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A change of heart

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Recommending personal protection insurance is all about finding the cheapest quote isn't it?

Not if you want to have a future making protection recommendations, it isn't, but that is a soap box I do not intend to get on here.

Cost effective protection solutions is another matter entirely and that is where the much overlooked Family Income Benefit (FIB) can help IFAs steal a march on the high street competition.

More years ago than I care to think about, when studying for the good old-fashioned FPC 2, I remember discovering all these products that the company I worked for did not sell. I was earning my "apprenteriship" in financial services working for a since departed Home Service company.

It was only then, when having to learn about products that I was not able to recommend, that I realised what a limited product range we had and what a threat other rival companies posed with their superior range. The tables have completely turned now but it is easy to forget this and think no further than the obvious.

Family Income Benefit is essentially a cost effective way of providing a known regular income for a family in the event of death to a parent or partner within a set timescale.

By way of an example, let us say that the identified income shortfall needed is £20,000 per annum for the next 15 years, in the event of death to a parent, until the children will be deemed financially independent.

Forgetting the need to address factors such as indexation and waiver of premium, for the purposes of this example one popular solution (for a 30 year old non-smoking male) would be Level Term assurance:

£20,000 x 15 years = 300,000 Level Term assurance over 15 years

The premium for this cover would be £12.76 per month

With a FIB solution, the same client could effect the desired £20,000 income per annum cover over 15 years for £8.46 per month

The structure of FIB is similar to that of a decreasing term assurance (DTA) because the total payout for the provider will be less as each month passes which of course is reflected in the reduced premium.

So for advisers who get drawn into playing the cost comparison game by their audience, FIB could be a valuable tool to win business because much of the competition does not recommend it.

Despite FIB being a potentially cost effective protection solution, there are compliance and Treating Customers Fairly (TCF) risks to consider, namely, that unless consumers and clients are aware that there is a lump sum option available as opposed to the FIB income method, we could be leaving ourselves open to a re-broking threat, or worse – a complaint. It's worth mentioning at this stage that in the event of a claim the life office will offer a commuted lump sum option, however; because this is effectively a decreasing sum assured the payment received is going to be well below what a level or index-linked sum assured would pay out. To ensure this does not happen we must make our clients aware of the two distinct options to let them make an informed decision and it is because of this process that we rarely sell FIB.

We are the first port of call for our clients in the event of a claim and in being so our experience has taught us that claimants rarely use the policy proceeds in the same way which was presented, discussed and perceived during the recommendation process.

In other words, they may take out cover with the intention of replacing an income in the event of death to a partner or they may intend to completely pay off their mortgage but in reality this rarely happens as envisaged.

This is because the family budget, albeit affected by death or the contracting of a critical illness (CI) to one partner, can sustain some form of mortgage repayment and they do desire the options which are available when having access to capital. Very common is the drastic change in the individual's and/or their family's priorities and outlook on life in general. It is not uncommon for the wife to have the high spec kitchen she has always wanted or for the family (and extended family) to have their dream holiday(s). This sounds like a cliché but it is very real.

Anyone who has lived through these experiences with clients or loved ones will testify to the powerful emotions which are evoked and how one's priorities and outlook on life changes. These emotions are very difficult to portray during financial planning but it is, in fact, these experiences which underpin the reasons that we rarely see FIB as our primary recommendation. The initial objective may be to produce a regular income in the event of death or diagnosis of a CI, however as highlighted above, the flexibility of a lump sum is highly desirable in reality.

Where I think FIB is a viable alternative to a level term assurance is with critical illness. Very often a CI is recommended as a rider to life cover and offered as an all or nothing option, particularly for mortgage protection. The cost of CI and life cover when compared to the cost of life cover alone can often mean that the consumer or client opts for life cover only. There should be several alternatives also discussed such as CI as a lower percentage of the sum assured to fit the client's budget or even level CI as a lower percentage of the sum assured to run along side decreasing mortgage cover however, not all providers offer this degree of flexibility and if the adviser is driven by cost when conducting their research and making their recommendations they may overlook this option.

So rather than have life cover alone why not have CI as a FIB plan to run alongside level sum assured life cover? Taking the above example of £300,000 level term assurance over 15 years for the 30 year old male non smoker at a premium of £12.76 per month; £5,000 per annum CI on a level FIB basis and the same term would cost just £8.36 per month. Providing alternative solutions have been discussed (and recorded) and the warnings given about the income limitations this is surely a good compromise between a client having no CI cover because they can't afford the full recommendation and CI cover which they struggle to afford and ultimately cancel.

When considering a packaged solution, FIB is a viable contender to partner other protection products as also identified by Alex King, head of protection at the reinsurer Pacific Life Re, who says: "FIB provides advisers with a flexible solution to recommend to clients and it has the added natural benefit in that it enables a clear differentiation between mortgage and personal protection advice. For instance, a single income family could be offered a DTA to cover the outstanding mortgage together with a FIB policy (with indexation) to cover their net salary until their youngest child reaches age 21. I feel a lot of clients would relate well to this packaged proposition and understand the need for the two different products".

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