Protecting your family

GIVING YOU CONFIDENCE THROUGH CLARITY

Close Brothers
Asset Management

Why you need to consider protection insurance

> **"OVER THE LAST FIFTY YEARS THE AVERAGE LIFE SPAN FOR A MAN HAS INCREASED BY TEN YEARS AND FOR A WOMAN BY EIGHT YEARS."**

SOURCE: Office of National Statistics 2010.

The following information has been provided to give you a balanced overview of the risks associated to the potential benefits you are about to read in this document.

Close Brothers provides financial planning advice which includes taking into account any tax planning opportunities that may be applicable to your individual goals. If you require specific advice on tax liabilities and treatments, then you should speak to a tax professional.

All investments carry risk. The value of an investment can go down as well as up and you could get back less than you invested.

For a long time, the protection industry has endeavoured to highlight the need for people to think about taking out relevant insurance cover to mitigate the risks presented by a sudden loss of income due to death, sickness or accident. The truth of the matter is that most people just don't want to think about their own mortality or the consequences of falling ill long term. The arrival of COVID-19 and the ensuing global pandemic in late 2019 provided a real life case study and a set of circumstances which meant that the majority of people were forced to consider how they would cope with an unanticipated drop in income. Or in some circumstances, the loss of income at a point in time where there was little chance of replacing it in the short term and perhaps the most difficult of all, sudden and unexpected death. Many people will have capital liabilities like loans or mortgages that they have to ensure can be extinguished should they die prematurely.

Faced with no choice but to follow Government advice to stay at home, many people came to realise what was really important to them; their families and their health and ensuring that they could rely on a regular income. The consequences of the pandemic are truly devastating on a global scale and it is true to say that life will never be the same again. Whatever the "new normal" looks like, many will have a new perspective and the appreciation for protecting those who are dear to them and the income which enables them to provide for them. Despite significantly increased initial interest in protection, witnessed in terms of levels of enquiries, this effect was temporary and short lived. Increased societal awareness may provide an opportunity to help close the protection gap. However, the need to sell the concept of protection is still very evident.

In the short term of course, the industry has had to consider its reaction and a comprehensive response has been required to ensure that those who currently hold cover are reminded of the value that it provides at a time when people may be reviewing their finances to try and identify non-essential spend. In terms of those considering cover now, many insurers have understandably had to place coronavirus exclusions on new policies in the interests of protecting their solvency. Efforts are also being made by insurers to look at alternatives to GP reports, including iGPRs, where they would usually be required. Efforts must continue to ensure that those who are now seeking cover are provided with options to find the peace of mind that they are looking for.

WHAT DO YOU DO WHEN THE WORST THAT CAN HAPPEN...HAPPENS?

- Today in the UK over 1,400 people will die.
- On average 2.1 million people will be off work for at least six months continuously through sickness or accident.
- More than 6 million people are claiming state benefits for illness or disability in the form of Universal Credit with 4.9 households relying on benefits. This represents an increase of 98% since March 2020.

The Department of Work and Pensions and ONS (2021).

No one wants to dwell on the worst things that can happen to you but especially when you have the responsibility of a young family it is important to think about what you need to do to ensure your family would be able to cope financially if anything serious happened to you or your partner.

Self-evidently protection insurance can't prevent an unwanted event happening. However, it can deliver a "financial rescue package" to those affected. And it's not just money that can be provided; the support services provided by these policies are increasingly being highlighted by insurers looking to underline the potential value of insurance.

In this guide we look at the key things families need to think about when they want to protect themselves from the financial effects of death or serious illness, what their options are and also suggest what their priorities might be.

We will also examine the reassurance that insurance cover can give them. Families are precious and it is important that people understand that their stability and development can be hugely compromised without the safety net that family, insurance-based, protection provides.

Buying the right sort of protection is not straightforward and often it is only with appropriate advice that the right sort of protection can be put in place.

WHAT ARE THE MOST IMPORTANT FACTORS TO PEOPLE WHEN CONSIDERING PROTECTION INSURANCE?

While price will always be important, a note of caution must be sounded. There are other important factors to take into account when deciding which type of cover will be most appropriate for you. A Close Brothers adviser will guide you through these choices.

In the one hundred years between 1911 and 2011, average life expectancy increased by three years per decade, at which point the rate of increase slowed. Since 2014 there has been little improvement to life expectancy for men or women in the UK. Current life expectancy for men stands at 79.4 years with the equivalent figure for women being 83.1 years (ONS 2021). This general upward trend is encouraging, although a significant amount of work is now being undertaken to discover the reasons for the lack of improvement to life expectancy in recent years and the performance of the UK in comparison to some of its international counterparts. Overall, the life expectancy figures are reassuring and a meaningful statistic.

Meanwhile our knowledge grows about those factors likely to have a detrimental impact on mortality rates. One such factor was highlighted by medical journal The Lancet in December 2018 in an article which highlighted how a BMI outside of the healthy range is associated with several years of lost lifespan. Previous estimates by the Canadian Institutes of Health Research have put the figure between three and ten years. Higher BMI is also associated with other health conditions affecting mortality rates such as Type 2 Diabetes. As the year 2020 highlighted, new health challenges will continue to emerge and success rates in dealing with different conditions will vary, as will the pace at which we see improvements in treatments for conditions such as cardiovascular disease and different types of cancer.

Sadly, we will all know people who died many years "before their time" and the lesson we need to absorb is that when we have family or other financial responsibilities we need to be prudent in making provision for the unexpected. This guide works on this premise and will try to help you to understand, in conjunction with an adviser, how to make the necessary insurance arrangements.

Single people will have different insurance needs, but it must be borne in mind that these may change if they do become involved in a relationship or take on new financial obligations. It is also worth emphasising that it is much easier and cheaper to buy cover the younger you are and this can prove very beneficial in later life.

THAT WAS THEN…

Fifty years ago if you had drawn a diagram of the likely lifeline of most adults it would almost certainly have been a very linear chart. Look through insurance textbooks of the fifties and sixties and financial planning, such as it was, was made on very predictable lines.

The assumptions were that people would marry in their early twenties, buy a house, have two children, buy a bigger house and maybe change jobs once in their career. It was much rarer for women to have careers than it is now and people would expect to retire at 65 having just paid off their mortgage loan and live for not much more than a further ten years.

BUT THIS IS NOW...

Over the last fifteen to twenty years, we have begun to realise that a predictable pattern is not the norm anymore. People have multiple relationships, marry later, divorce more often, have children in more than one relationship and at later ages, take career breaks, sabbaticals, have portfolio careers, retire early, withdraw from paid employment to work in the voluntary sector and may live in many different houses, areas and even countries, during their working life.

CHANGING RISKS IN A CHANGING WORLD

We may be living longer, but some of that increased longevity may be spent in poor health. Adults now may have contact with their own grandparents while they are grandparents themselves – a long and fascinating inter-generational link.

The linear view of product design that insurance companies used to employ is woefully out of date, meaning that the way we think about our insurance protection needs must reflect this sense of change and the need for flexibility.

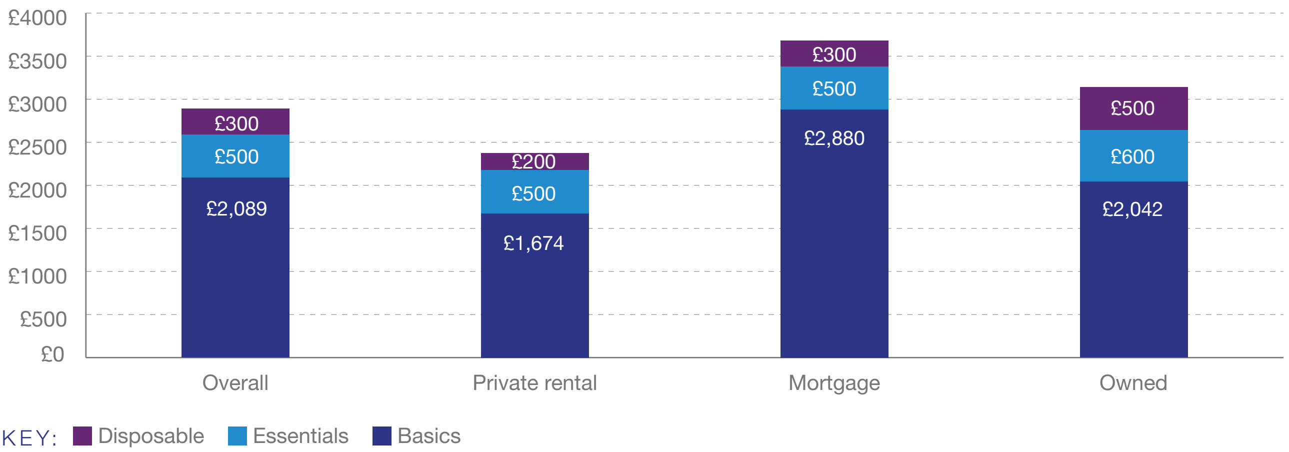
THE MOST PRESSING PROTECTION NEEDS

Let's now look at the range of risks that families may face and how best to provide for them. Inevitably, most people (for economic reasons) will have to decide which type of protection cover is the highest priority. A Close Brothers adviser can help you with this.

PROTECTING YOUR FAMILY ON YOUR DEATH

The risk that is immediately obvious to most people is that of death. Death is obviously a tragic situation and completely derails family life, especially if it occurs suddenly and without warning to the person responsible for the family's financial wellbeing. Most families will have financial commitments, like mortgages and loans, that do not disappear on death, but very few families have sufficient savings to protect themselves against the financial consequences of the death or illness of the breadwinner.

MONTHLY INCOME AND COSTS



SOURCE: Legal & General Deadline to Breadline 2020.

> **"ON AVERAGE, AROUND 2.4 MILLION PEOPLE WILL BE AWAY FROM WORK THROUGH SICKNESS OR DISABILITY FOR AT LEAST SIX MONTHS. IF THE PERSON ABSENT IS THE MAIN BREADWINNER, THE CHANCES ARE THAT A FAMILY WITH LITTLE IN THE WAY OF SAVINGS WOULD BE FINANCIALLY DEVASTATED. RESEARCH FROM THE SYNDICATE IN 2016 HIGHLIGHTED THE GAP THAT EXISTS FOR MANY BETWEEN SAVINGS PROVISION AND EXPECTATIONS OF HOW LONG THEY COULD SURVIVE FOLLOWING AN INCOME SHOCK."**

According to Legal & General in their Deadline to Breadline 2020 research, the average working household has just over £2,700 in savings and investments. The same research highlights that it would take the average working household 12 years to save the amount they would need to survive for a year without working income. The report suggests that the average household has savings that would last just 24 days in the event that their income stopped. 17% of respondents in the research reported not being able to save anything on a monthly basis, and 1 in 5 households had no savings at all. This is an example of how conflicted people are; they know that they will need a level of savings to survive even three months if they cannot work or the main breadwinner dies – but very few families can accumulate this level of savings. Perhaps more worryingly, analysis by the TUC in January 2020 showed that unsecured debt per household (excluding mortgages) had risen to £14,540 and now represented 27.5% of household income, highlighting the precarious position that many UK households would find themselves in if faced with a loss of income unexpectedly.

MAINTAINING AN INCOME WHEN SICK OR SERIOUSLY ILL

While life insurance cover payable on the death of the insured person is immensely important, the most important priority for any family is security of income should illness strike. As stated earlier in this guide, on average over two million people will be away from work through sickness or disability for at least six months at the current time. If the person absent is the main breadwinner, the chances are that a family with little in the way of savings would be financially devastated. All financial commitments would be compromised and financial meltdown is an inevitable consequence in many situations.

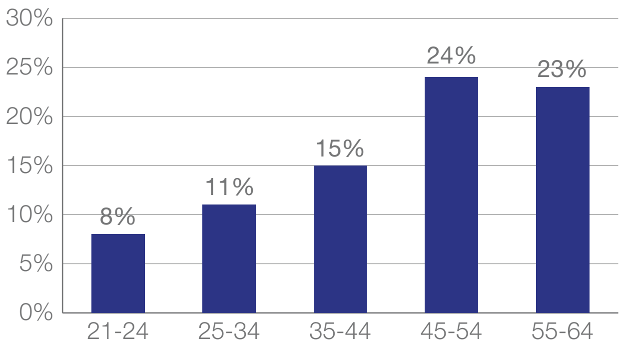
Critical Illness cover ("CIC") can provide capital to extinguish loan commitments but it is not an alternative to income protection insurance ("IP"). CIC would not pay out on around 50% of the claims paid by IP simply because it does not cover the two main causes of claim – mental illness and musculo-skeletal disorders. It is therefore illusory to think that it is a substitute for income protection. It is important in covering capital commitments, but it does not replace regular income.

The chart above illustrates the difficulties many households would face when trying to put money aside with most of their incomes accounted for by essential and basic expenses.

The aforementioned research by Legal & General highlighted that 37% of respondents would rely on their savings in the event of a loss of income. The same research suggested that the average household would need £30,000 saved to cover outgoings for a year. Alarmingly, while respondents anticipated that their savings would last approximately 90 days, the reality was closer to 24 days. The graph below shows the proportion of people, by age, who do not have any savings to rely on.

Relying on savings is clearly not an adequate coping strategy for the vast majority of people. Most have insufficient savings due to the basic high costs of living and relatively small growth in salaries in recent years.

HOUSEHOLDS SAVING NOTHING BY AGE



SOURCE: Legal & General Deadline to Breadline 2020.

Even at the most basic level then, if it is impossible to pay off a mortgage, it may be that the family home would have to be sold with the consequent severe disruption and stress that this would cause at an already highly emotional time for the family. ONS data on the Financial Resilience of Households and the Wealth and Assets Survey, updated in April 2020, showed that in 73% of households where the head of the house was employed, they could withstand a 25% drop in income for three months. 54% of households could withstand a larger drop of 75% of income for 3 months. In contrast 26% of adults said that they had insufficient means to survive for longer than a month and 10% said that they would be in financial difficulties after just a week (Source: ONS Wealth & Assets Survey to September 2019 and updated in April 2020).

SO WHAT SOLUTIONS SHOULD BE CONSIDERED TO PROVIDE FOR THESE NEEDS?

As we have indicated above there is a range of specifically designed products to provide financial protection on death, serious illness or sickness. We now consider these in a little more detail.

TERM ASSURANCE

Term assurance payable on the death of the life assured during the specified term of the policy is the “bread and butter” of life assurance protection cover. It is easy to understand and it is something that can provide considerable help to families. UK term policy prices are exceptionally competitive. Companies re-price policies regularly to stay competitive and as term assurance is perceived, not unreasonably as a commodity product, price is the driving factor in the purchase. This is unlikely to change.

Most consumers are amazed just how cheap term cover is and how much cover they are able to buy for a given amount of expenditure, especially if they do not smoke and are in good general health. In the past it was often the case that families bought decreasing term cover, particularly to cover a mortgage that will reduce over time as capital is paid off. This is no longer normal practice and most advisers believe that the small extra cost of purchasing level cover is justified because it can provide a valuable top-up amount on claim if the mortgage amount has reduced.

Because rates of premium generally reduce over time, if you have already put cover in place within the last few years it can sometimes be to your advantage to review whether it makes sense to switch to a company offering cheaper premiums.

However, It is very rarely advisable to move if there has been a change in your state of health which might attract an extra premium.

In assessing your need for term cover on death, the key issues a financial planner will take into account will be:

- Any need for specific sums of capital and income.
- Financial commitments, like mortgages, loans and other obligations such as school fees. Cover provided should ideally extinguish existing loans.
- Your state of health.
- The age of any children that you have (it is usual to regard children as likely to be dependent financially on their parents until the age of 23 because of higher education).
- Any special circumstances (e.g. children with special needs, dependent parents, job circumstances etc).
- Your current income and savings.

There is a variation on the basic term assurance theme that is often worth seriously considering as it can reduce the cost of cover.

It is Family Income Benefit, which is a policy with a sum assured that reduces uniformly over time but provides regular payments of capital on the death of the breadwinner life assured.

WHOLE OF LIFE ASSURANCE

For life assurance protection that will pay out on death at any time, whole of life assurance is appropriate. Once bought (and premiums are maintained) it will provide the required cover throughout life.

Whole of life policies come in a number of forms in the UK.

There are unit-linked policies which enable the buyer to choose the balance between investment and life cover and ordinary “flat cover” whole of life policies which may be taken out to cover inheritance tax liabilities.

CRITICAL ILLNESS COVER

Critical illness cover policies commonly provide for an acceleration payment of the sum assured under a term assurance policy or other life assurance policies. Critical illness cover can, however, also be bought on a stand-alone basis.

Critical Illness cover can represent a very worthwhile addition to life assurance taken out in connection with a mortgage. In these cases a big financial commitment can be removed if the life assured suffers ill-health on a significant scale. The removal of a financial obligation of considerable size can free a family from considerable stress which can aid the life assured’s recovery or enable a family, with this increased flexibility, to look at future options if the breadwinner’s health is likely to be a future problem, especially in terms of being able to work again.

MENU COVER

Menu plans enable clients to mix and match a range of covers to suit their individual needs and budget. These can be purchased with one application, one plan charge and one direct debit and some advisers and clients value the flexibility this type of plan gives them. Others prefer the opportunity to source the best elements of cover around the market.

TERMINAL ILLNESS COVER

This is an extra feature on most companies’ range of life policies. Policies pay out in full upon diagnosis of a terminal illness.

A terminal illness is one that has no known cure or has progressed to a point where it cannot be cured and, in the opinion of a hospital consultant or the insurer’s Chief Medical Officer, is expected to lead to death within 12 months.

No claim can be made after the death of the life assured or within 12 months immediately before the policy ends. This cover is only available on policies with a term of at least two years.

Once a terminal illness claim has been accepted, no further claims can be made. No premiums will be payable either and the policy will end. If, after a terminal illness, a claim has been paid and the life assured survives to the end of the term, it is not necessary to pay back the terminal illness payment received. Once the payment has been made the policy will end and no further claims can be made.

Terminal illness policies represent a good example of a sensible development that costs little to an insurer beyond its existing obligations but which can be of huge benefit to a family dealing with all the trauma and shock of discovering a father or mother has a life-ending medical condition.

INCOME PROTECTION INSURANCE

Income protection policies (IP) are not bought in huge numbers in the UK market but arguably they should be.

The risk of inadequate cover if sickness were to occur is a serious issue for many. One of the main reasons for the lack of action being taken to put in place appropriate cover could be due to a lack of understanding of which benefits the state would provide on sickness.

The Government has revised the way in which welfare benefits are provided.

State benefits do not provide much and it is unlikely that families could maintain their existing lifestyle and fulfil their financial commitments if they had to rely on them long-term.

A system of Universal Credit was introduced in 2013 to replace six means-tested benefits and tax credits which encompass Employment & Support Allowance. Roll out across the country for new claimants has been in stages and by postcode area. The purpose of the rollout is to simplify the system and to provide equivalent benefits and whatever welfare support is needed. It was announced in February 2020 that full roll out of the system for existing claimants had been delayed from 2023 until September 2024 (Source: BBC.)

Despite the relatively poor take up, IP insurance should represent an important part of almost all individuals' insurance cover plans.

PRIVATE MEDICAL INSURANCE COVER

Private medical insurance (PMI) reimburses all or some of the cost of private medical treatment for acute, short-term illnesses, which are diagnosed after you have bought a policy. They do not cover pre-existing medical conditions existing at the time the policy is bought.

PMI is relatively expensive because private medical treatment is expensive. People buy it because they want to be treated quickly and conveniently. It also provides them with the option of treatment by a chosen and recommended consultant; and they have access to treatments that are not available under the NHS.

PMI does enable people to receive faster treatment for them or their families. In addition, the facilities that they are treated in are generally better than those available under the NHS. PMI costs generally increase each year and there often comes a point in later life when people begin to consider self-funding through some forms of savings like ISAs. You can choose the type and level of cover that suits you and your budget.

Private medical insurance usually covers:

- In-patient tests and investigations.
- Surgery; either as an inpatient or day patient.
- Hospital accommodation and nursing care.
- Some outpatient tests, consultations, treatment and therapy.

Private medical insurance does not usually cover chronic long-term conditions or things like cosmetic surgery or organ transplants. It is a purchase that has real value if you experience acute health problems, but it is difficult to prioritise it over other forms of cover.

PMI may form part of a benefits package offered by your employer.

SOME ADDITIONAL PROTECTION-RELATED FACTORS TO CONSIDER

Your state of health

For obvious reasons your state of health will have a significant bearing on the premium you pay for most of the insurances we have discussed in this guide. Insurers have tried to speed up the process for accepting proposals but should there be any health issues, or you are applying for a large amount of cover, they may want to get reports from your doctor or even have you medically examined.

Straightforward proposals are usually processed quickly and cover can be assumed quite quickly. Some people resent the underwriting process or don't like the idea of having their medical history investigated in case it throws up bad news. Insurers respect the absolute confidentiality of medical records and if you do have medical problems it is better to deal with them as quickly as possible.

Should you suffer from a common medical problem like Type 2 Diabetes or have an abnormal Body Mass Index (BMI) some new plans which are designed to be impairment specific have been designed. They reward good control of your condition which results in premium reductions and in so doing helps sufferers to understand how to regulate their condition with medical advice. This type of product is likely to become more common and it may be worth considering if you have developed a condition like Diabetes.

HIERARCHY OF FAMILY PROTECTION NEEDS

Scenario	1st priority	2nd priority	3rd priority	4th priority
Couple – just bought house, no children	• Income Protection	• Term Assurance	• Critical Illness	• Private Medical Insurance
Couple – 2 children aged 2 and 5	• Term Assurance (inc FIB) • Income Protection	• Critical Illness	• Private Medical Insurance	
Couple – 2 children aged 15 and 18	• Income Protection	• Term Assurance	• Private Medical Insurance	• Critical Illness
Couple age 50 – no dependent children	• Income Protection	• Term Assurance	• Whole of Life Assurance	• Private Medical Insurance

Value added services

Value added services, a range of additional benefits included with protection policies, have gone from being an optional extra to an integral part of the protection offering. The range of services and benefits offered varies by provider but often includes:

- Access to (remote) GP services
- Second medical opinions
- Nutritional and fitness support
- Bereavement counselling and support
- Mental Health support services

The services are usually available to policyholders prior to claim and can often alleviate the stress of a situation, preventing the need for a claim on the policy. The value that such services provide has been noticeable during the pandemic when, particularly in the case of remote GP services, these added services were able to ease the burden on the NHS while ensuring that policyholders still had access to vital care and support.

Trusts

For ordinary life assurance protection, trusts are an essential way of ensuring that benefits can be paid quickly to beneficiaries, free of inheritance tax and without the need to wait for probate.

When you make a policy subject to trust it will usually be outside of your estate for inheritance tax purposes. This is usually done from the start of the policy but could also be done after the policy is in force.

You appoint trustees (and you can be one) to be the legal owners of the policy. They are then responsible for looking after and paying out the policy benefits to the beneficiaries.

The type of trust chosen that will depend on your circumstances. There are two main type of trust which would generally be used.

- Absolute (Bare) Trust – These should only be used when you are certain who you want to benefit from the sum assured paid under the policy and the shares they are to receive. Once the beneficiaries have been chosen, they can’t be changed neither can their share.
- Discretionary Trust – This is a very flexible type of trust. A number of beneficiaries and potential beneficiaries can be named in the trust document. Either you (during your lifetime) or the trustees can then choose, at a later date, who should benefit.

Each premium you pay to a policy in trust will be a gift for inheritance tax purposes but in most cases it is likely to be covered by an exemption.

The sum assured will then be paid free of inheritance tax. Special advice will be needed for policies with very large sums assured held in discretionary trusts.

SO WHAT NOW...

Given the wide range of needs that can require insurance to cover the financial consequences resulting from death or illness it is unlikely that many will be able (or inclined) to provide for all of them. If this is the position that you are in then you will have to make some choices over which insurance cover takes priority for your family. A Close Brothers adviser will help you to carry out this essential prioritisation if it is necessary.

Close Brothers provides financial planning advice which includes taking into account any tax planning opportunities that may be applicable to your individual goals. As tax rules can change, sometimes retrospectively, and any benefits rely on your own circumstances, if you require specific advice on tax liabilities and treatments, then you should speak to a tax professional.

To get you started, though, consider the above *Hierarchy of Family Protection Needs*.

This *Hierarchy of Family Protection Needs* is represented by a simple chart to give a very basic indication of the sort of considerations to take into account in prioritising family protection needs.

We hope you can appreciate that it is impossible to incorporate all the judgments that you need to make in a simple chart but we hope it will help get you started. Of course, if you have cover against death and sickness/ill health provided by your employer this will reduce your need to provide this cover yourself. It is essential therefore to find out exactly what, if any, cover you have and then start from there to look to “close the gap”.

The “protection gap” in the UK (broadly the difference between what one should have as life cover and the amount of cover you actually have is significant for most people. The FCA Financial Lives Survey in 2020 found that 53% of the adult population had no protection insurance in place.

The financial (and resulting emotional) effects of “the gap” should you fall sick, become seriously ill or die could be devastating for you and your family.

A Close Brothers financial planner can help you to carry out a protection-gap assessment and to take appropriate action to economically and tax efficiently close it.

For further information or to book a consultation with a Close Brothers adviser, please call **0800 5884 064** or email **advice@closebrothers.com**

We would be delighted to talk

If you would like further information or to arrange a complimentary initial meeting, please contact your closest office or email us at advice@closebrothers.com

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