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Loan Protection Insurance

Many businesses have loans to cover expansion, new capital equipment or even start-up costs. Most financial institutions require some kind of surety, such as private assets like the home, in order to approve the loan.

If you die or are permanently disabled and unable to work, the loan could default and in addition to losing your business, you could lose your home and any other assets you put up as surety.

Loan Protection insurance covers any loans you may have and as a result, protects your assets

Source: Money Matters



Is It Worth The Risk?

Financial planners cannot afford to take the risk of not advising their clients about risk insurance. Since the introduction of the Financial Services Reform in March 2002, financial planners now have a legal requirement to raise the issue of risk insurance with clients.

For financial planners, the term 'risk' usually refers to 'investment risk' i.e. the risk of losing money through an investment. However, there is also the 'risk' of what would happen to a client's financial position in the event of a death, total and permanent disability (TPD), trauma condition or becoming disabled and unable to work and earn an income.

We all know about the financial devastation that can occur from natural disasters and bush fires. Death or disability can also have negative financial consequences. People can lose their homes if adequate life insurance is not in place. Equally, without adequate income protection insurance, individuals' comfortable retirement goals can be ruined if they become disabled and are unable to work and earn an income. In these situations, individuals who are not self-sufficient through their own current assets may be forced to rely on government support payments.

Why do financial planners provide little or no advice in this area?

Although financial planners face the possibility of losing a client if the client's savings and retirement are in jeopardy, financial planners generally have a number of concerns about providing advice about risk insurance. These include, that they:

- Don't have the product knowledge;
- Don't understand the process;
- Feel uncomfortable asking those personal questions;
- Believe it's just too hard; and
- See this as a salesman's role.

In today's highly litigious society, financial planners can be sued for NOT recommending appropriate risk insurance strategies. Should a client suffer financially in the event of death or a disability, the

client or surviving spouse may be able to sue for any loss incurred.

Since the introduction of the Financial Services Reform in March 2002, financial planners now have a legal requirement to raise the issue of risk insurance with clients. While the client may not wish to pursue the matter, it must be at least discussed with them. As previously mentioned, financial planners who fail to raise insurance matters with clients expose themselves to the risk of litigation and also may find the regulator taking an interest in the adequacy of the advice provided.

Risk insurance should be an integral part of a financial plan for the following reasons, not only because it is legally required but also because:

- Of the value added for the client should a claim ever be required;
- It is a consistent and compounding source of revenue (even more important in practice business valuations from an ongoing revenue perspective);
- This ensures that there is no risk of losing a client that may otherwise look elsewhere for risk insurance advice; and
- It provides satisfaction for the client by providing full holistic financial planning needs.

Risk insurance should no longer be associated with 'product sales' because when providing risk insurance advice, financial planners now need to demonstrate that the 'know your product' and 'know your client' rules have been satisfied, just as they do when providing investment advice. Issues to consider here include:

- Having a reasonable basis for the recommendation;
- How much cover is appropriate;
- The most suitable products.

Risk insurance does, however, need to be 'sold' to clients. As an example, people will have no hesitation in insuring their new car the moment they buy one.

getting you from **a** to **b**

However, people still balk at the thought of implementing 'appropriate' levels of risk insurance cover, especially in the case of income protection, which will subsequently pay for the items such as car insurance should the client become disabled and unable to work and earn an income.

Income Protection Insurance

The ability to earn an income is a person's greatest asset. Income pays for your assets such as your house (mortgage, building and contents insurance), car (car payments and insurance), retirement (superannuation contributions) and everyday living expenses.

Could your client survive on \$241.05 per week?

This is the weekly amount your client may receive if he/she becomes disabled and reliant on disability support payments (based on disability support pension payments for a single person).

Why do people still balk when it comes to protecting their most important asset: their income? Some of the possible reasons include the widely held perceptions that:

- It costs too much;
- The insurance company will find a way not to pay a claim at claim time; and
- Insurance is a rip-off.

Cost has always been an issue with purchasing any form of risk insurance. Income protection (using the tax benefits associated with the premiums) can be just as economical as car insurance.

Even if the client was off work for six months, they would still obtain a greater 'return' from income protection than car insurance. In summary, for 'approximately' the same cost, you will note income protection will provide by far the greater benefit in the event of a 'write-off'.



Life Insurance

What would happen if the main breadwinner was to prematurely die, leaving behind a grieving spouse, a mortgage, two young children, and no adequate life insurance cover?

1. Spouse would need to return to work to survive (pay the mortgage etc);
2. If the spouse returns to work, they would need funds to provide for childcare and nannying costs;

3. Lose the house as the spouse's income may not be adequate to support the mortgage payments (as the main breadwinner's income has now stopped); and
4. Not being able to send the children to private school or help with university expenses.

Therefore, how much cover would ensure that the surviving spouse and children are adequately provided for and their financial position is not disrupted too much?

Case Study

1.	Clear the mortgage debt	\$200,000
2.	Provide an ongoing indexed income of \$50,000 net per annum from a portfolio returning 3% growth and 5% income	\$1,451,650
3.	Funeral, legal and medical costs	\$50,000
4.	Children's education needs	\$200,000
Total amount required (rounded up)		1,900,000

Using the example of the 35-year-old male, his earning capacity over the next 30 years (to retirement) is \$2,250,000 not including CPI and/or pay increases.

Therefore, using the above illustration, we are helping the surviving family to maintain their position for the next 30 years.

Business insurance – 'key person insurance'

Andrew Carnegie, one of America's best-known self-made businessmen once said:

'Take away my factories, my planes, my railroads, my ships, and my transportation. Take away my money, strip me of all these, but leave me my men. In two or three years I will have them again'.

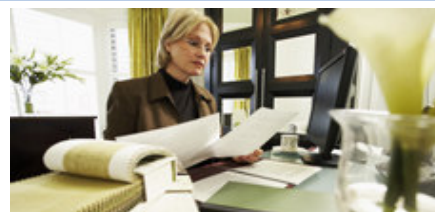
As previously discussed, people have no hesitation insuring their cars and houses but balk at insuring themselves.

The same goes within a business environment. Many businesses insure plant equipment and other tangible assets, yet fail to insure the most valuable assets – the key people that make it possible for a business to produce profits. It is the skill, judgement, integrity, experience, leadership, sales contacts and (in this day and age) technical expertise that build the profits for a company.

Each business has an employee whose loss of experience and/or expertise would severely affect the profit of the company should that person retire, prematurely die or become totally and permanently disabled.

Alternatives to key person insurance:

1. The financial loss to the business may be absorbed entirely by the profits:



2. Borrowing the funds from external sources; or
3. Realising business assets to obtain access to cash.

These alternatives are not very effective from a profit or business viewpoint.

In summary

Financial planners have two choices when it comes to providing their clients with risk insurance advice.

a. Providing the risk advice yourself (or someone else within your practice)

The benefits include:

- Personally servicing your clients;
- Protecting your client base from someone who advises in all areas (most important);
- Providing a stronger value proposition; and
- Building a new revenue stream and increasing the practice's value.

The challenges are:

- Keeping up-to-date with product and technical knowledge;
- Maintaining processing administration and underwriting knowledge; and
- Nurturing clients through the intensive assessment/underwriting process.

b. Referring risk advice (to a third party)

The benefits include:

- Enabling you to focus on your preferred discipline;
- Providing potential to receive financial planning referrals from the risk adviser; and
- Ensuring that your clients' risk needs have been fully considered and met.

Challenges are:

- Potential incomparability in the quality and style of advice provided;
- Relationship may be all one way (you may never receive any referrals);
- Client ownership – 'who owns the client'. Relationship in the event of a split or if one party sells their practice; and
- Disclosure and management of the referral agreement.

Risk insurance is an integral part of the financial planning process.

Source: *Infinsia*