Case Study

Title: Life Cover planning

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We are moving home and restructuring our mortgage and in doing so were keen to ensure our life cover is sufficient for our family of two parents and two financially dependent children. We only wish to address life cover requirements at present. How can we best achieve this?

Your process should begin by assuming you have no life cover in place, then ascertain the ideal levels of cover needed in the event of death to either of you, then cross-reference this against existing cover and employer provision to identify the shortfalls and areas for improvement. With a young family you ideally need to assume that should either of you die there is enough cover in place to grant the remaining parent maximum options and choices. For example; whether to go to work and fund the cost of child care or be at home with the children but have enough income to maintain a satisfactory standard of living.

In terms of life cover, for ease of management it is advisable to separate debt repayment and income replacement. Starting with your mortgage; you need life cover on both of you tailored to the mortgage structure, the outstanding balance and the remaining mortgage term. Since the debt only needs to be repaid once, a joint life first death policy will suffice.

For income replacement; the first step is to complete a budget planner. This is an essential tool for all manner of financial planning exercises and in this instance it will be used to identify the level of life cover which would be required to maintain financial security for the family in the event of death to either parent. Look at your outgoings, assume the mortgage would be repaid on death, and work out what level of outgoings will need to be met in the event of death to either of you. It is quite likely that the sum will be different for each of you. This is a more accurate way to asses the required level of life cover, rather than using a crude multiple of income method.

The next step is to cross-reference your existing provision against the established life cover needs. This includes existing policies, any Death-in-Service benefit and occupational pension spouses benefit provided by your employers. When checking the suitability of existing policies we need to ensure that the cover structure is appropriate, such as the policy's remaining term. You need to be mindful that should you rely on benefits provided by your employer, these benefits could be lost should you lose or change your job.

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The most cost effective method of providing this income replacement will be via a Family Income Benefit policy which should have a term equal to the anticipated term of financial dependency of the children. If your preference is for the provision of a lump sum from which an income can be derived, a term assurance providing a lump sum pay-out will be required, likewise for any anticipated increased future expenditure which needs to be factored in, such as future University fees.

Be aware that even with just life cover, cheapest is not always best as many quality products provide additional policyholder benefits and product flexibility. Think about the merits of index-linking the cover and if applying for multiple benefits, a menu plan is likely to be most efficient in several ways. Finally, seriously consider the merits of writing the individual covers in trust; for speed of payment, to ensure the correct recipient of the benefit and, in certain circumstances, to potentially mitigate Inheritance Tax.