LIFE INSURANCE – PART OF EVERY GOOD FINANCIAL PLAN

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Wealthy individuals tend to view managing risk as vital to long-term investment success. Risk influences investment selection and portfolio construction. Surprisingly, when it comes to managing risks to their income and the financial security of their family, many people aren't so careful.

According to a Perpetual survey of 3,000 Australians, just 52% of men and 47% of women in Australia have life insurance outside of super.[1]

One common reason for not having life insurance is because they believe "*it won't happen to me*". The truth is, it can happen to you:

- Around one in two cases of cancer are in people under age 66.[2]
- Cardiovascular disease was the underlying cause of death in 41,800 deaths in 2018[3]

As you approach retirement, life insurance should be an important part of every financial plan. It safeguards you, your family – and the retirement nest egg you've worked so hard for – should anything happen to you.

FIVE REASONS YOU NEED LIFE INSURANCE

If you're among the 50% of Australians who don't have life insurance (outside of super) or you haven't reviewed your life insurance recently, here are five top reasons – both financial and personal – why you should reconsider your insurance strategy:

1. **Peace of mind**
   You've worked hard to achieve your lifestyle and provide for your family. Don't let an accident put you under financial pressure. The right insurance cover means that your loved ones will be taken care of if anything happens to you – and that's one less thing you have to worry about.

2. **You have debt**
   High income earners can service a lot of debt and it's not unusual to have significant mortgages or business loan obligations even into retirement. If you were to pass away, it is likely that these obligations may have an impact on your next of kin, which means your spouse, children or even siblings may need to arrange for your debt to be paid.

   Insurance to cover your debt repayments will avoid a situation where the non-working spouse or other family members not only lose a loved one, but are then forced to downsize the family home.

3. **You have a family**
   For wealthy families, being accustomed to living a certain lifestyle can mean a household or estate quickly loses its money without the primary earner continuing to bring in an income.

   Insurance that provides an income or clears debt means your children can continue their education and ensure ongoing financial security.

4. **Your spouse is not working**
   Often over-looked is the importance of insurance for non-working spouses. If a non-working spouse is injured and requires care, without insurance you may need to stop work to care for them. The right insurance can ensure your spouse has the care they need, while you can still go to work and provide for your family.

5. **Reduces stress**
   The shock of injury or death can be devastating for your family. Dealing with the financial impact can make a difficult time even harder. Robust insurance policies with a stress-free claims process can ease the pressure, especially when they're already going through an emotional time.

WHAT INSURANCE IS RIGHT FOR YOU?

Understanding the different types of insurance for you and your family

There are four main types of insurance that can cover you and your family should the unexpected happen. The following summary covers the main features of these insurance types, and how they differ whether you hold them inside or outside super. We also look at some of the most common questions financial advisers at Perpetual receive from clients, including:

- What is life insurance?
- What is the difference between Total and Permanent Disability (TPD) and Trauma Cover?
- Does Income Protection cover me if I lose my job or suffer an illness?

Life / Death Insurance

What is it?	A lump sum payment made on the life insured's death (or diagnosis of terminal illness) to a nominated beneficiary.
How much does it cost?	In my observations, life insurance is often less expensive insurance relative to other personal risk insurances.
How can you hold the policy?	Can be owned inside or outside super. Premiums paid through your super are tax deductible to your super fund and therefore can be a tax-effective way to fund premiums, subject to circumstances. Premiums paid outside of super are not tax deductible.
How is it typically used?	The lump sum can be used towards clearing the life insured's liabilities (i.e. mortgage, investment loans etc), covering funeral expenses and provide an ongoing income to the remaining family.

Total and Permanent Disability (TPD)

What is it?	A lump sum payment made on the life insured's Total and Permanent Disability (TPD). The definition of TPD varies considerably between policies, however very generally speaking it is an illness or injury that makes it unlikely or impossible for the life insured to work again, in the way they used to.
How much does it cost?	In my observation TPD cover is typically more expensive than Life cover however more affordable than other types of personal risk insurances.
How can you hold the policy?	TPD insurance can cover you for being unable to work in either: • Your own occupation: The occupation for which you have been trained, usually one that is highly specialised

	in nature or relies on niche expertise. • Any occupation: Any occupation for which you are reasonably qualified by experience, education and training. 'Own occupation' cover is not available through your super and can only be purchased through a retail insurance provider. Premiums are not tax deductible. 'Any occupation' cover can only be held through your super fund with premiums tax deductible by your super fund. In addition, TPD policies held within super may be taxed at claim time, whereas policies owned personally are received tax free.
How is it typically used?	The lump sum can be used towards clearing debt, covering medical expenses, adjustments to your lifestyle (home/car alterations), ongoing care and housekeeping expenses and may provide an ongoing income to you and your family.

Income Protection Insurance

What is it?	Income Protection (IP) is an income stream paid to the life insured in the event that, due to illness or injury, you are unable to work and earn an income. It does not cover loss of employment for non-health related situations such as redundancies.
How much does it cost?	In my observations IP generally costs more than life insurance or TPD cover, however it can be structured around your personal circumstances to improve affordability.
How can you hold the policy?	Like other types of life insurance, IP can be held inside or outside of super. IP policies held through your super are generally more restrictive with more limited policy features and benefits than those held personally through a retail insurance provider. With IP held within super, in the event of a claim being paid, the funds would need to be released from super under the 'temporary incapacity' rules. While it can vary across products, the majority of the premiums paid outside of super (to a retail insurance provider) are tax deductible at your marginal tax rate.
How is it typically used?	The income stream will usually cover up to 75% of take home pay for a pre-determined benefit period (e.g. 2yrs, 5 years, to age 65) after a pre-determined waiting period (e.g. 30, 60, 90 days; 2 or 5 years).

Trauma / Critical Illness Insurance

What is it?	Trauma or Critical Illness insurance pays a tax-free lump sum paid to the life insured on diagnosis of a specified illness or 'trauma', even from one which you may recover. Unlike TPD or IP cover, trauma cover does not consider your ability to continue to work or earn an income. It focuses on whether you have met the definition of a certain traumatic health events, for example cancer, stroke or heart attack.
How much does it cost?	In my observations, as the likelihood of a trauma claim is high, trauma cover is often the least cost-effective cover of the four main life insurance types.
How can you hold the policy?	While historically it has been possible to hold Trauma cover within Superannuation, new policies must be held personally. No trauma cover is tax deductible.
How is it typically used?	Trauma cover is designed to cover out of pocket medical expenses including medication, surgery, treatment, rehabilitation therapy and fund time off work during your recovery.

INSURANCE INSIDE SUPER

Super funds generally offer these insurance types – with the exception of trauma insurance – through super. In fact, if you are under 65, it's highly likely you have some form of default life insurance automatically provided through your super fund.

Some people may consider this cover inside super is adequate – and for many young people just starting out in the workplace this may be the case.

However, as you move through different stages of life and you take on more responsibility, such as a family and a mortgage, insurance inside super may no longer be enough. In the all-important years leading up to retirement, when you're likely to be at your maximum earning capacity, protecting your income and wealth becomes even more important.

Policy differences between insurance held inside and outside of super can limit what claims are paid, or limit payouts. Unfortunately, often it's only when it comes time to claim that you find the cover you've been paying for through your super (and out of your retirement nest egg) could be inappropriate for your situation.

WHEN IS LESS INSURANCE OKAY?

Just like your investments, it's a good idea to review your insurance annually or during major life events such as getting married or divorced, having a baby, paying off the mortgage or retiring.

As you build your savings and pay off debt, you may need less insurance. When the time comes to retire, protecting your income is no longer relevant and therefore Income Protection insurance and other insurance that depends on you being employed is no longer needed.

After that, it's all about reassessing your cover and asking yourself – *'how much cover do I need?'*.

Working with a financial adviser who will proactively assess, often annually, how much cover is still needed and cancel or reduce the cover that's not needed, is a very useful exercise. Change is an inevitable fact of life, and illness/injury definitions within insurances also alter over time due to advances in medical knowledge as well as diagnostic technology. Without an expert regularly working with you to ensure your cover continues to be appropriate, you may unwittingly end up paying for cover that is essentially worthless at claim time.

WHAT COVER IS RIGHT FOR YOU?

Having looked at the various types of life insurance and how they can be structured, how do you go about reviewing or selecting the right protection for you?

It is always a good idea to seek professional financial advice before deciding on which policy to apply for, especially if you are intending to replace an existing insurance policy. This is because cancelling a policy without carefully considering its features could mean valuable benefits are lost. Or, that replacing the cover may end up being more expensive, perhaps if you have experience a relevant medical issue since the first policy was obtained.

At Perpetual, we follow this four-step process for our clients:

1. Understand what is important to you, what is your specific family and financial situation and what would you need, should something go wrong.
2. Review your existing policies and determine:
    - How appropriate is your level (amount) of cover?
    - Are there any gaps in your cover compared to what you need?
    - What is the cost of your required cover?
3. Provide recommendations across:
    - Types of life cover appropriate to your circumstances
    - The level of cover appropriate to your circumstances
    - Strategies regarding ownership of your cover (super, non-super or company owned)
    - Which insurance provider is aligned with your requirements that gives you the best possible chance of a successful claim, considering holistically the policy benefits and features versus cost.
4. If you need to make a claim, we manage the claims process on your behalf with the insurer as a preferred provider, to provide a swifter and more stress-free claims process. This can be of huge benefit at an incredibly stressful time. We will co-ordinate all the paperwork needed and have conversations with the insurer so the claim can be paid in a timely fashion, so you (or your loved ones) don't have to.

STRATEGIES FOR COST-EFFECTIVE INSURANCE

For pre-retirees or those recently retired, insurance premiums can become expensive, particularly if you are no longer accumulating wealth and they're eating into your nest egg.

After you've periodically reviewed – and possibly adjusted – the level of cover you need based on your changing circumstances, what else can you do to reduce the cost of your premiums?

Here are a few things to consider:

Stepped vs level premiums: Stepped premiums (which increase as you get older), usually start cheaper than the level premiums. If you intend to hold a policy for a long time, for example for 20 years from mid-40s to retirement, level premiums may be cheaper. In fact, there is an inflection point (commonly around nine years) where it becomes cheaper to have level than stepped premiums. Cumulatively, this inflection point is often around 13 years after a policy was taken out.

Start early: The younger you are, generally the cheaper the premiums. If you don't have insurance at the moment, remember – starting today is better than starting tomorrow.

Insurance held in super: While insurance held in super can be more restrictive due to the super laws that can prevent getting access to funds without a condition of release being met, it is also generally cheaper due to the ability to access wholesale pricing. It's important to consider affordability, impact on super balances over time, personal cash flow and tax-effectiveness, as well as other competing priorities (e.g. repayment of mortgage vs funding life insurance premiums) when deciding how to structure your policies.

Linked policies: It may be more cost effective to link policies whereby claiming on one type will reduce the cover on another. For example, if a linked life and TPD policy pays out a TPD claim, the claimed amount will reduce the life cover by that amount. It may also be possible to link an 'Any Occupation' TPD policy held inside super with an 'Own Occupation' policy held personally. This can be an effective strategy to maintain high-quality cover but reduce the impact on personal cash flow.

Insurance provider and payment terms: Some providers may offer a discount if multiple policies are held with them. Paying annually instead of monthly and using different ways to pay a premium, such as through an investment platform, can also reduce the premiums.

Life insurance is all about balance. Balance between the cover you need to protect your all-important final years of work, and a cost which doesn't eat excessively into your retirement nest egg. There are many ways to structure policies with varying levels of cover and premiums, held inside or outside super. The hardest part can be finding the right balance, tailored to your specific family and financial needs, plus medical history.

This doesn't mean you should put it in the 'too hard basket'. Talk to your financial adviser or contact us on 1800 631 381 to explore your life insurance options.

With the right advice you can find the best cover at the right cost, giving you peace of mind for your retirement and your family's future.

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1. Lembit, G., (2020) 'What do you care about', Perpetual Client Insights and Analytics
2. https://www.cancer.gov/about-cancer/causes-prevention/risk/age
3. https://www.aihw.gov.au/reports/heart-stroke-vascular-diseases/cardiovascular-health-compendium/contents/deaths-from-cardiovascular-disease