

Protecting your income – your most important asset

Most of us are aware of the need to prepare for our long-term financial security and this is evidenced by the increased interest in superannuation and other long-term investments.

However, preparing a long-term financial plan is also about protecting you from unforeseen risks that could occur throughout life's journey. We tend to take for granted that we will be able to work and earn an income. But if your income suddenly stops, as a result of injury or illness, it can have devastating results on your financial plan and harm you and your family's future financial security.

When asked what our greatest (physical) asset is, many people state their house and see the importance of insuring it and its contents. Yet many of us overlook our income. You might be surprised how much you may earn in your lifetime and therefore how important it is to protect your income. For example, if you are 35 and earn \$850 per week, you could earn more than \$2.9m* before you turn 65. No matter how large or small your pay is, generally it supports your family, your bills, your loan repayments and your lifestyle.

* assumes a 5% pa. salary increase

How does the strategy work?

Income protection insurance can be a flexible and tax-effective way to protect the asset that creates wealth for you and your family – you! If you suffer from an illness or injury and are unable to work, income protection insurance can pay a monthly benefit; typically of up to 75% of your pre-tax income to replace your lost earnings. While the insurance benefit can be measured against your pre-tax earnings, benefits paid are tax assessable as income.

You can insure for a range of benefit payment periods with maximum cover generally up to age 65, as well as a range of features, options and benefits, giving you the choice to select the income protection insurance that is most suitable to you. Most income protection policies offer a range of waiting periods (the length of time you have to wait before your insurance benefit starts accruing) and benefit periods (the maximum length of time you will receive the benefit). As a general rule, the shorter the waiting period and longer the benefit period, the more the insurance will cost. If cost is a consideration, it is generally better to trade off a longer waiting period rather than shortening the benefit period.

The Benefits

- Income protection insurance generally provides up to 75% of income in the event of disability.
- Income protection insurance premiums are generally tax deductible (but remember that the benefits paid are assessable as income).

Case Study

Leanne is a hairdresser in a busy salon. With an income of \$36,000 she needs to jointly service the family mortgage of \$240,000 that she and her fireman husband Rob share, as well as support their six year old daughter, Tayla.

A lover of all sports, Leanne and her family set off for a small ski resort in Thredbo in early July where within two hours of arrival, Leanne had badly twisted her knee - the prognosis didn't look good; a knee reconstruction was necessary. Having a knee reconstruction meant Leanne was going to be completely off her feet for at least three months and when she was able to return to work she would only be able to do so at 50% capacity.

Fortunately for Leanne, she had taken out income protection insurance for 75% of her monthly income. She received the full 75% figure of \$2,250 for two months after her initial 1 month waiting period, where she was covered by sick leave. When she returned to work 2½ days per week she was able to receive 50% of her monthly benefit based on the 50% loss of income.

With the added protection of her income protection policy, Leanne received \$12,750 during the five months she was disabled. Without this, Leanne's earnings would have been \$6,000.

Tips and Traps

- While most policies are indexed in line with the Consumer Price Index (CPI) automatically at each renewal, this facility generally stops during a period of claim. You should consider policies which allow your benefit to keep pace with inflation, particularly if a long-term claim eventuates.
- Check that you can insure for more than just your base salary. For employees, packaged items such as motor vehicles, school fees and superannuation contributions can be included as well as commissions, fees, regular bonuses, regular overtime and other fringe benefits.
- These days, most policies offer what is known as agreed value benefits, which guarantee the monthly benefit you apply for, ensuring that if your income reduces in the future your benefit payment in the event of disablement is assured. There are also products that provide an indemnity style benefit, which base the monthly benefit generally on the income earned in the twelve months prior to claim and are usually more economical.
- Income protection insurance is advisable when investing in a gearing strategy to help you meet any margin calls if you are disabled.

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