Risk protection strategies

Income protection insurance

Income protection insurance helps protect you by paying an ongoing income if you are unable to work due to illness or injury.

How it works

You can usually apply for cover of up to 75% of your earnings for a maximum time period. For business owners this is income after business expenses (which can be protected as well) but before tax. You may also be able to have an additional amount paid as contributions into your superannuation account and other ancillary benefits to help with your recovery.

The payments are taxable income but tax may not be withheld, so you should seek tax advice and make sure you set aside money to pay your tax liabilities if this is the case. If paid through superannuation, tax is usually deducted from each payment to help you manage this obligation.

The amount you receive may also be reduced if you receive payments from sick leave, social security, workers compensation or other legislative sources.

Agreed value or indemnity

Income protection cover is provided under an ‘Agreed Value’ or ‘Indemnity’ policy.

Under an Agreed Value policy, you will receive the agreed monthly benefit at the time of a successful claim, regardless of the amount you are earning at that time. With an Agreed Value policy, you are required to provide proof of income at the time you apply for cover. This may suit you if your income fluctuates over time, you are able to substantiate your income and want peace of mind at time of claim.

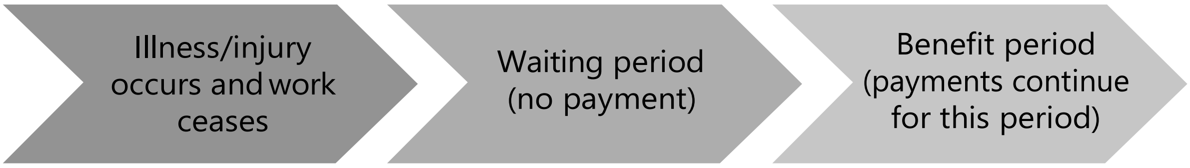
However, the regulator of the Australian life insurance industry (the Australian Prudential Regulation Authority or APRA) has intervened in the income protection sector due to heavy losses experienced by insurers and has announced a number of changes. The APRA changes include discontinuing the availability of new Agreed Value policies from 1 April 2020. However, policies in force as at this date (or submitted prior to this date and issued by 30 June 2020) may be maintained and altered in the future.

With an Indemnity policy, the amount you receive at the time of a successful claim will be assessed on the basis of your earnings in the 12 months prior to the disability. Some insurers have upgraded their Indemnity policies to look back further than 12 months – for example, assessing the claim on the highest 12 months’ earnings in the period of 2 or 3 years prior to claim.

Under an indemnity policy, you will need to provide proof of income at time of claim and if your income has reduced since time of application you may receive less than expected. The premium for an Indemnity policy is less expensive than an Agreed Value policy.

Waiting and benefit periods

In the event of a successful claim, benefit payments do not start immediately as a waiting period will apply during which no benefit is payable. The waiting period can be as short as 14 days or as long as two years. When choosing a waiting period, it's important to take into account any sick leave and related benefits provided by your employer. The shorter the waiting period, the higher the premium is likely to be.



The maximum period of time that payments continue is called the benefit period. A range of benefit periods are available - some as short as one year, with the longest continuing through to your 65th or 70th birthday. In general, the longer the benefit period, the higher the premium.

Policy Ownership

Income Protection Insurance can be owned either in your own name or within your superannuation fund. For business owners it may be appropriate for the business to own the cover. This ensures any claim proceeds are paid directly to the business so it can distribute the funds accordingly.

Self ownership

Owning the policy in your own name may allow you to better tailor the cover to suit your individual requirements (e.g. to obtain more comprehensive benefits and ancillary benefits). With self owned cover, you pay the premium from your cash flow. The premiums are tax deductible to you and benefits that you receive in the event of a successful claim are treated as assessable income and taxed at your marginal tax rate.

Superannuation ownership

You may also be able to purchase your income protection cover in your superannuation fund. This allows the premium to be paid by making contributions to superannuation or simply be deducted from your superannuation account balance so it does not affect your cash flow. The latter option will reduce your retirement benefits.

The premium is a tax deductible expense to your superannuation fund and can reduce the tax payable on contributions and investment income. The benefit to you will depend on your superannuation fund.
If additional contributions are made into superannuation to cover premiums it is important to ensure you do not exceed the limits on how much can be contributed.

The proceeds in the event of a successful claim are paid from your superannuation fund as a temporary incapacity benefit and will be assessable income that is taxed at your marginal tax rate.

In some circumstances, even if an insurer would otherwise pay a benefit to your superannuation fund, they may not be able to do so unless a 'condition of release' is met. One example is if you are not gainfully employed at the onset of the illness and injury, and another is if you reduce working hours but do not fully cease gainful employment including paid leave such as sick leave.

Optional benefits

Income Protection policies may offer important options including:

- An Increasing Claims option that ensures benefit payments are indexed in line with inflation
- A Superannuation Cover option that allows you to have contributions made to your superannuation fund (above the level of salary cover)
- Other ancillary and rehabilitation benefits.

Benefits

In the event that you cannot work due to illness or injury, income protection cover usually pays an ongoing monthly benefit for a specified period of time to help protect:

- Your lifestyle by helping you to continue to meet your living expenses and debt repayments, and
- Your wealth by reducing or removing the need to sell assets to generate cash.
- Without income protection insurance, if you are unable to work due to illness or injury, you may need to run down your savings, sell assets, and/or rely on family or Centrelink for assistance. You may find it difficult to maintain your standard of living or pay for the care and medical assistance you need. This can place extra stress on your recovery.

Risks, consequences and other important things to consider

These include:

- Funding the premiums from your superannuation balance will reduce the growth of your retirement savings unless you make additional contributions to offset the premiums. These contributions will count towards your contribution caps.
- Benefits are paid monthly in arrears so your first payment would be received one month after the end of your waiting period.
- Benefit payment is usually excluded if you suffer sickness or injury as a result of war (or an act of war) or a self-inflicted act.
- Before selecting an insurance policy, you should always carefully read the Product Disclosure Statement (PDS) and policy document, and once you have selected an insurance policy, you should keep these documents in a safe place.

Version: 1.15
Issue date: 24 September 2020