TOPIC 18

Types of financial protection II

LEARNING OBJECTIVES

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

- additional policy options, ie rider benefits, to increase the level of cover;
- protection schemes offered by employers;
- buildings and contents insurance, including standard coverage and exclusions;
- self-build insurance and landlord's insurance;
- other types of protection policies related to accident, unemployment and mortgages.

THINK ...

Before you start work on this topic, take a moment to think about what you already know about other types of financial protection.

For instance:

- Why do mortgage lenders insist that borrowers take out buildings insurance?
- What additional liabilities do landlords have over regular homeowners?
- What kinds of loss or damage does contents insurance cover?
- What kinds of specialist protection need may not be covered by CIC or IPI?
- Do employers always pay the costs of an employee group scheme?

TOPIC
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18.1 What are rider benefits?

Providers offer various rider benefits for a customer to increase their level of cover on life assurance, CIC or IPI plans. Sometimes they are automatic features, but usually they are additional charged options. This means it may be more appropriate to amend a client's existing policy when circumstances change than to start a new one. Common optional benefits that offer increased cover include the following.

Waiver of premium (WoP)

Providers often offer WoP as an option or automatic feature on most types of protection policy. WoP is designed to ensure that policy payments are maintained and benefits preserved if the insured is unable to work owing to accident, illness or disability.

If a person is unable to work, their income may fall and they may cut back on insurance, perhaps just at the time when they need the plan most.

With WoP, the provider waives the policy's premiums to ensure that the protection benefits remain in place.

- WoP typically raises premiums by 4–6 per cent.
- If the underlying plan is arranged on a joint-life basis (ie to cover two lives), WoP may only be available to one of the lives insured.
- In the event of a claim, there is normally a deferred period that must elapse between the insured event happening and the commencement of WoP.
- WoP appeals to the self-employed, whose income may be quickly affected if they cannot work. It can also be of value to the employed because sickness benefits will only be payable for a limited period, replacing a percentage of total remuneration.

EXAMPLE: WOP

Yana falls seriously ill and has to stop working as a teacher. She hopes this will be temporary, and her employer has a company sick pay scheme that maintains full pay for eight weeks of sickness.

However, Yana has now been ill for ten weeks and has gone down to half pay. She would be tempted to cancel her life assurance to make ends meet, but because she chose WoP the premiums are covered for her.

Terminal illness cover

Terminal illness cover can allow an accelerated payment of death benefit on a life or IPI policy where the life assured has a short life expectancy, typically under 12 months.

Accidental death benefit

Accidental death benefit typically pays a multiple of the sum assured if death occurs as a result of an accident.

Total and permanent disability cover

In a similar way to terminal illness cover, total and permanent disability cover enables an accelerated payment of the death benefit should the insured become permanently incapacitated and unable to work (as defined by the provider).

CHECK YOUR UNDERSTANDING 1

How many forms of model wording does the ABI provide for defining a total and permanent disability?

Guaranteed insurability options

Guaranteed insurability options enable the sum assured to be increased without the need for medical underwriting. Such an option may arise:

- at a set point in the plan's term; or
- when specified events occur, such as marriage, taking out or increasing a mortgage, or the birth of a child.

Life changes benefit

If the customer experiences a significant life event for which they have evidence, they can increase a life policy's sum assured without providing further underwriting information. Eligible life changes include:

- divorce, civil partnership dissolution, or separation;
- buying a first home;
- moving house;
- having or adopting a child;
- a child starting higher education;
- a substantial salary increase.

The amount by which the client can increase the sum assured varies by provider, but it may be up to 100 per cent. The benefit can be used whenever the client's circumstances change before they reach a specified age.

Replacement benefit

For a joint life policy, the policy ends in the event of one of the policyholders dying. With a replacement benefit, the remaining policyholder can start a new single policy without further underwriting.

Separation benefit

A separation benefit effectively splits a joint life or CIC policy into two single policies if a couple separates. The separation must be evidenced and the new policies will be subject to the terms and conditions applicable at the time they are taken out.

18.2 What is employee protection?

All UK employers must provide, and pay into, a workplace pension through auto enrolment. Smaller businesses may also offer group benefits in addition to life assurance, such as CIC or IPI. This provides income above the statutory minimum if an employee cannot work due to ill health. A firm may also offer protection in the event of death.

- A **death-in-service benefit** is a traditional group scheme that pays out a multiplier of an employee's salary to their family if they die while employed.
- A **relevant life policy** offers a variant on this benefit but with tax efficiencies for the employer.

Group cover should be tailored to the business's needs. Potential advantages for the business include:

- reducing long-term absences through effective intervention;
- promoting wellbeing in the workplace;
- the premiums generally qualifying as an allowable business expense that can be offset against the business's tax bill.

What are group schemes?

Employers can arrange IPI, CIC or accident and sickness schemes for employees on a group basis. The employer may cover the costs of NI and pension contributions. Medical underwriting may not be required, and the policies are flexible to allow businesses to choose the right type of cover for them, such as:

- how much cover to offer;
- which employees to cover; and

- different levels of benefits for different employees.

> **IN BRIEF**
>
> **WELLBEING SUPPORT**
>
> Additional benefits may include workplace wellbeing services, such as webinars, health promotion days, and return-to-work support.
>
> Training courses and workshops may also be available, including on mental health, mindfulness, physiotherapy, and stress management.

18.3 What is home insurance?

Varieties of home insurance are key to ensure a building and its contents are adequately protected against risk events.

18.3.1 Buildings insurance

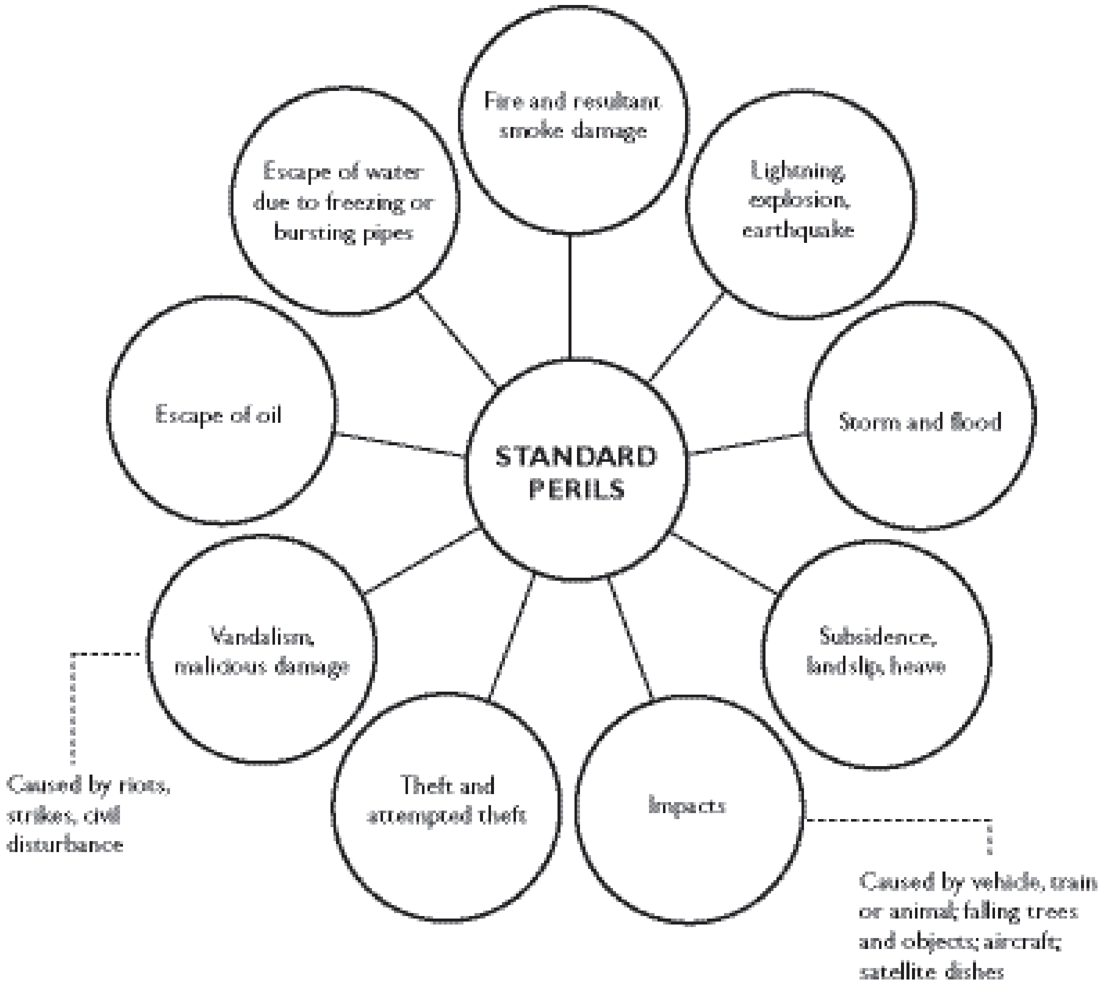
Lenders insist that a mortgaged property is adequately insured against damage or destruction. The protection policy must meets the lender's standards because the property is the main security for the loan, and any damage could reduce its value. It is also important from the owner's perspective that a property is insured.

> **CHECK YOUR UNDERSTANDING 2**
>
> From your studies in Topic 6, can you remember at what point in the buying process the buyer should arrange for buildings cover to start?

Buildings insurance covers the building and fixtures, usually defined as items physically attached to the property, such as fitted kitchen units, fixed wardrobes, window glass, sanitary ware and so on. In broad terms, the policy will pay for repairs, reinstatement or replacement needed as a result of damage, theft or attempted theft. Policies are usually renewed annually.

Each policy lists the perils (which cause a financial loss) or hazards (which make perils more likely) covered, in most cases including the perils in Figure 18.1.

FIGURE 18.1 STANDARD PERILS COVERED BY MOST BUILDINGS INSURANCE POLICIES



If major repairs are required, the property may not be habitable for a period, and so significant professional fees may be incurred in arranging the repairs. Most policies cover the cost of alternative accommodation while the property is unfit for occupation, and architects' and surveyors' fees incurred.

To keep premiums as low as possible, and to reduce the number of minor or frivolous claims, many of the standard perils carry an excess. The excess typically ranges from £50 for damage claims to £1,000 or more for subsidence claims.

Most insurers offer cover for accidental damage to buildings for an additional premium. This covers accidents such as putting a foot through the ceiling while in the loft, or cracking a bath by dropping a heavy object.

STANDARD EXCLUSIONS

A number of events are excluded from claims as a matter of course, including:

- damage caused by escape of water or oil when the property is unfurnished;
- damage to gates, fences and hedges caused by falling trees and branches;
- theft or attempted theft if the property was left unoccupied and windows and doors were not fully secured;
- damage to a heating system caused by rusting, corrosion or wear and tear.

On occasion there may be other exclusions specific to the property and circumstances.

Public liability insurance

Public liability insurance up to about £5m tends to be included as standard, covering the owner's legal liability to others, although the extent varies by insurer. Typical cover extends to the owner and their family, or their personal representatives if a claim arises after their death.

Standard level of cover

It is common for insurers to set a standard upper level of cover for buildings policies rather than a specific level for each property. For example, the policy might provide maximum cover of £500,000, regardless of the cost of reinstatement. However, the insurer will set specific sums assured for higher-value or unusual properties.

If the sum insured does not reflect a property's true reinstatement cost, the property is underinsured. In this case, the insurer is unlikely to meet a claim in full, and will reduce the payment in proportion to the level of underinsurance, known as averaging.

CHECK YOUR UNDERSTANDING 3

We introduced the concept of averaging in Unit 1 of UKFR. Can you recall how it works? Try to complete this calculation to check your understanding.

A property has an insurance reinstatement valuation of £180,000 but it is actually insured for £150,000. If a claim for £15,000 is submitted and a standard excess clause of £500 applies, how much will the insurer pay?

The borrower does not have to arrange insurance with their lender; they have the right to choose their own insurer from the wider marketplace. However, the lender has the right to insist that the borrower's proposed policy meets its minimum requirements and is with a reputable insurer. As a minimum, this will mean the insurer should be an ABI member.

Lender's rights

The lender has certain rights to ensure cover is maintained, as contained in the mortgage deed.

The lender has the right to:

- insist that a mortgaged property is **insured continuously** in accordance with its requirements;
- have its **interest noted on the policy** by the insurer (or even to have the policy written in the joint names of lender and borrower);
- secure a **right over the proceeds of any claim** made by the borrower and insist that they are used either to repair any damage, or to reduce the mortgage debt.

If the borrower chooses their own provider, the lender has the right to be informed if premiums are not paid before any action is taken to cancel the policy. The lender may choose to pay the outstanding premiums and add the payments to the mortgage loan.

18.3.2 Self-build insurance

Specialist buildings insurance policies are available for those undertaking a self-build project, because standard policies would not cover many of the specific risks. Self-build policies include the following elements.

- **Site insurance**: covers liability exposure on a project during development, from the time when the insured assumes responsibility on a plot or property that is to be redeveloped or demolished. The policy continues while they are planning and then covers the works in progress and the materials.

- **Ten-year structural warranty**: covers the cost of rebuilding or rectifying work to the housing unit after work is complete, up to a specified amount, if there is major damage attributable to a defect in the design, workmanship or materials, provided the insurer's liability does not exceed the reasonable cost of rebuilding to the original specification. The warranty also covers:
  - making good defects in the design, workmanship or materials of a newly constructed drainage system;
  - repairs or replacements owing to water damaged caused by a defect in design, workmanship, materials or waterproofing elements (Self-build Zone, no date).
- **Liability cover**: insures against risks to the public and any contractors while the work is going on, typically up to £5m and £10m respectively, including claims due to negligence.
- **Employer's liability insurance**: both compulsory and desirable, as the property owner or developer has a duty of care to the project's workers and could be subject to compensation claims if workers are injured.

18.3.3 Contents insurance

Property owners should insure the home's contents against theft and damage. Unfortunately, a significant amount of owners fail to do so, and a lender will not insist on this protection because its security is not affected by damage to contents.

Contents insurance compensates the insured for loss or damage to personal effects, money, and household fittings and furniture, as a result of a number of perils.

The basic structure and principles are similar to buildings insurance, and the plan covers loss or damage to contents from similar causes (see section 18.3.1).

Contents insurance also covers:

- the insured's money being stolen from another building following a forced entry;
- damage to computers, TVs and other appliances;
- replacement of locks and keys required as a result of any of the standard perils.

IN BRIEF

ADDITIONAL CONTENTS COVER

Most policies offer additional cover for an additional premium:

- accidental damage;
- cover for food in freezers lost as a result of breakdown or contamination;
- theft or damage of money, credit cards or other possessions that are temporarily away from the home (with limits for each item), known as 'all risks' cover;
- contents taken by a family member to university, up to a specified limit.

As with buildings cover, each claim is subject to an excess; the amount depends on the peril and the insurer.

18.3.4 Landlord's insurance

Most standard home policies do not offer cover for buildings, contents or the landlord's third-party liabilities while a property is being let out. So owners of buy-to-let property face additional risks compared to residential homeowners.

- If damage to the property makes it uninhabitable, the landlord will either lose rent or be required to cover temporary accommodation for the tenants.
- Tenants may default on their rental payments.
- There is a risk of damage to third parties or their property while in or around the property.
- Tenants may cause damage to the property or its contents.

Landlord's buildings insurance

Landlord's buildings insurance provides cover against financial loss for those renting out property, on a single- or multi-property basis. It normally covers the standard perils, together with a range of additional options such as accidental damage, terrorism, legal protection, alternative accommodation costs, rent guarantee insurance, and liability insurance to cover the landlord against tenants' claims for losses.

It insures the same elements as standard policies, but also covers fixtures and fittings such as carpets, laminate flooring, kitchens, bathrooms, white goods, light fittings and curtains.

Theft is generally only covered in the case of forcible or violent entry or exit. This is designed to preclude claims where a tenant or a friend steals a landlord's items.

Landlord's contents insurance

A landlord can insure the contents of the property where it is completely or partly furnished. This will only cover contents owned by the landlord. The tenant needs to insure any personal furniture or valuables.

Tenants' liability

Tenants taking out contents insurance may be covered, or take out additional cover, for their liability for damage to fixtures in the landlord's property, and for claims for accidental injury to domestic employees.

18.4 Other forms of protection

A number of protection policies are available to cover other protection needs.

18.4.1 Accident, sickness and unemployment (ASU) insurance

ASU is a type of general insurance that may be considered as an alternative to, or to work in conjunction with, IPI. It is relatively inexpensive compared to IPI, because it is not underwritten on a personal basis and will pay income benefits for a shorter period (typically 12 months but can be up to 2 years). Under the umbrella of ASU is a wide range of contracts from different providers.

Unlike life assurance contracts, ASU deals with probabilities, not certainties. With life assurance, the insured will either live or die, and will eventually die. The risks covered under accident, sickness and unemployment, however, may arise once, on several occasions, or never.

ASU policies are annually renewable at the discretion of the insurer. This means the insurer can increase premiums in light of poor claims experience, or even withdraw cover that was previously available.

CHECK YOUR UNDERSTANDING 4

Think back to Topic 17. Can an insurer withdraw IPI cover based on claims experience?

A regular income benefit can be provided if the insured is unable to work owing to accident, illness or unemployment via redundancy.

DISMISSAL AND VOLUNTARY RESIGNATION

Although these policies are known as ASU, a more accurate description would be accident, sickness and redundancy because policies will not cover unemployment where the insured is dismissed or has voluntarily resigned.

Income benefits are payable after a deferred period, typically one month, for a maximum specified period, typically one or two years.

Some providers only offer accident and sickness cover because they consider the unemployment element too risky. A limited number of providers offer unemployment cover as a standalone product.

Insurers may offer different levels of ASU at different levels of premium to suit customers' needs. Protection for the self-employed may be offered for if they permanently cease to trade.

Exclusions and restrictions

A number of restrictions are normally applied to ASU policies, as follows.

- The applicant must have been actively and continuously employed for a specified period before arranging the policy.
- Any redundancy that the applicant had reason to believe was imminent when they took out the policy will be excluded.
- No benefit is payable if redundancy occurs within a specified period of the cover starting.
- Unemployment tends not to be covered if the policyholder is self-employed.
- No benefit is payable if sickness is owing to a pre-existing condition.
- There is a maximum benefit payable, which may be a monetary limit or a percentage of the insured's salary, whichever is the lower.
- There will be a deferred period following unemployment or incapacity during which no benefit is payable.

Any event giving rise to a claim must fall within the precise terms set out in the policy document.

IN BRIEF

PERSONAL ACCIDENT INSURANCE

As opposed to the income benefits of ASU, personal accident insurance policies offer lump-sum payments in the event of specified conditions arising due to an accident. This can include accidental death and accidental personal injury for personal or family cover. Group accident and sickness schemes can be established in the same way as group IPI.

18.4.2 Payment protection insurance (PPI)

PPI is designed to protect repayments to service a loan or debt. It is commonly arranged in conjunction with a mortgage, a personal loan or an overdraft. Where a mortgage is arranged on a joint basis, it is possible to protect one borrower or both, the latter at twice the premium.

The level of assistance provided by the state if someone is struggling to make their mortgage repayments is limited. It is partly to avoid the need for people to rely on state provision that many mortgage providers offer PPI.

Clients taking out mortgages or loans often depend on their continuing income to maintain repayments. In all cases, clients should be encouraged to protect the loan in the event of death, ill health or redundancy.

All PPI benefit payments are tax-free. The policy is annually renewable, which means the insurer can decline to renew it.

Exclusions and restrictions

The exclusions applied to PPI are similar to those for ASU. Typical exclusions and restrictions include the following.

- Pre-existing medical conditions are not usually covered.
- Claims resulting from self-inflicted injury (other than accidents), alcohol or substance abuse, pregnancy or involvement in criminal acts are not generally covered.
- Permanent and total disability claims must meet the insurer’s criteria.
- The self-employed and small business owners (directors) may only be able to claim benefits if they play no part in running the business while making the claim. This makes it difficult for many such claims to succeed.

For unemployment cover:

- the applicant must have been continuously employed for a specified period;

- any redundancy that the insured could reasonably have anticipated when the policy was taken out will be excluded;
- no benefit is likely to be paid if the policyholder is made redundant within a specified period of the policy's start date;
- no benefit is payable if the policyholder becomes unemployed as a result of disciplinary action or voluntary redundancy.

IN BRIEF

PPI AVAILABILITY

PPI gained a bad reputation due to a prolonged mis-selling scandal involving hefty customer compensation, but it is still useful and available to those borrowers who need it.

Levels of cover

Cover is normally provided at a fixed cost per £100 of benefit. Basic cover can be arranged to cover mortgage repayments as well as other essential household bills, but the higher the level of benefit required, the higher the premium.

Payment will commence after a deferred period (typically between 30 and 60 days). Cover can be usually arranged for a benefit period of up to 12 months but some providers may provide benefit for up to 24 months. As with higher benefit levels, the cost of the policy will also be higher the longer the payment period selected.

18.4.3 Mortgage payment protection insurance (MPPI)

An MPPI policy covers the borrower's mortgage payments for up to two years if they are unable to work due to accident or sickness. The policyholder usually has the option to include redundancy cover as well. Although usually called MPPI, the policy is an ASU policy marketed as mortgage protection. The exclusions and restrictions are broadly the same.

An MPPI policy does not provide life cover and usually allows more than one claim to be made, provided that premiums are maintained. It has the following key features.

- Cover is usually available to those aged 18–65.
- Most insurers do not require a medical questionnaire.
- Benefit is payable after a deferred period, usually 28–30 days, and for a maximum period of up to 2 years, depending on the policy terms.

- The level of benefit is usually sufficient to cover the monthly mortgage payment and any associated insurance premiums. It may be increased to include an allowance for some essential living expenses.
- All benefit payments are tax-free.
- The policy is annually renewable, which means the insurer can decline to renew it.

THINK AGAIN …

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

For instance, can you:

- list standard perils covered by both buildings and contents insurance?
- explain what events contents insurance can cover for an additional fee?
- discuss a lender's rights to ensure buildings cover is maintained?
- outline the typical restrictions applied to ASU policies?
- describe the key features of MPPI?

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

Self-build Zone (no date) *Structural warranty* [online]. Available at: www.selfbuildzone.com/structural-warranty

Test your knowledge

?

Use these questions to assess your learning for Topic 18. Review the text if necessary.

Answers can be found at the end of this book.

1) Which of the following standard perils are specific to contents insurance?

    a) Damage by storm and flood.

    b) Damage or losses caused by theft and attempted theft.

    c) Damage to computers and TVs.

    d) Damage caused due to frozen or burst pipes.

    e) Damage caused by impact from falling trees.

    f) Replacement of locks and keys.

    g) Theft of the insured's money from another building.

    h) Subsidence, landslip and heave.

2) Damage caused by escape of water or oil is excluded from buildings insurance when the property is:

    a) furnished.

    b) unfurnished.

    c) self-build.

3) If a mortgage borrower fails to maintain their buildings insurance premiums, the lender may:

    a) repossess the mortgaged property.

    b) choose to pay the outstanding premiums and add the payments to the mortgage loan.

    c) choose to pay the outstanding premiums and charge the borrower a specified interest rate.

4) Landlord's contents insurance will cover:

    a) the landlord's contents only.

    b) both the landlord's and the tenant's contents.

    c) the tenant's contents only.

5) Accident, sickness and unemployment can work in conjunction with IPI. True or false?

6) An accident, sickness and unemployment redundancy claim is likely to be excluded if the applicant had:

   a) no reason to expect the redundancy when they took out the policy.

   b) previously been made redundant from a job unrelated to the claim.

   c) reason to believe the redundancy was imminent when they took out the policy.

7) If payment protection insurance is arranged on a joint basis to protect both mortgage borrowers, the premium will be:

   a) the same as that quoted to protect one borrower.

   b) double the amount quoted to protect one borrower.

   c) variable depending on the second borrower's health.

8) When using waiver of premium (WoP), if the underlying plan is on a joint-life basis the WoP is always available to both of the lives assured. True or false?

9) Which rider benefit splits a joint life or CIC policy into two single policies if the need is evidenced?

   a) Separation benefit.

   b) Replacement benefit.

   c) Life changes benefit.

10) Mortgage payment protection insurance usually allows:

   a) one claim to be made.

   b) more than one claim to be made.