INCOME PROTECTION – HOW MUCH DO I NEED?

If you earn $100,000 a year and couldn't work for the next 30 years because of an injury or illness, that is a minimum over $3M of lost income.

So, we've established having income protection is a 'no-brainer' – now, you have some choices to make:

Level of Cover

Most income protection policies allow you to insure up to 75% of your income including your contributions to super. So, unless you are part of the 0.01% of people who don't want or need all their income, insure up to the maximum amount.

Waiting period

This is the amount of time you need to be off work before you will start receiving your monthly benefit. Generally, the options are 14, 30, 60, 90, 180, 365 or 730 days. The decision really comes down to how long you can survive without an income. Ideally, the shorter the waiting period the better, but just like the excess on your car insurance, the less it is, the more expensive the premium is. Most people should be able to survive 14 days, so the next option is 30 days. This is probably the most common but have a think about if you could survive 90 days (using savings, sick leave, annual leave etc) as changing the waiting period to 90 days will have a big effect on your premium. Changing from a 30 to 60 day waiting period does not have a massive effect.

Benefit Period

This is the period you will be paid for as long as you are unable to work. You should probably choose a benefit period that matches your intended retirement age. This is to protect against the worst-case scenario of never being able to work again. The maximum benefit period available now is 'benefits payable to age 70'. There are options to choose shorter benefit periods such as 1, 2 or 5 years, but this is like choosing to insure your house for half its value so generally not a good option.

Agreed Value or Indemnity?

Agreed Value means that you agree with the insurance company at the time of application what your income is and if you must claim, that is the amount they pay you. This is ideal if you have a fluctuating income. It is also very ideal in terms of making the claims process easy – trust us we know.

Indemnity means that the insurance company pays you based on what you are earning at the time of claim.

An Agreed Value policy generally costs between 15-20% more than an Indemnity policy, but in our experience provides many benefits at the time of claim around certainty and ease.

Stepped or Level Premiums

You can read all about stepped and level premiums across this site, but because Income Protection is something that most people should have for the long term (their entire working life), selecting level premiums (especially at a young age) is likely to pay huge dividends in terms of long term affordability and also cost effectiveness (when comparing the total cost of either option side by side).

Basic or Bells and Whistles?

Most insurance companies offer at least two, sometimes up to four different versions of their policies. At the lower end, you have a basic type of policy that is designed to replace your income with no extra benefits all the way through to the 'Rolls Royce' option with every extra benefit under the sun. In our opinion, a good quality basic contract will generally do a good job for you (i.e. replace your income when you need it) compared to the more expensive, fully featured policy that will do this also but cost an arm and a leg extra for benefits you will rarely use or aren't worth the extra premium.

Increasing Claim Benefit

This is a feature that is sometimes built into the policy, or alternatively purchased at an extra cost. It means that if you go on a claim, every year that you are on a claim, the insurance company will increase your benefit payment in line with CPI. This is particularly useful if you are a long-term claimant as we all know that $100,000 per annum today won't be worth much in 10-20 years.

Which Insurance Company?

This is where it gets a little trickier. There are at least 10 retail insurance companies who offer decent quality income protection policies. Then there are the policies you have within your super. And then there are the countless offers you see on TV, your credit card provider or from the supermarkets or general insurance companies. It can be hard to choose.

In our opinion, in order of preference in terms of quality, cost and tax efficiencies we would say that you cannot go past a retail product. They are generally very well priced but most importantly of a very high quality. After all, why wouldn't you want something that was going to give you the best chance of replacing your income if you needed it. Secondly, you might consider what is on offer within your super but be careful as often, the quality of the policy is inferior, the options are limited (sometimes a maximum 2-year benefit period, no agreed value etc), and you won't receive the same tax deduction (unless you contribute extra to super to cover the cost). Then lastly, we have yet to see an offering from TV or the supermarkets that we would recommend to a client over a good retail policy.

Another thing to consider is your occupation. Without doubt there are some occupations like medical professionals, or tradies where there are one or two policies that are best suited to you. Also, self-employed vs employee should be taken into consideration when choosing a product.

Conclusion

We hope this has given you enough information to at least assess if what you already have is appropriate. If you would like some assistance in determining what is right for you please get in touch, and we will help with a no cost, no obligation initial discussion.

If you require further advice in relation to the above or business generally, please contact us.

More Information?

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