What is income protection insurance?

Being sick is hard enough, without having to also worry about your finances. As your ability to earn an income is one of your greatest assets it makes sense to protect it. This is where income protection insurance can help as it insures you against loss of earnings through injury or illness.

What does it cover?

Generally, income protection insurance is a monthly benefit that pays up to 70% of your pre-injury income while you are unable to work. The premium you pay will vary, depending on the amount of cover you require, and the waiting period selected. It will pay you an income until you can return to work or for the agreed period – whichever is sooner.

Some insurers offer a partial disability benefit as an optional extra, which covers you if you return to work but at a reduced capacity e.g., part time work.

These descriptions are general as what's covered under an income protection insurance policy can differ between insurers. To understand what's covered under an insurance policy, read the product disclosure statement (PDS) or speak to a financial adviser.

Do you need income protection insurance?

Have you ever thought about what would happen if you weren't able to bring home the same income you're earning now? What if you were suddenly earning less – or nothing – for a long time?

Income protection insurance is essential if you:

- Are keen to maintain your financial independence in the event of illness or injury
- Have debts, such as a mortgage, and need to make payments even if you are unable to work
- Are supporting a family or dependents who rely on the income you earn
- Are self-employed or a small business owner, as you may not have sick or annual leave.

What is income protection insurance?

Did you know...
An income protection policy is not claimable in the event of redundancy.

Do you qualify for income protection insurance?

You must be employed or self-employed and earning an income to qualify.

How to buy income protection insurance

The two most common ways to purchase insurance are outlined below.

1. You can arrange insurance directly in your own capacity. You are responsible for contacting insurers, comparing policy features and premiums etc. You should familiarise yourself with the pros and cons of purchasing insurance inside or outside of superannuation and structure your insurance accordingly, or.

2. You can work with a financial adviser who compares all the policies on offer and recommends one best suited to your circumstances. They will enquire about your finances, living situation, details about your family and more to determine cover appropriate to your needs.

   They can also assist with the application and claims process, review your insurance needs each year and keep you up to date with the latest insurance news and regulatory change that may impact your future insurance needs.

Whether you choose to arrange your insurance directly in your own capacity or work with a financial adviser, the following factors are a consideration.

For more information, refer to 'What is personal insurance' fact sheet.

Indemnity vs Agreed Value policy

When taking out an income protection policy, your cover is based on your income.

Under an indemnity value policy, the amount you're insured for is a percentage of your salary at the time you make a claim. At the claim stage you are most likely required to provide evidence of your income.

Under an agreed value policy, the amount payable is equal to the predetermined sum insured as at when you purchased the policy, no matter what your income is at the time of the claim.

From 1 April 2020, all new income protection insurance policies must be issued on an indemnity basis. Agreed value policies that were in force prior to 1 April 2020 are grandfathered and can still be retained.

Waiting and benefit periods

Income protection policies have a waiting period and a payment period. The waiting period is the time you must wait from when you make a valid claim, to the

time you become eligible to start receiving payments. Depending on the insurance provider, there may be a choice of waiting period of 14, 30, 90 days or one or two years.

The payment period is the period you can be paid so long as you remain unable to work. There's generally a choice of benefit payment period: two to five years, up to age 65 or 70. Other terms and conditions apply depending on the policy, with all these factors affecting the amount of premiums you pay.

What is income protection insurance?

Inside or outside of superannuation

You can hold income protection insurance in your own name, or in your superannuation fund. Many superannuation funds offer default income protection insurance that is cheaper than holding it in your personal name. Both options have pros and cons as outlined below.

	Advantages	Disadvantages
Insurance inside superannuation	• Income protection insurance premiums are generally tax deductible to your super fund. • You can pay your premiums using accumulated super money or by making additional super contributions – which may come from your before-tax income. • Premiums can be cost effective.	• While most insurance events for income protection insurance result in a condition of release, there are some limited situations where you may not be able to access the insurance benefits until you retire. • Features can be basic.
Insurance outside superannuation	• Income protection premiums are generally tax deductible. • Insurance benefits are paid directly to you. • Can have more features.	• Premiums can be expensive. • Tax is payable on claim amounts paid to you.

Taxation of premiums and benefits

Where you hold your insurance also influences how premiums and benefits are treated as outlined below.

	Are premiums tax deductible?	Are benefits taxed?
Insurance inside superannuation	Contributions you make to super to cover premiums may be claimed as a tax deduction.	Yes, the super fund will apply withholding PAYG tax to amounts paid.
Insurance outside superannuation	Yes.	Yes, amounts paid are taxed at your marginal tax rate.

Important changes to Income Protection from 1 October 2021

In December 2020, the Australian Prudential Regulation Authority (APRA) announced that it is concerned that life companies have been keeping premiums at unsustainably low levels to compete for customers. APRA expects life companies to review and update their product offering with a focus on long term sustainability, whilst ensuring products continue to meet the needs of consumers.

- With effect from 1 October 2021, the following apply to all new income protection insurance policies:
- The insured income is to be based on your annual income at the time you make a claim and are not able to look back more than 12 months. Currently, if a claim is made, some policies allow the insurer to look back over the past three years and use the best 12- month period to substantiate the claim.

What is income protection insurance?

- A maximum income replacement payment of 90% can be made in the first six months and 70% thereafter, with no limit on the monthly benefit.
- Claims will be assessed under the "own occupation" definition for the first two years under claim, then the definition will change to an "any" occupation definition based on training, education, and experience.
- Currently, all income protection claims are assessed under an "own occupation" definition which ensures individuals are protected if they become ill or injured and are deemed unfit to perform their own occupation.
- Insurance providers must have adequate risk management processes in place to mitigate the risks associated with long term benefit payment periods.

For more information, please also refer to 'What is Personal Insurance' and other fact sheets available on the Client education website.

Case study 1

Cris is a plumber who has recently started experiencing severe back and hip pain. He owns his own business and was unable to continue working due to the pain. He visited over 3 medical specialists to find the cause of the pain.

As he was already off work for 3 months and had passed his income protection insurance waiting period, his financial adviser helped with lodging his income protection claim and Chris was back paid 3 months' worth of income protection payment immediately, and the policy would continue to pay an ongoing monthly benefit of $8,000.

Case study 2

Susan fractured her shoulder in a bicycle accident. She was still able to work part time as a family doctor however could only carry out limited duties and not all procedures.

She wasn't planning on making a claim on her income protection policy as she could still work part time however her financial adviser noted that because it was a defined specific injury – she could claim.

Her financial adviser helped lodge the claim with the insurer and she was paid out a total of $50,000 before eventually returning to full work duties.