Opportunities in protection post-PPI

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Despite the well documented difficulties, the distribution of Payment Protection Insurance (PPI) was tremendously successful with many people receiving cover they would not otherwise have had.

Post-April 2012, PPI can no longer be sold alongside a loan, thus creating a new standalone market for this and other related products. The opportunity exists to write policies that cover not just loan repayments but a percentage of income and to widen the client's portfolio to include other protection lines too. This paper makes the case for recommending long-term income protection and addressing wider protection needs.

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Competition Commission

Following the PPI super-complaint by the Citizen's Advice Bureau in February 2007 and the subsequent investigation by the Office of Fair Trading (OFT), it was concluded that the root of the problem was lack of competition in the market and seven remedies were proposed, which apply to PPI and short-term income protection insurance.

Competition Commission remedies

- Point of Sale Prohibition (POSP)
- Ban on single premium PPI
- Provision of personal quotations
- Clearer marketing messages and information
- Clearer information in policy documents
- Provision of annual statements
- Availability of separate retail PPI

Some of the remedies took effect in October 2011 and the remainder, including the Point of Sale Prohibition (POSP) and the ban on single premium PPI, in April 2012. POSP means that a firm arranging credit for customers will not be allowed to sell them PPI or short-term income protection (STIP) policies at the same time but must wait seven days. This is to allow customers to shop around for suitable alternatives.

The information remedies will provide clearer information to consumers to help them understand what they are buying or what cover they currently have so that they can shop around more effectively.

Standalone cover

These remedies open up a new standalone market for creditor insurance. In the wake of the PPI mis-selling scandal, many traditional distributors of payment protection insurance have left the market, creating the opportunity for independent distributors to take their place. In the standalone environment, it makes sense to offer a policy that covers a percentage of client income rather than just the loan payments and this is evidenced by the increase in the number of new short-term income protection policies that have been launched and the commensurate decline in the number of PPI policies to cover personal loans and credit card debt.

The move from PPI to STIP is customer-centric; the emphasis shifting away from lenders simply selling policies that protect themselves against defaulters towards a market where, by virtue of covering a percentage of income, the client's financial vulnerability is addressed more effectively.

Product diversification

Short-term income protection, like PPI, can still be purchased direct and indeed this will continue to be an important distribution channel. However in an advised setting the dialogue can be widened to identify the suitability of better quality products and to address other financial needs. For example, long-term income protection may be deemed a better solution than the short-term product and the opportunity may exist to recommend life assurance and critical illness cover, where appropriate.

Mortgage brokers

The mortgage market has a very different landscape now than it had before the credit crunch. Stagnant for the last two years and showing little sign of recovery, mortgage brokers have turned their attention to selling all types of protection and general insurance products. Where formerly protection sales were to some extent a sideline and a hygiene factor, now they represent an indispensable revenue stream. With recent announcements by key mortgage lenders around reductions in procuration fees the focus on selling protection and general insurance products looks set to continue. The threat to brokers around dual mortgage pricing represents a selling opportunity for smart brokers. A pattern is emerging where brokers will assist clients to find a suitable mortgage but then encourage them to arrange it direct with the lender themselves, the broker choosing instead to devote time with the client to arranging protection cover. This is good for consumers, advisers and insurers because the opportunity exists to address more of the client's protection needs and to maximise business opportunities.

Whole of market / independent advisers

Independent financial advisers, who have always been in the position to provide holistic advice including protection solutions for clients but who as a group have largely focused on wealth management may, post-RDR, benefit by shifting their focus towards protection. Under adviser charging rules, advisers may continue to be remunerated by commission for pure protection sales and this presents an opportunity to service those clients that have financial planning needs but would be unwilling to pay a fee for financial advice. Like it or not, financial advisers have to compete with the banks and direct writers for their client's protection business, but advisers are ideally placed to offer more comprehensive protection solutions than lenders, single tie advisers and creditor insurers.

In January 2012, the Association of British Insurer's (ABI's) quarterly consumer survey reported that protection products such as payment protection insurance and critical illness cover were among those least understood. This underlines the importance of protection advice and the role of advisers. Of course, we are all only too aware of the seismic general protection gap that exists in the UK and indeed has done so for some time.

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The case for Income Protection Insurance (IP)

The income protection gap is estimated to be in the region of £190 billion per annum. Research by Bright Grey in April 2012 found that people do not consider themselves to be in serious debt until they owe £14,416. This paints a picture of a population where many people have no protection for their borrowings and lifestyle expenses and most likely would be in serious financial difficulty if they couldn't work.

Long-term income protection has significant advantages over creditor insurance. On the plus side payment protection insurance and short-term income protection plans often include redundancy cover as well as accident and sickness benefit. However, they typically only pay out for a maximum period of 12 months and they are annually renewable. Cover can be withdrawn or the premiums increased simply by the insurer giving notice. It is perhaps this aspect of creditor insurance rather than the short payment-terms that renders it inferior to long-term income protection. Upgrading clients from covering just their mortgage or loans payments to covering a percentage of their income is a good strategy and further upgrading their cover to a permanent long-term income protection policy establishes a firm foundation for the rest of their financial planning.

Protect your client: protect your business

Many advisers use the financial objectives quadrant to get their clients thinking about their needs. This is a useful way to help clients consider what their needs are and identify potential solutions.

Problem: Dying too soon

Solutions: level term assurance; family income benefit; whole of life

Problem: Living too long

Solutions: pensions, long term care

Income Protection

Problem: Making money

Solution: regular savings, ISA, MIPs, UTs OEICS

Problem: Raising finance

Solutions: mortgages, loans

Once a financial plan is agreed with the client it is important for them to understand that it is dependent upon their continuing income to fund savings, to service their loans, to pay for their life assurance. Income Protection therefore underpins the whole plan.

Advisers should ask their clients about what could disrupt their financial plans - if the answer is 'not being able to work' this is an opportunity to broach the subject of income protection.

A long-term income protection recommendation provides important cover for clients and an additional opportunity for advisers.

Corporate clients

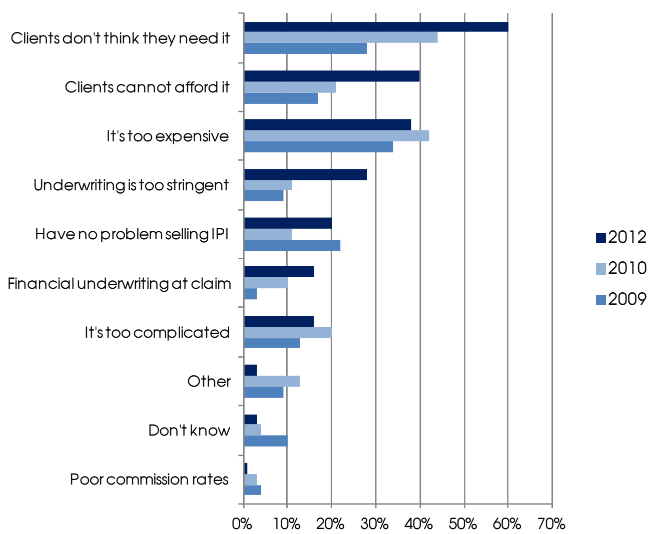
It is not only individuals that may not understand the importance and relevance of IP. Research by group IP provider Unum in April 2012 reveals that 74% of firms do not provide IP. A fifth said this was because of a lack of awareness among management and human resources. The research also showed that 10% of finance directors did not know what IP is and 40% thought it covered redundancy. Advisers are well placed to inform and educate their corporate clients. Arranging group benefits is a good way of reaching more people in one go and opens up potential work place marketing opportunities too.

Finance directors may not understand that IP is both a benefit for employees and a way of insuring the company's sick pay scheme and with the early interventions available from insured products can help to reduce absenteeism too. Unum also reports that three quarters of firms have not reviewed their organisation's employee benefits in the last three years, so there are real opportunities for advisers to exploit.

Positioning IP with the major objections to sale

In research undertaken by Defaqto with IFAs in March 2012, we asked why they thought income protection is difficult to sell. Encouragingly, 20% of respondents said that they have no problem selling IP but 60% reported that clients do not think they need it and nearly 39% cited affordability as a problem. Also 38% said that it is too expensive. The following section provides some facts and figures to help advisers position IP and deal with these common objections.

Why is IP difficult to sell?



It won't happen to me

"I am unlikely to be ill for an extended period of time"

In May 2011, the Department for Work and Pensions (DWP) reported that there are 2.61 million people of working age in receipt of disability benefits, 4% of the population, and over half of them had been in claim for more than five years.

"I could cope until I was well enough to go back to work"

According to the DWP the average length of disability claim is three years. Does the client have enough savings to pay their mortgage and household bills for three years? Long-term sickness is typically much longer than that. In February 2012, LV= reported that the average IP claim paid out for as long as seven years.

"The state will cover me if I fall ill and can't work"

Employment and Support Allowance (ESA) is typically about £99 per week. Also, fewer people can claim; now 54% of claimants are being adjudged as 'fit to work' and cannot claim compared with only 17% who were declined prior to the rule change in 2008.

In November 2011, the office for National Statistics reported that average household expenditure is £474 per week. ESA amounts to less than a quarter of that.

As an illustrative exercise, advisers could ask their clients how their household bills compare with this typical budget.

Household Monthly Expenditure		
Items	Typical values	My values
TV	£10	
Water	£70	
Council Tax	£190	
Cable/Sky	£30	
Telephone	£30	
Gas	£70	
Electricity	£60	
Mortgage	£500	
Food	£440	
Total	£1,400	

I'm already covered

"I have life cover for my mortgage; I don't need income protection as well"

According to the Office for National Statistics, people are 15 times more likely to suffer a long-term illness or disability than to die before retirement.

"I have critical illness cover; I don't need income protection as well"

Most long-term disability is due to back and mental health problems; no critical illness policy covers these. The lump sum required to produce enough income for a long-term sickness claim is likely to be far in excess of that provided by most critical illness policies.

CIC payout of £100,000 invested at 3% per annum where only the income yield is consumed would produce an income of just £250 per month.
This should be compared with typical monthly expenditure to determine suitability. Equally, for a younger person or young parent then even if capital were also used to supplement the income then the sinking fund would not last forever and potentially leave serious income vs expenditure shortfalls in future years.

I don't trust the insurance industry

"I don't trust the insurance companies; they'll take my money but turn down my claim

According to the ABI, in 2010, the UK insurance industry paid out the equivalent of £17 million per day in death and disability claims. This provided real help to real people helping them cope with life changing events.

Latest claims paid statistics show that insurers, on average, pay in excess of 90% of their income protection claims. Typically 2% of those declined are due to non-disclosure. Insurance companies want to pay genuine claims; always answer the questions on the application openly and honestly.

Making it real...

If a person's house contents were uninsured they might have a bill of hundreds of pounds, perhaps thousands: if they could not work, they might need many tens of thousands.

I can't afford income protection

Who can afford not to have income protection?

Is Sky TV affordable, when the sky falls in?

A Sky TV package could cost as much as £53 per month[1]. £1,000 per month Income Protection benefit costs £15-£40 per month depending on age and other factors.

The message to clients should be not to take a chance with their financial well being:

- The chances of winning the lottery are 1 in 14 million
- The chances of a person becoming disabled during their working life are much greater.

According to Social Security Online, a 20 year old has a 3 in 10 chance of becoming disabled during his/her working life. According to Theos, the Theological Think Tank, people in the earning bracket £15,000 - £20,000 spend on average £174.53 on the lottery each year. That's £15 per month, half of an income protection premium.

"If you and your family are having a tough time getting by on the breadwinner's salary, how would you get by without it?"

Who'll take the strain, when you're under stress?

Stress and mental disorders are the main cause of income protection claims. Imagine the stress if income is not protected.

Who'll provide the back-up, when you're on your back?

Back problems account on average for around one fifth of all income protection claims. Back problems are generally not covered by critical illness policies.

So, if someone insures their car on a fully comprehensive basis, why would they insure their health on a "third party" basis?

[1] Source: www.sky/com/shop/tv
Price accurate at the time of going to press

Maximising opportunities

The traditional model for protection sales made in conjunction with setting up a mortgage or loan is to focus on life assurance to cover the capital debt and some form of payment protection to guard against being unable to service the loan as a result of accident, sickness or unemployment. However this product driven approach while it may serve some customers well, potentially fails to address the wider needs a client may have.

Furthermore, it is often the loss of income that is the most critical and thus either an income benefit or an income equivalent from a capital sum should be planned for should disaster strike. Advisers can use a hierarchy of needs for compliance purposes and consistency of proposition such as that set out in the table below. This creates clarity of approach.

	Priority 1	Priority 2	Priority 3	Other options
Single no dependants	IP and/or ASU to protect income if unable to work	CIC to provide a lump sum in case of serious illness	PMI to provide prompt medical treatment if ill	Whole of life to cover funeral costs
Single with dependants	Life assurance for debt protection and IP/ASU to protect income	CIC to provide a lump sum in case of serious illness	Life assurance (FIB) for lifestyle protection for dependants	PMI to provide prompt medical treatment if ill
Married/partnered no dependants	Life assurance to protect joint loans/ debts	IP/ASU to protect income if unable to work	CIC to provide a lump sum in case of serious illness	Life assurance for lifestyle. PMI for prompt medical treatment
Married/partnered with dependants	Life assurance to protect joint loans/ debts	IP/ASU to protect income if unable to work	CIC to provide a lump sum in case of serious illness	Life assurance (FIB) for lifestyle protection. PMI for prompt medical treatment

Single people with no dependents may not have a pressing life assurance need but if they were to become sick or have an accident, they may need income protection, critical illness cover or private medical insurance cover. Some form of income protection is a priority.

If a single person has dependents then while IP is still arguably a priority, depending upon the circumstances some form of life assurance may also be appropriate if, for example, in the event of their death the estate is not sufficiently large in order to pay off the debts without having to sell the family home. But living benefits still feature prominently because in the event of serious illness or accident, the client effectively becomes his or her own dependant.

Life assurance for debt protection is a must for married or partnered people with joint debts. The priority afforded to life assurance for lifestyle protection and income protection will depend upon the earning capacity of the spouse or partner. If the spouse or partner cannot work or has low earning capacity, income protection is a must. Where there are dependants the ability of the spouse or partner to cope may be further reduced as they deal with childcare issues.

Where there are life assurance needs, critical illness cover is frequently provided as an accelerated benefit. Care should be taken to avoid using critical illness cover as a proxy for income protection. Both are important: IP to cover basic day to day living expense and critical illness for protection of lifestyle choices and income. However, critical illness cover does not pay out in the majority of cases where an income protection policy would pay out, for example where people are mentally ill or suffer back problems. Also, a significant lump sum is required to generate income over an extended period of long-term sickness and careful calculations and assumptions should always be made as to how long a sinking fund may last based around an investment assumed critical yield and an appropriate asset allocation.

Private medical insurance is often overlooked. It is an attractive product for single people who have met their income protection needs because it facilitates their prompt treatment and recovery if they are ill. It is attractive to families too, but budget may dictate that other protection needs must be met first making it unaffordable. An innovative proposition from PruProtect that combines life assurance, serious illness cover and medical insurance in one plan may be a cost effective option for those with wide ranging needs.

Cash plans are an alternative to PMI that may be attractive to some people. People may see the benefit of spreading the cost of routine dental and optical treatments by way of a cash plan and younger people, particularly for example those who are active and play sports, may find the elective treatments for fixing sporting injuries and providing physiotherapy attractive.

Conclusion

Income protection is the foundation of any client's financial plan. Without it savings and other planned spending is in jeopardy if he or she cannot work for an extended period. Advisers must make this their primary recommendation. Post PPI, with the debt protection market being opened up, a renewed look at IP will better serve clients and provide a business opportunity to help grow the adviser's business. Advisers should talk to clients about IP with renewed focus.

About Defaqto

We are an independent financial research and software company. We specialise in collecting, researching and analysing financial products and funds.

Since 1994 we have built the largest, whole of market, financial product database and become one of the leading providers of financial product and funds data in the UK. We now cover 35,000 products across banking, life, pensions, investments and general insurance. The data underpins our software packages, web services and consultancy.

Our insight supports all layers of the financial services sector including product providers, intermediaries, brokers, web aggregators and the public sector.

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