Insurance

Premium affordability

Aon Hewitt Financial Education Series

The most common reason given for not taking out insurance is "I can't afford it." The question that must be asked is "can you afford not to have insurance?" Your financial adviser can review your circumstances and will make recommendations that will meet your insurance objectives.

If the cost of the insurance is a consideration you should discuss this with your financial adviser as there are ways to reduce the premium while still taking out insurance cover. Some of the options available are:

Self insurance

The most common way to reduce the insurance premium is to reduce the amount of cover. You need to be aware that in these cases you are accepting additional risk and are deciding to self-insure for the difference. Your financial adviser can recommend a set level of cover based on your specific financial objectives and circumstances. If you do decide to take out a lower level of cover, then you should be aware that not all of your objectives may be able to be met.

Stepped versus level premiums

Stepped premiums increase each year, whereas level premiums remain constant over either a fixed period or the life of the policy.

Stepped premiums have a lower initial cost. Your premium will be re-calculated on each renewal date of your policy based on your age at that time. Premiums may also change according to other factors. Stepped premiums allow you to pay only for the cost of the actual risk inherent in the insurance depending on your age at the time of the premium payment. This means that the cost of your insurance will generally increase from year to year in line with your age.

This structure also allows you to potentially reduce your costs where you actively monitor your cover to ensure that the amount and type of cover moves in line with your needs. For example, if you have paid off your mortgage, or your children have left home, you could consider reducing the amount of your cover. Stepped premiums are a means to help you pay the actual costs for what you need at any particular time.

Level premiums are a means of smoothing the increasing costs of insurance premiums. Whilst paying higher premiums early in the policy in comparison to stepped premiums, they will not increase substantially over time. This smoothing may have particular benefits if you intend to retain your cover at fairly steady levels for a long period of time. It allows the premiums to be affordable for the long-term.

Using superannuation

By holding your Life and TPD insurance through superannuation, you may be able to reduce your premium cost. A further advantage of holding insurance through superannuation is that you may be able to use pre-tax money to fund the premiums. For example, if you are employed, you can use salary sacrifice to pay for the annual premium, and if you are self-employed, you should be able to claim a tax deduction for the premium. This may allow you to either take out additional insurance at the same cost, or take out the same level of cover at a reduced cost.

You need to be aware that tax may be payable on the insurance proceeds if paid through superannuation. For example if the proceeds are paid to a financially independent child who is over age 18, tax would be payable.

In addition, you need to be aware of the policy definition when holding insurance through superannuation. From 1 July 2014, superannuation laws changed so that any new insurance policies you hold through superannuation are only offered with conditions that allow you to access your benefit in the event of claim.

If your insurance was in place before 1 July 2014 and you made a claim, the insurance company would pay the money into your superannuation fund, but you may then be unable to access your superannuation until reaching preservation age or retirement. The aim of these changes is to ensure that if the insurance company pays the claim, you are then able to withdraw the money from your superannuation at the same time. Your financial adviser can provide advice in regard to your personal situation.

Increase the waiting period

The longer the waiting period for your income protection insurance benefit payment, the lower the premium. You need to be aware that most policies pay in arrears - this means if you have a policy with a 30-day waiting period, you will not receive an income payment until day 60.

If you increase your waiting period from 30 days to 90 days, which will decrease the premium payable, you will have to fund living expenses for an additional 60 days. If you have a large balance of sick or annual leave this can be used to fund your living needs during the waiting period, but if you don’t have a large amount of leave or a cash reserve you should think carefully before increasing your waiting period.

Reduce the benefit period

The benefit period is the period of time that your income protection policy will pay you an income. The shorter the benefit period, the lower the premium. You can have a benefit period as short as 2 years, or benefits payable until you reach age 65. However, you need to consider the impact if you were unable to ever work again.

If you have investments outside of superannuation that you can use to fund your living needs, then you could consider reducing your benefit period. In some cases you may be able to access your superannuation early, but you need to then consider what will fund your living expenses long-term and through retirement.