

FINANCE

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Are you covered if the unexpected happens?

Most of us know that we need to protect ourselves, our families and our homes against the financial hardships that could be caused by an illness or death in the family.

All protection plans are, basically designed to replace lost income and to provide a money benefit when it is needed most. However, many people are not sufficiently protected; they only consider life or serious illness cover if a bank insists on it for a loan, or when death or sickness strikes a colleague or family member. While we do not wish to frighten readers, some of the facts below might make them double check that they are adequately covered and that the policies that they have in place are suitable to their specific needs, rather than just a haphazard collection of policies accumulated over the years.

The Facts

- In 2009, 22% of claims for death under life cover policies were for individuals under 49 years of age; that is just over 1 in 5.
- 1 in 6 of Ireland's working population will be unable to work due to disability or sickness for more than 6 months at some time during their working career.
- The average claim duration is 5.5 years.
- Social Welfare disability allowance is just €10,286 per annum for an individual. For a family with one adult dependant and 2 children, it is just €19,610 per annum.
- There is no Social Welfare benefit for the self-employed.

- Only 15% of private sector workers are entitled to sick pay for more than 6 months.
- Public sector workers receive full pay for the first 6 months of absence followed by half pay for the next 6 months.
- 36% of employees mistakenly think that their salary is protected by other insurance e.g. Mortgage Protection, Loan Repayment Protection and Critical Illness cover. However, less than 10% of the Irish workforce has any form of private salary protection.

In this article (for purposes of brevity), we have concentrated on Income Protection as opposed to Critical Illness, Life Cover or Business Insurances (Keyperson, Co-Director or Partnership cover). Feel free to get in touch if we can be of any help on any of these other protection areas.

What is Income Protection?

Sometimes this is called Permanent Health Insurance (PHI) or Salary Protection. People do not usually think of their income and/or future earnings as an asset. However, this is what pays for everything - mortgage, bills, children's education, insurances and so on. While most people think that their biggest asset is their home, for many the greatest asset is their ability to earn an income. For example, if you are a 40-year-old with a current salary of €50,000 then, assuming a retirement age of 65 and a modest salary increase of 2% per annum, your earnings capacity to retirement is €1.68 million. If you no longer had this income - how would you pay for everything?

Income Protection offers financial security for yourself and your family if you are unfortunate enough to be out of work because of illness or accident and suffer a loss of earnings as a result. It gives financial support whilst you get back on your feet.

Employers are not obliged to pay for extended sick leave and the government illness benefit is minimal, €204.30 a week or €339.90 with an adult dependant. (See www.welfare.ie for further information.) So, unless you have a large nest egg set aside, you could struggle to cope financially if the unexpected happens.

An Income Protection plan provides a replacement income, which is a weekly benefit, payable after a deferred period of 8, 13, 26 or 52 weeks. The deferred period is the length of time between when the person last worked and when they started receiving an income from the Income Protection Plan; the longer the deferred period, the cheaper the cover.

In terms of income received, there are various options to choose from, with the main options being indexation or escalation. It is permitted to index the income benefit by 3% each year. This means that both the premium and benefit will increase by 3% each year of the plan. This, in effect, will help to ensure that the benefit automatically stays in line with salary increases. Alternatively, you can select an escalation policy. This means that the income benefit will escalate in payment by either 3% or 5% p.a. from the expiry of the deferred period, which is a more expensive option at

the outset but the premiums remain level under this plan. Some providers offer a guaranteed increase option, which allows you to increase your income benefit by 20% of the original income benefit without having to provide new evidence of health. This offer is made every 3 years, up to a maximum of 100% of the original income benefit. However, this option is not offered again should it be declined twice.

There are two options available regarding the premiums (i.e. what is paid each month). A guaranteed premium option will ensure that the premium will not change during the term of the plan if the chosen benefits remain the same. This allows a person to know, in advance, the total cost of the premiums over the term of the plan. This does not change, even if a claim is made. A reviewable premium option will guarantee the premiums to stay constant for the first 5 years of the plan after which the provider will review the premium every 5 years. In the review, they will take into account claims' experience over the preceding years and changes in economic conditions. They will also take into account any medical breakthroughs and the discovery of any new diseases. If it is necessary to change the premium, they will offer the choice of a change in either premium or benefits. Reviewable premiums do leave the insured at the mercy of the provider.

How much does it cost?

The cost of an Income Protection plan depends on the selected options, the age, occupation and health of the insured. It is very easy to fit a plan into your budget, which can be reviewed as circumstances change.

Let us look at an example. Philip currently earns € 50,000 per year and is 30 years old.

He has chosen to protect 50% of his salary i.e. € 25,000 per year until his retirement age of 65. He selects a 6-month waiting time and chooses to index link his premiums.

Benefit amount	€ 25,000 (or € 481 per week)
Gross premium	€ 56.51 per month
Philip pays	€ 33.34 per month*

*after tax relief based on 41%

Now consider this...

If Philip were to claim on his policy in 2 years' time (aged 32) and his claim lasted



for the average duration of 5.5 years, the provider would pay him over €156,259 in benefits.

If he were unable to return before retirement, then over that 35 year period the policy would pay him a total benefit of €1,460,000.

Income Protection is different from Critical Illness Cover.

Critical Illness, sometimes called Serious or Specified Illness, only covers a specified number of illnesses whereas Income Protection covers any illness, injury, accident or disability that prevents the insured from working. Critical Illness pays a once-off lump sum while an Income Protection Policy pays a regular income until the insured is able to return to work or until the end of the policy term. There is no tax relief available on Critical Illness, whereas tax relief can be claimed at the marginal rate on Income Protection premiums. A claim may only be made once on a Critical Illness policy but, with Income Protection, there is a multiple claim facility so that a claim may be made as many times as is necessary.

It is important to note that Income Protection does not cover you if you become unemployed.

How much Income Protection cover do you need?

An experienced financial advisor will be able to help you decide on the level of cover that you need - and can afford. The cover you start with should reflect your existing income. There are maximum limits to the level of Income Protection cover you may start with. The terms and conditions vary from provider to provider but, in general, the most cover you can have at any one time, including that provided under other Income Protection plans and continuing income from your job or pension is:

- 75% of the first €80,000 of your yearly earnings
- plus 50% of any yearly earnings over €80,000
- less any state benefits for disability (except benefits for children and other forms of income you may have)

The overall maximum amount of cover from Irish Life, for example, is €150,000 a year. The overall maximum amount of payments you can claim tax relief on is limited to 10% of your total income for the year of tax assessment. Your 'total income' is any 'earned income', as adjusted for tax purposes. Benefits payable are subject to tax under PAYE.

When reviewing which provider to choose, be careful to read the small print - it is not always about cost. Look also at the claims' experience of the provider. In 2009, Irish Life paid out €47million in Income Protection claims. Similarly, Friends First declare that almost 90% of all claims submitted are accepted and that the average payment for Income Protection is €18,000 per year.

Do not ignore the protection of one of your most important assets. I advise my clients to seriously consider Income Protection when they are reviewing their financial situation.

Joan Garahy is Managing Director of HBCL Investments & Pensions Ltd, part of Horwath Bastow Charleton in Limerick. She and her team give Independent Financial Advice to a range of clients including private individuals, business owners and company directors, many of whom are pharmacists. If you would like to discuss any protection, investment or pension issues with Joan please contact her at joangarahy@hbcl.ie or 061 310311.