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Income Protection - a short guide

Income protection is an often-overlooked member of the personal insurance family. While most people have life cover, and most have at least heard of critical illness, many are unaware of the benefits an income protection policy can offer.

Long term illness can be devastating for a family's finances, but income protection can provide a degree of security should the worst happen.

What is Income Protection?

An income protection plan is a long-term insurance policy that aims to pay out a regular benefit if you are unable to work due to illness or disability.

The amount paid out will be a proportion of your annual earnings, usually somewhere between 50% and 75%. The idea is to give you a regular income, broadly equivalent to your take-home pay when you were still in work.

The policy will be underwritten, and may require a simple health questionnaire, a report from your GP or a full medical, depending on the level of cover and any health or lifestyle conditions you disclose.

The younger and healthier you are, the cheaper the cover will be.

Many insurance providers now also offer health benefits such as discounted gym membership and fitness equipment or free health check-ups.

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When would it pay out?

The policy would pay out when you have been unable to work for a set period of time. This may be anything from one month to one year, known as the deferral period.

How long does it last?

Benefits can be paid out until the end of the plan term, or until you recover, whichever occurs earliest.

The payment term can be as short as one year, or until your retirement date.

The most comprehensive plan could start paying out after one month of ill-health and continue until age 70. This would be prohibitively expensive for many people, with a shorter term or longer deferral period being more realistic.

Bear in mind that a short payment period (for example, 1 – 5 years) would save money in the shorter term but limits your options if you don't recover from your condition, and still cannot work when the cover expires.

What are the options?

An income protection plan can be very flexible, with any of the following options available to customise:

- Cover amount (subject to a maximum, which varies between providers)
- Expiry Date
- Payment Term
- Deferral Period
- Inflation Proofing
- Age Rating (where the cover rises each year in line with your age. This can result in a cheaper premium at outset, but works out more expensive over the long term).

The insurer may assess the application based on:

- Own occupation – this means that if you cannot perform your own role, the benefit would be paid out, even if you could work in a less demanding job
- Suited occupation – the benefit would be paid out if you couldn't work in your field in some capacity, for example if your employer would allow you to switch from a manual job to a desk job, you would not receive a benefit. If your condition excluded you from your field altogether, you would be covered even if you could work elsewhere.
- Any occupation – you would need to be unable to work in any capacity to receive a benefit.
- Activities of daily living – you would need to be unable to perform basic functions of everyday life (such as washing or dressing yourself) to receive a benefit.

Some insurers offer guaranteed insurability, which means that you can increase your cover, usually after a major life event such as a promotion or the birth of a child. The advantage of this is that no further medical evidence is needed, even if your health has changed.

What does it not cover?

The plan will not cover any medical conditions excluded at outset. For example if you suffer from back pain, it is highly likely that the insurer will exclude this as a reason to pay out a benefit, unless it occurs as a result of an unrelated accident or injury.

It is important to disclose all medical conditions when you apply. If a claim is made, and the insurer reviews your medical history, they may not only exclude this particular claim. As the contract was agreed based on incomplete information, they may decide that the whole policy is void.

An income protection plan only covers health related issues. It would not pay out if you lost your job.

Additionally, an income protection plan would only pay out if you do not have other income. If you still receive sick pay from your employer, rental income, dividends or State benefits, your income protection amount would either reduce proportionately or stop entirely. Non-taxable income (such as child maintenance, gambling winnings or gifts) does not factor into this calculation.

How can I set it up?

Your employer may offer income protection, either as part of your remuneration package, or at a relatively low cost through a group scheme.

While it is worth taking advantage of, check the amount payable, the cover term and the deferral period. If your employer scheme would only pay out for a year or two, it may be worth setting up a personal plan with the longest possible deferred period, to ensure that you have continuous cover.

You can set up a plan yourself online, or through a financial adviser. If you have any health issues, lifestyle factors (such as smoking or extreme sports) or work outside the UK for long periods, it is worth obtaining advice on the best provider.

Are there are any tax benefits?

While personal income protection premiums cannot be offset against tax, the benefits are completely tax-free.

If your employer provides income protection cover, they can claim the premiums as a business expense, but must deduct tax and National Insurance from any payments made to you.

If your family’s financial security depends on your ability to earn an income, income protection is an essential component of your financial plan.

For more information

For more information and to ask us about this type of important protection, please contact us on:

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Risk Considerations

There are a number of risk considerations to be aware of as noted below. It's important you are aware of these as appropriate to your circumstances.

- Application for cover is personalised, is occupation based and medically underwritten, so:
- Failing to disclose (& honestly) any requested or relevant information (including medical history information) may adversely affect any future claims you might make.
- Cover is only maintained whilst premiums continue to be paid.
- The benefits are selected at outset when the policy is written. Over time, changes in your circumstances or inflation may mean the original cover is insufficient for your needs.
- Cover levels should be periodically reviewed to ensure they remain sufficient
- The policy has no cash value at any time.
- There is normally no continuation option at the end of the selected policy term. So, once the term is reached, cover will cease.
- The maximum benefit payable has to take into account any benefits which would be paid under any waiver of premium benefits written into other policies. So, if you have a waiver of premium benefit (also known as contribution protection benefit) to cover payments on other policies/plans, this/these would be deducted from the maximum benefit payable on an income protection policy.
- The payment of any benefits may affect your claim to means tested benefits.
- The payment of any other payments, such as sick pay, may have an impact on the benefits payable.
- The level of benefit may be reduced if you receive other regular income, such as salary/reduced salary or pension income.

Risk Warnings

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