PERSONAL INSURANCE

RISK MANAGEMENT

The objective of having insurance cover over your life and your assets is to protect yourself and your family from financial distress in the event of death, illness or accident. Where such an event occurs there is often considerable emotional distress. Financial planning aims to remove the financial distress at such a time.

There are two ways you can manage this type of risk:

- Self insurance; or
- Transfer of the risk/insurance to an insurance company.

There are many instances where people effectively elect to self-insure through lack of planning. This means that an event occurs which causes financial distress and people manage on what they have set aside. Other ways of self insuring are by planning and setting aside funds for protection in such an event. The most common form is, however, to recognise the risk and evaluate how much protection is required and then transfer that risk to an insurance company.

PERSONAL INSURANCE

There are four major types of personal insurance to consider. These include; Term life insurance, Total and Permanent Disability (TPD) insurance, Trauma insurance and Income Protection insurance.

Below is a summary of these insurances. We have also provided detailed information on each of these insurance further on in the document under '**WEALTH PROTECTION**'.

Term Life Insurance

Term life insurance is the most common form of life insurance policy. It pays a tax-free lump sum to a nominated beneficiary in the event of death or terminal illness of the insured.

Term life insurance is necessary to ensure that in the event of death sufficient funds are available to support your family and to ensure a desired standard of living can be maintained.

Your sum insured should be adequate to cover outstanding debts and provide an adequate lump sum to cover your dependants' income needs for the remainder of their lives. Over time as one moves from building wealth to maintaining wealth, the required level of insurance cover decreases.

Generally, it is most tax effective to hold your death cover within your superannuation fund.

Total & Permanent Disablement (TPD) Insurance

TPD insurance provides a lump sum if the life insured suffers an illness or injury which totally and permanently incapacitates them from working. It is usually offered as an option on a term life policy, however it can also be offered as a stand-alone policy.

Your sum insured should be adequate to cover outstanding debts and provide an adequate lump sum to cover:

- Your dependants' income needs; and
- The higher medical, rehabilitation, home/car modification and care costs associated with the insured's permanent incapacity.

Traditionally the waiting period is six months before a claim can be assessed.

TPD Occupation Definitions

TPD will normally be paid in the event that the insured is unable to ever work again in 'any' occupation for which they are reasonably suited by education, training or experience. However, TPD can also be based on an 'own occupation' definition. This means a benefit will be paid even if the insured is still able to work in some capacity but can never again work in their particular occupation.

The own occupation definition is more generous in that it is easier to meet. However the option may be subject to certain criteria and only available for individuals in certain job roles or professions. In addition the premium payable is higher for 'own occupation' cover.

Trauma Insurance

Trauma insurance (also known as Critical Illness insurance) pays a tax-free lump sum on the diagnosis of a defined medical illness to the insured. Examples of such medical illnesses are heart attack, cancer, stroke or by-pass surgery. Trauma insurance may also cover less severe medical illness including back injuries or stress.

Trauma cover may be regarded as the most expensive type of personal insurance – with good reason, because it covers the most likely events to occur, and some policies are very broad in their coverage of events.

The benefit of trauma cover is that a lump sum cash payment in the event of diagnosis can provide a financial resource for a period of time. This can cover medical costs and/or allow the partner to stop working and care for the ill partner.

Income Protection Insurance

Income Protection insurance provides you with a regular (usually monthly) taxable income in the event that you become sick or injured. You can insure up to 75% of your current income. This insurance can provide you with protection until you retire.

Income protection cover ensures that your assets aren't sold or spent to replace lost income. It also enables you and your family to continue to enjoy the lifestyle you have worked hard to build.

Also, as we have established an investment program to meet your lifestyle and financial goals, this insurance also ensures the ongoing implementation of your strategy.

Income protection insurance is tax deductible to the individual in their annual tax return. So, for a taxpayer on the top marginal rate, the cost is effectively half the annual premium.

Stepped vs. Level Premiums

Stepped premiums increase as you get older. The sum insured may be fixed, may increase (often with a CPI option, with some providers applying a minimum level of indexation) or may decrease, depending on the policy and options taken. Generally a lower premium will initially be payable compared to an equivalent level premium policy. However, at some point the premiums will overtake those of the level premium policy.

A level premium payment option ensures the premium rate per dollar of cover is the same over the duration of the policy. Level premiums are more expensive than stepped premiums in the early years of the policy and are cheaper in the latter years of the policy. Over the longer term, the savings of level premiums will outweigh the short term savings of stepped premiums, as long as the policy is in force for some years. The policy must continue to be held with the same provider to reap the benefits of this option. Note that the insurer still has the right to adjust the underlying premium rate. If CPI indexation applies to the sum insured, the premium payable will be adjusted accordingly.

WEALTH PROTECTION

To calculate the levels of insurance to be recommended, the capital required to provide for your ongoing income needs, including debts and contingencies needs to be determined. The following is a summary of how insurance sums can be arrived at.

Term Life Cover

This type of insurance pays a tax-free lump sum to a nominated beneficiary in the event of death of the insured. In the event of either incident occurring monies are required to either support your family or fund the increased costs in caring for yourself as well as your family.

In the event of your death, there should be enough insurance in place to provide sufficient capital to:

- Generate an income stream to support dependants - Determine how much income is needed to support your spouse and/or any dependent children annually. Next, work out for how many years this support needs to continue (eg pension age). Be sure to include the inflation rate when calculating the annual income stream. Also, estimate the net earnings that will be applied to the capital amount, taking into account the beneficiary's investment risk profile.
- Provide an income stream for extraordinary expenses (eg future school fees).
- Discharge debts (eg home mortgage and personal loans) - Where you have an investment loan, you need to decide whether to cancel out the debt if you should die by selling the underlying asset or using life insurance proceeds.
- Fund funeral and legal costs.
- Cover medical expenses.

- Pay lump sum payments (eg bequests or charitable donations).

To determine the required value of term life cover, add up the above capital requirements and offset these with the assets listed below:

- Your existing superannuation benefits.
- Any investment assets or disposable assets that will be sold on your death (less any estimated capital gains tax liability).
- Other life insurance policies (eg through super).

Total and Permanent Disablement Cover

This type of insurance pays a tax-free lump sum to a nominated beneficiary in the event of total and permanent disablement of the insured. In the event of either incident occurring monies are required to either support your family or fund the increased costs in caring for yourself as well as your family.

In the event that you are totally and permanently disabled (TPD), there should be enough insurance in place to provide sufficient capital to:

- Generate an income stream to support yourself and any dependants - Calculate as for Term Life Cover but be sure to add in the your needs.
- Provide an income stream for extraordinary expenses (eg future school fees).
- Discharge debts.
- Provide for medical expenses.
- Pay for a housekeeper/nanny/childcare facilities, as required - This lump sum amount should cover the anticipated length of service.
- Cover any other lump sum payments.

To determine the required value of TPD cover, add up the above capital requirements and offset these with the assets listed below:

- Your current superannuation benefits (though this may be risky, as to gain access to the superannuation benefits, the client will first have to prove to the Trustee of the superannuation fund that they can no longer engage in gainful employment for which they're suited by education, training or experience).
- Any investment assets or disposable assets that will be sold on your total and permanent disablement (less any estimated capital gains tax liability).
- Other TPD policies (eg through super).

Trauma Cover

This type of insurance pays a tax-free lump sum on the diagnosis of a defined medical illness to the insured. Examples of such medical illnesses are heart attack, cancer, stroke or by-pass surgery.

The benefit of trauma cover is that a lump sum cash payment in the event of diagnosis can provide a financial resource for a period of time. This can cover medical costs and/or allow the partner to stop working and care for the ill partner.

In the event that you experience a trauma event, there should be enough insurance in place to provide sufficient capital to:

- Replace the regular income stream during the trauma event - Determine the level of income required and the term for which this support needs to continue (eg one year following the trauma event). If the term is for any longer than one year, you'll need to take into account the net earnings on the capital and inflation.
- Cover medical expenses.
- Discharge debt.
- Fund 'carer' or home management services.
- Allow for any other costs (eg interruption to career/home improvements/holidays).

To determine the required value of trauma cover, add up the above capital requirements and offset with the assets listed below:

- Any investment/disposable assets that will be sold if you suffer a major trauma or critical illness (less any estimated capital gains tax liability).
- Other trauma insurance policies.

Income Protection

This type of insurance provides you with a regular (usually monthly) taxable income in the event that you become sick or injured. You can insure up to 75% of your current income. This insurance can provide you with protection until you retire.

Income protection cover ensures that your assets aren't sold or spent to replace lost income. It also enables you and your family to continue to enjoy the lifestyle you have worked hard to build.

Income protection insurance is tax deductible to the individual in their annual tax return. So, for a taxpayer on the top marginal rate, the cost is effectively half the annual premium.

In the event you suffer sickness or injury that will result in a reduction of your income, there should be sufficient insurance cover in place to:

- Substantially replace your greatest financial asset - your earning ability - When determining the level of cover, you should include all aspects of your remuneration package (including employer superannuation contributions and fringe benefits), providing that the relevant insurance policy allows this.
- *Provide replacement income for at least 75% of your gross remuneration package up to $250,000; 50% of the next $150,000; and 25% of the remaining remuneration package - This rough calculation will assist you meet your cost of living requirements, service any existing debt repayments, and pay for medical expenses.*

You also need to consider any amount that may be offset against the recommended policy (e.g. other income protection policies that will be retained, Worker's Compensation, potential social security benefits, and business or investment income). The receipt of these payments may impact the benefit payable from the income protection insurance policy that you are considering.

This type of insurance will pay a monthly benefit to meet the fixed expenses of running your business while you are unable to work due to sickness or injury. Generally, the benefit is only payable for up to 12 months.

Your sum insured will assist the cash flow of your business during your time of need. Despite your absence from the business you will receive financial assistance to meet the day to day operational costs of your business.

The premiums are tax deductible under current legislation.

Business Expenses Insurance

This type of insurance will pay a monthly benefit to meet the fixed expenses of running your business while you are unable to work due to sickness or injury. Generally, the benefit is only payable for up to 12 months.

Your sum insured will assist the cash flow of your business during your time of need. Despite your absence from the business you will receive financial assistance to meet the day to day operational costs of your business.

The premiums are tax deductible under current legislation.