

Introduction

Important as protection against short-term sickness or minor accidents may be, **the risks associated with a prolonged disability are much greater.**

The financial problems faced by a family when the main breadwinner suffers from a prolonged disability, can be much more serious than if that person had actually died.

The Reality That Must Be Faced

The thought that any of us might suffer from a prolonged disability is not something that we really want to dwell on. This is probably the main reason why only 10% of the working population currently insure themselves against such an event, **even though the results could be financially devastating for themselves and their families.**

The reverse of this is probably the reason that, each week, several million people stake their cash on the National Lottery. They like to think about having instant financial security for the rest of their lives, even though the chances of it 'being you' are rather slim - just one in around 14 million.

The Magic Box

In order to help us we can turn this thought process on its head. **Imagine for a moment that you have won**, not the National Lottery, but **a Magic Box**. This box has been wonderfully made by a power that is outside of our human understanding. What does the box do? **It makes entirely legal £50 notes!**

How often does it make them? It produces, through a slot at the front, **two £50 notes every morning and every afternoon, five days a week**. On Saturdays and Sundays it goes through a kind of automatic servicing routine but produces no notes.

How long will it go on producing these notes? It has the potential to do so until you reach the State retirement age. What is the catch! The only problem is to do with the highly complicated nature of the internal workings of the box. **If it goes wrong**, which it could do at any time, **you will never be able to fix it.**

There is, however, one very special engineer who was involved in the original design of the box. He has made quite a few of these magic boxes and has no difficulty in fixing them. He is prepared to service your box once a year and **guarantee to get it working within four hours if it ever goes wrong**. This guarantee is valid until you reach the State retirement age.

His fee? You just send him the **first two £50 notes that the box produces each month**. You will still be left on average with eighty four £50 notes every month.

The choice is yours. Do you want the magic box that you have won just as it is, or complete with the special service engineer?

The magic box is not, of course, a figment of your imagination. **The magic box is you!** Through the wonderful facilities your body provides you are able to work and earn lots of £50 notes each week. The magic box produces income at the rate of £52,000 a year.

Instead of sending the first two £50 notes each month to the special engineer, you send it to an insurance company which **guarantees to send you a replacement income, which together with Statutory Sick Pay and State benefits is not too far short of your current net income**, for the rest of your expected working life.

Are you really prepared to risk the loss of possibly hundreds of thousands of pounds of future income for you and your family any longer, when there is a simple solution to hand?


State Benefits During a Prolonged Disability

Many people **still seem to believe that the State will look after them** if they suffer from a prolonged disability.

The State does have a role in this but it is limited to providing a level of support that anyone in work would find it extremely difficult to live on.

Certainly the State support does not consider that you need to eat out, have good holidays, buy your own home or send your children to a private school. In other words if you rely on the State for assistance **you are letting a future Government determine how you will live during a period of prolonged disability.**

This can clearly be seen from looking at the summary of current State Incapacity Benefits which follows. It is particularly important to notice two things:

-  If you find yourself suffering from a prolonged disability for more than a year, the **maximum State Incapacity Benefit if you are under age 45** (it is less if you are older) **is £95 per week** (ie £4,940 per year (2007/08)). **Even this level of benefit is taxable**. If you are currently earning £52,000 a year that is a drop in income of 95%!

A In order to claim State Incapacity Benefit beyond the first 28 weeks **you have to have 'a work focused interview'** with a Department of Work and Pensions (DWP) personal adviser.

In essence you will need to be sufficiently disabled to be unable to do any paid work in the open market for at least 16 hours per week. This takes no account of whether you were specially trained for your previous occupation; no account of whether you are untrained in the work you are now classed as able to do, and more importantly, this takes **no account of whether there is any work available**.

Furthermore, in order to claim you require a sufficiently high points score from a questionnaire on your ability to function on a day-to-day basis.

A Summary of the State Incapacity Benefit (from April 2007)

Weeks 1 to 28 of disability

Incapacity Benefit - Short Term (Lower Rate)

To qualify: Unable to carry out **your own occupation**

	Benefit	Weekly Amount
Employees	Statutory Sick Pay (paid via employer and taxable)	£72.55 (Equivalent to £3,929 pa)
Self Employed	Incapacity Benefit (not taxable)	£59.20 (Equivalent to £3,078 pa)

Weeks 29 to 52 of disability

Incapacity Benefit - Short Term (Higher Rate)

To qualify: Unable to carry out **any occupation**

	Benefit	Weekly Amount
Employees and Self Employed	Incapacity Benefit (taxable)	£70.05 (Equivalent to £3,643 pa)

Week 53 plus of disability.

Incapacity Benefit - Long Term

To qualify: The Benefits Agency has to decide whether in their opinion continuing claim payments are warranted. If the claim is turned down you would be referred to the DWP to explore other (almost certainly lower) benefit entitlements.

	Benefit	Weekly Amount
Employees and Self Employed	Incapacity Benefit (taxable)	£78.50 (Equivalent to £4,082 pa)

Note: Extra money may be able to be claimed where the sick or disabled person has children. This is obtained via the Child Tax Credit which is claimed from and administered by the Inland Revenue.

Income Protection

If you are currently in good health and employed or self employed, **you can apply for income protection insurance cover**.

An income protection insurance policy provides a **totally tax free regular income** as long as it is needed, up to retirement age, if work is ruled out by ill health.

The premiums depend on a number of factors including the work that you do, whether you smoke, your sex and the length of time you will be ill before claiming (the waiting period).

More limited cover is also available for **homemakers** whose unpaid cleaning, cooking and childcare would need replacing with paid labour if they fell ill.

Under an income protection plan (IP), or permanent health insurance (PHI) policy as it is sometimes known, an income benefit would be paid to you if you were unable to work because of disability caused by sickness or accident.

The benefit is effectively paid as compensation for loss of earnings.

Benefit will **normally start at the end of an initial waiting period of 13 or 26 weeks**, although a shorter period of 4 weeks or a longer period of 52 weeks may be available as well.

If available, the premium for 4 weeks will be very much higher than for 13 weeks and so on.

The benefit is payable until you either return to work, die or the policy term expires.

The policy term is **normally linked to your expected normal retirement age**.

Premiums

The level of premium for the required amount of cover will depend on the type of plan and the company chosen.

Some companies offer **guaranteed or fixed premiums**, whilst other plans **reserve the right to review premium levels** or offer the potential to build up a surrender value.

For a slightly higher premium the option is normally available to have **the level of cover automatically increased each year** in order to provide protection against the effects of inflation.

As the insurance is to protect you against the possibility of a long term disability **we always recommend that you set up your cover on an inflation linked basis**.

Definition of Disability

The definitions of disability vary considerably. Generally, in order to make a valid claim, you must demonstrate that you are:

- **totally unable** by reason of sickness or accident **to follow your own occupation** (the widest cover), or
- **totally unable** by reason of sickness or accident to follow your own occupation **and any other for which you are suited by reason of experience and/or qualifications** (more restricted cover), or
- **totally unable** by reason of sickness or accident to follow **any occupation whatsoever** (the least generous cover).

The definition of disability, ie whether 'own occupation', 'any occupation for which you are suited' or 'any occupation', is obviously crucial for underwriting and claim purposes and will affect premium rates.

Benefit Level

The main objective of an income protection policy is to replace earnings lost through illness or disability **without reducing your financial incentive to return to work**. Otherwise you may simply be content to draw benefits for the rest of the term.

All income protection policies therefore stipulate a **maximum income benefit limit**. Typically, this is in the region of 50% - 60% of your average monthly earnings in the year prior to disablement.

Benefits from other income protection policies will be taken into account, and it is common for State incapacity benefit to be taken into account in calculating the benefit limit.

The benefit payable is **tax free** under current tax rules.

The Right Plan for You

When advising clients we use a combination of:

- Defaqto's **Aequos Engage** - product research and analysis software which is built on the latest technology and updated daily with real-time data. Defaqto offers respected expert commentary via monthly market reports and is the data collection agent for the FSA's Comparative Tables Service.
- The Exchange's **Exweb** - the most comprehensive online trading portal for the UK financial services industry. It covers a wide range of product areas and is supported by all of the UK's major product providers.

If you would like to obtain an illustration for your own income protection plan, without involving us, then please use our online quotes service which is accessible via our website at www.arch-fp.co.uk/quotes.php

Risk Factors

- Information given relating to Income Tax legislation and Social Security benefits is based on our understanding of legislation and practice currently in force. Whilst we believe our interpretation of current law and practice to be correct in these areas, we cannot be responsible for the effects of any future legislation or any change in interpretation or treatment.
- In particular you are warned that levels of tax and tax reliefs and also State Benefits are subject to alteration and, in any case, the value of such reliefs and benefits may depend on an individual's circumstances.
- These notes are intended as a guide only and do not replace the full product details that accompany each Income Protection Insurance illustration.
- You should review the level of cover required on a regular basis to ensure that it keeps in line with your earnings, otherwise, cover may be less than you need.
- If for any reason you cease contributions cover will lapse.
- The benefit payable may affect a claim for means tested state benefits.
- The present tax free treatment of the policy benefits may change.

Please note that **this information does not constitute personal advice** and should not be treated as a substitute for specific advice based on your circumstances. If you are in any doubt as to whether an income protection policy is suitable for you, then **you should discuss the matter with a suitably qualified independent financial adviser** such as ourselves.

For Further Info

If you would like to receive a personal illustration of an Income Protection Plan, or any other form of health insurance, please ask your usual Arch adviser or contact us via one of the following:

Tel: **0845 3700 661**
Email: **enquiries@arch-fp.co.uk**
Online: **www.arch-fp.co.uk**

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