurance offered must be consistent with the customer's demands and needs.

ICOBS 6: Product information

ICOBS 6 states that a firm must take reasonable steps to ensure a customer is given appropriate information about a policy so that they can make an informed choice about the arrangements proposed. Information that must be provided pre-contract includes the term, the definition of each benefit and option, means of payment and duration of premiums, tax arrangements of benefits, cancellation information, and complaints-handling procedures.

Other information given varies depending on factors such as:

- knowledge and experience of a typical customer for the policy;

- policy terms, benefits, exclusions and duration;
- policy complexity;
- whether the policy is purchased in connection with other products or services (FCA, no date).

For insurance that is not payable on death or in the event of injury, sickness or infirmity, the firm must provide an Insurance Product Information Document to the client in a durable medium.

FACTFIND

A durable medium allows the customer to store the information for future reference and to reproduce the information. For example, paper, email and PDF file format all meet this definition. The FCA provided clarifying information for firms:

www.fca.org.uk/firms/durable-medium

19.2.3 Cancelling or replacing protection contracts

It is not appropriate to recommend additional policies where needs are already adequately covered. It is not usually appropriate for an adviser to recommend cancelling existing policies and replacing them with similar ones. The regulator takes a dim view of this practice, known as churning.

However, it may be appropriate to recommend replacing an existing policy with a new one if it can be shown conclusively that:

- the same level and terms of cover can now be obtained at a reduced cost; or
- a more appropriate plan (possibly with better cover) can be obtained at a similar cost.

Examples would be where a previous smoker now qualifies as a non-smoker, rates for a specific type of policy have reduced or the cover for certain policies has been widened and would now be available at no (or minimal) extra cost.

To ensure the client remains protected at all times, the existing policy should not be cancelled until the new one is in force.

19.3 Identifying suitable products

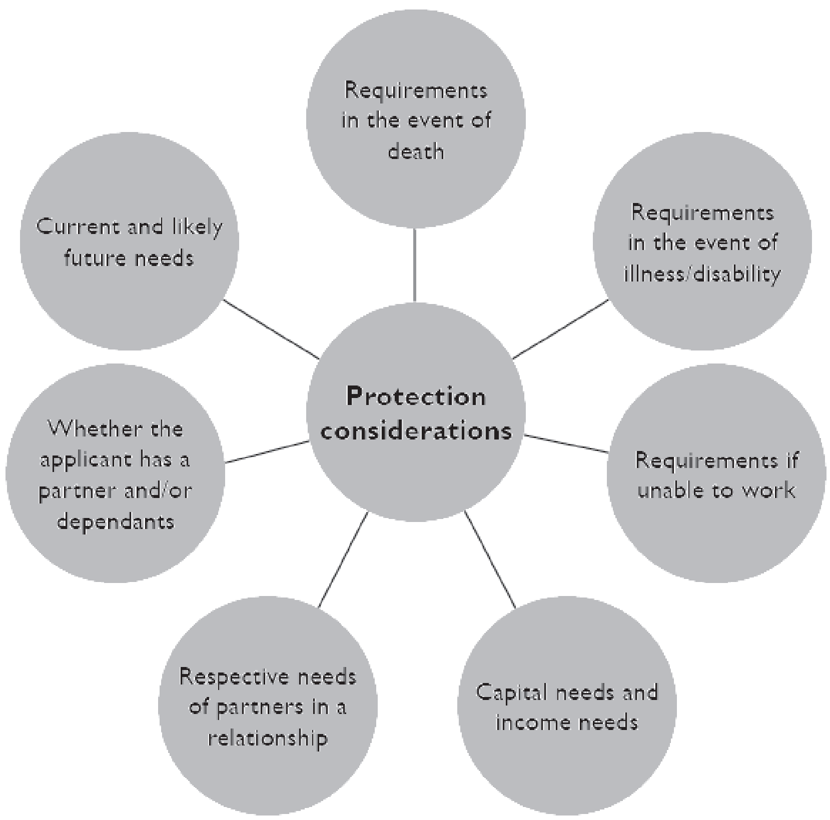
A customer's protection needs depend on their circumstances, and priorities will differ based on, for example, life stage, finances and family situation (as discussed in section 16.2.1). A person may have a large reserve fund or investment vehicle that helps to meet some of their needs, while another may only have state benefits to fall back on if a risk event occurs.

An adviser must evaluate the client's existing provision when assessing how much protection is needed – ie the size of the protection gap – and what products are suitable.

19.3.1 Assessing current and possible future needs

Assessing a client's protection needs may involve considering a number of issues.

FIGURE 19.1 ISSUES TO CONSIDER IN ASSESSING PROTECTION NEEDS



Set alongside this complex picture is a wide range of products, each designed to meet distinct protection needs. So it is essential to conduct a thorough factfind with the client to establish a full picture of current and likely future circumstances and needs.

Once needs are fully understood, a package of protection recommendations can be devised that best meets the client's requirements. After the solutions are in place, it is necessary to conduct regular reviews to ensure the recommendations continue to meet the client's needs.

19.3.2 Capital and income needs in the event of death

Protection needs on death are often based on the insured earner's debts and current income, which will be lost if death occurs. Strictly speaking, it may be more effective to base needs on any dependants' projected expenditure, with relevant consideration made for any additional expenditure required on death. This is a more accurate reflection of protection need.

A single person with no dependants has different protection needs than a couple with children. Their concerns are likely to include protecting against the effects of illness, accident or unemployment rather than providing for others in the event of their death. Single people also need to cover their debts, but on death these may be covered by savings and/or sale of a property.

Quantifying the need

Let's consider the provision of financial protection in the event of death by means of new policies. Clients may have both income and capital needs in the event of death. The adviser should establish the total cover needed, while being mindful that the two elements may require different cover types and/or different terms.

FACTFIND

Look at an example life cover calculator to see the costs typically considered for covering income and capital needs:

www.aviva.co.uk/insurance/life-products/life-insurance/life-insurance-calculator/

The total recommendation should be for an amount of cover that meets current needs but also anticipated future needs; these requirements will change over time.

Assessing the income need

It is helpful to start by understanding the required replacement income to arrive at the most effective income solution.

A simple tool for doing this is a budget planner, which helps the client to understand their outgoings each month and decide what can and cannot be stopped or reduced. This helps to affirm in the client's mind the need to protect their income.

Protection can be provided by:

- taking out a policy that would pay out a **regular income** equal to the shortfall, in monthly or quarterly instalments over the required period; or
- calculating a **lump sum** sufficient to generate an income equal to the shortfall for an appropriate period.

These solutions can be used in combination. If a lump sum is required, there are several calculation methods that can be used.

- A common older method is to take a **multiple** of either the insured earner's annual income or the projected income shortfall. Some advisers have used five times income or ten times income, but these figures can be arbitrary and may not reflect the client's needs.
- Another method is to multiply the additional annual income required by a **factor** that takes into account for how long the income will be required. A typical factor might be the number of years until the youngest child reaches the age of 18 or 21, or even until the life assured's planned retirement date.

When seeking to provide income in the event of death, note that an earner's income would probably have increased each year (at the least to offset the effects of inflation). Similarly, the cost of childcare and housekeeping will rise year on year, and this should be taken into account when calculating the level of cover needed for a dependent partner.

Assessing the capital need

People may also require additional capital, ie a lump sum, to cover costs beyond income.

- It is normal practice to address the capital need, such as a mortgage or a loan, with a policy to match the amount and term.
- The capital calculation is thus different than using a factor to determine the income need, and the client may end up with two (or more) different policies.
- A combined policy may be an option, but the suitability of the options can only be determined after discussion with the client.

IN BRIEF

THE REQUIRED TERMS

Once the amount and form (lump sum, income or both) of cover has been agreed, the term or terms must be decided. The discussion of cover is likely to involve a range of protection needs and may be based on different terms.

- Where the aim is protecting a dependent spouse and child in the event of an earner's death, capital needs are likely to be matched to the term of the debt.
- In respect of protecting a main earner's income, a certain level of cover may be required until dependent children are expected to have completed education.
- The level of cover may then reduce to a level required until retirement.
- At this time, needs change again as the individual becomes eligible for pension payments.

Selecting the appropriate term for cover is a complex issue, and the recommendation may well be for a portfolio of plans with different terms to meet different needs.

19.3.3 Capital and income needs in the event of illness or disability

Many of the factors that support the need for protection against the adverse financial consequences of death apply equally to protection against illness. However, the arguments for protection against this eventuality may be even stronger because:

- the financial consequences of a long-term illness can often be more severe than those that affect the family in the event of death;
- there is a greater chance of a person of working age suffering a long-term illness or disability than there is of them dying.

Yet, despite the fact that long-term illness is more likely to strike than premature death, relatively few people take out policies to protect against it.

Critical illness and income protection needs

The needs arising from illness and/or disability are potentially more complex than those arising on death. If death occurs, those left need to cope without the deceased's ongoing contribution, but there are more considerations for illness or disability.

In the event of a critical illness, it is possible that the insured may have to:

- give up work permanently as a result of the condition;
- give up work temporarily to undergo treatment;
- move house as a result of the condition; or
- pay for medical treatment or adaptations to the home.

An individual might suffer a critical illness, receive treatment and return to their job within a short period. Equally, they might suffer an illness that requires lengthy and costly medical treatment, as well as changes to their home, and that prevents them from performing any type of work in the future.

IN BRIEF

CIC AND IPI FUNDS

CIC will, on diagnosis of a specified insurable condition, provide funds to:

- allow debt repayment;
- provide for the costs of medical treatment, rehabilitation, etc; and
- maintain an acceptable standard of living.

In the event of a specified illness or disability preventing the insured from working, IPI will provide a replacement income after a deferred period. This income may be used to:

- service debt;
- maintain an acceptable standard of living; and
- allow recuperation without the added stress of financial worries.

Quantifying the need

The process for identifying the current shortfall in financial provision in the event of illness or disability is, in essence, the same as that for calculating the shortfall in the event of death.

The question of how much would be needed is subjective; the answer can only be based on the client's expectations of the future.

The amount needed to provide cover for illness or disability can be based on many of the same factors relevant to cover in the event of death. Again, it is sensible to base the calculation on projected expenditure rather than lost income, with due consideration given to any additional expenditure required. An adviser should bear in mind that policies, such as IPI, have a maximum benefit payable, based on the applicant's income.

Anticipated changes in outgoings are worthy of particular consideration. Illness or disability are likely to bring increased outgoings, as a result of the costs of medical treatment or of being at home more than normal (increased use of utilities, for example).

However, assessing the level of cover that might be needed in the event of illness or disability involves a degree of speculation since it depends on the severity of any condition: for how long will someone be off work? How much will medical treatment cost? Until the event actually happens, these questions cannot easily be answered.

19.3.4 Budgetary considerations

In assessing affordability, an adviser must ask the client for a budget they feel is realistic, affordable and sustainable. Clients might find it difficult to commit to a budget if they have little idea of the cost of protection policies.

- **A proper factfind involves a detailed discussion of current income and outgoings.** Not only will this information help to establish protection needs, but it will also help when agreeing a budget. The factfind indicates the client's level of disposable income (net income minus current outgoings), to be used as a starting point for budget discussions.
- **Only a proportion of current disposable income should be viewed as a maximum budget for protection** because overcommitting the client may mean policies are later cancelled. There must be room for flexibility in the client's spending pattern and in the event of unexpected expenditure.

If cost or the willingness or ability to take action are issues, some options allow compromise.

- A joint-life plan is cheaper than two single-life plans.
- Protection is cheaper the shorter the term of the plan.
- Mortgage-related plans can be kept separate from other plans to minimise cost (and can be arranged on a joint-life basis and to correspond to the mortgage term).
- Decreasing term assurance is cheaper than level term assurance.
- CIC can be arranged as an added benefit within a term assurance – there will be a payout on either a death or diagnosis of an insured illness, but this is appropriate if the objective is protection of debts.

- CIC can also be arranged on a joint-life basis. Again, the plan will cease on the first payout but premiums are likely to be lower than those for two single-life plans.
- Universal whole-of-life plans meet a variety of protection needs within one plan. They are flexible enough to be adjusted in the future.
- Since cost will increase the longer the term, it may be worth considering a portfolio of plans with varying terms, rather than one plan with cover to the maximum term.
- Most types of PMI scheme offer a range of cover types. Affordability can be addressed by selecting a lower-benefit scheme.

19.3.5 What are some other planning considerations?

Discussion of a client's protection needs is likely to identify other issues linked to financial protection, including the following.

TABLE 19.2 OTHER PLANNING CONSIDERATIONS

Savings/investments	If existing savings and investments form part of the agreed protection solution, the client may wish to make additional provision, such as to ensure original savings goals can still be achieved if some savings are reallocated to meet costs arising on death or illness
Relationship breakdown	The effect of divorce, dissolution or relationship breakdown on current protection planning may be particularly profound ▪ Joint-life plans may need to be re-evaluated and even replaced with single-life plans. The two parties may still have some joint financial interests, notably in ensuring the protection of children. Conversely, they may want a complete break, with the severance of all financial ties ▪ The nature of protection needs may change depending on the arrangements made between the two parties, eg if one party takes sole responsibility for any children

Relationship breakdown, continued	▪ Where protection was provided through one party's pension plan or where their employer provided sick pay, income protection or medical expenses cover, the gap created by the loss of this cover may need to be filled by additional personal arrangements ▪ If maintenance payments are agreed, the party in receipt of the payments has an insurable interest in the life of the paying partner and they may wish to ensure their payments are protected in the event of death or illness
Cancelling plans	While it is permitted to advise a client to cancel an existing protection plan and replace it with a new plan, eg at a cheaper cost, this is an area where the utmost care must be exercised. The new plan must offer cover that is at least equivalent to the plan being cancelled. This is crucial when considering replacing a CIC plan because the: ▪ range of illnesses covered on the new plan may not be as wide; ▪ definitions of illness on the new plan may be more restrictive in the event of a claim; ▪ definition of total and permanent disability on the plans may be different; ▪ new plan may only offer reviewable premiums, compared with fixed premiums on the original plan; ▪ rider benefits available on the current plan may not be available on the new plan; ▪ client may have a pre-existing condition that is covered by the current plan but that would be excluded under a new plan

19.4 Recommendations

A key consideration for an adviser is to put together a package of suitable recommendations flexible enough to cope with changes in the future.

EXAMPLE: CONSIDERING CHANGING INCOME

Keshia wants to protect her dependants financially, but her current income levels make it impractical to implement a full set of recommendations.

Keshia expects her disposable income to rise in the future through promotion at work. Her adviser recommends maximising protection at a low cost in the short term, then taking a more comprehensive set of actions as her income rises.

CHECK YOUR UNDERSTANDING 1

✓

What must normally elapse between the insured event happening and the commencement of WoP?

Suitability

Product suitability must be at the forefront of an adviser's discussions and thinking process. ICOBS 5 states that firms must take reasonable steps to ensure the suitability of advice to any customer who is entitled to rely on their judgement. Such advice must inform the customer of any needs that are not met, and it must take account of:

- level of cover;
- cost;
- relevant exclusions;
- excesses, limitations and conditions (FCA, no date).

Under ICOBS 5, firms must:

- take reasonable steps to ensure that a customer only buys a policy from which they are **eligible to claim benefits**;
- inform the customer if they find that **parts of the cover do not apply**, so the customer can make an informed choice (FCA, no date).

The adviser can help to ensure suitability by clearly summarising a recommended product's features and disadvantages.

COBS 9 applies to long-term insurance and investments. In the context of protection, it applies to whole-of-life assurance contracts and protection policies with an investment element. COBS 9 requires advisers to make sure advice is suitable for the client's needs, and the firm must provide the client with a suitability report.

CHECK YOUR UNDERSTANDING 2

The duty to give a customer appropriate information to make an informed choice about a policy is covered in which part of ICOBS?

THINK AGAIN ...

Now that you have completed this topic, how has your knowledge and understanding improved?

For instance, can you:

- list examples of protection products covered by ICOBS?
- explain what factors to consider when forming a protection recommendation?
- outline how to ensure a recommendation is flexible enough to meet future needs?
- describe the key pieces of protection policy documentation?
- discuss the importance of product suitability when making a recommendation?

Go back over any points you don't understand and make notes to help you revise.

Test your knowledge before moving on to the next topic.

Reference

FCA (no date) *ICOBS* [online]. Available at: www.handbook.fca.org.uk/handbook/ICOBS/

Test your knowledge

?

Use these questions to assess your learning for Topic 19. Review the text if necessary.

Answers can be found at the end of this book.

1) Whole-of-life assurance is a pure protection product. True or false?

2) When determining a person's budget for protection, the adviser should use which of the following as a maximum?

   a) A proportion of the person's current disposable income.

   b) A proportion of the person's future disposable income.

   c) All of the person's current disposable income.

3) Which whole-of-life plans meet a variety of protection needs within one plan?

   a) Joint life.

   b) Mortgage-related.

   c) Universal.

4) If a couple separates and the parties want to sever all financial ties, a joint-life policy is still appropriate. True or false?

5) Under ICOBS 5 suitability requirements, a firm must inform the customer if it finds that:

   a) they have made a misrepresentation.

   b) documents have been provided in a durable medium.

   c) parts of the cover do not apply.

6) Which remedy may be available to the insurer if a customer makes a careless misrepresentation?

   a) Refuse all claims but return the premiums.

   b) None: the insurer must pay any claim.

   c) Treat the contract as if it never existed.

7) Consumers' main duty of disclosure when entering into, or renewing, an insurance contract is:

   a) utmost good faith.

   b) fair representation.

   c) disclosure of all material facts.

8) Which section of ICOBS states that firms must take reasonable steps to ensure the suitability of advice to any customer who is entitled to rely on their judgement?

9) If some savings are reallocated to meet costs arising on death or illness, the client may wish to make additional protection provision. True or false?

10) Which piece of documentation is normally issued when the recommendations are presented to the customer?

   a) Acceptance letter.

   b) KFD.

   c) Cancellation notice.