

The importance of financial protection





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A good financial plan needs the right measures in place to make sure you and any family members are financially secure whatever the future brings, including in the event of serious illness, accident or death.

Planning is not just about growing wealth, it is also about making sure your loved ones are looked after and protected. Many people are under-prepared and it is estimated that around a third of UK employees have no financial back-up for unexpected events¹. Whilst the need for financial protection may not feel immediate, the Association of British Insurers estimates that a million UK workers each year find themselves suddenly unable to work due to illness or injury².

As a result, there is a real need for many to consider how they would cope if, for example, they became unable to earn an income or their spouse passed away.

Protection available

Financial help in the event of illness or a loved one's death can come from a variety of sources. For most people, it is likely to be a combination of:

State benefits	Employee benefits	Protection insurance
<p>The State may provide some benefits if you cannot work, for instance.</p> <p>However, many people overestimate what is available, therefore State benefits are best thought of as a safety net. They will rarely provide enough to cover living costs, and simply relying on help from the State would leave most people with a substantial shortfall.</p>	<p>Many people may expect to receive some assistance from their employee benefits package, which could include a death in service benefit or some form of sick pay. However, these are not necessarily linked to personal circumstances and so may not be sufficient to repay debts or meet living costs.</p> <p>Furthermore, self-employed individuals will not have such benefits to call on.</p> <p>Employment circumstances can also change and a previously relied on benefit may be lost on moving jobs.</p>	<p>'Financial protection' refers to policies available from insurance companies that provide a form of financial security.</p> <p>They are generally taken out to cover a variety of events, and two of the most common are to repay a loan (such as a mortgage) on death or to provide a replacement income in the event of illness or accident.</p>

Due to the modest level of benefits available from the State and the generic nature of employee benefits packages, there can, depending on circumstances, be a clear need to take out personally owned financial protection policies, which can be tailored to suit your specific needs.

Footnotes

1. Legal & General; <https://www.legalandgeneral.com/adviser/protection/news-insight/deadline-to-breadline/>

2. Association of British Insurers; <https://www.abi.org.uk/globalassets/sitecore/files/documents/publications/public/2014/protection/welfare-reform-for-the-21st-century.pdf>

Identifying the gaps

It can be difficult to work out what financial protection you need, if any.

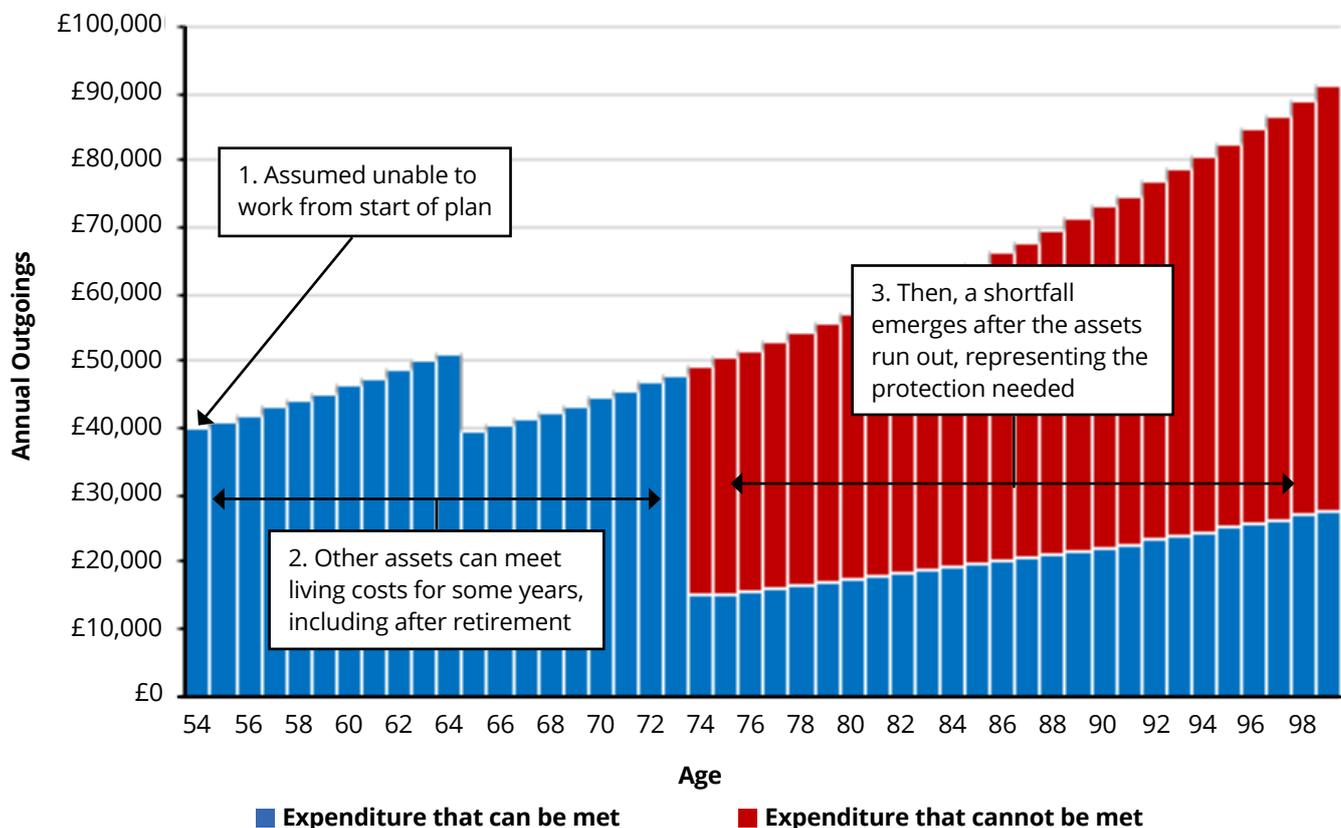
- Young, single people with no dependants may feel that they have no requirement at this stage of life. However, sick pay available from either the State or an employer (where available) is unlikely to be adequate and could mean, for example, being unable to maintain rent or mortgage payments.
- People with relatively simple circumstances, such as only having a mortgage to repay, may find it easy to work out what protection is needed as they simply want to repay their mortgage on death or ensure their repayments are covered if they fall ill.

For most people, however, working out the protection required is more complicated. There is no 'catch-all' solution and many families will be best served by a combination of different types of protection. As a result, the knowledge and expertise of a financial planner can be very helpful.

A financial planner can get to know you and, by understanding your needs and circumstances, make recommendations for a protection base to your financial plan. Many financial planners use sophisticated lifetime cash flow software to plot your financial future and, by modelling various scenarios, calculate your individual protection requirements based on:

- Your future milestones and objectives.
- Existing protection policies, if you have any.
- Any assistance available as part of your employee benefits package or from the State.
- Any existing debts or liabilities.

Working out the protection needed if someone is unable to work





Protection against loss of income

The level of savings amongst households in Britain is currently very low³, which means that being unable to earn an income due to either illness or injury would be financially devastating for many people.

Although statutory sick pay and/or workplace benefits may provide some relief, the most effective way to protect against being unable to work is with an **income protection policy**. These plans pay a tax-free income (after a deferred period) if someone is unable to work due to illness or injury, thus giving the recipient the benefit of being able to meet core living costs even when they cannot work.

Plans are flexible and can be tailored to suit different circumstances and budgets. For example, you can choose a longer waiting period before the income payments commence, or you may prefer to have the income paid until retirement age or just for a limited period, such as one or two years.

Protection in the event of death

The loss of a loved one is obviously a stressful and difficult time, which can be made worse if there are financial difficulties brought about by the death. Immediate questions that need to be considered might include:

- Can the family maintain its standard of living with the loss of an income?
- Does the surviving spouse have to continue working at a time when they would prefer not to?
- Will future milestones, such as paying for children's education, still be achievable?

Life insurance policies are one of the most straightforward ways to alleviate the financial stress associated with losing a family member. These plans can run for a pre-set term or provide cover indefinitely. A tax-free lump sum is paid out in the event of death during the term of the plan (for 'term insurance' policies) or simply whenever it occurs (for 'whole of life' policies).

Cover can be set to reduce each year and, as the insurance company has a reducing liability, this type of plan is more affordable. It is commonly used for protection alongside a repayment mortgage. Alternatively, the cover can remain level, or increase each year so that it retains its value in real terms.

A variation of the life insurance policy, called a **family income benefit** plan, exists and provides a tax-free regular income as opposed to a single lump sum. This is helpful in meeting ongoing costs of living or could be used to cover future expenditure, such as children's education.

Footnotes

3. Financial Times; <https://www.ft.com/content/9afd1596-61d3-11e9-a27a-fdd51850994c>

Protection in the event of serious illness

Typically, a person is more likely to suffer a serious illness than to die during their working life⁴. The financial impact can be just as challenging, for example, it may not be possible to continue earning an income, the need for private healthcare may emerge and adaptations to the home may be required.

Critical illness policies are similar to life insurance policies in that they provide a tax-free lump sum, but instead these plans pay out on the diagnosis of pre-defined illnesses, which include (but are not limited to) conditions such as heart attack, cancer or stroke. As policies have unique definitions and coverage, it is not always best to simply go for the cheapest option. For example, some lower cost plans are designed to cover certain more common illnesses whereas others have much broader definition on when they will pay out.

Due to the increased likelihood of a claim, critical illness plans are more expensive compared to life insurance policies. However, even a little cover is likely to provide some relief in the event of a serious illness diagnosis.

Existing policies

You may have existing protection policies that have not been reviewed for some time. This could mean that the policy is no longer appropriate (for example, an old mortgage protection policy may no longer be sufficient to repay your borrowing), but it could also mean that the policy no longer provides good value for money. The protection marketplace is ever evolving, and newer products are launched that can sometimes mean it is cost-effective to replace old cover.

As a general rule, existing protection policies should be reviewed at least at every life milestone (such as changing jobs or getting married), but ideally more often than that as part of an overall financial plan under the guidance of a financial adviser.

Do you need advice?

In our opinion, protection insurance underpins a successful financial plan. However, working out whether you need protection, how much you need and what types of policy would be best are not easy questions to answer. If you answer yes to any of the following, it is likely that you would benefit from financial protection advice:

- | Yes | No | |
|--------------------------|--------------------------|--|
| <input type="checkbox"/> | <input type="checkbox"/> | Is the income from your job the main way you meet your living costs? |
| <input type="checkbox"/> | <input type="checkbox"/> | Do you have existing protection plans you have not reviewed for a long time? |
| <input type="checkbox"/> | <input type="checkbox"/> | Are you self-employed? |
| <input type="checkbox"/> | <input type="checkbox"/> | Do you have an outstanding mortgage? |
| <input type="checkbox"/> | <input type="checkbox"/> | Is your family reliant on one main earner? |

Holden & Partners has experienced and highly-qualified advisers who can help you to assess protection needs, review existing policies and recommend a sound underpin for your financial plan.

If you would like to discuss your own financial protection, please do not hesitate to get in touch.

Footnotes

4. The Telegraph; <https://www.telegraph.co.uk/finance/personalfinance/insurance/criticalillness/6251215/How-important-is-critical-illness-cover.html>

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GPROT 092020