Understanding Personal Insurances

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Insurance can be considered as one of the most important aspects of planning for and protecting your financial future. Not many people consider how their family will cope financially if they die, become disabled or suffer a major trauma event.

Many people do not consider the consequences if they were suddenly unable to work and their income stopped and the impact this would have on financial commitments such as mortgage repayments and other miscellaneous expenses. These expenses do not necessarily stop when your income does.

You can protect yourself and your family by insuring yourself which will ensure that you can clear your debts, make up for lost income, cater for funeral costs or medical expenses and pay for ongoing rehabilitation. There are many different insurance policies allowing you to choose a level of cover that reflects your specific needs. For example, a 25-year-old single male with a car loan would need a different insurance policy from a 35-year-old man who is married with three children and a mortgage.

It may also be important to insure yourself even if you do not earn an income. Your contribution to activities such as home maintenance and childcare may be greatly affected if you became unable to perform these tasks.

There are various types of insurance that can protect your financial future:

- Life insurance
- Total and permanent disablement insurance
- Trauma insurance
- Income protection insurance

The above types of insurance may be offered inside or outside of superannuation.

Term life insurance

Research has shown that most Australians are underinsured or do not have life insurance at all. This is alarming considering the increasing debt levels among Australians. Term life insurance is the most common type of insurance because it is simple and low cost compared to other insurances. If you die or become terminally ill, you will be paid a lump sum. This can clear your debts and provide for your family (subject to individual circumstances and the sum insured).

You pay for life insurance through a regular premium. The cost of the premium is calculated based on your life expectancy as well as the insurance company's risk assessment of you. In simple terms, the older the person, the higher the premium. If the person is a smoker or likes to participate in hazardous activities, the higher the risk and the higher the premium.

The insurance company also considers your medical history.

The premium is generally indexed according to the consumer price index (CPI), or a formula based on the CPI. Therefore, the cost of premiums usually increases throughout the term of the policy even if you are paying a level premium.

Most life insurance policies will pay the benefit early if you are diagnosed with the terminal illness with no chance of remission or recovery. This will help you clear your debt, cover medical costs and provide for the loss of your income if you are no longer working.

Total and permanent disablement insurance

According to research conducted by General Reinsurance Life of Australia, the chance of suffering an illness or injury between the age of 35 and 65 that will lead to total and permanent disability is about one in ten.

Most people understand that an accident can occur to everyday people going about their everyday business. However, most people believe that it will not happen to them. The important thing to understand is that it can happen to anyone at anytime and, depending on the severity, it could prevent you from ever working again. Total and permanent disablement (TPD) insurance provides you with a lump sum if you become totally and permanently disabled and you are unable to earn an income.

TPD insurance can usually be taken as an addition to a term life policy. It can, however, also be established as stand- alone cover. A lump sum benefit is generally paid when medical professionals have established that, in their opinion, you will never be able to work again.

The definitions of TPD can vary between insures, and it is strongly recommended that you examine these conditions before you apply to ensure that they comply with what you believe would prevent you from working again.

There are generally two types of TPD options available: “own” occupation or “any” occupation.

- Own occupation provides a TPD benefit if you are unable to work again in your own occupation.
- Any occupation provides a TPD benefit if you are unable to work again in any occupation for which you are suited by education, training or experience.

Premiums for TPD insurance are affected by factors such as age, health, smoking habits, hazardous activities and occupation. Upon making a claim the insurance provider may also wish to have you examined by their own private medical professionals to ensure that your claim is valid.

Do you need term life or TPD insurance?

When considering term life or TPD insurance, you must consider a number of factors such as your current level of debt, the importance of your income to support ongoing living expenses for your family and any future expenses you anticipate, such as funeral costs, children's education expenses, and medical bills.

You can use various formulae to calculate the appropriate level of insurance for you. They take in to account your age, the age of your dependents, your current income, and your lifestyle and debts including a mortgage.

When considering insurance if you do not earn an income (e.g. you are a homemaker), you must remember that the surviving spouse will have two choices if you die. They can take leave from their own job to look after the household or employ someone else.

Both of these options require funds to cover the expenses involved, and both will have a negative impact on household income.

Trauma insurance

As people are becoming more aware of the statistical chances of suffering a critical illness condition or major trauma, the need for trauma insurance is becoming more of a priority. A trauma insurance benefit is paid when you are diagnosed with a “qualifying condition” as set out in the insurance policy. It is generally paid as lump sum when you are diagnosed with a specified illness, and can be used to cover lost income, medical and rehabilitation costs, and other varying expenses such as mortgage repayments.

A major trauma can affect you and your family's physical and emotional wellbeing. A lump sum can help towards easing the stress during what is most likely to be a stressful time.

A qualifying condition for trauma insurance varies between providers. The more common medical conditions are:

- Heart attack
- Major head trauma
- Cancer
- Stroke
- Open heart surgery.

Benefits are paid when the insurer receives a certificate from a qualified medical professional.

Trauma insurance is not generally offered within superannuation due to restrictions around when and how a payment can be made from superannuation.

Premiums vary depending on the level of cover you require, your age, and your medical history.

Trauma insurance is available if you are not currently employed, unlike some other forms of insurance.

Do you need trauma insurance?

If you had a mild heart attack, then became well enough to return to work after three months (once you had fully recovered) you may not be able to claim under you term life, total and permanent disablement or income protection policies (dependent on waiting periods) as your illness was not long- lasting.

Trauma insurance can help to fill the gap between term life, total and permanent disablement, and income protection insurance, and encompass scenarios not covered by other types of insurance.

If you have a family history of serious illness, or even a high risk/high stress job, trauma insurance may benefit you.

Income protection insurance

What would happen to your expenses and lifestyle if you are unable to work for an extended period of time due to an illness or injury? After sick leave provisions and any accrued leave, you may have within your employment have been exhausted, you may find that you cannot cover your ongoing expenses.
We tend to take for granted our ability to work and earn an income, and do not consider the prospect of being unable to do so.

However, losing your income could have devastating effects on your future plans and financial security.

Income protection insurance provides you with a portion of your employment income for a specified period of time or until you are able to return to employment (subject to conditions). The benefit is paid on an ongoing basis not as a lump sum and is taxable as normal income. Income protection policies generally pay up to maximum percentage 70% of your employment income or in some cases 75% of your employment income if the policy was taken out prior to October 2021. You are only eligible if you are employed (including self-employed).

Like life insurance, premiums are based on factors such as your age, medical history, and smoking habits. However, they are also substantially influenced by the type of employment you are involved in. For example, a coal miner would have a higher risk of being injured while at work in comparison to an office worker who stays indoors most of the day.

Another factor affecting the premiums is the waiting period and benefit period selected on the policy. The waiting period refers to the length of time you are unable to work before benefits are paid. For example, if you believe that you would survive without employment income for one month, you may require a policy with a waiting period of one month or more. Most policies offer waiting periods from 14 days up to two years. The waiting period you choose will depend on your personal situation including how much leave you have owing at work and the level of liquid funds you may have. The shorter the waiting period, the higher the premium.

The benefit period is the length of time you will receive a benefit payment for any one claim. It can range from one year to up to age 65 (both the waiting and benefit periods will depend on the insurance provider and the premium you pay). Again, the benefit period you select will depend on your personal situation.

You can mix and match different policies to ensure that you are fully covered. For example, if you have an existing income protection policy within your employer superannuation fund that has a benefit period of two years, you may then obtain an additional income protection policy that has a waiting period of two years and a benefit period of up to age 65.

Insurance inside superannuation

Term life, TPD, (and/ or trauma pre-2014) and income protection insurance may be held through superannuation.

The main implications of holding insurance inside superannuation include:

- Your superannuation balance may be used to fund premiums.
- The gross cost of premiums may be lower compared to holding the same policy outside superannuation.
- Group premium rates may apply which may be cheaper than individual premium rates.
- You may not need to provide a medical history nor undergo medical testing (up to an approved limit).
- There may be tax to pay on any term life, TPD (and/ or trauma pre-2014) insurance proceeds paid from superannuation.
- Insurance proceeds may be paid less quickly to you.
- TPD (and/ or trauma pre-2014) insurance proceeds may get trapped in superannuation in certain situations.
- Product features may be limited; and
- Your death benefit beneficiaries are restricted.

Note: There is no overall financial benefit from holding income protection insurance inside superannuation. However, there may be a benefit to cash flow.

As there are many factors to consider before holding insurance inside superannuation (or outside), you should discuss this with your adviser prior to making any decisions.

Note that from 1 July 2014 a superannuation fund must not provide an insured benefit in relation to a member unless the insured event is consistent with the death and terminal medical conditions or permanent incapacity conditions of release.

However, the prohibition does not apply to the continued provision of insured benefits to members who joined the fund (and were covered by the insured benefit) before 1 July 2014. The exemption extends to varying the level of cover they already have and adjusting the associated premiums.