Guide to Income Protection

What is Income Protection (Income Replacement Insurance?)

Income replacement insurance provides an income should you be prevented from working due to sickness or injury. It is commonly known as permanent health insurance or sometimes PHI schemes. The word "permanent" in the name, refers to fact that the policyholder is the only person who can stop the cover during the term of the policy (this would be through the non-payment of premiums or cancelling the policy directly.) The insurance company cannot withdraw cover, under any other circumstance, once the contract has been accepted and premiums have commenced.

These plans work by paying you an income, usually equivalent to 50 - 65% of your usual salary, if you are unable to work for a long period. The income is generally paid until the termination date of the policy, which can be before your retirement age, depending on the policy's terms and conditions.

If you are self-employed then the benefits under the plan are calculated based on the amount of your taxable income, normally for the 12 months before you became unable to work.

Care should be taken to check what the insurance company means by disability. As a general rule it is better to consider a plan that pays the benefit if you are unable to carry out your usual occupation. This type of cover is referred to as 'own occupation'. Some plans will only pay a benefit if you are so sick or disabled that you cannot work at all. You should take into account that it is far less likely you will be unable to do any work than you are unable to continue your usual occupation.

The income from a PHI plan or scheme is tax-free but you do need to be aware that any income you receive may have an impact on any state incapacity benefit that you wish to claim. There can also be situations where if you are receiving income from other sources, during the period of your sickness or injury, the benefits under you plan could be scaled back. A good example is where you are forced to retire early from your usual occupation and start receiving an ill health early retirement pension. In such instances the Insurance Company may scale back the benefits under your PHI plan.

What are the differenences between the types of plan?

The differences between plans are:

- The definition of occupation: Some plans will only accept a claim if you are unable to do any work, it is normally more advantageous to consider plans that provide cover against you being unable to carry out your usual occupation.
- Term of the cover: whether this is for a fixed term or throughout the remainder of your life.

- Waiver of premium: Where the premiums to the policy are suspended throughout the duration of a claim. However the policy is continues to be active and if you return to work the policy, and the protection available from it, is reactivated.

- Index-linked benefits: During the term of the policy, the level of cover increases in line with rises in your salary, a chosen index or perhaps rises in general inflation. In these instances the premium levels may also increase by a similar rate.

- Fixed premiums: the premium levels are fixed at outset and remain the same throughout the whole of the policy's term.

- Deferral periods: these represent the time periods that you must be away from work, due to illness or disability before the benefits under the policy may be claimed. Deferral periods range anything from 1 day to 12 months. Generally the longer the deferral period the lower the premiums to the policy will be.

You should ensure the length of deferral period established within your plan is appropriate to your circumstances. Many employed people can afford to set longer deferral periods, as their employers choose to pay them their normal income during the early months of a long term illness. The Self-employed should think carefully about the appropriate period of time of the deferral period.

What should I think about when choosing a policy?

If you are employed, it would be wise to check the level and structure of any sickness pay arrangements offered by your employer. Often employers elect to pay your usual salary for a given time before decreasing or, perhaps, stopping it altogether. The information available from your employer will make it possible to work out the deferral period most appropriate to your circumstances. Ideally you would claim benefits from the policy at the end of the period where your employer provides income. This would ensure you always have sufficient income, from either your employer or the policy, to provide for your needs.

Check the wording of all policies, especially the insurer's definition of disability. You would also be wise to consider any restrictions that are placed upon the type of work you might be allowed to do, were you unable to continue your normal employment.

Certain occupations are statistically more likely to cause illness or accidents, this means the risk of a policyholder making a claim is greater for the insurer. This extra risk has two ways of showing itself, either through higher premiums for such occupations or in a greater number of restrictions under the policy.

If you require guidance on whether your occupation is considered a higher risk than the average please contact us.

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