TOPIC 17

Types of financial protection I

LEARNING OBJECTIVES

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

- the role of state benefits in financial protection;
- the range of state benefits available to provide financial protection;
- mortgage repayment support;
- life assurance including term assurance and whole-of-life assurance;
- critical illness cover (CIC);
- income protection insurance (IPI).

THINK ...

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

For instance:

- How can eligibility for benefits affect a household's protection needs?
- What is a means-tested benefit?
- What are the possible consequences of people having to live with impaired earning capacity for months or even years?
- Which core conditions does CIC always cover, regardless of provider?
- In which situations is whole-of-life assurance appropriate?

17.1 State protection

In the UK, the state provides numerous benefits for a degree of financial protection against the adverse financial consequences of illness, unemployment, death, retirement, and the inability to pay a mortgage. However, the level of provision is minimal compared to the reality of most people's overall protection needs.

Partly to constrain benefit claims and to ensure that benefits are paid out only to those whose situation merits payment, each benefit typically has eligibility criteria attached.

KEY TERMS

ELIGIBILITY CRITERIA

Factors determining the circumstances in which someone is able to claim a particular benefit.

MEANS-TESTED BENEFIT

Eligibility depends not only on the claimant suffering from a certain condition or experiencing a certain life event, but also on the claimant's financial circumstances – in particular, how much income and/or savings they have.

Sometimes the only criterion applying to a benefit is that the claimant has suffered a certain condition or life event. For some benefits specific additional criteria apply, such as:

- National Insurance contribution (NIC) record;
- age; and
- means testing of savings and/or income.

There is also a benefit cap that limits the amount of overall state benefit claimed by each household.

With means testing, if savings and/or income exceed certain thresholds then either:

- the scale of benefits is reduced below the maximum available level; or
- no benefits are payable at all (even if others in a similar situation, but with lower levels of income or savings, may be able to claim).

FACTFIND

Browse the UK government website to supplement what you learn in this topic and to find current benefit rates:

www.gov.uk/browse/benefits

The main benefit that is means tested on income for new claimants is Universal Credit, which has replaced various other benefits.

A calculation is carried out to determine whether the claimant is eligible and, if so, what scale of benefit is payable.

In assessing income, the amount taken into account is usually that which the claimant – and their partner, if appropriate – has left each week after paying specified outgoings such as taxes and rent or mortgage.

Income will include earnings, certain state benefits, maintenance payments and some other receipts.

Eligibility may also be tested, additionally or alternatively, against savings.

!

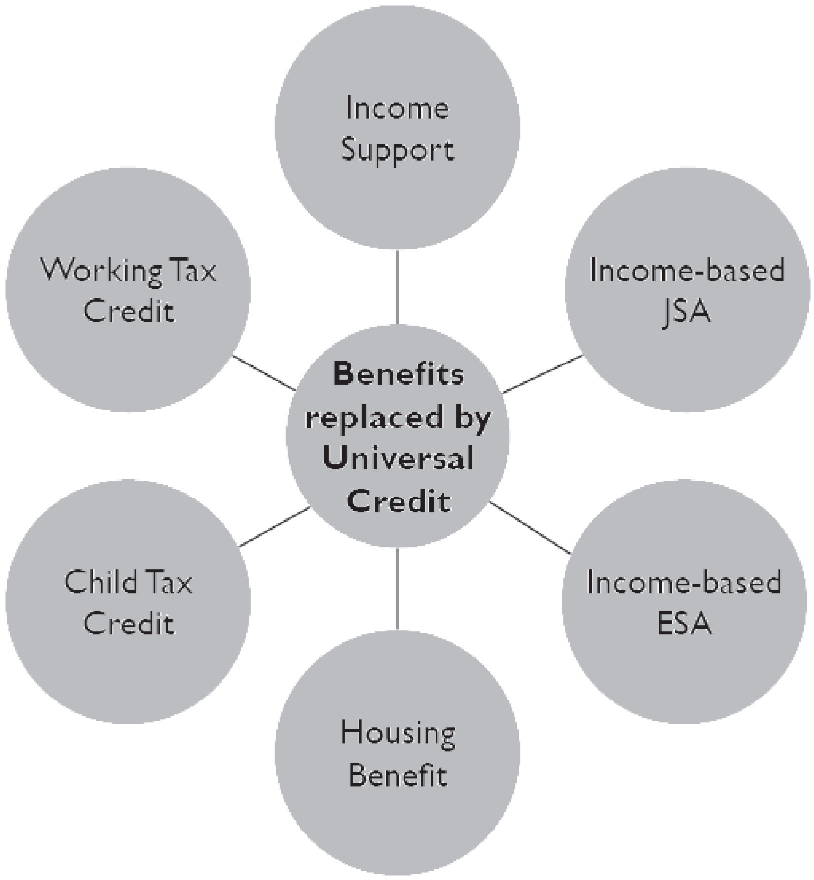
KEEPING UP TO DATE

Rules relating to eligibility and rates of state benefits change regularly. We provide an overview of the principles here, but when advising clients it is important to check that you have current information.

17.1.1 What is Universal Credit?

Since 2013, the UK system of working-age benefits and tax credits for people looking for work, or in work but on a low income, has undergone a gradual process of simplification. Universal Credit is an integrated means-tested benefit not limited to people who are in or out of work, thus aiming to improve the transition between the two.

FIGURE 17.1 WHICH BENEFITS DOES UNIVERSAL CREDIT REPLACE?



Claims for Universal Credit are made on a per-household, rather than per-individual, basis. The amount payable depends on the income and circumstances of all household members.

Transition phase

Those already receiving benefits which are being replaced by Universal Credit will be expected to move to the new system by 2024. Rollout of Universal Credit has made progress but has been beset by controversies and delays, with a number of postponements.

Eligibility

UK claimants may be eligible for Universal Credit if they:

- are aged 18 or over (with some exceptions for 16- and 17-year-olds);
- are on a low income or out of work;
- are, or have a partner who is, under state pension age;

- have household savings that do not exceed £16,000.

The number of children in the family may affect the level of benefit.

FACTFIND

Read the detailed eligibility criteria, including for those studying full-time:

www.gov.uk/universal-credit/eligibility

IN BRIEF

AMOUNT AND PAYMENT OF UNIVERSAL CREDIT

Universal Credit consists of a basic allowance with different rates payable for single people/couples and younger people.

There are additional payments for those with children or who meet other criteria.

If a claimant is working, the payment depends on their earnings and reduces as they earn more.

17.1.2 Support for people who are ill or disabled

This section summarises the main benefits for people who are sick, injured or disabled, or who need constant care.

Statutory Sick Pay (SSP)

SSP is paid by employers to employees who are off work owing to sickness or disability for four consecutive days or longer. (Employers pay the benefit on behalf of the Department for Work and Pensions and reclaim the amounts paid.)

- SSP is paid for up to a maximum of 28 weeks in any spell of sickness. Spells of sickness with less than eight weeks between them count as a single spell.
- SSP is payable to employees with earnings above the lower earnings limit (LEL) for NICs.
- SSP is not means tested.
- Amounts paid as SSP are subject to tax and to NICs, just as normal earnings would be. People who are still sick after 28 weeks may be able to claim short-term Incapacity Benefit.

> **LOWER EARNINGS LIMIT**
>
> The amount above which an individual is entitled to NIC-dependent benefits. For earnings in the LEL band, the person does not pay NICs but gets the benefits of paying.

Employment and Support Allowance (ESA)

New style ESA is for people who have a disability or health condition that affects how much they can work. Claimants need to have both:

- worked as an employee or have been self-employed;
- paid sufficient NICs (NI credits also count), usually in the last two to three years.

People cannot claim new style ESA if they claim either JSA or Statutory Sick Pay (SSP). People can claim Universal Credit and new style ESA at the same time, but the amount of Universal Credit payment is reduced by the amount they get for ESA. ESA is usually paid more regularly than Universal Credit.

Attendance Allowance

Attendance Allowance is a tax-free benefit for people who have reached state pension age and need help with personal care as a result of sickness or disability. It is neither means tested nor dependent on NICs.

There are two levels of benefit:

- a lower rate for people who need help with personal care **by day or at night**; and
- a higher rate for those who need help both **by day and at night**.

Personal Independence Payment (PIP)

PIP helps people with the additional costs arising from illness or disability, usually where the person:

- is aged 16 or over and is below state pension age; PIP will continue past state pension age for those in receipt of PIP at that point;
- has had difficulties with daily living or mobility for **three months**; and
- expects their difficulties to continue for **at least another nine months**.

The amount of benefit paid depends on how a person's illness or disability impacts on them. It is not NIC-dependent or means tested.

PIP is made up of two elements. A person may be entitled to one element or both.

- The **daily living component** is paid if a person needs help participating in daily life. Assessment focuses on the ability to perform ten daily living activities.
- The **mobility component** is assessed by reference to two mobility activities.

Carer's Allowance

Carer's Allowance is a benefit paid to someone who is caring for someone who is seriously ill or disabled, but not in hospital. The person being cared for must be eligible for specific benefits – PIP, Disability Living Allowance, Attendance Allowance, Constant Attendance Allowance, or Armed Forces Independence Payment.

The carer must be aged over 16, spend at least 35 hours per week as a carer, be earning no more than a certain amount and not in full-time education.

The benefit is not dependent on NIC contributions. Carers in receipt of the state pension cannot receive the full amount of both the state pension and Carer's Allowance, and so will not be eligible for Carer's Allowance if their state pension exceeds a specified figure.

17.1.3 Support for those on low income

Jobseeker's Allowance (JSA) is a benefit for people aged between 18 and state pension age (with some exceptions for those aged 16 or 17) who are either:

- unemployed and actively seeking work; or
- working less than 16 hours per week on average.

Types of JSA

There are two forms of JSA for new applicants.

- New style JSA depends on having paid sufficient Class 1 NICs. It is paid at a fixed rate, irrespective of savings or a partner's earnings, for a maximum of 182 days, but no additional benefits are paid for dependants.
- Contribution-based JSA is similar to new style JSA but people can only apply for it if they receive or are entitled to the severe disability premium.

17.1.4 State assistance with mortgage payments

Support for Mortgage Interest (SMI) is paid as a loan – not as a benefit – to people who are having problems meeting their mortgage payments if they are in receipt of:

- Universal Credit;
- Income Support;
- income-based JSA;

- income-based ESA; or
- Pension Credit.

Following a claim, the waiting period that must elapse before payment commences is three months for those receiving Universal Credit; 39 weeks for those in receipt of Income Support, income-based JSA and income-based ESA. There is no waiting period for those receiving Pension Credit.

SMI is paid to cover interest (not capital) on the first £200,000 of a mortgage, but claimants receiving Pension Credit are generally only covered for interest on the first £100,000.

Main features of SMI

- Claims can be made for the original mortgage amount. Claims may also be accepted for specific loans taken out to cover essential repairs or improvements necessary to maintain the home's fitness for habitation, or to buy an ex-partner's share in the home on separation.
- Payment is made directly to the lender to ensure the money is used for the purpose intended.
- Payments are calculated using a standard rate of interest, rather than the borrower's actual pay rate.
- Interest charged on the loan is usually lower than market interest rates and is reviewed every six months.

> **FACTFIND**
>
> Find out the current interest rate used to calculate SMI payments, and the current interest rate added to the loan:
>
> www.gov.uk/support-for-mortgage-interest/what-youll-get

- The SMI loan is secured by a second charge on the claimant's property, ie if the borrower misses mortgage repayments, the second charge is repaid after the original mortgage, which is the first charge. All legal owners must consent to the loan.
- The SMI loan must be repaid when the property is sold or transferred, or the owner dies, or when it can be repaid voluntarily if the claimant returns to work, with a minimum repayment of £100. If there is insufficient equity in a claimant's property to repay the whole SMI loan on one of these events, the balance will be written off.

- If the property is transferred to the claimant's partner on death and they remain in the property, the loan is not repayable at that point. This also applies where the property is transferred based on court orders or a maintenance agreement. The loan is repayable on the partner's death.
- Payments continue indefinitely until the claimant no longer qualifies. The claimant can opt to stop receiving payments at any time.
- Endowment premiums, buildings and contents insurance premiums, and certain arrears are not covered by the scheme.
- Where the claimant has been receiving SMI for at least 26 weeks but they are about to start a job that will make them ineligible, they can claim mortgage interest run-on. This pays the benefits for a further four weeks, and straight to the claimant rather than to the lender.

IN BRIEF

THE 52-WEEK LINKING RULE

Under the 52-week linking rule, a borrower who has already served the waiting period for SMI and then ceases to claim payments for up to 52 weeks will not have to serve a further waiting period at the start of the second claim. This means that those who claim SMI can accept offers of short-term or seasonal work without losing their entitlement to further SMI payments.

17.2 What is life assurance?

The life assurance industry offers a diverse range of policies to meet a diverse range of protection needs. Some cover can be in the form of a paid-up policy, meaning all premiums have been paid and the policy remains in force until death or policy termination.

Mortgage lenders may insist on the assignment of life policies to make sure the mortgage is paid off if the borrower dies, or to ensure an endowment policy is used to repay an interest-only mortgage. Assignment involves the policyholder signing over the benefits of the policy to the lender for the term of the mortgage. It gives the lender certain rights, including the right to surrender the policy if the borrower fails to make mortgage payments. The insurance company pays any policy proceeds to the lender when the policy matures or there is a death claim.

Assignment used to be normal practice among lenders, but it has become increasingly less common. An alternative is for the borrower to deposit the life assurance policy document with the lender. Although the lender has no legal rights over the policy, the fact that the lender has been given the policy creates an 'equitable right' for the lender over the policy.

The two main types of life assurance policy are term and whole-of-life assurance. Under these broad headings, a wide variety of policies meet different needs.

EQUITABLE RIGHT

Governed by the practice of equity, or fairness; indicates an agreement between the two parties that the policy has been given as a form of security.

17.2.1 Term assurance

All types of term assurance (or temporary assurance) share a common characteristic: the sum assured is payable only if the death of the life assured occurs within a specified period – the term.

KEY TERMS

LIFE ASSURED

The person covered by a life assurance policy.

SUM ASSURED

The monetary amount of cover provided by a life assurance policy.

Term assurance is the most basic form of life assurance: it is pure protection (see section 19.1) for a limited period with no element of investment. For this reason, it is also the cheapest. Term assurance can be used for personal and family protection, and also for many business situations. Business use includes protecting against a loss of profits resulting from the death of an important employee (ie key person insurance), and share protection schemes for business owners.

- The term can be anything from a few months to 40 years or more.
- If the life assured survives the term, the cover ceases and there is no return of premiums.
- There is normally no cash value or surrender value at any time.
- If premiums are not paid within a certain period after the due date (normally 30 days), cover ceases and the policy lapses with no value. Most companies allow reinstatement within 12 months, provided that all outstanding premiums are paid and evidence of continued good health is provided.

- Premiums are normally paid monthly or annually, although single premiums (ie one payment to cover the whole term) are allowed.
- Premiums are normally level (ie the same amount each month or year), even if the sum assured varies from year to year.

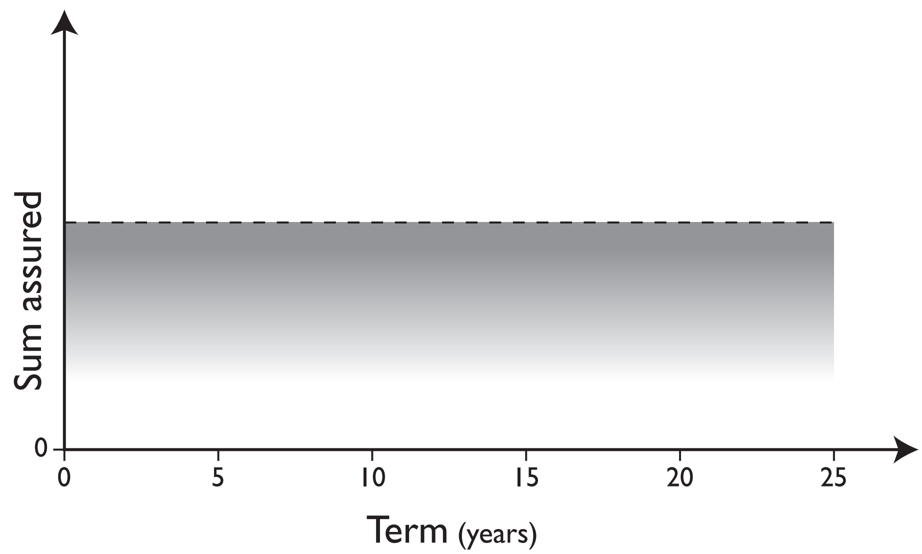
SURRENDER VALUE

An amount paid when cashing in an investment-linked policy early. This ends the policy and typically incurs high charges.

Level term assurance

With level term assurance, the sum assured remains constant throughout the term. The sum assured will be paid out on death during the term. The policy ceases at the end of the term or on earlier death.

FIGURE 17.2 LEVEL TERM ASSURANCE



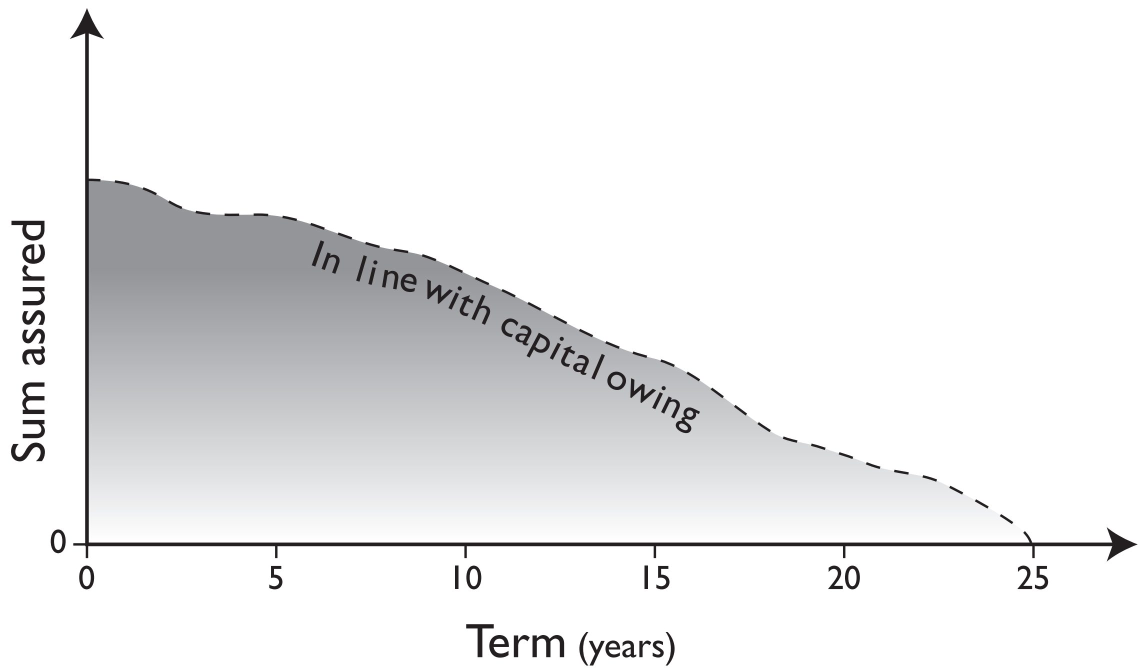
Level term assurance is often used when a fixed amount would be needed on death to repay a constant fixed-term debt, such as an interest-only mortgage.

It can also be used to provide family cover, for example until children leave home. If it is used for that purpose, the policyholder should bear in mind that the amount of cover in real terms will be eroded by the effect of inflation.

Decreasing term assurance

With decreasing term assurance, the sum assured reduces to nothing over the term of the policy, usually by equal annual amounts. Premiums are normally payable throughout the term and remain unchanged.

FIGURE 17.3 DECREASING TERM ASSURANCE

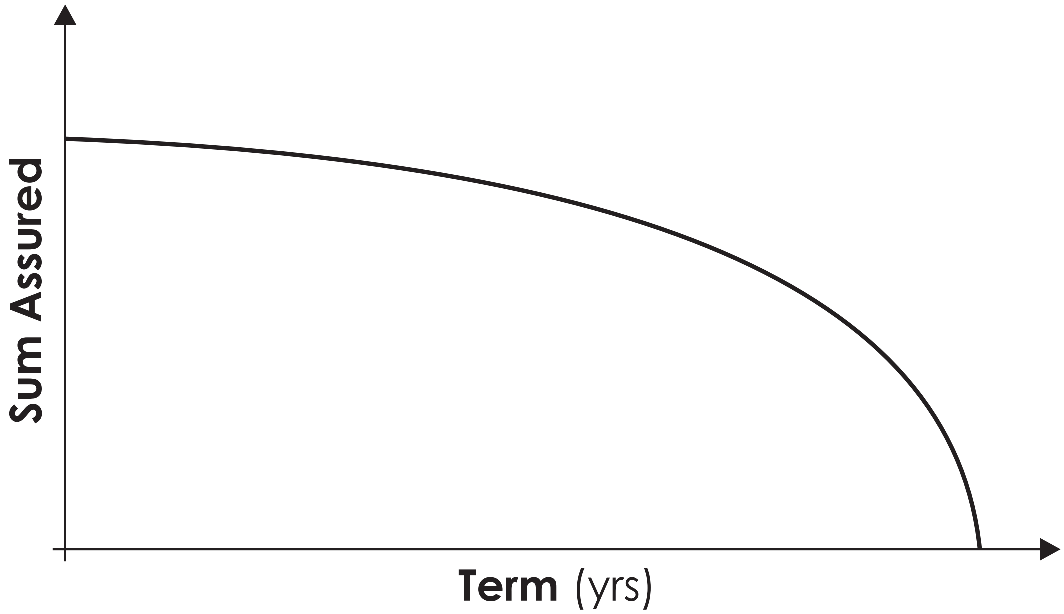


Decreasing term assurance may be used to cover the outstanding capital on a debt that reduces each year.

The most common use of decreasing term assurance is to cover the amount outstanding on a repayment mortgage; this is also known as mortgage protection assurance. The sum assured is calculated so that, as long as premiums are maintained, it is always equal to the amount outstanding on a repayment mortgage of the same term, based on a specified interest rate.

The sum assured, like the mortgage, decreases by lesser monthly amounts near the start and by larger amounts towards the end of the term (see Figure 17.4.

FIGURE 17.4 MORTGAGE PROTECTION ASSURANCE



Convertible term assurance

Convertible term assurance includes an option to convert the policy into a whole-of-life or endowment assurance without further evidence of health or additional underwriting. Underwriting only takes place at the policy's outset.

This guaranteed insurability means that the conversion is carried out at normal premium rates applying to the person when they elect to convert the plan, whatever their state of health at that time.

Generally, such a policy costs 10–15 per cent more than the premium for an equivalent policy without the conversion option. The option is normally included only on level term assurance policies, but there is no technical reason why it should not be included on others.

CONVERSION RULES AND RESTRICTIONS

- The conversion is normally carried out through cancellation of the term assurance, in part or in whole, and the issue of a new whole-of-life or endowment policy. A new endowment can extend beyond the end date of the original convertible term policy.
- The option can only be exercised while the convertible term assurance is in force.
- The sum assured on the new policy cannot exceed the original sum assured.
- The premium for the new policy is the current standard premium for the new term and for the life assured's age at the conversion date.

Personal pension term insurance

Until 2006 it was possible to arrange level term insurance as part of a personal pension arrangement and receive tax relief on the contributions. Policies in force at that point can continue until the individual's seventy-fifth birthday.

Pension term insurance cannot be held in joint names or assigned to a lender. People who have such cover in place should think carefully before cancelling due to the tax advantages.

17.2.2 Whole-of-life assurance

Whole-of-life assurance covers the life assured for their whole lifetime and pays out the sum assured in the event of death, whenever it occurs, provided that the policy remains in force (ie that the premiums have been paid). Whole-of-life policies are commonly used to provide financial protection for self and dependants, and to protect the value of the estate on death from IHT.

A whole–of-life policy can either have guaranteed premiums throughout the life of the policy or can be investment backed, where the policy combines life cover with investment. Premiums are reviewed at set times throughout the plan and if the investment has not matched assumptions the premiums will increase or decrease accordingly.

Uses and benefits

Whole-of-life policies are appropriate when the need is for a sum of money to be paid on an individual's death, whenever that may occur. Like all protection policies, an overriding benefit is providing peace of mind.

Whole-of-life policies can be used in personal and business situations, and for certain tax purposes. These uses include to:

- protect dependants against loss of financial support in the event of an income earner's death;
- provide a lump sum on death;
- fund additional expenses on death; and
- provide funds for the payment of IHT.

Different types of whole-of-life contract may be appropriate in different circumstances.

- **Non-profit** is suitable where an absolute fixed amount, no more and no less, is needed on death. In practice, such situations are rare.
- **With-profit** is suitable where a cautious approach to the provision of lifetime cover is required, but where an increasing benefit is also needed (eg to allow for inflation).
- **Unit-linked** is suitable where both lifetime cover and a potentially increasing benefit are required. Some of the money is used to buy the life assurance while the rest is invested. However, whole-of-life is primarily a protection policy, so more speculative funds should generally be avoided.
- **Universal whole-of-life** is suitable if the client has needs similar to those fulfilled by a basic unit-linked policy, but they want the flexibility of a variable mix of protection types.

17.2.3 Typical exclusions

Life policies, whether term or whole of life, may include exclusions that nullify cover in particular situations, or that prevent certain people from arranging cover.

Exclusions from cover

An applicant for life cover will not be accepted if they present what the insurer considers too great a risk. This could be because the applicant:

- **works in a high-risk job**, such as a builder or a member of the armed forces;
- **has risky hobbies**, such as motorcycling or mountaineering;
- **has a history of serious health issues**, such as cancer or diabetes; or
- **has a lifestyle that presents a high risk**, such as long-term smoking.

However, insurers have different attitudes to risk and about what they will and will not cover.

IN BRIEF

EXCLUDED CIRCUMSTANCES

Some life policies may not pay out if the insured dies:

- due to alcohol or drug misuse;
- as a result of war or terrorism;
- from suicide or self-inflicted injuries;
- due to a reckless act, eg gross negligence.

CHECK YOUR UNDERSTANDING

Fill in the table below, which considers life insurance policies that can be used with mortgages. Tick the relevant columns where features apply to the product, and fill in the last row using numbers.

Feature	Convertible term	Whole-of-life	Level term	Decreasing term
Limited term				
Can be investment-linked				
Conversion to whole-of-life or endowment				
Level sum assured				
Sum assured decreases in line with mortgage				
Order of cost (*lowest first – rank from 1 to 4*)				

17.3 What is critical illness cover?

As new protection needs have arisen, product providers have introduced a range of policies to meet them. CIC provides a lump-sum payment on diagnosis of one of a specified range of life-threatening or debilitating illnesses or medical

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conditions. Some providers also offer policies that can pay an income, though this actually means paying the lump sum in instalments.

CIC is available in different forms and is typically used for:

- the provision of long-term care, either in hospital or at home;
- alterations to living accommodation;
- the purchase of specialised medical equipment, such as a kidney dialysis machine;
- mortgage/debt repayment;
- protecting lump sum investments to avoid the need to draw on them in the event of illness;
- improving the quality of life of a terminally ill person.

The sum assured is paid on a successful claim following diagnosis of one of the conditions specified in the policy. The policy usually ceases on payment of the sum assured – on most policies it is not possible to claim more than once on the same CIC policy.

Core conditions and their definitions

The illnesses and conditions covered vary among providers, but the Association of British Insurers (ABI) requires all members to cover the following core conditions, which comprise the majority of CIC claims:

- most forms of cancer, excluding less advanced cases;
- heart attack of specified severity;
- stroke resulting in permanent symptoms.

In the past, many companies covered the same core conditions but applied very different methods to assess the conditions in the event of a claim. To help deal with this problem, the ABI developed model definitions of each core condition and issued several statements of best practice on CIC.

FACTFIND

Look through the ABI minimum standards for CIC:

www.abi.org.uk/globalassets/files/publications/public/protection/new-abi-guide-to-minimum-standards-for-critical-illness-cover.pdf

Where a CIC provider is a member of the ABI, the minimum standards must be met. Providers may offer more generous definitions of the core conditions if they wish. Many other conditions are often covered too.

FIGURE 17.5 OTHER CONDITIONS CIC COMMONLY COVERS

Dementia, including Alzheimer's disease (before a certain age) of specified severity	Aorta graft surgery	Benign brain tumour	Blindness	Coma
Coronary artery bypass	Deafness	Heart valve replacement or repair	Kidney failure	Loss of hand or foot
Major organ transplant	Motor neurone disease	Multiple sclerosis	Parkinson's disease before a certain age	Loss of speech
Third-degree burns	Total and permanent disability	Traumatic brain injury	Paralysis of limb	

As the range and definition of insured conditions vary by company, it is vital to check the exact terms and conditions of the policy when comparing providers. An adviser has a key role to play in ensuring the client understands the scope of coverage and definitions of insured conditions.

IN BRIEF

TOTAL AND PERMANENT DISABILITY

Many policies include a total and permanent disability feature that allows for payment of the sum assured in that event. However, ABI guidelines provide four options of model wording to define total and permanent disability. Customers and advisers should check which definition a provider is using.

Level, decreasing and increasing cover

CIC can be arranged on the basis of level, decreasing or increasing cover.

- **Level cover**: the cover and premium amounts stay fixed throughout the term.

- **Decreasing cover**: the cover amount decreases each month, generally in line with a repayment loan such as a mortgage, while applying a fixed interest rate chosen at the start.
- **Increasing cover**: indexed cover that is suitable where the plan is purely used to cover medical or care costs that typically increase year on year. Cover increases yearly within agreed limits, without the need for further underwriting. Premiums also increase.

Standalone and integrated CIC

- A critical illness plan that provides only critical illness cover is known as a standalone plan. To receive payment, the life assured must survive for a specified period after an insured event, typically 14 to 28 days (known as the survival period).
- As described below, some providers offer policies that provide life cover and CIC in a combined plan, often referred to as integrated cover.

Combined or integrated term CIC

Combined, or integrated, cover ensures protection benefits are provided in the event of the policyholder:

- dying; or
- suffering one of the defined critical illnesses.
- Most plans pay the sum assured on the earlier of death or a CIC claim (first claim), after which the plan ceases.
- Some plans will potentially pay out on **both events**: diagnosis of a critical illness and on subsequent death during the term.

Combined cover increases the cost of the plan compared with life assurance offering death benefits only, but it is usually cheaper than separate life and CIC.

IN BRIEF

COMBINED-NEEDS PLANS

On combined plans, death does not have to result from a critical illness for death benefits to be paid, and there is no survival period for CIC claims, as death is covered as part of the plan.

With most combined plans, life cover will cease once a CIC claim is paid, which can be problematic because life cover will be difficult to secure with a history of critical illness. Some providers offer a 'buyback option' for an additional premium. In the event of a CIC claim, this allows the policyholder to keep the life assurance element running, perhaps with a reduced sum assured, and some plans allow further CIC claims to be made on a limited range of conditions. No medical underwriting is required when exercising the option, but there may be a minimum period after the initial claim before a further claim can be made.

17.3.1 Premium structure

One of the main factors in underwriting a critical illness plan is the risk of morbidity. When CIC was introduced, it was common for providers to offer fixed premiums for the term of the contract; this was especially common on CIC plans arranged as part of term assurances.

Guaranteed premiums

Guaranteed (fixed) premiums have an obvious advantage when budgeting, but many providers find fixed premiums inappropriate. One reason is the limited experience of critical illness claims, because CIC is a relatively new product. As a result, the data on which premiums are based is incomplete and claims have sometimes been higher than expected.

Advances in medical science have also contributed; some conditions are now identifiable very early, where previously they remained undiagnosed for years before proving terminal shortly after diagnosis. Early diagnosis has improved the chances of recovery and seen CIC claims increase dramatically.

Reviewable premiums

Many companies offer a reviewable option on their products that can result in lower premiums in the early part of the plan; this can be beneficial to clients on a budget. However, the market is now favouring the certainty of guaranteed premiums.

A typical review structure might be after every five years of the plan. If, at review, certain factors are as expected, the premium can be maintained until the next review. The factors are the insurer's:

- claims experience;
- investment returns; and
- expenses.

Although guaranteed premiums are attractive, reviewable premiums might occasionally be reduced on review. This should not be used as a sales pitch for reviewable premiums, but it shows that it is incorrect to perceive guaranteed premiums as 'good' and reviewable premiums as 'bad'.

17.4 What is income protection insurance?

IPI is designed to provide replacement income in the event of an individual being unable to work owing to illness, disability or accident.

IPI is permanent, so the insurer cannot cancel the cover simply on the grounds of poor claims experience. This distinguishes IPI from short-term cover such as sickness and accident insurance, which is typically reviewed annually.

IN BRIEF

FORMS OF IPI

Income protection is available as a standalone policy, either:

- as a **pure protection plan**; or
- on a **unit-linked basis**.

IPI can also be available as an option on a universal whole-of-life plan. Where the unit-linked option is selected, an investment value may accrue that enables the plan to acquire a surrender value.

The insurer can cancel the policy if the client fails to maintain the premium payments. The client can also cancel the policy.

IPI is generally perceived to protect working people whose earned income needs to be replaced owing to illness or accident, but there is one major exception to this rule. Most providers also offer cover for dependent spouses or partners, because there is a clear need to provide income to pay someone else to do a dependent partner's ordinary work.

DEFINING SICKNESS/DISABILITY

Different companies have different definitions of what constitutes inability to work owing to sickness or disability. They may refer to an inability to carry out:

- the insured's own occupation; or
- any occupation for which the insured is suited by training, skill and experience.

For a dependent spouse or partner, the definition may be written in terms of 'being confined to bed' or 'an inability to leave the house'.

17.4.1 Benefit structure

To prevent prolonged IPI claims, life companies insist on a maximum benefit that can be paid out.

Traditionally, companies offer benefits set as a proportion of earnings (typically 50–65 per cent, though higher levels are available). Different companies offer different benefit levels:

- some offer a lower maximum percentage but do not take state benefits into account;
- others offer 50–60 per cent on the first band of earnings but a lower percentage on higher earnings.

MAXIMUM BENEFIT APPLIES TO ALL IPI POLICIES

The maximum benefit applies to all IPI policies a client may have. To enforce this rule, clients are asked, both on the proposal form and in the event of a claim, whether they have any other policies or other sources of income. Care must be taken to fairly represent any information provided to the insurer; if a misrepresentation is made, the insurer may refuse to pay a claim.

Many policies have a proportionate benefit clause under which, if a client returns to work but at a lower salary than previously, a proportion of the benefit will be paid.

It is also possible to index benefits. The rate of increase may be a fixed rate or in line with the Retail Prices Index (RPI). As IPI is income replacement and most people get an annual pay rise at work, it makes sense to have indexed benefits. Without indexation, what started off as a realistic level of IPI can soon lose its value owing to the effects of inflation.

KEY TERMS

INDEXATION

Linking the sum assured to an index figure, such as an inflation measure, so that the sum assured rises year on year in line with the index.

RPI

A UK inflation measure of the change in the cost of representative retail goods and services, including housing costs.

Term of income protection

Clients can generally choose any policy term as long as the policy does not run beyond their normal retirement date and is in line with the provider's rules. However, some providers have minimum terms, for example 5 years, and maximum terms, such as 40 years.

Benefits, when they become payable, are paid at regular intervals (usually monthly) until recovery and end of policy term, death or retirement, whichever occurs first.

17.4.2 Deferred period

Benefits are payable after the expiry of a deferred period, which for IPI tends to be at least four weeks. An effect of the deferred period is automatically excluding claims for short-term illnesses such as colds and flu, which would be expensive to cover and make premiums very high. A limited number of providers offer 'back to day one' cover, with benefit entitlement commencing on the first day of illness once the insured has been off work for three days.

Clients can choose from a range of deferred periods, the usual options being 4 weeks, 13 weeks, 26 weeks or 52 weeks. Two factors influence the choice of deferred period.

- **An employee's sick pay benefits**: if, for instance, a client's employer pays full salary for 6 months, the sensible choice would be a 26-week deferred period.

- **Cost**: the longer the deferred period, the less likely it is that periods of illness will be sufficiently long to result in a claim. Lower premiums can thus be charged for longer deferred periods.

Self-employed people tend to choose the shortest deferred period they can afford, as any inability to work will have an almost immediate effect on their lifestyle.

Low-cost options: limited-period benefits

Low cost: to reduce the cost of the premiums, the IPI benefit is paid out for a maximum of one, two or five years for each individual claim (depending on what was chosen at the outset). After they return to work, the insured can make further claims for other conditions.

Age costed or low start: the premiums start low but increase each year with the client's age. This is used for higher-risk occupation clients where standard and low cost might be too expensive for them.

17.5 CIC and IPI comparison

Although there are similarities between CIC and IPI, notably in that both plans aim to protect against the financial implications of illness, they have key differences.

- CIC is primarily aimed at meeting the additional costs associated with an illness. It will pay out a lump sum or possibly an income **if one of a range of specified illnesses is contracted**.
- IPI is designed to replace income when the insured suffers an illness or accident that **prevents the insured from working.** Although the lump sum from CIC can be invested to provide an income, IPI is much more suited to meet this need.

Payouts

A payout from a CIC plan may be triggered even if the insured has to take little, or no, time off work. For a payment to be triggered under IPI, the illness or condition must prevent the insured from working for longer than the deferred period agreed at the outset.

Benefits from IPI can continue until retirement, if the insured is out of work for that long, whereas CIC will only pay a single lump sum. Even if the sum paid under CIC proves insufficient to meet the insured's costs, there will be no more than that payout. Similarly, a CIC plan will cease once a claim has been made, whereas IPI plans keep running as long as premiums are paid, meaning multiple claims can be made in the event of successive illnesses.

17.5.1 What are the typical exclusions?

Many former standard exclusions on CIC and IPI policies have been removed. Exclusions set out the conditions under which payment will not be made in the event of a claim, even if the claimant suffers an insured condition.

Typical general CIC exclusions include:

- being diagnosed with a critical illness outside the policy term;
- not surviving for a specified period following diagnosis.

If a person with a single policy dies, standalone policies will not pay out (some providers give a nominal cash sum in the event of death).

FACTFIND

In 2018, the ABI removed discriminatory wording about people living with HIV from its CIC minimum standards. Traditionally, an HIV claim was only allowable when HIV resulted from a blood transfusion, a physical assault or an accident at work. Insurers are encouraged to review HIV-related exclusions in their policies. Read more:

www.nat.org.uk/press-release/hiv-discrimination-removed-new-insurance-policy-guidance

Personal exclusions

The underwriting process that assesses the risk of a claim, and that determines the premium rate, may result in some additional exclusions relating to the individual applicant's circumstances (eg historical conditions or injuries are likely to be excluded from future claims).

THINK AGAIN ...

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

For instance, can you:

- describe the main features of SMI and how the loan is secured?
- discuss the varieties of term assurance and their uses?
- list the main uses of whole-of-life policies?
- outline the conditions that CIC commonly covers?
- explain how the IPI maximum benefit rule works?

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.

Test your knowledge

?

Use these questions to assess your learning for Topic 17. Review the text if necessary.

Answers can be found at the end of this book.

1) Which UK state benefit has replaced various others?
2) Universal Credit is means tested. True or false?
3) SMI is paid as a:
    a) benefit.
    b) loan.
    c) gift.
4) Mortgage protection assurance is the most common use of which type of term assurance?
    a) Level term assurance.
    b) Decreasing term assurance.
    c) Convertible term assurance.
5) When exercising the conversion option on convertible term assurance, the new sum assured:
    a) cannot exceed the original sum assured.
    b) must be equal to the original sum assured.
    c) can exceed the original sum assured.
6) Which of the following are core conditions on a critical illness cover policy? Select all that apply.
    a) All forms of cancer.
    b) Heart attack of any severity.
    c) Stroke resulting in permanent symptoms.
    d) Heart attack of specified severity.
    e) Most forms of cancer.
7) When deciding whether to change a reviewable critical illness cover or income protection insurance premium, the insurer cannot consider its general claims experience. True or false?

8) For which of the following traditional exclusions did the Association of British Insurers revise its critical illness cover guidance in 2018?

   a) Self-inflicted injury.

   b) Participation in certain high-risk pastimes.

   c) HIV not resulting from a blood transfusion, an assault or a work accident.

9) A payout from a critical illness cover plan can only be triggered if the insured takes a specified minimum amount of time off work. True or false?

10) Income protection insurance benefits cease on the earliest of recovery and end of policy term, death or what else?