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The importance of personal insurances

Risk management and in particular personal insurances are a vital ingredient of any comprehensive financial plan. Just as you insure your house, car and other property against loss, so too you should ensure that you hold suitable personal insurances that may include life and income protection insurances.

Risk management and personal insurances must be considered as an integral part of the financial planning process. For example, have you thought about how your family or your partner would cope financially if you died? Personal insurances can help to ensure that those who depend on you will not be financially disadvantaged in the event of your death, a medical crisis or your disablement.

Most people purchase house, car, and health insurance without giving it much thought, but it is a well known fact that most people are either underinsured or uninsured for events such as death, trauma or disablement.

This article discusses the main types of personal insurances - those being life insurance, income protection, trauma insurance and total and permanent disablement insurance.

Life insurance

Life insurance is really fairly simple - the policy owner receives the insurance proceeds if the insured dies.

A premium is paid for the selected level of cover and is based on the insurance company's risk, eg. the older the person, the higher the risk, the higher the premium, or, if the person is a smoker or pursues hazardous leisure activities, the higher the risk and the higher the premium.

Life insurance can be taken out inside or outside of superannuation. Premiums are tax deductible inside superannuation, however are not deductible outside superannuation. The most appropriate option for you should be discussed with the aid of your financial planner.

Among the reasons why people take out life insurance are to pay out debts, to buy the full share of a business if your business partner dies, to pay for funeral costs and to provide for your family after you have gone.

The sad fact is the majority of Australians are significantly underinsured or do not have any life insurance at all.

After realising you need life insurance, the question then becomes - how much? There are various formulas that can be used and most take into consideration your age and the age of your dependants, your current income and lifestyle and debts, including a mortgage.

Generally, younger people require more life insurance as older people typically have less debt and their dependants have grown up and moved out of the house.

The question of how much life insurance depends on your own circumstances and should be considered with the aid of your financial planner.

Income protection

Income protection insurance - also referred to as salary continuance - is simply a regular payment made to you should you become disabled or sick.

Similar to life insurance, premiums are affected by factors including your age and smoking habits, however, with income protection insurance premiums are also affected quite significantly by the type of work your do, eg. blue-collar versus white-collar.

Premiums will also be affected by such things as a waiting period and the percentage of usual salary you want to insure, eg. the shorter the waiting period, the higher the premium - the larger percentage of salary covered, the higher the premium.

The maximum percentage of salary that insurers will cover is 75%. Waiting periods vary, but generally the shortest is 14 days. The waiting period is simply the time during which the insurer won't pay you. Only when you have been sick or ill for this period can you make a claim.

The length of benefit period is also important and again affects the premium for a policy. The payment period can be one year, two years or a longer period but will generally cease by age 65.

Income protection insurance is most appropriate for the self employed, those who primarily earn commission on sales and also for wage and salary earners with limited sick leave provisions under their employment.

Trauma insurance

While life insurance is very important to have, in some ways it can become obsolete. It is a fact that many people don't die quickly, instead they are often left with an illness or injury that can last for years. Life insurance is no good to you then, as payment is generally only upon death.

This is exactly where trauma insurance fills the gap. This type of insurance pays a lump sum in the event that you experience one of the specified traumas in the contract. There are usually between 20 and 30 'trauma events', but the vast majority pay out on the main traumas - those being cancer, heart attack, coronary bypass surgery and stroke.

As a general rule, trauma cover generally cannot be taken out within superannuation and the premiums are not tax deductible. However any lump sum payment is received tax free. Premiums again vary according to your own circumstances, similar to life insurance.

So why get trauma insurance? As we mentioned, life insurance is not paid until death. How would you cope if a stroke left you paralysed for a substantial period of your life? What if you could not continue to work and had debts to keep paying. It's not something we like to think about (as is the case for life insurance generally) but that's exactly the type of situation that trauma insurance provides for.

How much is appropriate and is this type of insurance for you? That's something that can be discussed with your financial planner.

Total and permanent disablement insurance

Total and permanent disablement (TPD) insurance covers you for disability that stops you from ever working again. It is a lump sum payment that is generally payable when your doctor/s are able to state that, in their opinion, you will never be able to work again.

It is important to examine the details of the policy, as the definition of TPD can vary markedly from one insurer to another. For example, some provide cover for disablement that prevents you from working in your current job and others cover you where you cannot work in *any* job.

Premiums for TPD insurance are affected again by factors such as age, health, smoking habits and your occupation. This type of insurance can be obtained inside or outside of superannuation.

You may wonder what the difference is between TPD and trauma insurance. The key difference is the fact that trauma insurance will be paid out if you suffer a medical emergency, regardless of how well you survive. However, TPD insurance will only be paid if you are unable to ever work again.

These are the main types of personal insurances that are available. Others include business expense insurance and key person insurance that mainly apply to those operating a small business.

As already stated, the sad fact is that most Australians are underinsured or not insured at all. Your financial planner can assist you to determine which insurance is appropriate for you and the level of cover you need.

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