A Guide to Income Protection Insurance

Dentists' Provident

Dentists' Provident has produced this guide to help you decide if income protection insurance is a suitable product for you. It gives additional information about this type of insurance and the cover we offer. The main areas covered by this guide include:

- What is income protection insurance?
- How does income protection insurance work?
- How can I decide whether I need income protection insurance?
- If I decide to buy income protection insurance, what decisions do I need to make?
- Should I obtain advice?
- What other kinds of health protection products are there?

If, after reading this guide, you decide you need income protection then you should find out more about the policies you are considering. Reading the Key Features Document of each policy is an excellent starting point.

WHAT IS INCOME PROTECTION INSURANCE?

Income protection insurance gives you a regular income, free of UK income tax, if you lose income by not being able to work due to illness or injury. The main types of contract include those designed to replace a proportion of your lost income and those that cover some of your living expenses, such as your mortgage.

HOW DOES INCOME PROTECTION INSURANCE WORK?

Not being able to work will affect your finances, but to what extent will depend on your personal circumstances. Income protection insurance gives you peace of mind that you and your dependants are financially secure, if incapacity stops you from working.

In return for the payment of a regular premium, your insurer agrees – subject to certain conditions – to pay you a regular income if you are too ill or injured to work.

One of the most important aspects of the insurance is the definition of what constitutes incapacity. Your insurer will normally define what constitutes incapacity when you take out your cover and a number of different definitions are used within the industry. You should check the definition carefully, as this determines the circumstances in which you can make a claim. The most common definitions are detailed in the section '*If I decide to buy income protection insurance, what decisions do I need to make?*"

With many policies, your benefits will only start after you have been incapacitated for a certain length of time, called the 'Deferred Period'. Some specialist income protection insurers, like Dentists' Provident, offer cover where there is no such waiting period and benefits can, if you wish, be paid from the first day of incapacity.

With income protection insurance, there is no limit on how many claims you can make and cover will continue until you decide to cancel the insurance or you reach a predetermined age.

As the benefits are not subject to UK income tax, the amounts you can receive are usually limited to anywhere between 50% and 75% of your normal income. Dentists' Provident will cover you for up to 60% of your gross income, up to a maximum initial benefit of £1,200 per week.

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HOW CAN I DECIDE WHETHER I NEED INCOME PROTECTION INSURANCE?

Nobody expects to fall ill or have an accident, and you may be prepared to gamble that it will never happen to you. However, dentistry is a physically and mentally demanding occupation, and it is not surprising that many dentists suffer some form of illness during their careers.

Ill health affects more people than you might think. According to the Department for Work and Pensions, as at August 2009, over two and a half million people of working age were claiming State incapacity benefits and, of these, half had been claiming benefits for over five years.

Today, Dentists' Provident protects over 13,000 dentists, and each year around 1,500 of these will claim benefits. Some of these members will never be able to return to work, and will receive benefits until they reach retirement age. Currently, we are paying long-term benefits to over 150 members, some of whom are just in their early 30s.

In light of these facts, the question is whether you can do without income protection insurance.

Your income

If you are an employee, the sick pay arrangements vary considerably. For example, in the National Health Service, you could receive your full salary for up to six months and half your salary for a further six months. Other employers may offer an income protection plan for all employees and you could receive an income for longer. On the other hand, some small employers may only pay Statutory Sick Pay of £81.60 per week for the first 28 weeks, after which you would be entitled to claim Employment and Support Allowance. If you are unsure about your entitlement to sick pay, you should speak to your employer.

If you are self-employed and a practice owner, your business may continue to generate some income for a short time after you stop work. For example, where you have associates in your practice or if you have a GDS / PDS contract, you may still receive your regular payments, but you could be liable to a claw-back if you do not meet your contracted targets. In the absence of any formal arrangements, you could find yourself dependent on State benefits.

If you are a self-employed associate, but not an NHS contract holder (i.e. there is a practice-based contract), then any sickness benefit will depend on the terms of your contract with the practice owner. In these circumstances, you may well find if you are not seeing patients you will not be paid.

The payments in respect of long-term sickness under the standard GDS / PDS contracts are subject to various qualification criteria and the benefits are only payable after four weeks of incapacity, up to a maximum of 22 weeks in a 52 week period.

State benefits

Under the rules of Employment and Support Allowance (ESA), an assessment phase rate of up to £67.50 per week is payable for the first 13 weeks of a claim whilst a decision is made on the claimant's ability to work through the Work Capability Assessment. For those under 25 this initial payment is lower still at up to £53.45 per week.

The Work Capability Assessment focuses on what people can do, rather than what they cannot do. If it proves that an individual's illness or disability limits their ability to work, the main phase of the ESA begins from week 14. There are two groups within this main phase: a Work Related Activity Group, which pays up to £94.25 per week, and a Support Group, which pays up to £99.85 per week. The Support Group is reserved for those whose illness or disability is deemed to have a severe effect on their ability to work, and so are consequently not expected to take part in any work. Those claiming ESA may also continue to be eligible for other means-tested benefits.

Those who do not qualify for ESA will instead be able to apply for Jobseeker's Allowance.

Alternative sources of income

When considering the need for income protection, you should assess whether you have any alternative sources of income you are able and prepared to use to fund your absence from work. Examples of things to consider include:

- Spouse / partner's income – You may consider that you can maintain your standard of living on just your partner's income. If you are considering this option, it is essential you think about the income protection arrangements in place for your partner.
- Alternative employment – You may be able to earn an income doing something else that is unaffected by your incapacity. However, including alternative income in your financial plans is risky as your possible future incapacity may be such that you cannot follow the alternative employment either.
- Savings & investments - If you have savings, you could use the income from investments or you could cash in some of your investments to maintain your standard of living. Please note that cashing in investments early may result in the amount you receive being significantly lower than you expected. Your savings could also affect your eligibility for some State benefits.
- Downsizing – Releasing capital by downsizing could provide enough funds to continue with an acceptable standard of living. However, you should think about the costs associated with such a move and your needs in the future.
- Early retirement – Depending on the rules of your pension scheme, you may be eligible for an early pension if you stop work due to your incapacity. However, please remember that, generally, early retirement pensions are likely to be significantly lower than if the pension started at the normal retirement date. Even if you are a member of the NHS pension scheme, the enhancement to your pension due to incapacity depends on your age and your length of service and your pension could still be lower than if it started at the normal retirement date.

Continuing & additional expenses

You should consider the effect of any prolonged period of incapacity on your personal expenses. Some of these, like mortgage, rent, council tax and other housing costs, will be unaffected by your incapacity. Although expenses like mortgage repayments, credit card and loan repayments may be covered by specific insurances, the benefits from such policies last a limited period, often around 12 to 24 months from the time you become incapacitated.

Certain expenses, like the cost of travel, may fall considerably, or even disappear.

You may have new costs or some of your existing costs may increase. For example, the cost of heating your home could increase if you had to stay at home all day, or there could be additional costs associated with medical treatment and possibly nursing care.

A number of expenses, like entertainment, clothing and holidays, are within your control and you could cut back on these to help adapt to your new lifestyle.

When might I need income protection insurance?

If, after considering the effects of incapacity on your income and expenses, you think you may have difficulties maintaining your standard of living, you should seriously consider taking out income protection insurance.

When might I not need income protection insurance?

If your calculations do not reveal a likely shortfall; you think you could realistically adapt your lifestyle to a reduced income; or you believe you have sufficient savings or other resources to live on, irrespective of the duration of incapacity, then you may consider that income protection insurance is unnecessary.

If your employer has a long-term sick pay scheme that adequately protects you, in terms of both amounts and duration of benefits, then income protection may be unnecessary.

If you think that State benefits are sufficient for your needs, then you may not want income protection insurance. You should note that the basis used to determine whether you are entitled to assistance from the State may be very different from that used by your insurer, so in some cases you may be entitled to claim insurance benefits but not State benefits.

However, before you make a final decision, it would be best to seek the opinion of an accountant or financial advisor.

IF I DECIDE TO BUY INCOME PROTECTION INSURANCE, WHAT DECISIONS DO I NEED TO MAKE?

Here are some relatively simple but important decisions you need to make:

Choose how long you want to wait before your benefit becomes payable

You can usually choose from a range of deferred periods. You will probably want to match this to your personal circumstances. For instance, if you are self-employed, you may want the benefit payments to start immediately. If you are employed, you may want your income protection insurance to start paying benefits when your pay stops. If you have savings, you may want to fund a short period of incapacity yourself, thus choosing a longer deferred period.

Normally, the longer the deferred period, the cheaper the cost of your income protection insurance.

Many policies have minimum deferred periods of 13 or 26 weeks, which may not be suitable for self-employed dentists who want their benefits to start earlier.

Dentists' Provident offers a choice of deferred periods, including benefits payable from the first day of incapacity (which is the most popular choice amongst self-employed dentists) to any weekly deferred period from 1 to 52 weeks, or 104 weeks. You can also choose to have multiple deferred periods. For example, if you work in private practice and a hospital, you could combine our extensive range of deferred periods to build a comprehensive income protection package covering each source of income.

Choose how long you wish your cover to last

It is important you are covered not just for the short term but also for the long term. It is sensible to think about covering yourself until your normal retirement age. Sales of budget plans, often added to mortgages and loans, are on the increase. However, these offer only short-term protection and many will stop paying benefits after one or two years in the event of a long-term incapacity.

Dentists' Provident offers a standard retirement age of 60 years. However, if you retire after the age of 50, you can cancel your membership without penalty. In certain cases, you can even extend your cover in later years, up to a maximum age of 70, if you decide to continue working after the standard retirement age.

Choose whether the premiums you pay remain fixed or change

You can choose between:

- Guaranteed rates – The amount you pay is fixed in advance and cannot be changed by your insurer, except in agreed circumstances (e.g. to rise in line with inflation);
- Reviewable rates – Your insurer can change the amount you are charged based on the insurer's overall claims experience, costs etc. Please note the changes in premiums do not depend on the claims you make as an individual;

- Renewable rates – Premiums are set for a fixed period. At the end of this period, you have the right to continue your contract and your insurer will set the premium level for a further fixed period, based on your age at that time.

The type of rate you choose will affect the amount you pay. Guaranteed rates can be significantly more expensive than reviewable rates, as your premiums will include a cost for the guarantee that your insurer will not increase the premiums. Renewable rates can become more expensive in later years, since they increase as you get older.

Choose whether you want your benefits to increase in line with inflation

Some insurers give you the option of having benefits which increase in line with inflation. This is because, if your insurance benefits remain at a constant level, over time the purchasing power will diminish and you may no longer be able to maintain your standard of living in case of incapacity. Your premiums will increase over the years as the level of cover increases.

Choose the definition of "incapacity"

As mentioned above, it is very important that you understand these definitions and choose the one which would be most appropriate to you. The main definitions of incapacity available from income protection providers are as follows:

- Own occupation – You can claim benefits if your incapacity prevents you from following your own occupation. Some insurers limit the length of time that a claim is subject to this definition;
- Any suited occupation – You can claim benefits if incapacity prevents you from carrying out your own occupation and any other occupation to which you are suited, as defined in your policy;
- Any occupation – You can claim benefits if incapacity prevents you from carrying out any job whatsoever;
- Activities of daily living – You can only claim if you are unable to carry out a selection of everyday tasks, such as washing and dressing yourself; and
- Activities of daily working – You can only claim if you are unable to carry out a selection of work-related tasks, such as walking, communicating and exercising manual dexterity.

As a dental professional, you should look at "own occupation" contracts where possible. Although these contracts are not as cheap as others, the cover is extensive and offers individuals the most comprehensive protection possible. Many forms of incapacity that may prevent you from practising dentistry may not qualify for benefits under a narrower definition of incapacity.

Dentists' Provident offers "own occupation" contracts as standard at competitive rates.

Choose your insurer

Many insurance companies only provide income protection contracts with no cash-in value, so when you cancel your insurance you do not receive any money, even if you have not made any claims.

Mutual insurers are different from normal public companies in that the surpluses they generate are used for the benefit of the members. This can be done by giving members bonuses or reducing the cost of the insurance.

Friendly Societies are mutual organisations with no external shareholders and are owned by their members. Some Friendly Societies, including Dentists' Provident, offer a unique contract called the 'Holloway Contract', which combines income protection insurance with a fund for retirement.

Under a Holloway Contract, in addition to receiving your regular income protection benefit payments, a part of the surpluses made by the Society, from its insurance and investment business, is allocated to you. Over a period of time, the share of surpluses which is allocated to you builds up to a lump sum, payable to you on

DENTISTS' PROVIDENT

retirement. Under current UK legislation, the lump sum is completely exempt from income tax and capital gains tax.

In fact, the terms enjoyed by members of a Holloway Society are so beneficial that only ten Friendly Societies are permitted by HM Revenue & Customs to write this type of business.

Dentists' Provident is one of the largest Holloway Societies and we have a strong history of competitive rates and excellent long-term returns. You may be interested to know that over 13,000 dentists in the UK and Republic of Ireland choose Dentists' Provident for their income protection needs.

SHOULD I OBTAIN ADVICE?

Most income protection providers publish a wide range of information on their products, but all are required to issue a Key Features Document to help you make comparisons between policies. Talking to an independent financial advisor can be helpful in making the right choice.

An independent financial advisor can also give you information on a broader range of protection and investment needs.

WHAT OTHER KINDS OF HEALTH PROTECTION PRODUCTS ARE THERE?

Insurance gives you the resources to cope when you encounter unexpected events. We all prize our health and well-being above most things. The insurance industry can help in a number of ways to protect you and your family against the financial consequences of illness or injury.

The main categories of product on offer can be split into long-term products, sold for more than one year at a time, and general insurance products, which are renewed annually. The key types are:

A. Long-term insurance products:

Critical illness

Critical illness insurance pays you a lump sum if you contract any of the *illnesses specified* in your policy. This contrasts with income protection which, subject to certain terms and conditions, pays a regular monthly income if you are too ill to work *regardless of the illness* you suffer from. You can use the lump sum or the income however you wish, for example, to pay off or maintain repayments on your mortgage.

Private medical insurance

Private medical insurance is designed to cover the costs of private medical treatment for what are commonly known as "acute conditions".

Long-term care insurance

This insurance is designed to finance long-term nursing and other long-term care. A claim is payable if your health prevents you from caring for yourself.

B. General insurance products:

Accident, sickness & unemployment cover

Accident, sickness and unemployment insurance typically provides benefits for a limited period. A common form of this type of insurance is mortgage payment protection insurance, which usually covers your mortgage payments for a maximum of 12 or 24 months in the case of accident, sickness or redundancy. There is usually a waiting period before payments are made of either 30 or 60 days.

Practice expenses/overhead insurance (locum cover)

Quite simply, practice or business overhead insurance provides reimbursement for the expenses of operating your practice if you are ill or injured and cannot work. These expenses may include mortgage payments or rent, electricity, telephone, heat, water, laundry and other fixed costs normal to the operation of the practice, and the costs of employing a locum.

You will need to decide which of these risks concern you, and then select the products which meet your needs.

Dentists' Provident Society Limited

Registered office:
91-94 Saffron Hill
London
England
EC1N 8QP

Telephone number: **+44 (0) 20 7400 5700**
We may monitor calls to improve our service.

Fax number: **+44 (0) 20 7400 5701**
Website: **www.dentistsprovident.co.uk**

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