Protection

Learning Outcome 4

By the end of this learning material you will be able to demonstrate an understanding of the range, structure and application of life assurance and pension based policies to meet financial protection needs.

| Retirement | Investments | Insurance | Health |

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4.1 Types of policies, comparative costs, benefits and disadvantages

Whole of Life Assurance

This is a long term insurance policy which will pay out a cash lump sum on death – whenever it occurs. These policies can build up a cash value over the period – although this is likely to be very low in the early years.

Many providers now offer a form of whole of life assurance policies without a surrender value at any time as this allows the provider to offer lower premiums.

- Policies can be with-profit
- Non-Profit – generally used for funeral plans
- Unit linked - have a flexible structure which means that
    - They generally offer a mix of investment and life cover
    - This can be changed depending on the investor's needs through time
    - The policy growth depends on the level of cover selected – and this will then affect any available surrender value
    - The initial premiums are set on the basis of an assumed investment return. Units which are built up by the premiums, are cancelled on a monthly basis to pay for the insurance cover
    - The premiums are generally reviewed every 10 years. The review period will shorten for older ages
    - This can then lead to problems if the value of the policy is not enough to maintain the required sum assured. The policyholder will then have the choice of
        - Increasing the premium
        - And/or reducing the amount of life cover
        - In some cases – it might even lead to the policy expiring without any value before death occurs

The flexible Unit-linked plans usually offer a choice of 3 ways of setting the plan up

Maximum Cover Plans.	Standard Cover.	Guaranteed Cover.
• The premium is fixed for a set period usually 5 or 10 years. The premium is then reviewed to a new, higher level in line with the client's current age. A small surrender value may accrue during this time – that will generally run out as time progresses. It is important that clients fully understand that the premiums will rise – generally quite substantially at the policy review	• The premium level is set at a rate that does not need to be increased over the client's lifetime – as long as the underlying fund meets the pre-determined required rate of return eg 6%pa.	• There is no investment part of the policy – although there may be a surrender value. There is a guaranteed level of cover throughout life which is paid for by a guaranteed premium. Often known as "whole life non-profit assurance"

- Some whole of life plans will offer cover until death but premium payment will stop at a pre-set age e.g. 85.
- Policies can be increasing or can be increased at future dates.
- Options such as Critical Illness insurance can be added to the benefits.
- The underlying investments cover the usual range of equity, fixed interest, property, cash and managed funds.
- Whole of Life plans are popular as Funeral Plans for older people. These generally have simplified underwriting combined with low sum assured and premiums. These plans may not always offer good value – but the guaranteed acceptance and simplicity of the product can appeal to the client who just wants the peace of mind of knowing that their funeral is provided for.

Term Assurance

Term Assurance is designed to pay out a cash lump sum on death during the term of the policy. There are a number of different variations of Term Assurance plans.

Level Term Assurance

The sum assured remains level throughout the term of the policy

Increasing Term Assurance

The sum assured increases during the term – either by a fixed amount e.g. 5% compound annually or in line with an index e.g. Retail Prices Index or National Average Earnings Index

Term 100

This is an alternative to a whole of life plan where the policy is written to age 100 – the gamble being that the life assured lives beyond 100 in which case the policy will not pay out as it will cease when they reach 100.

Decreasing Term Assurance

The sum assured decreases each year in a predetermined scale – reducing from the initial sum assured at inception to zero at the end of the term. Some policies require the premiums to be paid for a shorter term than the duration of the cover.

- **Mortgage Protection Assurance.** This is usually used in connection with a repayment mortgage. The sum assured reduces each year in line with the decreasing capital as long as the interest rate is within specified limits. The rate of decrease each year is directly linked to the interest rate assumed. The higher the interest rate, the slower is the year by year reduction in the sum assured in the early years of the loan

- **Return of Premium Assurance.** This type of policy pays out on death within the term but will also return the premiums if the life assured survives to the end of the policy term. Because of this return of premiums, the cost of the premiums is higher than other types of Term Assurance.

- **Gift Inter Vivos Term Assurance.** This is a type of decreasing term assurance where the sum assured falls in line with an expected Inheritance liability on a lifetime gift.

Family Income Benefit.

- This is one of the most straight forward types of term assurance
- The sum assured is a sum of money payable each year from death within the term of the policy
- The payments are paid until the end date of the policy
- The payments can be level or "escalating" e.g. by 5% per year
- This type of policy is often used to provide income for a young family - hence the title
- It may be possible to take the benefit as a lump sum on death rather than the regular annual income
- The lump sum that would then be paid out is reduced by the use of a rate of interest applied to the lump sum being paid out early.

There are other forms of term assurance. The cover can be

Renewable	Increasing or increased at future dates	Convertible	A combination of any of these.
• this means that at the end of the original term - the policy can be renewed with a new term and the premiums will be higher to reflect the older age of the life assured		• the policy holder can convert the policy to a whole of life during the term of the plan. This option used to be used to convert to Endowment plans – but this is not very common now.	

Term and Whole of Life policies can also be reviewable. This means that the premiums and/or the sum assured is only set for a set period and is then subject to a review to take account of mortality, expenses and investment returns and other relevant changes.   There is little difference between a whole of life maximum cover plan and a 10 year renewable, convertible term assurance policy – both in terms of cost of premiums and the benefits.

The client must be aware if a plan is reviewable that it likely that premiums will rise or the sum assured will decrease.

Relevant Life Policies.

These are a type of term assurance policy, taken out by an employer and designed to provide a 'death in service' benefit for an employee. That employee will be the life assured.

It is normally used by small companies who do not have access to a group life scheme or for specific employees i.e. to provide cover in excess of that provided under a group life scheme.

The Policy will be held under a 'relevant life' trust, which is normally a discretionary trust with the 'potential beneficiaries' being the employee's dependents. Thus, the benefits paid from the policy will be outside of the employee's estate for inheritance tax purposes.

Premiums will be paid by the employer and will normally be treated as an allowable expense for corporation tax purposes. However, they will not be treated as a taxable benefit paid to the employee, so no income tax or national insurance is paid by them.

Pension Term Assurance

Pension Term Assurance is not available to individuals. Employers can still take it out.

Pension Term Assurance offered an inexpensive method of providing death-in-service (or death-in-retirement) benefits because the premium attracted tax relief – only where they are paid by an employer. The lump sum could be used to provide a dependent's pension.

Before changes were made in April 2006 – the amount of Pension Term assurance that could be arranged was restricted by HMRC to 10% of the personal pension contribution.

Pension Simplification was introduced in April 2006 and this allowed anyone to contribute up to the limit of their annual allowance or up to £3,600 if not working or had no income. It also allowed for the amount of tax-favored death-in-service benefit to be linked to the Lifetime Allowance, which is currently £1m (2017/18).

Standalone Pension Term products were introduced by many providers which allowed people to arrange tax effective life assurance separately from their pension provision while enjoying the considerable tax reliefs available on the premiums.

HMRC changed the rules again in 2007 so that the tax relief on PTA would only be available on policies taken out by Employers.

PTA policies in existence by the cut off date in 2006 are allowed to continue and still received the tax relief.

Multiplans

These are policies that can incorporate a number of types of protection cover within the one product. They are very flexible and responsive to a client's changing circumstances.

A plan can start off with term assurance and critical illness cover. At a later date, the client can add say income protection. Changes to the level of cover as well as the type of cover are generally allowed.

They can even incorporate "general insurance" – protection for unemployment.

Why may Life Cover be needed?

There are many reasons to provide life cover and needs for protection e.g.

- Mortgage Protection – to pay off a loan in the event of death within the term of the loan.
- Loan Protection – many people have sizeable loans – secured or unsecured to their property.
- Dependent Protection – many people want to make sure that their spouse/partner and family will not suffer financially in the event of their death and want to "provide for them".
- This can include protection for the costs of educating children as well as ongoing support and maintenance costs. It can also be used to provide for other dependents e.g. elderly parents or disabled relatives who are financially dependent
- IHT costs anticipated on death
- Funeral costs
- Business liabilities
- Generally any financial dependency or burden can be protected by life assurance.

Assessing the need

This can be quite a difficult area to address as often the client has a different viewpoint from the "ideal world" scenario that a Financial Adviser may present.

It makes sense to establish what needs to be protected, for how long, for how much and protected against what.

Having established that - then the correct type of protection product can be identified, decision made on whose life/lives the protection should be written, the term of the policy and any additional options to be included. It is important too that the need for the policy to be written in Trust is decided to ensure that the proceeds go to the right place/person as quickly as possible in the event of death and to prevent those proceeds being part of the deceased's estate for inheritance tax purposes.

Whose Life?

Own Life: This is suitable where the life assured wants to be able to provide the policy benefit in the event of their death. It is important to consider the use of Trusts. Endowment policies are less common now but they were often written on an own life basis to allow for the life assured to receive the benefits on maturity.

Life of Another: This would be used where the Policy Owner wants to insure another life – and subject to insurable interest being established at the inception of the policy. A typical scenario would be a spouse/partner – one party "owns" the policy but a different person i.e. the spouse/partner is the life assured. Often used in matrimonial/relationship breakdown to ensure that agreed ongoing maintenance would be "received" in the event of the life assured's death. It is also used extensively in business protection – and this is covered in detail later.

Joint Life/First Death: This is where the joint owners of the policy each have their life insured. On the first death within the term – the policy pays out and the policy stops. It generally costs more than the cost of insuring one life – but less than the cost of insuring 2 separate lives by 2 separate policies. There can be problems with this type of arrangement

- As the policy stops on the first death – the survivor will be left without any life cover and they may still have "protection needs" they want to cover. Health problems at this time may make underwriting difficult or very costly.
- This type of arrangement may be problematical in relationship breakdown/divorce. Again, this could happen at a time when health issues or increasing age cause underwriting difficulties.

Joint Life/Second Death: This type of arrangement is commonly used to provide a lump sum that will only be needed on the 2nd death - usually an IHT liability that only arises on the 2nd death. On the 1st death – the plan continues with just the survivor as the life assured and only pays out on the 2nd death within the term - unless it is written on a whole of life basis. Trusts should also be considered to make sure that the sum assured does not add to the IHT liability.

How Much Cover and For How Long?

Agreement needs to be reached with the client on their financial needs to be protected i.e. do they need a lump sum, do they need income or a combination of both. It is also important to establish exactly how long the protection needs to be in place – failure to do this correctly could mean that the client does not receive the policy benefit he is relying on or is "over-insured" if the wrong term is selected.

Lump Sum or Income?

- A lump sum may be needed to repay a mortgage or other liabilities.
- A lump sum may be wanted to provide a lump sum of money for beneficiaries or pay IHT liability
- Income may be wanted to support the family/partner or indeed a business in the event of the death of the life assured.

How Long?

- If the policy is wanted to protect a mortgage or loan then it could be long term in the event of covering the mortgage or fairly short term e.g. 5 years for a loan
- It may be that income is needed to provide for the children's school and university education – and this term can generally be established fairly easily.
- It may be that the client wants to be in a position to provide an income for their dependent(s) until their deaths.

This could mean that a combination of protection types and terms are used to set up a tailored protection package for the client.

What Else to Consider?

The Financial Adviser needs to consider what protection benefits are already in place – either having been set up already by the client or provided by his Employer.

Existing Policies. These have to be carefully considered to establish if they can be used towards meeting the client's current needs or if they are no longer suitable and need to be replaced with more suitable cover.

Employer. The client may be entitled to death-in-service benefits from his employer – but consideration must be taken of the likelihood of this benefit being lost if the client changes jobs or the firm fails.

What is the best type of Policy?

The main considerations are

- What exactly is the client wanting to protect
- Does he want any investment content to the policy
- Budget – how much is the client willing to commit for the protection wanted
- Policy Options and Considerations – does the client want/will the budget allow for guaranteed premiums or are reviewable premiums more suitable? Is the client willing to accept and understands that with many arrangements – premiums can rise in the future, sometimes quite substantially

How much Flexibility is needed?

It can be difficult to set up a policy that is right for the client's circumstances now and remains right all the way through to the end of the plan. Life changes can affect the suitability of a plan e.g. additional children being born, periods of dependence extending beyond that originally planned, retirement ages being deferred etc.

Considerations:

- The plan could be written on a whole of life basis – and on a maximum cover basis initially to keep costs down
- Writing a term assurance plan with conversion/renewal options included – so that it can be changed at a later date and is not dependent on the client's current state of health at the time of the conversion/renewal.

If increasing levels of Insurance are needed

The effect of inflation and increasing levels of income need to be considered to make sure that the sum assured remains suitable for the purpose intended.

Possible solutions:

- Increasing sum assured. This can be achieved by linking the sum assured to an index or agreed rate of increase. RPI or NAE are most commonly used. Some policies can increase by a pre-agreed amount e.g. 5% per annum or a fixed amount after a fixed term e.g. 20% after 5 years.
- With most policies – if the client does not take up the increase – they will loose this benefit for the future.
- Some policies will also decrease for example in periods of deflation such as have happened in the recent past. Important to check closely the exact terms and conditions that apply to the increases.
- Some policies allow for a pre set increase in the sum assured on certain pre-agreed events e.g. birth of a child, marriage, moving home etc. There are generally quite clear conditions for these increases to apply and care must be taken especially around the time frames to take the benefit of the increase. The main benefit of this type of arrangement is special underwriting terms which allow for the increase without any reference to the life assured's current state of health.
- Regular Reviews. It makes sense to carry out regular reviews of the client's protection needs and solutions in place. This can also give the opportunity to consider any changes to tax, product features or to changes in the client's situation.

4.2 Cost and premium calculation factors

Insurance companies collect in premiums which go into a common fund to pay out the benefits when a claim arises. The insurer needs to ensure that they have enough in the pot to pay out the likely claims – and at the same time keep the premiums at a level that will be attractive to a customer and that they will maintain.

Life assurance uses Mortality Tables to help them to predict how many claims there will be. Mortality tables use the statistics of the last few hundred years – and this allows them to predict the likely claims with a high level of accuracy.

The mortality rate is the chance of dying at a specified age.

Actuaries use the mortality tables to calculate the premiums that should be charged.

Until the introduction of the EU Gender Directive on 21 December 2012, gender was also a factor used to calculate premiums, on the basis that the mortality rate for female lives is lower than for males of the same age. This factor can no longer be used.

Natural premiums

- Actuaries use the mortality table to find the mortality rate for any specified age.
- This is multiplied by the sum assured and thus the "natural premium" for that year is established. This means the premiums that would be required just to meet claims from those who would be anticipated to die in that year.
- This should mean that enough money is in the pot to pay out the expected claims. However, if the figures represented reality – then there would be nothing left over – and next year's costs would be higher as everyone would be a little older and closer to the anticipated age of dying.
- This would mean that the natural premium would increase each year.
- Historically this gave rise to problems as the premiums increase substantially in later years and people were unable to afford the cover when it was most needed. It also gave rise to the fittest lives not renewing their policies which reduced the income and meant that the lives assured remaining were the ones most likely to die and claims to be made.
- This meant that the inflow of premiums was not enough to meet claims leading to further rises in premium costs – just making the situation worse.
- Natural Premium was then replaced by Level Premium system which means that the premium paid by the customer is the same throughout the term of the policy.

Level Premiums

The risk of death increases with age. If a level premium is charged through the term of the policy it means that the premium charged in the early years will be higher than would be needed to meet the current claim costs. This means there will be money left over to meet the increased risk and claim costs in the later years – when the premium will be lower than would be needed to meet the claim.

The extra premiums paid in the early years of a policy make up a reserve which can then be drawn on to meet the increased costs in the later years of the policy.

The expectation is that in the early years of policies, there will just be a few deaths meaning just a small amount of the pot will be paid out in claims. The balance goes into the reserve pot to allow for future claims. As time goes on, the deaths will increase but there should still be some money in reserve to go into the fund to meet the deaths that will occur in the later years. The premiums will eventually level out and nothing will go into the reserve from that particular policy. This system happens with all the policies that the insurer holds – money goes into reserve in the early years to allow the claims to be paid out in later years.

Because the anticipated age of death has been increasing and mortality tables are based on historic information – the actual mortality experience is better than expected for life companies.

Insurance companies work on the basis that policies which pay out at an early stage are subsidized by policies where the claim arises at a later date. A single policy cannot exist in isolation and it is not possible to calculate the reserve under a single policy. The unit of calculation is a group of policies.

Interest on Premiums

We have looked at the premiums required to either pay the claims for that year (natural premium) or for each year under the level premium system. In fact, premiums are invested as soon as received and thus there is interest received.

Under the level premium system, the reserve is invested. Premiums are reduced to take account of this. The actuary takes account of this when calculating the premiums required.

The effect of the interest that could be expected will depend on the term of the policy. There would be little interest earned on a short term policy – but a longer term or whole of life plan where the paying time could be lengthy would have a greater effect.

Premium Loading

The actuaries use the mortality and interest figures to calculate what is in effect a "net premium" and certain "loadings" or adjustments to cost have to be made before the figure the customer will actually pay is established.

Factors to take into account are

- The expenses of the life company including
    - The wage bill of the company
    - Commission due to be paid to the people actually selling the policies
    - The life company's running costs for office accommodation, IT, administration and regulatory costs
    - Medical fees incurred during underwriting

There also needs to be a safety margin as a buffer against higher than anticipated death claims. The Life Company will also expect to make a profit.

Most of the expenses occur at the start of the policy e.g. commission and underwriting costs. This means that although the premiums are level throughout the policy – expenses are not. They are higher at the start and then tend to decrease during the lifetime of the policy. It is not possible to add a loading to the premium to cover the expenses at the time they are incurred. The higher initial costs have to be spread out over the term of the policy.

Most life companies charge a policy charge which is effectively a handling fee.

Frequency Loading

In practice, most premiums are paid monthly even if they are calculated on a yearly basis.

The actuarial calculation assumes the whole premium will be available from the start of the year but as most people elect to pay monthly – a frequency loading is made. This means that the monthly charge is a little bit more than the annual charge divided by 12. Some life companies quote monthly rates but will offer a reduced rate if the premium is paid in one lump sum in advance.

4.3 Legal requirements, ownership, uses and relevance of trusts

What are the advantages of using trusts for life policies?

- The stated beneficiaries will get the policy proceeds without having to wait for probate to be granted when the life assured dies (provided there are surviving trustees). This means that the beneficiaries generally receive the proceeds much faster as probate can slow things down by months or years.
- Placing a policy into trust may mean that it will not be liable for IHT.
  - The payments into the trust (the premiums) are classed as gifts for IHT purposes. They may be Chargeable transfers or potentially exempt transfers – depending on the type of trust.
  - However, they are generally covered under the IHT exemptions e.g.
    - Regular gifts from income that do not affect the donor's standard of living
    - Gifts up to £3,000 per year by any one donor
- By using a trust the Settlor can be sure that his wishes as to the destination of the proceeds of the policy will be met. This is especially useful if the policy owner does not have a will as it stops the proceeds of the policy being distributed under the rules of intestacy
- There could be better protection against creditors if the settlor goes bankrupt.

Married Women's Property Act Trusts (MWPA)

Historically, trusts could only be set up using a simple absolute trust e.g. MWPA.

MWPA trusts are:

- Relatively simple
- Offer greatest protection against creditors
- Not flexible – the beneficiaries are limited to children and spouse. They can only be set up at the inception of the policy.

There are better simple trusts available to use now – rather than MWPA trusts.

Flexible and discretionary Trusts

Most protection policies written in trust before 2006 were Flexible Interest in Possession trusts. This means that they have a settlor (the original owner and the person who creates the trust), trustees and beneficiaries. The settlor determines a list of potential beneficiaries and nominates one or more to have an interest in possession. If no other action is taken, the named beneficiary/ies will get the trust proceeds.

There are still many Flexible Interest in Possession Trusts in existence. The named beneficiaries are entitled to any income (if any) that arises within the trust. The trustees can decide which of the named beneficiaries, or potential beneficiaries of the trust should benefit from the trust capital. Potential beneficiaries may include the client's children or grandchildren, for example. These trusts can be quite complicated and expert advice should be obtained before attempting to make any changes to them

Changes to trust law in 2006 brought the IHT treatment of new Interest in Possession trusts into line with Discretionary Trusts.

- This means that assets put into trust are treated as chargeable transfers, the trust could be subject to a periodic charge every 10 years based on its value. This is usually the surrender value unless the individual was close to death and on payments made out of the trust

It is more usual now to use Discretionary Trusts as a Flexible Interest in Possession Trust carries no advantage over a full Discretionary Trust.

A discretionary trust lets the trustees decide who should benefit, from the list of 'potential beneficiaries', from the trust income or capital. No potential beneficiary has an interest in the trust's assets until an appointment is made by the trustees, although the trust will normally name 'default beneficiaries' who would receive the benefits of the trust if no appointment is made by the trustees.

Each discretionary trust has its own full nil rate band for IHT purposes. This means that when writing a policy with a large sum assured it may be more appropriate to write the policy as a number of smaller policies. This follows on from a case in the Court of Appeal (Rysaffe Trustee Co v CIR 2003) – where the ruling was that as long as each policy was put in trust on a different day – each trust could have its own IHT nil rate band – provided it is not connected or related.
This becomes relevant when each trust reaches its 10 year anniversary and may become subject to a "periodic" IHT charge.

Although, on 6 June 2014, HMRC issued a consultative document, 'Inheritance tax: A fairer way of calculating trust charges, that included proposals which would have removed the IHT benefit of this 'Rysaffe' trust planning, these changes are no longer to be made.

Simple absolute/bare trusts can also be used but they are not flexible and cannot be adapted to changing needs.

Appointing Trustees

- Trustees should have an understanding of what the settlor's wishes are
- Trustees should be sensible, honest and reliable
- It makes sense to appoint trustees who are younger than the settlor
- Settlor should appoint themselves as Trustee so they can make sure their wishes will still be followed during his own lifetime
- Financial Advisors should not be Trustees because of potential conflicts of interest. It can also cause issues if claims are made under their Professional Indemnity Insurance
- It makes sense for the Settlor to leave the Trustees a letter detailing his wishes on his death
- Trustees can resign (retire). It can be difficult to remove them – if they didn't want to leave – it could mean applying to court with associated costs, unless powers within the trusts provisions gives the settlor the right to do this.

Wording a Trust

Most insurers provide their own trust wordings and forms for their customers. In many cases the form itself is part of the application form. If the settlor's wishes are complicated then it would be best to consult a Solicitor.

What Policies can be written in Trust?

- Any existing Life Assurance policy so long as it is not already written in Trust
- Any new Life Assurance policy.
- Any Life Assurance written as part of a pension scheme. This is usually done under a master Discretionary trust

If the Life policy has Critical Illness cover included – then a "split" trust is normally used. This separates the Life and Critical Illness parts. In the event of a critical illness claim then the benefits would be able to go to the settlor rather than be paid to the beneficiaries.

4.4. Underwriting

Most individual policies and small group schemes are subject to a medical underwriting process where the application form requests details on

- Personal details, age etc.
- Current state of health
- Medical history
- Occupation and any hazardous pursuits
- Lifestyle

Larger group schemes generally have little or no individual underwriting. Some short term plans may apply a moratorium rather than full medical underwriting. This means that it may exclude pre-existing conditions from a stated period e.g. 5 years, and it may also exclude for 2 years after any treatment or check up. Or it may just exclude all pre-existing conditions.

In some instances, the insurer will accept a risk and apply no worse terms or continuing previous medical exclusions (CPME). In effect, the underwriter adopts the underwriting decision applied by a previous insurer from whom the risk is now being transferred. This can be applied to individual and group applications. CPME terms may be offered automatically or only if the insured is able to answer "yes" to a small number of medical questions.

These arrangements are only usually offered where an insurer wants to encourage customers to switch from a different firm over to them and the customer is reluctant to do so under full underwriting conditions.

In addition to the information on the application form, the underwriter may also require

- **GP Report**. No medical examination or interview is required, just a written report from the customer's own GP.
- **Paramedical**. A nurse will generally undertake a short medical questionnaire plus some basic tests e.g. Height, weight, blood pressure
- **Medical Examination.** Either conducted by the applicant's own GP or one nominated by the insurer.
- **Additional Health Questionnaire.** Typical conditions would be diabetes, asthma
- **Occupation or Pursuits Questionnaire.** Typical examples would be on private flying, deep sea diving etc.
- **Health Screening.** Certain non invasive tests such as saliva swabs, hair samples and urine tests can give the insurer more information about the applicant's health than copies of medical reports. The tests can be carried out at pharmacists or even by supplying samples by post
- **Tele-underwriting Interview.** What happens here is the underwriter will phone the applicant at an agreed time and go through additional questions. This can often be faster than a full medical application. Tele-underwriting has become more common and popular as it allows shorter application forms, faster underwriting – often with less medical evidence being required from Doctors. It can also result in less non-disclosure as the tele-underwriter can go on to ask additional questions depending on the applicant's responses. This process is sometimes carried out by non-underwriters e.g. qualified nurses.

Where additional medical information is required the insurer usually pays any medical practitioner fees.

Underwriting – Standard Terms or Special Terms

Having received and considered all the relevant and required information – the underwriter will then offer standard terms or apply special terms, In complex cases, the underwriter may refer the case to the Chief Medical Officer.

Special Terms

- The underwriter can apply a premium loading to the premium
- They can apply a percentage loading to the premium
- They can apply an age rating – effectively treating the applicant as if they are older
- They can decline/postpone or specific conditions may be excluded

Most long term policies will no longer offer waiver of premium or options to increase the cover at standard rates without evidence of health.

Insurers rely on "Utmost Good Faith" of their applicants and rely on them being honest when making an application. The responsibility is on the applicant to answer questions as fully, honestly and completely as possible. The applicant is encouraged to give any information asked and if in doubt to its relevance – to give the information.

Some types of policies – particularly Critical Illness plans have a high number of rejected claims because the applicant did not disclose some material facts. In order to resolve this situation, the ABI guidelines now require insurers to pay greater attention to the clarity of their application forms. As a result of this, many insurers now ask more questions and more detailed questions than in the past. The FOS encourages insurers not to reject claims where there has been innocent misrepresentation.

Non-Disclosure and Treating Customers Fairly

Full details and guidance at www.abi.org.uk

The Consumer Insurance Act 2012, which came into force on 6 April 2013, provides more clarity on what a customer needs to disclose.

It means that the Insurer will be required to ask specific questions in order to obtain the information required.

It also gives some legal protection to the customer if they unknowingly give incorrect or incomplete information. As a result, an insurer should not to be able to decline a claim on the ground of non-disclosure, unless it was shown that the customer carelessly or deliberately lied or misrepresented their circumstances.

However, clearly, a customer still has a legal duty to answer all questions correctly, so if they are unsure on any question, they should make their own further enquiries.

Insurers must also only ask for appropriate medical information when a claim is made. They may not "trawl" a customer's medical records in the hope of uncovering medical non-disclosure.

It is important for intermediaries to note that they should never be party to any non-disclosure. To do so would be a criminal offence as well as a breach of industry regulatory rules.

4.5 Terminal Illness Benefit

Terminal Illness benefit is a benefit usually added to a term or whole of life policy. Some Life Companies offer it as a free benefit on all policies; others offer it free on policies over a certain limit. If not offered as a free option, then it can usually be added for a small extra premium.

This benefit means that the sum assured is payable if the life assured is diagnosed as suffering from an advanced or rapidly progressing incurable disabling terminal illness where, in the opinion of the life office, the life expectancy is less than 12 months.

- It is in effect an accelerated death benefit
- With a term assurance policy - it will generally not apply in the last 18 months
- If the terminal illness benefit is paid and the life assured lives beyond the expiry date of a term policy – the payment does not have to be refunded to the life company.

The aim of the benefit is to make the last few months of the life assured as comfortable and pleasant as possible. Paying the lump sum can give him the opportunity to "get everything in order" or to enjoy a bit of luxury. In some cases however, the life assured is too unwell to get any benefits from the payment.

4.6 Assignments, surrenders, paid-up policies, claims

An assignment is a transfer of ownership from one person to another.

This often happens with life policies. The assignment may by permanent or for a temporary period of time. It can give an absolute or a limited interest.

The different types of assignments are

- Absolute assignments. These include assignments by sale and by gift.
- Assignments by way of mortgage.
- Assignments by operation of law on bankruptcy
- Assignments to trustees. Dealt with in a later chapter

Assignments can be made to a single assignee or to joint assignees. If the assignment is being made to 2 or more people – then it is important that attention is given on how the joint assignees "hold" the property i.e. joint tenancy or tenancy in common.

Joint Tenancy. If one joint tenant dies – then their interest passes automatically to the survivor. On the death of the last survivor the property passes to their legal personal representatives. Thus property held under a joint tenancy can be disposed of by will only by the last surviving joint tenant

Many joint life first death policies are held under a joint tenancy by the 2 lives assured. This means that when one dies the sum assured is payable to the other as the surviving joint tenant.

Tenancy in Common

On the death of a tenant in common their interest is passed to their estate and can then be disposed of by their will. It is rare for a joint life first death policy to be held under a tenancy in common by the 2 lives assured. However, it would mean that the sum assured would be payable 50% to the survivor and 50% to the estate of the deceased.

Assignment Act

The assignment of life policies is covered by the Policies of Assurance Act 1867. It provides that any person becoming entitled to a life policy by assignment has the legal power to sue in their own name to recover the money payable. This means that an assignee can sue the life office 'in their own name' without involving the assignor. An assignee can therefore claim from the life office as long as he can produce the policy document and the deed of assignment.

The Requirements and conditions of the Act are complex and fall outside the normal process for a Financial Adviser. Legal Advice should be obtained as appropriate.

A mortgage is a type of assignment used in connection with a loan. If an asset is being used as security for a loan, that asset will be mortgaged by the borrower to the lender to the term of the loan. It is not an "absolute Assignment" as the lender must reassign the asset to the borrower on full repayment of the loan.

Life policies can be mortgaged to banks, building societies and life offices themselves. When a Life Office gives a loan on the security of one of its own policies this will normally be by means of a mortgage deed. This will normally only happen on a policy with a surrender value.

Claims

The claims department should aim to pay out claims as efficiently and speedily as possible. They are also required to check that each claim is valid and that they pay the right amount to the right person.

In general, claims are subject to

- Premiums being paid up to date
- Policy document being produced
- Proof of title
- Proof of the event insured , i.e. death or terminal illness
- Proof of age on a death claim

Claims are either made on maturity or death / terminal illness.

Maturity Claims

Endowment Policies – on reaching the maturity date. Normally the life office will write to the policyholder prior to the maturity to remind him of the maturity date, detail the amount that will be payable and to give their requirements and paperwork to be completed on the maturity date. This includes the relevant form of discharge which needs to be completed by the policy owner. If the policy has been assigned then the relevant deed of assignment needs to be produced.

A Trust policy requires that any documents pertaining to the appointment or retirement of Trustees is produced. The Life Office must deal with the person who has legal power to sue (the trustees) even if they are not going to be retaining the money.

If the policy is mortgaged then this needs to be repaid. This is done by the Life Office passing the entire claim amount to the mortgagee. The mortgagee is responsible for passing any balance to the mortgagor, over and above the debt owed to them.

Death Claims

When death of the life assured happens then the claimant or the Solicitor dealing with the estate will contact the Life Office and request payment of the sum due.

- Date of death is obtained
- Validity of the claim is established – depending on the type of policy - the life office may need to know the cause of death.
- Proof of age is required if this has not already been provided
- The form of discharge must be completed and then the claim will be paid.

Proof of Death

- This is done with an original Death Certificate
- The Life Office will verify the details and cross reference with the details they hold
- ABI does operate a system to identify potential fraudulent claims

Presumption of Death

In the event of someone disappearing without any clear evidence of death then care needs to be taken when handling any claim made. There have been many attempts to defraud life offices in these circumstances.

Death may be able to be proved by circumstantial evidence e.g. in the event of a plane crash following confirmation that the person was on board and that there were no survivors.

The claimant can also apply to the court for an order presuming death – if the life assured had disappeared and has been missing for 7 years. This can cause difficulties in the case of a term assurance which expires during the 7 years. In this instance if would need to be established that death took place at a particular time.

Sometimes it is not necessary to wait the 7 years if the court is able to find that the life assured is dead e.g. A passenger on a ship that went missing.

Cause of Death

The cause of death is important where death is as a result of some particular activity which is excluded from the cover on the policy e.g. certain hazardous pursuits like mountaineering.

The Life Office may be suspicious if death occurs quite quickly after the policy comes into effect and would investigate in case of non-disclosure.

Financial Ombudsman Service

Most Life Offices would only deny a claim if the non disclosure was related to the cause of death. The FOS's view is that where non-disclosure is fraudulent or deliberate the Life Office can decline the claim, void the policy from outset and refuse to return premiums. Fraudulent non-disclosure is a criminal offence – although the person may be dead by that time!

If the non-disclosure is innocent, the FOS view is that the Life Office should meet the claim in full even if it would have increased the premiums or refused cover if it had known all the relevant facts. FOS says it is likely to conclude that non-disclosure is innocent if the questions on the proposal form were not clear e.g. minor childhood ailments. Proposers have no duty to disclose facts they are not aware of.

FOS is likely to conclude that non-disclosure was inadvertent if it seems to have arisen from an understandable oversight or carelessness rather than a deliberate act. The FOS may adopt a proportionate approach and work out the premium that would have been charged if the fact had been disclosed, they then calculate this as a percentage of the actual premium paid and base its settlement on that proportion.

FOS looks at each case on an individual basis.

Proof of Title

Proof of title is required before a claim is paid.

- In the case of Life of Another Policy – payment is made to the policy owner on production of the policy
- With a Trust policy – payment is made to the Trustees on production of the policy
- If the claim is being made by an assignee, then the policy and the deed of assignment is needed
- In the case of a non-assigned policy written on an own life basis – then payment is made to the estate. The estate is represented by the legal personal representatives and they can prove their title by producing the appropriate grant of representation which is issued by the court appointing them.
- The executors or administrators must produce a grant to prove their title. The Life Office is often asked to pay out on the policy before grant is obtained. This should be declined as it is not possible for the life office to know who the legal personal representatives are. The Life Office has to apply caution to make sure they are paying the money to the right person.

In some cases, the life office will pay out on very small policies without a grant.

- For a joint life/first death policy with joint assured lives the payment is made to the surviving assured on the basis that the assureds were joint tenants.
- For a joint life/second death policy then the payment is made to the estate of the second life.
- If both lives assured on a joint policy die together in the same incident and it is impossible to be sure who died first then it is assumed that the elder life assured died first. Payment would then be made to the estate of the younger person.

Proof of Age

Proof of age is required with a claim. The life office needs to verify that the life assured's date of birth was correctly stated on the proposal as the premiums are based on the life assured's age.

Normally confirmed with an official birth certificate. For a married woman, the marriage certificate will also have to be produced to link the name on the birth certificate with the current name.

If there is a discrepancy with the life assured's age then the relevant adjustments that would be in line with the correct premiums may be made by the life office.

Suicide

Special consideration needs to apply where it appears that the cause of death is suicide. If it is established that the life assured was not of sound mind then the claim is generally paid.

Lost Policies

The loss of the policy is inconvenient but not crucial. The company generally requires a proper search to be made and enquiries made of those who may know of its whereabouts or who may have an interest in the policy. If the policy is not found then the Life Office generally requires a Statutory Declaration to be made

Surrenders and Paid Up Policies

A surrender value is generally treated in the same way as a claim especially when establishing proof of title.

The FCA requires life offices to make sure that endowment policyholders who seek information on surrender values are told of other options available.

- They may be able to sell the policy on the traded market
- The policy can be made "Paid Up". This is only possible where the policy has an underlying value. This means that Pure Protection policies e.g. Term assurance, Critical Illness plans and most income protection plans do not have any underlying values and so cannot be made paid up.
- When a policy is made paid up – no further premiums are paid and the policy remains in place usually with a reduced sum assured. With a unit linked

policy – units continue to be encashed to pay for the life cover until there is no value left in the policy. The policy will then expire.

Protection Learning Outcome 4 (PROT) – End of Module Test

Multiple Choice Questions

Question	Answer	
4.1 - What would be the normal reason for a client to choose an Increasing Term Assurance over a Level Term Policy?	A.	In case further children are born in the term of the policy.
	B.	To offset the ravages of inflation.
	C.	Because it is a cheaper option.
	D.	In case their health takes a downturn during the policy.

4.2 - A Convertible Term Assurance allows the Policyholder the option to convert to?	A.	A Critical Illness Policy.
	B.	A Whole of Life Policy.
	C.	Another Convertible Policy.
	D.	An Increasing Life Assurance Policy.

4.3 - Utmost Good Faith means what to the proposer?	A.	To always take steps to reduce the possible loss as far as possible.
	B.	To disclose all material facts to the insurer.
	C.	To pay regular premiums to the insurer.
	D.	To take steps to prevent and insured loss.

4.4 - Which method that actuaries use to calculate premiums does this statement describe? In the early years the premium is higher than needed to meet the expected claims and the excess creates a reserve. In the later years, the reserves are used to meet claims made.	A.	This is known as the Pure Premium method
	B.	This is known as the Natural Premium method
	C.	This is known as the Level Premium Method
	D.	This is known as the Chargeable Premium method

4.5 - Peter takes out a Whole of Life Assurance policy on the life of his wife Nichola. At what stage must insurable interest exist for the contract to be valid?	A.	At the inception of the policy
	B.	At the time of a claim only
	C.	At the inception of the policy and the time of a claim
	D.	Constantly for the whole term of the policy

4.6 - Which one of the following best describes the operation of a flexible unit-linked whole of life policy set up on a Guaranteed Cover basis?	A.	There is a guaranteed level of life cover. The investment element includes an element of protection through the use of derivatives. Premiums are reviewed after a set period.
	B.	There is a guaranteed level of life cover, but no investment element. Premiums are also guaranteed.
	C.	There is a guaranteed level of life cover, but no guarantees apply to the investment element. Premiums are reviewed after a set period.
	D.	There is a guaranteed level of life cover, but no investment element. Premiums are reviewed after a set period.

4.7 - Which of the following are allowed to be beneficiaries under a MWPA trust?	A.	Spouse and children can be beneficiaries.
	B.	Spouse, children and grandchildren can be beneficiaries.
	C.	Only the spouse can be a beneficiary
	D.	Only children may be beneficiaries

4.8 - Which of the following best describes a split trust?	A.	A trust on a joint life 1st death policy that enables the surviving policyholder to benefit.
	B.	The trust separates the life cover and critical illness parts. In the event of a critical illness claim then the benefits would be able to go to the life assured rather than be paid to a third party.
	C.	Separate absolute trusts are created for each beneficiary.
	D.	Two discretionary trusts are created. One is created for current living beneficiaries. Another one is created for the benefit of any unborn children or grandchildren of the settlor.

4.9 - Fred and Jane have a joint life, second death policy, written as tenants in common. Fred dies before Jane. What happens on Fred's death?	A.	The policy continues with Jane as the sole owner and sole life assured, as Fred's share automatically passes to Jane.
	B.	The policy continues for half its value with Jane as the sole owner and sole life assured. The other half of the value of the policy is settled to Fred's estate.
	C.	The policy continues with Fred's estate and Jane as joint owners, and Jane as the sole life assured.
	D.	The policy continues for half its value with Jane as the sole owner and sole life assured. The other half of the value of the policy is lost on Fred's death.

4.10 - John assigned his own life policy to the XYZ Ltd Bank which has provided him with a loan. John died a few months later. The life company saw John's birth certificate when the policy started. What documentation will the life company require to settle the claim to the XYZ Ltd Bank?	A.	John's death certificate and the policy document.
	B.	The policy document and the deed of assignment.
	C.	John's death certificate, the policy document and the deed of assignment.
	D.	John's death certificate, the grant, the policy document and the deed of assignment.

- End of Questions -

Answers

Question	Answer	
4.1 - What would be the normal reason for a client to choose an Increasing Term Assurance over a Level Term Policy?	B	To offset the ravages of inflation.
4.2 - A Convertible Term Assurance allows the Policyholder the option to convert to?	B	A Whole of Life Policy.
4.3 - Utmost Good Faith means what to the proposer?	B	To disclose all material facts to the insurer.
4.4 - Which method that actuaries use to calculate premiums does this statement describe? In the early years the premium is higher than needed to meet the expected claims and the excess creates a reserve. In the later years, the reserves are used to meet claims made.	C	This is known as the Level Premium Method
4.5 - Peter takes out a Whole of Life Assurance policy on the life of his wife Nichola. At what stage must insurable interest exist for the contract to be valid?	A	At the inception of the policy
4.6 - Which one of the following best describes the operation of a flexible unit-linked whole of life policy set up on a Guaranteed Cover basis?	B	There is a guaranteed level of life cover, but no investment element. Premiums are also guaranteed.
4.7 - Which of the following are allowed to be beneficiaries under a MWPA trust?	A	Spouse and children can be beneficiaries.

4.8 - Which of the following best describes a split trust?	B	The trust separates the life cover and critical illness parts. In the event of a critical illness claim then the benefits would be able to go to the life assured rather than be paid to a third party.
4.9 - Fred and Jane have a joint life, second death policy, written as tenants in common. Fred dies before Jane. What happens on Fred's death?	C	The policy continues with Fred's estate and Jane as joint owners, and Jane as the sole life assured.
4.10 - John assigned his own life policy to the XYZ Ltd Bank which has provided him with a loan. John died a few months later. The life company saw John's birth certificate when the policy started. What documentation will the life company require to settle the claim to the XYZ Ltd Bank?	C	John's death certificate, the policy document and the deed of assignment.