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A GUIDE TO MANAGING PERSONAL RISK

A well constructed financial plan has two parts – wealth creation and wealth preservation. Wealth preservation helps you protect your ability to create wealth.

Wealth creation is the part of your financial plan that helps you build the assets to meet your financial goals. Your goals may include saving for your children's education or a future overseas holiday, or having enough money to live comfortably when you retire.

Wealth preservation (risk insurance) helps you protect your ability to create this wealth. Your wealth creation plan will be based on the assumption you'll stay healthy and live to a certain age. But there may be unforeseen circumstances which can impact your plans. Risk insurance will help you still meet your financial goals if you lose your ability to work or suffer a serious illness.

Why have risk insurance?

Risk insurance shifts the financial burden created by personal risks to insurers who can afford to cover them. It provides peace of mind that you and your family are financially secure by paying an ongoing income if you can't work because you're temporarily or permanently disabled, or if you die.

Different insurance for different needs.

Life Insurance

Life insurance provides financial protection for your dependents if you die. The cost depends on the type of cover you choose. You should review your cover regularly to ensure you're not under or over-insured.

The most appropriate policy is one that strikes a balance between affordability and favourable policy conditions. To decide how much cover you need, it's important to consider:

- your current assets and liabilities, especially the amount outstanding under mortgage.
- how much you'd need to maintain your family's standard of living
- whether you may need to pay for a housekeeper or day care for your children.

Life insurance can be used to repay debts, cover your dependants for the loss of your income and/or secure your business.

Total and Permanent Disability (TPD)

TPD is additional to life insurance cover. It pays a lump sum if you can't ever work again because of illness or injury. TPD can be used to repay your debts, cover capital gains tax liabilities and cover your dependants for the loss of your income.

The precise definition of TPD and the conditions that must be met to receive compensation vary considerably between insurance companies. So it's important you understand the condition under which the insurance company can pay a claim before taking out TPD cover.

Income Protection

An income protection policy generally pays you up to 75% of your monthly income if you can't work due to illness or injury until the policy anniversary prior to your 65th birthday.

The premiums you pay on this type of policy are tax deductible. However, payments you receive under the policy are classed as assessable income for tax purposes.

Trauma Insurance

Trauma insurance pays a lump sum if you suffer a specified traumatic event such as the diagnosis of cancer or coronary disease.

The benefit is paid when diagnosis is confirmed, not when you die of the condition. This is important because it means you and your family have a lump sum you can use at your discretion, when you most need it. You could use it to pay for your additional medical care, or to pay off the mortgage to relieve the financial pressure on your family.

Inside or outside of superannuation?

You can potentially benefit from tax deductions and cheaper costs when you hold insurance within superannuation. For this reason many super funds now offer insurance as an option in their products. But you should be aware that there's a wider choice of insurance cover available outside superannuation.

Why should you read and understand the contract?

When you take out insurance it's important to read the policy contract thoroughly and understand exactly what the policy is insuring you against. If there's anything that you aren't sure about, ask your financial planner to explain it to you. This may help you avoid any complications if you or your estate needs to make a claim on the policy.

Things you should consider

You need to be sure you aren't over-insured – or worse still, under-insured. The type and amount of risk insurance you may need depends on a number of factors such as:

- your personal financial circumstances and objectives
- your lifestyle needs
- how many dependants you have
- your age

As your wealth grows and personal circumstances change, your need for insurance cover may also change, so it's important to review your insurance cover regularly.

Case Study 1

Client Name: Alice

Status: 27, single, no children

Alice earned an income of \$50,000 and had \$3000 of credit card debt and a \$15,000 car loan. She also had \$100,000 life insurance cover provided under her superannuation policy, which had an accumulated value of \$20,000.

After seeing a friend become financially vulnerable and unable to work following a skiing accident, Alice decided it was a good time to take out insurance to help protect herself financially in case something similar happened to her.

With the help of her financial adviser, she selected \$200,000 Life, Total & Permanent Disability and Trauma cover in addition to the life insurance provided through her superannuation. The combination of superannuation and stand-alone insurance would provide Alice with a lump sum if she became totally and permanently disabled or suffered a specified traumatic condition. It would enable her to pay for any necessary treatment or alterations to her apartment.

Having organised cover to provide her with a lump sum to help deal with any immediate issues, Alice was still concerned about the result of suffering an illness or injury that prevented her from working. How would she pay her bills and afford to live?

Alice's employer provided up to four weeks of paid sick leave but without a regular salary, Alice would have no other income to rely on. She chose Income Protection cover with a monthly benefit of \$3,125 (being the maximum cover available – 75% of her income), a four-week waiting period and benefits paid to age 65. Alice chose to include an increasing claim option which would ensure that, if she was on claim, her monthly benefit would keep up with inflation.

Because Alice wanted to avoid sudden increases in premium payments as she aged, she chose to pay level premiums. With level premiums she knew she would be paying a little more than stepped premiums in the first few years of the policy, but she would save in the long run. The premiums on a level premium contract are likely to remain the same, unlike stepped premiums which usually increase as the insured gets older.

Case Study 2

Client Name: Max

Status: 35, married, 2 children

Accountant Max earned \$60,000 annually. His wife Sarah (34) stayed home to look after their two kids Billy (4) and Zac (2). Max's debts included \$140,000 for his mortgage, \$4000 on credit cards and a \$6000 car loan.

Max had \$50,000 life insurance cover provided under his superannuation policy but was concerned about what would happen to his family's lifestyle if he died or was to suffer an accident or illness that prevented him from working.

With the help of his financial adviser, Max selected \$1,000,000 Life Insurance and \$200,000 Trauma and Total & Permanent Disability Insurance, in addition to the life insurance provided under his superannuation cover. The combination of superannuation and stand-alone insurance would deal with all of the family debts and provide the family with another \$900,000 should Max die.

If Max was to suffer one of the medical conditions specified in his Trauma Insurance policy, or suffer a total and permanent disability, the lump sum would help him meet the medical costs associated with the treatment of the condition without the need to dip into personal savings or go further into debt.

Max also considered his wife Sarah's need for Life Insurance. They decided to purchase \$500,000 worth of Life Insurance to help provide child care if Sarah was not around to look after the children. They also included \$400,000 Trauma and Total & Permanent Disability cover on her life.

Max had read about children who suffered serious illnesses and the associated costs in treating these illnesses. As a result he included \$50,000 child's trauma insurance for his two children as part of his own Life Insurance policy.

Max also chose to protect his income with Income Protection insurance. His employer provided for sick leave up to three months, but without employment he'd have no other income to rely on. He chose a \$3,750 monthly benefit for his Income Protection cover (being 75% of his income, the maximum level of cover offered) with benefits paid through to age 65. Max included an increasing claim option on his income protection policy, so if he was on claim, his monthly benefit would increase to help keep up with inflation.

In order to avoid sudden increases in his premiums as he aged, Max chose a level premium option. Level premiums are slightly more expensive than stepped premiums in the first few years of the policy, but over the term of the policy its longer-term savings typically far outweigh short-term savings of stepped premiums.

Case Study 3

Client Name: Arthur

Status: 55, married, 3 children aged 17, 19 and 22

Arthur earned \$120,000 annually and was planning on retiring at 65. He had no debts and although his children had finished school, the youngest was starting university the next year. Arthur had \$200,000 life insurance cover included under his superannuation policy.

While he had no debts and his retirement was still almost 10 years away, it was important to Arthur that he should be able maintain his lifestyle if he was no longer able to work due to sickness or injury.

Arthur had a comfortable life with a number of assets, including a superb home and a fishing boat. He didn't want to have to sell any of these hard-earned assets or eat into his retirement savings to support his day-to-day living costs should he become injured or ill. So he took out \$200,000 Life Insurance with \$200,000 Total & Permanent Disability Insurance to help pay for any treatment and home alterations that could become necessary if he was totally and permanently disabled.

By taking out Income Protection Insurance with a benefit of \$7500 per month (the maximum 75% of his current income) to age 65, Arthur felt comfortable that he would be able to retain his current lifestyle without eating into his assets should he be unable to work. He also thought it important that any benefits paid under the Income Protection policy keep up with inflation, so he chose the increasing claim option.

Your financial adviser can help you assess your insurance needs as part of your overall financial plan.

This publication doesn't take into account your personal objectives, financial situation or needs. It's important for you to consider these matters before making any financial decision and we recommend you seek help from a financial adviser.